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Attorney for the Commission Staff

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF)
GEM STATE WATER COMPANY FOR) **CASE NO. BCS-W-19-01**
APPROVAL OF ACQUISITION OF THE) **DIA-W-19-01**
ASSETS AND TRANSFER OF THE CPCN'S OF)
DIAMOND BAR ESTATES AND BAR CIRCLE S) **COMMENTS OF THE**
WATER) **COMMISSION STAFF**
)

STAFF OF the Idaho Public Utilities Commission, by and through its Attorney of record, Edward Jewell, Deputy Attorney General, submits the following comments.

BACKGROUND

On April 29, 2019, Gem State Water Company, LLC (“Gem State Water” or “Company”) filed an Application seeking approval of the Company’s acquisition of the assets of Diamond Bar Estates, LLC (“Diamond Bar”) and Bar Circle “S” Water, Inc. (“Bar Circle S”) and the transfer of each Company’s respective Certificate of Public Convenience and Necessity (“CPCN”) to Gem State Water.

Northwest Natural Gas Company is a 160-year old natural gas utility that serves customers in the Pacific Northwest. As part of a recent reorganization, Northwest Natural Gas Company formed the Northwest Natural Holding Company, which holds companies including NW Natural Water Company, LLC and its subsidiary, NW Natural Water of Idaho, LLC

Gem State Water is a wholly owned subsidiary of NW Natural Water of Idaho, LLC. Gem State Water has applied to the Commission for authority to acquire the assets and CPCN's of two additional regulated Idaho water utilities, Diamond Bar and Bar Circle S. Diamond Bar serves about 46 customers under CPCN No. 413 in or near Kootenai County, Idaho. Bar Circle S serves about 218 residential customers and one commercial customer under CPCN No. 296 in or near Kootenai County, Idaho.

Gem State Water is not requesting any changes to rates, rate structure or other charges in this Application and states that any future changes will be based on prudently incurred capital expenditures and other accepted ratemaking principles.

STAFF ANALYSIS

As it has done in previous water company acquisition cases, Staff relied on the standards outlined in *Idaho Code* § 61-328 related to the sale of electric utilities. Those standards require the Commission to determine that:

- a) The transaction is consistent with the public interest;
- b) The cost of and rates for supplying service will not be increased by reason of such transaction; and
- c) The applicant for such acquisition or transfer has the bona fide intent and financial ability to operate and maintain the system in the public service.

Staff considered these requirements in its analysis, as well as applicable Idaho Department of Environmental Quality (DEQ) water system requirements that impact the above criteria. Staff recommends approval of the acquisition of Bar Circle S and Diamond Bar by Gem State Water and approval of the transfer of CPCN No. 413 for Diamond Bar and CPCN No. 296 for Bar Circle S to Gem State Water, with the caveat that costs incurred to obtain a secondary source of water for Diamond Bar not be included in customer rates.

Through its review, Staff uncovered two primary areas of concern: (1) the adequacy of the emergency water supply for Diamond Bar, and (2) the lack of specificity in the Agreement about which assets are included in the transaction. In particular, Staff was concerned that the Agreement did not transfer easements for both utilities and the water rights for Bar Circle S, but concluded those easements are included in the broad language of the Agreement. Staff's comments will address Diamond Bar and Bar Circle S separately.

I. Diamond Bar

For its investigation, Staff relied on DEQ Surveys, plans and design drawings prepared for Diamond Bar during the years 1994, 2004, and 2005, annual reports submitted by Diamond Bar, and information provided in the Application and in response to production requests. Staff's concerns with Diamond Bar are: 1) whether sufficient assets were transferred as part of the Agreement to satisfy the standards set forth in *Idaho Code* § 61-328, and 2) whether the system can operate adequately and reliably post-transaction given the short term nature of the agreement between the current owner of the system, Mr. Turnipseed, and Gem State Water for access to the backup well.

According to Diamond Bar's 2018 Annual Report, the system serves 57 residential customers. This differs from the 46 customers reported in the Company's Application. *See* Application at 4. According to information developed during Diamond Bar's last rate case (DIA-W-15-01), the system includes a 373 foot deep well, a 60 HP submersible well pump, a 55,000 gallon cistern, two 5 HP booster pumps, and a 20 HP fire pump that can be used as a booster pump during periods of abnormally high consumption. The 5 HP booster pumps and 20 HP fire pump are located inside a pump house. The 55,000 gallon cistern is located beneath the pump house floor. The well and 60 HP well pump are located outside the pump house. The system obtains water via two water rights. Municipal water is obtained via water right No. 95-10068, and irrigation water is obtained via water right No. 95-10067.

A. The Transaction is Consistent with the Public Interest.

Staff notes that Gem State Water, in conjunction with its parent companies, is actively seeking to expand its operations in Idaho. Gem State Water and associated companies have shown commitment to their growth plan through the acquisition of Falls Water (FLS-W-18-01), Spirit Lake East/Lynnwood Water (SPL-W-19-01), and the submission of this Application. The acquisition by Gem State Water may provide benefits through operational efficiencies and economies of scale as it acquires more water systems. In the case of Bar Circle S and Diamond Bar, Staff expects any efficiency or overhead savings to remain relatively small unless or until Gem State Water can acquire more water systems sufficiently close in proximity to operate in conjunction with each other.

B. The Cost of and Rates for Supplying Service will Not Increase Due to the Transaction.

Gem State Water states it will maintain the existing rates and charges post-acquisition, and that it will not seek to include the transaction expenses related to the acquisition in rates. *See Palfreyman Direct* at 6. Despite these assurances from the Company, Staff still has concerns that the transaction may create greater costs for the system and ultimately customers than would otherwise occur if the current backup well were transferred to Gem State Water.

i. Diamond Bar's Backup Well is not Included in the Transaction.

Staff is concerned that the acquisition of Diamond Bar may cause a cost increase for customers because Diamond Bar's backup well is located on Mr. Turnipseed's private property and is not included in the transaction. Although the backup well is not included in the transaction, Mr. Turnipseed and Gem State Water reached an agreement granting Gem State Water a one-year easement to use the backup well as necessary to operate the system.

Staff notes that between 2011 and 2015, Diamond Bar's main well failed no fewer than five times, thus indicating there is a clear need for a backup well. For example, in DIA-W-15-01, Staff commented that the system's primary source had gone out and the secondary supply source was required to keep the system operational. In that case, the Commission included in rates the operation and maintenance expense for the second supply source so that the ratepayers would have an emergency source of water.

In addition to Staff's system reliability concerns, DEQ requires a redundant source of ground water. DEQ's Ground Water Source Redundancy Rule states:

New community water systems served by ground water shall have a minimum of two (2) sources if they are intended to serve more than twenty-five (25) connections or equivalent dwelling units (EDUs). Under normal operating conditions, with any source out of service, the remaining source(s) shall be capable of providing either the peak hour demand of the system or a minimum of the maximum day demand plus equalization storage. See Subsection 501.18 for general design and redundancy requirements concerning fire flow capacity. (5-8-09) IDAPA 58.01.08.501.17.

In this case, DEQ indicated that the one-year easement between Gem State Water and Mr. Turnipseed satisfies DEQ requirements for a redundant source of water while the easement agreement is in effect. *See DEQ Supplemental Comments*. While the one-year agreement for

access to the secondary supply source gives Gem State Water time to provide a second source of supply, that source will necessitate additional capital projects, and therefore an increase in rate base, which would subsequently increase costs to the customers. DEQ gives no indication in its letter to the Commission whether an additional agreement for a longer term would satisfy DEQ's redundant source rule.

DEQ also requires redundant water sources to have a dedicated well lot if the system is intended to serve more than 25 customers. IDAPA 58.01.08.501.17. However, the backup well was constructed prior to the dedicated well lot rule, and therefore, under DEQ's interpretation of its own rules, there is no current requirement for the backup well to be on a dedicated well lot. *See* DEQ Supplemental Comments. However, if contamination is detected in the redundant emergency source, and it is determined that contamination is attributable to activities within the well setback distances, an alternative redundant source may be required by DEQ. *Id.* DEQ notes that the Hayden Area Regional Sewer Board ("HARSB") operates a recycled water irrigation site within the required 1,000 foot setback distance for a well lot. DEQ Comments at 2. DEQ also notes that the well is not down gradient from the HARSB, and has consistently been in compliance with DEQ monitoring requirements and contaminant requirements. *See id.* at 2-3, 6. Because of the known concerns related to the backup well at the time the parties made the Agreement, Staff recommends the Commission not allow the Company to collect costs related to securing a second supply source, because the emergency well should have been transferred, or the purchase price should reflect the exclusion of the backup well from the Agreement (which had already been included in customer rates), and the Company should have been aware of the redundant source rule and the well lot requirement.

ii. The Application Does Not Explicitly List All Assets Necessary to Operate the System.

Staff is concerned that the Agreement may not include all the assets necessary to operate the system reliably. For example, the Agreement explicitly includes the transfer of the municipal water right, 95-10068, from Diamond Bar to Gem State Water, but the Agreement does not list irrigation water right 95-10067. Current records on file with the Idaho Department of Water Resources indicate that those rights still belong to Robert Turnipseed. Given the large number of Diamond Bar customers who irrigate their property during summer months, Staff would be concerned if this water right was not included in the transaction.

Staff is also concerned that not all easements necessary to operate the system are included in the transaction. Staff notes that the Agreement's Diamond Bar asset list includes easements that were recorded in the official records of Kootenai County on August 17, 1994. However, the agreement does not mention easements that may have been obtained after that date, such as those that would be necessary to serve Boeckel Estates, which was incorporated into the system in 2004.

While the identified assets were not explicitly included in the Agreement, the Agreement contains a catch-all provision. Provision No. 1.1 of the Agreement states,

Seller will sell and deliver to Buyer, and Buyer will purchase from each Seller, free and clear of any Encumbrances, all of each Seller's right, title and interest in all of the assets, properties and rights of every kind and nature, whether real, personal or mixed, tangible or intangible (including goodwill), wherever located and whether now existing or later acquired (other than the Excluded Assets) that relate to, or are used or held for use in connection with, its Business (together, the "Purchased Assets"), including those set forth on Schedule 1.1(a).

The above provision addresses Staff's concerns with respect to easements and water rights. Staff notes that the fact that the backup well is not included in the transaction, which in Staff's interpretation would fall within the definition of Provision No. 1.1 of the Agreement, provides an additional layer of uncertainty as to what is and is not included in the transaction. Staff has discussed the incomplete asset list—including missing easements and water rights and exclusion of the backup well—with Gem State Water and Robert Turnipseed, and received assurances from the parties that they believe all assets needed to operate the system adequately and reliably are included in the transaction.

C. Gem State Water has the Bona Fide Intent and Financial Ability to Operate and Maintain the System in the Public Service.

Staff believes the Company has clearly demonstrated its bona fide intent and financial ability to provide continued operation of the system and reliable service. Staff has noticed a recurring problem in Idaho where small water companies are often owned by individuals who have no clear plan for succession of ownership. Water systems routinely require repair, replacement and extension of infrastructure to provide reliable and ample water service to

customers. Financing this infrastructure at a reasonable cost is a challenge for smaller water systems.

Gem State Water, through its parent company, Northwest Natural Holdings, has more than adequate financial ability to fund Diamond Bar capital requirements in a timely manner at a competitive cost. Staff notes that while Mr. Turnipseed successfully met his obligation to finance past system improvements, the purchase of these systems by Gem State Water will increase the access to capital beyond what Mr. Turnipseed can now provide. Northwest Natural Holdings has a \$400 million revolving line of credit, 2018 Net Income of \$64.6 million, 2018 cash flow of \$9.2 million, A1 credit rating from Moody's, and AA- credit rating from Standard and Poor's. Lower financing rates help control costs that ultimately are passed on to customers.

Gem State Water has committed in its Application to serve existing and future customers of Diamond Bar and Bar Circle S and to maintain or improve the existing level of services without any disruption to customers. *See* Application at 3. The Company noted in response to a production request that potential capital expenditures may be needed, and the Company has stated its intent to commission an engineering study to better estimate specific capital needs. The potential needs stated in the response do not include the secondary source of supply mentioned above.

II. Bar Circle S

According to the Bar Circle S 2018 Annual Report, the system serves 218 residential customers. *See* Application at 4. According to the 2016 Survey, the system includes a 342 foot well (Well 1) equipped with a 60 HP pump and a 360 foot deep well (Well 2) equipped with a 5 HP pump. Water from the two wells is pumped into a 185,000 gallon reservoir, and then pumped into the distribution system using a system of four 10 HP booster pumps and a 110 HP fire pump. A third well (Well 3), drilled in March 2016, is equipped with a 60 HP submersible pump; however, at the time of the 2016 Survey, it had not been connected to the Bar Circle S distribution system. Mr. Turnipseed stated during Staff's investigation in this case that all three wells are currently connected and operational.

Staff used the same legal framework to evaluate the proposed transaction between Bar Circle S and Gem State Water as it used to evaluate the Diamond Bar transaction. Staff was concerned whether sufficient assets were transferred as part of the Agreement.

A. The Transaction is Consistent with the Public Interest.

Staff's comments for Bar Circle S are the same as Staff's comments for Diamond Bar in this regard.

B. The Cost of and Rates for Supplying Service will Not Increase Due to the Transaction.

Gem State Water states it will maintain the existing rates and charges for Bar Circle S customers. The Company also states the transaction expenses related to the acquisition will be paid by Gem State Water's parent company and will not be recovered from ratepayers. *See* Palfreyman Direct at 6.

Similar to Staff's concern regarding Diamond Bar, Staff is concerned that the asset list in the Agreement does not include all easements necessary to serve existing Bar Circle S customers. Staff requested the Company provide agreements and system maps identifying any easements and equipment that are not Company owned. The maps provided by the Company are incomplete and barely legible. They appear to identify only a few of the easements that would be necessary to run the water system. Staff is particularly concerned that the easements required to operate in Double-T Estates were not included in the asset list. Staff questions the ability of the system to provide service to the current system as well as the recently approved development, Garwood Corner. The Agreement also mentions the possibility of further expansion of the system outside the current certificated territory.

Staff has discussed the incomplete asset list, including missing easements and water rights, with both parties to the Agreement. The parties stated understanding, which appears to be in alignment, in conjunction with Provision No. 1.1 of the Agreement, allow Staff to recommend approval of the transaction despite the uncertainty.

C. Gem State Water has the Bona Fide Intent and Financial Ability to Operate and Maintain the System in the Public Service.

Staff's comments for Bar Circle S are the same as Staff's comments for Diamond Bar in this regard.

CUSTOMER NOTIFICATION AND PRESS RELEASE

Rule 125 of the Commission's Rules of Procedure does not require customer notification unless the Company is requesting a rate change. IDAPA 31.01.01.125. In its Application, the Company stated its intention to publish a Customer Notice in the Coeur d'Alene Press regarding Gem State Water's agreement to purchase Bar Circle S and Diamond Bar. It is unclear whether the Company has already published this notice. Regardless of whether the Company published this notice, if the Commission approves the sale of Bar Circle S and Diamond Bar to Gem State Water, Staff recommends that Gem State Water provide direct notice to customers of the purchase, either through a separate mailing, a message on bills, or as an insert sent with bills.

COMPANY TARIFF

Currently, Bar Circle S and Diamond Bar have separate Commission-approved Tariffs, each with different rates, charges, and rules and regulations. If the sale is approved and Gem State Water wishes to create a single, combined Tariff that lists all the separate rates and charges for the water systems owned and operated by Gem State Water, Staff recommends the Company work with Staff to combine the separate Tariffs following issuance of the final order in this case.

COMPANY DOCUMENTS

The Company will need to update customer documents to reflect any changes brought about by the sale of the Companies. Staff is willing to work with Gem State Water to update its billing and collection documents as well as its Explanation of Rates and Annual Rules Summary. Staff recommends the Company work with Staff to make any necessary revisions within three months of issuance of the final order in this case.

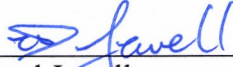
STAFF RECOMMENDATION

Staff recommends the Commission:

- Approve the sale of Bar Circle S to Gem State Water.
- Approve the transfer of Bar Circle S CPCN No. 296 to Gem State Water.
- Approve the sale of Diamond Bar to Gem State Water with the condition that the lack of a redundant source not affect future rates.
- Approve the transfer of Diamond Bar's CPCN No. 413 to Gem State Water.

- Direct Gem State Water to notify customers directly of the sale of Bar Circle S and Diamond Bar to Gem State Water, either through a separate mailing, a message on bills, or as a bill insert.
- Direct Gem State Water to work with Staff to file conforming Tariffs following issuance of the final order in this case.
- Direct Gem State Water to work with Staff to make any necessary revisions to its billing and collection documents and its Explanation of Rates and Annual Rules Summary within three months of issuance of the Commission's final order in this case.

Respectfully submitted this 23rd day of July 2019.



Edward Jewell
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CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 23RD DAY OF JULY 2019, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF**, IN CASE NOS. BCS-W-19-01/DIA-W-19-01, BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

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