

## **DECISION MEMORANDUM**

**TO: COMMISSIONER KJELLANDER  
COMMISSIONER SMITH  
COMMISSIONER HANSEN  
COMMISSION SECRETARY  
COMMISSION STAFF  
LEGAL**

**FROM: JOHN R. HAMMOND**

**DATE: DECEMBER 12, 2003**

**RE: IN THE MATTER OF THE APPLICATION OF CAPITOL WATER CORP. TO  
USE MONEY IN A SURCHARGE ACCOUNT TO RETIRE A LOAN EARLY.  
CASE NO. CAP-W-03-1.**

### **APPLICATION**

On September 30, 2003, Capitol Water Corp. filed an Application requesting Commission authorization to use \$100,000 in the surcharge account to retire a loan early (Loan 1), thereby immediately eliminating a surcharge (Surcharge 1) on customer rates. The Company says this is possible because the amount borrowed for another loan was less than anticipated and the interest rate was reduced from 7% to 5.65%. The amount to pay this loan off is about \$63,000. The Company claims that this would leave a balance of more than \$40,000 to help satisfy continuing Loan 2 amortization costs, phosphate purchases, and power expense. The Company contends that by retiring Surcharge 1 early money can be saved on the interest charges and will reduce consumers' bills. The Company requests the Commission approve its Application quickly because it contends it is in the best interest of ratepayers.

On November 10, 2003, the Commission issued Notice of Application and Notice of Modified Procedure. Order No. 29376. In response to the Commission's Order the Commission Staff was the only party to file written comments.

### **BACKGROUND**

On July 1, 1997, the Commission authorized Capitol Water Company to incur debt to fund certain water quality improvements for its system. Case No. CAP-W-96-2, Order No. 27022. The principal loan amount was \$402,624.71, (Loan 1). Order No. 27022. The Commission

authorized the Company to collect a surcharge (Surcharge 1) of \$3.27 a month from its unmetered residential customers and a 25.2% increase for metered commercial customers to recover loan amortization costs, annual Idaho Power Company Power Cost Adjustment (PCA) charges, the annual purchase cost of phosphates for water treatment and incremental income taxes associated with the surcharge. Order Nos. 27022 and 28801. The surcharge would allow the Company to amortize the loan over a seven-year period, ending August 1, 2004. *Id.*

On May 22, 2002, the Commission authorized the Company to incur an additional \$507,000 in debt (Loan 2) to finance improvements to its water system. Case No. CAP-W-02-1, Order No. 29035. The Commission authorized the Company to institute a second surcharge (Surcharge 2) of \$3.10 a month for residential flat-rate customers and 23.6% for metered customers that would recover only loan amortization costs and incremental income taxes associated with the surcharge over a seven-year period. *Id.*

#### **STAFF REVIEW**

Staff reviewed the Company's Application, audited the surcharge accounts, and worked closely with Capitol Water over the years to insure that both the borrowed funds and the amounts collected through the surcharges have been properly applied and accounted for.

Staff believes that the Company's contention that a surplus in its accounts has accumulated is accurate. However, Staff contends that the Company has undercharged its surcharge accounts and thus the balance is actually smaller than it claims. Staff believes two adjustments should be made to the Company's surcharge accounts. First, Capitol Water has undercharged its surcharge accounts by failing to include amounts paid to Idaho Power at PCA rates in place over the past several years. Staff believes the Company's surcharge account balance should be adjusted downward by \$4,126 to recognize the changes in PCA rates. In addition, Staff recommends that Capitol Water adjust its charges to the surcharge account each May when Idaho Power Company's PCA rate adjustment becomes effective. Second, Staff believes the Company has undercharged its surcharge account balance by \$11,597 for income taxes paid for the years 2001 and 2002. Staff recommends that every year Capitol Water calculate the effect of the surcharges on its income tax liability and charge the incremental income tax expense to the surcharge account in a timely manner. Based on these adjustments Staff believes the Company's surcharge account balance should actually be \$91,140 as of September 30, 2003.

Staff supports Capitol Water's request to pay off the balance of Loan 1 with the adjusted surplus balance and commends the Company for bringing this Application to the Commission. Accordingly, Staff recommends that the Commission authorize the Company to use the surplus funds in its surcharge account to retire Loan 1 early. Staff also recommends that the Commission authorize the Company to eliminate Surcharge 1 that is associated with Loan 1.

Staff was also concerned that the remaining surcharge, Surcharge 2, would not provide the cash flow for the Company to service Loan 2 and pay for the phosphates and Idaho Power's annual PCA rate changes. *See* Order Nos. 29035. Staff stated this could cause the Company to file a general rate case to recover these costs in its base rates. Thus, Staff recommends that the Commission authorize the Company to adjust the remaining surcharge upward by \$0.45 per month for flat rate customers and by 3.5 percentage points for metered customers. Staff believes this would provide sufficient revenue to cover the ongoing PCA and phosphate costs. The purpose of including the Idaho PCA charges and phosphate costs in the calculation is to make Capitol Water whole, neither benefiting nor penalizing the Company. Staff does not anticipate an increase in profits to the Company as a result of the incremental increase and any excess funds collected should be used to retire Loan 2 early.

Staff contends the elimination of Loan 1 and Surcharge 1 early in combination with the small upward adjustment to Surcharge 2 would allow the Company's flat rate customers to realize a reduction in surcharges from \$6.37 per month to \$3.55 per month or a surcharge reduction of 44.27%. The surcharges that metered customers pay will change from 48.8% per month to 27.1% or a 44.47% reduction. The elimination of Loan 1 at an interest rate of 9% would also benefit the Company's customers who are paying its carrying costs through Surcharge 1. Based on the recommended modifications to Capitol Water's Application, Staff believes Commission approval would benefit the Company's customers in the long run.

Finally, Staff reviewed the Company's improvement projects currently approved in Order No. 29306. The Company plans to install a back up generator at Well No. 4 at an estimated cost of \$75,000 and begin an aquifer recharge project to provide water quality improvements at an estimated cost of \$20,000. The Company has sufficient borrowing capacity in the 2002 loan to complete these activities. The interest rate of this loan is between 5.5 and 6% as represented by the Company.

Therefore customers will see a reduction in overall bills and the Company will be able to complete its project needs previously approved by the Commission.

**STAFF RECOMMENDATION**

Staff recommends approving the Company's request to use the existing funds to pay-off Loan 1 and retire Surcharge 1. Staff further recommends that Surcharge 2 be increased by \$.45 per month to \$3.55 for flat rate customers and 3.5 percentage points to 27.1% per month for metered customers to recover ongoing PCA and phosphate costs.

**COMMISSION DECISION**

Does the Commission wish to approve Capitol Water's Application with the modifications suggested by the Commission Staff?



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John R. Hammond

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