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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE EAGLE WATER)
COMPANY'S REQUEST FOR A TEMPORARY) CASE NO. EAG-W-05-2
SURCHARGE.)
) STAFF COMMENTS
)

COMES NOW the Staff of the Idaho Public Utilities Commission, by and through its Attorney of record, Donald L. Howell, II, Deputy Attorney General, and submits the following comments in response to Order No. 29870 issued on September 16, 2005.

THE APPLICATION

On August 3, 2005, the Commission issued an emergency Order directing Eagle Water Company to "use all deliberate speed" to increase low water pressure in the Eagle Springs subdivision. Order No. 29840. The Order also directed the Company to prepare an engineering report for its entire system and to file an Application for a surcharge to recover the costs of: (1) the immediate system improvements to correct the low-pressure conditions; (2) preparing the system engineering report; and (3) the costs to be incurred in preparing the Surcharge Application.

On August 24, 2005, Eagle Water filed its Application for a temporary surcharge. The Company also proposed three additional measures that it could implement to address low-

pressure concerns. On September 9, 2005, the Company supplemented its Surcharge Application with a request to immediately implement the temporary surcharge.

Eagle Water asserted in its Application that it has alleviated the low-pressure problems affecting Eagle Springs subdivision by replacing an 8-inch mainline with a 12-inch mainline. This mainline is connected to the booster pump serving the Eagle Springs subdivision. The Company estimated that the cost of replacing the 8-inch mainline with the larger 12-inch mainline was \$40,027. Application at 2. Eagle Water also estimated the cost of producing the engineering report and the legal/accounting costs to prepare the Surcharge Application. Id. at 5. These costs are reflected below.

<u>ITEM</u>	<u>COST</u>
Replace 8-inch line	\$ 40,027
Prepare Engineering Report	\$ 79,895
Legal & Accounting Expenses	<u>\$ 5,500</u>
TOTAL	\$125,422

Order No. 29870 at 2.¹ Eagle Water stated that it will take between three to five months to complete the engineering report. Exh. 4, p. 5.

A. Additional Low Pressure Measures

Although the Company believes that it has adequately addressed the immediate low-pressure problems in Eagle Springs, it is concerned that there may be occasional drops in water pressure, “especially in light of the continued wasting of water that has been observed in Eagle Springs.” Surcharge Application at 2. The Company’s engineer has identified three additional measures, which may “further alleviate water pressure problems in the Eagle Springs area.”

These additional measures are:

Option 1 – Increase the power of the current booster pump from 60 horsepower (HP) to 75 or 100 HP. The estimated cost of this option is \$87,075.

Option 2 – Install an additional booster pump buried under Big Springs Street at the 2,700-foot elevation. The estimated cost of this option is \$81,607.50 or approximately \$1,600 per customer for the 51 customers at the highest elevation in Eagle Springs.

¹ The Company’s Application misreported the legal and accounting subtotals as \$7,250. The table above shows the correct data and total amount.

Option 3 – Drill a new well under an existing permit from IDWR to serve the entire system. The estimated cost of this option is \$390,305. The Company has an existing permit to drill this well but expires on March 1, 2006.

Order No. 29870 at 2. The Company estimated that Option 1 and Option 2 would take approximately six weeks to implement. Option 3 would take 60 to 180 days. Application at 4-5. The Company's preference is for the Commission to authorize Option 3 (the new well).

The Company asserted that based upon DEQ criteria for estimating peak hourly demand, the peak demand for Eagle Water is approximately 2,000 gallons per minute (gpm). In addition to this normal peak demand, the Company maintained that fire-flow requirements for public safety are an additional 1,500 gpm. Using the DEQ standards, the Company estimated its system peak demand could exceed 3,500 gpm. *Id.* at 4. The Company reported that the maximum pumping rates of the four operational wells are: No. 1 – 600 gpm; No. 2 – 400 gpm; No. 4 – 2,000 gpm; and No. 6 – 2,000 gpm.² The total pumping rate for the four wells is 5,000 gpm – 1,500 gpm above the estimated peak demand. The Company stated that if either Well No. 4 or No. 6 should temporarily fail, there may “not be adequate quantity or pressure for the system” to meet DEQ standards. *Id.* at 4.

B. The Proposed Surcharge Alternatives

The Company estimated that a monthly billing surcharge of 16.85% over 3 years would recover the anticipated costs for: (1) correcting the immediate pressure problems; (2) preparing the engineering report; (3) recovering the legal/accounting costs; and (4) implementing either Option 1 or Option 2. This surcharge would recover \$214,147. Exh. 8.

The Company's preferred alternative would be to recover the immediate costs (the 3 elements above) and to implement Option 3 (the new well) for a total estimated cost of \$517,477. The Company's accountant has calculated that a monthly surcharge of 40.85% would recover this amount over three years. The Company estimates that this larger surcharge would result in an additional \$9.16 per month for the average residential customer. Even with the proposed surcharge, the Company asserted that the average customer's annual water bill would be lower than the annual water bills for customers of either the City of Eagle's municipal water system or United Water. Order No. 29870 at 3.

² In addition to the four operating wells (Nos. 1, 2, 4, 6) the Company uses Well No. 3 as a back-up supply source (sand problems) and Well No. 5 has never been developed. The proposed Option 3 (new well) would be Well No. 7.

The Company proposed that its Surcharge Application be processed under Modified Procedure. In its supplemental Application of September 9, 2005, the Company filed copies of its Press Release and Customer Notice to comply with the Commission's Customer Information Rule 102. IDAPA 31.21.02.102. In its supplement, the Company asked for an immediate effective date for its temporary surcharge. Order No. 29870 suspended the proposed surcharges until October 28, 2005.

EAGLE WATER COMPANY HISTORY

A. Hook-up Fees and Low Pressure

In 1992 the Commission issued Order Nos. 24319 and 24474, granting Eagle Water a \$100 engineering study hook-up fee and a \$500 construction hook-up fee (hook-up fees). Case Nos. EAG-W-91-1 and -92-1. These hook-up fees were intended to address customer complaints regarding inadequate water pressure and to fund a new well that was intended to allow the Company additional capacity to expand its system to accommodate additional developments in Eagle Water's service territory.

The Commission revisited the hook-up fees in Order No. 24890 issued in May 1993. During the construction of the new well, the Company applied for the authority to finance additional debt to pay for a variable speed pump to be used at the new well. In Order No. 24890, the Commission granted the Company's request to continue the hook-up fees to provide the necessary financing for the larger capacity pump. The Commission intended the proceeds from the hook-up fee to be used to amortize the debt for the new well and pump. The hook-up fee remains in the current tariff.

In July 2000, the Commission initiated a docket for investigation of Eagle Water Company and its ability to provide adequate water service to the customers of Eagle Springs Estates and adjacent areas. Staff reported that in July of 2000, Eagle Water's Well No. 4 failed causing low pressure in the water system. Pressure was particularly low in the Eagle Springs subdivision located east of Horseshoe Bend Road and south of Floating Feather Road. Eagle Water repaired the well pump and also installed a new booster pump, which increased pressures in the Eagle Spring subdivision. At that time Eagle Water indicated that it intended to drill a new well that would further help alleviate water pressure problems. It had obtained a water rights permit and was awaiting a well drilling permit. It expected to drill the well in the winter of

2000 and have it operational by the summer of 2001. The Company was also in the preliminary planning stages for a new storage reservoir that would be located in the foothills northeast of Eagle Springs. If the reservoir was built, the Company stated that it would help maintain and stabilize water pressures in the system as well as provide additional fire protection. See Order No. 28513.

In 2003 the Company filed to expand its service area. Staff pointed out in its Comments that Eagle Water had been planning for several years to drill a new well near the southeast corner of its service territory and to construct a storage reservoir near the northeast corner, but has yet to make progress on either project. Staff went on to say, it believes both may be necessary in order to maintain continuing capability to provide adequate service as additional development occurs on the east side of the Company's system.

B. Current Customer Complaints and Comments

As of October 17, 2005, the Commission had received 25 written comments from customers. The majority of the comments were from customers who felt the pressure problems improved when the 12-inch line was reconnected. These customers also feel that option 2 (the Big Springs booster) is necessary to fix problems with their portion of the system. However, these customers mistakenly thought the Company wanted the 51 subdivision customers served by the in-line booster pump to pay for it.

Three other customers are against the surcharge. Another customer was not opposed to the surcharge, considering it necessary to attain quality water service; however, he felt Eagle Water and the PUC should have fixed the problem earlier. One customer indicated that service has been bad for years and another customer stressed she has had pressure problems since 1997. Two customers felt the surcharge was a band-aid fix and would rather see a permanent rate increase sufficient to provide Eagle Water with the funds necessary to meet the demands of a continually growing population. Two customers objected to Eagle Water saying their subdivision has used excessive lawn irrigation. New hookups along Horseshoe Bend Road are a concern of almost all those who commented; because they fear those extra connections will further deteriorate the systems current low water pressure.

On October 12, 2005, the Commission held a workshop and hearing at the Eagle Senior Citizen Center in Eagle. About 20 people attended the workshop and hearing. Three Eagle Water customers testified at the hearing. All three customers were concerned about approving

any of the three additional options without proof that these options would permanently solve the pressure problems.

STAFF ANALYSIS

The Commission's Order No. 29840 directed Eagle Water to file an Application for a surcharge to recover the costs of: (1) the immediate system improvements to correct the low-pressure conditions; (2) preparing the system engineering report; and (3) the costs to be incurred in preparing the Surcharge Application. The Company's Surcharge Application in this case requests a surcharge to recover the three costs mentioned above and the cost of other facilities that it believes are necessary to correct the pressure problem, specifically a new well or one of two booster pump projects (the 3 options).

A. The Three Low Pressure Options

The Company asserts in its Application that the low-pressure problems affecting Eagle Springs subdivision have been alleviated by replacing an 8-inch mainline with a 12-inch mainline. To verify that the pressure problem had been remedied, the Company monitored the pressure in the Eagle Springs Subdivision for 14 days following the installation of the 12-inch mainline. During that period pressures were significantly improved but still dipped to about 20psi on several occasions. Although pressures improved, the Company's engineer, Jim Reese concluded that some additional improvements are necessary to completely correct the pressure problems. In the Company's Application, (Exhibit No. 4 pg.1), he states, "The 12-inch pipe installation, however, is only a short term fix. ... As a result, we have looked at alternate methods to ensure pressure would remain above the required DEQ minimums." Mr. Reese then proceeds to describe the three different Company Options.

DEQ, Eagle Water and a number of customers have commented that replacement of the 8-inch water main with the 12-inch water main is not sufficient to fully resolve the water pressure problems. They believe that improvements in the existing booster pump, or a new booster pump, or a new well will be necessary to completely correct the problems. Although Staff acknowledges that some additional facility improvements will certainly be required to correct the pressure problems, Staff recommends that the engineering report be completed prior to instituting any plant improvements. Staff maintains that until the comprehensive engineering study is complete, it is not clear what specific improvements are needed, what the proper size

and location of the well is, and what other improvements may be required. Other improvements may include mainlines, storage or booster pumps, to properly utilize a new well.

To illustrate the importance of these unknown considerations, Staff observes that there is ample water supply in the west side of the system, and additional water supply in that area would do little to resolve the existing pressure problems on the east side. Consequently, analyzing location and proper interconnection are critical to effectively utilize any additional supply. Completing the comprehensive engineering study to answer these questions prior to authorizing large expenditures is the prudent thing to do. Staff also agrees with the sentiment expressed by customers at the public hearing that the Company should not get the cart before the horse and make investments that might later prove to be less than optimum.

Facility improvements designed to increase water pressure in the Eagle Springs area have been planned by the Company since 2000. At that time the Company planned to drill a new well and construct new storage facilities. After five years of delay the well, although not complete, is still the preferred facility improvement but it is not clear why storage is not being considered or how it might fit in the comprehensive solution. Before the Company proceeds with storage, a booster or a new well, Eagle Water should complete the engineering study.

Therefore, Staff recommends that the Company be authorized to recover only those costs identified by the Commission in Order No. 29840: (1) the immediate system improvements to correct the low-pressure conditions; (2) preparing the system engineering report; and (3) the costs to be incurred in preparing the Surcharge Application. This recommended cost recovery of \$125,422 is comprised of \$40,027 for emergency repairs (Company Exhibit 2); \$79,895 for the Commission ordered engineering study (Company Exhibit 4); \$3,500 for legal fees (Company Exhibit 5); and \$2,000 for accounting fees (Company Exhibit 6).

Once the engineering study is complete, the Commission can be presented with the resultant plan of action for water quantity and quality requirements, and that any extension of the surcharge and change in the surcharge rate be determined in a future proceeding.

B. Financial Review

Staff's review of the Company's financial condition was utilized to determine whether a surcharge was even necessary. Staff and the Company have been working to verify the amount of prior hook-up fees collected, determine where the revenue has been used, and if the expenditures were booked properly. It appears that funds collected from the hook-up fees have

been used for purposes other than engineering fees and well improvements. The Company has not properly tracked and accounted for the hook-up fee funds once they were collected. The hook-up fees have been booked to Contributions in Aid of Construction (CIAC), yet it is not clear what corresponding entries were made. Eagle Water's 2004 Annual Report submitted to the Commission shows that it received about \$148,000 in hook-up fees, including the hook-up fees authorized in Order Nos. 24319, 24477 and 24890; yet plant in service only increased by about \$12,000. This incomplete booking has contributed to the Company now having a negative rate base.

In Case No. EAG-W-04-3 Eagle Water acknowledged its negative rate base and described the circumstances that led to the negative rate base. Although this case was withdrawn, the Company's prefiled testimony stated that the primary factor leading to the negative rate base was the failure to capitalize much of the cost of plant put into service. Instead plant has been expensed to minimize income taxes. The Company acknowledged that an extensive review of the prior years' accounting records was warranted to correct the problem of the negative rate base.

While the issue in this case is not negative rate base or its effect on a general rate case, the financial status and borrowing capabilities of the Company are an important part of the analysis required to evaluate the proposed surcharges. For the last four years the Company has reported an average net income of about \$100,000. The Company has used the surcharge proceeds for a variety of expenses other than what the surcharge was originally intended. These other expenses include meeting payroll requirements, meeting federal tax obligations, and in general, meeting the cash flow needs of the Company. Staff notes that the inflow of cash from the hook-up fees has most likely forestalled or delayed a need for a general increase in rates.

The Company has proposed three options that require additional funding beyond what Staff is recommending in this case. Staff's recommendation does not require a loan for completion of the project. However, the other options could require obtaining a loan to proceed. Idaho Banking Company has been consulted to determine what is necessary for Eagle Water to secure a loan. If the Commission allows the Company to fund expenditures under any of the Company's three options, then the financial institution's loan requirements will need to be provided by the Company for Staff review to determine the appropriate surcharge amount and recovery time period.

C. Staff Surcharge recovery period and rate design

1. Recovery Period. All of the Company's surcharge options, which include additional capital investment, are designed to recover the identified costs in a 3-year period. Staff is proposing that cost recovery be limited to those actions previously identified by the Commission. Consequently, Staff recommends a 1-year cost recovery period to coincide with completion of the system engineering study and construction of needed system facilities. If additional revenue is necessary, such revenue could be obtained by continuing or slightly modifying the existing surcharge for an extended period.

2. Gross-up. The total amount to be recovered must be grossed up for income tax effects. The gross-up factor, as calculated by the Company's CPA, Geneva Trent, is 127.88%. Staff finds the Company's calculation to be reasonable. After applying the gross-up factor, and assuming recovery for one year, the total to be recovered by the Staff's proposed surcharge is \$160,389. This surcharge is an increase of approximately 26% over total operating revenues of \$616,029 in 2004.

3. Rate Design. The Company has proposed in its Application to recover the surcharge as a uniform percent increase on all tariff rates. While this is a straightforward approach that would create a fairly level revenue stream, Staff believes that it is more appropriate to recover the surcharge on the commodity charge only. The improvements are required mainly to provide added water supply for the peak periods in the summer months. Therefore a surcharge, which is added only to the water use over the 600 cubic foot minimum, seems appropriate. Based on Company estimates, Staff has calculated that a surcharge on use above 600cf of 42.5% (19.2 cents/100cf) would generate the necessary revenue. This would raise the commodity rate from \$.451 per 100 cubic feet to \$.643 per 100 cubic feet. Even with this increase, Eagle Water commodity rate would still be 41% below United Water's winter rate and 53% below its summer rate.

In order to accelerate collection of the surcharge and to provide a conservation price signal in the summer months, Staff suggests that the surcharge could be set higher in the summer months. In the alternative, if the Commission chooses to apply the surcharge to all tariff rates as proposed by the Company, all rates would increase by 26% for a 1-year period. Staff will closely review the accounting for all surcharge revenue. Because actual sales could be more or

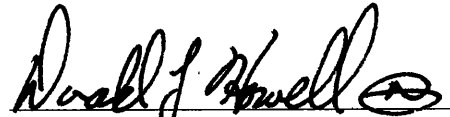
less than projected, surcharge costs may be recovered sooner or later than the 12-month period projected.

Questions remain with the 12-inch mainline. The Company has not fully explained why the initial 12-inch mainline was installed in a temporary easement, why it was subsequently damaged, or why it was replaced with an 8-inch mainline.

SUMMARY

Staff believes that water pressure has been an ongoing problem that has not been adequately addressed by the Company. The Commission will continue to receive complaints, and customers will continue to have inadequate service during periods of peak consumption if appropriate action is not taken. Staff recommends only allowing the Company to recover those costs authorized in Order No. 29840 over a 1-year period. This is a grossed-up amount of \$160,389. A long-term solution resulting from the completed engineering study should be put in place to ensure that adequate service is available to Eagle Water's customers.

Respectfully submitted this *18th* day of October 2005.


Donald L. Howell, II
Deputy Attorney General

Technical Staff: Kathy Stockton
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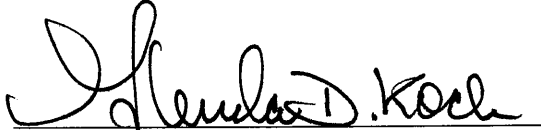
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CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 18TH DAY OF OCTOBER 2005, SERVED THE FOREGOING **FIRST PRODUCTION REQUEST OF THE COMMISSION STAFF TO EAGLE WATER COMPANY**, IN CASE NO. EAG-W-05-02, BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

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