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IDAHO PUBLIC
UTILITIES COMMISSION

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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

McKAY CONSTRUCTION CO., INC.,

COMPLAINANT

and

SCHMIDT CONSTRUCTION CO., INC.,

COMPLAINANT

vs.

UNITED WATER IDAHO INC.

RESPONDENT

Case No. UWI-W-08-01

STATEMENT OF POSITION

Introduction

As explained in more detail below, developers of residential subdivisions within United Water Idaho's ("United Water" or "Company") service area are permitted to choose contractors for the installation of water facilities from a list of pre-qualified contractors maintained by United Water¹. In January of 2008, United Water, believing that a list of ten contractors was adequate and that addition of more contractors would unnecessarily increase costs, determined to cap the number of pre-approved contractors at ten (10). In November and December of 2007 Schmidt Construction Co., Inc., ("Schmidt") and McKay Construction Inc., ("McKay")

¹ The short-hand description of this program is "*labor in lieu of cash*" because developers are permitted to provide their chosen contractor to perform mainline installations, rather than paying United Water to install the facilities.

submitted applications to be included on the pre-approved contractors list. Because the number of approved contractors had reached ten, Schmidt and McKay were notified on February 1, 2008, that they would not be included on the approved contractor list. Also, in late 2007 four other contractors submitted applications. They, too, were notified that United Water would not add additional contractors for the year 2008.

Schmidt and McKay have filed "formal complaints" with the Commission.

In this Statement of Position, United Water explains that, in the exercise of its business judgment, it decided to cap the number of approved contractors at ten in order to constrain the cost of administering the *labor in lieu* program.

Background

For many years United Water, with Commission approval, employed a single contractor, Owyhee Construction Inc., to install water facilities in residential subdivisions. The rationale for permitting a single provider was tied to the method by which construction of facilities in residential subdivisions was funded, known as the "guaranteed revenue and escrow method". Under that system, the Company (then Boise Water) would construct the main extension and necessary facilities at its cost. The developer and Company would sign an agreement in which the developer placed in escrow a sum that when combined with anticipated revenues from the development would provide the Company for five years with the rate of return on the new project as authorized by the Commission. Developers participating in the escrow program paid only a fraction of the costs of construction of a new water plant. In that circumstance, it was thought fair that the Company be allowed to use the contractor of its choice when it was responsible for so large an amount of the total costs of construction. (See Order No.23522, Case No. BOI-W-89-3, *In the Matter of the Investigation Upon the Commission's Own Motion of the*

Policies of Boise Water Corporation Concerning Line Extension Refunds). In contrast, developers of commercial or industrial developments fully funded those projects by contributions in aid of construction. Since developers of those projects provided the entire funding, they were not bound by the sole contractor method and could exercise choice in selection of a contractor.

Developers of residential subdivisions were unhappy with the sole contractor method and believed that a system of labor in lieu of cash would lower costs and promote efficiency. *See* Testimony of Ramon Yorgason and Ted Johnson, Case No. BOI-W-89-3.

In 1996, the Idaho Supreme Court decided the case of *Building Contractors Association of Southwestern Idaho vs. IPUC*, 128 Idaho 534, 916 P.2d 1259 (1996), which held that certain aspects of the Company's line extension policies were discriminatory. That decision made necessary a comprehensive review of the Company's connection fee and line extension policies, which the Commission undertook in case No. UWI-W-96-4, *In the Matter of the Connection Fees of United Water Idaho Inc., and other Related Issues Including Rate Design*.

In that case, developers again argued for elimination of the sole contractor method and for a labor in lieu of cash method. *See* Testimony of Ramon Yorgason.

Case UWI-W-96-4 was resolved by a settlement. The essential terms were that the guaranteed revenue and escrow method would be eliminated. Instead, developers would contribute the entire cost of extending the distribution system. United Water supported elimination of the guaranteed revenue and escrow method because, over the years, it had become difficult to administer. In addition, since developers would now contribute the entire cost of extending the system, the rationale for use of a sole contractor lost much of its force.

Accordingly, United Water agreed to implement a *labor in lieu* system making it possible for developers to exercise choice in selecting a contractor.

However, if multiple providers were to be allowed, United Water had two concerns. First, United Water desired to insure that only competent contractors be eligible to install systems that affected public health. Accordingly, the Settlement Agreement provided that a contractor must meet the Pre-Qualification Contractor Requirements that were then applicable to commercial and industrial developments.

Second, United Water was concerned that expanding the *labor in lieu* system to residential developments could increase administrative costs and burdens and could increase inspection and compliance costs. Accordingly, the Settlement Agreement provided that United Water should implement systems and procedures as are necessary to control administrative and inspection costs.

The Final Order in Case No.UWI-W-96-4, Order No. 26898, approved the terms of the Settlement Agreement.

Standard of Review

As President Redford noted at the Commission Decision Meeting on April 15, 2008, while United Water is a regulated utility, it is still a private corporation. This means that while the Commission has absolute authority with respect to United Water's retail rates, the Commission grants substantial deference to the judgment of the Company's management in the operations of its business. There are numerous examples of instances where the Commission has declined to second-guess the business judgment of the utility. *See e.g.* Case No. PAC-E-99-2, Order No. 28296 (Decision to sell interest in Centralia generating facility was within the business judgment of the utility); Case No. UWI-W-96-7, Order No. 27616 (Decision to lease

rather than purchase motor vehicles was within the business judgment of the utility); Case No. BOI-W-89-3, Order No. 23522 (Decision to require \$5 million insurance coverage rather than \$2 million for *labor in lieu* contractors was a reasonable business judgment).

Determining the size of the contractor pool is a matter upon which United Water may exercise its business judgment. United Water's Rules and Regulations, as approved by the Commission, are silent as to the size of the pool. Rule 67 provides only, "Applicant's contractor shall comply with Section 1 and Section 2 of the Company's *Requirements for Labor in Lieu of Cash Contractors*." Because the size of the pool is not defined by United Water's Rules and Regulations, United Water may exercise its business judgment to determine and adjust the size of the pool as circumstances warrant.

Thus, the question before the Commission is whether United Water's decision to limit the number of eligible *labor in lieu* contractors to 10 for the year 2008, for the purpose of constraining costs, was within the range of reasonable business judgment.

United Water's Decision to Cap the Number of Pre-Approved Contractors at Ten Was a Reasonable Business Judgment

A. A pool of ten (10) qualified contractors is adequate.

As noted above, residential subdivision developers prefer a *labor in lieu* system, believing it promotes price competition and choice of suppliers.

When the *labor in lieu* program was initiated in 1997, there were six approved contractors. Since then, the number of approved contractors has grown to ten.

Based on its experience in managing the *labor in lieu* program over the past ten years, United Water believes a pool of ten qualified contractors is sufficient to create price competition and to provide a sufficient choice of suppliers. By way of illustration, attached hereto as Exhibit

A, is a listing for the years 2004 through 2008 of contractor projects, setting out the footage of mainline pipe installed and the cost of installation². This illustrates that developers are, in fact, choosing from multiple suppliers and there are a sufficient number of suppliers to meet developer demands.

During the time United Water has been administering the *labor in lieu* program it has not encountered an experience in which a developer has been unable to obtain a bid for a developer's project. United Water has not received from any developer a complaint that the number of contractors is inadequate. To United Water's knowledge the Commission has not received any complaint from developers alleging there is an insufficient supply of contractors.

Additionally, as is well known, the residential housing construction market is experiencing a marked downturn compared to the years 2005 and 2006. As shown on Exhibit A, the year-by-year total number of developer projects was:

2004:	73
2005:	80
2006:	83
2007:	66
2008	15 ³

Thus, for the foreseeable future, the level of demand for contractors from developers is likely to be significantly less than in years when a pool of ten contractors was adequate to meet demand.

Accordingly, based on its experience, United Water believes that a pool of ten contractors is adequate to provide a choice of suppliers at competitive prices.

² The actual names of the contractor companies are not listed on Exhibit A for confidentiality reasons. Rather, they are referred to as "Contractor A", "Contractor B" etc.

³ The number of projects for 2008 is as of April 30, 2008. Because developers usually prefer to commence projects in the spring of each year, it is apparent that the number of projects in 2008 will be well below the number in previous years.

B. Increasing the pool of qualified contractors would increase cost and administrative burden without a commensurate benefit to United Water or its customers.

The managerial effort and cost of administering the *labor in lieu* program is substantial.

If United Water is not permitted to maintain an appropriate contractor cap, then in addition to McKay and Schmidt, United Water will have to contend with an unknown number of additional contractors, some of whom may be experienced, and some of whom may not.

As any one contractor is added to United Water's approved list there is also an added administrative burden that is not passed on to developers. The initial burden is in the time necessary to review submitted pre-qualification packages. During the review process there is a substantial amount of correspondence between United Water and the applicant, and between United Water and the applicant's references. If the decision is made to add a contractor then there is a one day training seminar conducted by United Water which the contractor must attend. This training session involves several United Water personnel. The contractor is instructed on how to provide estimates for projects in a format which United Water is able to use for preparing contracts for each project, protocol for notification for inspection, installation procedures based on "United Water Special Specifications and Standard Drawings", safety expectations and inspections, "as-built" instructions for mapping individual service and fire hydrant tickets, final job walk instructions and completion of final "Contributed Water Facilities" forms. Each of these items is involved in every developer funded main line extension project and is unique to United Water. None of this added administrative time and cost is passed on to any specific developer simply because there is no particular associated developer project against which the charges could apply. These costs therefore become part of the overall construction overhead charged to all capital improvement projects resulting in increased rate base and eventually increased rates

for all customers. In addition, it has been United Water's experience that new contractors require additional administrative time and effort to monitor and ensure that the items referenced above are actually accomplished in a complete, accurate, and timely fashion as the new contractor begins to perform work.

United Water maintains a separate file on each approved contractor. These files contain correspondence between the contractor and the Company, insurance requirement verification, annual review data, and other pertinent items. Every time United Water makes a change in its "Special Specifications and Standard Drawings" this results in correspondence to each contractor and two new sets of specifications are sent to each contractor for their use. Each contractor's insurance requirements are renewed at various times of the year requiring administrative time tracking and extra administrative cost. Since these costs are not related to any one project none of these administrative costs are charged directly to any specific developer's project.

United Water has also implemented an annual contractor review process to evaluate contractor performance and to control administrative cost. Once a year, usually in March, United Water meets with each contractor and reviews their previous years work. United Water has developed a tracking process for each project performed by the contractor during the year and scores the contractor in a variety of categories. The tracking process and annual review provides an opportunity for performance feedback to each contractor with the intent to improve future work flow and best utilize United Water's human resources by eliminating unnecessary iterations of administrative and inspection work. These annual reviews require preparation and administrative time from several United Water personnel. Attached hereto as Exhibit B is a United Water business Record entitled "Contractor Project Evaluation Results."⁴ As indicated by Exhibit B, the tracking process is rigorous and time consuming. The administrative time spent

⁴ As with Exhibit A, actual names of the contracting companies are not disclosed for confidentiality reasons.

preparing for and meeting with each contractor every year is another area of cost which cannot be charged directly to any single developer project. Obviously, the more contractors United Water has on its approved contractor list, the more cost will be incurred in preparing for and performing these annual reviews. United Water believes its decision to cap the approved contractor list at ten contractors is a prudent one.

Conclusion

For the reasons stated herein United Water respectfully requests that the Commission determine that the decision to cap the number of eligible contractors at ten was a reasonable exercise of United Water's business judgment, aimed at controlling the cost of the *labor in lieu* program. Alternatively, if the Commission desires to hear oral argument, United Water is prepared to do so. Alternatively, if the Commission determines that a further factual record should be developed, United Water requests that a pre-hearing conference be convened.

DATED this 5 day of May, 2008.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on the 6th day of May, 2008, I caused to be served, via the method(s) indicated below, true and correct copies of the foregoing document, upon:

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Boise, ID 83709

Hand Delivered
U.S. Mail
Fax
Fed. Express
Email

Heather Hule, legal Asst.
McDevitt & Miller LLP

Contractor	# of Projects	Feet Installed	Project Totals
2004			
Contractor A	7	9160	\$340,184
Contractor B	1	2400	\$74,687
Contractor C	8	3715	\$292,558
Contractor D	20	33480	\$1,214,659
Contractor E	3	7255	\$254,040
Contractor F	14	16000	\$736,374
Contractor G	12	20929	\$754,218
Contractor H	4	33530	\$1,565,006
Contractor I	4	12435	\$441,607
2005			
Contractor A	5	16360	\$932,794
Contractor B	2	3255	\$181,280
Contractor C	10	8930	\$644,560
Contractor D	19	43079	\$1,783,491
Contractor E	25	27640	\$1,431,610
Contractor F	13	28800	\$1,178,624
Contractor G	2	4835	\$168,261
Contractor H	4	7775	\$314,765
2006			
Contractor A	6	8555	\$525,548
Contractor B	3	7445	\$383,509
Contractor C	8	7215	\$460,685
Contractor D	11	12960	\$756,813
Contractor E	17	44060	\$2,258,110
Contractor F	19	26255	\$1,690,135
Contractor G	9	24390	\$1,182,555
Contractor H	5	24780	\$1,292,892
Contractor I	2	11570	\$555,431
Contractor J	3	4030	\$325,144
2007			
Contractor A	5	4455	\$283,182
Contractor B	2	2765	\$207,488
Contractor C	5	2520	\$184,826
Contractor D	6	6165	\$385,754
Contractor E	18	62265	\$3,060,661
Contractor F	11	31230	\$2,133,433
Contractor G	9	14455	\$825,891
Contractor H	4	6815	\$340,365
Contractor I	3	5175	\$455,225
Contractor J	3	2355	\$267,649
2008			
Contractor A	1	2520	\$108,692
Contractor B	2	1760	\$98,919
Contractor C	0	0	\$0
Contractor D	1	890	\$37,653
Contractor E	2	810	\$44,757
Contractor F	2	2605	\$161,120
Contractor G	3	4875	\$276,454
Contractor H	3	15805	\$729,099
Contractor I	1	560	\$26,321
Contractor J	0	0	\$0

Contractor Project Evaluation Results

Results for projects completed in 2007

Contractor	Project Average	Number of # Projects	Project Category Averages												
			Pre Construction			Construction/Inspection Results									
			Estimate	Per Notr.	Notification	Specs	Plans	Material	Clean Up	Quality	Safety	Tickets	Job Way		
A	64.0	6	5.00	5.00	5.00	5.00	5.00	5.00	4.83	5.00	4.67	4.67	4.67	4.83	
B	49.0	2	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	4.50	4.50	3.50	3.00	
C	54.8	12	4.92	5.00	5.00	5.00	5.00	5.00	5.00	5.00	4.83	4.83	5.00	5.00	
D	52.9	8	4.13	5.00	5.00	4.88	5.00	5.00	4.88	4.75	5.00	5.00	4.63	4.63	
E	53.5	19	4.63	5.00	4.74	5.00	4.89	5.00	4.89	4.79	4.79	4.79	5.00	4.74	
F	54.7	3	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	4.67	4.67	5.00	5.00	
G	53.3	45	4.95	5.00	5.00	5.00	4.95	4.91	4.93	4.98	4.95	4.95	4.89	4.95	
H	53.4	9	4.78	4.89	5.00	5.00	5.00	5.00	5.00	4.67	4.67	4.67	4.67	4.78	
I	52.6	5	4.60	5.00	5.00	4.80	5.00	5.00	4.60	4.40	5.00	5.00	4.60	4.60	
J	55.0	1	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	