

Service Date: December 21, 1977

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

IN THE MATTER OF the APPLICATION) UTILITY DIVISION
by THE BUTTE WATER COMPANY for)
authority to increase rates and) DOCKET NO. 6494
charges for water service to its) ORDER NO. 4348A
customers in the BUTTE, MONTANA)
service area and requesting rati-)
fication of the distribution of)
water service at no charge to)
certain customers.)

APPEARANCES

For the Applicant, Butte Water Company:

James A. Robischon, Esq., Poore, McKenzie, Roth,
Robischon & Robinson, P.C., Attorneys at Law, Suite 400
Silver Bow Block, Butte, Montana

For the Protestant, Montana Consumer Counsel:

Geoffrey L. Brazier, Esq., Montana Consumer Counsel, 34
West Sixth Avenue, Helena, Montana

For the Commission

Dennis R. Lopach, Esq., Staff Counsel
Frank R. Buckley, Administrator, Utility Division

Before :

James R. Shea, Presiding Officer
George Turman
P. J. Gilfeather
Thomas J. Schneider

FINDINGS OF FACT

A. General

1. The Butte Water Company, Applicant, is a public utility furnishing water services to consumers in service areas in and around the cities of Butte and Anaconda and is

subject to the regulatory jurisdiction of this Commission.

2. On the 18th day of February, 1977, Applicant filed an application in this Docket requesting authority from this Commission to increase its rates and charges for water service in the Butte, Montana, service area to produce additional annual revenues in the amount of \$702,971.

3. Pursuant to Notice of Public Hearing published in the Montana Standard, on April 29, 1977, a public hearing was conducted in the Webster-Garfield School Auditorium, Butte, Montana, on May 23 and 24, 1977, at which time Applicant's witnesses appeared and were cross-examined on their testimony and exhibits. The Montana Consumer Counsel participated and presented testimony and exhibits concerning the matters and things covered by said application.

4. Witness Dr. John W. Wilson, who testified for the Consumer Counsel, determined a revenue deficiency of \$377,032. This number was further reduced by Dr. Wilson's rebuttal testimony as a result of certain working capital adjustments.

5. This \$377,032 figure included a \$51,550 expense adjustment, which Applicant's witness C. M. Dunfee stated at the Anaconda hearing to be non-recurring.

6. Subtraction of the \$51,550 expense adjustment from Wilson's conceded revenue deficiency of \$377,032 results in a revised revenue deficiency of \$325,482.

7. By letter dated June 3, 1977, Geoffrey L. Brazier, the Montana Consumer Counsel, reaffirmed that he had no objection to a temporary rate increase in this Docket to the

conceded revenue level. On the 7th day of June, 1977, Order No. 4348 in this Docket granted a temporary rate increase to the Applicant in the amount of \$325,482.

8. Additional direct testimony was presented by Witness C. R. Sturgis for the Applicant at the July 12, 1977, hearing which contradicted Findings No. 5 and 6, above, and which requires the restoration of the sum of \$51,550.00 to the Applicant's operating expenses for the test year. B. Revenues and Expenses

9. Operating revenues under present rates were estimated for the test year ended September 30, 1976, at \$1,191,850.00 with pro forma adjustments. The Commission finds that the adjustments made by the Applicant to its audited experienced revenue results are reasonable, and accepts the Applicant's test year revenues.

10. Operating and maintenance expenses were estimated for the test year at \$1,290,874.00 with pro forma adjustments. The adjustments made by the Applicant to its audited and actually experienced maintenance expenses are reasonable and are accepted.

11. No affirmative evidence was presented that challenged the Applicant's evidence relating to its claimed deductions for depreciation, taxes other than income, and other allowable operating revenue deductions, and the Commission finds that the total operating revenue deductions for the Applicant's test year, with pro forma adjustments under present rates are in the amount of \$1,510,561.

12. Consumer Counsel Witness Wilson proposed revenue adjust estimated revenues to account for

meets increasing Applicant recessionary conditions and slack water demand during the test period.

13. The Commission rejects Wilson's adjustments as they were not related to any known or measurable changes affecting the test period. A majority of the revenues of the Butte division come from the unmetered, flat rate customers. These revenues are unaffected by climatic conditions. Furthermore, the bulk of the metered sales in Butte is to commercial and industrial users whose consumption is not significantly affected by climatic conditions.

14. Consumer Counsel Witness Wilson proposed an offsetting expense adjustment for productivity increases.

15. The Commission rejects this adjustment also as it was not related to any known or measurable change affecting the test period. Witness Wilson on cross-examination admitted that his contentions were based on theory only, and that the figures advanced were based upon studies unrelated to Applicant's operation that assume that productivity increases will offset approximately one-half of wage and salary increases made during the period, (Tr 300, et seq.). This approach is strictly theoretical, and absent a convincing showing that the theory has any validity for Applicant's operation, will not be applied.

16. The interest cost relied upon by Applicant for its capital cost computation, as set forth in Applicant's Exhibit 26 (FRL) p. 33, is accepted by the Commission for all purposes, including the computation of test year income tax. Applicant utilized this figure only in computing interest expense on its hypothetical capital structure. The Commission agrees with Dr. Wilson, however, that consistency requires

that this figure be used for all purposes to W. Wilson testimony, pp. 4-5).

17. The Applicant's method of computing its operating However, these credits applicable to taxable income is accepted. credits shall be amortized over a period of three years rather than the five year period advocated by Applicant. This amortization is consistent with Applicant's proposal to amortize rate case expense over a period of three years, and tends to assure that the credits will actually be used.

18. The Commission finds Applicant's test year federal income tax liability, following rate increase, to be (\$20,774), which is computed as follows:

THE BUTTE WATER COMPANY
BUTTE DIVISION

Federal Taxes on Income
12 Months Ended September 30, 1976

	As <u>1/</u> Audited	Pro Forma <u>1/</u> Adjustments	<u>1/</u> Adjusted	With Rate Increase
1. Revenues	\$1,241,668	\$(49,818)	\$1,191,850	\$1,705,624 <u>2/</u>
2. Operation & Maintenance	1,213,548	77,326	1,290,874	1,290,874
3. Taxes (Other than income)	174,199	(197)	174,002	174,360 <u>1/</u>
4. Depreciation	63,698	8,441	72,139	72,139
5. Interest				126,883 <u>3/</u>
6. Miscellaneous Expenses	2,763		2,763	2,763
7. Net Before Taxes	(212,540)	(135,388)	(347,928)	38,605
8. Tax Adjustments	19,997		19,997	19,997
9. Taxable Income	(192,543)	(135,388)	(327,931)	53,602
10. Federal Income Taxes	(92,421)	(64,986)	(157,407)	28,112
11. Unused Credits	63,204	64,986	128,190	
12. Credits Used				48,903 <u>4/</u>
13. Income Taxes Paid	(29,217)		(29,217)	(20,774)

1/ See Applicant's Exhibit 15, p. 8

2/ Rate Increase of \$513,774

3/ 91.52% of \$138,460

4/ $(159.000/3) (.48) (.9134) = 23,236$
 $77,000/3 = \underline{25,667}$
48,903

C. Rate Base

19. Applicant proposed a year-end original cost depreciated rate base of \$2,454,079, consisting of:

Utility Plant in Service	\$7,529,155
Less:	
Reserve for Depreciation	5,255,272
Add:	
Materials & Supplies	28,502
Cash Working Capital	<u>151,694</u>
	\$2,454,079

(C. M. Dunfee testimony p. 25, 1. 18 and Exhibit 15 (CMD), p.7).

20. Late-filed Exhibit S-1 (Revised) showed an average original cost

depreciated rate base of \$2,184,892, consisting of:

Average Plant in Service	\$7,211,053
Less:	
Average Depreciation Reserve	5,206,357
Add:	
Materials & Supplies	28,502
Cash Working Capital	<u>151,694</u>
	\$2,184,892

21. Montana Consumer Counsel Witness Wilson accepted the Applicant's rate base, with the exception of a negative adjustment to the cash working capital which he advocated in his rebuttal testimony.

22. The Commission rejects the negative adjustment to cash working capital as it finds Applicant's policy of promptly paying its bills to be a desirable one. Firms doing business with the Applicant should not be expected to supply the working capital for the payment of the Applicant's bills.

23. The Commission finds that an average rate base is appropriate in this proceeding. A rate base which reflects average investment in plant in service achieves a more proper matching of operating income with the investment that produced that income during a given test year period. Proper rate making requires that the test year revenues and expenses realistically reflect expected performance under the test year rate base.

D. Rate of Return

24. Butte Water Company's actual capital structure consists of the following components:

	Amount	% of Capitalization
Demand Notes to Parent	\$ 400,000	16.9
Accounts Payable to Parent	473,176	19.9
Common Equity	<u>1,499,231</u>	<u>63.2</u>
Total	\$2,372,407	100.

(Exhibit 14 (CRS), p. 3 and Exhibit 26A (FRL), p. 80).

25. The Commission agrees with Applicant that for the cost-of-capital determination, it is appropriate to use a hypothetical capital structure of 65% debt and 35% equity (Exhibit 26A (FRL), p. 80). This capital structure approximates the type of structure commonly employed in the utility industry.

26. The overall cost of debt in the hypothetical capital structure is 7.6 percent (Direct testimony, (FRL), p. 81).

27. The Butte Water Company is a third-tier subsidiary in a vertically pyramided corporate structure, with Butte Water being wholly owned by Anaconda and Anaconda in turn wholly owned by A.R.C.O., (J. W. Wilson testimony, p. 6, l. 35-48).

28. A reasonable return on common equity to the ultimate equity investors of Butte Water is 13 percent (J. W. Wilson testimony, p. 7, l. 23).

29. An 8.525% rate of return allowance for Applicant will yield a 13% return to the ultimate equity investors (J. W. Wilson testimony, p. 7, l. 19-23 and Exhibit JW 10). E. Revenue Requirement

30. In order to produce a return of 8.525% on the Applicant's average original cost depreciated rate base, the Applicant will require additional annual revenues in the amount of \$513,774 from its Butte, Montana, water utility. Of this total amount the Commission has heretofore authorized additional revenues in the amount of \$324,482, in our Order No. 4343.

31. Applicant is, therefore, entitled to revenues additional to those granted by the Commission in Order No. 4348 in this Docket in the amount of \$188,292.

32. Applicant's test year pro forma operating revenues, expenses and rate of return are summarized as follows:

THE BUTTE WATER COMPANY
SUITE DIVISION

12 Months Ended September 30, 1976

	As <u>1/</u> Audited	Pro Forma ^{1/} Adjustments	Pro Forma Present Rates <u>1/</u> Adjusted	With Rate Increase
1. Revenues	\$1,241,668	\$(49,818)	31,191,850	\$1,705,624 ^{2/}
2. Operation Maintenance	1,213,548	77,326	1,295,874	1,290,874
3. Depreciation	63,698	8,441	72,139	72,139
4. Taxes (Other than income)	174,199	(197)	174,002	174,360 ^{1/}
5. Income Taxes	(29,217)		(29,217)	(20,774)
6. Miscellaneous Expenses	2,763		2,763	2,763
7. Total Deductions			1,510,561	
8. Net Operating Revenues	(183,323)	(135,388)	(318,711)	186,262
9. Rate Base	2,454,079	(1,275)	2,452,804	2,184,892
10. Rate of Return	(7.47%)		(1299%)	8.525% ^{5/}

- 1/ See Applicant's Exhibit 15, p. 10
- 2/ Rate Increase cf \$513,774 (Finding No. 30)
- 3/ Finding No. 18
- 4/ Finding No. 20
- 5/ Finding No. 29

F. Other Matters

33. The allocation of the Applicant's revenue requirements among its various customer classes was tested against a cost of service study conducted for the Applicant by its consultants. The allocation proposed by the Applicant, although it departs from the cost of service study and favors the flat rate customers, is reasonable under the circumstances and the Commission will accept a tariff of rates and charges based upon the Applicant's proposed rate spread. Witness Wilson suggested four alternative methods of distributing any revenue increase (Exhibit J. W. - 3). Absent record evidence of the propriety of use of any of these methods, however, they must be rejected.

34. Applicant's proposed rate structure perpetuates an antiquated rate design which is of highly dubious merit. Unfortunately, the record lacks sufficient evidence to afford a basis for any other rate design. Applicant shall present as a part of its next general rate increase application a substantially

simplified and rational rate design.

35. The Commission finds that the long-standing practice of the Applicant in supplying water service at no charge to the classes of customers shown on Exhibit No. 13 (CWY) is a reasonable and non-discriminatory practice, and that it may be continued in the discretion of the Applicant.

CONCLUSIONS OF LAW

1. This Commission has jurisdiction over the Applicant and the level of rates and charges which it may charge under R.C.M. 1947 Section 70-101, et seq.

2. The applicant is entitled to additional revenue to that revenue ordered by this Commission as a temporary rate increase in Order No. 4348 in this Docket.

3. The rate of return resulting from a \$513,774 annual revenue increase will not exceed a fair return on Applicant's properties devoted to the service of its Butte, Montana customers. The resulting return will comply with the constitutional requirements established in the case of F.P.C. v. Hope Natural Gas Co., 320 U.S. 591 (1944).

4. The allocation of Applicant's revenue requirements among its various customer classes, as proposed by Applicant, is fair, reasonable and non-discriminatory and will be accepted by the Commission for this proceeding.

5. The average rate base employed in this proceeding is a proper means of assuring Applicant's properties at risk during the test period, and produces a better matching of test year investment, revenues and expenses than does a year-end figure.

6. The Applicant, in its discretion, may continue the long standing practice of supplying water service at no charge to the classes of customers identified in Finding of Fact No. 35.

ORDER

IT IS ORDERED that the Applicant shall submit for Commission approval a schedule of rates and charges which will produce a total annual revenue additional to

that now being collected of \$188,292, effective for services rendered on and after, January 1, 1978.

DONE IN OPEN SESSION this 20th day of December, 1977, by a vote of 3 to 1.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

GORDON E. BOLLINGER, Chairman

P.J. GILFEATHER, Commissioner

THOMAS J. SCHNEIDER, Commissioner

JAMES R. SHEA, Commissioner
(Voting to dissent)

ATTEST:
Gail E. Behan
Secretary

(SEAL)