Service Date: October 21, 1980

DEPARTMENT OF PUBLIC SERVICE REGULATION
MONTANA PUBLIC SERVICE COMMISSION

In the Matter of the Application of PACIFIC POWER & LIGHT COMPANY for authority to Increase Water Rates to its Bigfork, Montana Customers.	UTILITY DIVISION DOCKET NO. 6768 ORDER NO. 4705

APPEARANCES

FOR THE APPLICANT:
C. Eugene Phillips, Murphy, Robinson, Heckathorn & Phillips, One Main Building, Kalispell, Montana 59901.

George M. Galloway, Stoel, Rives, Boley, Fraser and Wyse 900 S. W. Fifth Avenue, Portland, Oregon 97204.

FOR THE INTERVENORS:

James C. Paine, Montana Consumer Counsel, 34 West Sixth Avenue, Helena, Montana 59601.

FOR THE COMMISSION:
Calvin K. Simshaw, Staff Attorney.

BEFORE:
GEORGE TURMAN, Commissioner & Hearing Examiner

FINDINGS OF FACT

1. On November 27, 1979, Pacific Power and Light Company (Applicant) filed an application with this Commission for authority to increase rates and charges for water service at Bigfork, Montana. The Applicant requested an average increase of approximately 30 percent which would result in an increase of $18,064 in annual revenue.

2. On June 11, 1980, at 10:00 a.m. pursuant to notice of public hearing, a hearing was held in the Music Room, Bigfork High School, Bigfork, Montana. The purpose of the public hearing was to consider the merits of the Applicant's proposed water rate adjustment.

3. It was stipulated by the parties that the record developed in Applicant's most recent Montana electric rate filing (Docket No . 6 7 2 8) was to be incorporated in its entirety as part of the record in this docket.

4. At the public hearing the Applicant presented the following four witnesses:

Charles E. McQueary, Jr.
Robert F. Lanz
James T. Watson
Andrea K. Walters

5. Eleven public witnesses testified in opposition to the proposed increase in rates advocated by the Applicant.

6. The 1978 test year is found by the Commission to be a reasonable period within which to measure Applicant's utility revenues, expenses and returns for the purpose of determining a fair and reasonable level of rates for water service.

7. The parties have stipulated to a final order being rendered in this docket.

CAPITAL STRUCTURE AND ASSOCIATED COSTS

8. Applicant proposed the following capital structure and associated costs:

Capital Type	Structure	Cost	Weighted Cost
Long-Term Debt	52.4%	7.75%	4.06%
Preferred Stock	9.7	8.59	0.83
Common Equity	34.9	14.80	5.17
Deferred Taxes	3.0 *	-	-
	100.0%		10.06%

9. Montana Consumer Counsel (MCC) proposed, in Docket No. 6728, the following capital structure and associated costs:

Capital Type	Structure	Cost	Weighted Cost
Long-Term Debt	54.0%	7.72%	4.17%
Preferred Stock	10.0	8.45	0.85
Common Equity	36.0	13.35	4.81
	100.0%		9.83%

10. Summary of capital structure variations between Applicant and MCC:

Long-Term Debt	1.6%
Preferred Stock	0.3
Common Equity	1.1
Total Variation	3.0%*

*This variation is attributable to the inclusion of deferred taxes in the capital structure by the Applicant. MCC, in Docket No. 6728, did not include deferred taxes in the capital structure. Applicant, however, does not associate any cost to the deferred taxes. These deferred taxes have been treated by Applicant as an item of "cost free" capital. Applicant contended in Docket No. 6728 that, "the use of deferred taxes for investment is no different than the use of the proceeds from issues of debt and equity for investment. All are forms of capital and should be included in the capital structure" (In. Br. pg. 8).

CAPITAL STRUCTURE

11. Applicant proposed to utilize its objective or target ratios in the capital structure, adjusted to reflect the addition of deferred taxes amounting to 3% of the capital structure. The Applicant's objective ratios are: 54% long-term debt, 10% preferred stock and 36% common equity Ex 11, p. 12, Docket No. 6728).

12. MCC accepted the Applicant's objective or target ratios, and utilized this capital structure in determining the cost of capital. Use of the Applicant's optimal capital structure is found to be reasonable by the Commission.

13. MCC does not include deferred taxes in the capital structure. This is consistent with previous Commission decisions to disallow deferred taxes in rate base and is accepted in this) Docket (Ex. B, p. 6, Docket No. 6728).

COST OF DEBT

14. The cost of debt capital is not a controverted issue in this case. The cost of long-term debt capital is based on the embedded

cost at September 30, 1979, and has been determined to be 7.75% by the Applicant. This cost is accepted by the Commission.

COST OF PREFERRED STOCK

15. The cost of preferred stock is not a controverted issue in this case. The cost of preferred stock is based on the embedded cost of preferred shares outstanding at October 31, 1979, and has been determined to be 8.586% by the Applicant. This cost is accepted by the Commission.

COST OF COMMON EQUITY

16. Applicant uses the following methodologies in arriving at a return on equity of 14.8%
Application of the Pacific model (Applicant's mathematical model) to the Applicant's financial data. The Model yielded a range of return on equity of 14.26
15.34.

1. The dividend payout ratio was estimated to be approximately 75%, based on the average historical payout ratio for the Applicant over the eleven-year period 1968 through 1978.(Ex. 2BT, p. 8).

2. Annual growth in common equity capital was estimated to be 10%. This estimate was derived by reviewing data on growth in net utility plant for the years 1962 through 1978, as growth in net utility plant is a good indicator of growth in common equity capital (Ex. 2BT, p. 9).

3. Future dividend growth rate was estimated to be 4.4%. This estimate was made after reviewing data on the compound growth in the Applicant's dividends per share over 12 different periods, each ending in 1978 (Ex. 2BT, p. 11).

4. An estimate of the dividend yield was developed by reviewing the Applicant's historical dividend yields, Salomon Brothers' Bond Market Round-up, dividend yields and a historical series of 91-day treasury bill bids. The Applicant's dividend yield was estimated to be 9.8%.

b. The Pacific Model's reliability was tested on seven Companies which the Applicant feels have investment opportunities similar to that of the Applicant. The selected Companies had March 31, 1973 through March 31, 1979 compound growth in dividends per share plus March 31, 1979 dividend yield between 13.3 percent and 14.3 percent. The average return granted to these seven

Companies was determined to be 13.61 percent, which is within the range of returns produced by the Pacific Model, 13.47 - 14.55%.

17. In Docket No. 6728, MCC used the following methodologies in arriving at a return-on equity of 13.35%:

a. Application of discounted cash flow (DCF) techniques to Applicant's-financial data. The DCF Methodology yielded a range of return on equity of 12.85 - 13.85%.

b. Application of the HOPE comparability standard, which specifies that the return on equity should be commensurate with returns on investments in other enterprises having corresponding risks, to a comparison group. The comparison group was comprised of eleven utilities meeting the following criteria:

(1) Common stock is traded on the New York Stock Exchange.
(2) Common stock has a beta coefficient of .70, according to Value Line (same as Applicant).
(3) Common stock has a safety rank of 1, according to Value Line.
The comparison group yielded a range of return on equity of 12.20 - 15.25%, with a group mean of 14.1%, and the estimate for the Applicant of 12.9% (Ex. A, pp. 23-25, Docket No. 6728).
c. Review of the Salomon Brother's stock research reports data on electric utilities for 13 Companies rated Baa/BBB, 7 Companies rated A/BBB or Baa/A and for 100 electric utilities of all ratings. For these groups, on the average, the required rate of return is above 12.5% (Ex. A, pp. 21-22, Docket No. 6728).

18. The Commission accepts the methodology sponsored by MCC as fundamentally sound. MCC relied primarily on a discounted cash flow (DCF) analysis to determine the cost of equity. Witness Rettenmayer applied the DCF techniques to the Applicant's data and to a comparison group of electric utility Companies. The application of the DCF techniques to Comparison Companies served as a check on the Applicants specific results.

The Comparison Group Companies were selected by MCC by using comparable beta coefficients, a measure of market price variability, and comparable safety ranks (Ex. A, p. 23, Docket No. 6728).
Data used in witness Rettenmayer's DCF calculations was the most currently available information at the time the testimony was completed in December, 1979. The twenty-six week time frame used by MCC is reasonable and acceptable to the Commission.
MCC witness Rettenmayer examined dividend growth, and considered earnings and book growth in his analysis. The included 1979 data in his analysis (Ex. A, pp. 1-7 of schedules, Docket No. 6728).
MCC utilized regression analysis growth rates. Applicant's witness

Lanz examined only dividend growth, and studied data through 1978 (Ex. 2B). MCC concluded that the estimates of future growth most reasonably assumed by investors lies between 2.3 and 4.2%, with the lower end of this range a more reasonable estimate (Ex. A, p. 18, Docket No. 6728). The use of the most current data available is preferable for decision making, and the Commission finds the estimate made by MCC to be reasonable.

RATE OF RETURN

19. Based on the findings for long-term debt, preferred stock and common equity, the following capital structure and cost are determined appropriate:

Capital Type	Structure	Cost	Weighted Cost
Long-Term Debt	54.0%	7.75%	4.19%
Preferred Stock	10.0	8.59	0.86
Common Equity	36.0	13.35	4.81
	100.0%		9.86%

RATE BASE

20. The following rate base proposal was submitted by the Applicant:

1978 TEST YEAR

Average Rate Base	
Net Plant in Service	$ 395,972
Reserve for Depreciation	(94,159)
Customer Advances for Construction	(50,821)
Materials & Supplies	1,949
Working Capital	3,935
Unamortized Leasehold Improvements and Other Misc. Deferred Items	147
Total	$ 257,023

21. Applicant's rate base contains a working cash requirement of $3,935.

The question of a working capital adjustment was addressed in Docket No. 6728. No additional information has been presented to the Commission with respect to this issue. For the same reasons noted in Order No. 4667 the Commission denies the adjustment by the Applicant for working capital. The amount of the deduction from rate base is $3,935.

CUSTOMER CONTRIBUTED CAPITAL

22. The Applicant proposed including deferred taxes at zero cost in the cost of capital and including these customer contributed funds in rate base. MCC proposed, in Docket No. 6728, to eliminate the deferrals from rate base. The Commission, consistent with prior decisions, finds the elimination of deferred taxes from rate base to be correct. The amount of the deduction is $1,547.

23. Based on the findings for working capital and customer contributed capital, the rate base approved by the Commission is $251,541.

REVENUE AND EXPENSES

24. The following income and expense proposals are accepted by the Commission:

1978 TEST YEAR

	Applicant Revenue and Expenses
Operating Revenues	$ 60,374
Operating and Maintenance Expense	31,616
Depreciation and Amortization	7,315
Taxes Other than Federal Income	15,422
Federal Income Tax	[3,3583]
Deferred Income Tax	12
Income Tax Deferred in Prior Years	109]
Investment Tax Credits Deferred	---
Investment Tax Credits	

Restored Total Deductions	50,898
Net Operating Revenues	$ 9,476

FEDERAL INCOME TAX

25. MCC proposed, in Docket No. 6728, to make a pro forma interest expense adjustment to decrease federal income taxes. The Commission has utilized this adjustment in the past and finds it to be appropriate in this Docket. The approved amount of federal income tax expense to be used in the revenue requirement calculation in this Docket is [$3,358].

INVESTMENT TAX CREDITS

26. In Docket No. 6728, MCC made use of a three-year period (1976 through 1978) to yield a short-term average. This would increase the amount of investment tax credits flowed through to ratepayers.

In the past, the Applicant has amortized investment tax credits to income over 5-year periods for those related to mass property additions and over 10-year periods for those related to major additions. The Applicant proposes to restore utilized investment tax credits on an 8-year basis or 12.5% per year.

The adjustments made by MCC is premised on the concept that short-term averaging is not being achieved using the Applicant's method of modified flow-through. As a result, the test year is increased to the average of the three-year period (1976-1978). To concentrate the benefits generated by plant having a life measured in decades in a three-year period is not a sound matching of revenue and expense. Future ratepayers should receive some of the benefits created by the addition of assets which generate investment tax credits. The Commission accepts the 8-year restoration proposed by the Applicant as the method that provides sound matching of investment tax credits to present and future ratepayers, which should be used in determining the additional annual revenue requirement for the Bigfork, Montana Water ratepayers.

REVENUE REQUIREMENT AND CALCULATION FACTORS

27. The following net income to gross revenue factors to be used in determining the total Bigfork, Montana water annual revenue requirement deficiency are accepted by the Commission:

NET TO GROSS FACTORS

	When Utilizing ITC	Other
Revenue Deficiency	100.000%	100.000%
Operating Revenue Deductions		
Uncollectibles	.227	.227
MCC Tax	.070	.070
State Taxable Income	99.703	99.703
State Tax at 6.75%	6.730	6.730
Federal Taxable Income	92.973	92,973
Federal Income Tax at 46%	42.768	42.768
Investment Tax Credit		
Utilized (70% of federal tax)	[29.938]	--
Investment Tax Credit Deferred (87.5% of ITC utilized)	26.196	--
Net Operating Income	53.947%	50.205%

28. The Commission finds that the additional annual revenue required in Applicant's Bigfork, Montana water operations, given the findings on rate of return, net operating revenues, rate base and net to gross calculation factors, is $29,951.

29. Although a higher revenue requirement has been demonstrated, Applicant sought an increase of only 30%, or $18,064 to be effective immediately. Applicant in its proposed findings of Fact (No. 30) submitted that the following should take place. First, that an increase of $18,064 in revenues should take effect immediately. Second, that the amount of the total revenue requirement demonstrated less $18,064 should be deferred in the form of a step increase. And third, that the Applicant should be allowed to file tariffs including the deferred increase in

revenues at a later date, but no sooner than six months.

30. The Commission finds that it cannot adopt such a proposed procedure for implementing rates in this case. Although Applicant's proposed findings and testimony address rate relief in excess of $18,064; its Application does not. The Application filed herein references only the revised tariff which was Exhibit 5L, which in turn would generate additional revenues only in the amount of $18,064. Even more crucial is the fact that the Commission's Notice of Public Hearing, which was prepared from the Application, mentions a requested rate increase of only 30% or $18,064. Although the Commission appreciates the Applicant's attempt to ease the impact of increased water rates, it feels constrained from granting
any relief at this time that is in excess of that outlined in the Application and Notice of Hearing. The Commission feels that it would not be appropriate to grant increased revenues beyond the amount of $18,064 without first providing a clear indication that such an amount will in fact be considered and thereby affording any interested person a full opportunity to be heard.

RATE STRUCTURE

31. Applicant proposed to increase rates on a generally uniform percentage basis. The Commission accepts Applicant's explanation that such a procedure recognizes that since 1976, all forms of costs incurred by the Company have increased.

In Order No. 4438 of Docket No. 6539, the Applicant was directed to reduce the differential between the irrigation rate for summer usage and the tail block rate for winter usage. In response to that Order, applicant proposed, in regard to Residential Service Schedule 73! to eliminate the irrigation rate for summer usage. The Commission approves this change.

Applicant further proposed, in regard to Residential Service Schedule 7 3, to combine the present three remaining blocks of commodity charge, and to eliminate the minimum charges for residential service requiring greater than a 1" meter size. The Commission approves this change.

In regard to Commercial and Industrial Service Schedule 76, The Applicant proposed to reduce the number of Commodity blocks from 4 to 3 by combining the third and fourth blocks. Additionally, Applicant proposed to set minimum charges for 3/4" and 1" meter sizes equal to the Schedule 73 minimums for the same size meters. These proposed changes in Schedule 76 are approved by the Commission.

Applicant proposed to increase fire protection Schedules 78 and 79 by a uniform percentage, and this is approved by the Commission.

32. The Applicant proposed the following amendments to its Rules and Regulations which the Commission accepts without comment; the adoption of a new numbering system and the reduction by 1 of the number designation for Rule Numbers 7 through 11.

33. The Applicant has proposed an increase in its charge for thawing frozen service pipe. The proposed change increases the charge for thawing pipes from $7.50 for each occasion to $15.00 per hour with a minimum charge of $30.00. The Commission accepts the increase but recommends that the Company notify all subscribers of the provisions of Rule 6 (L) which allows the customer to run water
to prevent freezing.

34. The Commission accepts the Applicant's proposal regarding the assessment of a minimum monthly charge to seasonally occupied dwellings. The Commission is of the opinion that it is equitable in that it minimizes the revenue burden on year-long customers of - maintaining service availability for recreational dwellings.

35. The Commission rejects the Applicant's proposed assessment of a fee for the tapping of the main. The Commission's general rules provide, in part, that "the Company at its own expense will tap the main and furnish corporation cock, clamp when necessary, and any other material used or labor furnished in connection with the

tapping of the main".

36. The Commission at the present time is in the process of revising and updating its General Rules and Regulations for water utilities and these revisions will address main extensions. For this reason the Commission rejects the revision of the present Rule No. 11. The Commission approves all these changes as applied for.

CONCLUSIONS OF LAW

1. The Applicant, Pacific Power & Light Company, is a "public utility" within the meaning of Montana law, Section 69-3-101, MCA.

2. The Commission properly exercises jurisdiction over the Applicant's rates and operations pursuant to Section 69-3-102, and 69-3-302, MCA.

3. The rate of return allowed in this Order meets the constitutional requirement that a public utility's return must be "commensurate with the returns on investments in other enterprises having corresponding risks sufficient to insure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital." Federal Power Commission v. Hope Natural Gas Company, 320 US 591, 603 (1944).

4. The rate structure approved herein and the approved changes in Applicant's rules and regulations are just, reasonable and not unjustly discriminatory.

ORDER

THE MONTANA PUBLIC SERVICE COMMISSION ORDERS THAT :

1. Pacific Power & Light Company shall file rate schedules which

reflect an increase in annual revenues of $18,064 for Bigfork, Montana water service, based on the test period ending December 31, 1978.

2. The increased water revenues authorized herein shall be distributed among Applicant's classes of service as provided herein.

3. Applicant shall file revised schedules incorporating the changes in its rate schedules and service regulations approved herein. The schedules associated with the increase shall become effective for service rendered on and after October 14, 1980.

4. All motions and objections not ruled upon at the hearing are denied.

DONE IN OPEN SESSION at a meeting of the Montana Public Service Commission held October 14, 1980, by a vote of 4-0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

Gordon E. Bollinger Chairman

Clyde Jarvis, Commissioner

Thomas J. Schneider, Commissioner

George Turman, Commissioner

ATTEST:

Madeline Cottrill
Commission Secretary

(SEAL)

NOTE: You may be entitled to judicial review of the final decision in this matter. If no Motion for Reconsideration is filed, judicial review may be obtained by filing a petition for review within thirty (30) days from the service of this order. If a Motion for Re consideration is filed, a Commission order is final for purpose of appeal upon the entry of a ruling on that motion, or upon the passage of ten (10) days following the filing of that motion. cf. the Montana Administrative Procedure Act, esp. Sec. 2-4-702, MCA; and Commission Rules of Practice and Procedure, esp.38.2.4806 ARM.