Service Date: December 10, 1981

DEPARTMENT OF PUBLIC SERVICE REGULATION
MONTANA PUBLIC SERVICE COMMISSION

IN THE MATTER of the Application of the Butte Water Company for Authority to Increase Rates and Charges for Water Services to its Butte, Montana customers.	)	DOCKET NO. 81.3.25 ORDER NO. 4801a

APPEARANCES

FOR THE APPLICANT:

James A. Robischon, Attorney at Law, Poore, Roth, Robischon and Robinson, P.C., 1341 Harrison Avenue, Butte, Montana 59701.

Dennis R Lopach, Attorney at Law, Scribner, Huss and Hjort, P.O. Box 514, Helena, Montana 59624.

FOR THE INTERVENOR:

James C. Paine, Montana Consumer Counsel, 34 West Sixth Avenue, Helena, Montana 59620.

FOR THE COMMISSION:

Eileen E. Shore, Legal Counsel, 1227 11th Avenue, Helena, Montana 59620.

BEFORE:

GORDON E. BOLLINGER, Chairman
JOHN B. DRISCOLL, Commissioner
HOWARD L. ELLIS, Commissioner
CLYDE JARVIS, Commissioner
THOMAS J. SCHNEIDER, Commissioner

FINDINGS OF FACT

A. General

1. On March 5, 1981, Butte Water Company (Applicant or BWC) filed and application with this Commission for authority to increase rates and charges for water service to its customers 1n Butte, Montana. The Applicant requested an average increase of approximately 25 percent, constituting a revenue increase of approximately $589,391 in annual revenues.

2. On April 14, 1981, BWC filed an application for an interim increase in rates of 15 percent equaling a revenue increase of approximately $363,054 annually.

3. On May 15, 1981, the Commission having considered the data filed with the Applicant's interim application, issued Order No. 4801 granting the Applicant interim rate relief in the amount of $l98,085 annually.

On September 9, 1981, pursuant to notice of public hearing, A hearing was held in the Montana Tech Student Union Building, Butte, Montana. The purpose of the hearing was to consider the merits of the Applicant's proposed water rate adjustment.

At the public hearing the Applicant presented the following witnesses:

James Byrne, President of BWC
C. Wayne Young, General Manager of BWC
Elmer Moke, Rate Consultant
Alvin E. Jensen, Consulting Engineer

6. The Montana Consumer Counsel presented the testimony of nine

public witnesses at the hearing.

7. The year ending December 31, 1980 test year was uncontested and 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.

B. RATE BASE

8. The Applicant proposed an average original cost depreciated rate base of $3,748,242. The rate base proposed by the Applicant was not challenged by any party participating in this proceeding and therefore is accepted by the Commission.

C. CAPITAL STRUCTURE

9. The Applicant proposed the following capital structure for rate case presentation:

Description	Amount	Ratio
Debt	$3,500,962	105.6
Equity	($ 186,696)	(5.6)
Total	$3,314,266	100.0

The capital structure proposed by the Applicant was not challenged by any party participating in this proceeding and therefore is accepted by the Commission.

D. COST OF DEBT

10. The debt capital of the Applicant consists of a $3 million loan from the Crocker National Bank, and a demand note payable to the Anaconda Company in the amount of $500,962. The cost of debt or interest on the Crocker loan is set by the daily prime rate of the Crocker National Bank through March, 1984. The Applicant has assigned the note payable, to the Anaconda Company, a debt cost at the level of the daily prime rate of Crocker National Bank i.e., both debt instruments have been assigned same cost.

11. The prime rate is the short-term interest rate charged by banks on loans to their best business customers, and therefore the prime rate reflects short run conditions. Due to the fact that the prime rate reflects short run conditions it may vary greatly. Despite the fact that the interest rate on these loans will vary, the Commission must assign a fixed interest rate to the loans for rate-making purposes.

12. The Applicant's witness, Elmer Moke, recommended a fixed interest rate or 15.18 percent be assigned to debt as that was the actual rate of interest paid during 1980 on the $3 million Crocker loan.

13. The Commission rejects Mr. Moke's assignment of a 15.18 percent overall cost of debt and finds it necessary to examine the prudence of the debt issues and financing alternatives.

a. The Commission in its Order No. 4699a discussed at length the Commission's reason for refinancing its debt, the timeliness of the refinancing and its effect on debt cost, the choice of an unusual financing mechanism and the effect the Company's decision had on the company's ratepayers. The

Commission will not reiterate the discussion from that order but does take notice of its content.

b. The Applicant's debt consists entirely of short-term debt in the form of a loan and note payable at the prime interest rate which are guaranteed by the parent company. The short-term refinancing mechanism utilized by the Applicant and its parents [Atlantic Richfield Co. (ARCO) and Anaconda Company (AC)] was more expensive than other financing alternatives available at the time the Crocker loan was consummated. This is substantiated by examination of ARCO's Annual Report on Form 10-K 1980. In this report at page 56 we see that ARCO issued long-term debt in May of 1980 and January, 1981 with interest rates of 11.375 percent and 13.45 percent respectively. These rates are substantially below the 15.18 percent interest rate assigned to the short-term debt of the Applicant. Given the fact the parent has guaranteed the short-term debt of the Applicant it is the Commission's opinion that the parent could have issued long-term debt at a lower fixed interest rate and flowed the proceeds of the debt issue to the Applicant and assumed no greater risk than its current obligation. In fact, the parent's risk would probably be less because the debt of the Applicant would have a fixed interest rate that could be measured and compensation for that cost could be recovered through the rate structure implemented.

c. Anaconda Company advanced funds to the Applicant during 1980 in the amount of $500,962. Until January 30, 1981 this amount was carried on the books as an Account Payable; at that time it was converted to Demand Note Payable and assigned an interest rate equal to the Crocker prime interest rate. The funds advanced by AC to the Applicant were utilized to cover the operation and maintenance expense of the utility i.e. payroll, property taxes etc. The record in this docket indicates that no one at the AC required the conversion of Accounts Payable to a Note Payable or that the interest rate on the note be at the level of the prime interest rate. The conversion of the accounts payable to a note payable is suspect, but, the Commission recognizes the necessity of the parent to be compensated at a level equal to its cost of acquiring the funds advanced. The rationale for setting the interest rate on this note at the prime rate is to insure that the Internal Revenue Service does not reclassify the debt as a contribution to the capital of the Applicant. It is the Commission's opinion that the Demand Note should carry no higher interest rate than the last debt issue of the parent closest to the date of conversion to a demand note payable. In January, 1981, ARCO issued debt at an interest rate of 13.45 percent and the accounts payable was converted to a demand note payable in January 1981, therefore, the Commission assigns an interest rate of 13.45 percent to the demand note.

14. In view of the above findings, the Commission finds that the Applicant's decision to finance its entire operation with short-term debt was imprudent. Under normal circumstances, such a finding would warrant a downward adjustment in authorized rates. However, in view of the need for a substantial construction program to bring the Applicant's system up to modern standards, the Commission finds that such an adjustment should not be made at this time. The Commission finds that the Applicant should proceed to convert the short term debt to a more normal form of financing, i.e., long-term debt, at such time as debt financing can be secured supported by the guarantee of the parent, at more favorable long term interest rates. The difference in revenue

requirements to cover present imprudent short term interest rates, and ordered long term interest rates should be used only to cover the financing costs of an accelerated reconstruction program. This Commission expects to be kept appraised of the details of the Applicant's refinancing and accelerated reconstruction planning.

E. CAPITAL STRUCTURE AND COMPOSITE COST OF TOTAL CAPITAL

Description	Amount	Ratio	Cost	Weighted Cost
Debt	$3,000,000	90.5%	15.18%	13.74%
Debt	500,962	15.1%	13.45%	2.03%
Equity	(186,696)	(5.6%)	15.18%	(.85)
Total	$3,314,266	100.0%		
Composite Cost of Total Capital				14.92%

F. OPERATING REVENUE

15. The Applicant reduced its test period operating revenues by $6,370 to depict normalized sales to the Anaconda Company. To determine normalized revenue, the Applicant utilized a memo from the Anaconda Company stating their consumption level in 1981 would approximate 4,500,000 cubic feet (c.f.) per month or an annual consumption of 54,000, 000 c.f. This proposal was a reduction in usage of 1,616,800 c.f. from the actual 1980 consumption of 55,616,800.

16. Actual usage for the Anaconda, Company for the period January through August, 1981 was 51,719,400 c.f. equaling an average monthly consumption of 6,464,900 c.f. The actual average monthly usage far exceeds the proposed average test year usage. The

Applicant attributed the increased usage to nonrecurring conditions but given the fact that 1980 usage cannot be utilized as a comparison year because of a prolonged strike a the Anaconda Company operations and the apparent miscalculation of its usage levels, the Commission rejects the proposed reduction and finds the appropriate consumption level to be the average of the eight months actual 1981 consumption.

17. Utilizing the actual 1981 average usage results in increased consumption to the Anaconda Company of 21,962,000 c.f. over 1980 actual and results in increased revenue of $86,530.

18. The Commission finds test period operating revenue to be $2,453,979.

G. OPERATING EXPENSE

19. The Applicant proposed an increase of $151,234 pro forma adjustments for operation and maintenance expense.

20. Included in the $151,234 is a $449 reduction in pumping cost associated with the proposed reductions in operating revenues from sales to the Anaconda Company.

21. Pumping costs should be increased as the Commission found sales to be at a level above those projected by the Application. Pumping costs should by increased by $6,548.

22. Pro forma operation and maintenance expense under the present rates are- found to be $2,047,028.

23. Depreciation expense is found to be $111,213.

24. Taxes other than federal income are found to be $183,721.

25. Total deductions from operating revenues are found to be $2,341,962.

26. Operating income is found to be $112,017:

Operating Revenue	$2,453,979
Operating Deductions	2,341,962
Operating Income	$ 112,017

H. REVENUE REQUIREMENT

Rate Base	$3,748,242	
Rate of Return	14.92%	
Return Requirement		$ 559,237
Adjusted Balance Available for Return		112,017
Return Deficiency		$ 447,220
Revenue Deficiency		$ 447,622
MCC Tax at .09%		402
Income Available for Return		$ 447,220

27. In order to produce a return of 14.92 percent on the Applicant's average original cost depreciated rate base, the

Applicant will require additional annual revenues in the amount of $447,622 from its Butte, Montana water utility.

I. SERVICE

28. Eight public witnesses testified at the public hearing in this docket. Most of these public witnesses expressed concern about sand in their service lines.

29. Mr. Alvin E. Jensen, a consulting engineer, was retained by the Applicant to review its handling of problems which resulted when sand entered the distribution system subsequent to a break in the Big Hole transmission line in 1975. Mr. Jensen stated that having reviewed the Applicant's procedures for purging the system of sand, it was his opinion the Applicant had acted in accordance with good utility and engineering practice. Mr. Jensen further stated that a certain amount of extraneous material, such as sand is common in any water system utilizing as its supply source surface water.

30. While the Commission agrees with Mr. Jensen's analysis of the Applicant's handling of the break and his testimony that all surface water supplies have extraneous material, the fact remains that as of September 1, 1981 the Applicant had installed 544 sand traps because of recurring sand problems in the consumers lines. Further there are numerous water utilities that utilize surface water as their source of supply and do not find it necessary to install sand traps to filter the water.

31. The Commission recognizes that the sand problem has improved,

but it still exists and those customers still experiencing the problem are not receiving adequate service and therefore, should continue to receive water service at a reduced rate.

32. Recognizing that the sand problem has diminished and to minimize the effect of the increase consumers would experience when the sand problem is rectified, the Commission finds that those consumers having sand traps at the present time should receive an increase but the rate for those consumers shall be $2.55 below the rate approved for consumers not having a sand trap. A rate of $2.55 below the rate for all other consumers maintains the approximate rate differential, currently existing, between sand trap customers and those without sand traps.

J. RATE DESIGN

33. The Commission accepts the rate design methodology employed by the Applicant with the exception that a 25 percent loss factor should be utilized in determining the volumetric basis. The 25 percent loss factor is substituted for the 10 percent loss factor because it is consistent with Order No. 4699a and no material change in the Applicant's water system has occurred since the issuance of that order that would alter the Commission's opinion that the loss factor would be less.

K. MISCELLANEOUS

34. The Applicant proposed a service rule which would authorize it to restrict sprinkling when necessary to conserve water or increase pressure to particular parts of its service area. The Commission finds this measure reasonable and has included such a

rule in its proposed "General Rules and Regulations for Privately Owned Water Utilities" and therefore finds it unnecessary to approve a special rule for the Applicant's operation.

35. There was discussion on the record relating to the condition of the Applicant's water plant in service. During the course of this discussion it was determined, that the Applicant had 390 leaks in its distribution system, that the distribution system contained approximately 124,207 feet of 2 inch distribution mains and treatment facilities should be improved to eliminate suspended material. The Commission recognizes that improvements to the Applicant's plant are necessary and is of the opinion, that if the Applicant refinances its current debt obligations at a lower rate of interest and utilizes the balance of the allowed interest costs to finance capital improvements to the distribution system no adjustment in the cost of debt will be made.

36. During the hearing it was brought to the Commission's attention that certain consumers of the water utility are provided water service at no charge. It is contrary to statute (69-3-305, MCA) to allow a utility to provide service at no charge to consumers and the Applicant should rectify this situation.

CONCLUSIONS OF LAW

1. The Montana Public Service Commission properly exercises jurisdiction over the parties and subject matter in this

proceeding.

2. The Commission afforded all parties interested in this proceeding proper notice and an opportunity to participate.

3. The rates approved herein are reasonable, just and proper.

ORDER

NOW THEREFORE, at a session of the Montana Public Service Commission, Department of Public Service Regulation, held in its offices 1227 11th Avenue, Helena, Montana 59620, on the 7th day of December, 1981, there being present a quorum of Commissioners, there came regularly before the Commission for final action the matters and things in Docket No. 81.3.25, and the Commission being fully advised in the premises;

IT IS ORDERED by the Commission that Butte Water Company shall file rate schedules which reflect an increase in annual revenues of $447,622 for its Butte, Montana water service, which however shall be reduced in accordance with the limitation in Findings of Fact No. 32. This increase is in lieu of rather than in addition to that granted on an interim basis in Order No. 4801.

IT IS FURTHER ORDERED that the water revenues authorized herein shall be distributed among Applicant's classes of service as provided herein.

IT IS FURTHER ORDERED that the Applicant shall pursue, through its parent company, conversion of its current short term debt obligations to long term debt consistent with Finding of Fact No. 14 and file a report with this Commission within sixty (60) days as to the feasibility, and progress toward such conversion.

IT IS FURTHER ORDERED that a full, true and correct copy of this order be sent forthwith by first class United States mail to the Applicant and to all other appearances herein.

IT IS FURTHER ORDERED that the rates will be effective for water service rendered on and after December 7, 1981.

THE FOREGOING ORDER was adopted by the Department of Public Service Regulation of the State of Montana, Public Service Commission IN OPEN SESSION at Helena, Montana this 7th day of December, 1981, by a vote of 5-0 .

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

GORDON E. BOLLINGER, Chairman

JOHN B. DRISCOLL, Commissioner

HOWARD L. ELLIS, Commissioner

CLYDE JARVIS, Commissioner

THOMAS J. SCHNEIDER, Commissioner

ATTEST:

Madeline L. 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 days (30) days from the service of this order. If a motion for Reconsideration 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.