

Service Date: June 26, 1984

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

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IN THE MATTER of the Application of	)	UTILITY DIVISION
MONTANA-DAKOTA UTILITIES, INC. for	)	
Authority to Establish Permanent	)	DOCKET NO. 83.8.58
Increased Rates for Gas Service in	)	
the State of Montana.	)	ORDER NO. 5020c

ORDER ON MOTION FOR RECONSIDERATION

FINDINGS OF FACT

1. On May 15, 1984, the Commission approved Order No. 5020b, which disposed of all matters then pending in Docket No. 83.8.58.

2. On June 8, 1984, the Montana-Dakota Utilities Company (MDU or Company) filed a Motion for Reconsideration concerning the following issues:

- (1) Officers' Salaries
- (2) S-2 and T-3 Revenues
- (3) Post-Test Year Plant Additions
- (4) Unamortized Gain on Reacquired Debt
- (5) Cost of Equity.

OFFICERS' SALARIES

3. The Company argued on reconsideration that this adjustment is based on a mistake of fact, is arbitrary and capricious, exceeds the jurisdiction of the Commission, and constitutes a violation of the due process and equal protection clauses of both the United States and Montana Constitutions.

4. Upon further scrutiny of the record, the Commission agrees with MDU that fully adequate evidence has not been developed

in this proceeding to justify the officers' salaries reduction of \$11,959. The Commission emphasizes, however, that this is the only argument of MDU on this issue with which the Commission agrees. This issue is important to the Commission and will be fully explored in the next general rate case. The Commission, therefore, GRANTS MDU's Motion for Reconsideration concerning officers' salaries. Acceptance of MDU's motion also results in a related FICA tax increase of \$1,070, which the Commission also finds proper. Because of the de minimus effect this change has on MDU's tariffs, the Commission determines that MDU should accrue this amount, with 10.84 percent annual interest (MDU's approved overall rate of return), and implement the change upon the next tariff change resulting from a new revenue level.

#### S-2 and T-3 REVENUES

5. The Company argued on reconsideration that this revenue increase adjustment of \$181,457 is a violation of the Supremacy Clause of the United States Constitution and is arbitrary and capricious.

6. The Commission disagrees with MDU. The S-2 and T-3 tariffs were approved by the Federal Energy Regulatory Commission (FERC) in June and August of 1983 and, therefore, represent a known change, similar to the Commission's allowance of known labor expense increases beyond the end of the test year. The only problem perceived by the Commission was measuring the change where the new rates had not yet been in effect for a full year. Just as known labor expense increases are annualized, so were the revenues from these FERC tariffs. To do this, the Commission relied on MDU's expertise in its projection of 1984 revenues from these tariffs.

This approach served as a reasonable proxy for annualizing these revenues.

7. Keeping in mind the FERC's approach to handling these revenues (offset to cost of gas in future trackers), the Commission carefully structured the reflection of these revenues in rates so that a smooth transition can occur when the revenue level exceeds the annualized amount of \$181,457. At that point, any additional revenues would be reflected using the FERC method, an offset to cost of gas in gas cost tracking proceedings.

8. In asserting that the Commission has no reason to reflect S-2 and T-3 revenues in this case, the Company ignores the obvious effect of timing. This is especially crucial given the number of revenue changes that have occurred in the recent past. Were MDU's proposed method of crediting those revenues through tracking mechanisms adopted, ratepayers would be paying rates which do not reflect the additional revenues, during a period when those revenues are being collected. The Commission finds this situation undesirable and unnecessary.

9. The overall result of the Commission's approach is that neither MDU nor its Montana ratepayers stand to lose or be penalized any revenues for the ratemaking treatment of the S-2 and T-3 revenues approved in this proceeding. MDU's remaining concern becomes one of Federal preemption. The Commission's approach does not upset any tariffs, nor does it attempt to supersede or pre-empt any Federal tariffs. This approach merely reflects a known change, and measures the change using MDU's own projected figures. The Commission has simply provided a way to flow through Montana's allocated portion of events that are actually taking place and

which required no construction of additional facilities or additional expenses.

10. The Commission's actions do not affect, directly or indirectly, the prices of interstate wholesales of natural gas. MDU itself has stated that a certain level of revenue will be derived from this change which has occurred within 12 months of the relevant test year. In setting retail rates, the Commission has merely determined the proper accounting for that revenue already being collected by MDU pursuant to FERC tariffs.

11. Indeed, the only effect conjured by the Company was that the Commission's decision results in a \$561,000 floor to be derived from S-2 and T-3 tariffs. This assertion is not well taken. Treatment of these known revenues is no different than accounting for revenues from, for example, industrial sales at current volumes. In this latter case, the Commission has certainly not set any permanent floors for revenue from industrial sales. This Commission, as well as all other regulatory commissions, must act upon the best current information available; if circumstances should change so that S-2 and T-3 revenues decline, the Company is free to request an adjustment based upon the new conditions, just as it did when revenues from FERC tariff X-5 declined. The Commission further rejects the notion that FERC can commandeer a retail rate-making mechanism established by a state commission; absent Montana's discretionary gas cost tracking mechanism, MDU would have no choice but to include this revenue adjustment in general rate cases.

12. MDU's Motion for Reconsideration concerning revenues from FERC S-2 and T-3 tariffs is DENIED.

13. The Commission's decision to recognize this known and measurable change while disallowing inclusion of major plant additions in rate base beyond the end of the test year is not discriminatory to MDU or an example of "picking and choosing" to the benefit of the ratepayer. Known and measurable changes should and do work both ways in the ratemaking process. As discussed above, the Commission has allowed, for example, the annualization of known labor expense increases beyond the end of the test year in an effort of recognizing a known and measurable change. Such adjustments result in effective ratemaking dedicated to the principal of allowing a utility a reasonable opportunity to earn its allowed rate of return.

#### POST-TEST YEAR PLANT ADDITIONS

14. The Company argued on reconsideration that this rate base reduction adjustment of \$3,575,642 and the related net decrease in operating expenses of \$96,092 is barred by the prohibition against arbitrary and capricious agency action.

15. At stake here is the consistent application of the historical test year concept. As discussed in Paragraph No. 53 of Order No. 5020b in this proceeding, if an historical test year is going to have any validity, proper matching must occur between revenues, expenses, and the plant which produced such revenues and expenses. Mr. Clark of MCC showed that inclusion of post-test year plant additions would not only affect the average rate base amount, but also would cause changes in the net operating income. All these changes would serve to destroy the usefulness of the historical test year from a matching standpoint. The Commission, however, believes that the historical test year must be preserved to insure

proper matching and, therefore, post-test year major plant additions cannot be added to rate base. MDU's motion, therefore, is DENIED.

#### UNAMORTIZED GAIN ON REACQUIRED DEBT

16. The Company argued on reconsideration that this rate base reduction adjustment of \$218,562 is a confiscation of MDU's property and is arbitrary and capricious.

17. As stated by MDU on page 11 of its Motion, "The FERC in its seminal decision, Re Manufacturers Light and Heat Company, 84 PUR 3d 511, declared that since the ratepayer paid the interest cost associated with the bonds, the ratepayer should enjoy the benefits associated with the transaction." Deducting the unamortized balance of the gain on reacquired debt from rate base provides the ratepayer with the total benefit, as determined to be proper by the FERC. If this Commission ignored the unamortized balance, MDU's stockholders would share in the benefits of this transaction and, therefore, deprive the ratepayers of realizing the full benefit. MDU's motion, therefore, is DENIED.

#### COST OF EQUITY

18. The Company argued on reconsideration that the approved cost of equity of 13.35 percent is incorrect and when incorporated into MDU's rates results in a confiscation of MDU's property in violation of the due process clauses of both federal and state constitutions.

19. The Commission concludes that the approved cost of equity of 13.35 percent represents a reasonable level. Concerning MDU's argument in its motion for reconsideration that its incremental

cost of long-term debt is 15 percent, the Commission finds that the incremental cost of debt for A-rated utility bonds has been varying to a degree that no particular trend can be determined. In making this analysis, the Commission believes that data supplied in written and oral testimony provides the proper basis for decision. Dr. Fitzpatrick's rebuttal schedules update data through the end of 1983, which encompasses most available data at the time of the hearing in January of 1984. MDU witness Dr. Fitzpatrick provided in his rebuttal testimony a schedule showing public utility bond yields for 1983. This exhibit shows A-rated utility bond yields for December of 1983 to be 13.5 percent, but looking at the recent months' data before December shows that no real trend for A-rated bond yields can be determined:

September, 1983	13.42%
October, 1983	13.25%
November, 1983	13.13%
December, 1983	13.5%

(MDU Exh. I, Sch. DBF-3, p. 1 of 1)

Indeed, if a trend were to be derived from all months shown on that exhibit, it appears to be generally downward.

20. MDU's chart of corporate bond yields, supplied as part of its Motion for Reconsideration, updates to June of 1984. As previously stated, the Commission believes that a cutoff date for updating data is necessary and that the data available at the time of the hearing (through December, 1983) constitutes the proper basis for making a reasonable decision. Even with that preface, the Commission finds support for the approved equity cost level of 13.35 percent, as being a reasonable level, in this MDU chart. The chart shows that for the 12 months ending June, 1984, for A-rated

utilities, the high yield for long-term bonds was 15.13 percent, and the low yield was 11.50 percent. This is a large range and shows the volatility of the market.

21. In making this decision, the Commission emphasizes that the unqualified proposition that equity must always be above the incremental cost of debt is not necessarily acceptable. Generally, that statement or theory may be correct, but exceptions certainly have occurred in recent years. The Commission is constantly aware of and sensitive to a utility's incremental cost of debt, but because of the volatility of the market or any of a number of other considerations, the Commission's approved cost of equity may not, at every point in time, be above a utility's incremental cost of debt.

22. The Commission carefully reviews cost of debt as one measure of reasonableness with regard to cost of equity. This is especially true in cases such as this where certain periods of incremental debt cost coincide with, or even exceed, the determined cost of equity. Upon reviewing the record, however, the Commission is satisfied that a 13.35 percent return on equity is within a range of reasonableness with respect to this measure and others presented in this proceeding. MDU's motion, therefore, is DENIED.

#### CONCLUSIONS OF LAW

1. The Applicant, Montana-Dakota Utilities Company, furnishes natural gas service to consumers in Montana, and is a "public utility" under the regulatory jurisdiction of the Montana Public Service Commission. §69-3-101, MCA.

2. The Commission properly exercises jurisdiction over the Applicant's rates and operations. §69-3-102, MCA, and Title 69, Chapter 3, Part 3, MCA.

3. The Commission has provided adequate public notice of all proceedings and opportunity to be heard to all interested parties in this Docket. Title 2, Chapter 4, MCA.

4. The Commission's determinations do not affect any Federally approved tariffs and are not preempted by Federal regulation under the Supremacy Clause of the United States Constitution.

5. The rate level and rate structure approved herein are just, reasonable, and not unjustly discriminatory. §69-3-330, MCA.

ORDER

1. The Montana-Dakota Utilities Company shall accrue at 10.84 percent annually the approved revenue increase of \$13,029, discussed in Finding of Fact paragraph No. g, and implement the increase upon the next tariff change resulting from a new approved revenue level.

2. All motions and objections not ruled upon are denied.

3. This Order is effective for services rendered on and after June 22, 1984.

DONE AND DATED this 22nd day of June, 1984, by a vote of 3-0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

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THOMAS J. SCHNEIDER, Chairman

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HOWARD L. ELLIS, Commissioner

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DANNY OBERG, Commissioner

ATTEST:

Madeline L. Cottrill  
Secretary

(SEAL)