Service Date: December 19, 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 Western Water Company to increase rates and charges for water service in its Missoula, Montana area.	)))	UTILITY DIVISION DOCKET NO. 84.4.17 ORDER NO. 5074a

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APPEARANCES

FOR THE APPLICANT:

C. W. Leaphart, Jr., 1 North Last Chance Gulch, Suite 6, Helena, Montana 59601

FOR THE INTERVENORS:

James C. Paine, Montana Consumer Counsel, 34 West 6th Avenue, Helena, Montana 59620.

FOR THE COMMISSION:

Opal Winebrenner, Staff Attorney, 2701 Prospect Avenue, Helena, Montana 59620

BEFORE:

Howard L. Ellis, Commissioner and Hearing Examiner

BACKGROUND

1. On April 24, 1984, Western Water Company (Applicant or WWC) filed an application with the Public Service Commission for authorization to increase water rates by approximately 55.6% for its Missoula, Montana customers on a permanent basis, which constitutes an annual revenue increase of approximately $51,550.

2. Concurrent with its filing for a permanent increase in rates, WWC filed an application for an interim increase in rates of approximately 10.9% equaling a revenue increase of approximately $10,076 or 19.5% of the proposed permanent increase.

3. On July 18, 1984, the Commission having considered the data filed with the Applicant's interim application, issued Order No. 5074 granting the Applicant interim rate relief in the amount of $5,425 annually.

4. On August 15, 1984, pursuant to notice of public hearing, a hearing was held in the City Council Chambers, City Hall, Missoula, Montana. A continuation of this hearing was convened in the Commission Offices, 2701 Prospect Avenue, Helena, Montana on October 15, 1984. At the close of the hearing on October 15, 1984, the parties stipulated to allow the Commission to issue a final order in this Docket.

FINDINGS OF FACT

5. At the public hearing, the Applicant presented the testimony and exhibits of:

Leon Spitz, Engineer, WWC
William Curran, President, WWC
Don Cox, Certified Public Accountant
Marqaret Mahlman, Certified Public Accountant

6. The Montana Consumer Counsel presented the testimony of five public witnesses at the hearing. The major concerns expressed by these witnesses were: that excessive operating pressure was being experienced in the Mainview/Skyview Avenue

area, and that this was possibly causing the numerous service line breaks experienced in the area; low pressure was being experienced in the Hillview Way area because of its proximity to the Hillview Reservoir; and the consumers' reluctance to pay increased rates for water service.

Rate Base

7. The Applicant, in its last general rate increase application (Docket No . 82.4.24, Order No . 4911a), attempted to establish a rate base upon which a rate of return could be earned. In that proceeding, the Commission found that it was unable to establish the Applicant's rate base or to allow a return on rate base because of the Applicant's inability to provide the Commission with sufficient information to insure that all customer contributions had been eliminated from the claimed rate base.

8. Again in this case, the Applicant is attempting to establish a rate base upon which a rate of return can be earned. The unanswered questions remaining from the last Docket that resulted in the Commission denying a rate base for WWC were:

1) Whether all customer contributions had been accounted for in determining the rate base presented by the Applicant,

2) Mr. Dennis Curran's inability to quantify how costs associated with the water utility were assessed against individual lots in the Hillview Heights area, and what costs associated with the water utility construction were included in lot prices.

9. In this application, WWC has proposed an average original

cost depreciated rate base of $352,586. Mr. William Curran, WWC President, presented testimony on the historical development of WWC and the funding sources for construction of various elements of WWC plant in service. Mr. Curran indicated that funds for construction of the water utility had been obtained from three sources: Curran Construction Company, the predecessor of WWC, Customer Contributions and Special Improvement Districts.

Regarding the development of the claimed rate base, Mr. Curran explained that plant in service had been reduced to reflect plant provided by Customer Contribution and Special Improvement Districts. He further stated that the rate base presented represents only that portion which has been provided through equity investment or issuance of debt. The purchase price of the lots did not include a recovery of utility plant investment.

10. Mr. Curran's statements concerning the development of rate base were supported by Company witness Don Cox. Mr. Cox stated that he had verified the cost of investor provided plant for the period 1975 through 1983 by examining invoices, checks and other accounting material available. Mr. Cox stated that he had not made an independent verification of investor provided plant during the period 1972 through 1974, because material was only available back to 1975.

11. Based upon Findings of Fact Nos. 9 and 10, the Commission is satisfied that the Applicant has made a good faith effort to present a rate base that includes only investor provided plant.

12. During the course of cross-examination, it was determined that WWC had not been granted a water right for Well No. 2 in

the Linda Vista/ Valley Vista subdivision. The Applicant indicated that the two wells located in this subdivision were emergency standby sources of supply. Without a water right for Well No. 2, the Applicant has no legal authority to draw water from this source, this means that the well and associated appertances are not used and useful. Since the well and associated appertances are not used and useful for providing service to consumers, their costs should be deducted from the Applicant's plant in service.

13. The Applicant's Exhibit No. 2 reflects an average balance of $472,640 for plant in service. This amount must be reduced by $15,008 to reflect the Commission's finding that Well No. 2 in the Valley Vista/Linda Vista subdivision is not used and useful (See "Replies to Data Requests, No. 2, submitted by the Applicant September 7, 1984). The Commission finds the Applicant's average plant in service during the test year is $457,632 (($472,640 - $15,008 = $457,632).

14. To properly reflect the Commission's disallowance of Well No. 2, in rate base, an adjustment to the "Accumulated Depreciation Account" must be made. Since the total cost of the asset is being eliminated from the plant accounts, the accumulated depreciation which is associated with that asset must also be eliminated.

15. In "Replies to Data Requests", the Applicant states the $7,414 cost of line 11, Exhibit No. 3, is entirely related to the construction of Well No. 2. Column 16 indicates that the total accumulated depreciation on this asset is $643.

16. Also in "Replies to Data Requests ", the Applicant states $5,794 and an additional $1,800 in costs associated

with Well No. 2 are included on Line 12 of Exhibit No. 3. The total original cost reflected in column 2, line 12 of Exhibit No. 3 is $15,790. This exceeds the costs associated with the construction of Well No. 2 contained on that line, therefore, the Commission must calculate the total accumulated depreciation attributable to assets associated with Well No. 2. The Applicant at column 3, line 12, Exhibit No. 3, indicates that the assets on that line have a useful life of 25 years. By application of straight line depreciation to the total costs for Well No. 2,contained on that line, the Commission has determined annual depreciation would equal $304 (($5,794 + $1,800) - 12 = $303.76). The applicant on line 12, Exhibit No. 3, indicates that 2 1/6 years of depreciation have been taken on these assets, therefore, the Commission finds total accumulated depreciation on the Well No. 2 assets contained on this line to be $658.

17. Based upon Findings of Fact Nos. 14, 15 and 16, the Commission finds that the Applicant's accumulated depreciation for the test period should be reduced by $1,301 to the level of $107,726.

18. The Commission finds that the Applicant's average original cost depreciated rate base for the test period to be $338,879. Calculated as follows:

Total Plant	$457,632
Less:	
Accumulated Depreciation	107,726
Unrestored In vestment Credit	11,027
TOTAL RATE BASE	$338,879

Capital Structure

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

Description	Amount	Ratio
Debt	$252,901	68.02%
Equity	118,882	31.98%
TOTAL	$371,783	100.00%

The capital structure proposed by the Applicant was not challenged by any party and is accepted by the Commission.

Cost of Debt

20. The debt capital of the Applicant consists of a $187,751 note payable to M. Henry, and a note payable to L. Twite in the amount of $65,150. The cost of debt or interest on the note payable to M. Henry is 7% and the cost of debt on the note payable to L. Twite is 12.50%.

21. There was discussion on the record regarding the increase in the amount of outstanding debt payable to M. Henry and the increased interest rate applicable to that note. WWC witness, William Curran, explained that WWC had been unable to make a scheduled payment to Mr. Henry and that the increased amount payable to him represented the accrued interest that had been due and payable. He further stated that as a condition for deferral of the interest payable, Mr. Henry desired an increase in the interest rate from 5% to 7%.

22. Regarding the $65,150 note payable to L. Twite, Mr. Curran stated that the proceeds from this note were used to construct a tie line between WWC service areas of Hillview Heights and Linda Vista/Valley Vista. Company witnesses indicated that construction of this tie line was necessary to

improve service in the Linda Vista/Valley Vista service area, and resulted in the Montana Department of Health and Environmental Sciences lifting its restrictions regarding future growth in the area which had been limited because of inadequate water supply.

23. The cost of debt presented by the Applicant, 7% on the note payable to M. Henry and 12.5% on the note payable to L. Twite, appears to be reasonable and is accepted by the Commission.

Cost of Equity

24. The Applicant, in its application, has requested that the Commission allow a return on equity of 15.0%. Company witnesses explaining how a reasonable return of equity was established indicated that the return level requested was predicated on a review of previous Commission grants of equity return, and a Wall Street Journal report indicating an average utility equity return of 15.7%.

25. In "Replies to Data Requests", the Applicant indicated that the list of Commission orders reviewed to determine a reasonable return on equity actually included only the Butte Water Company, Docket No. 82.3.13, Order No. 4896a. In that Order, the Commission assigned a return on equity of 15.18%. however, no findings of fact concerning Butte Water Company's cost of equity were made because the Company is 100% debt financed. The assigned equity cost to the negative equity is the cost of Butte Water Company debt with an additional return allowance of 1.14% to allow for implementation of an accelerated construction program. By allowing a return on the negative equity at the level just described, the Commission

affords BWC the opportunity to both earn a sufficient return on its rate base to cover the cost of debt, and to have funds available to make minor improvements to the water system. (1)

26. Regarding the Applicant's testimony on the Wall Street Journal report, of average utility equity return, it is the Commission's understanding

(1) Using this Commission's assignment of an equity return from one order having the uniqueness of Butte Water Company is not a convincing argument for the granting of a 15% return on equity.

that this average encompasses returns for all forms of fixed utilities, therefore, the average return in this report does not provide an adequate basis for comparison.

27. Absent substantial testimony that the equity return data relied upon by the Applicant to support its requested 15% return on equity is representative of its situation, the Commission find the data irrelevant. There is another privately owned water utility operating in Missoula which is similarly situated and probably more representative, for purposes of determining an equity return, than the utility data supplied by the Applicant. The Commission has granted this Company a return on equity of 13.5%, and finds this level of return to be appropriate for the Applicant.

Capital Structure and Composite Cost of Total Capital

Description	Amount	Ratio	Cost	Weighted Cost
Equity	$118,882	31.98%	13.50%	4.32%
Debt	187,751	50.50%	7.00%	3.54%
Debt	65,150	17.50%	12.50%	2.19%
Total	$371,783	100.00%		

Composite Cost of Total Capital 10.05%

Operating Revenues

28. The test period operating revenues are not a contested issue in this case. The Applicant used the actual 1983 revenues for WWC as test year revenue. Total test year revenues of $92,739, as presented by the Applicant, are accepted by the Commission.

Operating Expenses

29. The Applicant also proposed proforma adjustments increasing operation and maintenance by $4,000.

30. The Applicant has proposed an increase in operation and maintenance expense in the amount of $4,000 annually, which reflects a two year amortization of rate case expense associated with this filing.
The Applicant, in "Replies to Data Requests", indicated that actual 1983 operation and maintenance expenses included $4,639 of rate case expense, related to a 1982 rate application. The Commission in the 1982 Docket (Docket No . 82.4.24) recognized a three year amortization of rate case expense at a level of $1,333 annually. The Applicant for the test period will have a total rate case expense amortization requirement of $5,333 ($4,000 + $1,333 = $4,333). Since the Applicant had an actual 1983 expense of $4,639 and its test period amortization of this expense will equal $5,333, the appropriate proforma expense increase is $694.

31. The Commission accepts proforma adjustments increasing operation and maintenance by $694 and finds operation and maintenance expense to be $80,180.

32. The Applicant has proposed an adjustment to depreciation increasing this expenses by $1,709 annually to reflect full year depreciation on 1983 plant additions. This expense increase was not contested by any party and is accepted by the Commission.

33. Since this Commission disallowed the inclusion of Well No. 2 in the Applicant's rate base, an adjustment to depreciation expenses must be made. This adjustment will reduce the Applicant's annual depreciation expense and reflects the Commission's decision that it is not the responsibility of the consumer to reimburse the equity investor for the plant determined not to be used and useful. The Commission finds that the Applicant's depreciation expense should be reduced by $601 (See Finding of Fact No. 16 & Exhibit 3, line 11).

34. The Commission finds the net increase in depreciation expense will be $1,108 ($1709 = $601 = $1,108), and finds total annual depreciation expense to be $14,732.

35. The Applicant proposed total adjustments increasing "Taxes Other than Federal Income Taxes " by $1,457 annually . This account will not increase by the amount projected by the Applicant because of Commission adjustments previously discussed in this order. Commission calculations have determined that "Taxes Other than Federal Income Taxes" will increase by $1,190 to an annual level of $5,186.

36. The Applicant, in the recent past, has been incurring an operating loss therefore, there has been no federal income tax liability. With this increase, the Applicant will be generating an operating income and will incur a federal income tax liability. The Applicant projected a federal

income tax liability in the amount of $2,912. Due to the Commission adjustments previously discussed, this will decrease $2,376.

37. The Commission finds the following test period expense appropriate for WWC:

Operation and Maintenance	$80,180
Depreciation	14,732
Taxes Other than F. I. T .	5,186
Federal Income Taxes	2,376
Total Operating Revenue Deductions	$102,474

38. The Applicant is found to be sustaining an operating loss in the amount of $9,735 calculated as follows:

Operating Revenue	$92,739
Operating Deductions	102,474
Operating Loss	(9,735)

Revenue Requirement

39. Rate Base	$338,879	
Rate of Return	10,05%	
Return Requirement		$34,057
Adjusted Balance Available for Return		(9,735)
Revenue Deficiency		$43,792

40. In order to produce a return of 10.05% on the Applicant's average original cost depreciated rate base, the Applicant will require additional annual revenues in the amount of $43,792 from its Missoula, Montana water utility.

Service

41. The majority of the public witnesses testifying in this docket indicated that it was their belief that excessive operating pressures were being experienced in the Mainveiw/Skyview Avenue area. These consumers testified concerning the number of service line breaks that had been experienced in the area in the recent past.

In response to this testimony, the Commission requested WWC provide a late filed exhibit indicating the maximum operating pressure that would be experienced by consumers residing in this area. On October 22, 1984, WWC, through its engineer Leon Spitz, submitted a letter indicating that the maximum pressure that would be experienced in this area was 135 psi.

42. The information obtained during the course of this proceeding indicates that there are two factors contributing to the numerous service line breaks in the Mainview/Skyview area. The first being the maximum 135 psi operating pressure being experienced in the area, and the second being the indication from public witnesses that the service lines installed by the contractor constructing houses involved, possibly used substandard service line material.

43. The Commission will make no finding relative to the possibility that substandard service line material has been used in constructing the houses involved. Service lines pursuant to this Commission's rules for "Privately Owned Water Utilities" are the responsibility of the consumer, therefore, the Commission has no jurisdiction.

44. Regarding the maximum operating pressure of 135 psi, the

Commission finds this pressure to be excessive. Based upon the Commission's general knowledge of water utilities, typical maximum water pressures approach 80 to 90 psi. The fact that the pressure in the Mainview/Skyview area is exceeding typical experience, indicates to the Commission that the Applicant should determine why these pressures are being experienced and take the necessary steps to correct the situation.

Rate Design

45. The Applicant has proposed a uniform percentage increase be applied to the rates of all customer classifications for purposes of generating the increased revenues authorized in this order. Absent a cost of service study, the Commission is of the opinion that a uniform percentage increase in rates to all customer classifications is the most equitable method of implementing the revenue increase authorized herein and, therefore accepts the Applicant's proposal.

CONCLUSIONS OF LAW

1. The Montana Public Service Commission properly exercises jurisdiction over the parties and subject matter in this proceeding. Section 69-3-102, MCA.

2. The Commission afforded all interested parties in this proceeding proper notice and an opportunity to participate. Section 69-3-303, MCA.

3. The Commission has statutory authority to determine whether a public utility's property is actually used and useful for the convenience of the public. Section 69-3-

101, MCA.

4. The rates approved herein are reasonable, just and proper. Section 69-3-201, MCA.

ORDER

THEREFORE, THE MONTANA PUBLIC SERVICE COMMISSION ORDERS THAT:

1. Western Water Company shall file tariffs, consistent with the Findings of Fact herein, which reflect an increase in annual revenues of $43,792 for its Missoula, Montana service area.

2. Western Water Company shall examine the pressure problem in the Mainview/Skyview area and file a report with the Commission as to the cause of the problem and the most cost effective solution to the problem. This report shall be filed with the Commission within 90 days of the service date of this order.

3. The revenues granted herein are in lieu of, and not in addition to, the revenues granted in Interim Order No. 5074.

4. The rates approved herein shall become effective upon Commission approval .

DONE IN OPEN SESSION this 17th day of December, 1984 by a vote of 4-0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

THOMAS J. SCHNEIDER, Chairman

HOWARD L. ELLIS, Commissioner

CLYDE JARVIS, Commissioner

DANNY OBERG, Commissioner

ATTEST:

Madeline L. Cottrill
Commission Secretary
(SEAL)