

Service Date: July 17, 1985

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

IN THE MATTER Of The Application)
Of MOUNTAIN WATER COMPANY For) DOCKET NO. 84.9.59
Authority To Increase Rates And)
Charges For Water Service In Its) ORDER NO. 5139a
Missoula, Montana Service Area.)

APPEARANCES

FOR THE APPLICANT:

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FOR THE INTERVENORS:

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Montana Consumer Counsel
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Representing City of Missoula
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FOR THE COMMISSION:

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Staff Attorney
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Before

Clyde Jarvis, Commissioner
Howard Ellis, Commissioner
Tom Monahan, Commissioner

1. On September 26, 1984, Mountain Water Company f (Applicant or MWC) filed an application with this Commission for authority to increase rates and charges for water service in its Missoula, Montana service area. The Applicant proposes a permanent increase of approximately 29.5%, which constitutes an annual revenue increase of approximately \$973,248.

2. On April 16, 1985, pursuant to notice of public hearing, a hearing was held in the Missoula County Courthouse, Missoula, Montana. The purpose of the public hearing was to consider the merits of the Applicant's proposed water rate adjustments. At the close of the public hearing, the Applicant requested that the Commission authorize an interim revenue increase in the amount of \$308,978.

3. On May 20, 1985, the Commission having considered the t merits of the applicant's interim application, issued Order No. 5139 denying the applicant's request for interim rate relief.

FINDINGS OF FACT

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

Lee Magone, General Manager, MWC

Don Gallup, Vice President, Finance,
Park Water Company

Gerald Peasley, Certified Public Accountant

5. The Montana Consumer Counsel presented the testimony of four public witnesses at the hearing. It also presented the testimony of four public witnesses at the hearing. It also presented the testimony and exhibits of one expert witness:

Frank Buckley, Rate Analyst, Montana Consumer Counsel.

6. The year ending December 31, 1983 test year was uncontested and is found by the Commission to be a reasonable period within which to measure the Applicant's utility revenues, expenses and returns for the purpose of determining a fair and reasonable level of rates for water service.

RATE BASE

7. The Applicant, in its application, proposed an average original cost depreciated rate base of \$8,876,107. In the prefilled testimony of Frank Buckley, Exhibit MCC #1, an adjustment is made which increases the Applicant's rate base by \$1,700. This adjustment has been accepted by the Applicant since it reflects previous Commission precedent regarding treatment of liberalized depreciation associated with state income taxes. The Commission accepts the above adjustment and finds the applicant's original cost depreciated rate base to be \$8,877,807.

CAPITAL STRUCTURE

8. MWC proposed the following capital structure for rate case presentation:

Description	Amount	Ratio
Equity	\$5,334,661	61.68%
Debt	<u>3,314,321</u>	<u>38.32%</u>
Total	\$8,648,982	100.00%

9. In his prefilled testimony, the Consumer Counsel's witness, Frank Buckley, proposed modifying the capital structure presented by the Applicant. Mr. Buckley properly points out that the Commission, in Order 4851a, (MWC Docket

#81.9.06) ordered a reduction in book equity for ratemaking purposes to reflect the disallowance of an intangible asset. The Applicant's proposed capital structure does not reflect this adjustment; therefore, the Consumer Counsel's witness has reduced the equity of the applicant by \$457,775 to reflect the amount associated with the intangible. The Commission finds the proposed adjustment reasonable and further finds the equity component of the capital structure to be \$4,876,886.

10. The Consumer Counsel proposed a further adjustment to the Applicant's capital structure, that being the elimination of \$116,821 included in the debt component of the structure. The capital structure presented by the Applicant includes "Advances from Associated (Company's)" carrying interest at the rate of 13.50%. The "Advances from Associated" should be excluded from the debt component of the capital structure because they represent short term borrowings and, therefore, are not properly inculcable in the capital structure. The Commission finds the debt component of the capital structure to be \$3,197,500.

11. The Commission accepts the following capital structure for rate case presentation:

<u>Description</u>	<u>Amount</u>	<u>Ratio</u>
Equity	\$4,876,886	60.4%
Debt	<u>3,197,500</u>	<u>39.6%</u>
Total	\$8.074.386	100.0%

COST OF DEBT

12. The debt capital of the Applicant consists of a \$3,197,500 note issued by Park Water company to Montana Power Company. This debt is an obligation of Park Water Company

rather than its subsidiary, MWC, but the note has been properly assigned to the Applicant for ratemaking purposes.

13. The cost of debt, or interest, on this note is variable, the present cost being 9.0 percent and the cost at maturity being 10.0 percent. The cost of debt presented by the applicant was not challenged by any party participating in this proceeding and therefore is accepted by the Commission.

COST OF EQUITY

14. The Applicant has requested that the Commission allow a return on equity of 13.5%. The requested return on equity of 13.5% is consistent with that allowed by the Commission in MWC's most recent general rate increase application (Docket No. 81.9.86, Order No. 4851a). The Commission in its Order No. 4851a discussed its rationale regarding the allowance of a 13.5% return on equity for the Applicant. The Commission will not reiterate the discussion from that order but does take notice of its content, in finding the Applicant's request for a 13.5% return on equity to be reasonable.

CAPITAL STRUCTURE AND COMPOSITE COST OF TOTAL CAPITAL

15. The Commission finds the following capital structure and composite cost of total capital to be reasonable:

<u>Description</u>	<u>Amount</u>	<u>Ratio</u>	<u>Cost</u>	<u>Cost</u>
Equity	\$4,876,886	60.4%	13.5%	8.154%
Debt	<u>3,197,500</u>	<u>39.6%</u>	<u>9.0%</u>	<u>3.564%</u>
Total	\$8,074,386	100.0%		

Composite Cost of Total Capital

11.718%

OPERATING REVENUE

16. The Applicant proposed test period operating revenues of \$3,303,617. The test period operating revenues as presented by the Applicant were contested by the Montana Consumer Counsel; its expert witness contended that the revenues should be (increased by \$105,000 to properly reflect "normalized" water sales to the metered customer class.

17. The Applicant determined test period operating revenues for the metered customers using actual 1983 sales volumes which indicates that, in the Applicant's opinion, this level of sales is typical for this customer classification.

The Consumer Counsel's adjustment, increasing revenues by \$105,000, uses a five year average of sales volumes (1980 to 1984) instead of actual 1983 sales volumes. It is the Consumer Counsel's contention that the 1983 sales volumes used by the Applicant are atypical of the sales that would normally be experienced.

18. Examination of the tables submitted by the Consumer Counsel and the Applicant (Exhibits MCC-1 and H) which reflect the annual sales volumes to the metered customers indicate that the actual 1983 sales volumes are the lowest experienced in the five year period reflected on the tables. Sales volumes to metered customers will vary significantly depending upon weather conditions (temperature and precipitation) and restrictions placed upon water use by the water company. The testimony in this Docket indicates that MWC's sales volumes to metered customers in 1983 were affected by both weather conditions and implementation of

water use restrictions which caused a reduction in the sales volumes to metered customers.

The Commission finds the Consumer Counsel's proposed revenue increase of \$105,000 through use of a normalization of water sales to the metered customers to be reasonable.

19. The Commission finds the Applicant's test period operating revenues to be \$3,408,617.

OPERATING EXPENSES

20. The Applicant, in its application, proposed program adjustments increasing operation and maintenance expense by \$82,685.

21. Included in witness Buckley's prefiled testimony is an adjustment reducing the Applicant's purchased power expense by \$12,000. The testimony indicates that the Applicant has accepted this adjustment because it is nonrecurring or represents a duplication of expenses. The Commission finds the \$12,000 expense reduction acceptable.

22. MWC proposed a net increase in its purchased power expense totaling \$48,428, using the latest known rates for Montana Power Company (June 5, 1984). The increase in power expense reflects increased kilowatt usage arising from its conversion from a surface source of supply to a ground water source and a reduction in projected power costs due to the benefits arising from capital improvements to the water system.

23. Subsequent to the filing of the case by the Applicant, Montana Power Company was authorized an increase in its

electric rates; this increase was effective for services rendered on and after September 20, 1984. The increase in electric rates authorized Montana Power is a known and measurable change affecting the Applicant's operating expenses, occurred within 12 months of the end of the test year, and therefore, is an adjustment that should be reflected in this proceeding.

Using the electric rates which become effective September, 1984. it has been determined that the Applicant will experience a net increase in its purchased power expense totaling \$70,648. The Commission finds that this level of expense increase should be reflected instead of the \$48,428 originally calculated.

24. The Consumer Counsel's witness in his prefiled testimony identifies \$42,000 of miscellaneous expense which is nonrecurring and proposes that \$27,000 of it be eliminated and the remainder be amortized over a 3 year period. The Commission's examination of these expenses indicate that they are indeed nonrecurring but were incurred in an effort, on the part of the applicant, to insure an adequate source of supply which had been significantly diminished because the Rattlesnake source had been taken off-line as a result of possible girdia contamination.

The Commission is of the opinion that the nonrecurring expenses incurred by the Applicant, in an effort to insure an adequate source of supply, were necessary operational expenditures incurred to provide adequate customers. Therefore, it is inappropriate to of these expenses by the Applicant.

25. Since the \$42,000 in expense service to its

disallow recovery incurred by the Applicant to insure an adequate source of supply is nonrecurring, traditional ratemaking treatment dictates that it be amortized.

The period of amortization is subjective and the Commission finds that these expenses should be amortized over a period of 3 years which, from the testimony in this Docket, appears reasonable.

26. Based upon the preceding treatment outlined for the nonrecurring expenses the Commission finds that the Applicant's test year operating expenses should be reduced by \$28,000.

27. Pro forma operation and maintenance expense under the present rates are found to be \$1,828,875, recognizing total pro forma adjustments increasing expenses by \$64,905.

28. Depreciation expense is found to be \$285,411.

29. Taxes other than income are found to be \$289,490.

INCOME TAXES

30. One of the major contested issues in this case was the treatment that should be afforded net operating loss carry-forwards which are available to offset income taxes. The Consumer Counsel's witness indicated, in his prefiled testimony, that he calculated that the applicant had available approximately \$932,950 in net operating loss carry-forwards to offset taxable income on a dollar for dollar basis. The amount of available net operating loss carry-forwards was not challenged during the course of this proceeding.

31. The Applicant in calculating its income tax obligation fact that during the test year it had loss carry--forwards that could be used to offset its income tax liability; failure to reflect the net operating loss carry-forwards creates a hypothetical tax expense.

By ignoring the availability of net operating loss carry-forwards, the Applicant has overstated its actual income tax liability for the test year. The rebuttal testimony of the Applicant's witness, Gerald Peasley, states the Applicant's rationale for use of the hypothetical tax instead of the actual tax:

"...Mountain Water not only suffers the prior period business loss, but an unwarranted reduction in current period income by passing on to the ratepayer a tax benefit arising from a prior period and which was intended for the company, not the ratepayer"

32. The question of the treatment that should be afforded the net operating loss carry - forwards boils down to who should receive the benefit, the ratepayer or the company. In the briefs submitted by the Applicant and the Consumer Counsel, both parties cited the case of City of Helena vs. Montana Department of Public Service Regulation, _____ Mont._____, 634 p. 2nd 192 (1981), regarding the recoupement of past operating losses through rate making. This case prohibits the Commission from setting rates which would allow a utility to recover past operating losses.

If the Commission were to set rates utilizing the hypothetical tax calculated by the Applicant, which ignores the availability of net operating loss carry-forwards, the

Commission would be allowing the indirect recoupment of past operating losses. The actual tax paid by the utility would be lower than the hypothetical and the difference between actual tax paid and the hypothetical would flow through to the benefit of the equity investor. The Commission believes it should not allow indirect recovery of past operating losses when it cannot do so directly. The Commission, therefore, finds that the net operating loss carry-forwards available to offset the income tax obligation should be recognized in calculating the Applicant's income tax liability.

33. The Consumer Counsel proposed operating loss tax obligation Applicant's income tax a 2 year amortization of the \$932,950 of available net operating loss carry forwards, resulting in utilization of \$466,475 per year. The net operating losses incurred by the Applicant occurred over a 3 year period; therefore, the Commission finds that it would be appropriate to amortize the loss carry forwards over a three year period, resulting in utilization of \$310,983 per year.

REVENUE REQUIREMENT

34. Based on the preceding Findings of Fact, the Commission finds that in order to produce a rate of return of 11.72% on MWC's average original cost depreciated rate base, the Applicant will require additional annual revenues in the amount of \$494,594 from its Missoula, Montana water utility.

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

MOUNTAIN WATER COMPANY Missoula Division
 Computation of Net Income Test year 1983

	Present Rates (Company)	Adjustment	Test Year	To Produce 11.72% Rate of Return	Accepted by the Commission
Operating Revenues	\$3,303,617	\$105,000	\$3,408,617	\$494,594	\$3,903,211
Deductions:					
O&M	1,846,655	(17,780)	1,828,875		1,828,875
Book Depreciation	285,411		285,411		285,411
Taxes Other Than Income	289,385	105	289,490	494	289,984
Income Taxes	316,631	(103,464)	213,167	245,296	458,463
Net Income	\$ 565,535		\$ 791,674	\$ 248,804	\$ 1,040,478
Rate Base	\$8,876,107	\$ 1,700	\$8,877,807		\$ 8,877,807
Return on rate Base	6.37%		8.92%		11.72%

RATE DESIGN

36. The Applicant's proposed rate design was not challenged by any party participating in this proceeding. The Commission's examination of the rate structure indicates that it appears to equitably distribute the cost of providing service to the various customer classifications and accepted.

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 parties interested in this proceeding proper notice and an opportunity to participate. Section 69-3-303, MCA.
3. The rates approved herein are reasonable, just and proper, Section 69-3-201, MCA.

ORDER

THEREFORE, THE MONTANA PUBLIC SERVICE COMMISSION ORDERS THAT:

1. Mountain Water Company shall file rate schedules which reflect an increase in annual revenues of \$494,594 for its Missoula, Montana service area.
2. The water revenues authorized herein shall be distributed among the Applicant's classes of service as provided herein.

3. The rates approved herein shall not become effective until the tariffs and necessary calculation relating to their derivation have been submitted and approved by the Commission.

DONE IN OPEN SESSION at Helena, Montana this 15th day of July, 1985, by a vote of 3-0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

Clyde Jarvis, Chairman

Howard L. Ellis, Commissioner

Tom Monahan, Commissioner

ATTEST:

Trenna Scoffield
Commission Secretary

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 28.2.4806, ARM.