Service Date: July 10, 1986

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

* * * * *

IN THE MATTER of the Application of PACIFIC POWER AND LIGHT COMPANY for Authority to Adopt New Rates and Charges for Electric Service Furnished in the State of Montana.	)	UTILITY DIVISION DOCKET NO. 85.10.41 ORDER NO. 5169a

APPEARANCES

FOR THE APPLICANT:

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FOR THE MONTANA CONSUMER COUNSEL:

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

FOR THE COMMISSION:

Timothy R. Baker, Staff Attorney, 2701 Prospect Avenue, Helena, Montana 59620

BEFORE:

HOWARD L. ELLIS, Commissioner, Presiding
CLYDE JARVIS, Chairman
DANNY OBERG, Commissioner

PART A

BACKGROUND

1. The Pacific Power and Light Company (PP&L, Company, or Applicant) is a public utility furnishing electric services to consumers in the State of Montana, and is subject to the regulatory jurisdiction of the Montana Public Service Commission (PSC or Commission).

2. On October 3, 1985, PP&L filed with the Commission its application for authority to increase rates and charges for electric service. The proposed rates are designed to produce an increase in annual gross operating revenues of $3,500,000 based on a historic test year ended March 31, 1985, adjusted for known and measurable changes. Of this amount, the Company estimates that $1,295,000 can be recovered from the Bonneville Power Administration (BPA), pursuant to the terms of the Company's Residential Purchase and Sale Agreement with BPA, authorized by the Pacific Northwest Electric Power Planning and Conservation Act (Regional Act). Therefore, the proposed tariff schedules are designed to produce a net revenue increase of $2,205,000 or 8.5 percent.

3. Included in the filing was a request for interim rate relief, subject to rebate, in the amount of $3,500,000, based on a test year ended March 31, 1985. Table C of the interim filing showed that, net of the BPA exchange credit, PP&L required $2,299,000. On November 29, 1985, the Commission granted an interim increase, subject to rebate, of $1,703,000.

4. On October 16, 1985, the Commission issued a Notice of Application and Proposed Procedural Order. On November 5, 1985, the Commission issued a final Procedural Order.

5. On October 25, 1985, the Commission granted BPA's Motion to Intervene in this Docket.

6. On January 20, 1986, the Company filed revised testimony and exhibits, contending that it could justify an annual revenue increase of $5,239,000. This revised data did not amend the Company's requested annual revenue increase of $3,500,000.

7. The Montana Consumer Counsel (MCC) has participated in this Docket on behalf of electric utility consumers since the inception of these proceedings, and the Commission granted MCC's Motion to Intervene on December 12, 1985.

8. On March 18, 1986, the Commission issued a Notice of Public Hearing in Docket No. 85.10.41.

9. On April 15 and 16, 1986, pursuant to the Notice of Public Hearing, a hearing was held in Whitefish, Montana, and satellite public hearings were held in Libby and Kalispell, Montana, on the evenings of April 16 and 17, 1986, respectively.

10. During the hearing, the Company agreed to a one-week extension of the nine-month deadline (TR, p. 202).

11. Applicant proposes a March 31, 1985, test year adjusted for known and measurable changes, to be used as the test period in this Docket. The March 31, 1985, test period is found by the Commission to be a reasonable period within which to measure Applicant's electric utility revenues, expenses, rate base, and returns for the purpose of determining a fair and reasonable level of rates for electric service.

PART B

RATE OF RETURN

Capital Structure

12. Applicant proposed the following capital structure and associated costs (PP&L Exh. 4, Table 4a-3):

Description	Ratio	Cost	Weighted Cost
Long-Term Debt	52%	9.63%	5.01%
Preferred Stock	12	8.93	1.07
Common Equity	36	15.00	5.40
Total	100%		11.48%

13. MCC proposed the following capital structure and associated costs (MCC Exh. 2 CMS-l):

Description	Ratio	Cost	Weighted Cost
Long-Term Debt	54.9%	9.63%	5.29%
Preferred Stock	10.2	8.93	.91
Common Equity	34.9	12.00	4.19
Total	100%		10.39%

14. The two parties subsequently came to an agreement on the appropriate capital structure for this proceeding. The Commission accepts the following stipulated capital structure (Applicant's opening brief p. 4):

Long-Term Debt	56.34%
Preferred Stock	8.51
Common Equity	35.15
Total	100.00%

Cost of Capital

Long-Term Debt

15. The cost of long-term debt is not a contested issue in this proceeding. Both MCC and the Applicant originally proposed a cost of 9.63 percent as shown in Findings of Fact Nos. 12 and 13. The Applicant updated their embedded cost of long-term debt to include all changes through March 31, 1986. That updated cost of long-term debt is 9.17 percent (PP&L Exh. 22, p. 1). Therefore, the Commission accepts 9.17 percent as the cost of long-term debt.

Preferred Stock

16. The cost of preferred stock is not a contested issue in this proceeding. Both MCC and the Applicant originally pro posed a cost of 8.93 percent as shown in Finding of Fact Nos. 12 , and 13. The Applicant updated their embedded cost of preferred stock to include all changes through March 31, 1986. That updated cost of preferred stock is 9.11 percent (PP&L Exh. 22, p. 2). Therefore, the Commission accepts 9.11 percent as the cost of preferred stock.

Common Equity

Applicant

17. In prefiled, direct testimony, the Applicant's witness, Mr. Robert Lanz, recommended that the Commission set rates to achieve a return on equity of 15 percent (PP&L Exh. 3, p. 15). He relied on the standard DCF model in formulating his return on equity recommendation. Mr. Lanz revised that recommendation to a range of 13 to 15 percent in his prefiled rebuttal testimony (PP&L Exh. 20, p. 1). Improvements in the capital markets and upgraded credit ratings of Pacific's senior securities were cited as reasons for Mr. Lanz' revision.

18. Mr. Lanz reasoned that Pacific's high level of unregulated services made their common equity perform differently than that of other electric utilities (PP&L Exh. 3, p. 8). Therefore, Mr. Lanz based his recommendation on studies of two groups of comparable company data. The first group consists of three Northwest electric utilities, and the second group is made up of seven electric utilities that have bond ratings similar to Pacific 's. One company, Washington Water Power, is included in both groups.

19. Mr. Lanz' proposed dividend yield was calculated by averaging three months of dividend yield information for his groups of comparable companies. Mr. Lanz listed Solomon Brothers Inc.'s Electric Utility Monthly as his source of information (PP&L Exh. 3, p. 13). The three months used by Mr. Lanz were April, May and June of 1985. Mr. Lanz calculated the applicable dividend yield to be in the range of 9.8 to 10.1 percent (PP&L Exh. 4, Tables 4-8).

20. To determine investors' expected growth rate, Mr. Lanz preformed a five year study of the companies' growth in dividends, earnings, and book value. Mr. Lanz also examined analysts projected growth rates to verify his findings (PP&L Exh. 3, p. 14).

21. Mr. Lanz' historical study weighted dividend growth at 50 percent, earnings growth at 40 percent, and book value growth at 10 percent. He stated:

> These weights reflect my perception of the , importance investors assign these data. The least weight was assigned to book value growth because recent write-offs and write-downs of terminated projects for electric utilities have made that statistic less ' reliable. (PP&L Exh. 3, pp. 18-19.)

22. The results of Mr. Lanz' study are listed below:

	Historic Growth	Forecast Growth
Three Northwest Utilities	6.8%	4.7%
Similarly Rated Utilities	6.1	4.8
(PP&L Exh. 4, Tables 4-8)		

23. Dr. Caroline Smith testified on behalf of MCC. Dr. Smith's 12 percent return on equity recommendation was based on her DCF analysis of ten years of growth in dividends, earnings and book value. Dr. Smith also performed comparable earnings analysis to verify her DCF results.

24. The dividend yield used by Dr. Smith is calculated by dividing PP&L's current annual dividend by their high and low stock prices over a six month period. The six months utilized by Dr. Smith ran through December 31, 1985. Dr. Smith's calculations produced a dividend yield of 8.2 percent.

25. Expected growth rate was determined through a statistical analysis which measures the relationship between historic growth rates and current pricing patterns. Dr. Smith explained her study as follows:

Although Pacific Power & Light Company's dividend yield is a value that can be calculated, estimating the future growth , which might reasonably be anticipated by investors is less straightforward. In order to determine the growth rate for estimating the cost of equity for Pacific Power & Light Company, I have made statistical studies of growth expectations for the electric utility industry as a whole. My statistical approach makes it possible to estimate the long term dividend growth rates anticipated by investors for Pacific Power & Light Company in view of both the circumstances of the industry and the unique circumstances of 474 Pacific Power & Light Company. (MCC Exh. 2, pp. 8-9.)

The fact that Pacific Power & Light Company's cost of common equity cannot be accurately determined without reference to the rest of the electric utility industry is a matter of common sense. Virtually all investors determine the prospects for a particular company with regard to conditions affecting its industry. (MCC Exh. 2, p. 9.)

26. Dr. Smith's study produced a single best growth rate number of 2.4 percent, a three most important growth rates number of 3.5 percent, and an all growth rates number of 4.1 percent for PP&L (MCC Exh. 2, Table B-9).

Commission Analysis

27. The Commission has consistently found the DCF method of determining return on equity to be superior to all other methods. Both MCC and the Applicant rely on DCF analysis in making return on equity recommendations. In each model there are elements based upon the expert judgment of the individual witness.

28. The major differences between the DCF models in this proceeding are: (1) MCC's witness used 84 companies for analysis, and the Applicant's witness used nine companies; (2) MCC's witness relied on 10 years of growth data while the Applicants witness utilized 5 years of growth data; (3) MCC's witness relied on PP&L stock information and the Applicant's witness did not.

29. With respect to the number of companies used, the Commission finds the MCC approach preferable because factors which are unique to a firm or firms are minimized.

30. With respect to the time frame used for historical analysis, the Commission does not believe that investors limit their knowledge to five years of growth data. As stated by Dr. Smith:

Mr. Lanz's first error is his decision to limit his analysis to five-year growth in earnings, dividends and book value. Contrary to Mr. Lanz's expressed opinion, five years worth of data are not the most significant to investors. (MCC Exh. 2, p. 43.)

31. With respect to the use of PP&L stock data, the Commission does not agree with the Applicant that return on equity should be set without regard to PP&L stock data. While it is true that PP&L has engaged in diversifying their business interests, the Commission does not believe PP&L's diversification is at a level high enough to base a return on equity solely on comparable companies' data. This point is evidenced by the fact that electric utility net income represents 71.7 percent of PP&L's total company net income (MCC Exh. 2, p. 18).

32. In arriving at a cost of equity for PP&L, the Commission closely examined Dr. Smith's Table B-9. Between the three most important growth rates number of 3.5 percent, and the all growth rates number of 4.1 percent represents a reasonable range for PP&L's growth rate.

33. The Commission is cognizant of the fact that investors would not expect PP&L to soon incur large write-offs associated with the abandonment of nuclear plants as has recently occurred. Dr. Smith also does not believe investors expect such events to reoccur in the near future (TR, p. 73). This belief must also be tempered with the fact that investors likely do not expect rate of return authorizations to continue at the high rates that resulted during the recent years of extreme inflation. In light of these facts, the Commission accepts a 4.1 percent growth rate in this proceeding. When combined with a dividend yield of 8.2 percent the accepted return on PP&L's equity is found to be 12.3 percent.

34. A 12.3 percent return on equity places PP&L slightly below the average cost of equity for the electric utility industry. Dr. Smith calculated the average equity cost rate in the industry to be in the 12 to 13 percent range (MCC Exh. 2, p. 32).

Rate of Return

35. Based on the findings for long-term debt, preferred stock and common equity in this proceeding, the following capital structure and costs resulting in a 10.27 percent overall rate of return are determined appropriate:

Description	Ratio	Cost	Weighted Cost
Long-Term Debt	56.34%	9.17%	5.17%
Preferred Stock	8.51	9.11	.78
Common Equity	35.15	12.3	4.32
Total	100%		10.27%

PART C
RATE BASE

36. Consistent with previous Commission decisions, both PP&L and MCC proposed an average rate base or the 12 months ended March 31, 1985, adjusted to include certain known and measurable changes. One of the primary considerations of the Commission in rate base decisions has always been proper matching of test year income with the plant that produced that income. The Commission, therefore, finds an average rate base for the 12 months ended March 31, 1985, adjusted for certain known and measurable changes, to be appropriate in this proceeding.

37. The Company proposed several adjustments to its per books average rate base figures to arrive at its proposed proforma average rate base. The Commission finds that, unless specific rate base adjustments, such as those proposed by MCC, are addressed in this Order, PP&L's proposed pro forma level of various rate base items is approved in this proceeding.

38. All approved rate base adjustments and pro forma figures in this Order reflect the approved Montana jurisdictional allocation factors, as determined below. These figures will differ somewhat from the levels proposed in both PP&L's and MCC's testimony and exhibits, but only because PP&L's and MCC's figures are based on the originally filed jurisdictional allocation factors.

Montana Jurisdictional Allocation Factor

39. As discussed by MCC witness Peterson in his pre-filed testimony, PP&L operates in six states: California; Oregon; Idaho; Washington; Wyoming; and Montana. Some of the Company's costs are directly assignable to a particular state, while other costs are viewed as total system costs which must be allocated fairly to each state regardless of where the costs are actually incurred. In order to fairly allocate these system costs, such as the costs associated with a generating station whose power serves the entire integrated system, among the various state jurisdictions, a valid and rational method of allocation must be developed (MCC Exh. 3, p. 18).

40. In its original filing, the Company proposed a jurisdictional allocation method which has been accepted in recent PP&L filings. This method is referred to as the twelve coincident peak (12 CP) approach and applies to the allocation of system costs under Note 1, which, for Montana in this rate case, is 3.27 percent. Mr. Peterson explains:

> Pacific develops the Note l factor by trending each states' contribution to the December-January system coincident peak demands during the most recent five-year period.- The demands are trended to the middle of the rate year by least squares linear regression. The six pairs of coincident peak demands for Oregon, Washington, and California are temperature adjusted. Pacific claims that loads in Montana and Wyoming are less temperature sensitive. (MCC Exh. 3, p. 19.)

41. On September ll, 1985, the Commission requested that PP&L include in its filing in this Docket the results of a Note 1 allocation factor based on a five-year trend of all 12 monthly coincident peaks, the 60 CP method. (letter from Chairman Jarvis to J. T. Watson dated September 11, 1985; also provided as Attachment 1 to PP&L Exh. 21)

42. On October 15, 1985, PP&L submitted the 60 CP Note 1 calculation. With the filing, PP&L stated that it could not "endorse a change in the jurisdictional allocation methodology" pending the outcome of an anticipated jurisdictional allocation meeting to be attended by representatives of the various jurisdictions (letter from J. T. Watson to Dan Elliott dated October 10, 1985). The 60 CP method features a Montana Note 1 of 2.89 percent. The Company also included a four-year phase-in, which provides a progressive weighting of the 60 CP method and the 12 CP method in increments of 10 percent, 25 percent, 50 percent, and 100 percent. The corresponding Montana Note 1 factors are 3.23 percent, 3.17 percent, 3.08 percent, and 2.89 percent (PP&L Exh. 21, Att. 2).

43. Mr. Peterson criticized the Company's 12 CP trending procedures because of the inability to protect against wide swings from one year to the next in relative cost responsibility for each jurisdiction. He compared the Montana Note 1 factors in Docket No. 84.7.38, 2.84 percent, and the present Docket, 3.27 percent. He stated, "The increase from 2.84 percent to 3.27 percent represents an increase in Montana jurisdictional cost responsibility of over 15 percent in one year's time for no apparent reason other than vagaries of the allocation method!" Peterson further criticized the 12 CP method by performing a statistical analysis from which he concluded that the regression equations developed for Montana and California are unreliable. He argued that this swing in allocation is the result of the statistically invalid trending process which effectively exaggerates what could be a predominantly weather-related load pattern (MCC Exh. 3, pp. 19-24).

44. Mr. Peterson recommended that the 60 CP method not be utilized in Montana because "Pacific has presented no analysis that demonstrates that the 60 coincident peak method results in a better allocation, that is one which better (or best) reflects cost responsibility" (MCC Exh. 3, p. 27).

45. As a solution to his perceived problems with the 12 CP method, Peterson proposed that the six pairs of coincident peak demands should simply be averaged. He testified:

Absent an explanation for the wide variation in coincident peak loads over the five-year period which may, in part, be caused by weather conditions, the six pairs of coincident peak demands for these two states [California and Montana] should simply be averaged. The averaging of Montana's and California's loads is even more appropriate if it is shown that Montana's loads are temperature sensitive. (MCC Exh. 3, p. 24.) The result of this MCC proposed five-year average of coincident peaks is a Note 1 allocation factor of 2.973 percent (MCC Exh. 3, p. 25).

46. In his rebuttal testimony, Mr. Pearson of PP&L disagreed with MCC's stance concerning this issue. He listed some goals for a fair allocation of costs and said that Mr. Peterson's proposal does not meet those tests. Mr. Pearson discussed the unreasonableness of utilizing an allocation method for only one state which would have the effect of increasing other states' revenue requirement by approximately $1.4 million. He disagreed with Mr. Peterson's statistical analysis, stating:

> The purpose of smoothing the data using a time series is to reflect more current data and the trend of that data. The purpose of the time series is not to specifically predict the peak, but to develop a smoothed current responsibility for percentage allocation of cost. The time series does reflect direction of the data and, hence, cost responsibility better than a straight line anchored in 1982 such as is proposed by Mr. Peterson. Further, Mr. Peterson does not address the problem of significant swings in responsibility for costs caused solely by stepping in or out of conformance with his "t" test. (PP&L Exh. 21, p. 7.)

47. Mr. Pearson discussed the use by Mr. Peterson of a 90 percent level of significance of the “t" statistic on the five states Note 1 calculation over the past four years. The result was a mixture of the smoothed method and the averaging method. He perceived the problem with this approach as being a lack of fairness and uniform treatment of jurisdictional cost assignment responsibility among the states. Pearson concluded, "For the MCC witness to pick and choose a method for the express purpose of proposing a lowering of the Montana revenue requirement is both counterproductive to the process of reaching a consensus and bad regulatory and analytical policy" (PP&L Exh. 21, pp. 78).

48. PP&L witness Pearson also discussed the aforementioned 60 CP method and the accompanying four-year phase-in. He said that the Company is meeting with its various Commission staffs to attempt to reach agreement on a consistent methodology, but that no consensus has yet been reached.

He indicated that the Company believes that the 60 CP method is currently favored by several of the state Commissions and that it is an appropriate and reasonable methodology. He stated, "The Company is willing to accept the phase-in of the 60 CP method for purposes of this case, or a similar method, as is expected to be adopted by the Company's jurisdictions" (PP&L Exh. 21, p. 9).

49. In determining the appropriate allocation factor or methodology for purposes of this proceeding, the Commission is faced with a multitude of choices, most of them quite reasonable in their own context. The decision must consider several factors which all play an important role in addressing this difficult and ongoing issue. Many different approaches could be taken with reasonable rationale for each one, but the Commission believes that the cornerstone of this decision must be equity. Montana ratepayers must not bear an unfair burden. PP&L deserves some consideration for its continuing efforts to reach agreement among the states for a uniform allocation methodology. The Commission's decision, as discussed below, reflects a reasonable balance between the concerns of the Company and MCC.

50. The 60 CP method is clearly superior to the 12 CP method, primarily because of the use of much more pertinent data. The extreme data included in the 12 CP allocation factor proposed in this case (including the "megafreeze") unreasonably affected the end result of the trending. Montana's Note 1 allocation factor increased over 15 percent since the prior Docket (No. 84.7.38). To assume that Montana is going to continue to experience extreme weather conditions every winter is completely unfounded. This data should be smoothed out over time rather than used as a heavily weighted factor in determining a proper allocation. The 12 CP method may have positive aspects, but the evidence in the record points to some glaring weaknesses.

51. MCC's proposal is appealing because it utilizes past years' known and measurable data. By averaging that data, this method does tend to smooth out some of the extreme data which might otherwise tend to skew the product to an unreasonable result. However, in this regard, the Commission believes that the 60 CP method will provide a more reliable, superior result.

52. In all fairness, the Commission feels obligated to consider PP&L's concerns about the use of an allocation methodology throughout its system which will reasonably serve to put the Company in

a position to be "made-whole" for recovering system costs. Mr. Pearson's rebuttal testimony in this regard is well taken. Until a uniform methodology is finally adopted, the Commission wants to treat the Company fairly while recognizing MCC's concerns for a reasonable cost responsibility allocation to PP&L's Montana customers. This is not accomplished by adopting a change in methodology which only benefits ratepayers in the near term. As stated by Company witness Pearson:

> Since Mr. Peterson's approach has deviated from the methodology generally accepted by the Company's other jurisdictions, full recovery of costs is clearly in jeopardy. In this case, his proposal will result in under collection of costs. In a later period over collection could occur. I would note that Mr. Peterson's recommendation has the singular effect of only providing a benefit to Montana. It appears to be opportunistic and not a reasonable basis for setting rates currently or in the long run. (PP&L Exh. 21, p. 6.) (emphasis theirs)

53. Only a stable and consistently applied methodology will provide a fair result over time. There is no evidence in the record which would indicate that MCC's proposed allocation methodology is being considered as a possible methodology by the various jurisdictions within which PP&L operates. In contrast, several state commissions have moved toward adoption of the 60 CP method, or a phase-in of that method. The Commission does not believe MCC's five-year average approach is proper in this proceeding and, accordingly, denies Mr. Peterson's recommendation.

54. As stated above, the Commission believes the 60 CP method is the superior method. The four-year phase-in of the 60 CP method has some appeal in that it provides for gradual movement from the 12 CP method to 100 percent use of the 60 CP method. In this case, that range for Note 1 is 3.27 percent (100% 12 CP) to 2.89 percent (100% 60 CP). The Company asks for a four-year phase-in on the basis of fairness to the Company while it actively attempts to resolve this issue in all jurisdictions and, in so doing, gets an allocation method that would be endorsed in all, or most, states.

55. The Commission is willing to go partway on the idea of a phase-in, but the proper allocation methodology and the timing of the installation of the methodology in the states indicates that the approved approach in this proceeding should reflect the Commission's interest in making positive

efforts to resolve this issue fairly on a system-wide basis while not placing an unreasortable burden on PP&L's Montana ratepayers.

56. The Commission does not accept the full four-year phase-in. The record in this proceeding does not indicate that the 60 CP method is going to be adopted by all the states regulating PP&L in the near future or at the end of the four years. Accepting any phase of the phase-in plan at any level less than 50 percent 12 CP,-50 percent 60 CP provides an unfair benefit to PP&L's stockholders. After all, the 60 CP method indicates that Montana's Note 1 factor is 2.89 percent (PP&L Exh. 21, Att. 2). The Commission could justify the utilization of that figure in this case. However, such action may be somewhat harsh if the other states are using a less drastic allocation approach. The result would be PP&L's inability to have the opportunity to reasonably recoup all costs on a system-wide basis.

57. The Commission believes, then, that utilization of the third phase of the proposed phase-in plan is appropriate in this proceeding. The proper resulting Note 1 factor is 3.08 percent. This approach represents a fair, reasonable manner of reflecting both stockholder and ratepayer concerns. The 3.08 percent factor is fairly close to MCC's proposal and provides the Company with some time for a phase-in. This issue should again be closely scrutinized in PP&L's next general rate filing.

Plant Held For Future Use

58. The Company proposed to include in rate base $84,000 Of plant held for future use, adjusted to delete items no longer considered useful (PP&L Exh. 7, p. 8).

59. MCC witness Peterson recommended that, consistent with the Commission's findings in prior proceedings, the Company's request should be reduced by the amounts related to projects whose in-service dates are not imminent. The resulting adjustment proposed to reduce the Montana rate base by $69,000 (MCC Exh. 3, p. 8).

60. The Company did not rebut Mr. Peterson's proposal.

61. The Commission agrees with MCC that current ratepayers should not be burdened with carrying costs of property which will not be used in the imminent future. The Commission, therefore, accepts MCC's proposed adjustment in the reallocated amount of $64,000 as a reduction to pro forma rate base.

Materials and Supplies

62. Pursuant to the fuel expense adjustment proposed by MCC witness Towers, Mr. Peterson proposed to reflect the rate base effect of such reductions in the value of fuel stocks resulting in a proposed rate base reduction of $17,000 (MCC Exh. 3, p. 9).

63. In his rebuttal testimony, Mr. Pearson of PP&L stated, "While the Company does not agree with the adjustments to Jim Bridger and Dave Johnston coal costs, it will accept the calculation of the cost per ton for this proceeding" (PP&L Exh. 21, p. 5).

64. Consistent with the Commission's findings concerning fuel (coal) expense (see the Expense section of this Order), the Commission finds a reduction in rate base in the reallocated amount of $17,000 to reflect the proper level of materials and supplies to be proper in this proceeding.

AFUDC

65. MCC witness Peterson determined that the Company has been capitalizing allowance for funds used during construction (AFUDC) at a rate in excess of the rate calculated in conformance with a formula set by the Federal Energy Regulatory Commission (FERC). He testified, "Pacific's Form 1 Report to the FERC indicates that in 1984 its maximum rate calculated under the formula was 11.8 percent; effective March 1984, it began using a 12.0 percent rate." Peterson also noted that the Company's filing indicated that, effective March of 1985, it began capitalizing AFUDC at a 12.25 percent rate, which was a rate that greatly exceeded the Company's utility-related capital costs as determined by this Commission. He concluded, "It is inappropriate to use an AFUDC rate for Montana-allocated construction work in progress that is greater than what the Montana Commission has determined to be Pacific's cost of capital" (MCC Exh. 3, pp. 3031).

66. Based on this discussion, Mr. Peterson, questioning the appropriateness of requiring PP&L to retroactively adjust past AFUDC accruals, proposed that the Company should be required prospectively to use an AFUDC rate based on the FERC formula with adjustments to reflect the capitalization ratios and return on equity determined by this Commission. He testified, "This rate would be applied to Montana-allocated construction work in progress including the Montana-related portion of Colstrip Unit 4" (MCC Exh. 3, p. 32).

67. The Company rebutted MCC's proposal and Mr. Pearson summarized that Peterson's recommendation would be administratively cumbersome if not impossible to implement and is contrary to the accounting practices the Company is required to follow (PP&L Exh. 21, p. 11).

68. Mr. Peterson's testimony discusses two issues concerning PP&L's AFUDC rate. First, he claims that the Company is accruing AFUDC at a rate in excess of the rate allowed by the FERC formula. The Commission wholeheartedly agrees with Mr. Peterson that PP&L is in error for exceeding that rate and finds that the Company should accrue AFUDC at a rate not to exceed the rate determined by the FERC formula. Interestingly, the AFUDC rate determined by the FERC formula is a ceiling which would allow PP&L to accrue AFUDC at a rate lower than the allowed level, but the Company has apparently chosen to use at least the maximum ceiling level to accrue AFUDC over the last few years. The continual use of the maximum allowed AFUDC rate is somewhat disappointing, but exceeding that maximum level is unacceptable and will not be tolerated by this Commission. The Company should respond accordingly.

69. Concerning Mr. Peterson's proposal to have PP&L use an AFUDC rate based on the FERC formula with adjustments to reflect the capitalization ratios and the return on equity determined by the Montana Commission, PP&L's concerns about the difficulties inherent with adopting such a proposal seem quite valid. During cross-examination by PSC Staff Attorney Baker, Mr. Peterson responded:

> Q. Does your proposed AFUDC adjustment imply that the Company should have a separate AFUDC rate for each jurisdiction?

A. No, it does not.

Q. Can you explain that?

A. The Company could simply choose to adopt the Montana accepted AFUDC rate.

Q. Are you aware of any other multi-jurisdictional utility that would have a separate AFUDC rate for each state?

A. I'm not aware of any utility that has, but I'm aware of many utilities that employ an AFUDC rate less than the maximum allowable under FERC regulations. (TR, pp. 150-151.)

70. Mr. Peterson's above statements point out some obvious problems with adopting his proposal. The FERC rules for the AFUDC formula call for the use of the cost rate of common equity to be the rate granted common equity in the last rate proceeding before the ratemaking body having primary jurisdiction (PP&L Exh. 21, p. 10). Mr. Peterson did not establish for the Commission that Montana qualifies as PP&L's primary jurisdiction. The expectation, therefore, of PP&L using an AFUDC rate for all its jurisdictions based on Montana cost of capital figures seems unrealistic. Also, the Commission is reluctant to adopt Mr. Peterson's proposal when the record indicates that it is doubtful that any state commissions have required a multi-jurisdictional utility to have a separate AFUDC rate for each state. The Commission is unable to determine, based on the record in this proceeding, if approving MCC's AFUDC proposal would not violate the FERC regulations, especially concerning the issue of primary jurisdiction. Since the Commission is unaware of any similar treatment for other multi jurisdictional utilities in the nation, the Commission is hesitant to adopt the MCC position. The Commission, therefore, denies Mr. Peterson is AFUDC proposal.

71. While denying Mr. Peterson's proposal, however, the Commission encourages MCC to continue to monitor PP&L's AFUDC rate in an effort to check for errors and inaccuracies and to address the Commission's concerns, while researching further the appropriateness of determining an AFUDC rate based on Montana specific figures.

Malin-Midpoint Sale of Tax Benefits

72. The Economic Recovery Tax Act of 1981 allowed an owner of equipment in use to transfer the resulting investment tax credits (ITC) to a qualified taxpayer in exchange for a cash payment. The

Company entered into such an arrangement, a "safe harbor lease," with Standard Oil Company of Indiana in December of 1981. When PP&L received authorization for this transaction, the Commission clearly indicated that the proceeds from this sale would be subject to a ratemaking determination.

73. In Docket Nos. 81.8.70, 82.4.28, and 83.5.36, MCC witness, Mr. George Hess, proposed that the proceeds PP&L received from the sale of these Federal tax deductions, pursuant to a safe harbor lease transaction, should be amortized above the net operating revenue line and that the unamortized balance should be deducted from rate base. The Hess exhibits in those Dockets reflected his recommendation that the investment tax credits-related proceeds should be amortized over a period of five years, and the remainder of the proceeds should be amortized over a 30 year period in reverse order of the tax deductions associated with lease payments less interest income.

74. The Commission Orders associated with all the above Dockets, plus Order No. 5009a of Docket No. 83.5.36, reflected the acceptance of the proposed Hess method of giving proper ratemaking treatment for the safe harbor transaction.

75. In those previous Dockets, the Company contended that the Hess method for the amortization of the safe harbor proceeds could jeopardize the Company's tax benefits resulting from its safe harbor lease transaction because of the alleged likelihood of the Treasury Department disallowing the Hess proposal as proper treatment. The Commission addressed these concerns in the relevant Orders by explaining that the Commission does not want to jeopardize PP&L's tax benefits from its safe harbor lease transaction. However, the Commission found that no Treasury regulations had yet been promulgated, and it was not clear that, when and if any such regulations were adopted, they would address the ratemaking treatment of a utility's "proceeds," rather than "public utility property," from a safe harbor transaction.

76. To emphasize the Commission's stance that PP&L's tax benefits should not be jeopardized, the Commission, in Order No. 5128 of Docket No. 84.7.38, stated:

As the Commission stated in Order No. 5009a of Docket No. 83.5.36, should the Treasury Department promulgate rules contrary to the Commission's position, or should PP&L receive a Treasury ruling that the Commission's position is improper, the Commission will review the matter. (Order No. 5128, p. 34, Finding No. 86). In Docket No. 84.7.38, the Commission, therefore, continued to find, as it had in the previous three Dockets, that PP&L's tax benefit sale should be treated for ratemaking purposes in the manner originally proposed by MCC witness Hess as a sale of utility assets, with the corresponding various adjustments. (Order No. 5128, pp. 33-34, Finding No. 85.)

77. In the current proceeding, Docket No. 85.10.41, the Company's original filing reflected the methodology approved by the Commission in previous proceedings for the test year portion of the five-year amortization of the proceeds received from the sale. Because the test year extends three months beyond the end of the claimed amortization period (1980 through 1984) the credit to the test year cost of service was limited to 9/12 of the annual amortization. Accordingly, the related rate base reduction reflected the fact that the unamortized balance of the ITC related benefit is assumed to be fully amortized prior to the end of the test year (MCC Exh. 1, pp. 8-9).

78. Sometime afterward, the Company informed the Commission and MCC that it had changed its position concerning this issue. The Company stated that it had come upon an IRS private letter ruling issued in response to a request from an unidentified electric utility. PP&L said that the private letter ruling indicated that full normalization is required for the ITC portion of the proceeds from the sale. The Company also related that full compliance with the private letter ruling would require PP&L to recapture from Montana ratepayers the amounts amortized in prior years of approximately $397,000. Accordingly, the Company proposed to eliminate the test year portion of the five-year amortization of the ITC-related benefits and to recapture over the next five years the ITC-related benefits claimed to be previously conferred upon the Montana ratepayers prior to the test year ($79,000 per year) (MCC Exh. 1, pp. 9-10).

79. MCC witness, Mr. Robert G. Towers, examined this issue and concurred with PP&L in part. He recommended that the test year amortization and rate base reduction be eliminated from the revenue requirement determination as the end of the five-year amortization period represents a known and measurable change. In agreeing with the Company about the reflection of the end of the amortization period, Mr. Towers questioned the accuracy of the time frame described by the Company as the five-year amortization period because it assumes that the amortization period began on January l, 1980, when the safe harbor lease was executed in 1981. Nonetheless, Towers explained that even an amortization beginning in 1981 would have terminated at the end of 1985, which is prior to the date when the rates established in this case will become effective. Towers concluded:

> Either of these amortization schedules would justify excluding the actual test year amortization from the revenue requirement determination in this case on the grounds that the termination of the amortization is a "known change" that is measurable with precision. (MCC Exh. 1, p. 10.)

80. Concerning the private letter ruling, Towers referred to the previous Commission Orders to determine that no change in the ratemaking treatment is required. Be pointed out that the Commission had consistently stated that it would review its ratemaking treatment in this matter if either the Treasury Department issues a formal generic rule or if the Company obtains a private letter ruling specific to PP&L which holds that the Commission's treatment is improper. Mr. Towers concluded:

> The Treasury Department has issued no formal generic rule and, to my knowledge, the IRS has not issued a ruling on this issue in response to a request from PP&L. (MCC Exh. 1, p. 11.)

81. Concerning the Company's proposal of recoupment of prior years' amortizations, Mr. Towers said this matter will become an issue only if and when an adverse Treasury ruling is issued or PP&L receives an adverse private letter ruling. He stated that if either of these events occur and the Commission concludes that recoupment is required pursuant to such an adverse Treasury ruling, the amount of recoupment should be evaluated for accuracy because the amount put forward by the Company is overstated considering that there may have been no benefits provided to ratepayers prior to mid-1982 (MCC Exh. 1, p. 11).

82. The Company did not rebut or cross-examine Mr. Towers concerning his testimony on this matter.

83. After closely analyzing this issue, the Commission agrees with the MCC testimony in its entirety. The five-year amortization period of the ITC-related tax benefits has apparently come to an end, and therefore, this represents a known and measurable change that should be reflected in this rate case. The IRS private letter ruling does not meet the Commission requirements in that such a private letter ruling must be specific to PP&L. Further, as apparent from the face of the document, an IRS private letter ruling is not of precedential value. The Commission, therefore, finds that this letter does not have any bearing on this decision. The Commission views PP&L's proposed recoupment of prior ratepayer benefits as unacceptable in this proceeding. Without a promulgated Treasury ruling or PP&L-specific private letter ruling, the concept of allowing such recoupment or the accurate dollar amount of the recoupment can not appropriately be considered in this Docket. Based on the above discussion, the Commission, therefore, finds an increase in rate base in the reallocated amount of $33,000 to reflect the reversal of the effect of the five-year amortization of the ITC-related portion of the proceeds received from the sale in 1981 of the Malin-Midpoint tax benefits to be proper in this proceeding.

Centralia Impact Team

84. Pursuant to the approved reduction in costs at the Centralia plant discussed the Expenses section of this Order, an associated reduction in fuel (coal) inventory must be reflected. Based on the approved reduction in Centralia plant costs of $67,000, the Commission finds the reduction to fuel inventory in the amount of $15,000 to be proper in this proceeding. For further discussion concerning this issue, please refer to Finding of Fact Nos. 140 - 141.

Capacity Reserves

85. On January 20, 1986, PP&L witness, Mr. Dennis P. Steinberg, filed supplemental direct testimony. Mr. Steinberg referred to Order No. 5128 in Docket No. 84.7.38, Finding No. 66, in

which the Commission directed the Company in its next rate case to file testimony supporting PP&L's reduction of its MidColumbia resource peak capability for resource planning purposes. He said that the purpose of his supplemental testimony was to comply with that Commission directive and to discuss the Company's newly revised loads and resources plan (PP&L Exh. 18, p. 1).

86. The remainder of Steinberg's supplemental testimony was devoted to explaining the Mid-Columbia peak capability adjustment and the Company's most recent loads and resources study (PP&L Exhs. 18, pp. 1-10, and 19). PP&L witness Pearson later filed a revised Exhibit 9, which reflected the effects of Mr. Steinberg's supplemental testimony and accompanying exhibits. The overall result of the implementation of Steinberg's supplemental testimony was a revision in the amount of increased annual revenues the Company felt it could justify from the original amount of $4,890,000 to the revised amount of $5,239,000 (PP&L Revised Exh. 9, Table 9-11).

87. MCC witness Peterson reviewed the Company's revised loads and resources plan. He stated:

> For the 1986-87 power supply year, the year in which rates set in this case are likely to be in effect, Pacific's capacity reserves appear to be adequate without being excessive. (MCC Exh. 3, p. 33.)
>
> Peterson added that the inclusion of the recently negotiated 200 MW sale to Southern California Edison and the 170 MW sale to the Los Angeles Department of Water and Power results in a theoretical peak capacity deficit of 171 MW and a 14 percent installed capacity reserve margin (MCC Exh. 3, p. 33).

88. Concerning the 77 MW peak capacity reduction which reflected the down rating of the Mid-Columbia hydro resources, as discussed in Mr. Steinberg's supplemental testimony, Mr. Peterson stated:

> However, even if you reverse the 77 MW adjustment, Pacific's loads and resources : appear to achieve reasonable parity and there is no basis for an excess capacity adjustment at this time. (MCC Exh. 3, p. 34.)

89. At this point in time, it appears that the Mid-Columbia peak capacity downgrading is not a contested issue, since with or without the 77 MW adjustment, there does not appear to be excess capacity. For the purposes of this proceeding, the Commission accepts the supplemental testimony and exhibits of Mr. Steinberg. As Mr. Peterson has done in his testimony, Mr. Pearson's revised Exhibit 9 should be the primary data relied upon for the Company's case in determining the proper revenue requirement in this proceeding. However, the Commission does not intend to pass upon the propriety of the actual adjustment associated with the downgrading in this proceeding.

Total Rate Base

90. As a result of the various approved adjustments, the Commission finds the proper reallocated amount of total average rate base for the test year ended March 31, 1985, adjusted for known and measurable changes, to be $72,680,000.

PART D
REVENUES, EXPENSES, AND REVENUE REQUIREMENT

91. Mr. Stephen E. Pearson of PP&L sponsored exhibits and testimony which detailed the cost of service and average rate base amounts which support an annual revenue increase of $4,890,000 based on an overall rate of return of 11.68 percent. In his revised Exhibit 9, Mr. Pearson showed support for an annual revenue increase of $5,239,000 based on an overall rate of return of 11.68 percent. He indicated that the Company utilized an historical test period for the year ended March 31, 1985, as a basis for its filing and made various adjustments. Mr. Pearson concluded that, based on the proposed test period, the Company would require additional revenues of $5,239,000 in order to earn an overall return of 11.68 percent. PP&L witness, Mr. James T. Watson, discussed the Company's policy in this case to reduce its request to $3,500,000 from the $5,239,000 which the Company felt it could support in this proceeding. Mr. Watson stated, "Our goals are to limit the amount of the increase and expediate [sic] review of the case (PP&L Exh. 1, pp. 1-2).

92. Mr. David E. Peterson, a witness for MCC, presented testimony and exhibits on the cost of service and the proper rate base. Mr. Peterson urged the use of an average test year rate base, as was

also proposed by the Company, adjusted for certain known and measurable post-test year changes. He prepared a series of schedules and presented related testimony which culminates with the change in revenues required to produce the 10.39 percent rate of return recommended by Dr. Caroline Smith. Mr. Peterson concluded that, based on the average test year ended March 31, 1985, the Company requires additional permanent revenues of $1,840,000.

93. The Company proposed several adjustments to its per books revenues and expenses to arrive at its proposed pro forma revenues and expenses levels. The Commission finds that, unless specific revenues and expenses adjustments, such as those proposed by MCC, are addressed in this Order, PP&L's proposed pro forma levels of various revenues and expenses are approved in this proceeding.

94. All approved revenue and expense adjustments and pro forma figures in this Order reflect the approved Montana jurisdictional allocation factors, as determined in the Rate Base section of this Order. These figures will differ somewhat from the levels proposed in PP&L's and MCC's testimony and exhibits, but only because PP&L's and MCC's figures are based on the originally filed jurisdictional allocation factors.

OPERATING REVENUES

Amortize Unbilled Revenues

95. In May of 1983, PP&L changed its method of recording revenues for accounting and financial reporting purposes. Prior to 1983, the Company recognized revenues at the time customers were billed; in May of 1983, PP&L began accruing estimated unbilled revenues. As a result of the accounting change, PP&L recorded an after tax gain of $22.1 million. The Company has recognized the effect of test year unbilled revenues, and MCC agrees with this proposed adjustment (MCC Exh. 3, pp. 11-12).

96. MCC witness Peterson proposed an adjustment to reflect the effect of the Company's accounting change. Peterson recommended that Montana's portion of the gain, $1,521,000 be reflected in rates as a credit to revenues over a ten-year period of amortization, excluding the first year of recovery

pursuant to the Settlement Agreement accepted by the Commission in Docket No. 84.7.38. Therefore, the remaining $1,368,900 should be recovered over the next nine years by crediting revenues by $152,100 annually (MCC Exh. 3, p. 13).

97. Peterson stated that over the years, prior to the accounting change, the Company's revenues and earnings were understated as the result of a mismatch caused by the failure to record unbilled revenues. He testified:

> The mismatch between revenues and expenses grew over the years as sales increased. Therefore, rates set in the past have been overstated because of the Commission's reliance on Pacific's reported revenues and earnings. Since ratepayers have borne the burden of the Company's failure to adequately reflect revenues over the years, equity requires that they be compensated by recognizing, for ratemaking purposes, the cumulative effect of the Company's accounting change. (MCC Exh. 3, p. 12.)

98. Mr. Peterson addressed the issue of whether or not this adjustment constitutes retroactive ratemaking, stating that his recommendation results in ratepayers receiving a utility related benefit that accrued to the Company but has not yet been reflected in rates. He also mentioned that the Idaho Commission had recently approved a similar adjustment including a ten-year amortization for PP&L in Order No. 19333 in the Company's 1984 case (MCC Exh. 3, pp. 13-14).

99. PP&L witness Pearson rebutted this MCC proposal. Mr. Pearson countered MCC's matching arguments by saying that revenues and costs have always been matched as a result of the use of 12 monthly accounting periods for each. He stated that the unbilled revenue adjustment merely aligned them more accurately in time and that, in all cases, 12 months worth of revenues have been matched with 12 months of expenses. Also, Mr. Pearson said that adopting Mr. Peterson's adjustment would include revenue in the test period resulting from an extraordinary noncash gain relating to prior periods and would unreasonably provide the customer with 12 ½ months' revenue versus only 12 months' expense (PP`L Exh. 21, pp. 2-3).

100. Mr. Pearson emphasized that the Company did not receive any cash when it converted from accounting of such revenues to an accrual system. He testified:

> The Company received no cash when it made what was essentially just an accounting change. Acceptance of the MCC unbilled revenue adjustment would provide a cash transfer to customers for a noncash accounting transaction. (PP&L Exh. 21, p. 4.)

101. Concerning the issue of retroactive ratemaking, the Commission agrees with MCC that amortizing the unbilled revenues gain from an accounting change in 1983 does not constitute a violation of this ratemaking principle. The gain represents a one-time occurrence which is totally tied to the Company's ratepayers who obviously provide the revenues. Not to allow the ratepayers to benefit from this gain would be contrary to the concept of flowing through ratepayer-related benefits. The ten year amortization period proposed by MCC seems quite reasonable considering that this was a one-time gain and that the Idaho Commission approved a similar amortization period for PP&L. Since the gain occurred in May of 1983, this was within the test year of PP&L Docket No. 84.7.38. The unbilled revenue issue was part of a Settlement Agreement in that Docket, which saw MCC accept PP&L's proposed treatment of unbilled revenues (Order No. 5128, Docket No. 84.7.38, Finding No. 98). MCC accepted the PP&L approach, however, only for the purposes of that proceeding. The Commission respects that condition and interprets that condition to mean that the issue has not been resolved on its merits. The passage of one year does not preempt the Commission, under these conditions, from considering this issue on the basis of the retroactive ratemaking principle.

102. Concerning the matching issue, the Commission agrees that, prior to the accounting change in 1983, PP&L was proposing 12 months of both revenues and expenses. However, the 12 months of revenues and expenses were not in line with each other, as evidenced by the rebuttal testimony of PP&L witness Pearson. (See PP&L Exh. 21, p. 2.) Apparently, over time, and because of this misalignment, the cumulative result was to understate test year revenues, resulting in a greater revenue requirement. This is evidenced by the aforementioned gain that occurred when PP&L changed its accounting method. The magnitude of this failure to properly match revenues and expenses in a single year is reflected by the test year unbilled revenues adjustment proposed by

both PP&L and MCC in this case. Typically, an upward adjustment for unbilled revenues is indicative of the load growth that occurred between the last 15 days of the test year and the same 15 days of the previous year. The test year unbilled revenues adjustment is necessary to provide better matching, and is, therefore, proper.

103. The Company stressed that the gain was noncash in nature and that it would be, therefore, unfair to credit the ratepayers with a cash gain. The Commission views the critical aspect of this issue to be whether or not PP&L received any benefit from the gain, and the answer is quite clear that the Company did indeed benefit from the gain by shoring up its earnings so that a dividend would not have to be passed (TR, pp. 191192). Unlike the dividends that were subsequently paid to shareholders, the gain itself may not have been in cash form.

104. Concerning the Idaho Commission Order No. 19333 in PP&L's 1984 case, the Commission agrees with the decision in that Order but recognizes that the reasons behind that decision and this one could be different, based on the records in the proceedings. The Commission notes with interest that, to its knowledge, PP&L has not appealed the Idaho decision in that Order.

105. Based on the above discussion, the Commission accepts the MCC proposed adjustment concerning the amortization of unbilled revenues and finds the increase in pro forma revenues in the amount of $152,000 to be proper in this proceeding.

Weather Normalization

106. Under cross-examination of Staff Attorney Baker, PP&L witness, Mr. Dennis P. Steinberg, testified that, for the first time, the Company is proposing in this case an adjustment to reflect normal temperatures when adjusting the Montana retail load. Mr. Steinberg also stated that this adjustment has been done in all of PP&L's jurisdictions (TR, p. 103).

107. Company witness Pearson further elaborated about the temperature adjustment under cross-examination by Mr. Baker. He said that a similar methodology has resulted in adjustments in all of the other jurisdictions which were accepted. When asked about the effect in this case of this

proposed adjustment, Mr. Pearson said that the net effect was an increase in revenue requirement of approximately $100,000 to $110,000 (TR, pp. 127128).

108. The Commission is not opposed to the concept of normalizing weather. Indeed, such an adjustment is commonly made in Montana-Dakota Utilities Company gas rate cases, where that company's gas load is highly sensitive to weather conditions. The same cause and effect relationship may truly exist for PP&L's Montana load. The Commission is quite disappointed, however, by the Company's approach concerning this proposed adjustment in this filing. Staff Attorney Baker's cross-examination of Mr. Pearson revealed some very disturbing information:

Q. In whose testimony which was filed in this proceeding was it stated that this adjustment was being made?

A. I'm not sure if it was specifically stated in any of the testimony. I don't believe there's a specific reference I can give you.

Q. Could you look to Page 3 of what would have [been] Robyn Warsinske's testimony, Exhibit Number 7?

A. I have it.

Q. Would it be included somewhere in Line 2 through 22 on that page?

A. It would have to be considered as part of Subset C on Lines 9, 10 and 11, as close as I can tell.

Q. Well, if this was the first time that it was being used or proposed, then why wasn't it--this $100,000 adjustment noted somewhere in the testimony more specifically?

A. The specific reference to it--I don't recall exactly why it's not
specifically noted, but this would have been the last filing we made of the
cycle during 1985, and it may have just been an oversight. (TR, pp. 128-129.)

109. This purported $100,000 "oversight" leaves the Commission quite disenchanted with temperature normalization in this proceeding. Not only is this $100,000 adjustment admittedly not addressed in any of the witness' testimony, but it also, incredibly, does not appear in Workbook 5, which is supposedly dedicated to providing the workpapers behind all the Company adjustments being proposed in the rate case. Was this also "just an oversight"?

110. The Commission was also quite interested in the cross-examination of PP&L witness Pearson by the MCC, Mr. James C. Paine, concerning the normalization of weather for test period peak conditions (TR, pp. 177-181). Mr. Pearson acknowledged that no such adjustment is done for either Montana or Wyoming (TR, p. 178). When asked if the Company has conducted any studies to indicate whether or not the peak experience in Montana is sensitive to weather, Pearson replied, "There have been no studies conducted that I'm aware of since this allocation methodology was put in place back in the early 1970's" (TR, p. 179). Pearson continued:

There's been no study performed on peak, and we don't believe that it would be appropriate to look at that at this time because of where we appear to be going with the allocation process, in any event. (TR, p. 180.)

111. The Commission sees some potential positive aspects of normalizing for weather. As discussed by Mr. Pearson, such normalization should result in a smoothing of Montana's revenue requirement for normal usage, which should also promote rate stabilization (TR, p. 181). However, too many questions and concerns exist about the Company's approach in this case to warrant the approval of this adjustment in this proceeding. The Company's failure to provide any testimony, exhibits, or workpapers concerning this issue is paramount in the Commission's decision. There has been no justification for not normalizing peak for Montana when it is done in Oregon, Washington, and California (Workbook' 6, pp. 59-60). The Commission, therefore, denies the Company's proposal to adjust revenues in this proceeding to reflect temperature normalization, resulting in an increase in pro forma revenues in the reallocated amount of $121,000. In denying the Company's proposal, the Commission encourages the Company to present this proposal to the Commission in the next general rate filing, but cautions the Company that it must meet its burden of proof before such an

adjustment will be considered. Also, the Commission will expect a full analysis and discussion of the normalization of peak to be included in such a weather normalization adjustment proposal.

Total Revenues

112. The above adjustments to Operating Revenues result in approved reallocated pro forma revenues of $31,270,000 ($30,997,000 + $152,000 + $121,000).

EXPENSES

Cost of Coal

113. In his prefiled testimony, PP&L witness Watson stated, "[T]he Bridger Coal transfer price has been reduced to a 'utility' level return." Mr. Watson said that the Company does not necessarily agree with this adjustment, but it has included it in this proceeding to limit the issues. The Company proposed in its revised Exhibit 9 an overall reduction in the cost of coal in the amount of $75,000, including the effects of the production cost study, the Bridger Coal adjustment, and a labor expense adjustment (PP&L Exh. 1, p. 3, and Revised Exh. 9, Table 9
2).

114. MCC witness Towers recommended adjustments to the amounts claimed by PP&L for coal at the Dave Johnston and Jim Bridger plants. Mr. Towers testified:

> I would reduce the Dave Johnston fuel costs to eliminate test year "incentive payments" by PP&L to its affiliated supplier, Glenrock Coal Company. For Bridger, I developed a cost allowance using the method adopted by the Commission in its February 8, 1984 Order No. 5009a in Docket No. 83.5.36. (MCC Exh. 1, p. 7.)

The effect of his recommendations was to reduce the Company's proposed pro forma coal expense by $138,000 (MCC Exh. 1, p. 8).

115. In his prefiled rebuttal testimony, PP&L witness Pearson addressed the Company's position regarding Mr. Towers' proposed adjustments to the cost of coal at the Jim Bridger and Dave Johnston plants:

While the Company does not agree with the adjustments to Jim Bridger and Dave Johnston coal costs, it will accept the calculations of the cost per ton for this proceeding. (PP&L Exh. 21, p. 5.)

116. The Commission continues to agree with the methodology approved in Order No. 5009a of Docket No. 83.5.36 concerning the proper way to determine the cost of coal for the Jim Bridger plant. The Commission also agrees with MCC's position concerning incentive payments paid by PP&L to its affiliate Glenrock Coal Company. Such payments are highly suspect considering the affiliated relationship of the two companies, and the Commission believes that transactions of this nature should be closely scrutinized for the protection of ratepayers so that the consumers are not unduly burdened with unreasonable costs. The Commission, therefore, accepts MCC's proposed adjustments to the Company's pro forma coal expense resulting in a reallocated reduction of $137,000.

Institutional Advertising

117. To be consistent with past Commission decisions, MCC witness Peterson proposed to adjust advertising expense to eliminate test year institutional advertising in the amount of $8,000. He testified that such expenses are not necessary for the provision of safe, adequate, and reliable service and should not be charged to ratepayers (MCC Exh. 3, p. 14). The Company did not rebut this MCC proposal. The Commission, therefore, finds the proposed MCC reduction of advertising expense in the reallocated amount of $8,000 to reflect the elimination of institutional advertising to be proper in this proceeding.

Washington Generating Tax

118. MCC witness Peterson proposed to eliminate the tax on energy produced in the state of Washington by contract hydroelectric and qualifying facilities that had been improperly included in

the Company's filing (MCC Exh. 3, p. 14). The Company did not rebut this MCC proposal, which reduced expenses by $29,000.

The Commission, therefore, finds the proposed MCC reduction of Washington Generating Tax expense in the reallocated amount of $28,000 to reflect the elimination of the improperly included facilities in the calculation of this tax to be proper in this proceeding.

Property Insurance

119. MCC witness Peterson adjusted the Company's estimated annual property insurance premiums to reflect actual post-test year changes in the insurance premiums resulting in a proposed reduction to the pro forma property insurance expense by $7,000 (MCC Exh. 3, p. 15). The Company did not rebut this MCC proposal. The Commission, therefore, finds the proposed MCC reduction of property insurance in the reallocated amount of $7,000 to reflect known and measurable cost increases to be proper in this proceeding.

Sale of Malin-Midpoint Tax Benefits

120. MCC witness Towers proposed to reverse the $71,000 cost of service amortization of the proceeds associated with PP&L's sale of Malin-Midpoint investment tax credits in recognition of the end of the five-year amortization period (MCC Exh. 3, p. 15). The Company did not rebut this MCC proposal. The Commission, pursuant to the similar determination in the Rate Base section of this Order, finds the proposed MCC increase of income taxes deferred in prior years in the reallocated amount of $66,000 to reflect the end of the five-year amortization of

Debt/Equity Exchange

121. MCC witness Peterson proposed to eliminate the Company's proposed $110,000 amortization of its net gain on the 1982 debt/equity exchange to be consistent with MCC witness Dr. Smith's recommendation that the exchange be reversed for ratemaking purposes (MCC Exh. 3, p. 16). The Company did not rebut this MCC proposal. The Commission, pursuant to the similar determination in the Capital Structure section of this Order, finds the proposed MCC increase of income taxes deferred in prior years in the reallocated amount of $106,000 to reverse the effects of the 1982 debt/equity exchange to be proper in this proceeding.

EEI Dues Expense

122. PP&L witness Watson, under cross-examination of Staff Attorney Baker, explained the Company's policy toward payment of Edison Electric Institute (EEI) dues:

> Generally the Company has refused to pay EEI some of the advertising costs. And we feel that's directly related to the lobbying activity. Absent that, we pay dues to EEI--but we don't pay as much as they request--subtract out the advertising portion. (TR, p. 35.)

Under cross-examination of Staff Attorney Baker, PP&L witness Pearson further explained the Company's treatment of EEI dues. Mr. Pearson stated that PP&L actually get two bills from EEI, one for general membership dues, the other for EEI's media fund, which is not charged to ratepayers. He related that the Company Mr. Pearson stated that PP&L actually get two bills from EEI, one for general membership dues, the other for EEI's media fund, which is not charged to ratepayers. He related that the Company eliminates 2 percent of the dues for lobbying expenses based on information supplied by EEI (TR, pp. 125-126).

123. The issue of proper ratemaking treatment of EEI dues expense is an issue confronting commissions throughout the country as well as in Montana. As mentioned by Mr. Pearson, the National Association of Regulatory Utility Commissioners (NARUC) has been examining EEI, and some commissions have excluded all EEI dues (TR, p. 126). The Commission has very recently received the NARUC report referred to by Mr. Pearson, and, although the contents are not a part of this record, the report raises many questions about the proper treatment of this expense.

124. The proper treatment of EEI dues expense was examined in the last electric rate filing of Montana-Dakota Utilities Company in Order No. 5036a of Docket No. 83.9.68. In that Order the Commission eliminated 25 percent of the EEI dues expense, among other association dues expenses, and stated, "In making this adjustment, the Commission stresses that all association dues must be fully explained, justified, and quantified in the next general electric rate filing" (Order No. 5036a, Findings 114-115).

125. In making this decision in the case at hand, the Commission relies upon a proven and long-held premise of utility ratemaking that the burden of proof lies with the utility as reflected by the cross-examination of Mr. Pearson by Staff Attorney Baker:

Q. Would you agree, however, that it is the Company's burden of proof to establish the validity of the treatment of the EEI expense?

A. Yes, sir, just as it is for any other expense.

Q. And the burden is not EEI's?

A. No, sir. (TR, 126-127) (TR cite).

126. Based on the decisions of other commissions in the country, the Commission considered eliminating all of EEI dues expense in this case but felt that PP&L should be given the same opportunity afforded Montana-Dakota Utilities Company to justify this expense in the next rate filing. As a fair warning to PP&L, the Commission, therefore, finds the elimination of 25 percent of test year EEI dues in the reallocated amount of $2,000 to be proper in this proceeding. In PP&L's next filing, it must fully explain, justify, and quantify the EEI dues expense in order to avoid the total elimination of that expense.

Public Affairs Expense

127. In response to PSC staff audit Data Request No. 20, the Company explained the expenses in the amount of approximately $3,000 under Dept. 989 Public Affairs for Federal Affairs, Montana Legislation, and Miscellaneous. The Company responded:

> The charges for Montana legislation represent services related to amendments to Montana's major facility siting act, review and analysis of various Montana House Bills, review of statutes regarding consolidation and sale of property, and attendance at House Hearings on HB 294....The Federal Affairs and Miscellaneous expenses that are allocated to Montana on Note 21 include services related to federal legislative developments, hydro relicensing, IRS regulations regarding business and personal use of automobiles and computers, legal

> research on a presentation before the National Recreation and Park Association, and legislation to limit liability in injury claims. (PP&L Response to PSC staff audit Data Request No. 20.)

In that same response, the Company justified the allocation of these costs to Montana by saying that these expenses are incurred in the best interest of the Company and all its customers. During cross-examination by Staff Attorney Baker, Mr. Pearson described most of these activities as informational in nature for the benefit of those Company employees who might be affected by these legislative matters (TR, pp. 188-19O).

128. The Commission is very skeptical of expenses directly tied to legislative matters. The benefit to ratepayers is very questionable in that it is likely that many of the activities being monitored are sponsored by or tend to favor utility interests, which often oppose ratepayer interests. The Commission, therefore, finds the elimination of public affairs expenses in the reallocated amount of S3, 000 to be proper in this proceeding.

Outside Services - Investor Relations Expense

129. In its response to PSC staff audit Data Request No. 21 concerning outside services expense, the Company explained the nature of the investor relations expense of $21,892:

> Investor Relations Expense, $678,159 or $21,892 allocated to Montana, includes fees for consultants performing services such as surveys, research, writing, printing, graphics, advertising, analyst tours, and media development. These services are on behalf of brokers, analysts, annual reporting functions, communications, etc. These charges are allocated on Note 21 since they are necessary expenses associated with raising capital for the Company. (PP&L Response to staff audit Data Request No. 21.)

130. Under cross-examination of Staff Attorney Baker, Mr. Watson of PP&L said that the customers benefit from an investment relationship program because it helps to make PP&L stock more marketable (TR, p. 28). Concerning stockholder benefits from this expense, Watson testified:

> The stockholder gets a fair shake if, in fact, all of the things that we do in the investor community allow the stockholders a better opportunity to achieve their cost of capital. (TR, p. 29.)

131. The Commission believes that this is an expense where obvious benefits exist for both the stockholders and the ratepayers. As a result, a sharing of costs is a fair approach to handling this issue. The Commission, therefore, finds the elimination of half of the per books expense concerning investor relations in the reallocated amount of $11,000 to be proper in this proceeding.

Outside Services - Corporate Executive History Development

132. In its response to PSC staff audit data request No. 21 concerning outside services expense, the Company explained the corporate executive history development expense:

> Corporate Executive History Development, $35,729 or $1,153 allocated to Montana, involved charges for the development of a corporate history and the adaptation of the information to printed materials, speeches, etc. to be used in conjunction with PacifiCorp's 75th anniversary. The charges were divided among Pacific Power (electric), NERCO, and Pacific Telecom. The charges were allocated on Note 21 because the information was collected and distributed to customers, shareholders, and the general public throughout the system. (PP&L Response to PSC staff audit Data Request No. 21.)

133. The Commission believes that expenses associated with the celebration of the Company's 75th anniversary are a benefit to stockholders, but ratepayers should not be responsible for such costs because the Company has not demonstrated any benefits for the ratepayers through this celebration. The corporation executive history development expense does not in any way serve the customers or improve the quality of service. The Commission, therefore, finds the elimination of corporation executive history development expense in the reallocated amount of $1,000 to be proper in this proceeding.

WDSI Legal Expense

134. In response to PSC staff audit Data Request No. 19 concerning the legal expense charge relating to Western Distribution Service, Inc. (WDSI) appearing on page 96 of Workbook 2, the Company explained:

> The legal expense charge relating to Western Distribution Service, Inc. should have been charged below the line. An adjustment was made to reverse the entry in May 1985. (PP&L Response to PSC staff audit Data Request No. 19.)

135. The Commission agrees with the Company's explanation that WDSI legal expenses should have been charged below the line and the entry should have been accordingly reversed. The entry reversal, however, did not occur until two months after the end of the test year in this case, which means that, since no related adjustment was proposed, the WDSI legal costs have improperly been included in the pro forma legal expenses. The Commission, therefore, finds the elimination of the WDSI legal expenses in the reallocated amount of $1,000 to be proper in this proceeding.

WDSI Savings

136. In its response to PSC staff audit Data Request No. 11, the Company provided some information regarding its new supply subsidiary, Western Distribution Services, Inc., WDSI. The Company reported that WDSI began operations in early 1985 and is a materials and supply subsidiary providing materials purchasing, warehousing, and distribution activities to PP&L and other companies, allowing PP&L to achieve volume discounts and economies of scale (PP&L Response to PSC staff audit Data Request No. 11). PP&L calculated that annualized savings related to the operation of WDSI since March of 1985, representing reductions in the cost of goods purchased, are approximately $30,000 for Montana (PP&L Response to PSC staff audit Data Request No. 11, part d). The Company also calculated annualized salary savings of $18,236 for Montana because of a related reduction in the number of PP&L employees that were transferred to WDSI (PP&L Response to PSC staff audit Data Request No. 11, part b).

137. Concerning the labor expense savings of approximately $18,000 for Montana, Mr. Watson testified while under the cross-examination of Staff Attorney Baker, "We reduced the cost by that

level in one area, but correspondingly, those costs will be increased in another area, absent the 5 percent outside sales" (TR, p. 23). Watson explained that the increases related to the labor costs that would be included in the cost of the goods purchased from WDSI by PP&L (TR, p. 23). The 5 percent represents labor costs that PP&L should save because WDSI customers other than PP&L would be covering these labor costs through their purchases of goods from WDSI.

138. Concerning the $30,000 of cost savings related to cost of goods purchased since March of 1985 Mr. Watson testified:

> We estimated total company savings of approximately one million [dollars] and then allocated a certain portion of that to Montana [$30,000]. We feel that we have a fairly decent handle on the kinds of discounts that WDSI is getting that Pacific as a utility wouldn't be able to have offered to it, as well as some volume discounts that company's getting. (TR, pp. 23-24.)

139. The Commission believes that the creation of WDSI is an example of a utility parent/subsidiary operation that can prove quite beneficial to ratepayers by reducing the utility's cost of service. This parent/subsidiary operation will naturally be the subject of much continued scrutiny in the future, but the benefits should not be held back from the ratepayers in the meantime. The cost reductions associated with WDSI are a known and measurable change that began occurring immediately after the end of the test year, and not to flow through these cost reductions that have been ongoing since early 1985 would be to penalize the ratepayers. The Commission realizes that the savings provided in the Company's response to PSC staff audit Data Request No. 11 are not exact to the dollar, but accepts them as the Company's best effort to annualize the savings which were actually occurring in 1985. The Commission appreciates Mr. Watson's concerns that only 5 percent of the related labor expense will actually be realized as a savings due to WDSI sales to other utilities. The Commission, therefore, finds a reduction in expenses in the amount of $31,000 [30,000 + (18,236 x .05)] to reflect known and measurable savings stemming from the WDSI operations to be proper in this proceeding.

140. In response to PSC staff audit Data Request No. 23 concerning cost savings at the Centralia plant due to the work of the Centralia Impact Team, the Company explained:

> The research for the Impact Team's project was performed during the 1985 annual overhaul and the findings were presented in July 1985. The results of these findings suggested a significant cost savings and therefore the preventative maintenance procedures suggested by the team will continue to be practiced at Centralia to make operations more efficient. (PP&L Response to PSC staff audit Data Request No. 23, part b2.)

By comparing the 1984 year end station heat rate at the Centralia plant to the 1985 year end station heat rate, the Company calculated an annualized savings of $5,074,599 or $68,000 allocated to Montana. The Company stated in the response that it would not support an adjustment in this case to Centralia's coal costs based on this information since the cost savings are estimated at this time and would be recognized and incorporated in future rate filings through the actual cost of coal (PP&L Response to PSC staff audit Data Request No. 23, part b3).

141. The Commission believes that the organization of impact teams and the implementation of their cost saving recommendations are very positive efforts on the part of PP&L in ongoing programs to reduce overall costs while not reducing the quality of service to its customers. Certainly the ratepayers will benefit from the results of such efforts by different impact teams through reduced cost of service in the future, but the benefits from the cost saving proposals implemented at the Centralia plant from the work of the Centralia impact team should not be held back from the ratepayers in this case. The cost reductions associated with the Centralia plant are a known and measurable change that began occurring immediately after the end of the test year. Indeed, in Attachment 23b to PP&L's response to PSC staff audit Data Request No. 23, part tel., the report indicates that the Centralia impact team made a presentation on these cost savings on March 7, 1985, which is before the end of the test year. Not to flow through these cost reductions that have been ongoing since the middle of 1985 would be to penalize the ratepayers. The Commission realizes that the savings provided in the Company's response to PSC staff audit Data request No. 23 are not exact

to the dollar, but accepts them as the Company's best effort to annualize the savings which were actually occurring in 1985. The Commission, therefore, finds a reduction in expenses in the reallocated amount of $67,000 to reflect known and measurable savings stemming from the implementation of the recommendations of the impact team at the Centralia plant to be proper in this proceeding.

PacifiCorp Trans, Inc.

142. In response to PSC staff audit Data Request No. 10b concerning the Board of Directors meeting held october 10, 1984, the Company explained the formation of PacifiCorp Trans, Inc. (Trans), a subsidiary of PP&L which began operation on October 1, 1984:

> Prior to establishment of Trans, PP&L, NERCO, and PTI each owned and maintained their own aircraft. The costs of those aircraft owned by PP&L were charged to electric operating and maintenance expense accounts. When electric operations' personnel used aircraft owned by affiliates, the affiliate cross-charged electric operations. Consolidation of all PacifiCorp aircraft into one operation through the formation of a subsidiary simplified the process and created a clear standard procedure for efficient use of and charging for flight services. (PP&L Response to PSC staff audit Data Request No. 10b, part 2.)

143. In that same response, the Company listed some of the main benefits and cost savings associated with the creation and utilization of Trans: economies of scale such as the use of in-house maintenance, large volume discounts in parts and purchased fuel, and reduction of total administrative and management labor time; savings on commercial ticket sales from entering into a joint venture partnership with Travelwise; the immediate access to a larger, more versatile aircraft fleet without incurring the full cost of maintaining such a fleet; and isolation of all cost elements for accurate identification and reporting (PP&L Response to PSC staff audit Data Request No. 10b, part 5).

144. The Commission believes that the proper utilization of Trans by PP&L could result in sizeable cost savings over time, which is a benefit to both the Company and its ratepayers. This operation was in effect for six months of the test year resulting in some savings being reflected in the per books

numbers. As stated by PP&L witness Pearson (TR, p. 185), such test year cost savings should be annualized as a known and measurable change to allow the ratepayer to realize the benefit of such reductions in expenditures. In this particular instance, however, the Commission did not feel comfortable enough with the data that was presented to make an adjustment to annualize these cost savings. The Company agrees that the savings are real, but the Commission was unable to quantify the Montana-specific annualized cost savings. The Commission, therefore, finds that an adjustment annualizing cost savings related to the utilization of PacifiCorp Trans, Inc. is inappropriate in this proceeding.

145. This issue is frustrating to the Commission in that an adjustment to reflect the annualization of such cost savings seems quite appropriate, but implementation of the annualized reduction has been denied because of insufficient data. The Company should have proposed such a reduction in its original filing or at least alerted MCC that such savings are being realized and could be annualized with updated information. That statement may sound somewhat naive based on the roles of the parties in such proceedings as this one, but the utility should not forget its obligation to provide the highest possible quality of service at the lowest possible cost. Those words do not have empty meaning to the Commission. The Company is obviously taking many measures to reduce costs, certainly laudable efforts, but to allow the ratepayers to benefit from these reductions on a per books basis only is an unreasonable and improper approach. In future cases, the Commission encourages PP&L to make every effort to reflect known and measurable cost savings in its filing.

Off-System Sales Update

146. In keeping with the Commission's observations in the above Finding, the Company proposed during the hearing an update to off-system sales that would reflect a wholesale sales price of 19 mills per Kwh, resulting in an increase in revenue requirement of approximately $600,000 (TR, pp. 8, 94-97). Through a discussion between the MCC, Mr. Paine, and the Company attorney, Mr. Galloway, the Commission learned that the Company provided this data to indicate that it could increase the amount it could justify, but the Company was only putting this forward as further evidence of the reasonableness of its requested revenue increase of 3,500,000 (TR, pp. 98-99).

147. Company witness Steinberg provided the details of this proposed consideration. He discussed the availability and prices of oil and gas to southern California utilities and the effect on the market value of PP&L's power (TR, pp. 94-97). Steinberg concluded that if the wholesale market is valued at 19 mills per Kwh in this case, the wholesale power revenues would be lower by about $18,700,000 or $607,000 allocated to Montana (TR, pp. 96-97).

148. The Commission views this proposed consideration of the Company with much interest. The Company bases its testimony on occurrences happening in California beginning in 1986, events that have certainly not withstood the test of time to determine their reasonableness for being considered as a known and measurable change. Indeed, the hearing in this case was held beyond 12 months after the end of the test period. More importantly, this proposal and all its inherent assumptions were not the subject of any discovery or prefiled testimony. Therefore, based on these observations alone, the Commission denies the Company's proposal made during the hearing that PP&L's perception of the current California wholesale power market should be considered in this proceeding.

149. The post-test year adjustments allowed in this case do not likely represent all of the known and measurable changes that have occurred since the end of the test year. Without harming the integrity of the test year concept, however, the Commission has reflected many known and measurable changes that have served both to increase and decrease PP&L's revenue requirement (examples: labor expense and property insurance - increases; Centralia plant expenses and WDSI savings - decreases). The adjustments, unlike PP&L's proposed wholesale power market update, were the result of much analysis and were scrutinized by all parties in the case. To meet these requirements for this proposed update would necessitate, as intimated by MCC (TR, pp. 99-100), a new procedural schedule to allow for proper discovery
and the filing of related testimony with the opportunity for cross-examination.

Interest Synchronization

150. MCC witness Peterson calculated pro forma interest expense in an effort to include interest on construction. His interest expense derived for the purpose of developing an income tax allowance

reflected his proposed rate base and Dr. Smith's proposed pro forma interest rate, including the flow-through of interest on Montana's test year construction work in progress (CWIP) (MCC Exh. 3, p. 16).

151. The Commission finds that an interest synchronization adjustment is proper to reflect the tax effect of interest on construction. By utilizing the approved rate base and weighted cost of long-term debt in the methodology, the Commission finds an increase to Montana Corporation License Tax in the amount of $2,000 and an increase to Federal Income Tax in the amount of $11,000 to be proper in this proceeding.

REVENUE REQUIREMENT

152. The following table shows that additional annual revenues in the amount of $1,970,000 are needed by the Applicant in order to provide the opportunity to earn an overall return of 10.27 percent:

PACIFIC POWER & LIGHT COMPANY -- Docket No. 85.10.41
FINAL Revenue Requirements Chart
To Produce 10.27% Rate of Return
Test Year March 31, 1985
000

	PP&L.Pro Forma at 3.08% Factor	Total Accepted Adjustments	Accepted Pro Forma	Increase For 10.27% Return	Approved Total
Operating Revenue	$30,997	$273	$31,270	$1,970	$33,240
Operating Revenue Deductions .					
Operating Expenses	$18,492	($268)	$18,224		$18,224
Depreciation and Amortization	2,750	0	2,750		2,750
Taxes Other Than Income .	1,179	(28)	1,151	$2	1,153
State Income Taxes	295	40	335	133	468
Federal Income Taxes					
FIT @ 46%	1,877	255	2,132	844	2,976
ITC @ 85%	(1,018)	0	(1,018)		(1,018)
Net Federal Income Taxes	859	255	1,114	844	1,958
Deferred Income Taxes	357	0	357		357
Income Taxes Deferred in Prior Years	(322)	172	(150)		(150)
Investment Tax Credit Adjustment	1,012	0	1,012		1,012
Total Operating Revenue Deductions	$24,622	$171	$24,793	$980	$25,773

Net Income	$6,375	$102	$6,477	$990	$7,467
	===========	===========	===========	===========	===========
Average Rate Base	$72,743	($63)	$72,680		$72,680
	===========	==========	==========		==========
Rate of Return	8.76%		8.91%		10.27%
	===========		========		=========

PART E
OTHER ISSUES
Income Tax Tracker

153. In his prefiled testimony, MCC witness Peterson proposed to include a tax rate change tracking mechanism in the Company's Montana tariffs to pass along the benefit to ratepayers if PP&L's Federal corporate income tax rates are reduced by Congress. Mr. Peterson based his proposal on current legislation that is being considered by Congress. He listed some of the tax revision proposals as the elimination of the investment tax credit, revisions in depreciation deductions, and a substantial reduction in the maximum corporate income tax rate. Peterson was concerned with possible overcharges to ratepayers if rates were based on a tax rate that was higher than the corporate tax rate (MCC Exh. 3, p. 35).

154. When asked about the Company's view of Mr. Peterson's proposal, Mr. Pearson responded, "I don't believe we're either endorsing it or rejecting it" (TR, p. 199).

155. The Commission appreciates Mr. Peterson's concerns in this matter, and his proposal is certainly one reasonable approach in handling a change in tax laws. Rather than set up a tariff specifically to address any tax changes, however, the Commission believes that a preferred method is to require the Company to account for these changes, should they occur, immediately upon implementation and to reflect these changes immediately either through an imminent rate case or a filing dedicated entirely to the tax changes. With this approach, the ratepayers will realize immediate relief for any tax changes which serve to reduce PP&L's tax burden. Mr. Peterson's proposal is accordingly denied.

PART F
COST OF SERVICE

156. PP&L provided a calculation of Long Run Incremental Costs (LRIC) and a set of proposed prices which generate the proposed revenue level. The LRIC (Exh. 12 and 13) is utilized to apportion the proposed change in annual revenue to each rate schedule (Exh. 14, pp. 2-4; Exh. 17, Table 3) or class of customers. The LRIC also provides. the basis for setting specific prices within each rate

schedule (Exh. 14, P?. 4-6), although this basis was somewhat qualified over the course of this Docket (see, e.g., Discovery Document SS-1-a, b and TR, pp. 113-115, 120-121). No intervenor in this Docket has provided an opposing position.

157. PP&L's 1985 LRIC calculation represents at least one significant change over previous calculations: rather than de-escalating the single cost of a distant resource addition, the 1985 LRIC computes the levelized discounted present value of a 21-year stream of future generation costs. The inter~m order utilized the 1985 LRIC and the MPSC accepts its use for purposes of the final order as well.

158. In its original filing, PP&L proposed to recover any interim revenue increase via a uniform percent increase to each class' revenue level. On October 18, 1985, PP&L revised this request to allow for price changes on an interim basis that moved toward the Company's final proposal. The Company's final proposal is based on methods largely accepted by this Commission in PP&L's most recent rate case (Docket No. 84.7.38). In arguing for the revision, PP&L cited a concern that a uniform percent increase in the interim would move some prices in the wrong direction relative to the Company's final proposal.

159. In the interim order (Order No. 5169), the Commission allowed the $1.7 million interim increase to be spread to the various classes based on the 1985 LRIC. Before accounting for the BPA exchange credit, the percent increases to the "major schedules" revenue requirements were as follows: Residential (8.5%), Small General Service (5.7%), and Large General Service (1.8%).

160. The Commission also approves of the Company's proposal to achieve final rate spread goals based on "obtaining an amount equal to a uniform percentage of the difference between each class' present revenue and their marginal cost" (Exh. No. 14), for the "major schedules". Given the final approved revenue increase of $1,970,000 (in lieu of the interim), each major class will roughly experience the following final increase in revenue requirements (in lieu of the interim and before accounting for the BPA exchange credit): Residential ($1,315,000), Small General Service (Rates 22, 24 and 36) $550,000 and Large General Service $105,000. In refining these allocations, PP&L must revise the 55 percent factor to reflect the final approved revenue requirement, relative to the

company requested $3,508,000. The Company must also reflect the Commission's rejection of certain normalization adjustments (i.e., Finding No. 106 above). Detailed workpapers must be submitted documenting these changes, as well as, each class' final prices.

PART G
RATE DESIGN
Residential

161. Within the residential rate schedule (Sch. 7), PP&L proposes two changes in price structure: an increase in the Base Rate from $2 to $4 and a reduction of one-half in the inverted differential in the energy/demand price (Exh. 14, p. 4). In support of its proposed Base Rate, PP&L cites the LRIC study which suggests a full cost level of $10. In support of the proposal to reduce the inverted differential, PP&L cites its conformance with the PSC's previous order (Docket No. 84.7.28, Order No. 5128) and avoidance of customer impact.

162. The Base Rate proposal and the proposed reduction in the inverted differential are related via the unit LRIC and average unit revenue requirement. The level of the Base Rate and the initial block(s) have been reduced (e.g., Docket No. 6728) and increased (e.g., Docket No. 84.7.28) as needed to develop price signals which reflect marginal cost. In the Interim Order, the PSC allowed the Base Rate and both blocks of the two-step inverted energy rate to increase by an equal percentage, thus rejecting the proposal to reduce the inverted differential (Finding Nos. 22-24). At the time, this rejection was based on the absence of any cost support which would indicate that an increase in the Base Rate and initial block was necessary to balance tail block energy prices with marginal cost. The marginal cost information provided by PP&L - the LRIC still does call into question the cost basis for eliminating the differential. (See Finding No. 22 of Interim Order No. 5169.)

163. In response to data request (No. SS-1-a, b) and in cross-examination (TR, pp. 113-115, 120-121), PP&L cites the need to also consider short run marginal costs in setting prices, especially when the market conditions indicate the presence of short run surplus or shortage. PP&L estimates a short run energy/demand cost of around $.025/kwh (TR, p. 120). The existing tail block price is

$.0605/kwh. PP&L also cites the avoidance of customer impact as the only reason for not proposing to eliminate the inverted differential entirely (TR, p. 121).

164. The Commission finds that the residential rate inversion should be reduced and the Base Rate increased to generate this class' final revenue requirement, as discussed in the following. The seasonal differential shall remain. The Base Rate should be increased up to a ceiling of $4/month and the commodity prices lowered to generate the class' increased revenue requirement. So that the inverted differential is reduced, the percentage reduction in the tail-block rate must be twice the percentage reduction in the initial block rates.

165. Generally, the Company should note the Commission's concern for moving away from the Company's LRIC results towards LRIC estimates for pricing decisions. The record in this docket provided late and scanty testimony on this issue [e.g. TR 120 and Data Response SS-l-a]. The new direction proposed by the Company involves major economic and policy issues that reach beyond a PP&L rate case. Until such time the economic and policy issues (e.g., see Dr. Alfred Kahn's testimony in the Oregon PUC Docket UE-44, Data Response SS-1-b) are thoroughly addressed, the Company's LRIC will be the basis for future pricing decisions.

Small General Service

166. PP&L proposes (Exh. 13, pp. 4-5) to increase the fixed component of the General Service (Sch. 22/24) Base Rates from $3.75 to $5.75 for single phase less than 100 kw loads, and from $7.50 to S10.50 for -customers with greater than 100 kw of demand. Increases for three phase Base Rates were also proposed. The PSC finds that any final revenue increase must be to the fixed component of the Base Rates as proposed by the Company, but with no increase in excess of the Company's proposal. The current Base Rates should be increased by a uniform percent.

Large General Service

167. For Large General Service (Sch. 48T), PP&L proposes (Exh. 14, pp. 5-6) to 1) to increase the base rate from $50 to $65, 2) create a variable distribution-related price element of $.50/kw of load

size, and 3) apply the residual class increase to exclusively the demand charge, leaving the energy charge at its existing level. In the Interim Order, the PSC authorized a uniform percent increase to each price on this schedule except the energy price. The PSC found that the existing energy price was 38 percent greater than the energy LRIC. The PSC accepts the proposed price changes for Sch. 48T. Any necessary residual increase over and above the increased base rates and variable distribution charge should be applied exclusively to the demand charge.

168. For certain rate schedules, PP&L proposes (Exh. 14, p. 6) to apply the class increase evenly to the energy and demand price elements (Schs. 36 and 54) and, in the case of street lighting (Sch. 52 and 53), to the commodity charge only. With the exception of Schedule 36, this proposal is accepted. Based on current Sch. 36 energy charges relative to the LRIC results for schedules 22/24/36, the Company's proposal appears to move energy prices in the wrong direction. Until the Commission receives a counter proposal, the Company is directed to apply a uniform percent increase to all but the energy charges on Schedule 36.

169. PP&L proposed (Exh. 14, pp. 6-7) to establish two "partial requirements" price schedules. The two new schedules (Sch. 32 and 33T) correspond with the existing general service and large general service price schedules, but feature standby charges (50% of the otherwise applicable demand charges) tailored to recover the capacity costs associated with providing capacity to consumers who utilize their own generation. The PSC finds that, pending an examination of whether the Montana cogeneration and small power production rules will allow such pricing (see, ARM 38.5.1908 rates for sales), it would be premature to provide a ruling on this proposal.

CONCLUSIONS OF LAW

1. The Applicant, Pacific Power and Light Company, furnishes electric service to consumers in Montana, and is a "public utility" under the regulatory jurisdiction of the Montana Public Service Commission. Section 69-3-101, MCA.

2. The Commission properly exercises jurisdiction over the Applicant's rates and operations. Section 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 rate level and rate structure approved herein are just, reasonable, and not unjustly discriminatory. Section 69-3330, MCA.

ORDER

1. The Pacific Power and Light Company shall file rate schedules which reflect increased annual revenues of $1,970,000.

2. The increased rates authorized herein shall be effective for service rendered on and after July 9, 1986.

3. Rate schedules filed shall comport with all Commission determinations set forth in this Order.

4. The Applicant's tariff submittal shall reflect the current BPA Exchange Credit for qualifying schedules.

5. The Company is required to explain the impact of including and excluding the weather normalization adjustments on LRIC cost of service and rate design:

a) The Company must submit workpapers showing the impact on LRIC Cost-of-Service class revenue allocations of including and excluding, in the LRIC, the following temperature normalization adjustments: residential (10,344 MWH), Sch. 22 (3,355 MWH) and Sch. 24 (224 MWH). In the comparison, any necessary changes in the general business sales revenues, sales for resale etc., must be included. That is, the starting and ending general business sales revenues must vary for the two scenarios.

b) The Company must explain the basis and purpose of the "Cycle/Calendar" ratio as it appears in the Company's "Documentation and Workpapers For Exhibit 17".

c) The Company must provide all workpapers and a narrative explaining the derivation of the final "Cycle/Calendar" ratios. The impact of excluding and including temperature normalizations must also be explained with a narrative.

d) So that the Montana Consumer Counsel has an opportunity to analyze the impact of the Company's temperature normalization adjustments on LRIC Cost-of-Service and Rate De sign, the Company must provide the MCC copies of all related workpapers.

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

DONE AND DATED this 9th day of July, 1986, by a 3 - 0 vote.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

____

CLYDE JARVIS Chairman

____

HOWARD L. ELLIS Commissioner

____

DANNY OBERG, Commissioner

ATTEST:

Trenna Scoffield
Secretary
(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.