

Service Date: April 16, 2004

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

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IN THE MATTER OF ENERGY WEST) UTILITY DIVISION
MONTANA, Application for Automatic Rate) DOCKET NO. D2003.12.165
Adjustment and Tracking for Taxes and Fees) ORDER NO. 6556

PROPOSED ORDER

Note: This order is a proposed order. Each party has the opportunity to file objections with supporting argument (i.e., briefs) prior to a PSC final order. Objections and supporting arguments must be filed and served within 20 days of the service date of this proposed order. Arguments opposing exceptions must be filed within 10 days thereafter.

FINDINGS OF FACT, CONCLUSIONS OF LAW, AND DISCUSSION

1. On May 5, 2003, Governor Judy Martz signed HB 642 into law providing for public utility automatic rate adjustment and tracking for taxes and fees. The bill was codified at §69-3-308 Montana Code Annotated (Copy Attached).

2. On November 26, 2003 Energy West Montana (EW or Company) submitted to the Public Service Commission (PSC or Commission) rates schedules, tariffs and testimony in support of adjustments for a property tax increase that will be paid by EW pursuant to the property tax statements received by the Company.

3. On December 23, 2003, at a regularly scheduled work session, the Commission authorized an interim revenue requirement of \$455,052 recognizing certain errors and omissions in the filing. Those errors and omissions included:

- a) EW did not account for the income tax decreases due to property tax increases;
- b) EW did not distinguish between taxes paid and taxes expensed;
- c) EW had not proposed to recover its property taxes through an equitable rate design;
- d) EW did not distinguish between taxes on regulated versus unregulated properties; and

e) EW did not file separate rate schedules reflecting property tax recovery.

4. EW filed interim tariffs reflecting the above authorized revenue requirement of \$455,052. Interim tariffs became effective January 1, 2004.

5. The PSC issued on December 31, 2003, a Notice of Opportunity to Comment and Notice of Commission Action on Errors and Omissions. The notice did not include explicit direction on an interim rate design for the recovery of revenues. The Notice asserts that EW has not proposed a supportable rate design or an equitable recovery mechanism. In response to the Notice, EW and the Montana Consumer Counsel (MCC) filed comments. EW's comments do not address rate design except to note that rate schedule changes must include adjustments for the net change in tax liabilities. MCC's rate design comments are limited to the assertion that it supports a "uniform percentage" increase; the MCC, however, acknowledges the risk of bypass, a concern on which the MCC awaits more information.

6. **Revenue Requirement.** In its original filing, EW requested an annual increase in revenues of \$768,020. The increase was requested as a result of an increase in property taxes and as a result of an audit adjustment by the Montana Department of Revenue (MDOR).

7. EW contended that its new annual property tax expense was \$607,003 and that only \$129,712 was included in rates for property taxes necessitating an increase of \$477,291 above what was already included in rates. EW also proposed that the \$477,291 increase for 2003 above what was in rates be amortized over 10 years at \$47,729 per year.

8. The MDOR audit adjustment of \$2,430,000 was a tax only settlement agreement with EW for property taxes from 1992 through 2002. The adjustment is to be paid over a 10 year period with no interest and no penalties being charged. EW proposed an increase of \$243,000 per year for 10 years as a result of the adjustment.

9. EW acknowledged but did not agree with one of the provisions of HB 642, that being that the adjustment for state and local taxes and fees assessed against the public utility must include adjustments for the net change in federal and state income tax liability caused by the deductibility for state and local taxes and fees.

10. Using EW's provided estimated tax rate of 40.75 percent, the effects of the adjustment for taxes resulted in a reduction in revenue requirements of \$312,968 to the \$455,052 that was authorized in the Commission's interim rates.

11. As a result of data requests sent out by staff, it was determined that the property tax on some properties that were included in the property tax increase were in fact property taxes on non-regulated properties. EW had inadvertently included those taxes in its revenue requirement increase request.

12. The annual property tax expense contained a parcel of land that is affiliated with Cascade Gas, a different entity from EW-Great Falls. The property tax on this parcel is \$10,908. This has the effect of reducing the annual property tax increase from \$607,003 to \$596,095 and reducing the 2003 property tax increase amortization from \$47,729 to \$46,638.

13. Of the \$2,430,000 audit adjustment by MDOR, \$2,037,353 is attributable to the EW – Great Falls plant. This resulted in a decrease of annual amortization of the adjustment from \$243,000 to \$203,735 or \$39,265

14. The increase in revenue requirement reflecting the above adjustments is \$424,678. The below table illustrates the adjustments:

| | Energy West Proposal | Tax Adjustment | Data Request Adjustments | Revenue Requirement |
|--|-------------------------|-------------------|-----------------------------|------------------------|
| New Annual Property Tax Expense ¹ | \$607,003 | \$607,003 | (\$10,908) | \$596,095 |
| Property Tax Expense presently included in rates | <u>129,712</u> | <u>129,712</u> | <u>-0-</u> | <u>129,712</u> |
| Annual Increase above what is in rates | 477,291 | 477,291 | (10,908) | 466,383 |
| 2003 Property Tax Amortization ² | <u>47,729</u> | <u>47,729</u> | <u>(1,091)</u> | <u>46,638</u> |
| Total Increase | 525,020 | 525,020 | (11,999) | 513,021 |
| MDOR Tax Audit Adjustment ³ | <u>243,000</u> | <u>243,000</u> | <u>(39,265)</u> | <u>203,735</u> |
| Increase before Income Tax Adjustment | 768,020 | 768,020 | (51,264) | 716,756 |
| Reduction in Tax Liability ⁴ | <u>-0-</u> | <u>(312,968)</u> | <u>20,890</u> | <u>292,078</u> |
| Change in Revenue Requirement | \$768,020 | \$455,052 | (\$30,374) | \$424,678 |

15. **Rate Design.** The following discusses how rates in this docket were implemented on an interim basis and how rates must be modified to be implemented on a final basis, including a rebate for overcharges. To recover the interim allowed revenue requirement change of \$455,052 EW filed and received approval of tariffs that increase rates (\$/ccf) in the same amount. Four customers (MAFB, Montana Refinery, Benefis Hospital and Pasta Montana) were, however, exempt from this interim increase.

¹ The Energy West proposed annual property tax expense is reduced by the property tax expense associated with Cascade Gas. The reduction adjustment for \$10,908 is for property tax affiliated with Cascade Gas.

² EW is proposing to amortize the 2003 portion of the assessment that is not already included in rates over a 10 year period. This is to lessen the rate impact to ratepayers for the 2003 property tax assessment. With the annual increase in rates reduced to \$466,383 from \$477,291, this changes the yearly amortization amount of the 2003 taxes to \$46,638 from \$47,729.

³ MDOR conducted a property tax audit of Energy West for the years 1992 - 2002. As a result of that audit, Energy West agreed to pay \$2.43 million to the State of Montana as payment for past property taxes for those years. The amount is payable over a 10 year period and is a flat dollar amount settlement. There will be no interest expense or penalties incurred by Energy West as a result of that audit. $\$2,430,000 / 10 = \$243,000$ per year. In response to Data Requests by staff, of the \$2.43 million that was assessed, \$2,037,353 is attributable to Energy West Great Falls. This changed the amortization from \$243,000 to \$203,735.

⁴ The income tax rate is estimated to be 40.75% based on EW's original filing.

16. The interim increase was in the form of a new rate element labeled “Property Tax Recovery.” Because EW has other property tax costs that are embedded in existing rates EW reduced the existing “Distribution Base Rates” by its estimate of existing property taxes and, in turn, added the estimate to the interim approved incremental property tax increase of \$455,052. The combined total amount was then collected in the new Property Tax Recovery rate element. The net change in rates, however, only reflected the authorized \$455,052 increase. The interim Property Tax Recovery rate was the same \$.01588/ccf for each customer class.

17. The Commission finds necessary a revision to the above interim recovery of property taxes. To recover the final authorized revenue requirement of \$424,678, EW must flow through this lower overall increase on an “equal percentage basis.” By equal percentage basis, the Commission means that the final \$424,678 allowed revenue level must be recovered as an equal percentage increase to two rate elements, Distribution Base Rates and Customer Charges. The four above noted exempt customers will remain exempt. To compute the equal percentage increase EW must use the Distribution Base Rates and Customer Charge rates in place prior to the approval of interim rates in this docket. As a result, the actual change in Distribution Base Rates and Customer Charge rates will vary by customer class as the Distribution Base Rates and Customer Charges are not the same for each customer class. The actual rate changes that result from an equal percentage increase must replace the interim Property Tax Recovery rate elements that took effect January 1, 2004.

18. Whereas the interim rates approved by the Commission included in the Property Tax Recovery Rate estimated embedded property tax revenues the final rates may not. If it chooses, EW may use its recently filed general rate case (PSC Docket No. D2004.3.46) to identify any existing property taxes that it would then propose be recovered in the Property Tax Recovery Rate element. The Commission would add that whereas HB 642 creates a single issue docket a class cost of service study compliant with Commission rules (ARM 38.5.176) would allow for the full consideration of such costs in conjunction with all other costs relevant to rate design. The next opportunity for such consideration is in EW's recent general rate case filing D2004.3.46.

19. EW must estimate and rebate to customers a credit based upon the difference between the final allowed revenue requirement and the interim revenue requirement. The rebate amount must be computed based on the structure of the interim rate approval and the differential

between the interim and the final allowed revenue levels. The rebate amount must include interest at EW's last approved weighted cost of equity. The rebate must be apportioned to classes in relation to each class's contribution to the total overcharge. For each class, the rebate must be a one-time credit that is itemized on each customer's bill. The amount of the credit should be the same for each customer in each class unless EW has the ability to model for, for example, the actual contributions of customers in a class, in which case EW may have a customer specific rebate.

20. EW is to file work papers in support of its rate calculations. EW must also file revised tariffs implementing this final rate design. Consistent with its billing cycles EW's estimate of overcharges should be as inclusive as is possible. In this regard, an allowance of three work days should be anticipated for Commission staff approval of the compliance tariffs and rebate amounts.

21. EW is a public utility. The PSC has jurisdiction regarding the rates and services of public utilities. See, Title 69, Ch. 3, MCA.

ORDER

22. IT IS HEREBY ORDERED EW shall comply with the terms and conditions set forth above.

Done and dated this 6th day of April, 2004, by a vote of 5-0 (rebate/refund) and 3-2 (rate design).

(Note commissioners dissenting on rate design)

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

BOB ROWE, Chairman

THOMAS J. SCHNEIDER, Vice Chairman

MATT BRAINARD, Commissioner

GREG JERGESON, Commissioner

JAY STOVALL, Commissioner

ATTEST:

Connie Jones
Commission 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 ARM 38.2.4806.

Partial Dissent of Chairman Rowe

I would have preferred to recover the increase from all rates rather than the customer charge and distribution rates only. In other respects, I concur with the Order.

BOB ROWE
Chairman

ATTACHED - MONTANA CODE ANNOTATED 69-3-308

69-3-308. Disclosure of taxes and fees paid by customers of public utility -- automatic rate adjustment and tracking for taxes and fees. (1) A public utility may separately disclose in a customer's bill the amount of state and local taxes and fees assessed against the public utility that the customer is paying.

(2) (a) (i) The commission shall allow a public utility to file rate schedules containing provisions for the automatic adjustment and tracking of Montana state and local taxes and fees, except state income tax, paid by the public utility. The resulting rate schedule changes must include:

(A) adjustments for the net change in federal and state income tax liability caused by the deductibility of state and local taxes and fees;

(B) retroactive tax adjustments; and

(C) adjustments related to the resolution of property taxes paid under protest.

(ii) The rate schedules must include provisions for annual rate adjustments, including both tax increases and decreases.

(b) The amended rates must automatically go into effect on January 1 following the date of change in taxes paid on an interim basis, subject to any adjustments determined in subsection (2)(c).

(c) The amended rate schedule must be filed with the commission on or before the effective date of the change in taxes paid, and if the commission determines that the revised rate schedule is in error, the commission may, within 45 days of receipt of the revised rate schedule, ask for comment and order the public utility to address any errors or omissions including, if necessary, any refunds due customers.

(d) Failure of the commission to issue an order pursuant to subsection (2)(c) is considered approval on the part of the commission.

(e) A public utility may challenge an order issued by the commission under subsection (2)(c) in accordance with the provisions of 69-3-401 through 69-3-405.