

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

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IN THE MATTER OF the Investigation of) REGULATORY DIVISION
the Montana Public Service Commission)
into whether Mountain Water Company's) DOCKET NO. D2016.2.15
rates are Just and Reasonable)

**MONTANA CONSUMER COUNSEL MOTION TO RECONSIDER
ORDER NO. 7475i WITH INTEGRATED BRIEF**

Pursuant to Admin.R.Mont. 38.2.4806, the Montana Consumer Counsel (MCC) requests that the Montana Public Service Commission (PSC or Commission) reconsider several Findings of Fact in its Order No.7475i (Service Date: June 22, 2016). In this proceeding, the PSC investigated whether the rates that Mountain Water Co. (Mountain) charges its Missoula, Montana customers remain just and reasonable following the unauthorized acquisition by Liberty Utilities of Western Water Holdings, the sole owner of Park Water Company, which is the sole owner of Mountain. In Order No. 7475i, the Commission imputed the very low cost of Liberty's acquisition financing as the appropriate cost of debt to use in determining Mountain's approved retail rates, resulting in a rate reduction of \$1,111,484.

In this Motion, MCC will focus the Commission's attention on three specific Findings of Fact in which it believes the Commission has mistaken the basis for the recommendation of MCC's witness, Dr. John Wilson, overlooked binding legal precedent and misstated Montana law. Finding of Fact No. 14 states, in part, that

It is assumed that Mountain Water's equity is available to all potential investors at a 9.8 percent return. In fact, when establishing an appropriate ROE, the identity of individual investors, and the financing sources available to those individual investors are not factors that are considered in the determination of a fair ROE...

As discussed below (and as in most current holding company arrangements), there is just one investor. Here it is Liberty. Finding 14 continues, confusing separate recommendations of Dr. Wilson that rested on different bases. Dr. Wilson never recommended that "Liberty not be allowed to earn the 9.8% ROE..."

Finding ¶ 14. The Commission might view that as an effect of his recommendations but that conclusion would rest on one's view of MWC's capitalization, which is itself clearly hypothetical, and on one's view of the Algonquin financing savings. As to a total disallowance of equity returns, a review of page 18 of Dr. Wilson's testimony (Exhibit No. MCC-1) makes it clear that this recommendation was based simply on the fact that this Commission has not approved Liberty's ownership of Mountain: "Liberty is not entitled to receive any

equity return on its unapproved acquisition and ownership of Mountain Water's equity..." Dr. Wilson was not discussing any method of calculating financing costs in this regard, but an option of not recognizing and rewarding any equity investment until it is appropriately recognized by the regulator, the Commission. Finding of Fact No. 15 is of particular concern in that it fails to recognize a principle of Montana law that may be important in future ratemaking decisions. This Finding states, in relevant part, that

Basing the allowed ROE on the source of the equity owner's financing utilized to procure common equity does not comport to any rate making principle of which this Commission is aware. Use of such a methodology by this Commission would engender an unwarranted new and unique focus of investigation by the Commission when examining acquisitions and mergers.

The approach described in this Finding, known as double leverage, is neither new nor unique and was determined to be a warranted focus of the Commission by the Montana Supreme Court. In the case of Mountain States Telephone and Telegraph Co. v. Dept. of Public Service Regulation, 624 P. 2d 481 (1981), the Montana Supreme Court reviewed a PSC rate determination in which the capital structure of a Montana public utility, Mountain Bell, was financed in part by the debt-funded investment of a parent company.

Most utilities are financed by a mix of debt and equity. The Montana Supreme Court identified this reality as “leverage # 1”. 624 P. 2d 481, 483. The Court then discussed a second level of leverage, the debt financing used by AT&T to partly finance its equity investment in Mountain Bell. The PSC held that the return on equity should be reduced to take account of the reduced cost of equity to Mountain Bell’s shareholder that resulted from that debt financing, “the second or ‘double leverage’”. *Id.*

In summarizing the arguments against the PSC’s adjustment, the Montana Supreme Court noted that “Mountain Bell argues that the principle on which the ‘double leverage’ adjustment is based is that the source of funds determines its costs...” 624 P.2d 481, 485.

The Court rejected that objection and approved the PSC’s double leverage adjustment, stating that “It would appear that the PSC applied the “double leverage” adjustment in order to protect Montana ratepayers from paying excessive utility rates.” 624 P.2d 481, 486.

The import of the Mountain States decision, which has not been reversed by the Montana Supreme Court, is that the source of funding of a Montana public utility’s equity investment is a valid ratemaking consideration by the Public Service Commission. Finding of Fact No. 14 is inaccurate when it states that “Basing the source of the equity owner’s financing utilized to procure common

equity does not comport to any rate making principle of which this Commission is aware.”

While Mountain Water Co.’s witness argued that double leverage has largely disappeared from modern regulation (Exhibit No. MWC-4, p. 8), it seems more likely that the actual practice of financing operating companies with debt incurred at the holding company level has itself gone out of vogue because of regulatory resistance to and treatment of this financing practice. One of the more influential texts on public utility ratemaking also acknowledges the regulatory precedents for considering sources of financing and recognizes the rationale in the Mountain States decision. The latest version of Professor Bonbright’s text discusses this issue as follows:

Double leverage advocates are quick to point out that the parent really is not just another investor...It is a fact that the parent is the only possible investor (in a practical sense), and the subsidiary’s only source of external equity financing. The subsidiary cannot go to the equity market with a stock issue to raise equity capital...Bonbright, Danielsen and Kamerschen, Principles of Public Utility Rates, 2nd, Arlington VA: Public Utilities Reports, Inc. (1988), p. 310.

Finding of Fact No. 15, therefore, inaccurately portrays regulatory precedent and is inconsistent with governing Montana law.

In addition, Finding of Fact 23, when it repeats the suggestion that Dr. Wilson's recommendation of a zero percent ROE is based on the source of financing, also repeats the error in Finding 14. This recommendation was based on the fact that Liberty and Mountain defied the PSC's authority. Until and unless the Commission ruled positively on Liberty's fitness, Dr. Wilson believed that denial of an equity return, based on non-recognition of the equity investment, would be an appropriate regulatory response for Commission consideration.

Conclusion:

The referenced Findings mischaracterize the basis of Dr. Wilson's recommendation. More importantly, when Findings 15 and 23 suggest that the double leverage adjustment is inconsistent with generally accepted rate making principles, they overlook both Montana law and a substantial body of regulatory precedent. These Findings should be stricken or otherwise modified.

Respectfully submitted this 5th day of July 2016.



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