STATE OF ALASKA

THE ALASKA PUBLIC UTILITIES COMMISSION

In the Matter of the Filing of Tariff Revisions, Designated as TA43-4 and TA45-4 (Revised), ENSTAR NATURAL GAS COMPANY for Interim and Permanent Rate Increases	)	U-84-59 ORDER NO. 15

ORDER GRANTING RATE INCREASES; REQUIRING REFUND; PRESCRIBING RATE DESIGN SUBMISSION; AND MANDATING COMPLETION OF CONTINUING PROPERTY RECORDS SYSTEM

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Date: 6-20-17 Exh #H-106
Regulatory Commission of Alaska
U-16-066 By: SIW
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equity is likely to grow at a healthy rate. (T-7, p. 9; T-13, p. 25.) The Commission also notes that the return on equity granted in this proceeding does not expressly include an increment for Beluga or other project financing, and, for that reason as well, it would be inappropriate to continue an associated condition in the form of a restriction on dividends.

(c) Double Leverage

The Commission has previously articulated its policies with respect to when a hypothetical, instead of actual, capital structure should be used for ratemaking and what approaches are appropriate for this purpose. Specifically, the Commission has endorsed the use of a hypothetical capital structure under the following circumstances. First, if a utility's actual capitalization is determined to be inefficient and unreasonable, thereby producing an inflated rate of return, it may be appropriate to substitute a hypothetical capital structure. Second, if the level of debt capitalization subjects the utility to excessive risks, including possible impairment of capital, it also may be necessary to utilize an objective capital structure. Third, if a utility is part of a holding company system in which the utility's book capitalization and capital costs are not a true reflection of the system's capital costs with respect to the utility, its capitalization should be adjusted accordingly.

The common approaches to adjusting actual capitalization under the third circumstance are (1) to substitute the parent's capital structure for that of the subsidiary or (2) to restate the equity investment in the subsidiary in terms of the debt and equity capital of the parent, the so-called double leverage adjustment. (U-78-4(33), pp. 179-184; U-81-41(14)/U-83-40(1), p. 11.)

When a utility is a member of a larger corporate family, its capital structure will be determined in part, if not totally,

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by its parent. In particular, in a regulated environment there is a compelling financial incentive for the parent to maximize the percentage of equity in the utility's capital structure. This stretegy permits the parent to leverage its investment in the subsidiary inasmuch as the utility can be expected to receive a return on equity which is greater than the cost of the debt financing used to create some portion of that equity. In addition, the dollars which can reasonably be returned to the parent in the form of dividends are also increased. In any event, through the capital budgeting process and its own internal investment strategy, the parent generally is the final arbiter of the utility's capital structure.

ENSTAR is part of a larger corporate entity and, thus, may be subject to the aforementioned financial machinations observed generally in holding company situations. While the question of whether a double leverage adjustment was appropriate for ENSTAR surfaced during the hearing, it has not been examined in sufficient detail to permit the Commission to definitively decide the issue. Accordingly, the Commission will place ENSTAR on notice that this question will be considered in its next rate case. By deferring the subject until that time, the Commission will have the benefit of considering ENSTAR's actual operating experience under Seagull ownership, without dividend or capitalization constraints, as a factor in its deliberations. In the interim, the equity ratio used in developing rates in this proceeding is both conservative and developed without input from Seagull.

<u>Rate Case Expense</u>

The Staff and ENSTAR have agreed to the inclusion of $115,000 for rate case expense in the calendar year 1984 test year. This represents an additional $6,164 above the amount requested by ENSTAR in its filing. Staff disallowed all rate case

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