STATE OF ALASKA

THE ALASKA PUBLIC UTILITIES COMMISSION

Before Commissioners: Susan M. Knowles, Chairman
Carolyn S. Guess
Louis E. Agi
Kathleen L. Whiteaker
Peter Sokolov

In the Matter of the Filing of a Tariff Revision, Designated as TA158-121, by the MUNICIPALITY OF ANCHORAGE d/b/a MUNICIPAL LIGHT AND POWER DEPARTMENT for an Interim and Permanent Rate Increase	U-87-84 ORDER NO. 8

ORDER DECIDING REVENUE REQUIREMENT ISSUES AND REQUIRING FILINGS

BY THE COMMISSION:

Introduction

On September 30, 1987, the MUNICIPALITY OF ANCHORAGE d/b/a MUNICIPAL LIGHT AND POWER DEPARTMENT (ML&P) filed a tariff revision, designated as TA158-121, requesting a 10.66 percent interim and a 11.6 percent permanent increase to its rates on an across-the-board basis. Order No. 1, dated December 4, 1987, suspended permanent operation of TA158-121, granted ML&P an interim, refundable rate increase of 5 percent, and designated Commission Staff (Staff) a party to the proceeding. Order No. 1 also vacated the filing schedule which had been previously established in Docket U-87-56 to consider a cost-of-service (COS)

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stated that the methodology is not particularly important so long as the level of rates allowed is adequate, and ML&P's expert witness recommended that the rate base/rate of return metholodogy be used after ML&P builds some equity and escapes what ML&P defines as its present critical financial condition.

For all of these reasons, the Commission has determined that the revenue requirement of ML&P should be established using a rate base/rate of return methodology. However, consideration of the DSC which will result from the rates which are determined through the rate base/rate of return methodology will continue to operate as a further check on the level of rates granted. Such a check is required in order to ensure that that the DSC is sufficient to meet bond covenants. AS 42.05.431.

In determining the return on equity component of the rate of return which should be allowed to ML&P, the Commission believes that it should be possible to avoid much of the expense and argument that generally accompanies resolution of that issue. The Commission generally endorses the recommendation of ML&P's witness Morin that the zone of reasonableness for ML&P's return on equity should be bound on one end by ML&P's cost of debt and on the other end by the return on equity of "comparable" investor-owned utilities. Determination of the specific return on equity which should be allowed in a given case will depend much

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more on factors such as ML&P's current financial condition, equity goals, and management performance than it will on the cost of capital of "comparable" utilities. For that reason, the Commission encourages Staff and ML&P to focus more on these factors than on small differences in the perceived cost of capital to "comparable" utilities, a figure which will form, at most, the top of the zone of reasonableness applicable to ML&P.

In the present case, ML&P should be allowed a return on equity of 13 percent and a hypothetical capital structure of 70 percent debt/30 percent equity. A return on equity of 13 percent is at the top of the 12-13 percent range estimated by ML&P's expert witness as a reasonable return on equity for ML&P. Applying that return to the hypothetical capital structure will produce a return on ML&P's actual equity which is quite high by any standards. Nonetheless, the Commission will allow that return because the Commission is convinced of ML&P's need to increase its equity, which will require present ratepayers to contribute to building that equity.

The reasonableness of the 13 percent return on equity on a hypothetical capital structure is confirmed by the DSC "check." ML&P's expert witness testified that a 13 percent return on a hypothetical 30 percent equity ratio implies a DSC of 1.59. (T-3, p. 24.) This level of DSC is substantially in excess of ML&P's bond covenant minimum requirement; and, therefore,

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