

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

June 10, 2008

IN RE:)	
)	
PETITION OF TENNESSEE AMERICAN)	DOCKET NO.
WATER COMPANY TO CHANGE AND)	06-00290
INCREASE RATES AND CHARGES SO)	
AS TO PERMIT IT TO EARN A FAIR)	
AND ADEQUATE RATE OF RETURN ON)	
ITS PROPERTY USED AND USEFUL IN)	
FURNISHING WATER SERVICE TO ITS)	
CUSTOMERS)	

**DISSENTING OPINION OF DIRECTOR RON JONES WITH REGARD TO
SALARIES AND WAGES EXPENSE AND PENSION EXPENSE**

The above-styled docket came before a panel of the Tennessee Regulatory Authority (“Authority”) during an Authority Conference on May 15, 2007. At that conference, a majority of the panel determined: (1) the salaries and wages expense recoverable by Tennessee American Water Company (“TAWC”) in the attrition period should be reduced to remove the portion of the Annual Incentive Plan (“AIP”) attributable to achieving financial goals¹ and (2) the amount of pension expense TAWC is entitled to recover during the attrition period is \$0.² I respectfully dissent from these determinations and write separately to provide the justification for my decisions.

I. SALARIES AND WAGES EXPENSE

Consistent with the motion made by Director Miller during the deliberations, the majority concluded in the *Order* that it was appropriate to reduce TAWC’s attrition year forecast of salaries and wages expense of \$4,702,966 by \$29,390, an amount offered by the Consumer

¹ *Order*, p. 24 (Jun. 10, 2008).

² *Id.* at 28.

Advocate Division of the Office of the Attorney General (“Consumer Advocate”) as being equal to the portion of the AIP expense attributable solely to the meeting of financial goals.³ As a basis for its decision, the majority asserts that the reduction is consistent with the Authority’s decisions in recent cases.⁴

I agree with the majority that the Authority has in the past disallowed recovery from ratepayers of the expense of incentive plans that reward employees for meeting certain financial goals.⁵ I continue to support that position today. Nonetheless, I am compelled to dissent from the motion and resulting *Order* because I disagree that there is sufficient evidence in the record from which one can conclude that the attrition period salaries and wages expense proposed by TAWC contains any amount attributable to the financial percentage of the AIP expense. To the contrary, it is my studied opinion of the record that the evidence supports only the conclusion that the attrition period forecast does not include an amount attributable to the financial portion of the AIP.

It is undisputed that the AIP includes provisions for monetary incentives to be paid to employees as a result of employees meeting certain financial, operational and personal goals. Given the Authority’s precedent on incentive plans, it is appropriate to investigate whether TAWC is attempting to recover in the attrition period salaries and wages expense an amount equal to the amount of monetary incentives it will have to pay pursuant to the financial goals percentage of the AIP. In my opinion and contrary to the opinion of my colleagues, the record is

³ *Id.* at 24.

⁴ *Id.*

⁵ See, e.g., *In re: Petition of the Consumer Advocate to Open an Investigation to Determine Whether Atmos Energy Corp. Should be Required by the Tennessee Regulatory Authority to Appear and Show Cause that Atmos Energy Corp. is not Overearning in Violation of Tennessee Law and that it is Charging Rates that are Just and Reasonable*, Docket No. 05-00258, *Director Miller’s Motion*, pp. 4-5 (Oct. 25, 2006) (moving to deny Atmos Energy Corporation’s request for recovery of its long-term incentive plan expense) and *Transcript of Proceedings*, pp. 6-8 (Oct. 26, 2006) (voting in favor of Director Miller’s motion with regard to the long-term incentive plan expense).

clear that TAWC did not include in its attrition year forecast of salaries and wages expense an amount attributable to the financial goals portion of the AIP expense.

The evidence in the record, in fact, reveals that expenses related to achieving financial goals were not included in the forecasted AIP expense. Mr. Michael Miller, Treasurer/Comptroller of TAWC, testified in his pre-filed rebuttal testimony as follows:

Q. What is the Company's Position on Mr. Buckner's Assertion that in some years there is no payment of the AIP?

A. The AIP is not intended to be, nor is it, an employee give away. There are aggressive goals concerning financial and operational results, including challenging individual goals for each employee to assure their contribution to service goals. What Mr. Buckner fails to recognize is that for both the TAWC AIP and AIP included in management fees for the attrition year started with the historical test year costs for the AIP. The AIP payments for both 2005 and 2006 did not include an award for the financial category of the AIP, because AWWC did not meet the threshold for the financial target. Therefore, TAWC's attrition year expenses did not reflect any AIP related to the financial portion of the AIP.

If Mr. Buckner's adjustment to AIP cost included in both his salary and wage, and management fee recommendations were accepted, it would eliminate an expense from the attrition year that was not in the attrition year of TAWC's filing. Mr. Buckner's recommendation regarding eliminating the financial portion of the AIP should be disregarded.⁶

During the hearing, Mr. Miller affirmed his pre-filed testimony:

Q. (By Mr. Butler) The consumer advocate has not proposed disallowing the entire annual incentive plan. Do you agree with that Mr. Miller?

A. I agree with that and would like to explain that in the historical year for Tennessee American Water Company, there was no financial payment for 2005 because Tennessee American did not meet its financial goals. Therefore, the base year, the historical base year included no financial component for the AIP, and to eliminate something that was not there in the historical test year in the attrition year is not proper, and that's what I point out in my pages 50 and 51, 52 of my rebuttal testimony. That's my point.⁷

Mr. Miller's testimony that the attrition period forecast does not include expenses related to the financial percentage of the AIP expense is supported by TAWC's responses to Item 13, TN-

⁶ Pre-Filed Rebuttal Testimony of Michael Miller, 51-52 (Apr. 9, 2007).

⁷ Transcript of Hearing, pp. 674-76 (April 19, 2007) (Michael Miller Cross-Examination by the Consumer Advocate).

TRA-01-Q013-LABOR (“Item 13”) and TAWC’s response to Consumer Advocate Discovery Request No. 1, Part II, Question 26 (“Question 26”).

Question 26 asked TAWC to “[p]rovide the forecasted Incentive Payroll (“AIP”) for the twelve months ended February 28, 2008, both allocated and TAWC amounts.” TAWC responded that the total forecasted for TAWC for the attrition year, the amount relevant to the calculation of the salaries and wages expense, was \$97,968. Consistent with the position of the Consumer Advocate, the majority adopted this number as the gross forecast for the attrition year AIP expense.⁸ The methodology used to calculate the gross AIP forecast expense is revealed in TAWC’s response to Item 13, TN-TRA-01-Q013-LABOR, at page 33. This response demonstrates that TAWC began with the 2006 costs accrued thru July 2006 divided by seven and multiplied by twelve to calculate the attrition year AIP expense forecast dollar amount of \$97,968.⁹ The Consumer Advocate failed to provide evidence demonstrating that the AIP expense relating to the financial portion of the plan was included in the test period salaries and wages. During cross-examination, Mr. Buckner testified that he did not perform any analysis of the AIP expense for the test period to determine the payments for operational, individual and financial goals.¹⁰ Later, he stated, “I don’t really know what was in the test period.”¹¹

Thus, if one is to accept that the financial expenses were absent from the actual 2006 numbers and to recognize that the gross AIP forecast for the attrition year was simply calculated by annualizing seven months of 2006 numbers without any additions, then the only reasonable conclusion is that the gross calculation of the attrition year AIP forecast did not include the expense related to the financial portion of the AIP. To me, the critical question here is whether the test period contained expenses related to the financial percentage of the AIP expense. The

⁸ See Pre-Filed Supplemental Direct Testimony of Terry Buckner, Revised P8 (April 3, 2007).

⁹ $(\$57,148/7)*12=\$97,968$.

¹⁰ Transcript of Proceeding, p. 1233 (April 26, 2007) (Cross Examination of Terry Buckner).

¹¹ *Id.* at 1234.

only specific proof responsive to this critical question is the testimony of Mr. Miller. There is no evidence in the record discrediting this proof. Based on the foregoing, I conclude that TAWC's forecast for salaries and wages expense should not be reduced as proposed by the majority. This conclusion is based on my findings that the test year expenses did not include expenses related to funding the financial percentage of the AIP and the attrition period forecast of the AIP expenses portion of the total salaries and wages expense was calculated by simply annualizing seven months of 2006 actual AIP expense.

II. PENSION EXPENSE

Consistent with the motion made by Director Miller during the deliberations, the majority concluded in the *Order* that the attrition period pension expense should be \$0 based on the Actuarial Report from Towers Perrin dated August 2006.¹² The majority further concluded that its decision is consistent with the Authority's past treatment of pension expense.¹³ As with salaries and wages expense, I agree with the majority's recognition of the Authority's past actions, yet I am compelled to dissent because I cannot agree with the analysis of the evidence. To explain, I agree with the majority that the Authority has determined in the past that a company should only be permitted to recover its minimum required pension payments for the attrition year.¹⁴ Moreover, I am of the opinion that this determination represents sound regulatory policy designed to guard against ratepayers bearing the expense of regulated utilities over-funding their pension plans. Moreover, I reject TAWC's contention that it should be permitted to recover its actual contributions.¹⁵ If a regulated utility over-funds its pension plan,

¹² *Order*, p. 28 (Jun. 10, 2008).

¹³ *Id.*

¹⁴ See, e.g., *In re: Petition of the Consumer Advocate to Open an Investigation to Determine Whether Atmos Energy Corp. Should be Required by the Tennessee Regulatory Authority to Appear and Show Cause that Atmos Energy Corp. is not Overearning in Violation of Tennessee Law and that it is Charging Rates that are Just and Reasonable*, Docket No. 05-00258, *Director Miller's Motion*, pp. 4-5 (Oct. 25, 2006) (moving to include a minimum pension contribution of \$0 for the twelve months ended September 2007) and Transcript of Proceedings, pp. 6-13 (Oct. 26, 2006) (voting in favor of Director Miller's motion with regard to pension expense).

¹⁵ Pre-Filed Rebuttal Testimony of Michael A. Miller, pp. 59-60 (Apr. 9, 2007).

it should not be permitted to recover those payments simply because the utility chose to make the payments. There are a variety of reasons for why a company may over-fund its pension plan, some of which may not benefit ratepayers. Despite my agreement with the majority's regulatory policy, I cannot agree that the evidentiary record demonstrates that the minimum required contribution during the attrition period equals \$0.

It is true that the August 2006 Actuarial Report relied upon by the majority contains a minimum required contribution amount of \$0. However, the years examined in that report are the 2005 and 2006 plan years. These years are not included in the attrition period adopted in this docket.¹⁶

There is evidence in the record supporting the conclusion that in fact the American Water Works Company, Inc. ("American Water") affiliated companies will be required to make payments in 2007 and 2008 to meet the ERISA minimums. The attrition period adopted in this docket covers 10 months of 2007 and 2 months of 2008. A letter between two American Water employees lists payment amounts for 2007 totaling \$49.6 million and notes that with the exception of the first quarter amount, which exceeds the ERISA minimums by 7.5 million, the numbers are based on ERISA minimums.¹⁷ Lending support to this evidence of the existence of an ERISA minimum contribution is a draft letter regarding American Water's pension and postretirement welfare projections from Towers Perrin, the company that prepared the August 2006 Actuarial Report. This draft letter indicates that the estimated ERISA minimum required contribution for American Water for plan year 2007 is \$59.0 million and for plan year 2008 is \$56.2 million.¹⁸ In my opinion, there has been no sufficient criticism of this evidence, and I can

¹⁶ Actuarial Valuation Report, Exhibit 25 to the hearing, MS-1 & MS-9 (stating that "[t]he credit balance as of June 30, 2005 will be sufficient to cover any required quarterly contributions for the 2006 plan year based on this year's valuation results").

¹⁷ Letter to Ellen Wolf from Mahaveer Jain dated February 16, 2007, Exhibit 27 to the hearing.

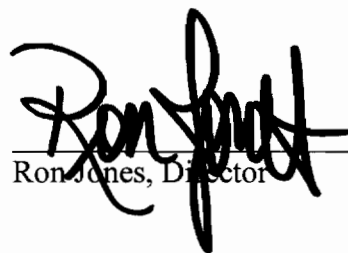
¹⁸ Pre-Filed Rebuttal Testimony of Michael A. Miller, Rebuttal Exhibit MAM-16, p. 13 (Apr. 9, 2007).

find no reason to disregard it. Thus, it is my opinion that the evidence in the record demonstrates that TAWC should be able to recover an amount greater than \$0 for its pension expense.

The amount I calculated for the recoverable expense is \$572,119. This amount equals TAWC's proportional share of the \$49.6 million estimate provided by American Water employees less TAWC's proportional share of the 7.5 million excess multiplied by the operations and maintenance expense factor of 78.79%.¹⁹

III. CONCLUSIONS

Based on the foregoing discussion, it is my opinion that the majority erred in reducing salaries and wages expense by \$29,390 and by allowing \$0 for pension expense. Therefore, I dissent from the majority order. As explained herein, it is my opinion that the reduction to salaries and wages advocated by the Consumer Advocate was not supported by the record and should be rejected. As to pension expense, the evidence weighs in favor of the conclusion that TAWC should be permitted to recover \$572,119.



Ron Jones, Director

¹⁹ $(\$855,492 - (\$7,500,000 * 1.7248\%)) * 78.79\% = \$572,119.40$. The operations and maintenance expense factor of 78.79% was used by TAWC in its calculation of the expense included in the rate case initially. See Tennessee American Water Company Response to TRA Staff Data Request, First Set, Item 13, TN-TRA-Q013-LABOR, p. 15 (Dec. 28, 2006).