

IN THE TENNESSEE REGULATORY AUTHORITY
AT NASHVILLE, TENNESSEE

IN RE:

PETITION OF TENNESSEE AMERICAN
WATER COMPANY TO CHANGE AND
INCREASE CERTAIN 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

DOCKET NO. 10-00189

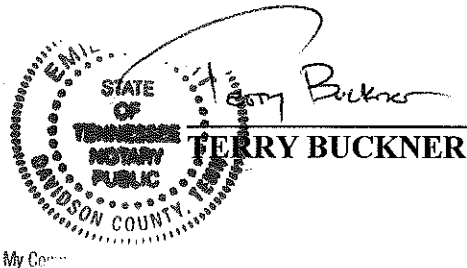
AFFIDAVIT

I, Terry Buckner, Analyst, for the Consumer Advocate Division of the Attorney General's Office, hereby certify that the attached Terry Buckner Rebuttal Testimony represents my opinion in the above-referenced case and the opinion of the Consumer Advocate Division.

Sworn to and subscribed before me
this 24th day of Feb., 2011.


NOTARY PUBLIC

My commission expires: Aug 23, 2011



1 Q. Please state your name for the record.

2 A. My name is Terry Buckner.

3

4 Q. By whom are you employed and what is your position?

5 A. I am employed by the Consumer Advocate and Protection Division
6 ("Consumer Advocate") in the Office of the Attorney General for the state of
7 Tennessee ("Office") as a Regulatory Analyst.

8

9 Q. Are you the same Terry Buckner who previously filed direct and
10 amended testimony in this docket?

11 A. Yes.

12

13 Q. What is the purpose of your rebuttal testimony?

14 A. The purpose of my rebuttal testimony is to provide a response to the
15 information Ms. Pat Schumaker provided concerning the Affiliate Audit Re-
16 port ("Schumaker audit") in a deposition that took place at the TRA on Feb-
17 ruary 18, 2011; and to respond to the revised income tax position of TAWC.

18

19 Q. How useful is the Schumaker audit in terms of determining the appro-
20 priate amount of management fees for the attrition year in this docket?

21 A. While the Schumaker audit contains some helpful information, the
22 audit is not a proper basis to determine the appropriate amount of manage-
23 ment fees included in rates for the attrition year in this docket. Ms. Schu-
24 maker stated during the deposition the audit was conducted from a "busi-
25 ness perspective" rather than a rate-making perspective. (Depo -90-91) She
26 has no opinion or recommendations regarding the appropriate attrition year

1 amount of management fees. (Depo - 91)

2
3 Q. Have there been other audits that have examined the management fees
4 paid by subsidiaries of American Water Works?

5 A. Yes. As stated in my direct testimony¹, the management audit carried
6 out for the New Jersey Board of Public Utilities was just recently made avail-
7 able to the public. The management audit provides a valuable ample com-
8 parison to the Schumaker audit report filed in Docket No. 09-00086 and in
9 this rate case. A "Comprehensive Management Audit of New Jersey Ameri-
10 can Water Company" was performed by NorthStar Consulting Group ("New
11 Jersey Audit") and filed with the New Jersey Board of Public Utilities ("New
12 Jersey Board") on or around December 20, 2010. (See ATTACHMENT) It
13 was released to the public by a vote of the New Jersey Board on February 10,
14 2011. Ms. Schumaker indicated she was generally aware of this proceeding.
15 (Depo -109-110) The New Jersey audit began on January 12, 2010 and the final
16 report is dated December 20, 2010. The timing of the work performed by Ms.
17 Schumaker and NorthStar Consulting roughly overlaps.

18
19 Q. What were the objectives of the New Jersey audit?

20 A. The objectives were to provide an audit to assist the New Jersey Board
21 in determining if management practices, functions, operations procedures
22 and other internal workings of New Jersey American Water Company
23 ("NJAWC") are cost effective. (p. I-1)

24
25

¹ Amended Direct Testimony, T. Buckner, Page 37, Lines 32-33.

1 Q. Did this include the management fees paid to American Water Works
2 Service Company?

3 A. Yes. The New Jersey audit concentrated on areas of management
4 functions and processes, including affiliate cost allocations and affiliate rela-
5 tionships.

6
7 Q. The Schumaker audit and the New Jersey audit have some similar con-
8 clusions?

9 A. Yes. For example, both audits agree that a method of allocating Tier 2
10 cost allocations based solely on the number of customers is not representa-
11 tive of cost-causative principles. (Schumaker audit, p. 40-41, New Jersey au-
12 dit, p. II-7) Both audits agree that the respective contracts between the ser-
13 vice company and the regulated affiliates do not include provisions for some
14 of the services provided by the service company to the affiliates (Schumaker
15 audit, p. 45, New Jersey audit, p. IV-8)

16
17 Q. Are there areas in which the New Jersey audit and the Schumaker audit
18 disagree?

19 A. Yes, there are several areas of disagreement between the two audits.
20 The disagreements are highlighted below:

21
22 (1) Control of service company charges at the regulated company level

23 The New Jersey audit concludes NJAWC does not control the scope or
24 cost of services provided by AWWSC. (p. II-7) The audit goes on to con-
25 clude there is little control over service company costs or budget overruns, or
26 a method of determining the value of services received from AWWSC. The

1 audit goes on to conclude NJAWC has very limited opportunities to "push
2 back" on services or cost assignments from AWWSC. (p. VI-7)

3 The Schumaker audit, on the other hand, concluded the internal controls
4 over affiliate transactions are generally appropriate and TAWC has had more
5 access to service company charge details since November, 2009. (Schumaker
6 audit, p. 37) The service company itself, within the Financial Planning &
7 Analysis Group reporting to the Eastern Division, is responsible for review-
8 ing the charges for appropriateness. (Schumaker audit, p. 36)

9
10 (2) Competitiveness of services provided via the AWWSC agreement

11 The New Jersey audit concluded that "the services provided via the
12 AWWSC agreements are not competitive in terms of "market conditions"
13 and a potential for "cross subsidization" between NJAWC and its affiliate
14 exists." (p. IV-8)

15 Yet, the Schumaker audit examined what Mr. Baryenbruch "had done to
16 see that the company was doing some kind of cost-to-market comparisons.
17 We did not do a specific cost-to-market comparison ourselves." (Depo - 78)
18 Mr. Baryenbruch is employed as a witness on behalf of TAWC in this docket.

19
20 (3) Disparity in Cost Allocation amounts and Direct Charge amounts

21 The New Jersey audit concluded "AWWSC does not direct charge NJAW
22 for its services to the extent possible." (p. II-7) "The primary directive of
23 AWK's cost allocation manual to utilize direct charges whenever possible is
24 not achieved." (p. XIII-9)

25 The Schumaker audit did not have a finding on the subject.
26

1 **(4) Call Centers of the Service Company**

2 The New Jersey audit concludes a 24 hour 7 day a week call center is not
3 necessary. (p. II-4)

4 Again, the Schumaker audit did not have a finding on the subject.

5
6 **(5) Business Development Costs**

7 The New Jersey audit stated the ratepayer receives questionable value
8 from business development activities, but is charged for these activities on a
9 regular monthly basis. (p. IV-9)

10 The Schumaker audit did not examine costs from a rate-making pers-
11 pective.

12
13 **Q. Please summarize your comparison of the New Jersey audit with the**
14 **Schumaker audit.**

15 **A.** In summary, the Consumer Advocate is concerned that the TRA will
16 give TAWC “a clean bill of health for the amount for Management Fees in
17 this rate case”² due to the Schumaker audit. The New Jersey audit affirms
18 the Consumer Advocate’s concern. The Consumer Advocate hopes the TRA
19 will find a just and reasonable amount of Management Fees based on all of
20 the evidence in the record in behalf of the ratepayers of TAWC.

21
22 **Q. Please describe the Consumer Advocate’s issue with TAWC’s revised**
23 **income tax amounts.**

24 **A.** Initially, TAWC “calculated both its accumulated deferred income
25 taxes and deferred income tax expense on a consistent (non SFAS 109) basis

² Amended Direct Testimony T. Buckner, Page 24, Lines 15-16.

1 for only the timing differences in book and tax depreciation which are re-
2 quired to be normalized by the IRS regulations.”³ As a result, TAWC’s initial
3 direct testimony did not include the amortization of the SFAS 109 regulatory
4 assets and has since been referred to as the “APB 11 approach”⁴. Both West
5 Virginia and Virginia utilize the APB 11 approach to book/tax timing differ-
6 ences.⁵ The TRA has implicitly denied the amortization in TRA Docket #06-
7 00290⁶ and #08-00039.⁷

8 Initially, the Consumer Advocate did not include the SFAS 71 regula-
9 tory assets due to SFAS 109, because the TRA has not formally recognized
10 the SFAS 109 regulatory assets through an order. In this docket, the Con-
11 sumer Advocate believed it was “premature” to again include the SFAS 109
12 regulatory assets without the TRA formally memorializing their approval of
13 the SFAS 109 regulatory assets. Regulatory accounting is determined by reg-
14 ulators, not SFAS 71. Paragraph 55 of SFAS 71 states, [SFAS 71] “does not ad-
15 dress an enterprises regulatory accounting. Regulators may require regu-
16 lated enterprises to maintain their accounts in a form that permits the regu-
17 lator to obtain the information needed for regulatory purposes. [SFAS 71]
18 neither limits a regulator’s actions or endorses them.”

19 Since then, TAWC has added \$623,832⁸ to their income tax expense
20 forecast for the attrition year. The amount is referred to as TAWC’s “Re-
21 vised Deferred Tax Calculation SFAS 109 and is the result of the amortiza-
22 tion of regulatory assets, which were created through the normalization of
23 temporary differences flowed-through to ratepayers prior to 1981.

³ TAWC Direct Testimony, M. Miller, Page 58, Lines 16-19.

⁴ TAWC Revised Rebuttal Testimony, M. Miller, Page 34, Line 25.

⁵ TAWC Revised Rebuttal Testimony, M. Miller, Page 39, Lines 12-13.

⁶ TRA Docket #06-00290, Order dated June 10, 2008, Page 38.

⁷ TRA Docket #08-00039, Order dated January 13, 2009, Page 36.

⁸ TAWC response TN-CAPD-03-Q1-ATTACHMENT Page 1 of 2.

1 Subsequently, the Consumer Advocate corrected its "one-legged" en-
2 try by including the SFAS 71 regulatory assets in the rate base to offset the
3 same amount in Accumulated Deferred Income Taxes resulting from SFAS
4 109.

5 Therefore, the Consumer Advocate recommends that the TRA contin-
6 ue to implicitly adopt the APB 11 (or non SFAS 109) approach for setting
7 rates for TAWC, which is consistent with prior dockets for TAWC.

8 However, the TRA may want to explicitly not recognize the SFAS 109
9 regulatory assets and related accumulated deferred income taxes in this
10 docket. A fundamental principle of intergenerational equity is the benefit
11 principle. According to this proposition, ratepayers of each generation
12 should pay for services from which they derive benefit. In other words, they
13 should 'pay their way' without either subsidizing or being subsidized by ra-
14 tepayers in other time periods. This is the core issue at stake in calculating
15 income taxes for setting rates in this docket.

16
17 Q. Does this conclude your rebuttal testimony?

18 A. Yes.
19
20
21