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March 21, 2011

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Via E-Mail and FedEx
Chairman Mary Freeman
c/o Ms. Sharla Dillon
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243

Re: Petition of Tennessee American Water Company
Docket No. 10-00189

Dear Chairman Freeman:

Enclosed please find an original and five (5) copies of the City of Chattanooga's Post Hearing Brief. Please file this electronically. I would appreciate you stamping the extra copy of the document as "filed," and returning it to me in the enclosed, self-addressed, stamped envelope.

With best regards, I am

Sincerely yours,

Frederick L. Hitchcock

FLH:pgh
Enclosures

cc: Mr. J. Richard Collier (w/encl.)
Mr. R. Dale Grimes (w/encl.)
Mr. Vance L. Broemel (w/encl.)
Mr. Ryan L. McGehee
Ms. Mary L. White
Mr. David C. Higney (w/encl.)
Mr. Henry M. Walker (w/encl.)
Mr. Michael A. McMahan (w/enc.)
Ms. Valerie L. Malueg
Mr. Mark Brooks (w/encl.)
Mr. Scott H. Strauss (w/encl.)
Ms. Katharine M. Mapes
Mr. Donald L. Scholes (w/encl.)
Ms. Kelly Cashman-Grams (via email)
Ms. Monica Smith-Ashford (via email)
Ms. Shilina Chatterjee Brown (via email)

BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

IN RE:	)	
	)	
PETITION OF TENNESSEE	)	
AMERICAN WATER COMPANY TO	)	**Docket No. 10-00189**
CHANGE AND INCREASE CERTAIN	)	
RATES AND CHARGES.	)	

CITY OF CHATTANOOGA'S POST HEARING BRIEF

Table of Contents

The City of Chattanooga ("City"), by and through counsel, submits the following Post Hearing Brief.

I.
INTRODUCTION AND SUMMARY OF ARGUMENT

In this brief, the City addresses the 28 percent rate increase sought by Tennessee American Water Company ("TAWC"), the fifth increase sought by the company in seven years. The brief focuses on legal principles applicable to the TRA's consideration of TAWC's rate increase request and addresses TAWC's demands for recovery of three major cost elements: capital expenses, management fees, and legal expenses. The City also addresses the inconsistency of TAWC's claim that it must receive a rate of return on equity that is more than twice the return on equity accepted by investors in TAWC's parent, from which TAWC receives all of its equity.

Applicable law and the record establish that TAWC is not entitled to the unprecedented rate increase that it seeks. In addition to the relief requested by the Consumer Advocate, the Chattanooga Regional Manufacturers Association, and the Utility Workers Union of America, the City respectfully requests:

- That the Authority find that TAWC has not met its burden of proving that additions to utility plant in service claimed in this case are necessary, reasonable, or used and useful, and reduce utility plant in service to the amount approved in the Order in the Docket No. 08-00039 (the "2008 Rate Case") of $209,341,111, less applicable depreciation and other appropriate adjustments;
- That the Authority find that TAWC has not met its burden of proving that the management fees to be paid to American Water Works Service Company

("AWWSC") are reasonable and necessary and reflect prudent management decisions. The City requests that (i) TAWC's total Administrative and General ("A&G") expenses, whether incurred locally or as management fees, be limited to the average A&G expense per customer for peer water companies; and (ii) TAWC's total customer account services expenses, whether incurred locally or as management fees, be limited to the average customer account services expenses per customer for peer water companies, both as reflected by the testimony of Ms. Kim Dismukes. Alternatively, the City requests that total management fees be limited to the amount allowed in the Order in the 2008 Rate Case, $3,529,933;

- That the Authority deny recovery by TAWC of any legal expenses as rate case expenses; and
- That the Authority find that TAWC's requested return on equity of 11.50% is not just and reasonable and that TAWC's rates be set to reflect a return on equity of less than 6%, consistent with that accepted by investors in TAWC's publicly-traded parent, American Water Works Company ("AWWC").

II.
TAWC HAS NOT MET ITS STATUTORY BURDEN OF PROVING THAT ITS PROPOSED RATE INCREASE IS "JUST AND REASONABLE"

TAWC's request for a rate increase should be denied, because the utility has failed to meet its burden of proving that the increase sought is just and reasonable, as required by Tenn. Code Ann. § 65-5-103(a). This burden never shifted to the City or to other parties to prove the contrary conclusion, *i.e.*, that the requested increase was not just and reasonable.

A. Tenn. Code Ann. § 65-5-103(a) Squarely Placed Upon TAWC the Burden of Proving that Its Requested Increase in Rates Is Just and Reasonable.

At all times relevant to the proceedings before the TRA, TAWC had the burden of proving that its requested rates are just and reasonable, a burden that is expressly placed upon TAWC ***by operation of statute***. In clear terms, Tenn. Code Ann. § 65-5-103(a) sets forth in mandatory language the procedure for approving changes or increases in rates charged by utilities such as TAWC:

> When any public utility shall increase any existing individual rates, joint rates, tolls, fares, charges, or schedules thereof, or change or alter any existing classification, the authority shall have power either upon written complaint, or upon its own initiative, to hear and determine whether the increase, change or alteration is just and reasonable. ***The burden of proof to show that the increase, change, or alteration is just and reasonable shall be upon the public utility making the same.*** In determining whether such increase, change or alteration is just and reasonable, the authority shall take into account the safety, adequacy and efficiency or lack thereof of the service or services furnished by the public utility.

See Tenn. Code Ann. § 65-5-103(a) (emphasis added). Thus, while a utility has the power to set its own rates, this authority is subject to the TRA's power to suspend those rates for a limited time during which it is determined if the increase, change, or modification of the rates are just and reasonable. *See* Tenn. Code Ann. § 65-5-103; *Consumer Advocate Div. v. Bissell*, No. 01-A-01-9601-BC00049, 1996 WL 482970, at *2 (Tenn. Ct. App., Aug. 28, 1996), *reh'g denied* Sept. 18, 1996, *no perm. to appeal sought* (copy attached). At all times, the statute places upon the public utility the burden of proving that the increase, change, or alteration is just and reasonable. *See* Tenn. Code Ann. § 65-5-103(a); *see also Consumer Advocate Div. v. Greer*, 967 S.W.2d 759, 762-63 (Tenn. 1998); *In Re: Citizens Telecomms. Co. of the Volunteer State*, Docket No. 98-

00686, 1999 WL 33505914, at *2 (Tenn. Reg. Auth., July 2, 1999) ("Furthermore, pursuant to Tenn. Code Ann. § 65-5-[1]03(a), the burden of proof in justifying rates lies with the public utility. After consideration of the tariffs and the briefs of the parties in this matter, the Directors determined that Citizens of the Volunteer State did not provide such justification for its proposed rate increase in this case, and the Directors voted unanimously to deny Tariff 98-00686.") (copy attached).

That the utility is charged with the burden of proving that any requested increase in its rates is just and reasonable is confirmed by Tenn. Code Ann. § 65-2-109(5), which similarly provides that "[t]he burden of proof shall be on the party or parties asserting the affirmative of an issue; provided, that when the authority has issued a show cause order pursuant to the provisions of this chapter, the burden of proof shall be on the parties thus directed to show cause." This standard is also reiterated in Tenn. Comp. R. & Regs. Rule 1220-1-2-16(2), a provision that similarly provides that the "burden of proof shall be on the party asserting the affirmative of an issue, provided that when the Authority has issued a show cause order pursuant to T.C.A. § 65-2-106, the burden of proof shall be on the party thus directed to show cause." Thus, in at least three separate provisions of law—two statutorily based, and one recognized by regulation—the burden of establishing just and reasonable rates falls squarely upon the utility.

B. <u>The Burden of Proof Placed Upon TAWC Required TAWC to Bring Forth Evidence Sufficient to Support a Finding That Its Requested Increase in Rates Was Just and Reasonable</u>.

The practical consequence of TAWC's bearing the burden to establish that its requested increase in rates is just and reasonable is that the TRA should deny TAWC's requested increase if the Company fails to submit sufficient proof to establish that its

requested rates would be just and reasonable. Although Tennessee appellate courts have not had occasion to address the practical effects of a public utility's failure to meet its burden under Tenn. Code Ann. § 65-5-103(a), courts in other states with similar regulatory schemes have clearly established that a utility's failure to present evidence as to the reasonableness of its request requires denial of the request.

Most recently, the Mississippi Supreme Court faced review of an order by the Mississippi Public Service Commission denying a request by Bellsouth Telecommunications, Inc. for a rate increase for certain telephone service. *See Bellsouth Telecomms., Inc. v. Mississippi Pub. Serv. Comm'n*, 18 So.3d 199 (Miss. 2009). On appeal, Bellsouth argued that the decision of the Public Service Commission to deny the increase was arbitrary and capricious. However, the Mississippi Supreme Court rejected the argument, finding that Bellsouth failed in its burden to show the reasonableness of the requested rates:

> AT&T bore the burden of proof to show its requested rate increase was just and reasonable. The PSC asserted in its order and in its brief to this Court that AT&T ***adduced no evidence at all to establish the just and reasonable nature of its requested rate increase***. AT&T does not dispute this, but relies instead upon the argument it was not required to put on any such evidence given the amendment to Mississippi Code Section 77-3-35(4)(a).
>
> ***Since all parties agree AT&T submitted no evidence to support its requested rate filing, AT&T did not carry its evidentiary burden.*** The absence of evidence was the basis of the PSC order's finding the proposed rate increase was not just and reasonable. There does not appear to be a legitimate basis for finding the PSC was arbitrary or capricious in reaching its conclusion.

18 So.3d at 205 (emphasis added; citations omitted). Thus, in applying a similar burden of proof, the Mississippi Supreme Court recognized that where a utility presents no

evidence in support of its requested rate increase, its requested rate increase must necessarily be rejected.

In *Citizens Utility Bd. v. Illinois Commerce Comm'n*, 658 N.E.2d 1194, 1201 (Ill. App. Ct. 1995), the Illinois Court of Appeals addressed a situation in which the Illinois Commerce Commission approved the request of a telephone local exchange carrier to restructure its rates from flat rates to those based upon usage and to increase its total revenues. Upon a challenge by the Illinois Attorney General that the record contained no proof of—and that the Commission therefore failed to consider—the impact of the rate change on consumers, the Illinois Court of Appeals agreed that the utility failed in meeting its burden of proof. Finding that the applicable statute placed the burden of proof upon the utility,[1] the Court concluded that the utility had failed to meet its burden because it did not bring forth evidence showing the effect of the restructuring on ratepayers:

> The Commission's finding that the restructured rates are just and reasonable is not supported by sufficient evidence because the order reports no evidence concerning the effect of restructuring. Where the utility has presented no evidence concerning the impact of rate restructuring on ratepayers, it has not met its burden of proving the restructuring just and reasonable for those ratepayers.

658 N.E.2d at 1201 (citations omitted). The Illinois Court of Appeals vacated the administrative order approving the rate change. *See id.* The *Citizens Utility Bd.* decision shows that where a utility presents no evidence in support of particular aspects of its requested rate increase, it will necessarily have failed in its burden to show that those aspects of the proposed increased rate are just and reasonable.

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[1] *See* 220 Ill. Comp. Stat. 5/9-201(c) ("In such hearing, the burden of proof to establish the justness and reasonableness of the proposed rates or other charges, classifications, contracts, practices, rules or regulations, in whole and in part, shall be upon the utility.").

Although Tennessee courts have not addressed, in the context of administrative proceedings, what the consequences are of failing to meet the burden of proof by submitting no evidence to support aspects of requested rate increases, the holdings in these cases from other states reflect what Tennessee law generally holds with respect to burdens of proof. For example, the Court of Appeals has recognized that "[w]here a necessary fact is not established, the party having the burden of proving such fact must suffer the loss." *See, e.g., Stockburger v. Ray*, 488 S.W.2d 378, 382 (Tenn. Ct. App. 1972). Indeed, the Court of Appeals has often recognized that "[i]t is axiomatic that, when a party fails to present any evidence on an issue as to which he bears the burden of proof, the party has failed to carry his burden." *See, e.g., Howard v. Howard*, 991 S.W.2d 251, 255 (Tenn. Ct. App. 1999) (citing authorities). Indeed, as the Court of Appeals recognized long ago with respect to burdens of proof generally,

> The necessity of producing this final preponderance is burden of proof, properly so called. It is the essence of such a burden that it can not shift; it is a guarantee as to the result of the entire proceeding. The opponent never has this burden or any share in it. **[The opponent's] position is that he succeeds, if the holder of the burden fails to sustain it either because he is unable to produce enough evidence originally or because the matter is undecided, the scales are even, at the ends.** Accordingly he who has the burden of proof, i.e., the actor, must introduce, at the outset, evidence, or its equivalent, in support of his contention. He must put something into his side of the scales until [the scales], level at the beginning, preponderate to the predetermined extent. This is the burden of evidence.

See Chattanooga-Dayton Bus Line v. Lynch, 6 Tenn. App. 470, 480 (1927) (citations omitted; emphasis added), *perm. app. denied*, Feb.10, 1928.

The City respectfully asserts that where a utility fails to introduce enough evidence to tip the scales of proof to establish the justness and reasonableness of its requested rates, the Authority may not permit collection of such rates.

C. **The Law Places No Obligation Upon the City or Other Intervenors to Bring Forth Evidence to Show that TAWC's Proposed Rate Increase Is Unjust or Unreasonable**.

In what perhaps seems an obvious point of law, Tenn. Code Ann. § 65-5-103(a) does not provide any mechanism by which the statutory burden of proof could shift to parties other than the utility seeking a change or increase in rates. For example, the statutory burden of proof ***does not*** accord the utility a ***presumption*** that its requested change or increase in rates is just and reasonable, thereby shifting to other parties the burden to prove that the proposed changes are unjust or unreasonable. Moreover, Tenn. Code Ann. § 65-5-103(a) ***does not*** shift the burden of proof ***upon production of evidence*** by the utility tending to support a finding of a just and reasonable rate, but rather places the burden of establishing the justness and reasonableness of the proposed rates on the utility at all times.

Indeed, when deciding whether the proposed increased rate is just and reasonable, or when deciding what increased rate would be just and reasonable, the TRA may utilize its experience, technical competence, and specialized knowledge, ***but only in the evaluation of evidence presented to it.*** *See* Tenn. Code Ann. § 65-2-109(4); Tenn. Code Ann. § 4-5-314(d). This statutory scheme involving the decision-making process of administrative agencies clearly contemplates that the utility must produce evidence in support of a request for a rate change, and the evidence considered by the TRA must be in the record. As Tenn. Code Ann. § 4-5-314(d) establishes, "Findings of fact shall be based exclusively upon the evidence of record in the adjudicative proceeding and on matters officially noticed in that proceeding. The agency member's experience, technical competence and specialized knowledge may be utilized in the evaluation of evidence."

Taken in context, the statutory burden of proof at issue in this case is really only a reflection of the law as it has existed for some time. As the Court of Appeals has long recognized in the scope of administrative proceedings, once the burden of proof has been placed upon a particular party with respect to an issue, "that burden does not shift" later to other parties. *See, e.g., Big Fork Min. Co. v. Tenn. Water Quality Control Bd.*, 620 S.W.2d 515, 520 (Tenn. Ct. App. 1981). Accordingly, it is clear that the City and other Intervenors did not possess any burden to show that the rate increase requested by TAWC was unjust or unreasonable. Rather, the burden of showing that the requested rate increase was just and reasonable remained with TAWC throughout the course of the administrative proceedings, and TAWC alone must bear the consequences of failing to meet that important burden.

III.
ARGUMENT

A. The Record Does Not Establish that TAWC has Carried its Burden of Proving that Claimed Capital Additions are Necessary, Reasonable, and Used and Useful.

TAWC captioned its petition as a request to permit it to increase its rates "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."[2] In the past two rate cases and in this case, TAWC has sought to increase "its property used and useful in furnishing water service to its customers" from the $189,828,780 allowed in the final Order in Docket No. 2006-00290 to $226,384,490 at the end of the Attrition Year, a proposed net increase of $36,555,710. TAWC Exhibit 1, Schedule 2, Page 1. In this case alone, TAWC seeks to

[2] In addition to a rate of return on its "property used and useful", TAWC also seeks to recover depreciation expense and taxes.

increase "its property used and useful" by a net $17,043,379 above the amount authorized in the Order in the 2008 Rate case of $209,341,111. Nevertheless, TAWC has presented no evidence in the record supporting that its claimed capital additions are necessary, reasonable, or used and useful.

Rather than fulfill its burden of showing that the property additions upon which it claims a return are used and useful, TAWC has attempted to shift the burden to the City to prove that its property additions since 2006 are ***not*** used and useful. Tr. Ex. 14 is TAWC's response to the City's discovery request No. 8, which asked TAWC to state the date that each addition to utility plant in service claimed in the 2006, 2008, and 2010 rate cases was placed in service and to explain how each addition was used and useful to TAWC ratepayers as of that date.[3] TAWC refused to provide the requested information, instead asserting that ***"[t]he Company would indicate*** that all utility plant in service ("UPIS") requested in rate base for this case and completed through September 2010 (the latest monthly completed accounting close) is used and useful in the business." Tr. Ex. 14 (emphasis supplied). TAWC also asserted that its plant additions and plant balances were subject to management's representations to its outside auditors that they are used and useful for the provision of service. *Id.* TAWC offered to do nothing more than "make its massive property records available to the City for review." *Id.*

In its December 1, 2010 Supplemental Response to request No. 8, TAWC submitted only two documents, constituting the management representation letters to TAWC's outside auditors, which were introduced as Tr. Ex. 36 (Confidential). The two letters contain no reference whatsoever to whether the additions to utility plant in service

[3] Request No. 8 referenced Requests Nos. 4, 5, and 6, which asked TAWC to identify each addition to utility plant in service claimed in Docket Nos. 10-00189, 08-00039, and 06-00290. *See* Tr. Ex. 14.

claimed in the 2006, 2008, and the current rate cases were necessary, reasonable, used and useful for its ratepayers. TAWC President John Watson admitted that the letters did not contain the phrase "used and useful." T. Vol. II-C, 309.

Absurd as it is, TAWC apparently contends that it can carry its burden concerning rates recovering a return on increases in utility plant in service by simply asserting that ***"[t]he Company would indicate*** that all utility plant in service ("UPIS") requested in rate base . . . is used and useful in the business."

Because TAWC has not met is burden of proving that its requested additions to utility plant in service were necessary, reasonable, and used and useful, the TRA should deny recovery of any return on investment, depreciation expense, taxes, and related expenses on all additions to utility plant in service requested by TAWC above the amount authorized in the Order in the 2008 Rate case. Accordingly, TAWC's Utility Plant in Service should be reduced to no more than $209,341,111, less depreciation and other appropriate adjustments.

B. The Record Does Not Establish that TAWC has Carried its Burden of Proving that Claimed Management Fees are Necessary, Reasonable, and Prudent.

During a time of great economic distress for its customers, TAWC has continued to increase the amounts that it sends to its affiliate, American Water Works Service Company ("AWWSC") to pay for ever-increasing numbers of AWWSC employees. The record shows that no one associated with TAWC knows how many AWWSC employees bill time to and do work for TAWC. TAWC's president does not know. T. Vol. I-C, 277. Ms. Schumaker does not know. T. Vol. II-B, 180. Mr. Baryenbruch does not know. T. Vol. V-A, 36-37.

No meaningful controls exist over the number of employees billing time to TAWC. TAWC's president has no control over who provides services to TAWC. T. Vol. I-C, 274-75. When asked to identify all instances in which TAWC challenged any of the thousands of charges billed to TAWC each year, TAWC could identify only one. Tr. Ex. 11. Testimony of J. Watson, T. Vol. I-C, 283-86. Without meaningful challenge or control, AWWSC billed TAWC during the 12 months ending March 31, 2010, a total of 71,166 hours at an average loaded rate per hour of $74. T. Vol. VI-A, 40-41; *see* Tr. Ex. 81.

To justify the continuing and growing transfer to AWWSC of one of every seven dollars collected from its ratepayers, TAWC has offered a series of reports authored by persons captive to TAWC or person who, if not captive, have relied without meaningful independent examination upon information provided by TAWC and AWWSC employees. Neither these reports, from Ms. Schumaker and Mr. Baryenbruch, nor any other proof in the record show that the amounts paid by TAWC to AWWSC for management fees were reasonable and necessary or were the result of prudent management decisions.

1. The Schumaker Report did not establish that TAWC's claimed management fees were reasonable and necessary or were the result of prudent management decisions.

a. The Schumaker Report did not evaluate whether TAWC was being charged for the proper level or amount of services.

The Schumaker Affiliate Audit Report (the "Schumaker Report") did not measure, test or evaluate whether AWWSC provided the proper amount of services to TAWC. While the audit report looked at the types of services provided to TAWC by

AWWSC, it did not "audit" those services to determine whether the amounts were appropriate. T. Vol. II-B, 154. Ms. Schumaker did not determine how many of the over 1600 employees of AWWSC charged time to TAWC or whether those charges were appropriate, necessary, or the correct amount. *See* T. Vol. II-B, 180-81. In fact, Ms. Schumaker did not examine or audit any service charges on the employee level to determine whether they were reasonable and necessary. *Id.*

The Schumaker Report's conclusions concerning the reasonableness of AWWSC's management services focused only on the ***types*** of services provided by AWWSC, but did address at all the ***level or amount*** of services provided to TAWC. T. Vol. II-B, 154-56. As such, there is no evidence in the Schumaker Report to determine whether such fees paid by TAWC are necessary, reasonable, and prudent.

b. The Schumaker Report was not an independent review.

Patricia Schumaker testified she relied extensively on information from employees of TAWC, AWWSC, and other affiliates of TAWC, without independently confirming the accuracy of those reports. For example, Ms. Schumaker acknowledged that the company did not audit or independently confirm the information provided by Mr. Miller that served as the basis for the breakdown of the functional services provided by AWWSC to TAWC contained in Exhibit II-10 on page 25 of the Schumaker Report. Schumaker Dep. 36:14-17 (Feb. 18, 2011); T. Vol. II-B, 155-56; Tr. Ex. 29. Ms. Schumaker submitted her draft report to TAWC and AWWSC for comment and made significant changes in the report based on TAWC and AWWSC suggestions. T. Vol. II-B, 171-75. *Compare* Tr. Ex. 29 to Tr. Ex. 32. In her deposition, Ms. Schumaker admitted that she did not undertake an audit or analysis of the information provided by

the company related to payments made by TAWC to any affiliate. Schumaker Dep., 35:6-14. Further, Ms. Schumaker testified that while she had been told in interviews with TAWC representatives that employees regularly challenged specific charges from AWWSC, she could not recall seeing any specific documents confirming those assertions. Schumaker Dep. 102-03. Relying only on what she had been told in interviews with TAWC employees, she could not quantify how many service company charges had been challenged by TAWC. T. Vol. II-B, 163, 193. In fact, TAWC's response to the City's discovery request No. 13 shows that TAWC challenged but a single charge included among the thousands and thousands of charges included on monthly bills provided to TAWC. T. Vol. II-B, 192-93; Tr. Ex. 11.

c. The Schumaker Report relied on Baryenbruch's flawed report rather than undertaking independent research on the reasonableness of management fees charged to TAWC.

Ms. Schumaker did not undertake any independent research to determine whether amounts charged by AWWSC to TAWC were equal to or less than the market price for such services. Instead, Schumaker relied on Baryenbruch's flawed report to support its finding that American Water has verified that AWWSC charges are the lower of cost or market. T. Vol. II-B, 170-71; Schumaker Report, Tr. Ex. 29 at 42-43. As discussed in more detail below, Baryenbruch's relationship with AWWC and TAWC can hardly be described as "independent", and his study was devoid of information to support the assertion that management fees charged to TAWC are reasonable, necessary, and prudent. The Schumaker Report included no independent analysis of whether such services are equal to or less than market costs.

Ms. Schumaker testified in her deposition that Mr. Baryenbruch's hypothetical

outsourcing to law firms, accounting firms, professional engineering firms, and management consulting firms is not the only way to measure the "market" against which TAWC management fee costs would be compared. Ms. Schumaker stated that TAWC could either hire people directly to perform the work or outsource those services to another organization. Schumaker Dep. 74:11. However, Ms. Schumaker's report did not consider either of these cost-effective approaches and relied solely on Mr. Baryenbruch's limited and inflated cost-to-market comparison. *See* T. Vol. II-B, 200.

Similarly, the Schumaker Report unquestionably relied upon Mr. Baryenbruch's flawed benchmarking approach, in which he compared the administrative and general costs of TAWC to those of much larger electric and gas utilities. Ms. Schumaker addressed the differences in complexity between a regulated water utility such as TAWC and gas, electric, and nuclear companies by asserting that the complexity of the ***American Water Works system as a whole***, was comparable to the complexity of Baryenbruch's comparison group of large electric and gas utilities. Ms. Schumaker acknowledged that TAWC itself was not a complex operation: "Well I think Tennessee American itself ***may not be as much***—there are certain complexities within any organization, but I was referring mostly to the American Water system." Schumaker Dep. 85:10-13 (emphasis added). Aside from stating that the ***American Water Works system as a whole*** is a complex organization, Ms. Schumaker provided no support or documentation that a group of complex electric and gas utilities was reasonable or appropriate for comparison to TAWC.

Indeed, when questioned whether other water companies, rather than electric and gas companies, would be more appropriate as a comparison group for TAWC, Ms.

Schumaker admitted, "It would be nice if you could include water companies. I would probably look at both, if I had my preference." *Id.* at 106:9-11. Finally, when Director Roberson questioned why she did not include data from water companies, Ms. Schumaker replied, "I would love to have water data in there . . . It would have taken a lot more time." T. Vol. II-B, 210.

2. Mr. Baryenbruch's flawed report failed to establish that the management services for which TAWC paid AWWSC were reasonable and necessary or were the result of prudent management decisions.

a. Mr. Baryenbruch's report has the same flaws as his 2006 report, which the Authority rejected.

In addition to Ms. Schumaker's testimony related to affiliate charges, TAWC attempted to support its claim that its payments to AWWSC for management fees were reasonable and necessary by once again offering the testimony of Patrick L. Baryenbruch. TAWC previously offered the testimony of Mr. Baryenbruch in Docket No. 06-00290. For that case, Mr. Baryenbruch prepared an almost identical report, aside from one additional section which consisted of a comparison of TAWC's A&G costs to the A&G costs of much larger electric and gas companies. The testimony and report presented by Mr. Baryenbruch in Docket No. 06-00290 caused Director Jones to conclude in the May 15, 2007 Authority Conference as follows:

> Expenses with respect to the management fees, I dissent from that motion in one respect. The intervenors here have fully satisfied me that further inquiry must be made into whether the underlying functions performed by the services company are necessary, efficiently executed, and a result of prudent management decisions.
>
> The record in this docket was void of information on which to answer these very, very important questions.

T. Vol. IV-C, 194 (May 15, 2007 Authority Conference at 17-18).

As was the case in 2006, Mr. Baryenbruch's testimony offered no evidence that management services for which AWWSC was paid millions of dollars were necessary, reasonable, or useful. His analysis comparing TAWC's A&G cost-per-customer to that of much larger electric and gas companies does not support the proposition that AWWSC's fees are reasonable. Mr. Baryenbruch asserted that his peer group was appropriate because electric companies share similar types of A&G functions to TAWC. Although service companies may perform the same types of functions for water and for electric and gas utilities, Mr. Baryenbruch offered no evidence that a medium-sized water company requires those types of management services at the same frequency, with the same time constraints, or with the same level of employee expertise. *See* T. Vol. IV-C, 177; T. Vol. V-A, 19. The A&G needs of a group of large, complex electric and gas companies do not provide any evidence to support any conclusion concerning the reasonableness and necessity of TAWC's claimed service company expenses.[4]

b. Mr. Baryenbruch's flawed report provides no evidence that TAWC is paying AWWSC the lower of cost or market for management services.

To support his claim that AWWSC charges for management services were the lower of cost or market, Mr. Baryenbruch focused on 39,973 hours billed to TAWC by AWWSC at an average loaded rate of $102.54 per hour, for a total of $4,099,018. T. Vol. IV-D, 362; Tr. Ex. 81. Mr. Baryenbruch classified these services as "management and professional" services, even though

- He had no idea how many individual employees billed the 39,973 hours T. Vol. IV-D, 344-45;

[4] *See* testimony of Ms. Kim Dismukes, at T. Vol. II-C, 233-34 and Dismukes pre-filed testimony at 4 – 5.

- Although he acknowledged that persons providing "management and professional services" must have at least a bachelor's degree, he had no idea what were the qualifications of the AWWSC employees who billed the "management and professional" services. T. Vol. IV-D, 61-62.

Mr. Baryenbruch divided the 39,973 hours of management and professional services for which TAWC paid into four categories: management consultants, attorneys, certified public accountants, and professional engineers. T. Vol. V-A, 29; Exhibit 55, 17-18. Mr. Baryenbruch testified that he did not look at individual employees, charges, or qualifications, but rather categorized employees based on business units. T. Vol. IV-D, 244-45. Mr. Baryenbruch admitted that:

- He had no idea whether persons he characterized as "Attorneys" had law degrees or law licenses, which he described as necessary qualifications for Attorneys, T. Vol. V-A, 32-36.

- He had no idea whether persons he characterized as "Management Consultants" had baccalaureate degrees, which he described as a necessary qualification for such work. *Id.*

- He had no idea whether persons he characterized as "Professional Engineers," had degrees in engineering or had passed the PE exam, which he described as minimum qualifications for professional engineers. *Id.*

- He had no idea whether persons he characterized as "Certified Public Accountants" had bachelor's degrees and had passed the CPA examination. *Id.*

Mr. Baryenbruch testified that he had never seen Tr. Ex. 59, which listed the job titles of some 1,600 persons who billed time to TAWC and for each specified the hours billed to TAWC, base pay, and fully loaded salary rates. This was the case in spite of the fact that this discovery response from TAWC to the City stated that these were AWWSC employees included in Baryenbruch's Exhibit 3. T. Vol. V-A, 40. Tr. Ex. 59 lists numerous job titles that obviously would not require the same qualifications as an

"Attorney," "Management Consultant," "Certified Public Accountant," or "Professional Engineer."

Indeed, Mr. Baryenbruch did not ask, inquire, study, or determine how many of the over 1,600 service company employees provide services that TAWC needs or that TAWC actually received. *See id.* at 36-37. Rather, he testified repeatedly that it was not necessary or pertinent to his study to look at individual employees or their specific job functions and responsibilities. *Id.* at 28-29, 32, 37, 40. Mr. Baryenbruch's employee classification and comparison methodology had no factual or logical basis, and completely discredits his "cost to market" report.

c. Mr. Baryenbruch's report focused upon a comparison of cost to an artificially constructed and irrelevant "market".

Mr. Baryenbruch's report compared TAWC's payments to AWWSC to a fictional "market" that no prudently managed utility would choose. The logical markets to which AWWSC's management fees should be compared are the Chattanooga labor market for persons who could provide comparable services or the market for competitively bid services from independent providers of truly comparable services. However, Mr. Baryenbruch conceded that he did not analyze how the $102.54 an hour charged by AWWSC for services he classified as "management and professional services" compared to the cost of TAWC directly employing persons to provide the services. Indeed, he admitted that he made no inquiry at all as to the option of TAWC hiring local employees to provide these services. *See* T. Vol. V-A, 44, 52. Evidence in the record shows that, even if TAWC needed to hire attorneys, management employees, accountants, and engineers to provide some of the services for which AWWSC is being paid, such professionals could be directly hired from the local market at rates much lower than

charged by AWWSC. *See* Exhibits 60-63 (Tennessee Department of Labor prevailing wages for Chattanooga market); T. Vol. V-A, 47-48, 53-62; T. Vol. V-B, 67-71. Based upon the job titles listed on Tr. Ex. 59, TAWC could hire non-professionals from the local market at much lower rates to provide the bulk of services for which AWWSC bills TAWC.

In response to questions of Director Roberson, Mr. Baryenbruch rejected out of hand the possibility of comparing AWWSC charges to services competitively bid by outside providers, asserting that a hypothetical bidding process would not develop accurate comparative information. T. Vol. V-B, 115. Of course, any problem with a "hypothetical" bidding process would be avoided if TAWC was ordered by the Authority to undertake a valid, genuine process of soliciting competitive bids from independent service organizations, such as call center operators.[5]

As previously discussed, Mr. Baryenbruch undertook no analysis showing that the work completed by AWWSC employees was comparable to that provided by qualified Attorneys, Management Consultants, CPA's, and Professional Engineers. Beyond that failure, Mr. Baryenbruch provided no evidence or any logical argument that prudent management would ever, for example, retain an outside law firm at $265 an hour to complete functions of AWWSC employees he classified, without analysis, as "Attorney"; retain an outside management consulting firm at $231 an hour to complete functions of AWWSC employees he blindly classified as "Management Consultant"; retain an outside certified public accounting firm at $108 an hour to perform the functions of AWWSC employees he blindly classified as "Certified Public Accountant"; or retain an outside

[5] The Illinois Commerce Commission ordered Illinois American Water Company to complete such a competitive bidding process. See T. Vol. V-B, 115 - 16.

professional engineering firm at $111 an hour to perform the functions of AWWSC employees he blindly classified as "Professional Engineer". *See* Baryenbruch Report at 23.

Indeed, TAWC's repeated endorsement of the absurd proposition put forth by Mr. Baryenbruch that TAWC would retain outside professional firms as an alternative to paying AWWSC for management services itself shows an absence of prudent management. The fact that TAWC's affiliates have presented Mr. Baryenbruch's absurd proposition to regulators at least 24 other times demonstrates that the entire American Water Works system lacks prudent management judgment.

d. Mr. Baryenbruch's report fundamentally lacked trustworthiness.

Undermining the entirety of his testimony and his flawed report asserting the necessity and reasonableness of the management fees paid by TAWC is the fact that, within the past three years, he has completed at least five virtually identical reports for other AWWC subsidiaries. T. Vol. IV-C, 201. Mr. Baryenbruch testified that he has completed some 24 virtually identical reports for AWWC companies. *Id.* at 220. In total, Baryenbruch has authored approximately 43 virtually identical reports for utility companies, including those for AWWC. *Id.* at 198. In each of those 43 reports, Mr. Baryenbruch testified that he came to the same conclusion that management fees paid by the utility were necessary and reasonable. *Id.* at 199. Aside from one additional question, which Mr. Baryenbruch added to each report beginning in 2007 through the present, each of the 43 reports asked virtually identical questions and reached the same conclusion. *Id.* at 198-99.

Mr. Baryenbruch has prepared similar reports for numerous AWWC companies

and has admitted that the conclusions to those reports were identical to the conclusions in his report for TAWC. Mr. Baryenbruch can hardly be considered an independent consultant, and his report for TAWC lacks objectivity and trustworthiness. Mr. Baryenbruch vividly illustrated his lack of any independence when, during his testimony, he referred to another TAWC witness as "our witness." T. Vol. IV-D, 348.

3. Both Ms. Schumaker and Mr. Baryenbruch made unsupported assertions that controls were in place at TAWC to assure that AWWSC management fees were reasonable and necessary.

Both Ms. Schumaker and Mr. Baryenbruch relied on interviews with employees of AWWSC or TAWC that the company implemented certain control mechanisms related to budgeting and billing of management fees. Neither Ms. Schumaker nor Mr. Baryenbruch conducted any independent investigation of those controls to confirm this information. Both Ms. Schumaker and Mr. Baryenbruch based their control conclusions on information from Mike Miller.

Ms. Schumaker asserted that she was told challenges were made to AWWSC billings to TAWC, but she never viewed evidence of any such challenges. Schumaker Dep. 102-103. Certainly, Ms. Schumaker's belief that TAWC controlled AWWSC management fees by regularly challenging charges is not supported by Tr. Ex. 11, TAWC's response to the City's request No. 13, which asked TAWC to ***identify*** and provide documentation of each AWWSC service charge or expense challenged by TAWC. TAWC responded with a single email challenging one employee's hours over a two-month period. Tr. Ex. 11. The Company identified no other instance in which any of the thousands of charges from AWWSC was challenged by TAWC.

Mr. Baryenbruch also received his information on controls from employees at

TAWC and AWWSC without conducting any independent analysis. Regardless of its source, cross examination established that there was no factual basis for Mr. Baryenbruch's assertion on page 37 of his report that "[t]here are several ways by which TAWC exercises control over Service Company services and charges." Tr. Ex 55. Mr. Baryenbruch admitted in his testimony that TAWC does not control the areas listed under this section of the report. *See* T. Vol. IV-C, 213-218. To the extent that his testimony on supposed TAWC controls was not simply based on what Mike Miller told him, Mr. Baryenbruch admitted that it was based on his speculation. *See* T. Vol. IV-C, 224-234.

4. Ms. Dismukes' analysis comparing TAWC's service company expenses to those of other water utilities demonstrates that TAWC's management costs are unreasonably high.

a. TAWC's A&G and customer account expenses should be reduced to the average expenses of peer water companies.

The City's witness, Kimberly H. Dismukes, testified regarding TAWC's service company charges and affiliate transactions. Ms. Dismukes testified that there are significant differences between electric and gas companies and water companies, which made Mr. Baryenbruch's and Ms. Schumaker's benchmarking comparisons inappropriate. T. Vol. II-C, 233-35. Ms. Dismukes explained that compared to water companies, electric and gas companies run more complex operations with higher employee compensation and a more complex customer base. *Id.* at 233-34. She noted that Mr. Baryenbruch provided no documentation that the level or scope of services provided by AWWSC to TAWC was comparable to those services provided by the much larger gas and electric service companies included in their comparative groups. *Id.* at 234.

Ms. Dismukes presented an alternative comparative analysis, which used data from water and combination water and wastewater companies operating in the states of

Arkansas, Florida, Kentucky, Missouri, South Carolina, and Virginia. In total, Ms. Dismukes' analysis compared A&G and customer account services expenses of 26 water and combination water and wastewater companies to those of TAWC, and demonstrated that, by comparison, TAWC's A&G and customer account service expenses were excessive. *Id.*

Revised Schedule KHD-15, included in Tr. Ex. 35, shows that the average A&G expense per customer was $71 for the water companies in Ms. Dismukes' comparison group, compared to $124 for TAWC. The Schedule shows that the higher A&G expense per customer incurred by TAWC increased its A&G expenses by $3,962,133 for 2009. *Id.*

Revised Schedule KHD-16, also included in Tr. Ex. 35, shows that the average customer account service expense per customer was $26 for the water companies in Ms. Dismukes comparison ground, compared to $32 for TAWC. The Schedule shows that the higher customer account service expense per customer incurred by TAWC increased its customer account service expense by $462,842 for 2009. *Id.*

Ms. Dismukes testified that she compiled her statistics by using data from official annual reports filed by the water companies. *Id.* at 250-51. Ms. Schumaker acknowledged that compiling data from water utilities would be preferable, T. Vol. II-B, 210, and Ms. Dismukes' analysis shows that such comparisons are feasible and that information for water companies is publicly available.

TAWC attacked Ms. Dismukes' analysis, principally through the rebuttal testimony of Mr. Miller, who asserted that if the water companies used in Ms. Dismukes' analysis were more efficient, their overall rates would be lower than TAWC's rates to

customers. T. Vol. II-C, 237. Mr. Miller compared hypothetical bills for residential customers of TAWC to bills based upon the rates of the water companies included in Ms. Dismukes' peer sample, and asserted that TAWC had lower rates on average. *Id.* Ms. Dismukes testified that this simplistic analysis was severely flawed, because there are numerous factors, in addition to A&G costs, which dictate water utilities' ultimate rates. *Id.* These factors may include capital structure, the rate of return allowed by the regulatory authority, the rate structure, the operating and maintenance expenses of the utility, the cost of local electricity, chemical expenses, density of the customer service territory, the age of the system, the type of treatment facilities, geography, and the amount of unaccounted water. *Id.* at 238.

As Ms. Dismukes suggested, the City requests that TAWC's A&G and customer account service expenses in excess of the average for the comparison group of water utilities be disallowed in this proceeding. Alternatively, the City requests that total management fees be limited to the amount allowed in the Order in the 2008 Rate Case, $3,529,933.

b. Further investigation of the relationship between TAWC and AWR is warranted to ensure that TAWC receives benefits from providing customer lists and endorsements to AWR.

In addition to demonstrating that TAWC's A&G and customer account service expenses were higher than peer water utilities, Ms. Dismukes also recommended that the Authority investigate TAWC's relationship with AWR more closely, because AWR does not compensate TAWC for the benefits produced from its association with TAWC. As a non-regulated affiliate of AWWC, AWR provides insurance-like protection from problems with home water and sewer lines. As Ms. Dismukes testified, AWR benefits

from the use of TAWC's customer lists and addresses, good will, logos, and reputation, for which it pays nothing. *Id.* at 232, 288. Ms. Dismukes recommended an investigation of the benefits that arise from AWR's relationship to TAWC and the implementation of a royalty fee or similar payment arrangement to compensate TAWC and its ratepayers for the lucrative arrangement.

Ms. Dismukes noted that such a payment arrangement would be consistent with the position taken by TAWC's witness, Bernard L. Uffelman, in a book providing guidance on cost allocation. *Id.* at 232, 242-43. Mr. Uffelman wrote the following regarding compensation to the regulated affiliate:

> For a disaggregated entity's use of a utility's brand name or logo, states have rules ranging from requiring that the nonregulated affiliate pay a royalty fee to the regulatedd affiliate, to placing restrictions on the use of the brand name and logo in lieu of a royalty fee. One commission ordered an unregulated affiliate to pay its regulated affiliate a referral fee for successful referrals.

Exhibit 53, 19-19; T. Vol. IV-B, 81-83.

According to information provided by TAWC, AWR earned more than $306,000 from its affiliation with TAWC. TAWC Response to TRA Request 150, Attachment, p. 2. It is appropriate for the TRA to investigate the TAWC/AWR relationship and order TAWC to implement a royalty arrangement by which AWR shares with TAWC a significant portion of its revenue received from TAWC customers.

5. TAWC's management of its relationship with AWWSC reflects a lack of prudence.

The record establishes that TAWC's management of its relationship with AWWSC reflects a marked lack of prudence. These deficiencies increase the Company's burden of proving that it should be allowed rates that permit it to recover from ratepayers

the ever-increasing management fees paid to AWWSC. TAWC's lack of prudence tips the scales against the Company's claim that rates recovering AWWSC management fees would be just and reasonable.

The record establishes numerous examples of imprudence. In addition to those previously noted, the record establishes these additional examples:

- Although TAWC president John Watson testified that TAWC has faced difficulty in recent years attracting capital from its parent AWWC to complete important system improvements, the Company has not reduced its management fees to AWWSC. *See* T. Vol. I-C, 260-62. In fact, from the period beginning November 30, 2007 through the projected attrition year ending December 31, 2011, TAWC has proposed an increase in management fees from $4,789,601 to $5,226,034. *Id.* at 271.
- Mr. Mike Miller testified that TAWC's requested local employment full time equivalents ("FTEs") had fallen from 125 FTEs in 2003 to 110 after TAWC shifted work to AWWSC. T. Vol. VI-A, 40. However, in 2009, AWWSC billed approximately 71,000 hours to TAWC, which translates to 34 additional FTEs. *Id.* at 40-41.
- Tr. Ex. 81 shows that TAWC pays approximately $74 per hour for each hour billed by AWWSC. The City demonstrated that local wages in the Chattanooga area for a range of management and professional services were significantly lower than $74 per hour, which indicates that TAWC is not efficiently sourcing its labor by shifting responsibility to AWWSC. *See* Tr. Ex. 60-63 (wages for various types of workers providing legal, management,

accounting, and engineering services).

- TAWC's O&M expenses have increased 56.3% since 2004. T. Vol. VII-B, 57. In contrast, the rate of inflation over the same period of time has only been 16.5%. *Id.* at 58. CAPD witness, Mr. Terry Buckner testified that an increase of O&M expenses far in excess of the rate of inflation reflected imprudent management and stated the following:

> In my opinion, the company has either a recourse to produce expenses or raise rates. They've chosen the latter in increasing expenses.
>
> It doesn't comport with the economic conditions during this time frame and therefore is unreasonable. There's no economic growth measurement that you can apply and make any reasonable—just and reasonable comparison for the difference between the [CPI] growth and the growth in O&M expenses for the company.

Id. at 59.

D. TAWC Has Not Carried its Burden of Proving that Rates Recovering its Requested Return on Equity Would be Just and Reasonable.

The record does not support TAWC's claim that prudent investors would not invest capital in TAWC unless the TRA approved rates permitting the Company to recover a rate of return of 11.5%. Mr. Miller testified that TAWC obtains all of its capital from its parent company. T. Vol. VI-B, 131-32. He acknowledged, based on AWWC's stock price, that investors in AWWC are willing to accept a rate of return of only about 5.5%.[6] T. Vol. VI-B, 135-137. The rate of return that is demonstrably acceptable to AWWC investors shows that TAWC's request for a much higher return on equity is excessive.

[6] AWWC's stock symbol is AWK. Information concerning its earnings, stock prices, and shares traded daily is available from public filings with the Securities and Exchange Commission and from other public sources of which the TRA may take judicial notice. Tenn. R. Evid. 201.

Mr. Miller acknowledged that TAWC's difficulty in obtaining capital was the result of AWWC's deliberate decision to send capital to other subsidiaries. T. Vol. VI-B, 131-32. Mr. Miller justified AWWC's decision to deprive TAWC of needed capital by asserting that it was reasonable to send capital to better performing subsidiaries. *Id.* 131-34.

Terry Buckner testified that imprudent management can affect whether a utility company achieves its authorized return on equity. In addition, he stated that numerous factors could contribute to a lower return on equity, including a shortfall in revenue forecasts; unjust or imprudent operating expenses; unanticipated rate base additions; and extraordinary expenses such as high rate case expenses. T. Vol. VII-B, 63.

As AWWC's investors prove daily, a return on equity of nowhere near 11.5% is needed to attract capital from prudent investors. AWWC's refusal to provide needed capital to TAWC is not consistent with the actions of a prudent investor, it is an effort by AWWC to leverage higher rates to recover an unjust and unreasonable rate of return.

E. The Authority Should Deny TAWC Recovery of Any Attorneys' Fees in its Rate Case Expenses Because Such Fees Are Not Authorized Under the American Rule and are Actually Prohibited By Applicable Statutory and Regulatory Authorities.

In this case, TAWC sought eeks to shift to its ratepayers, made up principally of the City and its citizens and the Chattanooga Manufacturers Association and its members, over $1,240,000 in rate case costs, including over $1,000,000 in legal fees. Rebuttal Test. M. Miller 78; Rebuttal Exhibit MAM-11. By motion filed March 16, 2011 (the "Joint Motion"), the parties have advised the TRA of their agreement that, if the TRA allows TAWC to recover its rate case costs from its ratepayers, those costs should be no more than $645,000. The Joint Motion specified, *inter alia*, that the City reserved the

right to continue to argue that TAWC cannot, as a matter of law, recover legal expenses as a component of rate case expense. As explained below, the City urges the TRA to deny recovery from TAWC's ratepayers of the Company's legal expenses incurred in connection with this or other rate cases.

Although the City acknowledges that the TRA has previously awarded fees and expenses in rate contested cases, the City respectfully asserts that no authority permits TAWC to recover any rate case expenses comprised of legal fees. For example, in *House v. Estate of Edmondson*, 245 S.W.3d 372 (Tenn. 2008), the Tennessee Supreme Court addressed the question of whether a successful party in a derivative action involving a for-profit corporation could recover its legal fees. In so doing, the court denied the recovery, applying a strict interpretation of the American Rule and denying the application of the common trust doctrine as an exception to that rule.

As the TRA knows well, the American Rule provides that a party may not recover attorneys' fees absent "a specific contractual or statutory provision providing for attorney's fees as part of the prevailing party's damages," and this policy is "firmly established in this state." *See House*, 245 S.W.3d at 377; *see also Cracker Barrel Old Country Store, Inc. v. Epperson*, 284 S.W.3d 303, 308 (Tenn. 2009) ("Under the American rule, a party in a civil action may recover attorney fees only if: (1) a contractual or statutory provision creates a right to recover attorney fees; or (2) some other recognized exception to the American rule applies, allowing for recovery of such fees in a particular case."). The *House* Court also explained that Tennessee's adherence to the American Rule is based upon several public policy considerations, including the following:

> **First**, since litigation is inherently uncertain, a party should not be penalized for merely bringing or defending a lawsuit. **Second**, the poor might be unjustly discouraged from instituting actions to vindicate their rights if the penalty for losing included paying the fees of their opponent's lawyer. **Third**, requiring each party to be responsible for their own legal fees promotes settlement. **Fourth**, the time, expense, and difficulty inherent in litigating the appropriate amount of attorney's fees to award would add another layer to the litigation and burden the courts and the parties with ancillary proceedings.

See id. at 377 (citations omitted) (emphasis added); *see also Epperson*, 284 S.W.3d at 308 (same). Indeed, the *House* decision noted that, "as a general principle, the American Rule reflects the idea that public policy is best served by litigants bearing their own legal fees regardless of the outcome of the case." *See House*, 245 S.W.3d at 377.

Each of the four policy reasons supporting application of the American Rule applies with much force in this case. First, the ratepayers, represented by the Intervenors, should not be penalized for merely participating in this regulatory process. Second, the ratepayers and their representatives should not be unjustly discouraged from asserting their rights to require TAWC to justify its rate demands. Third, requiring each party to be responsible for their own attorneys' fees encourages settlement. As this case so vividly illustrates, permitting TAWC to shift its expenses has encouraged great excess by TAWC in the preparation and presentation of their case. Fourth, the time and expense involved in determining the appropriate amount of attorneys' fees would add another dimension to the litigation and would impose an unnecessary burden on the courts and the parties.

Importantly, TAWC cannot cite to any statute or contractual obligation that authorizes it to shift its own attorneys' fees to the ratepayers as is required under the American Rule. To the contrary, applicable authorities from statute and TRA regulations

specifically provide that parties to a rate case proceeding should **bear their own expenses** of counsel. For example, under the procedures established by the General Assembly for contested cases under the Tennessee Uniform Administrative Procedures Act ("**UAPA**"), Tennessee Code Annotated section 4-5-305(b) specifically requires each party to bear the expenses of their own counsel:

> Whether or not participating in person, any party may be advised and represented ***at the party's own expense by counsel*** or, unless prohibited by any provision of law, other representative.

(emphasis added). Indeed, in a different context, the Supreme Court has recognized that a party is not entitled to an award of attorneys' fees in proceedings under the UAPA, although such fees may be awarded if authorized by another statute. *See Wimley v. Rudolph*, 931 S.W.2d 513, 516 (Tenn. 1996) (in an action where plaintiff joined a claim for attorney's fees under 42 U.S.C. § 1983 with her appeal under the UAPA, awarding plaintiff fees under § 1983, but also recognizing that the remedy is "not available under the Uniform Administrative Procedures Act."). Consequently, while TAWC cannot be refused the representation of counsel in proceedings before the TRA, *cf. Simmons v. Traughber*, 791 S.W.2d 21, 24 (Tenn. 1990), the plain and unambiguous language of section 4-5-303(b) could not be more clear that it is TAWC alone that bears the expense of its counsel if it chooses to be so represented.

This statutory provision is not an anomaly. Indeed, in proceedings before this Authority itself, a virtually identical provision is found in the Authority's regulations governing practice and procedure in these cases. In section 1220-01-02-.04 of the Tennessee Compiled Rules and Regulations governing contested rate cases such as the

one at bar, the following provision also requires parties to bear the expenses of their own counsel:

> Any party to a contested case may be advised and represented, ***at the party's own expense***, by a licensed attorney or attorneys.

See id. (emphasis added). Thus, consistent with the provisions of the UAPA set forth in Tenn. Code Ann. § 4-5-305(b), the Authority's own regulations unambiguously allow for parties to be represented in a contested case, but only at that party's own expense.[7]

The City respectfully submits that the award of attorneys' fees is not authorized by statute, and that such an award is, in fact, contrary to statutory and regulatory authority that requires the parties to bear their own expenses of counsel. This statutory and regulatory language could not be more clear or unambiguous, and as such, TAWC should not be permitted to recover *any* attorneys' fees in any amount as part of its rate case expenses. *See, e.g., In re Estate of Tanner*, 295 S.W.3d 610, 614 (Tenn. 2009) ("When a statute is clear, we apply the plain meaning without complicating the task. Our obligation is simply to enforce the written language."). Indeed, any other interpretation of these unambiguous statutory and regulatory provisions to force the ratepayers to bear the expense of TAWC's counsel necessarily, and improperly, would do violence to the plain language of these provisions. Accordingly, the Authority should conclude that it is

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[7] This provision requiring parties to bear their own expenses of counsel is also in contrast to the Authority's regulations allowing for attorneys' fees in electric utility cases. In ratemaking proceedings for electric utilities, this Authority recognizes that intervenors may be entitled to an award of attorneys' fees and costs if the "intervenor's participation has substantially contributed to the approval, in whole or in part, of a position advocated by such intervenor in such proceeding." See Tenn. Comp. R. & Regs. 1220-04-04-.51; Tenn. Comp. R. & Regs. 1220-04-04-.54.

Of course, this ability to recover attorneys' fees and costs in this context is based upon specific entitlement under the federal Public Utility Regulatory Policies Act of 1978. See 16 U.S.C. § 2632(a). Thus, the presence of this federal act in ratemaking cases for electric utilities reinforces the fundamental requirement under Tennessee law that an entitlement to attorneys' fees must be grounded in statute or contract. No similar provision appears with regard to ratemaking proceedings involving water utilities.

obligated to require that TAWC incur its own attorney fees and to reject its request that they be shifted to the Intervenors and their citizens and members.

IV.
CONCLUSION

TAWC has not shown that its requested rate increase is just and reasonable. In addition to the relief requested by the Consumer Advocate, the Chattanooga Regional Manufacturers Association, and the Utility Workers Union of America, the City respectfully requests:

- That the Authority find that TAWC has not met its burden of proving that additions to utility plant in service claimed in this case are necessary, reasonable, or used and useful, and reduce utility plant in service to the amount approved in the Order in the Docket No. 08-00039 (the "2008 Rate Case") of $209,341,111, less applicable depreciation and other appropriate adjustments;
- That the Authority find that TAWC has not met its burden of proving that the management fees to be paid to American Water Works Service Company ("AWWSC") are reasonable and necessary and reflect prudent management decisions. The City requests that (i) TAWC's total Administrative and General ("A&G") expenses, whether incurred locally or as management fees, be limited to the average A&G expense per customer for peer water companies; and (ii) TAWC's total customer account services expenses, whether incurred locally or as management fees, be limited to the average customer account services expenses per customer for peer water companies,

both as reflected by the testimony of Ms. Kim Dismukes. Alternatively, the City requests that total management fees be limited to the amount allowed in the Order in the 2008 Rate Case, $3,529,933;

- That the Authority deny recovery by TAWC of any legal expenses as rate case expenses; and
- That the Authority find that TAWC's requested return on equity of 11.50% is not just and reasonable and that TAWC's rates be set to reflect a return on equity of less than 6%, consistent with that accepted by investors in TAWC's publicly-traded parent, American Water Works Company ("AWWC").

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing pleading was emailed and was served upon the following person(s) via ☐ hand delivery or ☑ United States first class mail with proper postage applied thereon to ensure prompt delivery:

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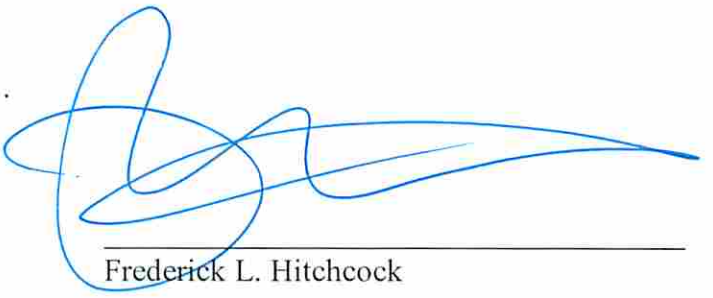
This 21st day of March, 2011.



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1996 WL 482970

SEE COURT OF APPEALS RULES 11 AND 12
Court of Appeals of Tennessee.

CONSUMER ADVOCATE DIVISION,
Office of the Attorney General State
of Tennessee, Petitioner/Appellant,
v.
Keith BISSELL, Chairman; Steve Hewlett,
Commissioner; Sara Kyle, Commissioner;
Constituting the Tennessee Public Service
Commission, Respondents/Appellees.

No. 01-A-01-9601-BC00049. Aug. 28,
1996. Rehearing Overruled Sept. 18, 1996.

APPEALED FROM THE PUBLIC SERVICE COMMISSION AT NASHVILLE, TENNESSEE

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Opinion

OPINION

CANTRELL, Judge.

**1* The only question in this case is whether the Public Service Commission exceeded its authority by approving a tariff which allows Kingsport Power Company to pass its purchased power costs along to its customers without going through a ratemaking proceeding. We affirm the action of the Public Service Commission.

I.

Kingsport Power Company (KPC) furnishes electric power to retail customers in upper East Tennessee. It buys its electricity from an affiliated company, Appalachian Power Company. Both companies are wholly owned by American Electric Power (AEP).

The price KPC pays Appalachian for electric power is regulated by the Federal Energy Regulatory Commission (FERC), and state regulatory commissions must accept the FERC-approved rates as reasonable. *Nantahala Power & Light v. Thornburg,* 476 U.S. 953, 90 L.Ed.2d 943, 106 S.Ct. 2349 (1986). Under the FERC rules, however, Appalachian may put its increased rates into effect while FERC conducts its investigation. If upon concluding its investigation, FERC decides that the rate increase was not justified, Appalachian is required to refund the amount of the increase to KPC, with interest.

Historically, when Appalachian increased its rates to KPC, KPC would file an application with the Tennessee Public Service Commission (PSC) for an increase in its retail rates to its customers. The PSC would then conduct a ratemaking proceeding under Tenn.Code Ann. § 65-5-203.

In 1992 the Commission suggested that its staff and KPC work out a rule or a tariff that would allow the increased power costs to be passed along to KPC's customers without going through a formal ratemaking proceeding. On November 14, 1994, KPC petitioned the PSC to implement a tariff called a purchased power adjustment rider. After several skirmishes with the Consumer Advocate Division of the Attorney General's Office and with the Kingsport Power Users Association, the Commission entered a final order on November 30, 1995 approving the tariff. As we have noted, the tariff allows KPC to raise its rates by a formula in the tariff to pass the increased cost of power along to its customers. In the event KPC receives a refund after a final order from FERC, KPC is required to pass the refund along to its customers as well.

II.

Ratemaking In General

A public utility has the authority to set its own rates-subject to being regulated by the legislature or by a body delegated

the legislative power. *See* 64 Am.Jur.2d *Public Utilities* § 81; 133; 240:

> Until the legislature or other body having the right to prescribe the rates to be charged by public utilities has exercised this power, the rates are the subject of contract between the corporation and its patrons....

Id. § 81.

The legislative control over public utility rates at the time this controversy arose was expressed in Part 2 of Title 65 Chapter 5 of the Tennessee Code. [1] The first section of that chapter provided:

1 We should point out that the Public Service Commission was abolished by the legislature and replaced by an appointed body, the Tennessee Regulatory Authority. See Acts 1995, ch. 305 (effective July 1, 1996).

The commission has the power after hearing upon notice, by order in writing, to fix just and reasonable individual rates, joint rates, tolls, fares, charges or schedules thereof, as well as commutation, mileage, and other special rates which shall be imposed, observed, and followed thereafter by any public utility as defined in § 65-4-101, whenever the commission shall determine any existing individual rate, joint rate, toll, fare, charge, or schedule thereof or commutation, mileage, or other special rates to be unjust, unreasonable, excessive, insufficient, or unjustly discriminatory or preferential, howsoever the same may have heretofore been fixed or established....

*2 Tenn.Code Ann. § 65-5-201.

That chapter also provided:

(a) When any public utility shall increase any existing individual rates, joint rates, tolls, fares, charges, or schedules thereof, or change or alter any existing classification, the commission shall have power either upon written complaint, or upon its own initiative, to hear and determine whether the increase, change or alteration is just and reasonable. The burden of proof to show that the increase, change, or alteration is just and reasonable shall be upon the public utility making the same. In determining whether such increase, change or alteration is just and reasonable, the commission shall take into account the safety, adequacy and efficiency or lack thereof of the service or services furnished by the public utility. The commission shall have authority pending such hearing and determination to order the suspension, not exceeding three (3) months from the date of the increase, change, or alteration until the commission shall have approved the increase, change, or alteration; provided, that if the investigation cannot be completed within three (3) months, the commission shall have authority to extend the period of suspension for such further period as will reasonably enable it to complete its investigation of any such increase, change or alteration; and provided further, that the commission shall give the investigation preference over other matters pending before it and shall decide the matter as speedily as possible, and in any event not later than nine (9) months after the filing of the increase, change or alteration. It shall be the duty of the commission to approve any such increase, change or alteration upon being satisfied after full hearing that the same is just and reasonable.

(b)(1) If the investigation has not been concluded and a final order made at the expiration of six (6) months from the date filed of any such increase, change or alteration, the utility may place the proposed increase, change or alteration, or any portion thereof, in effect at any time thereafter prior to the final commission decision thereon upon notifying the commission, in writing, of its intention so to do; provided, that the commission may require the utility to file with the commission a bond in an amount equal to the proposed annual increase conditioned upon making any refund ordered by the commission as hereinafter provided.

Tenn.Code Ann. § 65-5-203(a)(b)(1).

Thus the legislature has recognized that a public utility may set its own rates, subject to the PSC's power to suspend the rates for a certain period of time while it makes the utility prove that the rates are just and reasonable. *Cumberland Tel. & Tel. Co. v. Railroad and Public Utilities Commission,* 287 F. 406 (M.D.Tenn.1921). If the utility fails to carry that burden, the agency has the additional authority to fix rates that meet the just and reasonable criteria. *CF Industries v. Tennessee Public Service Commission,* 599 S.W.2d 536 (Tenn.1980).

*3 Under these statutes the rates charged by a public utility are not always the product of a ratemaking proceeding in the Commission. New tariffs automatically become effective unless the Commission elects to suspend them while conducting an investigation. [2] Therefore, there is nothing inherently wrong in KPC's power costs being passed along

to its customers without a ratemaking proceeding in the Commission. [3]

2 The investigation, or ratemaking proceeding, would then be conducted according to the contested case provisions of the Administrative Procedures Act. Tenn.Code Ann. § 4-5-301.

3 We should note also that the Commission has the authority at any time to investigate any public utility's earnings, Tenn.Code Ann. § 65-5-201, and the Consumer Advocate may request such an investigation. Tenn.Code Ann. § 47-18-114.

III.

Retroactive Ratemaking

The Consumer Advocate argues, however, that the Commission's order is illegal because it amounts to retroactive ratemaking. This conclusion is drawn from the fact that if FERC later finds that the increase it allowed Appalachian was unjustified, Appalachian must refund any overpayment to KPC and the tariff requires KPC to pass the refund along to its customers.

This court has consistently held that the Commission does not have the authority to approve temporary or tentative rates subject to refund. In *South Central Bell v. Tennessee Public Service Commission,* 675 S.W.2d 718 (Tenn.App.1984) we said that the Commission's power to order refunds was limited to that expressly stated in Tenn.Code Ann. § 65-5-203. (The conditions described in that section are not involved here.)

We are of the opinion, however, that under the circumstances of this case, the PSC had the power to approve a tariff with a contingent refund provision. The tariff allows KPC to pass its increased power costs along to its customers, but it also requires KPC to give back to its customers that part of the increase (if any) that is refunded by Appalachian to KPC. If our analysis in Part II of this opinion is correct, the only offending part of the tariff is the refund provision. Otherwise, the tariff operates prospectively and comes within the powers granted the PSC by the legislature.

But, what makes this case different from *South Central Bell v. Tennessee Public Service Commission,* supra, is that the refund in this proceeding is merely the third step in a larger proceeding, the first two steps of which are governed by federal law. First, the PSC must accept the FERC-regulated cost of KPC's power purchased from Appalachian. Then, Appalachian must refund to KPC that part of the cost found by FERC to be unreasonable after it concludes its investigation. The third step, the refund included in KPC's tariff, is necessary to complete the obvious intent of the federal scheme to return the refund to the class that ultimately has had to pay it. If we struck the refund provision in the tariff, KPC would receive the refund and keep it.

We should note, also, that the problem would be no different if KPC were required to go through a ratemaking proceeding before beginning to collect its increased power costs. The question of what could be done with a refund received by KPC after the new rates had gone into effect would still have to be answered. Because a refund order by the PSC would amount to retroactive ratemaking, KPC could not be forced to account for the refund to its customers.

IV.

Due Process

**4* The Consumer Advocate also argues that the tariff violates the ratepayers' right to due process. This argument is based on the part of Tenn.Code Ann. § 65-5-201 that says "the Commission has the power after hearing upon notice" to fix just and reasonable rates. We think, however, that the notice required by that section is notice to the utility. When the PSC exercises its statutory authority to modify the utility's posted rates the utility is entitled to the statutory notice and hearing.

> Whether notice and a hearing in proceedings before a public service commission are necessary depends chiefly upon the statutory or constitutional provisions applicable to such proceedings, which may make notice and hearing prerequisite to action by the commission, and upon the nature and object of such proceedings, that is, whether the proceedings are, on the one hand, legislative and rule-making in character, or are, on the other hand, determinative and judicial or quasi-judicial, affecting the rights and property of private or specific persons.

64 Am.Jur.2d *Public Utilities* § 266.

Ratemaking is a legislative function. *See* 64 Am.Jur.2d *Public Utilities* § 240. It is not an adjudicatory proceeding affecting the vested property rights of the individual ratepayers. *Hatten v. City of Houston,* 373 S.W.2d 525 (Tex.App.1963). *(See also Cope v. Bethlehem Housing Authority,* 514 A.2d 295 (Pa.1986) on the general question of what process is due when an agency deals with non-vested rights). Therefore, since it is a legislative function, a change in rates by the PSC does not require notice to the individual ratepayers.

We hold that the tariff does not violate the due process rights of the rate-payers because it raises or lowers their rates without a hearing.

The order of the Commission is affirmed and the cause is remanded for any further proceedings that may become necessary. Tax the costs on appeal to the State.

LEWIS and KOCH, JJ., concur.

Parallel Citations

Util. L. Rep. P 26,561

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1999 WL 33505914 (Tenn.R.A.)
PUR Slip Copy

Re Citizens Telecommunications Company

Docket No. 98-00686
Tennessee Regulatory Authority
July 2, 1999

Before Malone, chairman, and Greer, Jr. and Kyle, directors.

BY THE DEPARTMENT:

ORDER DENYING TARIFF

*1 This matter came before the Tennessee Regulatory Authority ('Authority or the TRA') at the regularly scheduled Authority Conference held on April 20, 1999, for consideration of Citizens Telecommunications Company of the Volunteer State ('Citizens of the Volunteer State' or 'the Company') Tariff to Restructure Digital Centrex Service. This Tariff was originally filed with the Authority on October 1, 1998, with the proposed effective date of October 30, 1998.

BACKGROUND

On November 4, 1997, the TRA opened Docket 97-07506 for the purpose of addressing the improper assessment by Citizens Telecommunications Company of Tennessee and Citizens of the Volunteer State (jointly 'Citizens') of its existing Centrex tariffs. [1] In advance of the issuance of a show cause order the Consumer Services Division and Citizens submitted a settlement agreement that was approved by the Authority on June 30, 1998. In addition to providing for the forward-looking procedures for implementation of the existing Centrex tariff and monetary penalties, the settlement agreement set forth the following requirements:

Existing Centrex customers would be notified of the billing errors which resulted in under billing. This notice was to be provided within ninety (90) days of the approved settlement agreement. Centrex customers would be notified of the financial impact of correcting their bill. On or before October 1, 1998, Citizens would file revised Centrex tariffs to 'simplify the Centrex service offering to eliminate the problems currently encountered with selling, provisioning, billing and overall administration, all of which contribute to customer confusion.' For those customers discontinuing Centrex service, (a) Citizens would purchase the customer owned equipment (CPE), (b) if Citizens owned the equipment, the customer would not incur any termination costs or penalties, or (c) for CPE owned by other entities, Citizens would pay all lease termination cost including penalties. Citizens of Tennessee was directed to remove the $19.30 monthly charge for each Centrex line terminating on a PBX/Key system. [2]

On October 1, 1998, Citizens filed revised Centrex tariffs proposing to implement the above requirements for Citizens of Tennessee and Citizens of the Volunteer State. The proposed tariffs would remove the network access register (NAR) and allow access to the outside world on all intercom lines. However, Citizens also proposed to increase the charges for intercom lines by approximately 300% (from $11/month to $35/month). In addition, if the customer wished to terminate Centrex service in a PBX or key system, the line rate would be increased to $60 per month.

These tariffs were placed on the Authority Agenda for consideration at the December 15, 1998 Conference. Prior to that Conference, Citizens requested that the tariffs be removed and that Authority Staff be allowed to work with Citizens to resolve any issues arising from the tariffs. TRA Staff members David Foster and Joe Shirley, with subsequent legal review by Edward Phillips (hereafter, 'TRA Staff'), were designated as parties to this proceeding for the purpose of working with the company to eliminate these concerns. The tariff was suspended through February 1, 1999.

*2 As a result of the on-going negotiations between the parties, the tariff was suspended at the January 19, 1999 Authority Conference, the March 2, 1999 Authority Conference and again at the April 6, 1999 Authority Conference. Upon the breakdown of negotiations, Citizens and the TRA Staff were directed to file briefs with the Authority for the purpose of determining approval or denial of the proposed tariffs. In accordance with the schedule agreed to by the parties, briefs were submitted on March 11, 1999, with reply briefs submitted on March 17, 1999.

The Centrex tariff restructure of Citizens of the Volunteer State results in a 15% overall revenue increase to the company. This increase is in addition to the increase realized when Citizens of the Volunteer State correctly applies its existing tariff. Furthermore, three (3) out of the Company's twelve (12) customers will receive a rate increase under the proposed tariff with largest customer increase being $703 per month, or 81%. This increase is in addition to the 74% increase that the customer will experience when Citizens of the Volunteer State begins applying its tariff correctly. Another customer will receive a $106 per month, or 21% rate increase under the proposed tariff in addition to the 46% increase that the customer will experience when Citizens of the Volunteer State begins applying its tariff correctly.

The proposed tariff would result in significant rate shock to two customers. Both of these customers are small, having less than fifty (50) Centrex lines; therefore, it is reasonable to expect that approval of the proposed tariff could present financial difficulty to both of these subscribers. Citizens of the Volunteer State offers little justification for the proposed rate structure. Its brief, filed jointly with Citizens of Tennessee, focuses primarily on the proposition that correct application of the existing tariff results in higher charges to the majority of customers than the proposed tariff. However, upon review of the analysis provided by Citizens of the Volunteer State, the proposed tariff generates 32% additional revenue to the Company while the correct application of the existing tariff generates 16% additional revenue to the Company.

The necessity of restructuring its digital Centrex tariff would not exist had Citizens of the Volunteer State followed the terms and conditions of its existing tariffs. In approving the

original settlement agreement, the Authority directed Citizens of the Volunteer State to simplify its tariffs. This instruction in no way implied that Citizens of the Volunteer State should implement a rate structure that includes an additional rate increase. The Authority agrees with the objective of Citizens of the Volunteer State to reduce the rate increase that customers will realize when Citizens correctly applies its Centrex tariffs, but the proposed tariff fails to accomplish this goal for all customers.

Tenn. Code Ann. § 65-5-203 gives the TRA the authority to hear and determine if a rate increase is just and reasonable. Furthermore, pursuant to Tenn. Code Ann. § 65-5-203(a), the burden of proof in justifying a rate increase lies with the public utility. After consideration of the tariffs and the briefs of the parties in this matter, the Directors determined that Citizens of the Volunteer State did not provide such justification for its proposed rate increase in this case, and the Directors voted unanimously to deny Tariff 98-00686.

IT IS THEREFORE ORDERED THAT:

*3 Citizens Telecommunications Company of the Volunteer State Tariff to Restructure Digital Centrex Service is denied.

FOOTNOTES

1 Centrex service is an alternative to PBX or key systems. With Centrex, all of the switching features and functions needed for a customer's internal telecommunications are located in the telephone company's central office instead of located at the customer's premise as is the case with a PBX or key system. Centrex service typically consist of three elements: 1) the Centrex line or intercom component that provides station-to-station calling; 2) the network access register that permits calls to be made to and received from the outside world; and 3) features.

2 Citizens of Tennessee removed the $19.30 charge for Centrex lines terminating on a PBX/Key system on February 3, 1999, Tariff 99-00053.

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