

**PETITION OF TENNESSEE
AMERICAN WATER COMPANY
FOR A GENERAL RATE
INCREASE, IMPLEMENTATION OF
A DISTRIBUTION SYSTEM
INFRASTRUCTURE CHARGE AND
THE ESTABLISHMENT OF
TRACKING MECHANISMS FOR
PURCHASED POWER, PENSIONS
AND CHEMICAL EXPENSES**

DOCKET NO. 12-00049

Michael P. Gorman

City of Chattanooga



**BEFORE THE
TENNESSEE REGULATORY AUTHORITY**

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AMERICAN WATER COMPANY
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INCREASE, IMPLEMENTATION OF
A DISTRIBUTION SYSTEM
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Direct Testimony of Michael P. Gorman

1 **Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A Michael P. Gorman. My business address is 16690 Swingley Ridge Road, Suite 140,
3 Chesterfield, MO 63017.

4 **Q WHAT IS YOUR OCCUPATION?**

5 A I am a consultant in the field of public utility regulation and a Managing Principal of
6 Brubaker & Associates, Inc., energy, economic and regulatory consultants.

7 **Q PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

8 A This information is included in Appendix A to my testimony.

9 **Q ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?**

10 A I am appearing on behalf of the City of Chattanooga.

1 **Q WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

2 A In my testimony, I will comment on the proposed adjustments to the following:

- 3 1. Tennessee-American Water Company's ("TAWC" or "Company") rate base,
4 and
5 2. The Company's proposal to implement a Distribution System Infrastructure
6 Charge ("DSIC").

7 **Q PLEASE DESCRIBE THE ADJUSTMENTS YOU ARE PROPOSING TO THE**
8 **COMPANY'S RATE BASE.**

9 A I propose the following adjustments to TAWC's rate base:

- 10 1. TAWC's accumulated deferred income tax ("ADIT") balance is understated
11 and should be corrected.
12 2. The Company's balance for customer advances for construction is
13 understated and should be adjusted.
14 3. Business Transformation ("BT") cost should be removed from TAWC's rate
15 base. The BT program is being developed by the American Water Works
16 Service Company ("AWSC"), not TAWC. AWSC should minimize the
17 allocated BT cost to its operating utilities and charge a level annual fee for
18 these services based on AWSC's cost, consistent with a third-party provider
19 transaction. The BT cost should be removed from TAWC's rate base and
20 amortization expense and replaced by a uniform annual AWSC charge.

21 **Q PLEASE DESCRIBE YOUR RECOMMENDATIONS CONCERNING THE DSIC.**

22 A The Company's proposal to implement a DSIC should be rejected for the following
23 reasons:

- 24 1. The DSIC will erode customer protection by eliminating a detailed review of
25 the prudence and reasonableness of qualifying investments proposed to be
26 recovered in the DSIC.
27 2. Tennessee regulatory mechanisms eliminate the need for a DSIC.
28 3. A DSIC places customers at risk of paying more than DSIC total cost of
29 service.

Further, TAWC's claim that the DSIC will have customer benefits is erroneous. The DSIC may result in more frequent rate changes, but it is not to the benefit of customers to have more frequent rate changes, if the overall increase in rates is no lower than that which would be accomplished under base rate traditional rate-setting mechanisms.

Rate Base Adjustments

Q ON A PRELIMINARY NOTE, DOES THE COMPANY'S PROPOSED RATE BASE APPEAR TO BE REASONABLE?

A No. From a very high level, there clearly is a problem between the Company's rate base and its other cost of service components. Specifically, as shown in Ms. Linda Bridwell's testimony on her Exhibit RB-1-Summary-LCB, the Company is proposing an attrition year rate base of \$135.82 million. This attrition year rate base however, is approximately \$10 million more than the amount of investor capital identified by TAWC witness Gary VerDouw on his Petitioner's Exhibit CS-1-Capital Structure-GWV, Schedule CS-1.1 at page 1. The Company in this case is asking to earn a rate of return on \$135 million of rate base where it only has \$125 million of outstanding investor capital. Simply put, one cannot invest \$135 million in utility plant and equipment related working capital requirements, if it only has \$125 million of capital. So I would state at the outset, that there is a clear problem in the Company's cost of service filing. It simply does not have enough capital to support its claimed rate base.

Q PLEASE SUMMARIZE YOUR RECOMMENDED RATE BASE ADJUSTMENTS.

A The Company's attrition year rate base is overstated by \$16,494,952. I recommend adjustments to the Company's rate base for the following items:

- 1 1. Adjust ADIT to reflect the taxes collected from ratepayers not yet paid to
2 governmental taxing authorities,
- 3 2. Adjust the Company's amount of Customer Advances for Construction used
4 as a rate base offset;
- 5 3. Remove the Company's BT software costs. These are AWSC level
6 investments, and should not be included in TAWC's rate base.

7 **Q PLEASE EXPLAIN YOUR PROPOSED ADJUSTMENT TO TAWC'S ADIT**
8 **COMPONENT OF ITS RATE BASE.**

9 A TAWC witness Linda Bridwell sponsors the development of the Company's proposed
10 attrition year rate base. She does that on her Exhibit RB-1-Summary-LCB. As shown
11 on that exhibit, on line 22, she recommends an ADIT rate base offset of
12 \$23.58 million in the historical test year, and \$23.41 million in the attrition year. I
13 have one concern and one error I think she made in calculating the appropriate
14 balance of ADIT as a rate base offset.

15 First, my concern is that it is surprising to me that the amount of ADIT would
16 decrease in the historical test year relative to the attrition year given the current
17 bonus depreciation allowed by the federal government in 2011 and in 2012. The
18 federal government allowed companies to take a 100% and 50% write-off of certain
19 plant additions in 2011 and 2012, respectively. I would expect this additional tax
20 depreciation to significantly increase the ADIT balance.

21 Second, and more specifically, I believe Ms. Bridwell has understated the
22 amount of ADIT available as a rate base offset on her Exhibit RB-9-Deferred Taxes-
23 LCB. As shown on that exhibit, Ms. Bridwell reduces the amount of ADIT recorded on
24 TAWC's balance sheet, by six regulatory asset and liability accounts. Her adjustment
25 reduces ADIT in the historical test year by \$7.44 million. This reduces the amount of
26 ADIT used as a reduction to rate base to \$23.5 million, from the \$31 million actually

1 recorded on TAWC's 2011 balance sheet. In addition, although it is not reflected on
2 Exhibit RB-9-Deferred Taxes-LCB, based on my review of the Company's 12/31/2011
3 financial statements, the balance of ADIT has been reduced for uncertain tax
4 positions ("UTPs").

5 **Q DID MS. BRIDWELL EXPLAIN WHY IT IS APPROPRIATE TO REDUCE THE ADIT**
6 **OFFSET BY THESE REGULATORY ASSETS AND LIABILITIES?**

7 A No. She describes the adjustments to the ADIT balance which reflect TAWC's
8 adoption of Financial Accounting Standard 109. However, she does not explain why
9 adoption of a financial reporting standard is appropriate for determining the regulatory
10 investment for use in establishing rates in this case.

11 **Q PLEASE EXPLAIN THE ADIT ISSUE IN THIS CASE FOR UTPs.**

12 A In accordance with Financial Accounting Standard 48 ("FIN 48"), the Company is
13 required to record a liability for financial reporting on its books associated with its best
14 estimate of any amount of ADIT that the Company, as a taxpayer, has already
15 claimed on its tax returns that the Company may be required to pay in the future to
16 the taxing authority. TAWC is required to record a reduction to its ADIT balance to
17 reflect UTPs.

18 **Q WHY IS REDUCING THE ADIT INCLUDED IN RATE BASE FOR UTPS**
19 **INAPPROPRIATE RATEMAKING?**

20 A In prior years, the Company took tax deductions that reduced its state and federal
21 income taxes. However, those reductions were not reflected in the income tax
22 expense included in rates. This difference is reflected in the ADIT balance. As a

1 result, the Company is currently realizing the full benefit associated with these tax
2 deductions and it is appropriate to reduce the Company's rate base by the associated
3 ADIT. This treatment is required because the ADIT represents non-investor supplied
4 capital. The recognition of UTPs reduces ADIT, increases rate base and fails to
5 recognize the non-investor supplied funds currently in the hands of the Company.
6 Under the circumstances, UTPs should not be reflected as a reduction to the ADIT
7 balance.

8 **Q WHAT IS ADIT?**

9 A ADIT is the accumulation of income taxes TAWC has collected in its rates from retail
10 customers but has not yet remitted to government taxing authorities. Hence, ADIT
11 represents a sum of funding available to TAWC that it can use to make investment in
12 utility plant and equipment up until it is required to remit those income tax payables
13 (collections recovered from customers) to the government taxing authority. Hence,
14 TAWC has no cost associated with its ADIT balances, and these funds are available
15 to reduce TAWC's carrying charge on its rate base.

16 **Q WHAT IS THE EFFECT OF REDUCING THE DEFERRED TAX ACCUMULATIONS**
17 **FROM CUSTOMERS BY CERTAIN REGULATORY ASSETS AND LIABILITIES AS**
18 **WELL AS UTPs AS PROPOSED BY MS. BRIDWELL?**

19 A The net effect of recognizing these reductions to the ADIT balance is an increase in
20 rate base. This is a concern since many of the regulatory assets she identifies
21 appear to already be included in rate base. For example, the regulatory assets
22 include construction work in progress ("CWIP") and allowance for funds used during
23 construction ("AFUDC") assets. CWIP and accumulated AFUDC are already included

1 in rate base. These reductions to ADIT should be explained and justified, or
2 removed. My total proposed adjustment to increase ADIT is \$8,580,818 and is
3 calculated on Exhibit MPG-1, page 2.

4 **Q PLEASE DESCRIBE YOUR PROPOSED ADJUSTMENT TO RATE BASE FOR**
5 **CHANGE IN CUSTOMER ADVANCES FOR CONSTRUCTION.**

6 A On Ms. Bridwell's Exhibit RB-1-Summary-LCB, on line 24, she shows her proposed
7 offset to utility plant in-service for customer advances for construction. There she
8 proposes a test year customer advances balance of \$4.7 million which is developed
9 on her Exhibit RB-10-Customer Advances-LCB. On that exhibit, she takes the full
10 amount of customer advances recorded in the historical test year of \$5.4 million and
11 reduces it by \$700,000.

12 Again, she provides no explanation of why the amount of customer advances
13 recorded on the test year balance sheet should be reduced by \$700,000. She does
14 notate this amount as the current portion of the customer advances balance, which
15 could indicate either TAWC is making repayments to the customers who paid
16 advances, or the time has elapsed for additional customer repayments and TAWC is
17 moving that amount of funds from customer advances to contributions in aid of
18 construction. However, contributions in aid of construction has not increased to
19 reflect such a transfer.

20 Because Ms. Bridwell provided no proof or support nor even an explanation
21 for this reduction in customer advances, I am rejecting her rate base adjustment. I
22 propose that customer advances reflect the full test year balance unless the
23 Company can provide an explanation of why that amount should be reduced in the

test year and attrition year. Absent proof that the adjustment is reasonable, it should be rejected.

Q PLEASE DESCRIBE YOUR PROPOSED ADJUSTMENT TO RATE BASE TO REMOVE BT COST.

A I will explain this BT cost adjustment in more detail below. However, I propose to eliminate the 13-month attrition year test year amount of BT cost included in the Company's rate base, and eliminate the attrition year depreciation expense for the BT cost.

In lieu of these ratemaking treatments, I propose to include a level annualized recovery of BT cost in TAWC's cost of service. The level annualized amount for the reasons set forth below will be based on appropriate BT charges from AWSC, at cost, to TAWC, using a proxy of a third-party leasing structure for the BT cost.

Q HOW MUCH BT DEPRECIATION EXPENSE HAS TAWC INCLUDED IN ITS RATE FILING?

A At page 18 of her testimony, Ms. Bridwell stated that the Company included \$592,709 in the attrition year for BT depreciation expense. This BT depreciation expense is included in the \$1.7 million total attrition year depreciation expense adjustment. I recommend that this amount of BT depreciation expense (\$592,709) be removed from the attrition year depreciation adjustment of \$1,727,463 shown on Exhibit EXP-16-Depreciation Expense-LCB.

Rate Base Adjustment Summary

Q CAN YOU DESCRIBE THE IMPACT ON TAWC'S RATE BASE AS A RESULT OF YOUR PROPOSED ADJUSTMENTS?

A Yes. This is developed on my Exhibit MPG-1, page 1. As shown on that exhibit, the first column is the attrition year 13-month average rate base proposed by Ms. Bridwell. The second column shows my proposed adjustments to the utility plant in-service and certain other items described above. The third column shows my proposed adjusted attrition year rate base for TAWC.

As shown on that column, I recommend an attrition year rate base of \$119,325,304. This is a \$16,494,952 reduction from the \$135.82 million attrition year rate base recommended by TAWC witness Bridwell.

Business Transformation ("BT") Cost

Q IS THE COMPANY PROPOSING TO INCLUDE BT COST IN ITS FILING?

A Yes. TAWC witness Gary VerDouw requests inclusion of BT cost at pages 26-31. Mr. VerDouw states that BT is a new software system that is being developed by AWSC. The cost of this software development is proposed to be allocated across all utility subsidiaries of American Water Works. Mr. VerDouw states that AWSC projects to invest approximately \$320.3 million to develop the BT program. The BT program is then a software program and customer service program that consists of enterprise resource planning, enterprise asset management, and customer information system.

The Company proposes to allocate a portion of the total AWSC fees to TAWC based on its percentage of customers to total operating utility customers. This results in an allocated share of the total BT cost to TAWC of 2.42%.

Q ARE YOU RECOMMENDING ANY ADJUSTMENTS TO THE COMPANY'S PROPOSED BT COST?

A Yes. At pages 40 and 41 of his testimony, Mr. VerDouw describes the BT cost. He states there are four categories of cost including:

1. Physical assets (for example, primary service, networking equipment, etc.);
2. Software licenses;
3. Capitalized labor cost required to design and modify the base software packages, develop transition routes to modify business processes, implement the go-live use of the software and train employees on the new software; and
4. The initial plant studies.

Q ARE YOU PROPOSING ANY ADJUSTMENTS TO THE COST COMPONENTS AS OUTLINED BY MR. VERDOUW?

A Yes. I propose adjustments to the ratemaking treatment and the amount of cost to be recovered from customers. I would also note that many of the expenditures for the BT program as outlined at page 39 of Mr. VerDouw's testimony, have been incurred over the period 2009 up through the end of 2012, which is the beginning of the attrition year.

As I understand it, TAWC has not received Commission approval to defer the payments made to AWSC for the BT cost. Hence, while the Company proposes to capitalize and amortize these costs now, it claims to have paid the BT cost as AWSC fees in prior years. If that is the case, the attrition year cost of service for the BT program should be approximately \$1.2 million for calendar year 2013, as shown in Table 2 at page 39 of Mr. VerDouw's testimony. TAWC should not be allowed to retroactively defer BT cost.

However, if the TRA allows for the capitalization of these expenses, it should only allow for deferral and recovery of the physical assets and software licenses. The

1 deferred labor and initial planning and processing, are related to TAWC and AWSC
2 employees. All of these employee costs have already been fully paid for by TAWC's
3 customers. The AWSC labor fees and TAWC's employee expenses have been
4 embedded in TAWC's rates since 2009 in past rate cases. It would be double
5 recovery for TAWC to capitalize internal labor expenses related to the BT program
6 when these labor expenses were recovered from customers in the year the labor
7 expense was incurred.

8 Further, a rate base treatment of the physical assets and software costs is
9 also unjustified. As Mr. VerDouw states at page 41, the hardware will be purchased
10 from Laurel Oak Properties and leased to AWSC. As such, it is the lease payment
11 that should be subject to recovery by TAWC. TAWC's proposal to pay the physical
12 asset investment cost and carry it at its weighted average cost of capital is
13 inappropriate and not justified. Rather, TAWC should simply pay its allocated share
14 of the annual lease payment to Laurel Oak Properties which should be included in the
15 AWSC fee to TAWC.

16 Similarly, per Mr. VerDouw at page 41, the software costs are a component of
17 an AWSC licensee. Indeed, Mr. VerDouw even states that TAWC will pay its share of
18 the license fee through AWSC because it is more economical than the vendor issuing
19 individual invoices to each participating regulated utility. (Page 41). It is not clear
20 how the compensation for the software lease is structured. Nevertheless, the AWSC
21 cost should be passed onto TAWC and other affiliates as if provided by a
22 non-affiliated third party. Hence, AWSC should carry the software licensee cost and
23 allocate it to TAWC with a carrying charge in its annual service fee to TAWC over the
24 expected life of BT.

1 AWSC then should be allowed to charge a competitive lease structure interest
2 rate on the software and hardware BT program costs. Importantly, it is not
3 reasonable or prudent for TAWC to prepay AWSC for the BT cost and then carry
4 these costs at its weighted average cost of capital, unless TAWC can show that a
5 prepayment is a lower cost alternative to a leasing structure.

6 **Q PLEASE DESCRIBE THE TWO COST ADJUSTMENTS YOU PROPOSE TO THE**
7 **BT PROGRAM COSTS.**

8 A Mr. VerDouw's Schedule BT-1.1 lists the cost components included in BT. I
9 recommend three adjustments to the BT cost.

10 First, the internal labor expense should be removed. This cost relates to labor
11 that was part of the TAWC and AWSC team that helped to develop BT. Including the
12 labor costs in the BT deferral is inappropriate because TAWC and AWSC internal
13 labor costs are already being recovered in TAWC rates via an allocation of AWSC
14 cost to TAWC, reflected in TAWC's cost of service. Recovering the AWSC and
15 TAWC labor cost currently through TAWC rates, and also deferring these labor costs
16 as a component of the BT cost allows for double-recovery of the labor costs.

17 Second, the Company also is including a contingency factor in the cost of BT.
18 I believe it is not appropriate to include a contingency factor in this cost, because a
19 contingency does not reflect the known and measurable expense, and has not been
20 shown to be a prudent and reasonable cost. To the extent it is later determined that
21 the Company's estimated cost of BT varies from actual cost, then the Company
22 should have an opportunity to come back and show that its actual implementation
23 costs were prudent and reasonable. However, inclusion of a contingency cost in the
24 development of TAWC cost of service is inappropriate and should not be permitted.

1 Third, the Company included a carrying cost based on its AFUDC rate. I have
2 reduced this component to reflect the eliminations I am recommending to the labor
3 and contingency components.

4 **Q HOW IS THE BT COST CHANGED BY THESE TWO ADJUSTMENTS?**

5 A Based on the two adjustments described above, the AWSC BT cost of \$320.2 million
6 is reduced to \$227.6 million, as developed on Exhibit MPG-2, line 18. This will
7 reduce the Tennessee allocated BT cost from \$7.75 million estimated by
8 Mr. VerDouw down to \$5.51 million (Exhibit MPG-2, line 20).

9 **Q WHAT IS THE IMPACT ON TAWC'S COST OF SERVICE THROUGH YOUR**
10 **PROPOSED BT DEFERRED COST RECOVERIES, AND A RATEMAKING**
11 **TREATMENT FOR THE BT COST?**

12 A Removing the proposed BT cost from TAWC's rate base and depreciation expense,
13 and including a level annualized cost recovery to be added to the AWSC fees will
14 lower TAWC's test year cost of service for the BT cost by \$766,256, as described on
15 Exhibit MPG-3.

16 This amount was developed using an interest rate for the lease payments for
17 the software and hardware BT cost of 4% which is generally consistent with the cost
18 of "A" rated utility bonds. AWSC's credit standing should certainly justify this level of
19 interest rates in the current low-cost capital environment.

Distribution System Infrastructure Charge (“DSIC”)

Q PLEASE DESCRIBE THE COMPANY’S PROPOSED DSIC.

A As described in the direct testimony of TAWC witness Gary VerDouw, the Company is proposing to implement a DSIC. Mr. VerDouw states that TAWC’s infrastructure is between 50 and 100 years old, and is nearing the end of its useful life. He states that the infrastructure replacement pace is an increasing concern for TAWC. He believes that a DSIC will more accurately reflect the ongoing investments and improvements that are made in the water distribution system versus the less frequent but larger step increases that will result from base rate increases without a DSIC.

Mr. VerDouw describes his expected DSIC benefits as follows:

1. Allow for smaller step increases rather than a bigger step increase implemented with more frequent base rate increases;
2. Allow for aged infrastructure to be replaced on an accelerated basis which will produce direct customer benefits in the form of improved and sustained water quality increase, improved fire protection, fewer service disruptions and lower operation and maintenance costs over time; and
3. He opines that capital cost savings may also be achieved through increased coordination with sharing the paving costs with the Tennessee Department of Transportation, local government or other utilities.

Q HOW DOES THE COMPANY PROPOSE TO OPERATE THE DSIC?

A The Company proposes to use the DSIC to recover costs associated with qualified infrastructure investment between rate cases. Mr. VerDouw states that TAWC will recover return “on” and “off” qualifying investments in the DSIC tracker.

Mr. VerDouw describes the proposed DSIC as follows:

1. He states that the DSIC will be established on an annual prospective basis utilizing 13-month average end-of-month balances and will reflect only those qualified plant additions installed after the conclusion of the initial rate year after the TRA’s final order in this case.

2. The qualified plant additions would be reduced by the projected retirements associated with the DSIC additions in the calculation of applicable depreciation and property tax expense.
3. The Company will make its DSIC filing to establish the applicable DSIC charge not later than 90 days prior to the effective date of each DSIC implementation.
4. Not later than 60 days after the conclusions of each DSIC year, the Company would file reconciliation schedules detailing any over or under-recoveries, with such over/under-recoveries returned to or recovered from customers as applicable in the succeeding DSIC year.
5. The DSIC would be cumulative and remain in place until reset to 0% at the conclusion of the Company's next base rate filing, at which point the capital costs and depreciation previously recovered through the DSIC are then subsumed within base rates.
6. The Company proposes to cap the DSIC charge between base rate cases at 10% of the authorized revenue level as established by the TRA in the Company's most recent rate proceeding prior to the inclusion of any other surcharges.

Q WHAT PLANT INVESTMENT DOES THE COMPANY PROPOSE TO INCLUDE AS QUALIFIED DSIC PLANT INVESTMENTS?

A Mr. VerDouw (Direct Testimony at page 48) proposes specific plant investments to include the following:

1. Account 331 – Transmission and Distribution Mains, including valves;
2. Account 333 – Services;
3. Account 334 – Meters and Meter Installations; and
4. Account 335 – Hydrants.

The above accounts would include main extensions to eliminate dead ends and the reimbursed costs associated with relocations of mains, services and hydrants occasioned by street or highway construction. Mains installed to provide service to new customers would not be included in the DSIC.

DSIC Response

Q IS THE COMPANY'S PROPOSAL FOR A DSIC REASONABLE?

A No. The Company's proposal for a DSIC in this case should be rejected for several reasons:

1. The DSIC will not provide an adequate forum to determine if the DSIC investments are prudent and reasonable.
2. The DSIC will allow for separate rate-setting mechanisms in between rate cases which may result in TAWC charging customers excessive prices.
3. Tennessee regulatory mechanisms already accommodate increasing plant investment in setting base rates. A DSIC is not needed to support TAWC's capital program.

Q PLEASE EXPLAIN WHY THE CURRENT TENNESSEE REGULATORY MECHANISMS ARE ALREADY ADEQUATE WITHOUT A DSIC.

A TAWC's current rate-setting methodology allows it to include projected plant additions for an attrition year that is up to 23 months after the end of the historical test year. The attrition year timing closely matches the first year that rates determined in a rate case will be in effect. Hence, there is a reasonable pattern of reflecting actual attrition year cost of service with the development of rates. TAWC's attrition year has historically reflected a significant increase in rate base relative to the actual historical year.

For example, in TAWC's last several rate cases, the attrition year rate base was 8% to 9% higher than the historical test year rate base. The attrition year rate base growth reflects TAWC increasing plant investment that is incurred to upgrade and modernize its aging utility infrastructure. Because the Tennessee regulatory mechanisms already reflect future changes in plant investment in setting base rates, a DSIC is not needed.

1 **Q PLEASE EXPLAIN WHY THE DSIC WILL NOT PROVIDE AN ADEQUATE FORUM**
2 **TO DETERMINE IF THE QUALIFYING DSIC INVESTMENTS ARE PRUDENT AND**
3 **REASONABLE.**

4 A The Company proposes to file the DSIC with approximately 90 days to review the
5 costs before the rate goes into effect. Such a short period will not allow parties
6 adequate time to investigate (review support, issue discovery, assess prudence) the
7 additions and develop adjustments. In addition, 90 days will not allow sufficient time
8 for the TRA to conduct hearings to address disputes.

9 **Q PLEASE EXPLAIN WHY THE DSIC COMBINED WITH BASE RATES MAY**
10 **RESULT IN CUSTOMERS PAYING EXCESSIVE CHARGES.**

11 A Traditionally, rates are set based on a full review of all revenues and the operating
12 cost of service for the utility to determine whether or not a change in rates is
13 necessary. The DSIC will allow TAWC to increase rates with only a review of
14 changes to the qualifying investments that will be included in the DSIC. This may
15 result in excessive rates to customers if the DSIC increases, but base rate revenues
16 increase and/or cost of service components decline.

17 For example, TAWC's sales revenues could increase, its operating expenses
18 and/or capital costs could decline, or its non-DSIC rate base investment could decline
19 between rate cases. The possible decline in these non-DSIC costs could offset the
20 increase in the DSIC costs, and eliminate (in whole or in part) the need for a rate
21 increase to cover the DSIC increased costs. However, absent a full review of all
22 revenues and costs, TAWC may receive a DSIC rate increase when a rate increase
23 would not be justified if all revenues and costs are reviewed.

1 Second, TAWC has a historical practice of adjusting rates about every two
2 years. This frequency of rate cases, along with the attrition year process allowed in
3 Tennessee, facilitates a synchronization of TAWC's increasing cost of service,
4 caused by a significant capital improvement program, with the development of rates
5 that reflect the high capital investment costs during the period rates are in effect. The
6 DSIC is not necessary given the ratemaking structure in Tennessee.

7 **Q DO THE OTHER JURISDICTIONS THAT WERE IDENTIFIED BY TAWC HAVE**
8 **SIMILAR REGULATORY MECHANISMS?**

9 A No. For example, in Missouri, rates are set based on actual data only. Attrition year
10 projections are not allowed. As such, the DSIC-type mechanism available in Missouri
11 is very different because Missouri is not allowed, as is TAWC, to use projected costs,
12 some almost two years after the end of the test year, in setting its rates. Again, the
13 regulatory mechanisms in Tennessee eliminate the need for a DSIC.

14 **Q DO YOU BELIEVE THAT TAWC'S ASSERTION IS ACCURATE THAT A DSIC**
15 **WILL MITIGATE THE RATE INCREASES ON RETAIL CUSTOMERS AS**
16 **EXPLAINED BY MR. VERDOUW AT PAGE 44?**

17 A No. A DSIC will not mitigate rate increases or rate shock to customers. Rather,
18 TAWC will simply increase rates on an annual basis, rather than on a biannual basis.
19 The suggestion that smaller annual rate increases benefit customers rather than
20 somewhat larger biannual rate cases, is unfounded and erroneous.

21 **Q DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

22 A Yes, it does.

Qualifications of Michael P. Gorman

1 **Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A Michael P. Gorman. My business address is 16690 Swingley Ridge Road, Suite 140,
3 Chesterfield, MO 63017.

4 **Q PLEASE STATE YOUR OCCUPATION.**

5 A I am a consultant in the field of public utility regulation and a Managing Principal with
6 Brubaker & Associates, Inc., energy, economic and regulatory consultants.

7 **Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND WORK
8 EXPERIENCE.**

9 A In 1983 I received a Bachelors of Science Degree in Electrical Engineering from
10 Southern Illinois University, and in 1986, I received a Masters Degree in Business
11 Administration with a concentration in Finance from the University of Illinois at
12 Springfield. I have also completed several graduate level economics courses.

13 In August of 1983, I accepted an analyst position with the Illinois Commerce
14 Commission ("ICC"). In this position, I performed a variety of analyses for both formal
15 and informal investigations before the ICC, including: marginal cost of energy, central
16 dispatch, avoided cost of energy, annual system production costs, and working
17 capital. In October of 1986, I was promoted to the position of Senior Analyst. In this
18 position, I assumed the additional responsibilities of technical leader on projects, and
19 my areas of responsibility were expanded to include utility financial modeling and
20 financial analyses.

1 In 1987, I was promoted to Director of the Financial Analysis Department. In
2 this position, I was responsible for all financial analyses conducted by the Staff.
3 Among other things, I conducted analyses and sponsored testimony before the ICC
4 on rate of return, financial integrity, financial modeling and related issues. I also
5 supervised the development of all Staff analyses and testimony on these same
6 issues. In addition, I supervised the Staff's review and recommendations to the
7 Commission concerning utility plans to issue debt and equity securities.

8 In August of 1989, I accepted a position with Merrill-Lynch as a financial
9 consultant. After receiving all required securities licenses, I worked with individual
10 investors and small businesses in evaluating and selecting investments suitable to
11 their requirements.

12 In September of 1990, I accepted a position with Drazen-Brubaker &
13 Associates, Inc. ("DBA"). In April 1995, the firm of Brubaker & Associates, Inc. ("BAI")
14 was formed. It includes most of the former DBA principals and Staff. Since 1990, I
15 have performed various analyses and sponsored testimony on cost of capital,
16 cost/benefits of utility mergers and acquisitions, utility reorganizations, level of oper-
17 ating expenses and rate base, cost of service studies, and analyses relating to
18 industrial jobs and economic development. I also participated in a study used to
19 revise the financial policy for the municipal utility in Kansas City, Kansas.

20 At BAI, I also have extensive experience working with large energy users to
21 distribute and critically evaluate responses to requests for proposals ("RFPs") for
22 electric, steam, and gas energy supply from competitive energy suppliers. These
23 analyses include the evaluation of gas supply and delivery charges, cogeneration
24 and/or combined cycle unit feasibility studies, and the evaluation of third-party
25 asset/supply management agreements. I have participated in rate cases on rate

1 design and class cost of service for electric, natural gas, water and wastewater
2 utilities. I have also analyzed commodity pricing indices and forward pricing methods
3 for third party supply agreements, and have also conducted regional electric market
4 price forecasts.

5 In addition to our main office in St. Louis, the firm also has branch offices in
6 Phoenix, Arizona and Corpus Christi, Texas.

7 **Q HAVE YOU EVER TESTIFIED BEFORE A REGULATORY BODY?**

8 A Yes. I have sponsored testimony on cost of capital, revenue requirements, cost of
9 service and other issues before the Federal Energy Regulatory Commission and
10 numerous state regulatory commissions including: Arkansas, Arizona, California,
11 Colorado, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas,
12 Louisiana, Michigan, Missouri, Montana, New Jersey, New Mexico, New York, North
13 Carolina, Oklahoma, Oregon, South Carolina, Tennessee, Texas, Utah, Vermont,
14 Virginia, Washington, West Virginia, Wisconsin, Wyoming, and before the provincial
15 regulatory boards in Alberta and Nova Scotia, Canada. I have also sponsored
16 testimony before the Board of Public Utilities in Kansas City, Kansas; presented rate
17 setting position reports to the regulatory board of the municipal utility in Austin, Texas,
18 and Salt River Project, Arizona, on behalf of industrial customers; and negotiated rate
19 disputes for industrial customers of the Municipal Electric Authority of Georgia in the
20 LaGrange, Georgia district.

1 **Q PLEASE DESCRIBE ANY PROFESSIONAL REGISTRATIONS OR**
2 **ORGANIZATIONS TO WHICH YOU BELONG.**

3 A I earned the designation of Chartered Financial Analyst (“CFA”) from the CFA
4 Institute. The CFA charter was awarded after successfully completing three
5 examinations which covered the subject areas of financial accounting, economics,
6 fixed income and equity valuation and professional and ethical conduct. I am a
7 member of the CFA Institute’s Financial Analyst Society.

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Tennessee American Water Company

Adjusted 13-Month Average Attrition Year Rate Base

<u>Line</u>	<u>Description</u>	<u>As Filed Attrition Year 13 Mo Avg Nov. 12 - Nov. 13 (1)</u>	<u>Rate Base Adjustments (2)</u>	<u>Adjusted Attrition Year 13 Mo Avg Nov. 12 - Nov. 13 (3)</u>	<u>Reference</u>
	Utility Plant				
1	Utility Plant in Service	\$ 250,455,533	\$ (5,507,459)	\$ 244,948,074	Exhibit MPG-2, Page 1.
2	Construction Work in Progress	3,581,671	(1,706,675)	1,874,996	Exhibit RB-3-CWIP-LCB, Page 10
3	Utility Plant Capital Lease	1,590,500	-	1,590,500	
4	Deferred Maintenance	-	-	-	
5	Limited Term Utility Plant	-	-	-	
6	Total Utility Plant	\$ 255,627,704	\$ (7,214,134)	\$ 248,413,570	Sum of Lines 1-5
7	Accumulated Provision for Depreciation UPIS	\$ 81,011,226	\$ -	\$ 81,011,226	
8	Accumulated Amortization of Utility Plant Capital Lease	1,576,226	-	1,576,226	
9	Total Accumulated Depreciation:	<u>\$ 82,587,452</u>	<u>\$ -</u>	<u>\$ 82,587,452</u>	
10	Net Utility Plant:	\$ 173,040,252	\$ (7,214,134)	\$ 165,826,118	Ln 6 - Ln 9
11	Working Capital	<u>\$ 3,188,192</u>	<u>\$ -</u>	<u>\$ 3,188,192</u>	
12	Total Additions	\$ 3,188,192	\$ -	\$ 3,188,192	
13	Deferred Income Taxes	\$ 23,407,464	\$ 8,580,818	\$ 31,988,282	Exhibit MPG-1, Page 2.
14	RWIP	-	-	-	
15	Customer Advances for Construction	4,473,724	700,000	5,173,724	Exhibit RB-10 Customer Advances - LCB
16	Contributions in Aid of Construction	12,466,115	-	12,466,115	
17	Unamortized Investment Tax Credit	20,965	-	20,965	
18	Utility Plant Acquisition Adjustment	<u>39,920</u>	<u>-</u>	<u>39,920</u>	
19	Total Deductions:	\$ 40,408,188	\$ 9,280,818	\$ 49,689,006	Sum of Lines 13-18
20	Rate Base	\$ 135,820,256	\$ (16,494,952)	\$ 119,325,304	Ln 10 + Ln 12 - Ln 19

Tennessee American Water Company

Deferred Income Tax Adjustment

<u>Line</u>	<u>Description</u>	<u>Amount</u>	<u>Reference</u>
	Deferred Income Taxes		
1	Regulatory Assets	\$ 7,620,777	Exhibit RB-9 Deferred Taxes - LCB
2	Regulatory Liabilities	(175,869)	Exhibit RB-9 Deferred Taxes - LCB
3	Uncertain Tax Positions (FIN 48)	<u>1,135,910</u>	TAWC 12/31/11 Financial Report, Page F-33
4	Total Adjustment	\$ 8,580,818	

Tennessee American Water Company

Adjusted Business Transformation Costs

<u>Line</u>	<u>Description</u>	<u>Total</u> (1)	<u>Adjustment</u> (2)	<u>Adjusted Total</u> (3)
Labor				
1	Internal - Business	\$ 50,217,502	\$ (50,217,502)	\$ -
2	Internal - ITS	21,942,489	(21,942,489)	-
3	External - Support	110,076,964	-	110,076,964
4	External - Other	<u>7,572,960</u>	<u>-</u>	<u>7,572,960</u>
5	Labor Subtotal	\$ 189,809,915	\$ (72,159,991)	\$ 117,649,924
6	Employee Expenses	18,997,741	-	18,997,741
7	Hardware	18,181,054	-	18,181,054
8	Software	28,780,876	-	28,780,876
9	Program Operations	3,996,660	-	3,996,660
10	CPS	6,341,302	-	6,341,302
11	Contingency	<u>14,300,003</u>	<u>(14,300,003)</u>	<u>-</u>
12	BT Subtotal	\$ 280,407,551	\$ (86,459,994)	\$ 193,947,557
Other				
13	AFUDC - BT	<u>\$ 20,238,249</u>	<u>\$ (6,240,199)</u>	<u>\$ 13,998,050</u>
14	Total BT	\$ 300,645,800	\$ (92,700,193)	\$ 207,945,607
15	BT Controls/OI	\$ 18,345,618	\$ -	\$ 18,345,618
16	BT Controls/OI AFUDC	<u>1,289,735</u>	<u>-</u>	<u>1,289,735</u>
17	Total BT Controls/OI	\$ 19,635,353	\$ -	\$ 19,635,353
18	Total	\$ 320,281,153	\$ (92,700,193)	\$ 227,580,960
19	TN Allocation Factor	<u>2.420%</u>	<u>2.420%</u>	<u>2.420%</u>
20	TN Allocated	\$ 7,750,804	\$ (2,243,345)	\$ 5,507,459

Source:

Petitioner's Exhibit BT-1, Schedule BT-1.1, Page 1

Tennessee American Water Company

Revenue Requirement Impact of BT Cost Adjustments

<u>Line</u>	<u>Description</u>	Total Tennessee 13 Mo Avg <u>Nov. 12 - Nov. 13</u> (1)	Adjusted Tennessee (2)
1	TN Allocated BT Costs ¹	\$ 7,214,134	\$ 5,507,459
2	Pre-Tax Rate of Return ²	<u>11.83%</u>	
3	Lease Return ³		4.04%
4	Return on TN Allocated BT Costs	\$ 853,789	
5	Annual Depreciation Expense ⁴	<u>592,709</u>	
6	Revenue Requirement - 1	\$ 1,446,498	
	Revenue Requirement - 2		\$ 680,242
7	Revenue Requirement Impact		\$ (766,256)

Sources:

¹ Exhibit MPG-1, Page 1.

² Exhibit CS-1-Capital Structure-GMV, Schedule CS-1.1, Page 1

³ <http://credittrends.moodys.com/>.

⁴ Bridwell Direct at 18

Notes: TAWC proposed pre-tax rate of return is used for illustrative purposes only.

I am not endorsing this recommended return.

BEFORE THE
TENNESSEE REGULATORY AUTHORITY

PETITION OF TENNESSEE
AMERICAN WATER COMPANY
FOR A GENERAL RATE
INCREASE, IMPLEMENTATION OF
A DISTRIBUTION SYSTEM
INFRASTRUCTURE CHARGE AND
THE ESTABLISHMENT OF
TRACKING MECHANISMS FOR
PURCHASED POWER, PENSIONS
AND CHEMICAL EXPENSES

DOCKET NO. 12-00049

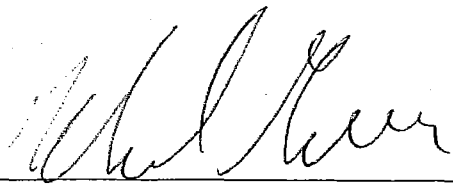
STATE OF MISSOURI)
)
COUNTY OF ST. LOUIS)

SS

Affidavit of Michael P. Gorman

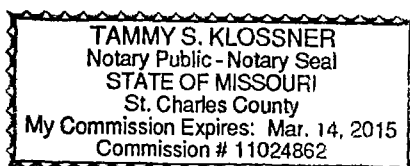
BEFORE ME, the undersigned authority, duly commissioned and qualified in and for the State and County aforesaid, personally came and appeared Michael P. Gorman, being by me first duly sworn deposed and said that:

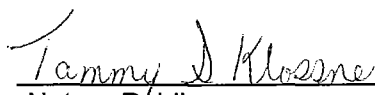
He is appearing as a witness on behalf of the City of Chattanooga before the Tennessee Regulatory Authority, and if present before the Authority and duly sworn, his testimony would be as that set forth in the annexed consisting of 18 pages, plus the appendix, and schedules or Exhibits MPG-1 to MPG-3.



Michael P. Gorman

Subscribed and sworn to before me this 27th day of August, 2012.





Notary Public

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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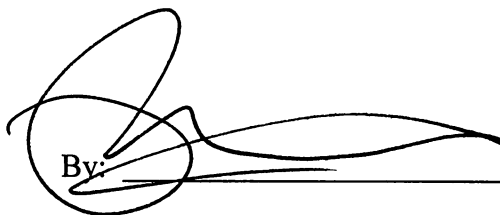
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This 27th day of August, 2012.

By:  _____