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IN THE TENNESSEE REGULATORY AUTHORITY
AT NASHVILLE, TENNESSEE

IN RE:	)	
	)	
PETITION OF NAVITAS TN NG, LLC	)	**DOCKET NO. 12-00068**
FOR AN ADJUSTMENT TO ITS NATURAL	)	
GAS RATES AND APPROVAL OF REVISED	)	
TARIFFS	)	

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DIRECT TESTIMONY
OF
CHARLENA S. AUMILLER

****

November 21, 2012

IN THE TENNESSEE REGULATORY AUTHORITY
AT NASHVILLE, TENNESSEE

IN RE:	)	
	)	
PETITION OF NAVITAS TN NG, LLC FOR AN ADJUSTMENT TO ITS NATURAL GAS RATES AND APPROVAL OF REVISED TARIFFS	))))	**DOCKET NO. 12-00068**

AFFIDAVIT

I, Charlena S. Aumiller, Assistant Attorney General, on behalf of the Consumer Advocate Division of the Attorney General's Office, hereby certify that the attached Direct Testimony represents my opinion in the above-referenced case and the opinion of the Consumer Advocate Division.

Charlena Aumiller
CHARLENA S. AUMILLER

Sworn to and subscribed before me
this the 21st day of November, 2012.

Emily Knight
NOTARY PUBLIC

EMILY KNIGHT STATE OF TENNESSEE NOTARY PUBLIC DAVIDSON COUNTY, TENN.
My Commission Expires JULY 6, 2015

My commission expires: July 6, 2012

INTRODUCTION

Q. Please state your name and position.

A. My name is Charlena S. Aumiller. I am an Assistant Attorney General with the Consumer Advocate and Protection Division ("Consumer Advocate" or "CAPD") in the Office of the Attorney General for the State of Tennessee ("Office").

Q. What positions have you held with the CAPD?

A. I was hired as a Legal Assistant in August 2012 with the understanding that I would be promoted to my current position after completing the requirements to be sworn into the Tennessee Bar. My entire tenure with the Office has been with the CAPD.

Q. In addition to your JD, have you earned any other degrees?

Yes, I have a Bachelors of Science degree in Accounting from Missouri State University in Springfield, Missouri. I earned my Juris Doctor from Washington University School of Law in St. Louis, Missouri.

Q. What work experience do you have?

A. I was an auditor for over seven years before attending law school. I worked as an external auditor at BKD, when it was the seventh largest public accounting firm in the United States. My primary responsibilities included financial statement audits for healthcare, manufacturing, and financial institutions. I also worked on taxes and business valuations.

I additionally worked as an internal auditor at KPMG, a Big 4 public accounting firm, in its Risk Management group. I primarily assisted mining and manufacturing companies with implementing Sarbanes-Oxley ("SOX"). My tenure at KPMG included a temporary transfer to Australia to train and assist KPMG Australia in SOX implementations.

After KPMG, I worked for publicly held companies, including a Fortune 500 Company. I worked on SOX and implementations generally, including a company-wide, full SAP[1] implementation that replaced all legacy systems except the database used to track the company's Asset Retirement Obligation ("ARO").

Q. Have you earned any certifications?

A. I earned and maintain my Certified Public Accountant ("CPA") license in Missouri in 2003.

Although currently inactive, I also earned the Certified Information Systems Auditor ("CISA") license. The CISA requires passing a test, meeting certain experiential requirements, and being recommended by experienced professionals. The CISA is the equivalent of the CPA license for IT auditors, and it is a license generally required by all Big 4 accounting firms for their IT auditors.

I have also earned the Certified Fraud Examiner ("CFE") license and Certified Internal Auditor ("CIA") license, both of which required passing a four-part test, meeting the experiential requirements, and receiving recommendations from experienced professionals. My CFE and CIA licenses are also currently inactive.

Finally, I earned my Green Belt in Six Sigma. The Six Sigma methodology is a business philosophy that incorporates proven statistical and problem-solving techniques focusing on the reduction of variation, cycle time, and waste to significantly improve quality, cost, and time performance to achieve efficiency without compromising the effectiveness of the process.

Q. Do you have any experience with utility rate making?

A. Yes. I was fully engaged in all aspects of two recent rate cases before the TRA: Docket No. 12-00049 ("TAWC") and Docket No. 12-00064 ("Atmos"). I participated in those cases from analysis through settlement negotiations. I recently completed the 40th Eastern NARUC Utility Rate School and participated

[1] SAP is a German multinational software company that makes enterprise software to manage business systems and customer relations. SAP was founded by former IBM engineers. Oracle is SAP's major competitor.

in the NARUC/NASUCA meetings in Baltimore, Maryland. In addition to working on this Docket, I am fully engaged in TRA Docket No. 12-00030 ("Laurel Hills").

Q. In addition to your academic credentials and experience, is there any other authority under which you testify?

A. Yes. Under Tenn. Code Ann. § 65-4-118 (a), the CAPD "shall consist of various positions which may include attorneys, accountants/financial analysts, support personnel and other personnel as determined by the attorney general and reporter to be appropriate and necessary to accomplish the purposes of this section." Section (b)(1) states that the CAPD "has the duty and authority to represent the interests of Tennessee consumers of public utility consumers."

Q. What is the purpose of your testimony?

A. My testimony will support and address the CAPD's positions and concerns with respect to the Navitas TN NG, LLC ("Navitas", "Company", or "TN") Petition for an Adjustment to its Natural Gas Rates and Approval of Revised Tariffs filed with the TRA on July 2, 2012 ("Petition"). My testimony will include various Exhibits, Schedules, and Work Papers. The testimony and supporting documentation will address Rate Base, Revenues, Operation and Maintenance ("O&M") Expenses, Depreciation Expense, Taxes Other Than Income, Income Taxes, and other concerns for Navitas. Because Navitas's proposed test year ending December 31, 2011 did not include twelve months of costs for its largest expense,[2] the CAPD utilized a test year ending March 31, 2012 for expense and revenue determinations. Navitas agreed the change in test year data was warranted to help ensure the revenue requirement from this rate case would cover twelve months of expenses.

Q. What documents have you reviewed in preparation for your testimony?

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[2] Per discussion with Thomas Hartline and Joey Irwin, January 2011 expenses from Navitas Utility Corporation ("NUC") were not allocated to Navitas TN.

A. I have reviewed Navitas's Petition along with the testimony and exhibits presented with their filing. In addition, I have reviewed its work papers, responses to the relevant data requests submitted by the TRA and the CAPD, and various financial statements and transaction details from Navitas's accounting system. I also participated in several meetings and multiple teleconferences with the Navitas principals and accounting staff.

Q. Does Navitas maintain its books and records in accordance with the Federal Energy Regulatory Commission's ("FERC") Uniform System of Accounts ("USOA")?

A. No, although the USOA is the prescribed methodology for maintaining records in this jurisdiction, Navitas uses a chart of accounts that does not follow USOA. The variance from the USOA may have resulted in some accounts containing transactions that would have been separately identified under USOA. Navitas has been transparent with their books and records throughout this process. Per our discussion with Mr. Thomas Hartline, Navitas President, Navitas has pledged to move toward the USOA.

NAVITAS BACKGROUND

Navitas is a Tennessee limited liability company under the laws of the State of Tennessee and is engaged in the transportation, distribution, and sale of natural gas service to approximately 545 customers[3] residing in Campbell County, Tennessee and Whitley County, Kentucky (the "Jellico System"),[4] Pickett County, Tennessee (the "Byrdstown System") and Fentress County, Tennessee (the "Fentress System").[5] Navitas also furnishes natural gas to approximately

[3] This is not an average of customers each year, but rather the number of customers as of October 2012, per information provided by Mr. Hartline.

[4] By Order of the Public Service Commission of the Commonwealth of Kentucky dated August 13, 1990, service to Kentucky residents in Kentucky Hill and Black Oak in Whitley County, Kentucky is effective under the jurisdiction of the TRA as part of the Jellico Distribution System.

[5] *See Order Approving Amended Settlement Agreement* ("Order") dated December 1, 2011 in Docket No. 11-00060.

4100 customers located in various parts of Oklahoma and in Clinton County, Kentucky (the "Albany System").[6] Navitas Utility Corporation ("NUC") is located in Eakley, Oklahoma and provides management, accounting, customer service, billing, and operations and maintenance for all operations in Oklahoma, Kentucky, and Tennessee.

Tennessee has one employee dedicated to it and half the time of a contracted employee. Services provided by a third party are directly charged to each system for which the services were performed. The primary service provider for each system, and the largest expense for Navitas TN, is NUC. NUC allocates its cost of service to each system based on what they call a "customer density per mile." This allocation method is described more in the discussion of O&M expenses.

Navitas is a public utility pursuant to the laws of Tennessee, and its public utility operations are subject to the jurisdiction of the TRA.[7] Navitas is a wholly-owned subsidiary of Navitas Assets, LLC, a Delaware limited liability company. The principal office and place of business of Navitas is located at 3186D Airway Avenue, Costa Mesa, California 92626. Local offices are maintained at 613 Sunset Trail, Jellico, Tennessee 37762 and 9825 Hwy 111, Static, Tennessee.[8]

On December 30, 2010, the TRA issued an Order in TRA Docket 10-00220 approving the transfer of control of the utility systems of Gasco Distribution Systems, Inc. ("Gasco") to Navitas. At the time of the acquisition by Navitas of Gasco, Gasco operated as Debtor in Possession while in proceedings before the United States Bankruptcy Court for the Southern District of Ohio, Eastern Division.[9] Navitas adopted all of Gasco's existing tariffs.[10]

On April 20, 2011, Navitas filed a Petition for Emergency Relief ("2011 Petition") in which the Company sought approval to increase the rates paid by the

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[6] This is not an average of customers each year, but rather the number of customers a of October 2012, per information provided by Mr. Hartline.
[7] *Id. See also Amended Proposed Settlement Agreement* ("Settlement") attached to Order at paragraph 1.
[8] *Id.* ¶ 2.
[9] Gasco filed for Chapter 11 bankruptcy protection (Case No. 09056171) in the United States Bankruptcy Court for the Southern District of Ohio, Eastern Division, on June 1, 2009.
[10] *See* Settlement, ¶ 3.

Navitas TN customers. Since acquiring the system formerly held by Gasco, Navitas has been operating at a loss. The 2011 Petition sought to implement a monthly customer charge of $6.00 and a charge of $1.00 per 9 Ccf per month. The relief sought was estimated to reduce the operating losses of Navitas from $159,000 to $62,000.[11] In the 2011 Petition, Navitas did not seek to cure the entire revenue deficiency it claimed it was incurring, nor did it seek to make any return on its investment.[12]

On May 5, 2011, the CAPD filed a petition to intervene to investigate the need for emergency relief sought by Navitas and the impact of such relief on Tennessee customers. After informal discovery and review, Navitas and the CAPD undertook settlement discussions and ultimately entered into a Settlement Agreement on July 14, 2011, which was approved by the TRA on December 1, 2011.[13]

Among other things, the Settlement and Order provided for an increase to customer charges and volumetric rates, that such increases were temporary pending Navitas filing a formal rate case by a date certain, and that the temporary rates would expire at the conclusion of the rate case when the TRA puts new rates into effect.[14] Pursuant to the Settlement and Order, Navitas timely filed the present petition for a formal rate case.

SUMMARY OF RESULTS

Q. Please summarize the results of the CAPD's Analysis of Navitas's Petition.

A. Navitas's test year in this case is the twelve months ending December 31, 2011. The CAPD used Navitas's test year for rate base calculations, but CAPD utilized the period of April 1, 2011 through March 31, 2012 as the test year for revenues and expenses.[15] Although the determination of rate base was possible

[11] *Petition for Emergency Relief,* April 20, 2011, p. 3; Ex.D.
[12] *See* Settlement, ¶ 4.
[13] *See supra* Order and Settlement.
[14] *Id.*
[15] CAPD received reports from Navitas to enable the adjustment of the test period for revenues. CAPD has attached the first quarter 2011 and first quarter 2012 profit and loss statements that it used to roll forward the test year to the twelve months ended March 31, 2012, as available in CAPD Exhibit B. Navitas

using the 2011 data, the cost and revenue information from January 2011 was insufficient for proper analysis of Navitas's revenue and expenses, which made the 2011 test year incomplete with only eleven months of costs.

Moreover, the CAPD believes that substituting the first quarter of 2011 for the first quarter of 2012 produces a more realistic picture of Navitas's costs and revenues for two reasons. First, Navitas TN was acquired at the end of 2010 and, per discussion with Mr. Hartline, it takes a few months after system acquisition to stabilize and develop consistent expenses reflective of normal operations. Second, the first quarter of 2012 is a more recent quarter than the first quarter of 2012, and generally more recent information is preferred.

Navitas's revenue request is based on its calculated revenue deficiency for the test year of approximately $390,000, or 150% increase in Navitas's gross profit margin.[16] To match the expenses with the rates that a company receives, ratemaking has been consistently prospective. The CAPD's revenue requirement calculations are based on Navitas TN's actual cost structure, rate base, and the O&M costs that actually directly or indirectly benefit the customers of Navitas TN.

Navitas's Petition proposed the calendar year of 2012 as the attrition year. The CAPD has adopted an attrition year of the twelve months ending December 31, 2013. The reason for this is because, at this date, it is doubtful that any rate adjustment would affect 2012, and the CAPD therefore believes that the forecasted revenue requirements for 2013 better matches the revenue with the expected expenses. Per discussion with Mr. Hartline, Navitas agrees with the CAPD's use of 2013 as the attrition year.

Navitas's attrition period revenue requirement is based on the following formula:

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provided additional data to assist with CAPD's analysis; however, the CAPD requests Navitas to file this additional data directly with the TRA to avoid inadvertently revealing confidential data.

[16] The revenue deficiency would not apply to cover costs of gas since those costs are passed through to the customers. Navitas erroneously included the purchased gas revenues and expenses in its calculation of the 85% increase it contends the $390,000 reflects. The actual gross profit margin is calculated by taking the Company's revenue deficiency of $390,00 divided by $259,859 (the Company total revenue less $224,324 in purchased gas cost, as shown on Schedule 5).

Rate Base x Rate of Return
+ Operations and Maintenance ("O&M") Expense
+ Depreciation and Amortization Expense
+ Taxes
Revenue Requirement

As shown in detail on CAPD Schedule 2, the rate base for the test and attrition periods are $829,599 and $666,179, respectively.

As shown in detail on CAPD Schedule 10, the rate of return in this case for the attrition period is 8.71%.

As shown in detail on CAPD Schedule 4, the total operations and maintenance ("O&M") expenses for the test and attrition periods in this case are $302,949 and $355,387, respectively.

As shown in detail on CAPD Schedule 4, the depreciation and amortization expense in this case for the test and attrition periods are $55,094 and $41,458, respectively.

As shown in detail on CAPD Schedule 4, the taxes in this case for the test and attrition periods are $10,469 and $10,911, respectively. Notably, the Company did not include income tax expenses in its revenue requirement in the Petition.[17] The CAPD also did not include any provisions for Navitas or its corporate parent to pay Federal Income Taxes in its calculation. The reason for this is that the various Navitas entities are organized as Limited Liability Companies ("LLC"). LLCs may elect pass through taxation whereby each owner reports his or her share of the profits on his or her personal tax return where it is taxed only at the individual owner's personal income tax rate. Although LLCs do not have to pay tax at the corporate level, the LLC must still file a tax return with the IRS. The owners are required to submit Form 1065 to the IRS, which supplies information about the company's income and deductions. This return is purely informational, and no tax is due when it is submitted. Obviously, the CAPD does

[17] See Navitas's response to Item 48(e) in the Company filing.

not believe Tennessee ratepayers should be required to pay the personal income taxes of Navitas's owners.

Finally, as shown in detail on CAPD Schedule 9, the revenue requirements for the test and attrition periods are $435,988 and $690,122, respectively.

The CAPD analysis and forecast are based on the cost of service. Based on that principle, the proposed margin change in revenue is approximately 96%. This revenue increase is derived from CAPD's revenue calculation using Navitas's actual cost structure, rate base, and fair allocation of O&M costs, whereas Navitas's $390,164 increase – nearly double what customers presently pay for gas including the purchased gas costs –[18] was calculated by adjusting the Gasco rates by the CPI index for each year since 1993, the year of the last rate increase before the emergency tariff.[19]

While there are several factors that contribute to the $140,000 revenue difference between CAPD and Navitas, the major difference is in the approach used to calculate the revenue deficiency. Based on Mr. Hartline's testimony, it appears that Navitas multiplied its costs by its interpretation of the changes to the CPI since Gasco's last rate case. The CAPD does not accept this approach as a sound basis for calculating a revenue requirement. The CAPD and the TRA do not use the CPI for determining rates. For some forecasted expenses, the CAPD and TRA may adjust appropriate test year expenses by the Gross Domestic Product ("GDP") Implicit Chained Price Deflator index ("GDP Deflator").

Usually, the CAPD testimony identifies and discusses the differences it has with the Company's proposed revenue requirement. Because Navitas's filing uses an approach to revenue requirement that is inappropriate, CAPD focuses its testimony on identifying and explaining the differences between the current revenue deficiencies on test year data and the revenue requirement proposed based on CAPD's calculations for the 2013 attrition year. The CAPD believes

[18] Under current rates and flow, customers pay a normalized amount of $435,988, as shown in CAPD's calculation on Schedule 5. Taking the Company's revenue deficiency of $390,000 plus the normalized revenue of $435,988 divided by the normalized revenue under current rates shows the rates (including gas charges) will increase by 190% for customers.

[19] CAPD Exhibit, Exhibit C.

that explaining the increase in the proposed revenue requirement that was calculated based on Navitas actual cost structure, rate base, and fair allocation of O&M costs is more informative than identifying and explaining the differences between the proposed revenue requirement of the Company and the CAPD. For future rate cases, however, the CAPD requests that Navitas ensure its filing is based on its books and records as adjusted for forecasts and elimination of expenses not benefiting Tennesseans.

Q. What is the CAPD's revenue Deficiency Calculation for this case?

A. As shown on CAPD Exhibit, Schedule 1, the CAPD's revenue deficiency calculation required to produce the 8.71% overall return by Dr. Klein is approximately $250,000.

RATEMAKING THEORY AND PRACTICE

Q. What is a public utility?

A. In the context of this case, a public utility is a business formed as a shareholder-owned corporation. Even though the public utility in this case is a for profit corporation, it is also important to note that this public utility is:

> an organization that has been designated by law as a business affected with a significant public interest, and that also possesses all of the following characteristics: (1) The business is essentially free from direct competition, i.e., it operates in a monopolistic environment; (2) The business is required by law to charge rates for its services that are reasonable and not unjustly discriminatory; (3) The business is allowed to earn (but not guaranteed) a "reasonable" profit; and (4) The business is obligated to provide adequate service to its customers, on demand.[20]

Q. Does Navitas possess these public utility characteristics?

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[20] *Accounting for Public Utilities,* Hahne and Aliff §1.01.

A. Yes. Navitas is a shareholder-owned public utility that has been granted the advantage of operating in a monopolistic environment in exchange for special obligations, namely, the requirement to provide adequate service to all customers at rates that are just, reasonable, and non-discriminatory.

Q. From a regulated ratemaking perspective, what is the TRA called upon to do in this proceeding?

A. In a rate case such as this one, the TRA is asked to establish the amount of revenues that the utility should collect in order to cover its reasonable and necessary expenses and to reasonably compensate the utility's investors for their investment in the plant and equipment necessary to provide utility service to the public. The following ratemaking formula can be used to express this concept:

Rate Base x Rate of Return
+ Operations and Maintenance ("O&M") Expense
+ Depreciation and Amortization Expense
+ Taxes
Revenue Requirement

In this equation, "Rate Base" is essentially the plant and equipment paid for by the investors in the utility. The "Rate of Return" is comprised of two major components: (1) the "Cost of Debt," which constitutes the interest rate on borrowed money and (2) the "Return on Shareholders' Equity" ("ROE"), which is the rate of compensation that flows to the owners of the utility for their investment. "Operations and Maintenance Expense" is the costs of operating the utility day-to-day, such as payroll, employee benefits, rent, office supplies, postage and billing costs, etc. "Depreciation Expense" is the systematic recovery of the cost of the plant and equipment over their useful lives. "Taxes" are the business taxes owed by the utility to federal, state, and municipal governments, such as income taxes, payroll taxes, property taxes, and franchise taxes. In order to arrive at the appropriate amount for each component of the ratemaking formula, the TRA should consider the expert witness testimony of economists, accountants, and other subject matter experts. These experts usually calculate the amount of each component of the ratemaking formula for the "Test Year." In making their "Attrition Year" forecast, ratemaking experts often consider "Test Year" data.

Q. Please explain the difference between a "Test Year" and an "Attrition Year."

A. A "test year" is a measure of a utility's financial operations and investment over a specific twelve month period. It is the "raw material" for developing a test year measure of the utility's financial operations and investment (that is, the utility's Rate Base, Operations and Maintenance Expense, Depreciation Expense, and Taxes). Therefore, the selection of the test year is quite important:

> The selection of the timing of the test year may be the most significant single factor in the rate-making process. The more outdated the test year levels of operations, the more critical is the need for significant restatement to produce representative levels of future conditions.[21]

An "attrition year," also known as a forecast period, is the "finished product" and is to be representative of the period for any rate adjustment. The test year can also be viewed as the first year during which the TRA's rate order will be applied.

In this case, CAPD used a different test year for the rate base and revenue and expense determinations. For rate base, CAPD used the test year proposed by Navitas, which is the twelve months ended December 31, 2011. CAPD started to utilize the same test year for the revenue and expense determinations, but after initial inquiries, it became apparent that January of 2011 did not include all the expenses that would normally occur in a given winter month. CAPD adjusted the test year for revenue and expense determinations to the twelve months ended March 31, 2012. The attrition year is the same for both rate base as well as the revenue requirement (which encompasses the forecasted expenses), but the CAPD

[21] *Accounting for Public Utilities,* Hahne and Aliff §7.03.

attrition year of 2013 is different than Navitas's proposed attrition year of 2012. CAPD used 2013 as its attrition year because any rate increase will go into effect in 2013.

Q. Please explain how the TRA should calculate any adjustment in customer rates to be applied during the test year.

A. Once the TRA arrives at the appropriate Revenue Requirement for the test year as previously described, it must then determine whether a rate adjustment is needed. If the Revenue Requirement is greater than the amount of operating revenue forecasted for the test year at present customer rates, then a rate increase is required. However, if the Revenue Requirement is less than the amount of operation revenue forecasted for the test year at present customer rates, then a rate decrease is required.

In determining whether a rate increase or rate decrease is warranted, the TRA should again consider the testimony of the parties' expert witnesses. In addition to forecasting the Revenue Requirement for the test year, these experts also forecast the amount of operating revenue that the utility is expected to collect during the test year at the current customer rates set forth in the utility's tariff.

RATE BASE

Q. Please describe the CAPD's Rate Base for this case.

A. As shown on CAPD Exhibit, Schedule 2, the CAPD determined the rate base in this case to be $666,179 as of December 31, 2013.

This is slightly more than the purchase price.[22] The $666,179 is calculated using a Utility Plant in Service cost of $1,806,641 plus Other Long Term Assets of $33,000 plus Working Capital of $37,077 minus Accumulated Depreciation of $977,377, Accumulated Amortization of Other Long Term Assets of $8,250, and the Acquisition Adjustment net of amortization of $224,912.

[22] The prior owner of the Tennessee operation was Gasco which went bankrupt. On or about December 31, 2010, Navitas acquired Gasco for $610,500. This is confirmed by Navitas's 2011 ad valorem tax return which shows that the total gross investment in plant in Tennessee is $610,500. *See also supra* note 9.

Q. What are the differences between CAPD's Rate Base and Navitas's Rate Base?

A. As made clear on CAPD Schedules 2 and 2.A, the difference of $824,147 in rate base between the Company filing and CAPD's attrition year is a result of (1) the CAPD's use of 2013 as the attrition year, (2) the Company filing indicating its Utility Plant in Service was $2,443,206 for Navitas's proposed test year of 2012, and (3) the Company filing including capitalizing $179,327 in Organizational Costs and $35,111 in legal fees associated with the emergency tariff petition.

First, the use of different attrition years impacts the rate base by the amount of an additional six months of accumulated depreciation to arrive at the average rate base for 2013. This difference, however, is at least partially offset by CAPD's increase to Utility Plant in Service. CAPD increased rate base by forecasted capital expenditures for 2012 and 2013. Additionally, CAPD increased rate base by the value of meters. Navitas transferred the cost of meter cores to NUC and has been capitalizing the replacement meters in NUC's fixed asset records. These meters are the property of Navitas TN. They are utility property and should properly be included in TN's rate base. CAPD increased rate base by the amount of meters Navitas TN originally transferred to NUC upon acquisition ($9,000) as well as the cost of meters actually replaced in 2011 and 2012 and the meters expected to be replaced in 2013, as discussed on CAPD Schedule 2A.

A second reason for the difference is the starting point for rate base. The Company filing indicated gross Utility Plant in Service was $2,443,206, as shown on CAPD Schedule 3. This number is unsupported by Navitas TN's financial records, which indicated on Navitas TN's Balance Sheet that gross Utility Plant in Service in Navitas TN's was $1,755,227, which is the amount CAPD used in its calculation of the test year, as shown on CAPD Schedule 2 and on Navitas TN's 2011 Trial Balance. The Company filings are somewhat unclear as to how it determined that Utility Plant in Service should be $2,443,206 for the 2012 attrition year, but it seems to be based on some type of customer allocation and it appears to include the company airplane cost of $1,660,186, which is not TN's fixed asset. Even if the company plane was Navitas TN's fixed asset, the CAPD maintains that a regulated utility should not burden the rate payers with the cost of having a private airplane that cost over $1.5 million.

The third reason for the difference in CAPD's rate base and Navitas TN's rate base is that CAPD eliminated much of the Other Long Term Assets. According to Navitas TN's fixed asset listing, as reproduced in part on Schedule 4.A.3, Navitas TN capitalized $179,327 in Organizational Costs and $35,111 in legal fees associated with the 2011 emergency tariff petition. CAPD eliminated both of these assets from rate base. CAPD maintains that the Organizational Costs were incurred to benefit the investors, not the customers, and should therefore be excluded from rate base. As for the legal fees Navitas TN contends it incurred with respect to the 2011 emergency tariff petition, CAPD maintains that these are improperly capitalized because the 2011 Petition was not a full rate case, and thus the legal fees are not rate case expense. Moreover, these expenses are properly excluded from the test year expenses because they are non-recurring. To allow Navitas to recover in 2013 rates the legal fees associated with a 2011 emergency tariff would constitute retroactive ratemaking, which is strictly prohibited as a general principle of rate making. If Navitas wanted to recover these fees, it had the opportunity to negotiate such fees in the settlement of the 2011 emergency tariff petition.

Q. Does CAPD's Rate Base include a provision for capital expenditures?

A. Yes. CAPD notes that Navitas made no provisions in its filing for capital expenditures. Per discussions with Mr. Hartline, Navitas makes capital expenditures as needed but does not plan for periodic replacement other than for the replacement of meters. Navitas's capital expenditures were $17,137 in 2011 and $12,270 in 2012 up to August 2012. Per discussion with Navitas, these capital expenditures reflect the cost to extend gas pipelines to new customers. In addition to increasing Utility Plant in Service for the cost of meters as discussed previously, CAPD also increased Utility Plant in Service for the annualized amount of capital expenditures for 2012 and the estimated capital expenditures for 2013. CAPD calculated the forecasted 2013 capital expenditures by taking the average of the 2011 actual capital expenditures and the annualized 2012 capital expenditures. CAPD Schedule 4.A.2 shows TN's fixed assets and Schedule 2.A discusses CAPD's increases to Utility Plant in Service.

Q. Does CAPD's Rate Base include a provision for the rate case expense?

A. Yes. CAPD notes that Navitas made no provisions in its filing for current rate case expense. CAPD requested the rate case expense information to help ensure that its revenue requirement would be fair to the Company. The amount of $33,000 in rate case expense was added to Other Long Term Assets, as shown on Schedule 4.A.3.

CAPD would like to point out that the legal fees associated with the full rate case in 2012 are less than the legal fees Navitas capitalized for the 2011 emergency tariff petition. While the $33,000 rate case expense is comparable to other similarly sized utilities, CAPD finds it odd that the 2012 rate case expense is less than the legal fees for an emergency tariff increase, which did not require extensive discovery requests or other similar cost drivers for legal fees. The CAPD has not reviewed any legal invoices since the 2011 legal fees are eliminated as an improperly capitalized cost, however, the CAPD thought the comparison of legal fees for the different types of cases demonstrates an inconsistency and hopes that the Company will continue to work to keep its rate case expense at a cost effective level.

Q. Are there any other components of CAPD Rate Base? Please explain.

A. CAPD offset the Utility Plant in Service by the acquisition adjustment, as found on Navitas TN's balance sheet. Navitas acquired more Utility Plant in Service than it actually paid. The Utility Plant in Service carries over to Navitas from the amount that was in Gasco's financial statements. To reflect that the investors received a discount on the acquisition, and thus did not have to invest funds for the entire Utility Plant in Service, Navitas properly recorded an acquisition adjustment.

Q. How did CAPD calculate Working Capital?

A. Regarding working capital, the CAPD agrees with Navitas that it is reasonable to use the "one-eighth method" to calculate working capital. The "one-eighth method" presumes that the necessary cash working capital equals 1/8 (or 45 days/ 360 days) of the O&M expense. The CAPD working capital amount is therefore a mathematical function of O&M expense. For purposes of this filing, the O&M expenses are NUC's charges to Navitas TN. The remaining expenses charged to Navitas TN are administrative in nature (e.g. bank fees, bad debt), as shown on CAPD Schedule 4.A, and are therefore not O&M expense requiring working capital.

RATE OF RETURN

Q. Did you have an opportunity to review the Testimony and Exhibits filed by Dr. Christopher C. Klein, including amendemnts?

A. Yes.

Q. And what is your understanding of Dr. Klein's expert opinion?

Dr. Klein recommends that the capital structure of the Navitas companies be consolidated as of December 31, 2011. He recommends a cost of equity of 15.40% in this capital structure in order to yield an interest coverage ratio of 2, comparable to other Tennessee utilities. The resulting overall rate of return is 8.71% to be applied to the rate base of Navitas TN. Dr. Klein also recommends that Navitas TN's payments on the debt incurred by Fort Cobb Fuel Authority for the acquisition of the Tennessee natural gas utility operation not be included in the calculation of the revenue requirement in order to avoid a double recovery of capital costs.

Q. And have you taken Dr. Klein's opinion into consideration in your analysis?

A Yes, I have not included Navitas TN's payments on the debt incurred by Fort Cobb Fuel Authority for the acquisition of the Tennessee natural gas utility operation in the calculation of the revenue requirement in order to avoid a double recovery of capital costs.

Q. And based on your analysis, what is the overall return on the Navitas rate base?

A. Dr. Klein recommended 8.71%. My final analysis yields a return of 8.71%

Q. Does the CAPD analysis yield an interest rate coverage ratio of 2?

A. Yes. Interest expense from Schedule 10 is $29,026 and the net operating income under proposed rates from Schedule 9 is $57,997, which is 1.999 times the interest expense.

Q. How does CAPD's Rate of Return compare to Navitas's proposed Rate of Return?

A. Navitas uses a Fair Rate of Return of 9.198%, a difference of half of 1% (for details about Dr. Klein's numbers, please see his testimony in this docket). Both the CAPD and Navitas use the Navitas Consolidated Companies for their calculations and both use a traditional weighted average cost of capital. Notably, Dr. Klein breaks out debt between long term and short term while Navitas considers all of its debt to be long term.

OPERATING AND MAINTENANCE ("O&M") EXPENSES

Q. Please summarize CAPD's understanding of Navitas TN's expenses.

A. As can be seen by Navitas TN's income statement, most of Navitas's costs are from NUC's bills. NUC records the costs and bills Navitas TN monthly for direct charges as well as an allocation of NUC's expenses. The only items NUC tracks on a per system basis appears to be capital and non-O&M expenses like bank fees and postage for billing. Although NUC has several employees that are dedicated to a specific system, such as the one employee dedicated to TN, NUC does not separate out this dedicated labor expense and charge it to the related system. Instead, all O&M expenses are charged to TN through the "customer density per mile" allocation, even though these are costs that could easily be identified as solely benefiting one system.

Costs of capital are entered at least annually and include an overhead allocation of 5% of the cost of the capital. For example, if Tennessee received $10,000 in pipe replacement, NUC would directly charge those costs to Navitas TN as a capital cost of $10,500. Such overhead allocation to capitalized costs is common when shared services centers provide services to multiple operations.

NUC erroneously charges each system a 5% overhead on non-capital expenses like postage as well. Since NUC's costs are allocated to each system, the additional markup of expense items is inappropriate. As shown on Schedule 4.A, CAPD removed the costs related to the markup of non-capital expenses.

Q. How did CAPD approach analyzing NUC's costs?

A. CAPD obtained NUC's profit and loss statement and inquired about what each expense was. Based on that discussion, CAPD determined that some costs could be easily tracked per system, such as labor. CAPD removed any of NUC's costs for the costs that benefitted only one system before applying an allocation. CAPD added any costs that benefit only TN as a direct cost. These adjustments are shown and described on CAPD Schedule 4.A.1.

The labor adjustments are the largest, as shown on Schedule 4.A.4. CAPD acknowledges that the cost of tracking the time of which system an employee works on throughout the day may be more costly than the benefits. For the employees that are shared among the operations, CAPD identified whether they were used for customer service or billing, which is a cost driven by the number of customers, or whether the employee was used for other shared services, such as maintenance. For the customer-driven labor like customer service and billing personnel, CAPD allocated 10.7% of the costs to TN, which is the cost allocation

Navitas proposes in its testimony. Navitas has 37 employees, of which CAPD discovered during its inquiries that 20 employees are dedicated to Oklahoma operations. Since TN does not benefit from any of these 20 employees, CAPD reduced the labor costs for these salaries as approximated for the adjusted test year ending March 31, 2012. CAPD did the same analysis of the contractor that splits time between Tennessee and Kentucky. CAPD reduced the labor allocable to Tennessee by $603,106 (internal and outside labor). Of the remaining allocable labor, $75,788 was determined to be directly related to TN operations. After applying TN's allocation percentages to the remaining indirect labor of $914,694, CAPD determined TN's portion as approximately $86,149. The calculations and analysis are shown and explained further on Schedule 4.A.4.

Q. Does CAPD agree with the usage of the customer density per mile allocation that NUC used to bill Navitas TN?

A. No. CAPD believes that its shared services allocation, modeled after the shared services allocation Atmos uses to allocate its shared services cost incurred at its Kentucky, Mid-states division, is more reflective of TN's allocation of costs NUC incurs for non-customer driven services. For costs solely driven by the number of customers, such as billing and customer service, CAPD agrees that a per customer allocation is appropriate for costs that are not directly charged to the systems, such as postage for bills.

Q. Why does CAPD model its shared services allocation after Atmos's Kentucky, Mid-states division instead of using Navitas's customer density per mile?

A. To arrive at the customer density per mile, Navitas assigns a value to the miles of pipe based on how many customers that mile of pipe services. Navitas uses this method to incorporate the efficiencies of cost to service a mile of pipe that has more customers. For example, the cost of service to a mile of pipe that furnishes gas to ten customers has a lower cost per customer than a mile of pipe that services one customer (i.e. 90% less cost of service in this hypothetical).

This efficiency becomes readily apparent when one compares the miles of pipe to the number of customers in each system NUC services. For example, Navitas TN uses less than 3% of the pipes serviced by NUC but has around 10-11% of the customers, depending upon which month one reviews. NUC utilizes the cost per density mile as a method to reflect that the cost of service to approximately 34 miles of pipe for fewer than 550 customers will be lower and more efficient than the cost of service to over 1000 miles of pipe for around 4,000 customers.

CAPD agrees that allocating NUC's costs per customer would erroneously ignore the cost efficiencies associated with servicing the miles of pipe that serves more customers; however, CAPD disagrees with the customer density per mile allocation and proposes an allocation similar to what Atmos uses for its Kentucky, Mid-state operations. Like Navitas TN is primarily serviced by NUC, Atmos's Tennessee operations are primarily serviced by its service company in Kentucky. Per page 15 of Atmos Energy Corporate Cost Allocation Manual as of April 1, 2008,[23] Atmos's allocation model is a simple average of:

1) Gross direct property, plant, and equipment ("PPE") in each state as a percentage of the total PPE serviced by the regional company;

2) Number of customers in each state as a percentage of the total customers serviced by the regional company; and

3) Total direct O&M expense in each state as a percentage of the total direct O&M expense.

Since NUC does not track much of the O&M expense by system, the CAPD replaced the third component of Atmos's allocation with the percentage allocation of miles of pipe serviced by NUC in each state. Since the miles of pipe drives the cost of maintenance, the miles of pipe included in the allocation would fairly represent a cost driver of NUC's O&M expense.

[23] TRA Docket 08-00197.

Q. Please explain the allocation method utilized by CAPD.

A. CAPD utilized one of two allocations: (1) the 10.7% allocation provided in Mr. Hartline's testimony for customer-driven costs, or (2) the CAPD shared services allocation based on the modification of Atmos's allocation as calculated on Schedule 4.A.5. In summary, the CAPD shared services allocation calculation is a simple average of:

1) Navitas TN's allocation of PPE is 14.03%

2) Navitas TN's allocation of customers is 10.7% (as taken from Navitas's rate case petition)

3) Navitas TN's allocation of miles of pipe is 2.94%
The average of the three is 9.23%.

Q. In addition to the change in allocation methodology, does CAPD recommend a different approach to tracking NUC's costs for Navitas TN?

A. Yes. CAPD suggests that Navitas directly charge each system for costs that benefit only that system. Such costs like dedicated employees, uniform services, and legal costs are easily tracked and are merely a bookkeeping entry that would not incur any extraordinary or otherwise costly efforts to track and directly charge. For any O&M services that are directly charged to a system and are not capital, NUC should not also allocate 5% of its overhead since overhead related to all expenses will be allocated as an indirect charge. The benefits of allocating direct costs to the appropriate states far outweigh the costs associated with creating separate accounts to track costs that are clearly associated with only one system.

Q. Does CAPD have adjustments to NUC other than labor?

A. Yes. In addition to the large adjustment to labor, CAPD reduced NUC's allocable charges to Navitas TN by the costs of the company plane. Based on discussions with Joey Irwin, Navitas's accountant, the entire costs of NUC account # 6241 relate to plane charges. Additionally, NUC account #6242, includes both truck fuel and plane fuel. Per reports provided by Irwin, the fuel costs for the plane for 2011 were approximately $70,000. CAPD eliminated these plane charges. CAPD recommends NUC track plane fuel in a separate account in the future.

CAPD also learned that there is a $5,000 monthly charge for travel and transportation for two executive officers. These charges and other miscellaneous personal charges were eliminated from NUC account #6240 as unreasonable and imprudent. CAPD inquired of planned trips and made adjustments to the indirect and direct costs of travel to Navitas TN based on the planned trips and the estimated lodging and subsistence per diems.

CAPD made other smaller adjustments that are identified and explained on Schedule 4.A.1.

Q. Does CAPD have adjustments to any other expenses incurred by Navitas TN?

A. Yes. CAPD reduced the expense for NUC-Asset Billing because this amount reflects an intercompany lease between NUC and Navitas TN for the meters at a rate of $3 per meter. As discussed previously and further explained on Schedules 2.A and 4.A, CAPD believes these meters should be included in Navitas TN's fixed assets because they are utility assets. Moreover, the intercompany lease provides NUC with a profit for each meter in the amount of the difference between $3.00 and the allowable recovery of cost per meter plus the related rate of return for its portion of rate base. The creation of profits through intercompany leases is disfavored under U.S. Generally Accepted Accounting Principles ("U.S. GAAP"), but is especially disfavored for regulated entities because such intercompany leases provide a mechanism for an unregulated entity to improperly profit from rate payers by charging its regulated-entity affiliate. For these reasons, CAPD eliminated these costs.

Q. Does CAPD have adjustments to any other expenses incurred by Navitas TN?

A. CAPD made other minor adjustments to both TN's expense and NUC's expenses, all of which are identified and explained on Schedules 4.A and Schedules 4.A.1, respectively. Additionally, CAPD adjusted all expenses that are affected by inflation (e.g. labor and some administration fees) by the compounded GDP deflator. The calculation of the inflation rate is shown on Schedule 4.A.6.

Q. After all adjustments, what is CAPD's expense, including O&M expense, for the 2013 attrition year?

A. As shown on Schedule 4.A, CAPD determined that Navitas TN incurred approximately $355,000 in total expenses, of which $297,000 are O&M expenses charged from NUC. The total expenses for the test year ended March 31, 2013 were $409,000, of which $335,000 were charges from NUC for services and lease expense for meters. The attrition year is $53,810 less than the test year, and this reduction includes any positive adjustments for inflation.

DEPRECIATION AND AMORTIZATION EXPENSES

Q. How did CAPD calculate depreciation and amortization expense?

A. CAPD utilized the straight-line depreciation method and took a full month of depreciation or amortization in the month of acquisition, even if the acquisition occurred on the last day of the month. The calculation of depreciation and amortization expense is shown on Schedules 4.A.2 and 4.A.3, respectively.

Q. Is this the same depreciation method Navitas used?

Yes.

Q. Please explain why the CAPD's depreciation and amortization expense for the attrition year of 2013 is lower than the Company's filing?

A. The $13,636 difference in depreciation and amortization is a result solely of the additions and eliminations of capitalized costs in rate base. As previously discussed, the main adjustments to rate base that resulted in the difference in depreciation and amortization expense are (1) CAPD's adding into rate base the meters and forecasting capital expenditures for the remainder of 2012 and for the attrition year and (2) eliminating from rate base the Organizational Costs and the 2011 legal expenses Navitas capitalized, which is partially offset by CAPD's inclusion of the 2012 rate case expense that Navitas failed to include in its petition. These adjustments to rate base are shown on Schedule 2.A.

TAXES

Q. Please explain why there is no provision for Federal Income Taxes in Schedule 4.

A. The CAPD did not include any provisions for Navitas or its corporate parent to pay Federal Income Taxes in its calculation. The reason for this is that the various Navitas entities are organized as Limited Liability Companies ("LLC"). LLCs may elect pass through taxation whereby each owner reports his or her share of the profits on his or her personal tax return where it is taxed only at the individual owner's personal income tax rate. Although LLCs do not have to pay tax at the corporate level, the LLC must still file a tax return with the IRS. The owners are required to submit Form 1065 to the IRS, which supplies information about the company's income and deductions. This return is purely informational, and no tax is due when it is submitted. The CAPD does not believe Tennessee ratepayers should be required to pay the personal income taxes of Navitas's owners.

Q. Please explain why there is no provision for State excise taxes in Schedule 4.

A. The Tennessee excise tax rate of 6.5% is based on total revenues above $0 income. Because Navitas has experienced losses at the current rates, there is no provision for excise taxes. This is further reflected on Schedule 8. Notably, in Schedule 11, the CAPD makes provisions for the TN excise tax for the attrition year ending December 31, 2013. As discussed further in the following Revenue Deficiency section, it does this by way of the Revenue Conversion Factor calculus. The CAPD maintains that Navitas should have the opportunity to earn a fair rate of return. Assuming the proposed rates allow for that, then Navitas will be liable for excise taxes in future years.

Q. Please explain provisions for Other Taxes.

A. In Schedule 7, the CAPD makes allowances for property and franchise taxes. TRA inspection fees are included with this Schedule. The $10,911 is included in the Attrition Amount on Schedule 4.

Q. How did CAPD calculate the provision for Other Taxes?

A. CAPD requested and received from Navitas copies of the franchise and excise tax returns as well as the most recent property tax bills.

Q. Does Navitas directly charge the customers for any taxes?

A. Yes. Per review of a copy of a utility bill for a TN customer, Navitas directly charges its customers for taxes.

Q. What taxes does Navitas pass through to its customers?

A. According to Navitas, it directly charges its customers for sales tax, local franchise taxes, and the gross receipts tax. These taxes appear as a single line item on the customer's invoice.

Q. Did the CAPD include a provision in its revenue requirement for these taxes?

A. No. The CAPD did not include a provision for sales tax, local franchise taxes, and the gross receipts tax for two reasons. First, Navitas is not actually incurring the expense related to these taxes since it passes the charges directly to the customer. Until the customers are no longer charged for the tax directly, the expenses should not be included as a component of the rates. If CAPD had included a provision for these taxes, then Navitas would recover these taxes twice: once as a separate line item on the bill and again as a component of the rates.

Second, the gross receipts tax applicable to Navitas is uncertain. Navitas has requested an Opinion Letter from the Department of Revenue ("DOR") asking whether the applicable tax rate is 3% or 1.5%. The DOR had not issued a letter at the time of the rate case. Currently, Navitas calculates its pass-through tax charges at 3% and submits to the DOR the funds actually received from customers associated with these pass-through taxes. Navitas has assured the CAPD that in the event that the correct amount is the lesser 1.5%, then Navitas would refund the difference from the increased collection back to the customers.

In an abundance of caution, the CAPD did not make a provision for the gross receipts tax. This is reflected on Schedule 7.

Q. Does CAPD have concerns about Navitas directly charging customers for its taxes?

A. Yes. CAPD does not believe Navitas is authorized under the Tennessee laws that govern utilities to pass its gross receipts tax expenses directly to the customer as opposed to making it a component of the rate case. If the TRA confirms that passing through taxes is inappropriate, Navitas must reimburse all the customers for the taxes it has charged directly to the customers. Moreover, if the TRA should confirm CAPD's understanding that the gross receipts tax should be a component of the rate as opposed to a pass through tax, the CAPD will amend its calculation of the proposed revenue deficiency to include the gross receipts tax expense Navitas TN will incur. The CAPD has no evidence that Navitas has intentionally made any errors in its treatment of taxes.

REVENUE DEFICIENCY

Q. Please summarize the reasons why the CAPD has a difference of approximately $250,000 less in revenue deficiency than Navitas.

A. As previously discussed, revenue requirements are based on a standard formula. The revenue deficiency is the amount of additional revenue required over and above current rates to permit the utility to recover its reasonable and prudent expenses as well as earn a fair return on its investment. CAPD's revenue deficiency is based on its calculation of revenues based on current flow and at the current rates less the reasonable and prudent expenses plus the fair rate of return of 8.71% on the rate base CAPD calculated.

Q. How did CAPD calculate the revenues?

A. CAPD obtained the flow for the year ended March 31, 2012 and multiplied it by the emergency tariff rates and the PGA rate. The calculation is shown on Schedule 6.

Q. Why are the revenues different than what Navitas recorded in its financial statements?

A. There are three major reasons for the difference. First, Navitas's revenues only included a few months of the revenue under the current emergency tariff rates. To determine the revenue deficiency under current rates, the revenue must be normalized for any mid-year tariff changes. Second, Navitas's revenues include an account called Unbilled Revenue, which reflects adjustments to the gas costs from the allowable Purchased Gas Adjustment ("PGA") rate. For purposes of determining the revenue requirement, CAPD assumed the cost of gas would equal the allowable PGA revenue using the approved PGA rate, and therefore PGA revenue and costs net to zero. While the utility may have a net loss or net income related to the pass through costs of purchased gas, CAPD assumes any net differences are merely timing differences since the company either reimburses customers for net income or gets reimbursed by customers for net losses. Since the net effect of purchased gas should be zero, it should not impact the revenues for purposes of calculating the revenue deficiency in determining what rate increase is fair.

Q. What impact does the calculation of revenue have on the determination of the revenue deficiency?

A. If revenues are calculated inaccurately, then the revenue deficiency will be inaccurate.

Q. How does the different calculation of revenue affect Navitas's proposed rate increase?

A. Navitas erroneously calculated its revenue deficiency of $390,000 without making the purchased gas costs and related revenue net to zero. Navitas's contention that their revenue deficiency is merely an 80% rate increase is inaccurate. Actually, Navitas's proposed revenue requirement of $390,000 is a 150% increase over the current gross profit margin, as calculated by taking the $390,000 divided by the current gross profit margin of $259,859, as shown on the Comparative Income Statement using normalized revenues on Schedule 5.

Q. What impact does a revenue deficiency have on the rest of the income statement?

A. As revenues increase, other revenue-driven costs also increase, such as revenue-based taxes (e.g. excise), customer penalties, and bad debt. CAPD calculated a revenue conversion factor to adjust these revenue-driven expenses. The revenue conversion factor calculation is shown on Schedule 11 and its effect is shown on the income statement is shown on Schedule 9.

In this case, the CAPD's proposed revenue requirement permits Navitas to shift from a net operating loss to a net operating income. When Navitas had a net operating loss, it did not have to pay excise tax. CAPD calculated the revenue conversion factor to account for the fact that a portion of the revenue requirement is necessary to offset a net operating loss. CAPD did this to limit the allowable excise tax for the portion of the company's estimated net operating income.

RATE DESIGN

Q. What rate design does the CAPD propose?

A. The CAPD proposes that the revenue deficiency be recovered through a combination of increases to customer charges and base rate commodity charges. The CAPD recommends that at least some of the revenue increase should be on the customer charges. This would shift more of the Company's revenue recovery towards fixed charges and would avoid radical changes of existing commodity rates.

Furthermore, CAPD agrees with Navitas's petition filing that rate shock is an issue. CAPD supports Navitas's suggestion to spread the rate increase over four years, which would significantly reduce the risk of rate shock. Although CAPD would not object to a rate increase over four years, if Navitas filed a rate case before each phase of the rate increase related to the present case are complete, then any phase in of the current revenue requirement would cease and be replaced by the outcome of the future rate case.

Q. Will the rate design proposed by Navitas in its filing be sufficient?

A. No. The rate design suggested in Mr. Hartline's testimony totals only a $112,543 increase in revenues based on the flow from the twelve months ended March 31, 2012.[24] Nothing in Navitas's filing or subsequent conversations with CAPD suggests that Navitas believes the flow will significantly increase to sufficiently cover Navitas's proposed revenue requirement.

At this time, CAPD requests that Navitas provide a more specific rate design proposal, including one that reflects the phased-in revenue increases over four years.

Q. Please discuss Navitas's proposed "disconnect" fee.

A. One issue that Mr. Hartline raised in the Navitas petition was implementing a disconnect fee of $36 to address the decrease in customers during the warm months. Per discussion with Mr. Hartline, he prefers to avoid having a reconnection fee because he wants to avoid upfront costs for new customers. CAPD acknowledges that Navitas's concern of customers disconnecting in the warm months is legitimate. In analyzing the billing determinants for 2011 and 2012 provided by Mr. Hartline, it appears that there are a significant number of customers that stop service in the warm months. On average, Navitas has

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[24] Navitas's proposed rate design was $6.00 customer charge, $1.00 surcharge, and $0.585/0.485 flow rate.

approximately 80 fewer customers in the six-month period between April and September. If the customer service charge is increased significantly, the number of temporary summer disconnects is likely to increase.

In looking at the latest tariffs for Atmos and Piedmont, those companies have a reconnect charge of $40 and $55 respectively. Considering the fact that Navitas is located in a rural area, Navitas's proposed fee of $36 is appropriately lower than the more urban areas that Atmos and Piedmont serve. Nonetheless, the CAPD cannot agree to a disconnect fee without more information as to the actual costs to the company to disconnect service. Moreover, it seems there may be some issues with Navitas collecting a disconnect fee – as opposed to a reconnect fee – since customers who want to abandon services have less incentive to pay the final bills, including any disconnect fees.

The CAPD did not include a provision for any additional revenues associated with disconnection or reconnection. With more information to support Navitas's request, the CAPD may consider some type of fee arrangement.

Q. Does the CAPD have any observations about the rate case generally?

A. Yes. Clearly, a public utility emerging from bankruptcy and which has not sought a rate increase for two decades is a struggling entity. Nevertheless, going from a claimed $159,000[25] operating loss, as reported during the 2011 emergency tariff petition, to a claimed revenue deficiency of $390,000 in 2012 is a substantial adjustment. The CAPD recognized rate increases are necessary from time to time to help ensure safe and reliable utility service. Administrative costs and indirect expenses allocated from affiliates, however, must be controlled. The bulk of the rate increase requested in this case is based on the NUC allocation of expenses.

All three Tennessee counties within the Navitas TN service area have greater unemployment than the state average of 8.3% and the national average of

[25] Docket 11-00060, *Petition for Emergency Relief*, April 20, 2011, p. 3; Ex.D.

7.8%.[26] Fentress County has an unemployment rate of 9.1% and Campbell County stands at 10.1%.[27] Picket County has one of the highest unemployment rates in Tennessee at 11.3%.[28] Navitas also serves approximately 150 customers in Clinton County, Kentucky. The rates set in this docket will be applied to these Kentucky customers.[29] Unemployment in Clinton County is at 9.8%, also above the national average.[30] Also, according to data compiled by the Tennessee Housing Development Agency, foreclosure rates in Fentress and Campbell County are the 10th and 22nd highest respectively in the state.[31]

The households and businesses served by Navitas are being asked to pay a significant rate increase in the midst of many severe economic challenges. Even with the adjustments proposed by the Consumer Advocate, the proposed rate increase would remain substantial. Any rate increase of this magnitude would constitute "rate shock."

Under the current economic conditions, all public utilities are expected to exercise the same fiscal restraint that competitive companies must perform, as well as what the utility's customers must perform to make ends meet. This fiscal restraint to reflect a down economy is expected not only of the regulated entity but also of the unregulated affiliates that service the regulated entity.

Q. Other than the four-year phasing of rate increases proposed by Navitas and supported by CAPD, does CAPD have any other proposals?

A. Yes. If a substantial rate increase is granted in this docket, the Navitas customers should be provided with a mailed notice of the rate increase prior to its implementation. Many customers may need sufficient noticed to adjust their household budgets accordingly. Additionally, if the TRA determines a phased-in rate increase is necessary to avoid rate shock, such notice should explain the timing and phases in which the incremental rate increases will take effect.

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[26] Exhibit C, Labor Forces Estimates.
[27] *Id.*
[28] *Id.*
[29] Docket 11-00060, *Order Approving Amended Settlement Agreement*, December 1, 2011, fn 1.
[30] Exhibit C, KY labor force estimates doc.
[31] Exhibit C,TN Housing Development Agency doc.

Also, CAPD encourages the TRA to permit Navitas to implement the flexibility to work on payment plans with customers who are in financial distress in order to avoid disconnection and maintain service in the coming winter months.

Q. Does this conclude your testimony?

A. Yes, it does.