

IN THE TENNESSEE REGULATORY AUTHORITY
AT NASHVILLE, TENNESSEE

IN RE: JOINT PETITION OF TENNESSEE)	
AMERICAN WATER COMPANY, THE CITY OF)	
WHITWELL, TENNESSEE AND TOWN OF)	DOCKET NO. 12-00157
POWELL CROSSROADS, TENNESSEE, FOR)	
APPROVAL OF A PURCHASE AGREEMENT AND)	
WATER FRANCHISE AGREEMENT AND FOR)	
THE ISSUANCE OF A CERTIFICATE OF)	
CONVENIENCE AND NECESSITY)	

REPLY BRIEF OF THE CONSUMER ADVOCATE

Robert E. Cooper, Jr., the Attorney General and Reporter for the State of Tennessee, through the Consumer Advocate and Protection Division ("Consumer Advocate"), respectfully submits this brief in reply to the *Post-Hearing Brief of Tennessee-American Water Company* filed in Tennessee Regulatory Authority ("TRA" or "the Authority") Docket No. 12-00157.

I. **INTRODUCTION**

The Consumer Advocate incorporates the introduction from its *Post-Hearing Brief*, filed in this Docket on May 24, 2013.

II. **THE LEGAL AUTHORITY PROVIDED BY TAWC FAILS TO SUPPORT ITS REQUEST FOR AUTHORITY DETERMINATION OF RATE BASE AND OTHER RATEMAKING TREATMENT IN THIS PROCEEDING.**

In its *Post-Hearing Brief*, TAWC asserts the TRA has both the expressed and implied power to approve the accounting and ratemaking treatment. TAWC also cites case law in an effort to persuade the Authority to approve the accounting and ratemaking treatment of the acquisition in this proceeding. The authority provided by TAWC fails to support these requests.

A. The TRA's plenary power must be used within the boundaries of the law, which prevent the TRA from authorizing rate base and ratemaking treatment in this proceeding.

TAWC's first argument that the Authority's plenary power permits it to approve the rate base and ratemaking treatment in this proceeding ignores the legal boundaries of the TRA's plenary power.¹ The Consumer Advocate does not dispute the Authority has plenary power over the public utilities in its jurisdiction, which are essentially non-government owned utilities. Like all administrative agencies, the TRA is still bound to the law when using its plenary power.

The Tennessee Supreme Court has held that reviewing courts determine whether the administrative decision is "supported by substantial and material evidence." When reviewing administrative decisions, a reviewing court considers whether the decision is supported by "evidence that is both substantial and material in the light of the entire record," and "the court shall take into account whatever in the record fairly detracts from its weight" when considering substantiality.² Although a reviewing court may not substitute its judgment on questions of fact,³ the Tennessee Supreme Court has recently held that "[a]scertaining whether a record contains material evidence to support a board's decision is a question of law."⁴

As demonstrated in Part II of the *Post-Hearing Brief of the Consumer Advocate*,⁵ TAWC has failed to provide substantial evidence that using a net original cost value for rate base, without adjustments for impairments and necessary improvements, is appropriate in this proceeding. At this point in time, the condition of the assets and whether they are used and useful to the acquirer is not known and measurable and will be more certain after the comprehensive planning study, which is to be performed after acquisition. Moreover, there is

¹ See *Post-Hearing Brief of Tennessee-American Water Company*, Docket No. 12-00157, pgs. 7-8 (May 24, 2013).

² Tenn. Code Ann. § 4-5-322(h)(5)(A)-(B).

³ Tenn. Code Ann. § 4-5-322(h)(5)(B).

⁴ *Heyne v. Metro. Nashville Bd. of Pub. Educ.*, 380 S.W.3d 715, 738 (Tenn. 2012).

⁵ *Post-Hearing Brief of the Consumer Advocate*, Docket No. 12-00157, pgs. 3-35 (May 24, 2013).

strong evidence in the record that detracts from the financial statements as being the appropriate value of the assets, including that the financial statements recently had adverse audit opinions. Those audits indicate Whitwell has numerous financial control deficiencies that may have affected the recording of water system assets and the system reported unaccounted for water of 43% to 53% for two years;⁶ and testimony of the City and TAWC asserts that any owner will need to spend at least \$5 million to reduce the unaccounted for water.⁷ TAWC could not review the financial records of the system because they were unavailable,⁸ and therefore it cannot provide any more confidence than the auditors could that the financial control deficiencies have not affected the system's assets. In considering all the evidence in the record, including the red flags of the system's poor condition, it would be inappropriate to use only the net original cost according to the financial records to determine rate base.

Additionally, the Tennessee Supreme Court has held reviewing courts determine whether the administrative decision "exceeds constitutional or statutory limits."⁹ In Part II.B of its *Post-Hearing Brief*, the Consumer Advocate discusses how approving the rate base and ratemaking treatment of the acquisition at the time of the CCN application and before the value and used and usefulness of the acquisition assets is known and measurable exceeds the limits of the law in Tennessee. Without sufficient information on the value or the condition of the assets, a meaningful hearing cannot be held to determine the rate base and ratemaking treatment. Also, it became evident after the hearing that the details of the acquisition and the impact on rates were not discussed with the City or the system's customers. Mr. Bickerton testified he told the City

⁶ *Transcript of Proceedings*, Vol. I, Docket No. 12-00157, Ex. 2, pg. 21, Ex. 3, pg. 22 (May 6, 2013).

⁷ *Id.* pg. 83; *Transcript of Proceedings*, Vol. II (Confidential), Docket No. 12-00157, Ex. 18 (May 7, 2013).

⁸ *RE: Joint Petition of Tennessee-American Water Company, The City of Whitwell, Tennessee, and the Town of Powells Crossroads, Tennessee, for Approval of a Purchase Agreement and a Water Franchise Agreement and for the Issuance of a Certificate of Convenience and Necessity*, Docket No. 12-00157, Direct Testimony of Dan Bickerton, pg. 3 (Dec. 27, 2012).

⁹ *United Cities Gas Co. v. Tennessee Public Service Comm'n*, 789 S.W.2d 256, 259 (Tenn. 1990) (citing Tenn. Code Ann. § 4-5-322(h)).

“in all likelihood there would be a rate impact *at some point*. We did not discuss any details of what that might be.”¹⁰ Thus, TAWC has not appropriately informed the City how the acquisition or this proceeding impacts the rates.

Approving rate base now would necessarily shift the burden to ratepayers to seek any reductions in future rate proceedings after the condition of assets becomes certain. In Mr. Bickerton’s pre-filed rebuttal testimony and during the proceeding, he asserted the Authority could change the rate base in future rate cases in “appropriate circumstances,” suggesting this freedom to change somehow removes or diminishes the problems of approving rate base in this proceeding.¹¹ The Tennessee Supreme Court’s *United Cities Gas Co. v. Tennessee Public Service Commission* decision overruling the appellate opinion cited in TAWC’s *Post-Hearing Brief* held that *res judicata* does apply to litigated issues, like rate base.¹² Although a commission is “free to reverse its course if public policy demands it,” the Court held it can only do so if there are new arguments or new evidence.¹³ Since it is highly unlikely TAWC will raise new arguments or produce new evidence to reduce rate base on its own accord in a future rate proceeding, the burden to raise new arguments or produce new evidence would necessarily shift to the ratepayers. A burden shift is unfair to ratepayers for many reasons, such as TAWC is in control of the information it seeks during acquisition and it has failed to provide sufficient evidence establishing the condition of the assets with any certainty during this proceeding. The finality of rate base determinations weighs against the Authority using its plenary power to authorize rate base now.

¹⁰ *Transcript of Proceedings*, Vol. I, Docket No. 12-00157, pg. 101 (May 6, 2013) (emphasis added).

¹¹ *See Post-Hearing Brief of the Consumer Advocate*, Docket No. 12-00157, pgs. 10-11 (May 24, 2013).

¹² *United Cities Gas Co. v. Tennessee Public Service Comm’n*, 789 S.W.2d 256, 257, 259 (Tenn. 1990).

¹³ *Id.*

For the reasons stated above and the reasons stated in its *Post-Hearing Brief*, the Consumer Advocate does not dispute the TRA's authority to approve the acquisition itself; however, the legal limits of the TRA's plenary authority do not permit it to authorize rate base and ratemaking treatment in this proceeding. Moreover, even if the TRA decides it can use its plenary power to approve rate base and ratemaking treatment at this time, the Consumer Advocate recommends the Authority assert its discretion and not use its plenary power because of the negative effects it can have on buyers' incentives to negotiate the lowest purchase price during an acquisition.

B. The case law TAWC relies upon to persuade the Authority to approve net original cost as the rate base actually supports waiting until a rate proceeding to determine rate base.

TAWC's summary of *United Cities Gas Co. v. Tennessee Public Service Commission*¹⁴ is incomplete and incorrectly characterizes the court's opinion. First, the Tennessee Supreme Court decision overruled the appellate court on a point making the appellate court's analysis unnecessary. The Tennessee Supreme Court held *res judicata* applied, and as the appellate court noted, if it did, no further analysis would be necessary.¹⁵ Second, TAWC's summary is incomplete because it neglected to note that the Court articulated "the Public Service Commission approved the sale with the express reservation that 'any issue relating to future cost of service or inclusions in rate base shall be reserved and considered by the Commission in any future rate case filed by United Cities.'"¹⁶ Third, TAWC incorrectly stated the appellate court "acknowledged that recording assets at original cost is the practice in Tennessee for accounting for assets in an acquisition."¹⁷ The appellate court acknowledged "[t]he parties are agreed that

¹⁴ 1987 Tenn. App. LEXIS 3046, *1 (1987); *Post-Hearing Brief of Tennessee-American Water Company*, Docket No. 12-00157, exhibits (May 24, 2013).

¹⁵ *United Cities Gas Co. v. Tennessee Public Service Comm'n*, 789 S.W.2d 256, 259 (Tenn. 1990).

¹⁶ *Id.* at 256 (quoting the Commission's order).

¹⁷ *Post-Hearing Brief of Tennessee-American Water Company*, Docket No. 12-00157, pg. 10 (May 24, 2013).

the practice in Tennessee in accounting for acquisition of assets is to record them at the original cost of the first utility to put them in service, less depreciation.”¹⁸ It is one thing for a court to acknowledge a methodology, but it is quite another for the court to acknowledge the parties agreed to the methodology. Because the parties agreed original cost less depreciation was the book value and just could not agree on how to calculate original cost, the issue of whether net original cost was the best method was never litigated or reviewed by the appellate or Supreme Court. Indeed, when TAWC states the court “again recognized that the original-cost method was the proper method to apply to determine the value of the Franklin system,”¹⁹ it misses the important part of the opinion. The Court of Appeals clearly declared, “It is not our function to decide what, in our opinion, is the best method.”²⁰

TAWC’s discussion of jurisprudence in other cases is not persuasive. As TAWC mentioned, Montana’s law uses the original-cost basis as the general rule, but it also allows for exceptions if there is a “compelling reason.”²¹ When discussing Missouri law, TAWC failed to mention Missouri does not determine rate base at the time it approves the acquisition, but rather it waits until a rate case.²² Also, the Missouri case cited by TAWC references discussion that an acquisition adjustment could be theoretically possible even though none had been permitted yet in Missouri.²³ It should also be noted that, unlike Missouri’s commission, the TRA has permitted a negative acquisition adjustment as part of a settlement agreement.²⁴

¹⁸ 1987 Tenn. App. LEXIS 3046, *2 (1987) (emphasis added).

¹⁹ *Post-Hearing Brief of Tennessee-American Water Company*, Docket No. 12-00157, pg. 10 (May 24, 2013).

²⁰ 1987 Tenn. App. LEXIS 3046, *18 (1987).

²¹ *Post-Hearing Brief of Tennessee-American Water Company*, Docket No. 12-00157, pg. 11 (May 24, 2013).

²² *In the Matter of the Joint Application of Great Plains Energy Inc., Kansas City Power & Light Co., and Aquila, Inc., for Approval of the Merger of Aquila, Inc., with a Subsidiary of Great Plains Energy Inc. and for Other Related Relief*, 266 P.U.R. 4th 1, 549, #13 (2008) (“Nothing in this order shall be considered a finding by the Commission of the value for ratemaking purposes of the transactions herein involved.”).

²³ *Post-Hearing Brief of Tennessee-American Water Company*, Docket No. 12-00157, MO Ex. p. 6 (May 24, 2013).

²⁴ *See Order Approving Settlement Agreement with Modifications*, Docket No. 12-00068, Schedule 4.A.2 (Apr. 18, 2013). Navitas purchased the gas system out of bankruptcy and the system had incomplete supporting documents

Finally, TAWC incorrectly asserts the Authority's approval of the purchase price as rate base in this case would be consistent with the reasoning and regulatory treatment the TRA has used in setting TAWC rates.²⁵ First, as confirmed by Mr. Bickerton, ordinarily TAWC's capital expenditures are of new assets.²⁶ Purchasing new assets significantly reduces the risk the asset is impaired or in need of significant, immediate repairs or replacement. Mr. Bickerton agreed this particular acquisition of used assets has a list of risks.²⁷ The Whitwell assets TAWC seeks to purchase are far from new and show significant signs of impairment.²⁸ Second, as TAWC articulates, the TRA ordinarily approves the net original cost standard to *set rates*. Even though TAWC is not seeking to change the rates, it is seeking the TRA to make determinations that necessarily impact rates outside of a rate proceeding. TAWC has failed to provide sufficient evidence why such a request should be granted outside of a rate proceeding and before the assets values are known and measurable.

As discussed in its *Post-Hearing Brief*, the Consumer Advocate recommends the Authority deny TAWC's requests for determinations that necessarily impact rates outside of a rate proceeding in order to avoid single-issue ratemaking and to ensure due process for ratepayers.

III. TAWC'S ARGUMENTS ARE INSUFFICIENT TO MEET ITS BURDEN OF PROOF FOR THE TRA TO AUTHORIZE ITS REQUESTS FOR RATE BASE AND OTHER RATEMAKING TREATMENT IN THIS PROCEEDING.

The Consumer Advocate agrees there is nothing "sinister" about TAWC's approach of asking the TRA to approve rate base and other ratemaking treatment in this proceeding.

from the previous owner as well. *See Pre-Filed Testimony of Thomas Hartline*, Docket No. 11-00060, pg. 4-5 (June 17, 2011); *Petition*, Docket No. 12-00068, Testimony of Thomas Hartline, 11Q (July 2, 2012).

²⁵ *Post-Hearing Brief of Tennessee-American Water Company*, Docket No. 12-00157, pg. 11 (May 24, 2013).

²⁶ *Transcript of Proceedings*, Vol. II (Confidential), Docket No. 12-00157, pg. 214 (May 7, 2013).

²⁷ *Id.* at 209.

²⁸ *See Part III; Post-Hearing Brief of the Consumer Advocate*, Docket No. 12-00157, Part II (May 24, 2013).

However, since the requests require the Authority to shift risk from the shareholders to the ratepayers,²⁹ it would be unfair to require ratepayers to pay TAWC to make such requests³⁰ and therefore, the Consumer Advocate recommends the Authority deny TAWC's requests.

The Consumer Advocate also does not dispute TAWC's ownership of the Whitwell system would benefit the Whitwell customers, but the Consumer Advocate has concerns who will pay and at what cost. Although not stated by TAWC, the Consumer Advocate reiterates that even if TAWC may be reasonably expected to provide benefits to the Whitwell customers, it does not mean the City's ownership would be a detriment to its customers if it continued as owner.³¹ Indeed, while TAWC may be able to save ratepayers on some purchases, the City's ownership of the system saves on costs like taxes and return on equity. Either owner has benefits and drawbacks for ratepayers. As mentioned in Part II.C.4 of its *Post-Hearing Brief*, the Consumer Advocate has concerns that TAWC's existing customers will subsidize many of the necessary improvements, especially if increases to the Whitwell rates are incorporated into TAWC's tariff like Suck Creek's rate increases have been handled.

The Consumer Advocate challenges TAWC's other arguments. First, TAWC's in-depth discussion in Part III.B of its brief as to the weaknesses in the system that TAWC can benefit contradict TAWC's argument in Part III.C that the record supports a net original cost value unadjusted for any impairments or necessary improvements by whoever is owner. Second, TAWC's arguments in Part III.C are supported only by conclusory statements or, in some cases, contradict the evidentiary record.

²⁹ See *Post-Hearing Brief of the Consumer Advocate*, Docket No. 12-00157, Part II.A (May 24, 2013).

³⁰ Although the Consumer Advocate was denied access to review the due diligence charges, at least some of the due diligence costs TAWC seeks to defer are presumably related to legal fees and AWWC charges associated with requesting the determination of rate base and other ratemaking treatment.

³¹ See *Post-Hearing Brief of the Consumer Advocate*, Docket No. 12-00157, Part IV (May 24, 2013).

- A. TAWC's argument of how it will benefit the system because of the system's many needs for improvement contradicts its argument that the record supports a rate base value of net original cost unadjusted for impairment or necessary improvements.

TAWC asserts its ownership will benefit customers by resolving several problems with the system but then ignores these problems when it comes to the purchase price and argues no reductions to the net original cost are warranted for the rate base determination.

All the parties agree the system has problems and will require immediate capital expenditures to whoever owns it. In the last two years the system has had 43% to 53% unaccounted for water.³² As Mayor Easterly stated, no matter who owns the system, "\$5 million is going to be spent one way or another."³³ Indeed, state law requires Whitwell to reduce the unaccounted for water if it remains owner, which all parties agree, will lead to infrastructure improvements and related capital expenditures, the amount of which is uncertain at this time.³⁴ Also, in its *Post-Hearing Brief*, TAWC indicated its acquisition would result in system modernization and efficiencies, and the existing system is outdated and inefficient.³⁵ TAWC asserts that it can improve the system's reliability and safety, suggesting the system is somehow not reliable or safe at this time.³⁶

In the very next section of its brief, however, TAWC argues the net original cost value of the system is supported by the record and ignores all the system's problems and the financial statements used as the basis of the net original cost value. TAWC contends that even though the auditors could not issue clean, unqualified audit opinions and reported numerous deficiencies in the financial controls, the financial statement amounts are still accurate because when Mr.

³² *Transcript of Proceedings*, Vol. I, Docket No. 12-00157, Ex. 2, pg. 21, Ex. 3, pg. 22 (May 6, 2013).

³³ *Transcript*, Vol. I., Docket No. 12-00157, pg. 83 (May 6, 2013).

³⁴ *Post-Hearing Brief of the Consumer Advocate*, Docket No. 12-00157, pgs. 26-27 (May 24, 2013).

³⁵ *Post-Hearing Brief of Tennessee-American Water Company*, Docket No. 12-00157, pg. 14 (May 24, 2013); *see also Transcript of Proceedings*, Vol. I, Docket No. 12-00157, Ex. 2, pg. 21, Ex. 3, pg. 9 (May 6, 2013).

³⁶ *Post-Hearing Brief of Tennessee-American Water Company*, Docket No. 12-00157, pg. 14 (May 24, 2013); *see also Transcript of Proceedings*, Vol. I, Docket No. 12-00157, Ex. 2, pg. 21, Ex. 3, pgs. 62-68 (May 6, 2013).

Bickerton reviewed the audit report, he did not uncover any significant issues with the deficiencies. But Mr. Bickerton did agree faulty financial statements and findings of fraud in management make the investment a higher risk,³⁷ and Whitwell has had faulty financial statements and fraud performed by its leaders.³⁸ Although TAWC argues the auditor's adverse opinions and the deficiencies are not dispositive and "must be appropriately reviewed, analyzed and weighed,"³⁹ it did not weigh the risk at all since it did not incorporate any risk of unreliability into the purchase price.

In addition to the many examples of risk the Consumer Advocate pointed out in Part II.C.2 of its *Post-Hearing Brief*, TAWC's *Post-Hearing Brief* shows an example of the inaccuracies in the financial statements. According to Mr. Bickerton and TAWC's *Post-Hearing Brief*, "several miles of pipeline along the Cartwright Loop have been *replaced* due to the issue with Class 160 PVC."⁴⁰ Indeed, the Cartwright Loop is listed as a separate asset on *Transcript* (Vol. I) Exhibit 4, the Utility Plant & Depreciation Detail. TAWC has provided no evidence it has ensured the replaced assets were written off. Actually, evidence indicates no adjustments were made. The Utility Plant & Depreciation Detail shows that the original cost of the West Valley assets did not change from January 1, 2004 (the in-service date of the West Valley assets) and June 30, 2011 (over a year after the in-service date of the Cartwright Loop); nor does the accumulated depreciation as of June 30, 2011 reflect anything but the ordinary 5% depreciation rate since the 2004 acquisition.⁴¹ Since several miles of pipeline were replaced, the West Valley asset should have been reduced to reflect the original asset was no longer in service.

³⁷ *Transcript of Proceedings*, Vol. I, Docket No. 12-00157, pg. 120-21 (May 6, 2013).

³⁸ *Transcript of Proceedings*, Vol. I, Docket No. 12-00157, pg. 77; Ex. 1, pg. 20; Ex. 2, pg. 20 (May 6, 2013).

³⁹ *Post-Hearing Brief of Tennessee-American Water Company*, Docket No. 12-00157, pg. 18 (May 24, 2013).

⁴⁰ *Id.* at 22 (emphasis added).

⁴¹ See *Transcript of Proceedings*, Vol. I, Docket No. 12-00157, Ex. 4 (May 6, 2013).

In addition to ignoring the high risk of errors in the financial statements, TAWC incorrectly sets aside any evidence suggesting the system is impaired when determining the purchase price, including but not limited to the excessive unaccounted for water and the over \$5 million in immediate necessary capital expenditures. As stated in the Consumer Advocate's *Post-Hearing Brief*, TAWC can negotiate any purchase price it wants, but the cost of overpaying for assets should not be shifted to ratepayers by including the overpayment in rate base.

- B. The record indicates many red flags exist that the net original cost may require significant reductions for impairments and necessary improvements, but the evidence is insufficient to ascertain the known and measurable value of rate base in this proceeding.

The Consumer Advocate agrees with TAWC that starting the determination of rate base using the net original cost is appropriate; however, the Consumer Advocate disagrees with TAWC's assertion to stop the valuation of rate base at the net original cost and ignore all the red flags of impairment and necessary system improvements that would decrease the system's value.

TAWC's reasons for relying solely on the financial statements are not persuasive to meet the burden of proof necessary to determine rate base. Utilities have the burden to prove that changes affecting rates, like rate base determinations, must be just and reasonable.⁴² One of TAWC's main argument with utilizing the financial statements as the sole basis for rate base is that Mr. Bickerton has become comfortable with them.⁴³ If CPA auditors could not verify the accuracy of the financial statements after a thorough financial statement audit conducted in accordance with U.S. Generally Accepted Accounting Principles, then it is without support to assert Mr. Bickerton, who is not a CPA, could determine the financial statements are accurate merely by reading the audit opinion and observing above-ground aspects of the system. TAWC

⁴² Tenn. Code Ann. § 65-5-103(a).

⁴³ *Post-Hearing Brief of Tennessee-American Water Company*, Docket No. 12-00157, pg. 17-18 (May 24, 2013).

could neither review historical financial records⁴⁴ nor inspect the underground pipes in its limited review.⁴⁵ Indeed, the evidence clearly indicates TAWC intends to spend over \$1 million in water main replacement starting immediately after acquisition.⁴⁶ Perhaps the notion that the ratepayers would assume all the risk of overpayment for assets contributed to Mr. Bickerton's comfort with the financial statement value since it is clear that TAWC does not want to accept the risk if Mr. Bickerton's assessment after limited observation is incorrect.

TAWC's arguments that the West Valley system appraisal is not relevant and lacks credibility because it is was done by an engineer are misguided. The fact that the valuation was done for a condemnation proceeding has no effect on the fair market value since valuations in condemnations must be based on a willing buyer and willing seller in Tennessee.⁴⁷ TAWC intends to rely on the West Valley system appraisal as a system record after acquisition,⁴⁸ so TAWC must find it in some way reliable and relevant to the condition of the system. TAWC questions the credibility of the West Valley's "valuation," but that system appraisal contains more analysis than what TAWC has performed in negotiating the purchase price and its recommendation for rate base in this case. Moreover, an engineer assessing the condition of a system is more appropriate than a CPA, since presumably an engineer will know what parts of the system need to be replaced and can do basic mathematical calculations.

TAWC cannot meet its burden of proof that the system's value is known and measurable and also assert the condition of the system is uncertain. Costs must be known and measurable

⁴⁴ RE: *Joint Petition of Tennessee-American Water Company, The City of Whitwell, Tennessee, and the Town of Powells Crossroads, Tennessee, for Approval of a Purchase Agreement and a Water Franchise Agreement and for the Issuance of a Certificate of Convenience and Necessity*, Docket No. 12-00157, Direct Testimony of Dan Bickerton, pg. 3 (Dec. 27, 2012).

⁴⁵ *Transcript of Proceedings*, Vol. I, Docket No. 12-00157, pg. 129-30 (May 6, 2013).

⁴⁶ See *id.* at 22, lines 24-25; *Transcript of Proceedings*, Vol. II (Confidential), Docket No. 12-00157, Ex. 18 (May 7, 2013).

⁴⁷ See, e.g., Tenn. Code Ann. 29-16-114; *Nashville Housing Authority v. Cohen*, 541 S.W.2d 947 (Tenn. 1976).

⁴⁸ *Tennessee American Water Co.'s Second Responses to Data Requests by Consumer Advocate and Protection Division of the Office of the Attorney General*, Docket No. 12-00157, DR #27 (Apr. 4, 2013).

before inclusion in rate base. When asked about the condition of the system and costs necessary to reduce the water loss, Mr. Allen said it would be speculative to try to estimate changes to the capital expenditure forecast before a thorough study.⁴⁹ Mr. Allen testified the former West Valley system is a source of the water loss, and he also believes it is likely there are other sources of water loss that would be found during the comprehensive study.⁵⁰ Indeed, TAWC mentions several other possible causes of water loss in its brief but indicates no certainty as to the sources and remedies.⁵¹ TAWC argues the only evidence relevant to determine the purchase price is the financial statements, but in its next breath says the condition of the system is too uncertain to reasonably estimate the costs to reduce its water loss. Acquiring assets without knowing their condition contradicts the assertion that rate base is known and measurable.

C. TAWC's arguments as to the necessity of the connection to the Dunlap system are unpersuasive, and the Consumer Advocate renews its recommendation for the Authority to provide guidance.

None of TAWC's arguments for the justification of over \$■ million being spent to connect Whitwell to Dunlap addresses the issues the Consumer Advocate points out in Part II.D of its *Post-Hearing Brief*. TAWC does raise a new justification that it did not seem to rely on during the hearing that the Consumer Advocate will address in this reply brief. TAWC asserts Mayor Easterly's testimony justifies the Dunlap connection is necessary; however, Mayor Easterly's testimony should be taken in context of the facts that she is not an engineer and was not involved in meetings discussing the connection.⁵²

Moreover, whether a project should be performed should be considered using a cost-benefit analysis, and the City did not have sufficient information to do such analysis. If the

⁴⁹ *Transcript of Proceedings*, Vol. I, Docket No. 12-00157, pgs. 21, 23-25 (May 6, 2013).

⁵⁰ *Id.* at pg. 21 (May 6, 2013).

⁵¹ *Post-Hearing Brief of Tennessee-American Water Company*, Docket No. 12-00157, pg. 23 (May 24, 2013).

⁵² *See Transcript of Proceedings*, Vol. I, Docket No. 12-00157, pgs. 810-81 (May 6, 2013).

benefits do not outweigh the costs, a project should not be performed. In some cases, costs may be high, but the benefit of the project is that it is necessary or otherwise required by law. In this case, no one from the City was informed of the costs of the project, not even Mayor Easterly, thus preventing the City from making an informed decision as to whether the Dunlap connection is cost-beneficial and should therefore occur. TAWC has asserted that this is a “necessary” project because the system’s storage is only “one day.”⁵³ One day of storage is all that the state of Tennessee requires.⁵⁴ And all the evidence indicates the system will have even more than one day of water storage after addressing the excessive water loss.⁵⁵ For these reasons, the Consumer Advocate recommends the Authority require its approval prior to commencing construction on the connection to the Dunlap system, at a time after the comprehensive planning study and the efforts to reduce the unaccounted for water are significantly under way.

IV. CONCLUSION

For the reasons explained above and in its *Post-Hearing Brief*, the Consumer Advocate does not dispute TAWC’s request for a CCN, franchise, and approval of the acquisition itself; however, the Consumer Advocate recommends the Authority deny all of TAWC’s requests for accounting and ratemaking treatment and deny TAWC’s request for a deferred accounting for the due diligence costs. The Consumer Advocate recommends the denial of the accounting and ratemaking treatment in this Docket because (1) there is insufficient evidence to determine the known and measurable value of the used and useful assets and related impairment in this proceeding; (2) TAWC could not provide ratepayers with adequate notice that the Authority will make decisions that will impact rates in the future; and (3) approval of rate base prior to the

⁵³ *Post-Hearing Brief of Tennessee-American Water Company*, Docket No. 12-00157, pg. 19 (May 24, 2013).

⁵⁴ *See Post-Hearing Brief of the Consumer Advocate*, Docket No. 12-00157, Part II.D (May 24, 2013).

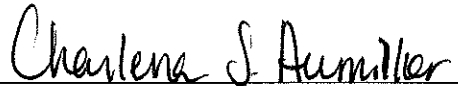
⁵⁵ *Id.* n. 123 and accompanying text.

acquisition can undermine the negotiation process. Moreover, the Consumer Advocate recommends the Authority require TAWC to file a rate proceeding to determine the Whitwell-specific costs after a set period of time to allow it to gather sufficient test period data. The Consumer Advocate recommends denial of TAWC's request to defer due diligence costs because it is unfair to make ratepayers pay for risks shifting from shareholders, and it is inconsistent with the criteria the Authority has previously used (as well as other states) in approving such requests.

Also, since the Dunlap connection is an extraordinary construction and the system is currently in compliance with all state requirements despite its excessive water loss, the Consumer Advocate recommends the Authority require its approval prior to construction commencing on the connection to the Dunlap system, at a time after the comprehensive planning study and the efforts to reduce the unaccounted for water are significantly under way.

If the Authority does approve rate base at this time, the Consumer Advocate recommends the Authority require an acquisition adjustment of negative \$■ million so that existing TAWC customers do not subsidize the Whitwell system improvements based on current estimated costs. If the Authority approves a deferred accounting, the Consumer Advocate recommends the Authority order a deferred accounting of both the costs and revenues related to the acquisition to permit the ratepayers to reap the benefits and not only the costs of the acquisition.

RESPECTFULLY SUBMITTED,


Charlena S. Aumiller (BPR #031465)
Assistant Attorney General
Office of the Attorney General
Consumer Advocate and Protection Division
P.O. Box 20207
Nashville, Tennessee 37202-0207
(615) 741-2812

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing reply brief was served via U.S. Mail or electronic mail upon:

Junaid Odubeko
Melvin J. Malone
Butler, Snow, O'Mara, Stevens & Cannada, PLLC
1200 One Nashville Place
150 Fourth Avenue, North
Nashville, TN 37219-2433
(615) 503-9105
mmalone@millermartin.com

Kevin Rogers
Operations Manager
Tennessee-American Water Company
1101 Broad Street
Chattanooga, TN 37402
(423) 755-7622
Kevin.n.rogers@amwater.com

This the 31st day of May, 2013.



Charlena S. Aumiller