

**BEFORE
THE TENNESSEE REGULATORY AUTHORITY**

JOINT PETITION OF TENNESSEE-)
AMERICAN WATER COMPANY, THE)
CITY OF WHITWELL, TENNESSEE,)
IT'S 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
WILLIAM H. NOVAK**

**ON BEHALF OF
THE CONSUMER ADVOCATE AND PROTECTION DIVISION
OF THE
TENNESSEE ATTORNEY GENERAL'S OFFICE**

April 12, 2013

ATTACHMENTS

Attachment WHN-1
Attachment WHN-2

William H. Novak Vitae
Dilutive Effect of the Whitwell Acquisition

1 ***Q1. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND***
2 ***OCCUPATION FOR THE RECORD.***

3 ***A1.*** My name is William H. Novak. My business address is 19 Morning Arbor Place,
4 The Woodlands, TX, 77381. I am the President of WHN Consulting, a utility
5 consulting and expert witness services company.¹

7 ***Q2. PLEASE PROVIDE A SUMMARY OF YOUR BACKGROUND AND***
8 ***PROFESSIONAL EXPERIENCE.***

9 ***A2.*** A detailed description of my educational and professional background is provided
10 in Attachment WHN-1 to my testimony. Briefly, I have both a Bachelors degree
11 in Business Administration with a major in Accounting, and a Masters degree in
12 Business Administration from Middle Tennessee State University. I am a
13 Certified Management Accountant, and am also licensed to practice as a Certified
14 Public Accountant.

15
16 My work experience has centered on regulated utilities for over 30 years. Before
17 establishing WHN Consulting, I was Chief of the Energy & Water Division of the
18 Tennessee Regulatory Authority where I had either presented testimony or
19 advised the Authority on a host of regulatory issues for over 19 years. In
20 addition, I was previously the Director of Rates & Regulatory Analysis for two
21 years with Atlanta Gas Light Company, a natural gas distribution utility with
22 operations in Georgia and Tennessee. I also served for two years as the Vice
23 President of Regulatory Compliance for Sequent Energy Management, a natural

¹ State of Tennessee, Registered Accounting Firm ID 3682.

1 gas trading and optimization entity in Texas, where I was responsible for ensuring
2 the firm's compliance with state and federal regulatory requirements.

3

4 ***Q3. ON WHOSE BEHALF ARE YOU TESTIFYING?***

5 ***A3.*** I am testifying on behalf of the Consumer Advocate & Protection Division
6 ("CAPD" or "the Consumer Advocate") of the Tennessee Attorney General's
7 Office.

8

9 ***Q4. HAVE YOU PRESENTED TESTIMONY IN ANY PREVIOUS***

10 ***TENNESSEE-AMERICAN WATER COMPANY RATE CASES?***

11 ***A4.*** Yes. I presented testimony in Dockets U-86-7402, U-87-7534, 89-15388, 91-
12 05224, 93-06946, 10-00189 and 12-00049 concerning Tennessee-American
13 Water Company ("TAWC" or "the Company") rate cases as well as other generic
14 tariff and rulemaking matters. In addition, I previously advised the TRA on
15 issues in other TAWC dockets where I did not present testimony.

16

17 ***Q5. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS***

18 ***PROCEEDING?***

19 ***A5.*** My testimony will support and address the CAPD's positions and concerns with
20 respect to the Company's Petition. Specifically, I will address the Company's
21 proposed accounting and regulatory treatment for the Whitwell acquisition.

22

1 **Q6. WHAT DOCUMENTS HAVE YOU REVIEWED IN PREPARATION OF**
2 **YOUR TESTIMONY?**

3 **A6.** I have reviewed the Company's Joint Petition filed on December 27, 2012, along
4 with the testimony and exhibits presented with their filing. In addition, I have
5 reviewed the Company's workpapers supporting the proposed acquisition. I have
6 also reviewed the Company's responses to the data requests submitted by the
7 TRA as well the Company's responses to CAPD's discovery requests.

8

9 **Q7. PLEASE DESCRIBE THE RELIEF THAT TAWC IS ASKING FROM**
10 **THE TRA IN ITS PETITION.**

11 **A7.** Among other things, the Company is asking the TRA to "approve accounting and
12 rate base treatments that reflect the full purchase price plus the acquisition and
13 transactions cost in TAWC's net original cost rate base or other guidance that
14 shows that future rate base determinations will be consistent with the value of the
15 full purchase price plus acquisition and transactions costs."² In essence, TAWC is
16 asking the TRA to approve the regulatory treatment of the estimated \$1.6 million
17 acquisition outside of a formal rate case and before the complete cost of the
18 Whitwell system is known and measurable.

19

20 **Q8. DOES THE CAPD AGREE WITH THIS PROPOSED REGULATORY**
21 **TREATMENT OF ACQUISITION COSTS?**

22 **A8.** No, we do not. In this case, the Company has proposed to use the historical book
23 value on the Whitwell financial statements as a proxy for fair market value.

² Company Petition, Page 9.

1 While useful for accounting purposes, historical costs rarely represent the fair
2 market value of the assets acquired. For example, in TRA Docket 03-00388,
3 TAWC acquired the assets of the Suck Creek Utility District with a historical
4 book value of \$960,443 for only \$153,269. In this case, the Company is
5 proposing to pay the historical cost of approximately \$1.6 million on the books of
6 the City of Whitwell as the fair market value of the assets acquired.
7

8 ***Q9. HAS THE COMPANY PROPOSED A RATE ADJUSTMENT IN THIS***
9 ***CASE FOR THE COST OF THE WHITWELL ACQUISITION?***

10 A9. No. The Company has proposed to maintain the current rate structure until a
11 future rate proceeding. However, their request for the TRA to approve the
12 regulatory treatment of the \$1.6 million acquisition price in this case will
13 ultimately bind the TRA in future rate proceedings. Therefore, even though
14 TAWC is not asking for a rate increase at this time, the accounting and regulatory
15 treatment that it has requested will ultimately impact rates.
16

17 ***Q10. HOW DID THE CAPD DETERMINE THAT THE HISTORICAL COST IS***
18 ***NOT AN APPROPRIATE PROXY FOR FAIR MARKET VALUE OF THE***
19 ***WHITWELL ASSETS?***

20 A10. In paragraph 21 of the Company's petition, it states the following:

21 "21. Mildly stated, upon a thorough and reasoned evaluation,
22 TAWC considers the System to be materially under-supported.
23 Whitwell has been under review by the State of Tennessee's
24 Comptroller's Office. Among other things, and as regarding the

1 System, Whitwell has a limited source of supply, has previously
2 exceeded its plant designed capacity, has imposed a selective
3 moratorium on new taps, and has a history of water quality
4 advisories. Furthermore, Whitwell must invest in significant
5 infrastructure replacement to eliminate unreasonably high water
6 loss.”

7 Because of the current condition of the Whitwell system, TAWC estimates that it
8 will need to spend an additional [REDACTED] beyond the initial purchase price
9 over the next 5 years in order to provide safe and adequate drinking water for only
10 2,754 customers.³ Based upon these statements and evaluations, the CAPD
11 hardly believes that the historical book value of the Whitwell system is an
12 appropriate proxy for the market value. As a result, if the TRA were to approve
13 the Whitwell acquisition at historical cost value then it would have a dilutive
14 effect of approximately [REDACTED] that would then have to be paid for by all
15 other TAWC customers.

16
17 ***Q11. HOW DID THE CAPD CALCULATE THE DILUTIVE IMPACT OF THE***
18 ***WHITWELL ACQUISITION?***

19 A11. A complete calculation of the dilutive effect of the Whitwell acquisition is
20 contained in Attachment WHN-2 to my testimony. However, I have summarized
21 the calculation as shown below.

22

³ Company response to CAPD Data Request, Item 8, page 16 (Confidential).

	<u>AMOUNT</u>
Existing TAWC Rate Base per Customer	\$1,772
Whitwell Rate Base per Customer at 5 Year Buildout	[REDACTED]
Difference	[REDACTED]
Number of Whitwell Customers	<u>2,754</u>
Rate Base Acquisition Adjustment (Negative)	[REDACTED]

1 This negative acquisition adjustment of approximately [REDACTED] will be
2 necessary in order to avoid other TAWC customers from paying for the
3 acquisition and upgrade of the Whitwell system. Furthermore, this acquisition
4 adjustment will either need to be recognized now or in a later proceeding in order
5 to reflect the true market value of the Whitwell system.

6
7 ***Q12. IS THE CAPD RECOMMENDING THAT THE TRA DENY THE***
8 ***COMPANY'S PROPOSED ACQUISITION BECAUSE OF THE***
9 ***DILUTIVE IMPACT?***

10 A12. No. The CAPD is saying that a negative acquisition adjustment must be
11 recognized at some point to prevent other TAWC customers from paying for the
12 cost of the Whitwell acquisition **if** the TRA intends to approve the accounting and
13 regulatory treatment at this time as requested by the Company. However, as a
14 preferred alternative, the CAPD would recommend that the TRA only approve the
15 acquisition at this time and defer the decision for the accounting and regulatory
16 treatment until a later proceeding when the necessary capital expenditures are
17 both known and measurable.

1

2 ***Q13. DOES THIS COMPLETE YOUR TESTIMONY?***

3 ***A13.*** Yes it does. However, I reserve the right to incorporate any new data that may
4 subsequently become available since the Company has indicated that they may
5 modify their responses to the CAPD's data requests for new information.⁴

⁴ Company response to CAPD 2nd data request, general objects, paragraph 3.

ATTACHMENT WHN-1

William H. Novak Vitae

William H. Novak

19 Morning Arbor Place
The Woodlands, TX 77381

Phone: 713-298-1760

Email: halnovak@whnconsulting.com

Areas of Specialization

Over twenty-five years of experience in regulatory affairs and forecasting of financial information in the rate setting process for electric, gas, water and wastewater utilities. Presented testimony and analysis for state commissions on regulatory issues in four states and has presented testimony before the FERC on electric issues.

Relevant Experience**WHN Consulting – September 2004 to Present**

In 2004, established WHN Consulting to provide utility consulting and expert testimony for energy and water utilities. Complete needs consultant to provide the regulatory and financial expertise that enabled a number of small gas and water utilities to obtain their Certificate of Public Convenience and Necessity (CCN) that included forecasting the utility investment and income. Also provided the complete analysis and testimony for utility rate cases including revenues, operating expenses, taxes, rate base, rate of return and rate design for utilities in Tennessee. Assisted American Water Works Company in preparing rate cases in Ohio and Iowa. Provided commercial and industrial tariff analysis and testimony for an industrial intervenor group in a large gas utility rate case. Industry spokesman for water utilities dealing with utility commission rulemaking. Consultant for the North Carolina and Illinois Public Utility Commissions in carrying out their oversight functions of Duke Energy and Peoples Gas Light and Coke Company through focused management audits. Also provide continual utility accounting services and preparation of utility commission annual reports for water and gas utilities.

Sequent Energy Management – February 2001 to July 2003

Vice-President of Regulatory Compliance for approximately two years with Sequent Energy Management, a gas trading and optimization affiliate of AGL Resources. In that capacity, directed the duties of the regulatory compliance department, and reviewed and analyzed all regulatory filings and controls to ensure compliance with federal and state regulatory guidelines. Engaged and oversaw the work of a number of regulatory consultants and attorneys in various states where Sequent has operations. Identified asset management opportunities and regulatory issues for Sequent in various states. Presented regulatory proposals and testimony to eliminate wholesale gas rate fluctuations through hedging of all wholesale gas purchases for utilities. Also prepared testimony to allow gas marketers to compete with utilities for the transportation of wholesale gas to industrial users.

Atlanta Gas Light Company – April 1999 to February 2001

Director of Rates and Regulatory Analysis for approximately two years with AGL Resources, a public utility holding company serving approximately 1.9 million customers in Georgia, Tennessee, and Virginia. In that capacity, was instrumental in leading Atlanta Gas Light Company through the most complete and comprehensive gas deregulation process in the country that involved terminating the utility's traditional gas recovery mechanism and instead allowing all 1.5 million AGL Resources customers in Georgia to choose their own gas marketer. Also responsible for all gas deregulation filings, as well as preparing and defending gas cost recovery and rate filings. Initiated a weather normalization adjustment in Virginia to track adjustments to company's revenues based on departures from normal weather. Analyzed the regulatory impacts of potential acquisition targets.

Tennessee Regulatory Authority – Aug. 1982 to Apr 1999; Jul 2003 to Sep 2004

Employed by the Tennessee Regulatory Authority (formerly the Tennessee Public Service Commission) for approximately 19 years, culminating as Chief of the Energy and Water Division. Responsible for directing the division's compliance and rate setting process for all gas, electric, and water utilities. Either presented analysis and testimony or advised the Commissioners/Directors on policy setting issues, including utility rate cases, electric and gas deregulation, gas cost recovery, weather normalization recovery, and various accounting related issues. Responsible for leading and supervising the purchased gas adjustment (PGA) and gas cost recovery calculation for all gas utilities. Responsible for overseeing the work of all energy and water consultants hired by the TRA for management audits of gas, electric and water utilities. Implemented a weather normalization process for water utilities that was adopted by the Commission and adopted by American Water Works Company in regulatory proceedings outside of Tennessee.

Education

B.A, Accounting, Middle Tennessee State University, 1981

MBA, Middle Tennessee State University, 1997

Professional

Certified Public Accountant (CPA), Tennessee Certificate # 7388

Certified Management Accountant (CMA), Certificate # 7880

Former Vice-Chairman of National Association of Regulatory Utility Commission's Subcommittee on Natural Gas

ATTACHMENT WHN-2
(Public)
Dilutive Impact

Tennessee-American Water Company - Whitwell Acquisition Calculation of Dilutive Impact

12-00157
CAPD Exhibit
Schedule 1

	TAWC Rate Case Amount
TAWC Current Rate Base (TRA Docket 12-00049)	\$132,015,472 A/
Current TAWC Customers	74,514 B/
Current TAWC Rate Base per Customer	\$1,772
Whitwell Acquisition Price	\$1,618,557 C/
Year 1 Capital Expenditures	D/
Year 2 Capital Expenditures	D/
Year 3 Capital Expenditures	D/
Year 4 Capital Expenditures	D/
Year 5 Capital Expenditures	D/
Total Whitwell Rate Base at Buildout	
Customers	2,754 E/
Whitwell Rate Base per Customer	
Acquisition Adjustment Calculation:	
Existing TAWC Rate Base per Customer	\$1,772
Whitwell Rate Base per Customer at Build-out	
Difference	
Whitwell Customers	2,754
Rate Base Acquisition Adjustment (Negative)	

- A/ TRA Order, Attachment A-Settlement Exhibits, Schedule 8.
B/ TRA Order, Attachment A-Settlement Exhibits, Rate Design Schedules:

Residential	783,720
Commercial	99,784
Industrial	1,802
Other Public Authority	8,807
Other Water Utility	49
Total Bills	894,162
12 Months	12
Average Customers	74,514

- C/ Company response to CAPD Data Request #9.
D/ Company response to CAPD Data Request #8, Page 16 (Confidential).
E/ Company response to CAPD Data Request #13.

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
POWELL CROSS ROADS, TENNESSEE, FOR
APPROVAL OF A PURCHASE AGREEMENT AND
WATER FRANCHISE AGREEMENT AND FOR
THE ISSUANCE OF A CERTIFICATE OF
CONVENIENCE AND NECESSITY

)
)
)
)
)
)
)
)

DOCKET NO. 12-00157

AFFIDAVIT

I, William Novak, CPA, 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.


WILLIAM NOVAK

Sworn to and subscribed before me
this 12 day of April, 2013.



NOTARY PUBLIC

My commission expires: 7-24-15

