

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

January 27, 2016

IN RE:

PETITION OF TENNESSEE-AMERICAN WATER
COMPANY FOR APPROVAL OF A QUALIFIED
INFRASTRUCTURE INVESTMENT PROGRAM, AN
ECONOMIC DEVELOPMENT INVESTMENT RIDER,
A SAFETY AND ENVIRONMENTAL COMPLIANCE
RIDER AND PASS-THROUGHS FOR PURCHASED
POWER, CHEMICALS, PURCHASED WATER,
WHEELING WATER COSTS, WASTE DISPOSAL,
AND TRA INSPECTION FEE

DOCKET NO.
13-00130

ORDER APPROVING AMENDED PETITION

This matter came before Chairman James M. Allison, Vice Chairman Herbert H. Hilliard and Director Kenneth C. Hill of the Tennessee Regulatory Authority (the “Authority” or “TRA”), the voting panel assigned to this docket, at a regularly scheduled Authority Conference held on April 14, 2014, to consider the *Petition* filed by Tennessee American Water Company on October 4, 2013, and amended by a *Stipulation* filed on January 10, 2014 and by tariffs filed on March 25, 2014 (the “*Amended Petition*”).

BACKGROUND

Tennessee American Water Company (“TAWC” or the “Company”) provides residential, commercial, industrial and municipal water service to customers in Tennessee and North Georgia. TAWC is a wholly-owned subsidiary of American Water Works Company, Inc. On October 4, 2013, TAWC filed a *Petition*, along with necessary tariffs, pursuant to Tenn. Code

Ann. § 65-5-103(d)¹ and TRA Rule 1220-4-1-.04, seeking to implement a Qualified Infrastructure Investment Program (“QIIP”) Rider, Economic Development Investment (“EDI”) Rider, Safety and Environmental Compliance (“SEC”) Rider (sometimes referred to as Investment Riders or Capital Recovery Riders) and a Pass-Through Mechanism for Purchased Power, Chemicals, Purchased Water, Wheeling Water Costs, Waste Disposal and TRA Inspection Fee (Production Cost and Other Pass-Throughs, or “PCOP”).

During the October 21, 2013 Authority Conference, the panel assigned to this matter convened a contested case and appointed General Counsel or her designee to prepare this case for hearing.² Subsequently, the Hearing Officer suspended the proposed tariffs through February 4, 2014, granted the intervention request of the Consumer Advocate and Protection Division of the Office of the Tennessee Attorney General (“Consumer Advocate”) and issued a procedural schedule with a hearing date of January 13, 2014.³

On January 10, 2014, TAWC and the Consumer Advocate (together, the “Parties”) filed a *Stipulation* that purported to resolve outstanding issues between the Parties.⁴ By its terms, the *Stipulation* changed the terms of the riders requested by the Company. Although the Consumer Advocate agreed not to oppose the petition and tariffs as amended by the *Stipulation*, the Consumer Advocate took no position on whether the tariff riders were in the public interest.⁵ Simultaneous with the Hearing on January 13, 2014, TAWC filed new tariff pages consistent with the terms of the *Stipulation*. At the Hearing held on January 13, 2014, TAWC confirmed

¹ Tenn. Code Ann. § 65-5-103(d) went into effect on April 19, 2013, and authorizes the Authority to implement alternative regulatory methods.

² See *Order Convening a Contested Case and Appointing a Hearing Officer*, p. 1 (October 23, 2013).

³ See *Order Establishing Procedural Schedule*, p. 2 (October 29, 2013).

⁴ The *Stipulation* was filed on Friday, January 10, 2014 and the Hearing on the merits of the *Petition* was scheduled to be heard on Monday, January 13, 2014.

⁵ *Stipulation*, p. 3 (January 10, 2014).

that the *Stipulation* was an amendment to the *Petition*.⁶ Mr. Gary VerDouw, Central Division Director of Rates for TAWC, summarized the *Stipulation*. Members of the public were given an opportunity to comment.

Pursuant to Tenn. Code Ann. § 65-5-103(d)(1), the TRA has 120 days from the initial filing of a petition for an alternative regulatory method by a public utility to make a determination as to whether or not it should be approved. If there is a denial of the petition, the Authority must specify its reasons and the utility then has 60 days to amend the petition. The Authority is given 60 days to approve or deny the amended plan.⁷ The statute is silent as to the Authority's ability to make material changes to the terms of a petition, but contemplates an amendment of the petition by the utility after a denial by the Authority. Therefore, the panel determined that material changes made to a petition or the filing of an amended petition by a utility should be treated as a new petition under the statute. The panel concluded that the *Stipulation* should be treated as a new petition and that the deadline for a determination by the Authority was 120 days from the filing of the *Stipulation*.

Following additional revisions, data responses, and discussions between the Parties and TRA Staff for clarification purposes and the correction of errors, TAWC filed the final revised tariffs on March 25, 2014. The tariffs had an effective date of April 15, 2014. The original *Petition*, *Stipulation*, and revised tariffs, are collectively referred to as the *Amended Petition* and are described below.

THE AMENDED PETITION

The *Amended Petition* requests approval of four alternative rate mechanisms, which are briefly described as follows:

⁶ Transcript of Proceedings, p. 5 (January 13, 2014).

⁷ Tenn. Code Ann. § 65-5-103(d)(1)(C).

Qualified Infrastructure Investment Program (“QIIP”) Rider

According to TAWC, a substantial portion of the Company’s distribution infrastructure is between 50 and 100 years old and is nearing the end of its useful service life.⁸ The need to replace service lines, meters, hydrants, treatment structures, pumps, and equipment, is critical to maintaining public safety, continuous, and cannot be delayed.⁹ The timely recovery of the fixed costs of infrastructure replacement through the QIIP rider provides an incentive for increased and continued levels of capital infusion, resulting in a stronger and more reliable water distribution and production system.¹⁰ According to TAWC, the QIIP will allow the Company to prudently invest in necessary infrastructure repair and improvement projects absent the burden of bearing or carrying the investment in full without an opportunity to earn a fair rate of return on that investment until the next rate case.¹¹

Economic Development Investment (“EDI”) Rider

The EDI Rider will allow TAWC to work alongside the communities it serves by making the investment in either the replacement of existing or placement of new infrastructure. The Company will install or replace the infrastructure so that the community can use the improvement for economic development purposes.¹² TAWC is requesting to recover expenses associated with these efforts to promote economic development within its service territory.¹³

Safety and Environmental Compliance (“SEC”) Rider

The SEC Rider will allow the Company to recover the operational expenses and capital costs related to safety requirements and environmental compliance.¹⁴ Additional infrastructure

⁸ Gary M. VerDouw, Pre-Filed Direct Testimony, p. 12 (October 4, 2013).

⁹ *Id.*

¹⁰ *Id.*

¹¹ Deron E. Allen, Pre-Filed Direct Testimony, pp. 6-7 (October 4, 2013).

¹² *Id.* at 7.

¹³ *Id.* at 8.

¹⁴ *Id.* at 9.

investment may be required to meet safety and environmental compliance mandates from both state and federal government. According to the Company, the most appropriate way to address a potential alternate rate-making approach for safety and environmental compliance is well in advance of the need to invest in the infrastructure. The SEC Rider will allow infrastructure investment on a proactive rather than reactive basis, while avoiding rate shock, if possible.¹⁵

Production Cost and Other Pass-Throughs ("PCOP")

TAWC is requesting pass-through recovery of purchased power, chemicals, purchased water, wheeling cost, waste disposal and regulatory expense related items. According to the Company, the cost of these essential expenses incurred during its regular operations is outside of TAWC's control. If there is an increase, the Company cannot recover for such increases until its next rate case, negatively impacting its opportunity to earn the rate of return set by the TRA.¹⁶ Under the PCOP, the costs could be recovered in between rate cases and any decrease in costs would be passed through to customers via a monthly line item.¹⁷

The adjustments and clarifications that were made to the Company's original filing and included in the *Stipulation* filed with the TRA on January 10, 2014 changed the Company's original proposed revenue requirement surcharge amount very little. The Company's original filed QIIP, EDI and SEC Riders were to generate a total surcharge that would add 1.11% to the bills of Tennessee American customers. With the adjustments made and included in the *Stipulation*, the QIIP, EDI and SEC Riders will generate a total surcharge of 1.08%, with a

¹⁵ Gary M. VerDouw, Pre-Filed Direct Testimony, pp. 34-35 (October 4, 2013).

¹⁶ Deron E. Allen, Pre-Filed Direct Testimony, p. 9 (October 4, 2013).

¹⁷ *Id.* at 10.

resulting total annual revenue requirement of \$510,837.¹⁸ TAWC asserts that implementation of the PCOP mechanism will reduce consumers' bills by 1.15% during the first year.¹⁹

TAWC avers that the four alternative rate mechanisms are in the public interest. According to the Company, each of the proposed mechanisms is mutually beneficial to the ratepayers, the public, and TAWC. Among other things, the ratepayers benefit from the reduced need for general rate cases and from the lessening of the occurrence of "rate shock." The ratepayers and the public benefit from the safety and reliability components and from the more seamless and timely capital investment in infrastructure, coupled with the related support to economic development, growth and job creation. The Company benefits from a more efficient, streamlined regulatory process that presents TAWC with the opportunity to timely recover its expenses and earn a fair rate of return on its investments.²⁰

APRIL 14, 2014 HEARING

A Hearing in this matter was held before the voting panel on April 14, 2014.

Participating in the Hearing were the following Parties and their respective counsel:

Tennessee American Water Company – Melvin J. Malone, Esq., Butler, Snow, O'Mara, Stevens and Cannada, PLLC, The Pinnacle at Symphony Place, 150 3rd Avenue South, Suite 1600, Nashville, TN 37201

Consumer Advocate – Joe Shirley, Esq., Office of the Attorney General, 425 Fifth Avenue North, Fourth Floor, John Sevier Building, P.O. Box 20207, Nashville, TN 37202

Mr. Gary M. VerDouw appeared as a witness for TAWC and was subject to questions from the panel.²¹ Members of the public were given an opportunity to present comments to the panel.

¹⁸ Gary M. VerDouw, Pre-Filed Supplemental Testimony, p. 10 (January 17, 2014).

¹⁹ Gary M. VerDouw, Pre-Filed Supplemental Testimony, Revised Exhibit 2, p. 13 of 14 (April 1, 2014).

²⁰ Gary M. VerDouw, Pre-Filed Supplemental Testimony, pp. 10-12 (January 17, 2014).

²¹ All of the witnesses who submitted pre-filed testimony on behalf of TAWC and the Consumer Advocate were available for questions during the Hearing. However, only Mr. VerDouw presented testimony at the Hearing. The Consumer Advocate waived cross-examination of the witness.

FINDINGS AND CONCLUSIONS

Tenn. Code Ann. § 65-5-103(d)(1)(A) reads: “The [A]uthority is authorized to implement alternative regulatory methods to allow for public utility rate reviews and cost recovery in lieu of a general rate case proceeding before the [A]uthority.” Further, Tenn. Code Ann. § 65-5-103(d)(2)(A) states:

A public utility may request and the authority may authorize a mechanism to recover the operational expenses, capital costs or both, if such expenses or costs are found by the authority to be in the public interest, related to any one (1) of the following:

- (i) Safety requirements imposed by the state or federal government;
- (ii) Ensuring the reliability of the public utility plant in service; or
- (iii) Weather-related natural disasters.

Under Tenn. Code Ann. § 65-5-103(d)(3)(A), “[a] public utility may request and the authority may authorize a mechanism to recover the operational expenses, capital costs or both related to the expansion of infrastructure for the purpose of economic development, if such expenses or costs are found by the authority to be in the public interest.” Tenn. Code Ann. § 65-5-103(d)(4)(A)(i) states, “[a] public utility may request and the authority may authorize a mechanism to recover expenses associated with efforts to promote economic development in its service territory, if such expenses are found by the authority to be in the public interest. In addition, Tenn. Code Ann. § 65-5-103(d)(5) provides:

(A) A public utility may request and the authority may authorize a mechanism to recover the operational expenses, capital costs or both related to other programs that are in the public interest.

(B) A utility may request and the authority may authorize a mechanism to allow for and permit a more timely adjustment of rates resulting from changes in essential, nondiscretionary expenses, such as fuel and power and chemical expenses.

The General Assembly’s enactment of the alternative regulatory rate-making methods under Tenn. Code Ann. § 65-5-103(d) did not alter or limit the Authority’s general supervisory, regulatory and rate-setting powers over public utilities within its jurisdiction. Tenn. Code Ann. §

65-4-104 grants the Authority “general supervisory and regulatory power, jurisdiction and control over all public utilities.” Under Tenn. Code Ann. § 65-4-117(a)(3) the Authority has the power to “fix just and reasonable standards, classifications, regulations, practices or services to be furnished, imposed, observed and followed thereafter by any public utility.” Tenn. Code Ann. § 65-5-101(a) authorizes the Authority “to fix just and reasonable individual rates, joint rates, tolls, fares, charges or schedules thereof, as well as commutation, mileage, and other special rates which shall be imposed, observed, and followed thereafter by any public utility as defined in § 65-4-101.” The Authority’s jurisdiction over public utilities is to be liberally construed in favor of the Authority under Tenn. Code Ann. § 65-4-106.²² The Authority has a broad grant of authority under Tennessee law over the utilities within its jurisdiction.²³

Pursuant to its authority to implement alternative regulatory methods, as well as its general rate-setting powers, the TRA has the authority and discretion to determine whether an alternative rate mechanism produces rates and charges for public utilities services that are just and reasonable and in the public interest. In this regard, the Authority’s power and discretion to consider the substantive impact of an alternative ratemaking method or mechanism applies not only to the initial rate adjustment, but also to all subsequent rate adjustments made under an approved alternative rate mechanism. In carrying out its responsibilities, the Authority may consider whether an alternative regulatory method: (1) is consistent with applicable TRA orders, rules, and established ratemaking policies and principles; (2) ensures that recoverable costs and

²² Tenn. Code Ann. § 65-4-106 states: “This chapter shall not be construed as being in derogation of the common law, but shall be given a liberal construction, and any doubt as to the existence or extent of a power conferred on the authority by this chapter or chapters 1, 3 and 5 of this title shall be resolved in favor of the existence of the power, to the end that the authority may effectively govern and control the public utilities placed under its jurisdiction by this chapter.”

²³ See, e.g., *CF Industries v. Tennessee Public Service Commission*, 599 S.W.2d 536, 542 (Tenn. 1980); *Tennessee Cable Television Association v. Tennessee Public Service Commission*, 844 S.W.2d 151, 159 (Tenn. Ct. App. 1992); *Laurel Hills Condominiums Property Owners’ Association v. Tennessee Regulatory Authority*, 2014 WL 1494126, *4-*8 (Tenn. Ct. App. Apr. 14, 2014), *perm. app. denied* (Tenn. Oct. 15, 2014).

expenses are reasonably and prudently incurred by the utility for provisioning regulated services; (3) provides for timely, meaningful and transparent review and approval of all rate adjustments made under the alternative rate mechanism; (4) continues to be in compliance with TRA orders and tariffs establishing the alternative rate mechanism; and (5) remains in the public interest taking into account any changed circumstances or conditions.

At the regularly scheduled Authority Conference held on April 14, 2014, the panel considered the *Amended Petition* and tariffs filed on March 25, 2014. Based upon the pleadings of the parties, arguments of counsel and presentation of the witness, as well as review of the tariffs and entire administrative record, the panel made the following findings:

1. The *Amended Petition* and, specifically, the tariffs establishing the alternative rate mechanisms filed on March 25, 2014, meet the requirements of Tenn. Code Ann. § 65-5-103(d).

2. The methodologies contained in the tariffs provide for recovery of operating expenses and costs related to investment in infrastructure which are generally permissible for utility ratemaking purposes.

3. The tariffs provide for definitions of investments and expenses authorized for recovery and formulas for computing revenue requirements and rate adjustments consistent with established ratemaking policies, principles, methodologies, and the authorized rate of return approved in the Company's most recent rate case.²⁴

4. The tariffs are designed to ensure that customers ultimately pay no more than the amount authorized for recovery under the alternative rate mechanisms through annual true-up provisions.

²⁴ *In re Petition of Tennessee American Water Company for a General Rate Increase, Implementation of a Distribution System Infrastructure Charge and the Establishment of Tracking Mechanisms for Purchased Power, Pensions and Chemical Expenses*, TRA Docket 12-00049, *Order Approving Settlement Agreement* (November 20, 2012).

5. The tariffs provide for filing procedures and requirements, including submission of supporting documentation, intended to ensure timely and transparent review of all proposed rate adjustments.

6. The operating expenses to be recovered under the PCOP mechanism were reasonably and prudently incurred in the provisioning of regulated water services.

7. The expenses and costs related to investments in infrastructure to be recovered under the QIIP, EDI and SEC mechanisms are the type of expenses and costs that are generally allowable for utility ratemaking purposes. The reasonableness and prudence of such costs and expenses will be determined by the Authority after they are incurred.

8. The alternative rate mechanisms allow TAWC to recover the funds necessary to repair and replace necessary plant in a timely manner resulting in safe and reliable drinking water to customers.

9. The Company's timely recovery of prudently incurred costs related to investments in infrastructure and related expenses under the Capital Recover Riders, along with its recovery of prudent operating expenses under the PCOP Rider, should lessen the need for full-scale rate case proceedings, which in turn should result in a decreased amount of legal fees and rate case expenses included in customer rates.

10. According to evidence presented, the initial QIIP, EDI and SEC mechanisms will result in a combined 1.08% increase to consumers' bills, while implementation of the initial PCOP mechanism will reduce consumers' bills by 1.15%. In total, consumers will experience a decrease in their monthly bills of 0.07% during the first year.

After review of the filings and evidence presented in this docket, and in light of the foregoing findings and conclusions, the panel found that the proposed Qualified Infrastructure

Investment Program, Economic Development Investment Rider, Safety and Environmental Compliance Rider and Production Costs and Other Pass-Through Mechanism to be reasonable and in the public interest. Therefore, the panel approved the *Amended Petition* and the tariffs submitted on March 25, 2014, to become effective on April 15, 2014.

IT IS THEREFORE ORDERED THAT:

The *Amended Petition* filed by Tennessee American Water Company and as discussed herein, is approved. The tariffs submitted on March 25, 2014 are approved and shall become effective on April 15, 2014.

Vice Chairman Herbert H. Hilliard and Director Kenneth C. Hill concur. Chairman James M. Allison concurred with the motion.

ATTEST:



Earl R. Taylor, Executive Director