BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

February 5, 2016

IN RE:	)	
	)	
PETITION OF TENNESSEE-AMERICAN WATER COMPANY REGARDING THE PRODUCTION COSTS AND OTHER PASS-THROUGHS RIDER	)))	**DOCKET NO. 15-00001**

ORDER ON DECEMBER 1, 2013 THROUGH NOVEMBER 30, 2014 PCOP RIDER EXPENSES

This matter came before Chairman Herbert H. Hilliard, Director Kenneth C. Hill, and Director James M. Allison of the Tennessee Regulatory Authority ("Authority" or "TRA"), the voting panel assigned to this docket, during a regularly scheduled Authority Conference held on August 17, 2015 to consider the *Petition* filed by Tennessee-American Water Company ("TAWC" or the "Company") on December 30, 2014.

BACKGROUND

TAWC's initial Production Cost and Other Pass-Throughs Rider mechanism ("PCOP" or "PCOP Rider") was approved in TRA Docket No. 13-00130 to recover incremental changes in certain essential, non-discretionary expenses.[1] This mechanism is calculated retrospectively meaning recovery for the costs is requested after the costs have been incurred.[2] The initial PCOP was based on a comparison of the forecasted attrition year expenses used in the last rate case for the period of December 1, 2012 through November 30, 2013 to the actual expenses for the same

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[1] Linda C. Bridwell, Pre-filed Direct Testimony, p. 4 (December 30, 2014). *See 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* (January 27, 2016).

[2] *Id.*

time period.[3] The actual expenses per 100 gallons of water were $542,382 less than expenses approved in the last rate case; therefore, the PCOP was set to reduce consumers' bills by 1.15%.[4]

Pursuant to the approved tariff, the PCOP is to be filed annually within 30 days of the end of the most recently authorized attrition year. The Company must make annual filings every twelve months subsequent to the end of that attrition year calculating the amount collected through the PCOP tariff rider versus the amount approved for collection, along with recovery of any change in the costs for the previous twelve-month period.[5]

On February 2, 2015, the Consumer Advocate and Protection Division of the Office of the Attorney General ("CAPD" or "Consumer Advocate") filed a *Petition to Intervene.* During the Authority Conference held on February 9, 2015, the panel assigned to this matter convened a contested case proceeding, granted the Consumer Advocate's *Petition to Intervene*, and appointed the Authority's General Counsel or her designee to act as Hearing Officer in this matter.

PETITION

On December 30, 2014, the Company filed its *Petition* regarding the PCOP Rider. The *Petition* represents TAWC's required annual PCOP filing for the review period December 1, 2013 through November 30, 2014. The *Petition* requests that the Authority approve the proposed PCOP percentage and tariffs as submitted. It also states the *Petition*, along with the supporting documentation, is consistent with Tenn. Code Ann. § 65-5-103 and serves the public interest.[6]

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[3] *Id.*

[4] *Id.* at 15.

[5] Interest on this amount is included and then the total amount is grossed up based on the authorized gross receipts tax and uncollectible rate approved in the latest rate case.

[6] *Petition*, p. 7 (December 30, 2014).

TAWC explains that the PCOP percentage approved in TRA Docket No. 13-00130 was based on a twelve-month recovery period beginning January 2014. According to TAWC, due to the timing of the docket the percentage actually became effective April 15, 2014, which reduced the recovery period from twelve months to eight and one-half months creating a mismatch, which TAWC proposes to eliminate with the proposed rates in the tariff filed with its *Petition.*[7]

TAWC's *Petition* encompasses a current review of actual expenses for the period of December 1, 2013 through November 30, 2014 compared to the forecasted attrition period expenses in TAWC's last rate case[8] and a true-up of the actual recovered amount from April 15, 2014 through December 31, 2014 to the last approved refund amount.

AUGUST 17, 2015 HEARING AND APPEARANCES

A hearing in this matter was held before the voting panel at the regularly scheduled Authority Conference held on August 17, 2015. Participating in the hearing were the following parties and their respective counsel:

TAWC - Melvin J. Malone, Esq., Butler, Snow, O'Mara, Stevens & Cannada, PLLC, 1200 One Nashville Place, 150 Fourth Avenue North, Nashville, Tennessee 37219.

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

At the hearing, the panel considered the pre-filed testimony and docket filings, and the parties did not present live witness testimony. Members of the public were given an opportunity to present comments to the panel, but no one came forward to comment. The panel deliberated the matter immediately following the hearing.

[7] *Id.* at 6-7.

[8] The attrition period in TAWC's last rate case (TRA Docket No. 12-00049) was December 1, 2012 through November 30, 2013. *See 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,* Docket No. 12-00049, *Order Approving Settlement Agreement* (November 20, 2012).

POSITIONS OF THE PARTIES

PCOP EXPENSES

TAWC

The operational expenses included within the PCOP Rider are: Chemical, Fuel & Power, Waste Disposal, Purchased Water and TRA Inspection Fee Expenses. The calculation begins with historical expense incurred during the attrition period (year ending November 30, 2014) and adds the over- or under- collections from the prior year.

In her direct testimony, TAWC witness, Linda Bridwell, proposes a PCOP Rider of negative 0.83%, which would result in a refund to customers. Since customers received a larger refund of 1.15% last year, customers will actually see a rate increase of 0.32%.

Chemical Expense

Ms. Bridwell testifies that the Company's revised PCOP Rider rate includes actual gross Chemical Expense of $918,055.[9] The Company's calculation of Chemical Expense includes a 15% reduction for unaccounted water loss, consistent with the Authority's decision in TRA Docket No. 12-00049, resulting in net Chemical Expense of $834,074.[10]

Fuel & Power Expense

The Company's revised PCOP calculations include actual gross Fuel & Power Expense of $2,641,148.[11] This includes a 15% reduction for unaccounted water loss, consistent with the Authority's decision in Docket No. 12-00049, resulting in net Fuel & Power Expense of $2,399,543.[12]

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[9] *Schedules Supporting Rebuttal Testimony of Linda C. Bridwell,* TAW_Final Version Filed Exhibit_080615, Page 3 of 6 (August 7, 2015).
[10] *Id.*
[11] *Id.*
[12] *Id.*

Waste Disposal Expense

The Company's revised PCOP Rider rate includes Waste Disposal Expense of $347,764.[13]

Purchased Water Expense

The Company's revised PCOP Rider rate includes Purchased Water Expense of $43,465.[14]

TRA Inspection Fee Expense

The Company's revised PCOP Rider rate includes TRA Inspection Fee Expense of $181,344.[15]

2014 Under-Refunded Amount

Each PCOP calculation includes an over- or under-recovered amount related to the prior year's revenue recoveries from the PCOP Rider.[16] The adjustment includes the amount over- or under-recovered and interest. For 2014, the Company determined that customers did not receive the full refund due from the PCOP Rider. Therefore, customers are due $234,289 (including interest) from the PCOP Rider.[17]

Ms. Bridwell testifies there are two reasons the full refund of $542,382 approved in TRA Docket No. 13-00130 did not occur. First, because the PCOP did not go into effect until April 15, 2014, the implementation time was reduced by three and one-half months and secondly, water sales were below those projected for the attrition period in the last rate case.[18]

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[13] *Id.*
[14] *Id.*
[15] *Id.*
[16] *Id.* at 7-8.
[17] *Id.* at *Petitioner's Exhibit -PCOP Calc- LCB,* Page 1 of 1 (December 30, 2014).
[18] *Id.* at 10.

The result of these two factors resulted in an under-collection of revenues of $234,289, which will be collected from customers in the upcoming year.[19]

CAPD

CAPD witness, William H. Novak's testimony addresses the calculations supporting TAWC's tariff filing and aspects of the methodology used for truing-up the PCOP tariff rider.[20] Mr. Novak testifies that "[o]verall, the calculations supporting the Company's tariff filing appeared to be reasonable and logical."[21] However, Mr. Novak notes two errors in the Company's calculations. First, although the Company calculated the historical fuel and purchased power expense correctly, Mr. Novak testifies that TAWC included an incorrect amount in the PCOP calculation.[22] Second, according to Mr. Novak, the Company used an incorrect attrition year sales volumes from the last rate case in its PCOP calculations.[23] After correcting the two errors, Mr. Novak recommends a PCOP surcharge rate of negative 0.73%.[24]

Also, Mr. Novak testifies that his review reveals TAWC is paying sales tax on water purchased from Eastside, Hixon and Walden's Ridge.[25] He points out that it is inappropriate for TAWC to pay sales tax on water purchased for resale.[26] In response to a Consumer Advocate Data Request, TAWC states this charge is an error and the Company is seeking recovery of these taxes that were paid in error to the Department of Revenue.[27] For this reason, Mr. Novak

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[19] *Id.* at 10-11.
[20] William H. Novak, Pre-filed Direct Testimony, p. 3 (June 12, 2015).
[21] *Id.* at 4.
[22] *Id.*
[23] *Id.* at 4-5.
[24] *Id.*
[25] *TAWC's Response to Second Set of Informal Request for Information*, No. 6 (March 31, 2015).
[26] William H. Novak, Pre-filed Direct Testimony, p. 6 (June 12, 2015).
[27] *TAWC's Response to Second Set of Informal Request for Information*, No. 6 (March 31, 2015).

testifies that the Authority should direct TAWC to include any future recovery of sales tax on purchased water in its PCOP filing.[28]

METHODOLOGY

CAPD

Mr. Novak expresses concern about the methodology the Company uses to calculate its PCOP rate.[29] Mr. Novak points out that as requested by the Authority, TAWC used vendor invoices in calculating the PCOP rather than the amounts recorded on the general ledger. Mr. Novak testifies that this method of reviewing invoices may result in significant problems.[30] First, the amounts in a rate case are based on general ledger amounts and therefore a true-up of invoiced amounts to attrition year general ledger amounts "results in an 'apples to oranges' type of comparison."[31] Second, tracing PCOP amounts to invoices would be a monumental task, which Mr. Novak testifies is "potentially beyond the resources that are available for a PCOP audit by the TRA."[32] Third, Mr. Novak states that general ledger amounts are independently audited but invoices are not and using invoices does not necessarily mean they were paid, whereas general ledger amounts incorporate all expenses and payments.[33] For these reasons, Mr. Novak recommends the Authority reconsider its previous decision and require future PCOP filings to be based on general ledger amounts rather than individual invoices.[34]

TAWC

In her rebuttal testimony, Ms. Bridwell addresses an issue regarding the method for the PCOP filings that was raised by Mr. Novak. Ms. Bridwell testifies that TAWC is willing to

[28] William H. Novak, Pre-filed Direct Testimony, p. 6 (June 12, 2015).
[29] *Id.*
[30] *Id.*
[31] *Id.*
[32] *Id.*
[33] *Id.* at 7.
[34] *Id.* at 6-7.

continue the current methodology, but agrees that the concerns addressed by Mr. Novak are significant.[35] According to Ms. Bridwell, the current methodology takes considerable effort and resources to prepare and likely takes significant effort and resources for the TRA and Consumer Advocate to audit.[36] Ms. Bridwell agrees that the general ledger is independently audited and that the invoices are not.[37] While TAWC is willing to use vendor invoices as directed by the Authority, the Company agrees with the conclusions of Mr. Novak and believes the use of general ledger amounts is more appropriate.[38]

RECONCILIATION PROCESS

TAWC

Ms. Bridwell explains that the delay in implementing the PCOP last year causes a mismatch between the reconciliation process and implementation of the new PCOP percentage.[39] If the tariff was strictly followed, both the expenses and the revenues would be trued-up over a twelve-month period. She states that this would require TAWC to make two filings – one in December 2014 to review and true-up expenses that were incurred from December 1, 2013 through November 30, 2014 to the last rate case, and one in June 2015 for the reconciliation of revenues over the period of April 15, 2014 to April 14, 2015.[40] To reduce administrative costs to all parties, TAWC proposes to include the eight and one-half month revenue reconciliation in this annual filing instead of reconciling revenues over twelve months and making a second filing. If allowed, this should eliminate the mismatch of the reconciliation periods.[41] Furthermore,

[35] Linda C. Bridwell, Pre-filed Rebuttal Testimony, p. 3 (June 26, 2015).
[36] *Id.* at 3-4.
[37] *Id.*
[38] *Id.* at 3.
[39] *Id.* at 12.
[40] *Id.*
[41] *Id.* at 10-12.

absent a combined reconciliation process, the two separate filings would also require two separate rate changes which could lead to customer confusion.[42]

PUBLIC INTEREST

TAWC

Ms. Bridwell testifies that the Riders: 1) are mutually beneficial to the Company, ratepayers and the public; 2) will reduce the need for rate cases; 3) will lessen rate shock; and 4) will streamline regulation. Ms. Bridwell states that the ratepayers and the public both benefit from addressing costs that are largely outside the Company's control without the expense of a rate case. The Company benefits from being able to timely recover its expenses in a more efficient streamlined regulatory process.[43] Ms. Bridwell testifies that customers have benefited over the last year and will continue to benefit this year from the Company's reduced PCOP expenses, which she states is in the public interest.[44]

Further, Ms. Bridwell testifies that the legislation's intent was to encourage timely recovery of expenses to enhance financial stability, while reducing costs to customers and utilities for regulatory review and implementation, and promoting rate gradualism for consumers. According to Ms. Bridwell, the approved PCOP Rider is achieving that goal and without the alternative rate mechanisms, the Company would be preparing for another rate case.[45]

FINDINGS AND CONCLUSIONS

Tenn. Code Ann. § 65-5-103(d)(3)(A) provides:

> 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

[42] *Id.* at 12.
[43] *Id.* at 6-7.
[44] *Id.* at 16.
[45] *Id.*

> are found by the authority to be in the public interest. Expansion of economic development infrastructure may include, but is not limited to, the following:
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> (i) Infrastructure and equipment associated with alternative motor vehicle transportation fuel;
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> (ii) Infrastructure and equipment associated with combined heat and power installations in industrial or commercial sites; and
>
> (iii) Infrastructure that will provide opportunities for economic development benefits in the area to be directly served by the infrastructure.

In authorizing the Authority to implement alternative regulatory methods under Tenn. Code Ann. § 65-5-103(d), the General Assembly did not alter or limit the Authority's general supervisory, regulatory and rate-setting powers over public utilities within its jurisdiction.[46] Pursuant to its authority to implement alternative regulatory methods, as well as its general utility rate-setting powers, the Authority has the authority and discretion to determine whether alternative rate mechanisms produce rates and charges for public utilities services that are just and reasonable and in the public interest. The Authority's power and discretion in this regard 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 costs and expenses recoverable under the alternative rate mechanism are reasonably and prudently incurred by the utility for the provision of authorized public utilities services; (3) provides for timely, meaningful and transparent review and approval of all rate adjustments made pursuant to 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 in light of changed circumstances or conditions.

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[46] *See* Tenn. Code Ann. §§ 65-4-104, 65-4-117(a)(3) and 65-5-101(a).

Upon review of the entire evidentiary record in this matter, the panel made the following findings and conclusions addressing (1) the Company's proposed reconciliation process; (2) the amount of recoverable PCOP Rider expense for the period ending November 30, 2014; (3) a request to change the methodology used to calculate the PCOP rider; and (4) whether the PCOP Rider remains in the public interest.

First, the panel finds the Company's proposal for a single reconciliation for the PCOP Rider, which includes a true-up of actual expenses over twelve months and a revenue true-up over eight and one-half months, to be acceptable and appropriate. A single reconciliation will lessen the administrative costs for all parties, reduce confusion for customers, and address the mismatch of reconciliation periods. For these reasons, the panel voted unanimously that the Company's proposed combined reconciliation is appropriate and directed the Company to file tariff language revising the procedures to be followed in a combined reconciliation process and implementation of the PCOP percentage in future annual filings.

Next, the panel voted unanimously to adopt $3,571,144 as the total actual net PCOP expense for the year ending November 30, 2014. This amount includes $833,611 for Chemical Expense, $2,399,271 for Fuel & Power Expense, $347,764 for Waste Disposal Expense, $43,443 for Purchased Water Expense and $181,344 for TRA Inspection Fee Expense. These expenses should be reduced by $234,289 to recognize the amount due to customers for the under-refunded 2014 PCOP Rider. The panel directed TAWC to file amended calculations including the PCOP percentage and tariffs consistent with the approved PCOP expense. Additionally, the panel noted that if TAWC receives any refund for sales taxes paid on water purchased for resale, the Company is directed to include the refund in the future PCOP filings.

Regarding the methodology, the panel found that auditing the invoices rather than a sole examination of the general ledger is vital, especially at the inception of this alternative rate mechanism. It is important to scrutinize all types of expenses that are filed for inclusion in the riders to ensure that imprudent or otherwise unrecoverable expenses are excluded. For these reasons, the panel voted unanimously that the current methodology remain in place and that the Company should continue to provide invoices for its actual PCOP expenses and a reconciliation between the invoices and general ledger.

Finally, the panel found that the PCOP Rider remains in the public interest. The PCOP Rider benefits the Company by allowing timely recovery of expenses without filing a rate case. Consumers benefit by not paying for expensive rate cases that the Company might otherwise have to pursue if expenses increase, while also receiving immediate refunds when expenses within PCOP Rider decrease. For these reasons, the panel found that the PCOP Rider is still in the public interest.

IT IS THEREFORE ORDERED THAT:

1. The proposed combined reconciliation contained in Tennessee-American Water Company's *Petition* is approved.

2. Tennessee-American Water Company shall file tariff language revising the procedures to be followed in a combined reconciliation process and implementation of the Production Cost and Other Pass-Throughs Rider mechanism percentage in future annual filings.

3. The total actual net Production Cost and Other Pass-Throughs Rider expense for the year ending November 30, 2014 shall be $3,571,144. This amount includes $833,611 for Chemical Expense, $2,399,271 for Fuel & Power Expense, $347,764 for Waste Disposal Expense, $43,443 for Purchased Water Expense and $181,344 for TRA Inspection Fee Expense.

These expenses shall be reduced by $234,289 to recognize the amount due to customers for the under-refunded 2014 Production Cost and Other Pass-Throughs Rider.

4. Tennessee-American Water Company shall file amended calculations including the Production Cost and Other Pass-Throughs Rider expense percentage and tariffs consistent with the approved Production Cost and Other Pass-Throughs Rider expense.

5. If Tennessee-American Water Company receives any refund for sales taxes paid on water purchased for resale, the Company shall include the refund in future Production Cost and Other Pass-Throughs Rider filings.

6. Tennessee-American Water Company shall maintain the current methodology used to calculate the Production Cost and Other Pass-Throughs Rider and should continue to provide invoices for its actual Production Cost and Other Pass-Throughs Rider expenses and a reconciliation between the invoices and general ledger.

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

Attest:

Earl Taylor

Earl R. Taylor, Executive Director