

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

February 8, 2016

IN RE:)	
)	
PETITION OF TENNESSEE-AMERICAN WATER)	DOCKET NO.
COMPANY FOR THE RECONCILIATION OF)	15-00029
THE 2015 CAPITAL RIDERS)	

ORDER GRANTING, IN PART, AND DENYING, IN PART, PETITION

This matter came before Chairman Herbert H. Hilliard, Director Kenneth C. Hill, and Director Robin Morrison of the Tennessee Regulatory Authority (“Authority” or “TRA”), the voting panel assigned to this docket, at a regularly scheduled Authority Conference held on October 19, 2015, for consideration of the *Petition in Support of the Calculation of the 2015 Capital Riders Reconciliation* (“*Petition*”) filed by Tennessee-American Water Company (“TAWC” or the “Company”) on March 1, 2015.

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. Pursuant to Tenn. Code Ann. § 65-5-103 *et seq.*, TAWC filed its *Petition* on March 1, 2015 in support of its calculation of the 2015 Qualified Infrastructure Investment Program (“QIIP”) Rider, the Economic Development Investment (“EDI”) Rider, and the Safety and Environmental Compliance (“SEC”) Rider (collectively referred to as “Capital Riders”).¹

¹ *Petition* (March 1, 2015).

In its *Petition*, TAWC requests approval of the calculations of its 2015 Capital Riders Reconciliation, certain tariffs based thereon filed with its *Petition*, and, consistent with such approvals, that the TRA issue an Order granting its *Petition*. In TRA Docket No. 13-00130, the Authority approved TAWC's request to recover prospectively infrastructure investment through three separate capital riders: (1) the Qualified Infrastructure Investment Program ("QIIP"); (2) the Economic Development Investment Program ("EDI"); and (3) the Safety and Environment Compliance Rider ("SEC").² The approved tariffs resulting from Docket No. 13-00130 were approved pursuant to the provisions of Tenn. Code Ann. § 65-5-103(d)(3)(A).³

Pursuant to the approved tariffs in Docket No. 13-00130, the Company must file new capital rider percentage rates for recovery of subsequent annual review periods by December 1st of each year. On October 29, 2014, in Docket No. 14-00121, the Company made the required new capital rider rate for the period ending December 31, 2015 which the Authority adjudicated on June 29, 2015. As part of Docket No. 14-00121, the Authority approved the QIIP as filed by the Company.⁴ The Authority approved the Company's revised SEC rider, which removed incremental expenses attributable to increases in chemicals, electricity and hauling. For the EDI, the Authority directed the Company to remove any investment in infrastructure related to provisioning of service to new customers.⁵ The Authority further disallowed the Chamber and STEM donations totaling \$45,000.⁶ The Authority also decided that the Company had not

² *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 Purchase Power, Chemicals, Purchased Water Wheeling Costs, Waste Disposal, and TRA Inspection Fees*, Docket 13-00130, *Order Approving Amended Petition*, (January 27, 2016).

³ *Id.* at 7-8.

⁴ *In re: Petition of Tennessee-American Water Company Regarding the 2015 Investment and Related Expenses Under the Qualified Infrastructure Investment Program Rider, the Economic Development Investment Rider, and the Safety and Environmental Compliance Rider*, Docket No. 14-00121, *Order Granting, In Part, and Denying In Part, Petition*, p. 12 (February 1, 2016).

⁵ *Id.* at 13-14.

⁶ *Id.* at 14-15.

proven that alternative fuel vehicles were in the public interest.⁷ The Authority determined that alternative fuel vehicles under the EDI be denied and future filings to recover alternative fuel vehicles should be filed under the QIIP Rider based on sufficient evidence of public benefits to suggest prudence. On July 1, 2015, the Company filed tariffs to comply with the Authority's decision and place the new capital rider rate for 2015 in effect beginning June 30, 2015.

On March 1, 2015 the Company filed in the current docket its *Petition* for reconciliation between the forecasted capital investment and recovery for the year ending December 31, 2014, set in Docket No. 13-00130, and the actual capital investment and recovery that occurred for the same year. The current docket was filed to comply with terms set forth in the approved Capital Rider tariffs established in Docket No. 13-00130, which require that the Company file an annual reconciliation by March 1st of each year. TAWC requests that the Authority approve the reconciliation of the QIIP, EDI and SEC riders for the annual review period of January 1, 2014 through December 31, 2014. TAWC's *Petition* was accompanied by the testimony of Linda Bridwell and Brent E O'Neill, P.E. along with supporting schedules, work papers and proposed tariffs. In addition, the *Petition* requests that the Authority approve a single reconciliation filing for the annual review period.⁸

On March 9, 2015, the Authority appointed a Hearing Officer to prepare this matter for hearing. On May 1, 2015, the Hearing Officer granted the Consumer Advocate and Protection Division of the Office of the Tennessee Attorney General's ("CAPD" or "Consumer Advocate") petition to intervene. Discovery and pre-filed testimony was filed pursuant to the procedural schedule. Following the filing of pre-filed direct testimony of Mr. Hal Novak on behalf of the CAPD on August 13, 2015, TAWC gave notice by correspondence that the Company had elected

⁷ *Id.* at 15.

⁸ *Petition*, p. 6 (March 1, 2015).

not to submit pre-filed rebuttal testimony as permitted under the procedural schedule.⁹ Thereafter on August 31, 2015, the parties jointly represented to the Authority that the docket was ripe for consideration on the merits.¹⁰

POSITION OF PARTIES

TAWC

The Company calculated a QIIP reconciliation rider of 0.254%, an EDI rider of 0.052% and a SEC rider of 0.064% resulting in a total capital recovery rider of 0.370%. Ms. Bridwell estimates this would increase a typical Chattanooga residential customer's bill \$.08 per month or \$.96 per year.¹¹ Ms. Bridwell testifies that this filing is to address any over- or under-collection for the capital riders for the review year ending December 31, 2014.¹² Each Rider is individually reconciled and then the three Capital Riders are combined for a total Capital Rider Recovery Rate.

According to Ms. Bridwell, each reconciliation calculation includes the following four factors: 1) a budget to actual adjustment; 2) over- or under-collection adjustments; 3) an earnings test adjustment; and 4) an interest adjustment.¹³

Ms. Bridwell testifies that the budget to actual adjustment is a calculation of the difference between budgeted expenditures and actual disbursements. In the current filing, TAWC provides actual infrastructure investments for January 1, 2014 to December 31, 2014. She states that this calculation is a regulatory oversight and public interest component that will true-up if the investment did not occur (up or down) as forecasted. To calculate the budget to

⁹ TAWC Correspondence to the Chairman (August 27, 2015).

¹⁰ Joint Correspondence to the Chairman (August 31, 2015).

¹¹ Linda C. Bridwell, Pre-filed Direct Testimony, p. 20 (March 1, 2015).

¹² *Id.* at 9.

¹³ Tariff No. 14-0048 Original Sheet No. 12-QIIP-5, Original Sheet No. 12-SEC-5, and Original Sheet No. 12-EDI-5 effective April 15, 2014.

actual adjustment, Ms. Bridwell states the Company used the cost of capital, depreciation rates, property tax rates, and projected annual revenues determined in the Company's last rate case, which was filed in TRA Docket No. 12-00049.¹⁴

Ms. Bridwell testifies the actual capital costs for each rider were adjusted for plant retirements, contributions in aid of construction, accumulated depreciation, and accumulated deferred income taxes multiplied by the pre-tax rate of return from the last rate case. The pre-tax return is then adjusted for depreciation expense, property taxes, franchise taxes and the associated expenses for the SEC and EDI. This results in a revenue requirement before taxes, which is then adjusted for forfeited discounts plus uncollectible expense rate and gross receipts tax rate to arrive at the forecasted revenue requirement.¹⁵

Ms. Bridwell testifies that the over- or under-recovery adjustment protects consumers if the actual sales exceed the sales authorized in the last case and protects the company if the sales are less than authorized. Ms. Bridwell testifies that the over- or under-recovery adjustment relates to actual recoveries for the period of April 15, 2014 to December 31, 2014.

The Company will make an adjustment if TAWC exceeds its earnings allowed in the last rate case. Ms. Bridwell testifies that an earnings test adjustment was not made for this filing.¹⁶ According to the tariff, interest will be calculated at 50% of the prime value (published in the Federal Reserve Bulletin or in the Federal Reserve's Selected Interest Rates) of the sum of the budget to actual adjustment, over- or under-collection adjustment and earning test adjustment.

The sum of the four adjustments listed above provides the Annual Reconciliation Amount or the total over- or under-recovered capital rider collection for the review period. The total over or under capital rider collection for the review period will be divided by the authorized sales

¹⁴ Linda C. Bridwell, Pre-filed Direct Testimony, pp. 12-14 (March 1, 2015).

¹⁵ *Id.* at 7-11.

¹⁶ *Id.* at 20.

volumes from the last rate case to determine a new capital rider percentage.¹⁷ The capital rider percentage will be applied to the total customer bill prior to any taxes, surcharges or other charges and will show up as a separate line item on a customer's bill.¹⁸

Ms. Birdwell states that a strict application of the tariff's language as to the filing date of the reconciliation would impose a two-step requirement in order to complete the annual reconciliation, requiring: (1) a filing for the recovery of investments for calendar year 2014, filed on March 1, 2015, and (2) another filing to capture the difference in dollars collected from April 15, 2014 through April 14, 2015, which would not be filed until June, 2015.¹⁹

Ms. Bridwell states the new capital rider percentage, if approved by April 1, 2015, would be recovered over a nine month period (April 1, 2015 through December 31, 2015).²⁰ She explains that using the annual review period of January 1, 2014 through December 31, 2014 for investments along with a nine month recovery period will eliminate the mismatch of reconciliation periods and reduce expense and administrative burdens for all parties.²¹

A copy of all capital expenditures is attached to the testimony of Ms. Bridwell. She explains that all expenditures related to capital projects implemented in 2014 are included, while any expenditures for capital projects placed in service prior to or scheduled for implementation later than 2014 are excluded.²² Based on the calculations demonstrated in the exhibits attached to her testimony, she explains that \$3,700,168 capital investment was placed in service by TAWC while only \$3,389,028 had been budgeted. However, because the projects were put in place later in 2014 than projected and the cost of removal was lower than projected, the actual

¹⁷ Linda C. Bridwell, Pre-filed Direct Testimony, p. 9 (March 1, 2015).

¹⁸ *Id.* at 12.

¹⁹ *Id.* at 15.

²⁰ *Id.* at 14-15.

²¹ *Id.* at 16.

²² *Id.* at 18-19.

revenues required for recovery were less than projected (\$467,122 vs. \$510,911). The revenues collected to offset the capital investments however was \$172,266 less than projected. This is because the collection period was only 8 and ½ months, and the water sales were lower than projected in the last rate case. Because TAWC did not earn above its authorized rate of return in the review period, no earnings test adjustment is made to the reconciliation.²³ As part of its filing Mr. Bridwell attests the Company is not aware of any market conditions or other factors that affect the public interest aspect of the Capital Riders.²⁴

TAWC witness Brent E. O'Neill, P.E., the Company's Director of Engineering, describes the two areas of investment for which recovery is sought: (1) the recurring projects, such as "water main installation for new development, smaller main projects for reinforcement and replacement, service line and meter setting installation, meter purchases and the purchase of tools, furniture, equipment and vehicles;"²⁵ and (2) major investment projects. Recurring construction costs are based upon prior and forecasted costs data. Estimates for installation of new main lines, meter settings and the purchase of new meters are developed in consultation with government, developers, homebuilders and engineering firms. New tools, furniture, equipment and vehicles are based on needs at current year pricing. Major projects are estimated based upon a Comprehensive Planning Study developed to ensure safe, dependable, and reliable service and to allow the facilities to meet regulatory requirements. The projects are prioritized by importance and placed in budget based on availability of funds.²⁶

TAWC has a Capital Investment Management Committee ("CIMC") comprised of TAWC's President, Operations Manager, Engineering Project Manager, Financial Analyst and

²³ *Id.* at 19-20.

²⁴ *Id.* at 24.

²⁵ Brent E. O'Neill, P.E., Pre-filed Direct Testimony, p. 3 (March 1, 2015).

²⁶ *Id.* 3-4.

Operations Specialist. This committee meets monthly to review and approve the capital expenditure plans, compare budget to actual expenditures, and discuss any variances in an effort to keep actual expenditures in line with budget. Additionally, TAWC has a “Functional Sign-Off” Committee comprised of its Operations Manager, Engineering Project Manager, Operations Specialist and the appropriate Distribution and Operations supervisors and project managers. The Functional Sign-Off Committee oversees and coordinates the projects to communicate their progress and cost to the appropriate personnel.²⁷

CAPD

Mr. Novak presents testimony setting forth CAPD’s concurrence with TAWC’s petition. He states that the Company has calculated the reconciliation surcharge in accordance with the terms of its approved tariff.²⁸ Mr. Novak states that his review did not include a review of the individual plant amounts recorded in the Company’s ledger.²⁹ He notes in his review that the Company includes only calendar year 2014 information in its reconciliation period for both cost and revenue recovery.³⁰ Mr. Novak states that he agrees with this adjustment and recommends its approval.³¹

While concurring with the petition as filed, Mr. Novak recommends two potential changes for future filings. First, he requests that the Authority direct TAWC to “produce a clear audit trail for all of the Company’s calculations in future filings.” He testifies that he was able to confirm the reconciliation factor calculations, but there was not a clear audit trail. He states that

²⁷ *Id.* at 3-5.

²⁸ William H. Novak, Pre-filed Direct Testimony, p. 5 (August 13, 2015).

²⁹ *Id.* at 4.

³⁰ In the Company’s calculation, the revenue is trued-up over an 8.5 month period instead of reconciling revenues over a 12 month period in a separate filing.

³¹ William H. Novak, Pre-filed Direct Testimony, p. 6 (August 13, 2015).

while the Company's calculation methodology produces a correct answer, it is just as important to be able to readily verify and independently review the information.³²

Mr. Novak also recommends the TRA Staff and the Parties be directed to meet to consider appropriate sampling techniques to address reviewing and evaluating individual charges to the plant in service for each of the Capital Riders.³³

THE HEARING

A Hearing on this matter was held before the voting panel on September 14, 2015, as noticed by the Authority on September 3, 2015. Participating in the Hearing were the following parties:

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 – Wayne Irwin, Esq., Office of the Attorney General, 315 Deaderick Street, 19th Floor, P.O. Box 20207, Nashville, TN 37202

The parties waived opening statements and cross-examination of the expert witnesses of each respective party.³⁴ Ms. Linda Birdwell appeared as a witness for TAWC and was subject to questions from the TRA Staff.³⁵ Members of the public were given an opportunity to present comments to the panel.

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

³² *Id.* at 6-7.

³³ *Id.* at 7.

³⁴ Transcript of Hearing, p. 6 (September 14, 2015).

³⁵ 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 Ms. Birdwell was sworn and subject to examination by the TRA Staff. The Consumer Advocate waived cross-examination of the witness.

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:

- (i) Infrastructure and equipment associated with alternative motor vehicle transportation fuel;
- (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.³⁶ 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.

³⁶ See Tenn. Code Ann. §§ 65-4-104, 65-4-117(a)(3) and 65-5-101(a).

At the regularly scheduled Authority Conference held on October 19, 2015, the panel considered the *Petition* and tariffs filed on March 1, 2015. 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:

TAWC's petition presents a timing issue for the reconciliation and the appropriate reconciliation factor for the QIIP, EDI and SEC. To address the timing, the panel finds that the Company is authorized to calculate a nine-month recovery factor for the annual over- or under-collections to eliminate any future mis-match of recovery periods and reduce administrative costs due to the cost of additional subsequent filings. Further, the panel finds that because of the delay in the deliberations in this docket, the recommended nine-month reconciliation factor will only be in place two months of the nine month collection period (April 1st to December 31st). This will leave a portion of over/under-collections outstanding at year end (7/12s). In an effort to lessen administrative costs, the remaining costs over- or under-collected for 2014 should be included separately in the 2015 reconciliation filing and include only the remaining balance of 2014 over- or under-collections with the appropriate interest. The Company shall revise its tariff to reflect this decision.

The panel further considered the Company's proposed EDI investment, which included investment in the provision of service to new customers. In response to TRA Data Requests, the Company confirmed that it included in the EDI reconciliation \$709,660 for 535 new service lines, \$131,631 for 535 new meters, and \$144,915 for 535 new meter installations in 2014, totaling \$991,206 of investment and expenses related to providing new services.³⁷ The Company indicated at the hearing that the proposed EDI investment included investment and related expenses for new services with the understanding that such items would be removed "going

³⁷ TAWC Responses to TRA First Set of Data Requests, Nos. 8, 9 and 10 (July 14, 2015).

forward.”³⁸ In Docket 14-00121, the Authority disallowed proposed EDI investment in infrastructure related to the provision of service for new customers.³⁹

Consistent with the previous actions of the Authority regarding TAWC’s proposed EDI investment in infrastructure related to provisioning service to new customers, the panel voted to deny inclusion in the EDI of investment in infrastructure for the provision of service to new customers for three reasons: First, TAWC’s proposed recovery of its EDI investment for new services is inconsistent with the plain language of the Company’s own EDI tariff, wherein it states “EDI allows the Company to recover outside of a rate case its qualifying incremental non-revenue producing plant infrastructure investment and expenses.”⁴⁰ Second, TAWC’s proposed EDI investment for new services is not related to expansion of economic development as required by statute and, therefore, does not meet the statutory requirements for recovery. Third, allowing recovery of infrastructure for provisioning service to new customers under the EDI Rider could result in double recovery of investment and related expenses – expenses which are also recovered by TAWC’s revenues generated under its tariff rates established in the Company’s most recent rate case.

With respect to the audit issues raised by the CAPD, the Company is directed to provide all calculations with a clear audit trail in future capital rider reconciliation filings, including all references to supporting workpapers and underlying calculations to reduce the administrative cost and review time to all involved parties. The Company is to meet with the CAPD and Authority Staff to consider and adopt sampling techniques relative to the individual charges of

³⁸ Transcript of Hearing, p. 8 (September 14, 2015).

³⁹ *In re: Petition of Tennessee American Water Company Regarding the 2015 Investment and Related Expenses Under the Qualified Infrastructure Investment Program Rider, the Economic Development Investment Rider, and the Safety and Environmental Compliance Rider*, Docket No. 14-00121, *Order Granting, In Part, and Denying In Part, Petition*, pp. 13-14 (February 1, 2016).

⁴⁰ Tariff No. 15-0155 No. 19, First Revised Sheet No. 12-EDI-2

the plant in service amounts included for recovery in future reconciliation filings. This will assist the Authority in ensuring that future filings include the appropriate plant in service pursuant to T.C.A. § 65-5-103 and should serve to reduce administrative costs and assist in streamlining the reconciliation review process.

IT IS THEREFORE ORDERED THAT:

1. The *Petition in Support of the Calculation of the 2015 Capital Riders Reconciliation* filed by Tennessee-American Water Company on March 1, 2015 is approved, in part, and denied, in part.

2. Tennessee-American Water Company is authorized to calculate a nine month recovery factor for the annual over- or under-collections with the intention of eliminating any future mismatch of recovery periods. The remaining costs over- or under-collected shall be included in the 2015 reconciliation filing in a separate component of the filing with appropriate interest.

3. The portion of Tennessee-American Water Company's Economic Development Investment Rider tariff related to investment in infrastructure for provisioning service to new customers for inclusion in the reconciliation is denied.

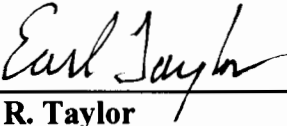
4. In future Capital Rider reconciliation filings, Tennessee-American Water Company shall provide all calculations with a clear audit trail, including references to supporting workpapers and underlying calculations.

5. Tennessee-American Water Company shall meet and consult with the Consumer Advocate and Protection Division and the Tennessee Regulatory Authority Staff to consider and adopt sampling techniques relative to individual charges of plant in service amounts.

6. The Company shall file tariffs reflecting this decision with an effective date of November 1, 2015.

Chairman Herbert H. Hilliard, Director Kenneth C. Hill, and Director Robin Morrison concur.

ATTEST:



Earl R. Taylor