

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

July 26, 2016

IN RE:

**PETITION OF TENNESSEE-AMERICAN WATER
COMPANY REGARDING THE PRODUCTION
COSTS AND OTHER PASS-THROUGHS RIDER**

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**DOCKET NO.
15-00131**

ORDER ON DECEMBER 1, 2014 THROUGH NOVEMBER 30, 2015 PCOP RIDER EXPENSES

This matter came before Chairman Herbert H. Hilliard, Vice Chairman David F. Jones and Director Robin Morrison of the Tennessee Regulatory Authority (the “Authority” or “TRA”), the voting panel assigned to this docket, at a regularly scheduled Authority Conference held on May 9, 2016, to consider the *Petition* filed by Tennessee-American Water Company (“TAWC” or the “Company”) on December 30, 2015.

BACKGROUND

TAWC 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(d), 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 The Authority approved changes to the PCOP rider tariff providing for

¹ Linda C. Bridwell, Pre-filed Direct Testimony, pp. 3-4 (December 30, 2015). *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).

a single reconciliation, which includes a true-up of actual expenses over twelve months and a revenue true-up over eight and half months in TRA Docket No. 15-00001.²

The PCOP tariff approved by the Authority requires TAWC to file within 30 days of the end of the most recent authorized attrition year, and every twelve (12) months thereafter, an annual filing calculating the PCOP percentage rate applicable to customers' bills for the twelve (12) months following the approval of the PCOP percentage rate. The latest approved PCOP percentage was approved in TRA Docket 15-00001 on August 17, 2015, for the actual costs incurred during December 1, 2013 through November 30, 2014.

In accordance with the PCOP tariff, on December 30, 2015, TAWC filed the *Petition* for the period of December 1, 2014 through November 30, 2015. The Authority convened a contested case during the January 11, 2016 Conference and appointed General Counsel, or her designee, as Hearing Officer in this matter. The Consumer Protection and Advocate Division of the Office of the Attorney General ("Consumer Advocate") was granted intervention in this matter on February 24, 2016.

PETITION

Through the PCOP rider, TAWC seeks to recover the incremental changes in purchased power expense, wheeling charge expense, waste disposal expense and TRA inspection fee amounts from those levels approved in its most recent rate case, TRA Docket No. 12-00049. In the *Petition*, TAWC is requesting to recover changes between the actual expenses for the twelve month period ending November 30, 2015 and those approved in TRA Docket No. 12-00049. Additionally, this filing includes a reconciliation adjustment to recognize any over- or under-recovery of those expenses included in its last PCOP filing in TRA Docket No. 15-

² See *In re: Petition of Tennessee-American Water Company Regarding the Production Costs and Other Pass-Through Riders*, Docket No. 15-00001, *Order on December 1, 2013 Through November 30, 2014 PCOP Rider Expenses*, p. 11 (February 5, 2016).

00001.³ In support of the *Petition*, the Company submitted the pre-filed testimony of Linda C. Bridwell. The data used to compute the PCOP is derived from the official records of the Company, employees of the Company and other internal sources, which Ms. Bridwell examined and adopted this information as her own in this matter.⁴

Ms. Bridwell provides the following explanation of the PCOP Rider calculation pursuant to TAWC's tariff approved in TRA Docket Nos. 13-00130 and 15-00001: First, the most recent approved amounts for purchased power, chemical, water, wheeling charges, waste disposal and TRA Inspection fee assessment are divided by the most recent approved level of water sales in hundred gallons. This provides the authorized amount per hundred gallons of water sales. Second, the actual amount of production cost and pass through amounts are determined. Then, the amount of any over- or under-recovery of PCOP (inclusive of interest) from the previous period is determined. The two amounts are added together and divided by the most recent approved level of water sales per one hundred gallons resulting in the incremental change in production costs per hundred gallons of water sales. This incremental change is compared to the authorized amount per hundred gallons of water sales, and the difference is multiplied by the latest authorized water sales per hundred of gallons to determine the total amount of deferred production costs. Third, this total deferred amount is grossed up for gross receipts tax and uncollectibles⁵ and divided by projected annual revenues to determine the PCOP percentage. A negative percentage results in a refund to customers; while a positive percentage resulted in an added surcharge to customers' bills.⁶

Ms. Bridwell attests the calculations in the *Petition* are supported by workpapers demonstrating their consistency with those outlined above. Additionally, TAWC is including

³ Linda C. Bridwell, Pre-filed Direct Testimony, pp. 3-5 (December 30, 2015).

⁴ *Id.* at 6.

⁵ TAWC used gross receipt rate and uncollectible rate established in TRA Docket No. 12-00049.

⁶ Linda C. Bridwell, Pre-filed Direct Testimony, pp. 7-8; Exhibit PCOP CALC – LCB page 1 of 1 (December 30, 2015).

all of the invoices for the review period with this filing. Ms. Bridwell testifies that the amounts in the Company's general ledger were reconciled with the actual invoices, and any inconsistencies with previous rulings of the Authority were removed. The Company also reduced power and chemical expenses to reflect the 15% authorized water loss. TAWC included a proposed tariff with the resulting PCOP percentage to be effective until a new PCOP filing is made or a rate case proceeding commences.⁷

Ms. Bridwell explains that the PCOP established in TRA Docket No. 15-00001 went into effect on May 1st of last year leaving the previous higher PCOP refund percentage in place for eight months. This was more than offset by water sales which were lower than those authorized in TAWC's last rate case. These two factors resulted in an under-refund of the previous year's PCOP which has been included in this filing.⁸ With this filing, TAWC is proposing to refund \$208,035, or a surcharge of -0.44%. The Company calculates that a typical residential customer living in the City of Chattanooga using 4,154 gallons of water per month would receive a *decrease* in their monthly bill of \$0.09 or \$1.08 per year.

Ms. Bridwell testifies that the PCOP Rider continues to recover approved production costs without incurring the additional costs of a rate case, has passed expense savings to customers and, therefore, remains in the public interest. Further, TAWC is not aware of any changes in market conditions that would affect the PCOP remaining in the public interest.⁹

REVISIONS TO THE PETITION

In the course of responding to discovery and data requests after the filing of the *Petition*, the Company made corrections and revisions to its calculations and provided additional clarification. In preparing a response to the data request of the Consumer Advocate,

⁷ *Id.* at 8-10.

⁸ *Id.* at 10-11.

⁹ *Id.* at 14-15.

the Company discovered several errors in its calculation of the PCOP.¹⁰ In response to this data request and an informal data request of the TRA Staff, the Company provided updated calculations of the PCOP on April 12, 2016. The corrections result in the PCOP surcharge increasing from -0.44% to -0.37%.¹¹

Additional revisions followed and TAWC submitted corrected workpapers demonstrating actual PCOP expenses for the year ending November 30, 2015 of \$3,735,214, resulting in a PCOP surcharge percentage of -0.36%.¹² TAWC further clarified that it was working to comply with the Authority's Order in Docket No. 15-00131 and resolve sales tax charges erroneously paid by the Company for purchased water.¹³

THE CONSUMER ADVOCATE

In his pre-filed direct testimony, Mr. William H. "Hal" Novak agrees that the Company's revised PCOP of -0.37% sufficiently addresses the correction of minor errors discovered during his review. Mr. Novak explains in his pre-filed direct testimony that the Company inadvertently referred to the PCOP change as a decrease, but rather, the *Petition* will actually increase the current PCOP surcharge of -0.73% to -0.37%.¹⁴ Following additional revisions made by the Company prior to the hearing, Mr. Novak agreed with a PCOP surcharge of -0.36%.¹⁵

Mr. Novak highlights the Company, as previously ordered by the Authority, used vendor invoices to determine expenses while the revenue surcharge amounts (including interest) are based on general ledger recordings. Mr. Novak maintains his disagreement,

¹⁰ TAWC Response to First Discovery Requests of the Consumer Protection and Advocate Division, Nos. 16, 17 (March 4, 2016).

¹¹ TAWC Response to Second Discovery Requests of the Consumer Protection and Advocate Division, No. 4 (April 12, 2016).

¹² Transcript of Authority Conference, pp. 65-66 (May 9, 2016).

¹³ TAWC Response to the Third Data Request of the TRA, Nos. 1-3 (April 27, 2016).

¹⁴ William H. Novak, Pre-filed Direct Testimony, p. 4 (April 20, 2016).

¹⁵ Transcript of Authority Conference, p. 69 (May 9, 2016).

asserted in previous dockets, with the use of invoices to calculate the PCOP. However, Mr. Novak recommends that the revenue surcharge reconciliation should be based on invoice amounts to maintain consistency with the Authority's previous decision. Given the time and resource constraints, Mr. Novak asserts it was only possible for him to review the amounts recorded on the Company's general ledger. For this reason, Mr. Novak encourages the Authority to direct the TRA Staff and Parties to meet and possibly come to an agreement on an appropriate sampling technique.¹⁶

MAY 9, 2016 HEARING AND APPEARANCES

A Hearing in this matter was held before the voting panel on May 9, 2016, as noticed by the Authority on April 29, 2016. During the hearing, the parties waived opening statements and cross-examination of the respective expert witnesses and jointly requested the record in the docket, including the discovery, be made part of the evidentiary record.¹⁷ 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.

The voting panel heard testimony by Ms. Linda Bridwell on behalf of the Company. Mr. Hal Novak provided testimony on behalf of the Consumer Advocate. During the hearing, the public was given an opportunity to offer comment, but no member of the public sought to comment on the *Petition*. Following the conclusion of the testimony, the voting panel considered the *Petition*.

¹⁶ William H. Novak, Pre-Filed Direct Testimony, pp. 5-6 (April 20, 2016).

¹⁷ Transcript of Authority Conference, pp. 61-62 (May 9, 2016).

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 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.¹⁸ 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

¹⁸ See Tenn. Code Ann. §§ 65-4-104, 65-4-117(a)(3) and 65-5-101(a).

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.

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, 2015; (3) a request to change the methodology used to calculate the PCOP rider; and (4) whether the PCOP Rider remains in the public interest.

Upon review of the entire evidentiary record in this matter, the panel voted unanimously to adopt an amount of \$3,735,214 as the total actual net PCOP expense for the year ending November 30, 2015. This amount includes \$723,408 for Chemical Expense, \$2,256,687 for Fuel & Power Expense, \$387,332 for Waste Disposal Expense, \$51,841 for Purchased Water Expense and \$186,811 for TRA Inspection Fee Expense. Additionally, the panel voted unanimously that \$129,135 be added to the total PCOP expense due to the Company over-refunding amounts to customers in the 2015 PCOP Rider. The panel directed TAWC to file amended calculations including the PCOP percentage and tariffs consistent with the approved PCOP expense. Additionally, if the Company receives any refund for sales taxes paid on water purchased for resale, the panel directed the Company to include the refund in any future PCOP filings.

Further, the panel found that auditing invoices is a vital practice and allows to scrutiny of 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 to affirm the current methodology utilized for the PCOP and that the Company should continue

to provide invoices for its actual PCOP expenses and a reconciliation between the invoices and general ledger.

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

IT IS THEREFORE ORDERED THAT:

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

2. The total actual net Production Cost and Other Pass-Throughs Rider expense for the year ending November 30, 2015 is \$3,735,214. This amount includes \$723,408 for Chemical Expense, \$2,256,687 for Fuel & Power Expense, \$387,332 for Waste Disposal Expense, \$51,841 for Purchased Water Expense and \$186,811 for TRA Inspection Fee Expense. Additionally, \$129,135 should be added to the total PCOP expense due to the Company over-refunding amounts to customers in the 2015 PCOP Rider.

3. 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.

4. 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.

5. 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, Vice Chairman David F. Jones and Director Robin Morrison concur.

ATTEST:

A handwritten signature in cursive script, appearing to read "Earl Taylor", written in black ink.

Earl R. Taylor, Executive Director