

BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION

NASHVILLE, TENNESSEE

November 2, 2017

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| IN RE: |) | |
| |) | |
| PETITION OF TENNESSEE WASTEWATER |) | DOCKET NO. |
| SYSTEMS, INC. FOR APPROVAL OF |) | 16-00139 |
| ADJUSTMENT OF ITS RATES AND NEW |) | |
| TARIFF |) | |

FINAL ORDER DENYING PETITION

This matter came before Chairman David F. Jones, Vice Chairman Robin L. Morrison and Director Kenneth C. Hill of the Tennessee Public Utility Commission (the “Commission” or “TPUC”), the voting panel assigned to this docket, at a regularly scheduled Commission Conference held on August 15, 2017, for consideration of the *Petition of Tennessee Wastewater Systems, Inc. for Approval of Adjustment of Its Rates and New Tariff* (“*Petition*”) filed by Tennessee Wastewater Systems, Inc. (“TWSI” or the “Company”) on November 29, 2016.

BACKGROUND AND TRAVEL OF THE CASE

TWSI, as a public utility, is subject to the Commission’s jurisdiction. TWSI is a wholly-owned subsidiary of Adenus Group, LLC, which also owns wastewater systems in Alabama, Kentucky and Ohio. TWSI provides wastewater services to approximately 2,875 customers in 23 counties throughout Tennessee.

On November 29, 2016, TWSI filed a *Petition* seeking an increase in its rates and charges because its “current and projected rates and charges are not sufficient for the Company to have a

fair opportunity to recover its reasonable operation costs and to provide a fair and reasonable net operating income.”¹ TWSI’s *Petition* requests approval to increase service rates by 24% to generate an additional \$493,000.00 annually. Based upon the Company’s projections, it estimates a net operating loss of \$305,216 for the attrition period ending December 31, 2015.² TWSI’s *Petition* includes proposed adjustments to Residential and Commercial (non-cabin) rates, an adjustment to the calculation of cabin rates, imposition of an escrow recovery rider of \$2.64 per customer for 36 months and a \$6,000 capital capacity fee for Williamson County, Tennessee.³ In support of its *Petition*, the Company filed the testimony of Charles Hyatt, Chief Executive Officer of Adenus Group, LLC, in which Mr. Hyatt offered ratemaking analysis based on a 2015 test year.⁴

On December 13, 2016, the Consumer Protection and Advocate Division of the Office of the Tennessee Attorney General (“Consumer Advocate”) filed a *Petition to Intervene*.⁵ The intervention of the Consumer Advocate was subsequently granted by the Hearing Officer.⁶ Following the submission of discovery and pre-filed testimony pursuant to a procedural schedule, the parties prepared for a hearing.

THE HEARING

A Hearing on this matter was held on July 10, 2017, as noticed by the Commission on June 30, 2017. Participating in the Hearing were the following parties:

Tennessee Wastewater Systems, Inc. – Jeff Risdien, Esq., General Counsel, Tennessee Wastewater Systems, Inc., 851 Aviation Parkway, Smyrna, TN 37167; Henry M. Walker, Esq., Bradley Arant Boult Cummings, LLP, 1600 Division Street, Suite 700, Nashville, TN 37203.

¹ *Petition*, p. 2 (November 29, 2016).

² *Id.*

³ *Id.* at 3.

⁴ Pre-Filed Testimony of Charles Hyatt, pp. 1-3 (November 29, 2016).

⁵ *Petition to Intervene* (December 13, 2016).

⁶ *Order Granting the Petition to Intervene Filed by the Consumer Advocate* (December 21, 2016).

Consumer Protection and Advocate Division – Vance Broemel, Esq. and Karen Stachowski, Office of the Attorney General and Reporter, P.O. Box 20207, Nashville TN 37202-0207.

At the Hearing, the panel heard testimony from witnesses Charles Hyatt, Matt Pickney and Robert T. Buckner, on behalf of the Company. William H. “Hal” Novak testified before the panel on behalf of the Consumer Advocate.⁷

In addition, members of the public were given the opportunity to present comments to the panel. No members of the public sought recognition to do so.⁸

POST-HEARING FILINGS

The parties were directed to file post-hearing briefs. TWSI submitted a post-hearing brief advocating for approval of its *Petition* for an adjustment of its rates on July 26, 2017. The Consumer Advocate filed its post-hearing brief on the same date, arguing that TWSI had failed to meet its burden of proof on its *Petition*.

FINDINGS AND CONCLUSIONS

The Commission has jurisdiction to set the rates of public utilities operating in the State of Tennessee.⁹ TWSI is a public utility which was granted a Certificate of Public Convenience and Necessity (“CCN”) (then known as On-Site Systems, Inc.) by the Commission in Docket No. 93-09040.¹⁰ TWSI’s most recent rate case was completed in 2009.¹¹

CRITERIA FOR JUST AND REASONABLE RATES

In setting rates for public utilities, the Commission balances the interests of the utilities

⁷ Transcript of Hearing (July 10, 2017).

⁸ *Id.* at 8-9.

⁹ Tenn. Code Ann. §§ 65-4-101(6); 65-4-104; 65-5-101, *et seq.*

¹⁰ *Application of On-Site Systems, Inc. for a Certificate of Convenience and Necessity to Provide Sewage Collection, Treatment and Disposal for a Proposed Development in Maury County*, Docket No. 93-09040, *Order Granting Certificate of Public Convenience and Necessity* (April 6, 1994).

¹¹ *Petition of Tennessee Wastewater Systems, Inc., for Approval to Amend its Rates and Charges*, Docket No. 08-00202, *Order Approving Revised Settlement Agreement* (July 8, 2009).

subject to its jurisdiction with the interests of Tennessee consumers, i.e., it is obligated to fix just and reasonable rates.¹² A public utility possesses the burden of proof on a petition to approve an adjustment of rates.¹³ The Commission must also approve rates that provide regulated utilities the opportunity to earn a just and reasonable return on their investments.¹⁴ The Commission considers petitions for a rate increase, filed pursuant to Tenn. Code Ann. § 65-5-103, in light of the following criteria:

1. The investment or rate base upon which the utility should be permitted to earn a fair rate of return;
2. The proper level of revenues for the utility;
3. The proper level of expenses for the utility; and
4. The rate of return the utility should earn.

The Commission has wide discretion with regard to setting rates and the manner in which it utilizes test periods. The Commission may “utilize an historical test period, a forecast period, a combination of these where necessary, or any other accepted method of rate making necessary to give a fair rate of return.”¹⁵ The Supreme Court noted in *Powell Tel. Co. v. Tennessee Pub. Serv. Comm’n* that, “there is no statutory nor decisional law that specifies any particular approach that must be followed by the Commission. Fundamentally, the establishment of just and reasonable rates is a value judgment to be made by the Commission in the exercise of its sound regulatory judgment and discretion.”¹⁶ Accordingly, the Commission is not limited to adopting any particular approach or to adopting a specific test period in making known and measurable

¹² Tenn. Code Ann. § 65-5-201 (2015).

¹³ Tenn. Code Ann. § 65-5-103(a) (2015).

¹⁴ See *Bluefield Water Works and Improvement Company v. Public Service Commission of the State of West Virginia*, 262 U.S. 679, 43 S.Ct. 675 (1923).

¹⁵ *Powell Tel. Co. v. Tennessee Pub. Serv. Comm’n*, 660 S.W.2d 44, 46 (Tenn.1983); *Am. Ass’n of Retired Persons v. Tennessee Pub. Serv. Comm’n*, 896 S.W.2d 127, 133 (Tenn.Ct.App.1994).

¹⁶ *Powell*, 660 S.W.2d at 46.

adjustments to produce just and reasonable rates.¹⁷ Applying these criteria, and upon consideration of the entire record, including all exhibits and the testimony of the witnesses, the panel made the following findings and conclusions.

CONTESTED ISSUES

A number of aspects of the proposed rate increase were contested by the intervening party. Based on the evidence in the record and the Commission's own expertise, the panel considered the arguments and positions of the parties, summarized here, and made the following determinations.

A. Test Year

In Tennessee, utility rates are based on a utility's projected revenue requirement in a forward-looking period of time known as the "attrition year." The attrition year is generally the first year during which new rates will be in effect. One of the first steps in projecting the various components of the revenue requirement is to identify an historical study period to be used as the foundation for the attrition year forecast. This twelve-month historical period is known as the "test year." The test year's financial and operational data are studied and adjusted to reflect a "normal year" by removing the nonrecurring items that are not expected to repeat in the future, out-of-period items that are not attributable to the utility's operations during the test period, items that are disallowed for ratemaking purposes (e.g., lobbying expenses, contributions, advertising, fines and penalties, nonregulated revenues and expenses, etc.). Once the test year has been "normalized" through such normalizing adjustments, the operational and financial data are adjusted further to account for "known and measurable changes" that are likely to occur through the attrition year.

¹⁷ *CF Industries v. Tennessee Pub. Serv. Comm'n*, 599 S.W.2d 536, 543 (Tenn. 1980).

In order to develop a sound attrition year forecast, it is essential to examine the utility's business plans, budgets and prior operational and financial results, as well as various drivers and economic indicators of future capital investments, revenues and expenses. The most recently available test year is generally used in the rate-setting process because it most often provides the best information about the utility's current financial position, as well as the base level of revenues and expenses most relevant to forecasting utility operations into the attrition year.¹⁸ Use of an updated test year is especially important when, as in this case, the utility is operating in a dynamic business environment characterized by customer growth¹⁹ and recent company restructuring.²⁰

1. 2015 Test Year

In its *Petition*, TWSI utilized a 2015 test year and a 2015 attrition year to show that it would lose approximately \$305,000 annually after normalizing adjustments.²¹ However, in the pre-filed rebuttal testimony of its witness, Robert T. Buckner, Mr. Buckner provided an analysis of the Company's financial results based upon a 2016 test year which contained significant variances from the 2015 test year provided by TWSI witness Charles Hyatt. First, Mr. Buckner computed attrition period revenues at present rates for 2016 that are \$213,000 greater than the

¹⁸ The Commission has broad discretion to choose an appropriate test year for ratemaking purposes. *See, e.g., A.A.R.P v. Tenn. Pub. Serv. Comm'n*, 896 S.W.2d 127 (Tenn. Ct. App. 1994).

¹⁹ Comparison of TWSI's 2015 and 2016 Annual Reports on file with the Commission shows that during 2016, the Company reported 129 new customers generating an additional \$163,000 of service and access fee revenues for the year; the Company also reported gross plant additions of \$1.25 million and a *reduction* in total operation and maintenance expense of \$154,000 for the year.

²⁰ The Company recently reorganized and restructured its operations to become self-supporting through its own employees and financing arrangements, and it no longer utilized or relied on its affiliate, Aenus Operations, to sustain the regulated operations of TWSI. Transcript of Hearing, pp. 33-37, 69, 110 (July 10, 2017). The Company's redirecting its operations to become a stand-alone entity resulted in a financial recasting of its books and records in July 2014. *Id.* Accordingly, the more recent financial and operational information recorded in TWSI's books and records is of greater value in determining the financial position of the stand-alone Company on a forward-looking basis.

²¹ *Petition*, p. 2 (November 29, 2016); *See also* Pre-filed Direct Testimony of Charles Hyatt, p. 3 (November 29, 2016).

revenues computed by Mr. Hyatt based on 2015.²² Mr. Buckner also shows normalized test year expenses that are \$40,000 greater than the normalized 2015 expenses shown by Mr. Hyatt.²³ With regard to the attrition year forecast at new rates, Mr. Hyatt's 2015 analysis projected revenues of \$2,577,000 and expenses of \$2,216,000, resulting in a net income of \$361,000; whereas, Mr. Buckner's 2016 analysis projected revenues of \$2,790,000 and expenses of \$2,584,000 resulting in a net income of \$206,000.²⁴ It is evident from comparing Mr. Buckner's 2016 analysis with Mr. Hyatt's 2015 analysis that Mr. Buckner's more recent analysis provides substantially different results, with Mr. Buckner concluding that, "[t]he normalized test year of 2016 is far more likely to reoccur in the future..."²⁵ and that "the 2016 test year should be used as – with normalized adjustments – should be used for setting rates going forward."²⁶ Mr. Buckner also stated that, "normalized 2016 is a fair picture of the financial position of the company's earnings at this time and ... prospectively."²⁷ Although the Company filed its rate case using a 2015 test year and a 2015 attrition year, the Company itself acknowledged that "[t]he most credible evidence in the record of the Company's current financial situation ... is the normalized 2016 test period prepared by the Company and supported by the testimony of Company witness Robert 'Terry' Buckner."²⁸

The Consumer Advocate agrees that a 2016 test year is appropriate.²⁹ The Consumer Advocate's witness, William H. Novak, testified that the 2015 test period proposed by TWSI in

²² Compare Pre-Filed Testimony of Charles Hyatt, Exh. 2 (November 29, 2016) with Pre-filed Rebuttal Testimony of Robert T. Buckner, Exh. 1 (June 28, 2017).

²³ *Id.*

²⁴ *Id.*

²⁵ Transcript of Hearing, p. 60 (July 10, 2017).

²⁶ *Id.* at 94.

²⁷ *Id.*

²⁸ *Post-Hearing Brief of Tennessee Wastewater Systems, Inc.*, pp. 1-2 (July 27, 2017).

²⁹ *Post-Hearing Brief of the Consumer Advocate*, p. 5 (July 27, 2017).

its *Petition* is stale, and he recommends a 2016 test year for more up-to-date numbers.³⁰

The parties, therefore, agree that a 2015 test year is not appropriate. The panel finds that, as the Company acknowledged, a normalized 2016 test year would be a better reflection of financial results that are likely to reoccur in the future. Based upon the evidence in the record, the panel holds that the Company's use of a 2015 test year is stale and does not reasonably reflect a normalized period of operations on which to establish reasonable, forward-looking base rates and, therefore, should be rejected.

2. 2016 Test Year

As previously indicated, TWSI proposed a 2016 test year in its rebuttal testimony and Post-Hearing Brief instead of the 2015 test year proposed in its *Petition*. TWSI filed its 2016 test year calculations on June 28, 2017, just twelve days prior to the Hearing on July 10, 2017.³¹ The date of filing of the 2016 test year calculations was also beyond the procedural deadlines established by the Hearing Officer for conducting discovery and filing rebuttal testimony.³² The close timing of the filing of the proposed 2016 test year prevented a thorough analysis of the proffered rate calculations through normal hearing procedures, including discovery and cross-examination, which are fundamental to the basic rules of fairness and due process set forth in the Commission's rules³³ and the Uniform Administrative Procedures Act.³⁴ Further, TWSI did not amend its *Petition* to include a 2016 test year as its case in chief.

The 2016 test case calculations submitted on behalf of TWSI came in the form of a one-page summary of its ratemaking calculations attached to the rebuttal testimony of Mr. Buckner.³⁵

³⁰ Pre-filed Direct Testimony of William H. Novak, p. 5 (May 23, 2017).

³¹ *Id.* at Exhibit 1.

³² *Order Granting Second Motion for Extension of Time and Amending Procedural Schedule* (May 25, 2017).

³³ Tenn. Comp. R. & Regs. 1220-1-2-01 *et seq.*

³⁴ Tenn. Code Ann. § 4-5-301 *et seq.*

³⁵ Pre-filed Rebuttal Testimony of Robert T. Buckner, Exhibit 1 (June 28, 2017).

When asked if there were any supporting exhibits, documentation and explanation of the one-page summary, Mr. Buckner stated that there was an Excel file that supported the summary which could be forwarded to the Commission, but he acknowledged that it had not been submitted prior to the hearing.³⁶ In the closing moments of the Hearing, counsel for TWSI stated that he had been reminded during lunch that TWSI's response to Discovery Request, No. 3, Question 1 contained the supporting exhibits for the Company's 2016 test period analysis.³⁷ However, as the Consumer Advocate notes in his *Post-Hearing Brief*, since Mr. Buckner did not reference this discovery response in his rebuttal testimony as support for his 2016 analysis, the Consumer Advocate had no opportunity to ask any discovery questions regarding it; and since Mr. Buckner did not offer this discovery response as support during his live testimony, the Consumer Advocate had no opportunity to cross-examine Mr. Buckner about it.³⁸ Similarly, for these same reasons, Commission Staff had no reasonable opportunity to properly investigate and analyze the 2016 ratemaking calculations and is, therefore, unable to conclude without additional data requests and analysis whether the 2016 rate calculations are reasonable for rate-making purposes.

Therefore, it would be procedurally flawed to allow the Company to amend its rate case *Petition* to request rate relief based on its proffered 2016 rate calculations. The panel finds that TWSI did not timely request that its 2016 rate calculations be used for determining base rates and that such untimeliness unreasonably limited the Consumer Advocate and the Commission Staff's ability to investigate the accuracy and reliability of the proffered rate calculations.

In addition to the procedural issue, the panel holds that substantive issues with the 2016 rate analysis preclude use of the calculations for setting rates in this matter. First, contrary to the

³⁶ Transcript of Hearing, p. 95 (July 10, 2017).

³⁷ *Id.* at 150.

³⁸ *Post-Hearing Brief of the Consumer Advocate*, p. 14 (July 27, 2017).

Company's claims, its response to Discovery Request No. 3, Question 1 does not provide adequate support for the one-page summary of the 2016 rate calculations. As correctly noted by the Consumer Advocate, there are substantial and material differences between the projected revenue requirements indicated in the one-page summary calculations provided by Mr. Buckner and the discovery response documents that the Company indicates are supportive of the 2016 rate analysis.³⁹ The 2016 calculations proffered by the Company through Mr. Buckner's rebuttal testimony show revenue requirements of \$2,790,000, whereas the discovery response indicates that revenue requirements are \$2,840,000.⁴⁰ Because the revenue requirements are computed differently, Mr. Buckner's analysis shows that a rate increase of \$492,915 is needed to generate a "fair margin" of \$205,777 or 7.9%, whereas the discovery response calculations indicate that a rate increase of \$543,426 is required to generate a "fair margin" of \$176,089 or 6.6%.⁴¹ Therefore, it is evident that the discovery response referenced by the Company's counsel at the close of the hearing does not support the 2016 rate calculations exhibited in Mr. Buckner's rebuttal testimony and instead materially conflicts with Mr. Buckner's recommended rate adjustments and attrition period analysis.

Second, Mr. Buckner's 2016 rate calculations improperly exclude developer income for rate-setting purposes. Mr. Buckner testified that it would be improper to include developer income in the calculation of regulated revenue requirements, though he acknowledged on cross-examination that he was unaware of recent Commission orders requiring that developer income be treated as above-the-line regulated operations and included in the computation of utility

³⁹ *Id.* at 13-14.

⁴⁰ Compare Pre-filed Rebuttal Testimony of Robert T. Buckner, Exhibit 1 (June 28, 2017) with *TWSI's Informal Discovery Responses to the CAD*, Exh. 2-2016 (June 2, 2017).

⁴¹ *Id.*

service rates.⁴² Rule 1220-04-01-.11 requires that all public utilities under the Commission's jurisdiction follow a uniform system of accounting.⁴³ In addition, Rule 1220-04-01-.07 requires that special contracts providing for rates, services and practices not covered or permitted by general tariffs are subject to the supervision, regulation and control of the Commission and must be filed for review and approval.⁴⁴ Requiring regulatory accounting treatment of developer contracts is proper since the contract activities and associated payments clearly relate to regulated operations; namely, the construction and acquisition of certificated wastewater systems and the provisioning of certificated wastewater services. Further, allowing a utility to pocket the income received from developers to subsidize the operations of a wastewater system without regard to the rates charged to customers for recovery of such operating costs could result in windfall profits to the utility.

Hence, in Docket No. 16-00015, the Commission required TWSI to account for certain developer income as regulated revenues.⁴⁵ Further, in Docket No. 16-00127, the Commission ordered rate relief for another wastewater utility that included developer income in the calculation of service rates.⁴⁶ TWSI's exclusion of developer income from its 2016 rate calculations is contrary to these Commission decisions. In addition, the Consumer Advocate points out that if developer income is considered in the calculation of revenue requirements, the alleged revenue deficiency in this case disappears.⁴⁷ While the precise impact of inclusion of developer income is unknown due to the inadequate opportunity to explore this issue, as noted above, inclusion of such income would likely have a material impact on service rates since the

⁴² Transcript of Hearing, pp. 88-91 (July 10, 2017).

⁴³ Tenn. Comp. R. & Regs. 1220-04-01-.11.

⁴⁴ Tenn. Comp. R. & Regs. 1220-04-01-.07.

⁴⁵ See *In re: Petition of Tennessee Wastewater Systems, Inc. for Approval of Special Contract*, Docket No. 16-00015, *Order Affirming and Clarifying Previous Order* (January 10, 2017).

⁴⁶ See *In re: Joint Petition of Cartwright Creek, LLC and TRA Staff (As A Party) to Increase Rates and Charges*, Docket No. 16-00127, *Order Approving Rate Increase* (January 10, 2017).

⁴⁷ *Post-Hearing Brief of the Consumer Advocate*, p. 2 (July 27, 2017).

Company reported developer revenues of \$151,000 in 2016.⁴⁸ Mr. Buckner's exclusion of developer income in his 2016 calculations constitutes a significant flaw in his ratemaking analysis.

Third, Mr. Buckner's attrition year forecast of escrow expenses based on 2016 information is materially greater than Mr. Hyatt's attrition year forecast based on 2015 data, which calls into question the appropriate level of the Company's escrow expenses on a going-forward basis. Mr. Buckner's escrow expense forecast (also known as "Materials and Supplies") of \$568,000 is about 32% greater than Mr. Hyatt's forecast of \$429,000 for the attrition period.⁴⁹ Further, the booked amounts of escrow expenditures appearing in the Company's general ledger are \$254,000 for 2015 and \$717,000 for 2016, which represents an annual increase of 182%.⁵⁰ Neither Mr. Hyatt nor Mr. Buckner offered explanation or support for their varying forecast or the significant jump in recent escrow charges, though it is noted that Mr. Buckner's attrition year forecast is not supported by the limited historical information that is available. Therefore, at least one of the Company's escrow expense forecasts, and perhaps both, is not representative of a normalized, forward-looking year, and accordingly cannot be used for rate-setting purposes.

Fourth, a review of Mr. Buckner's 2016 rate analysis indicated that depreciation expense appeared too high in light of the circumstances. Most of the Company's utility property is contributed by developers, and the regulatory accounting rules set forth in the Uniform System of Accounts require that such property be treated as contributions in aid of construction ("CAIC"). Since the property is contributed by others and does not require an investment by the utility's owners/shareholders, ratemaking policy does not permit the utility to count depreciation

⁴⁸ *TWSI's Informal Discovery Responses to the CAD*, Exh. 1-2016 (June 2, 2017).

⁴⁹ *Compare* Pre-Filed Testimony of Charles Hyatt, Exh. 2 (November 29, 2016) *with* Pre-filed Rebuttal Testimony of Robert T. Buckner, Exh. 1 (June 28, 2017).

⁵⁰ *Compare* 2015 General Ledger Account 265 *with* 2016 General Ledger Account 265.

expenses related to such property toward the calculation of revenue requirements for determining service rates. A review of the Company's 2016 Annual Report on file with the Commission revealed that it has only \$258,000 of net property that has not been contributed by others, and yet Mr. Buckner's 2016 rate calculations shown on Exhibit 1 of his rebuttal testimony reported \$111,639 of annual depreciation expense, which equates to a composite annual depreciation rate on net plant of about 43%. To arrive at this depreciation amount, Mr. Buckner utilized an accelerated depreciation method known as "double-declining balance" to compute depreciation expense for his 2016 rate analysis, which is permitted for tax purposes.⁵¹ It is long standing Commission policy, as well as standard regulatory practice throughout the United States, to allow only "straight-line" depreciation for utility rate-making purposes. When adjusted to reflect straight-line depreciation, Mr. Buckner's 2016 rate calculations would be reduced by approximately \$43,000 for the attrition year, which would have a material impact on the calculation of revenue requirements and corresponding service rates in this case.

Fifth, as the Consumer Advocate asserts, the misapplication of tariffed service rates for commercial customers during 2016 seriously undermines the credibility and reliability of the Company's service revenue figures for the 2016 test year.⁵² Mr. Novak testified that the billing rates for 65 commercial service accounts did not tie back to the Company's approved tariffs and that the Company was unable to provide a reconciliation or explanation for these discrepancies.⁵³ The Company responded that the billing issues raised by the Consumer Advocate was a "tempest in a teapot" and "not important to the financial reporting and financial position of the Company," and it offered the report of a CPA firm which shows that an agreed-upon procedures review of

⁵¹ *TWSI's Response to TPUC Second Data Request*, 2-54 (May 9, 2017).

⁵² Pre-filed Direct Testimony of William H. Novak, pp. 8-10 (May 23, 2017).

⁵³ *Id.* at 9.

the Company's billing system indicated billing variances of less than 1%.⁵⁴ However, the ability to reconcile the rates and charges appearing on customer bills with the rates and charges contained in the approved tariffs on file with the Commission is fundamental to the regulatory process of ensuring that customers are billed authorized service rates and that the utility is collecting revenues at the level authorized by the Commission. Hence, the billing and collection of authorized service rates contained in the utility's tariff are directly and materially related to the utility's financial reporting of its authorized service revenues and, consequently, to the determination of the utility's financial position. As a result, in any case where the billed rates do not agree with the tariffed rates, the utility's financial position in relation to its authorized earnings is unknown and, by extension, the merits of any request for rate relief are likewise unknown. Only after an appropriate period of billing and collecting the authorized service rates found in its tariff will a utility know its financial position relative to its latest rate order. Consequently, the billing issue is pivotal to the determination of reasonable service rates in this case.

Further, the Company's offering of a CPA report showing a 99% billing accuracy rate does not address the billing issue raised by the Consumer Advocate. The CPA report demonstrates accuracy between the customers' bills and the billing data found in the Company's billing system and customer service agreements rather than the degree of accuracy between the customers' bills and the service rates and charges contained in the Company's approved tariffs on file with the Commission. As it made the following findings and recommendations, the CPA report itself indicates concerns with regard to the accurate billing of tariff rates:

3. Deficiencies – Rate coding and classifications

⁵⁴ *Post-Hearing Brief of Tennessee Wastewater Systems, Inc.*, p. 5 (July 27, 2017).

We noted that the descriptions and rate codes utilized in the billing system do not translate to the assigned rate descriptions and codes utilized in the State's tariff format.

Management should consider implementing policies and procedures to ensure that all charges are clearly related and agreed to the approved tariffs and related costs reimbursements in contracts.

4. Deficiencies – Rate coding and classifications

It does not appear the management maintains a cross walk or similar documentation to relate billing codes to specific rates and dockets approved by the regulatory body.

Management should consider implementing policies and procedures to ensure that all charges are clearly related and agreed to the approved tariffs and related costs reimbursements in contracts.

* * *

8. Best practices – UMS Billing Register Reporting – Billing Register Data

We noted that the UMS billing register report is not “static” in relation to customer rates. That is to say a customer's rate class on any given day is the rate class that will be reported on the billing cycle regardless of the rate class in effect at the time. This issue might lead to misclassification issues that would delay historical analysis of the rate classes and related accounting entries.

Management should implement procedures to ensure all billings are consistently agreed to the system and the system be routinely reviewed and tested to remove inconsistency in reporting options.⁵⁵

As the Consumer Advocate pointed out, “the CPA firm's analysis did nothing more than attempt to compare what TWSI's billing records indicated should be billed against the amount actually billed.”⁵⁶ The CPA firm's analysis did nothing to resolve the crucial question of whether the

⁵⁵ Pre-filed Rebuttal Testimony of Robert T. Buckner, Revised Exh. 2 (June 28, 2017) (Revised Exh. 2 filed July 7, 2017).

⁵⁶ *Post-Hearing Brief of the Consumer Advocate*, p. 9 (July 27, 2017).

amounts billed to customers agree with the approved tariffs and, in fact, as noted by the report quotes above, raises the same billing concerns that Mr. Novak raises in his testimony.

Finally, it should be noted that the procedural difficulties created by the late filing of the 2016 test year provided opportunity for only a cursory review of the Company's 2016 rate summary. While the limited review identified several substantive issues that materially affect the Company's attrition year forecast based on 2016 calculations, additional substantive and material issues affecting the computation of the Company's revenue requirements and related service rates for the attrition year could have been discovered with a reasonable opportunity to conduct a more thorough analysis. In the absence of a fully detailed and thorough analysis, the panel cannot find that the Company's rate calculations are reasonable and reliable for establishing service rates in this proceeding.

Therefore, as a result of the procedural and substantive issues, the panel finds that the updated 2016 rate analysis proffered by the Company does not provide a reasonable basis for determining forward-looking rates in this case. The panel rejects the 2016 rate analysis proffered by the Company in its entirety for ratemaking purposes.

The panel rejects both the Company's proposed 2015 rate analysis and the proposed 2016 rate analysis. Therefore, the panel finds that TWSI has failed to meet its burden of proof to show that the request to increase base service rates is just and reasonable.

B. Escrow Recovery Rider

In its *Petition*, TWSI seeks to terminate its escrow account and establish an Escrow Recovery Rider in its base rates in the amount of \$2.64 per customer for 36 months in order to recover a deficiency in the escrow reserve account.⁵⁷ The Company utilizes the escrow account for maintenance and repairs of its wastewater systems, but the corresponding expenses have

⁵⁷ *Petition*, p. 3 (November 29, 2016).

exceeded escrow revenue. The proposed Escrow Recovery Rider would recover the shortfall over a period of three years.⁵⁸ TWSI indicates that the elimination of the escrow account and charge of the Escrow Recovery Rider is an undisputed issue.⁵⁹

In 2007, the Commission authorized the Company to maintain an escrow account in which escrow surcharges collected from customers could be deposited and used to pay non-routine operation and maintenance expense, including equipment replacement, tank pumping, and preventive maintenance not covered by base service rates.⁶⁰ While it may be appropriate to consider eliminating the escrow account and include escrow surcharges and related expenditures in the calculation of revenue requirements, because of the material differences between the escrow expense forecasts presented for the attrition year through the testimony of Mr. Hyatt and Mr. Buckner as well as insufficient time to investigate the 2016 materials and supply forecast presented in the Company's 2016 rate analysis, Commission Staff is unable to conduct a fully detailed thorough analysis of the escrow account and its surcharges and related expenditures.⁶¹ In addition, the test year amounts for escrow charges used in Mr. Hyatt's analysis vary greatly from the amounts used in Mr. Buckner's analysis.⁶² Further, since the escrow account authorized the purchase of equipment replacements, some of the escrow disbursements may properly be attributable to rate base investment and, consequently, excluded from operations and maintenance expenses. However, as it does not appear any corresponding adjustments were made to the escrow expense forecasts of either Mr. Hyatt or Mr. Buckner, the record leaves a

⁵⁸ Pre-filed Direct Testimony of Charles Hyatt, p. 5 (November 29, 2016).

⁵⁹ *Post-Hearing Brief of Tennessee Wastewater Systems, Inc.*, pp. 8-9 (July 27, 2017).

⁶⁰ *In re: Docket to Determine the Reserve/Escrow Requirement for Tennessee Wastewater Systems, Inc. Pursuant to TRA Rule 1220-4-12-.07(8)*, Docket No. 07-00063, *Order Determining Escrow Requirements* (December 18, 2007).

⁶¹ *Compare* Pre-filed Direct Testimony of Charles Hyatt, Exh. 2 (November 29, 2016) (attrition year escrow forecast of \$429,000) *with* Pre-filed Rebuttal Testimony of Robert T. Buckner, Revised Exh. 1 (June 28, 2017) (attrition year escrow forecast of \$568,000).

⁶² *Compare* Pre-filed Direct Testimony of Charles Hyatt, Exh. 2 (November 29, 2016) (escrow charges of \$254,000) *with* Pre-filed Rebuttal Testimony of Robert T. Buckner, Revised Exh. 1 (June 28, 2017) (escrow charges of \$717,000).

clouded picture of the appropriate amount of escrow-related expenses going forward.⁶³ The Consumer Advocate, through the testimony of Mr. Novak, indicates that it has no position with regard to the proposal to eliminate the escrow account on a going-forward basis.⁶⁴ For the foregoing reasons, the panel finds that escrow expenses cannot reasonably be included in the calculation of service rates at this time and that the proposed elimination of the escrow account is rejected.

Because of the escrow expense differences discussed above, it is difficult to determine what, if any, escrow expense shortfall results from the application of the authorized escrow mechanism. However, even if such amount could be determined, current rules prohibit the collection of any escrow shortfall from the customers. Rule 1220-4-13-.07(9) states that purpose of the escrow account as follows:

Reserve/escrow accounts established by the public wastewater utility to pay for non-routine operation and maintenance expense shall meet the conditions as specified by the [Commission]. The public wastewater utility shall file bank statements and a report that details the expenses on all disbursements from the escrow account with its annual report or as the [Commission] may direct. The [Commission] may require public wastewater utility employees having signature authority over such account to obtain a fidelity bond. The public wastewater utility's tariff shall set forth the specific amount charged to customers to fund the reserve/escrow account.⁶⁵

Consumer Advocate witness Mr. Novak described the proper accounting treatment of the Company's escrow account as creating a regulatory liability in his testimony:

Now, as far as the escrow, the way that works, the Commission has set that up. That is – that comes up as a liability.

We're asking customers with an escrow to pay that amount in advance for to cover anticipated items that may occur that are

⁶³ *Id.*

⁶⁴ Transcript of the Hearing, p. 122 (July 10, 2017).

⁶⁵ Tenn. Comp. R. & Regs. 1220-4-13-.07(9).

unusual or infrequent in occurrence. So those show up on the balance sheet. That escrow shows up as a liability. And when the company pays things out of that escrow, those amounts are transferred to the balance sheet as a deduction of that liability.⁶⁶

Hence, the escrow account mechanism does not authorize the Company to defer expenses into a regulatory asset account for potential future recovery from customers. Instead, the opposite is true: the escrow account provides for the customers to advance the funds for payment of future expenses. In order to qualify any portion of the escrow expenses for potential recovery in a future period, the Company should have petitioned the Commission for authority to defer such expenses into a regulatory asset account in accordance with the regulatory accounting requirements established by the Commission.⁶⁷ The Uniform System of Accounts (“USOA”) adopted by the Commission describes this account as follows:

186.3 Regulatory Assets

A. This account shall include the amounts of regulatory-created assets, not included in other accounts, resulting from the ratemaking actions of regulatory agencies. (See Definition 28.)

B. The amounts included in this account are to be established by those charges which would have been included in net income determination in the current period under the general requirements of the Uniform System of Accounts but for it being probable that such items will be included in a different period(s) for purposes of developing the rates that the utility is authorized to charge for its utility services. When specific identification of the particular source of a regulator asset cannot be made, such as in plant phase-ins, rate moderation plans or rate levelization plans, Account 407.5 – Amortization of Regulatory Liabilities shall be credited. The amounts recorded in this account are generally to be charged, concurrently with the recording of the amount in rates, to the same account that would have been charged if included in income when incurred, except all regulatory assets established through the use of

⁶⁶ Transcript of the Hearing, pp. 124-125 (July 10, 2017).

⁶⁷ See Tenn. Comp. R. & Regs. 1220-04-01-.11 (requiring all public utilities under the Commission’s jurisdiction to follow a uniform system of accounting and specifically requiring wastewater utilities in subsection (h) to follow the Uniform System of Accounts as adopted and amended by the National Association of Regulatory Utility Commissioners (“NARUC”).

Account 407.5 shall be charged to account 407.4 – Amortization of Regulatory Assets, concurrent with the recovery of the amounts in rates.

C. If rate recover of all or part of an amount included in this account is disallowed, the disallowed amount shall be charged to Account 426 – Miscellaneous Nonutility Expenses, or Account 434 – Extraordinary Deductions, in the year of the disallowance.⁶⁸

Additionally, Definition 28 of the USOA provides:

“Regulatory Assets and Liabilities” are assets and liabilities that result from rate actions of regulatory agencies. Regulatory assets and liabilities arise from specific revenues, expenses, gains or losses that would have been included in determination of net income in one period under the general requirements of the Uniform System of Accounts but for it being probable that: 1) such items will be included in a different period(s) for purposes of developing the rates the utility is authorized to charge for its utility services; or 2) in the case of regulatory liabilities, that refunds to customers, not provided for in other accounts, will be required. Regulator assets and liabilities can also be created in reconciling differences between the requirements of general accepted accounting principles, regulatory practice and tax laws.⁶⁹

Applying these principles of the USOA, the Commission must authorize the utility’s creation of a regulatory asset through its ratemaking actions, thereby permitting the utility to defer expenses to a future period for probable inclusion in the determination of service rates. Previously, this Commission has demonstrated this type of ratemaking mechanism in Docket No. 13-00121, wherein the Commission authorized Kingsport Power Company to defer incremental storm damage costs as a regulatory asset, stating, “[t]his method will allow the Company appropriate ratemaking treatment for extraordinary storm costs in a future rate proceeding.”⁷⁰ Without such rate order in place, the recovery of any prior expenses through prospective rates is impermissible.

⁶⁸ *Uniform System of Accounts for Class A Wastewater Utilities of NARUC*, § 186.3 (1996).

⁶⁹ *Uniform System of Accounts for Class A Wastewater Utilities of NARUC*, Definitions, ¶ 28 (1996).

⁷⁰ *In re: Petition of Kingsport Power Company d/b/a AEP Appalachian Power for Approval of Deferred Accounting*, Docket 13-00121, *Order Granting Deferred Accounting*, (November 13, 2013).

The panel holds that the Company did not request, nor did it receive, an approval to defer any portion of escrow expenses for potential recovery in a future period as set forth in the accounting rules adopted by the Commission. Absent an order authorizing deferred accounting or alternative ratemaking mechanisms, the Commission has prospective ratemaking authority. Thus, the retroactive review of revenues and expenses such as the Company has proposed, is impermissible. Therefore, the Company's request for an Escrow Recovery Rider is denied.

C. Convenience Fee

TPUC Rules require “a copy of the public wastewater utility’s tariff as specified in Rule 1220-4-1-.02 that includes the rates, rules, terms and conditions, and that describes the policies and practices in rendering service that conform to all applicable rules and regulations, shall be filed with the [Commission].”⁷¹ In addition, TPUC Rules also require “rules and regulations of the utility that in any manner affects the rates charged or to be charged or that define the extent or character of the service to be given shall be included with each tariff.”⁷²

In its case, the Consumer Advocate asserts that TWSI has been assessing an unauthorized credit card convenience fee. Mr. Novak testified that since 2011, TSWI has collected a 3% surcharge to its tariff rates for customers who pay by credit card, but that the surcharge was never approved by the Commission or included in the Company’s tariff.⁷³ Mr. Novak further testified that for the 2016 test year, \$6,327 was unlawfully collected from customers.⁷⁴

TWSI responded with testimony from Matt Pickney indicating that he spoke with TPUC Staff member Patsy Fulton prior to finalizing plans to accept credit card payments in 2011 and was informed that the fee need not be included in the tariff. He further testified that the fee is

⁷¹ Tenn. Comp. R. & Regs. 1220-1-2-.04(1)(a).

⁷² Tenn. Comp. R. & Regs. 1220-1-2-.03.

⁷³ Pre-filed Direct Testimony of William H. Novak, p. 10 (May 23, 2017).

⁷⁴ *Id.*

noncompulsory and is only applicable if customers pay their bills by credit card.⁷⁵ Mr. Pickney testified at the Hearing that he was told that since the fee was not compulsory and the payment option was at the customer's discretion, it was not required to be included within the tariff at the time the fee was implemented, but that TPUC Staff "has had a change of opinion in the interim...."⁷⁶ TWSI witness Charles Hyatt described the convenience fee in his testimony at the Hearing as, "an in-and-out charge," of which customers are fully informed and reflective of the amount the bank charges for the convenience of paying by card.⁷⁷

The panel finds that the collection of the 3% surcharge to customers paying by credit card was unauthorized because tariff approval was not obtained as required by TPUC Rules. The panel further finds that the Company must either cease billing and collecting the surcharge or file a proposed tariff seeking approval to bill and collect the surcharge. In addition, the panel holds that under the specific circumstances of this matter, where evidence was presented that customers were aware of the amount of the surcharge prior to paying bills by credit card, refunds of convenience fees collected from customers is not warranted.

D. TWSI Billing and Recordkeeping

In the presentation of its case, the Consumer Advocate asserts that deficiencies in TWSI's books and records create impediments to the confidence in the data and information provided by the Company necessary for ratemaking purposes.⁷⁸ Mr. Novak, in his pre-filed testimony, identified 65 commercial accounts in which billing rates did not consistently tie to a TWSI tariff rate.⁷⁹ Mr. Novak further indicates that TWSI failed to provide reconciliation or explanation

⁷⁵ Pre-filed Rebuttal Testimony of Matt Pickney, pp. 2-4 (June 28, 2017).

⁷⁶ Transcript of Hearing, pp. 47-48 (July 10, 2017).

⁷⁷ *Id.* at 31-32.

⁷⁸ *Post-Hearing Brief of the Consumer Advocate*, pp. 5-6 (July 26, 2017).

⁷⁹ Pre-filed Direct Testimony of William H. Novak, p. 8 (May 23, 2017).

during discovery for the billing discrepancies.⁸⁰ Mr. Novak also indicated that TWSI had very limited records with regard to expenses due to “realignment” or “recasting” of the Company’s books.⁸¹ Finally, Mr. Novak recommends in his testimony that the Commission conduct a compliance audit of TWSI’s billing and revenues due to the imposition of the convenience fee, commercial account billing discrepancies, and unreliability of TWSI’s books.⁸²

In rebuttal to the Consumer Advocate’s case, the Company presented testimony of Robert T. Buckner utilizing a report from an independent CPA firm which indicates that “there are no material deficiencies in the Company’s recording of revenues and expenses.”⁸³ The CPA firm reviewed the 65 commercial accounts identified by the Consumer Advocate along with a sample of the Company’s other bills and found variances of .09% in Middle Tennessee and .23% in East Tennessee.⁸⁴ With regard to the limited records of expenses, TWSI witness Charles Hyatt testified that data for multiple expense categories simply did not exist prior to the 2015 expense data. Mr. Hyatt testified that prior to 2015, TWSI did not have employees or equipment of its own, but once it became a self-supporting, stand-alone entity, the Company began to incur its own expenses in the categories of employees, equipment and equipment maintenance.⁸⁵

The panel finds that there are deficiencies in the billing and recordkeeping practices of the Company that warrant further examination. The panel finds that a compliance review should be conducted, and Commission Staff is directed to examine the billing and accounting records and practices of TWSI and to report the results of the examination to the Commission.

⁸⁰ *Id.* at 9.

⁸¹ *Id.* at 3.

⁸² *Id.*

⁸³ Pre-filed Rebuttal Testimony of Robert T. Buckner, p. 12 (June 28, 2017).

⁸⁴ Transcript of Hearing, p. 78 (July 10, 2017).

⁸⁵ *Id.* at 34-37. See also *Post-Hearing Brief of Tennessee Wastewater Systems, Inc.*, p. 7 (July 26, 2017).

SUMMARY OF FINDINGS AND CONCLUSIONS

After the Hearing on July 10, 2017, the panel considered the *Petition*. The panel denied the *Petition* of Tennessee Wastewaters Systems, Inc. based on the following:

1. A Test Period for the twelve months ending December 31, 2015 is not appropriate, as agreed upon by the parties;
2. While a Test Period for the twelve months ending December 31, 2016 is the appropriate Test Period, the 2016 Test Period calculations presented by Tennessee Wastewater Systems, Inc. are rejected;
3. The 2016 Test Period calculations presented by Tennessee Wastewater Systems, Inc. were not timely submitted;
4. The 2016 Test Period calculations presented by Tennessee Wastewater Systems, Inc. contain substantive deficiencies that preclude the use of these calculations for ratemaking purposes;
5. Tennessee Wastewater Systems, Inc. did not provide appropriate support or reconciliation of two proposed Attrition Period Maintenance and Repair forecasts and offers no explanation concerning which, or either, of the forecasts represents a normalized amount of escrow expenses on a going-forward basis;
6. Tennessee Wastewater Systems, Inc. did not request or receive approval to defer any portion of escrow expenses for potential recovery in a future period as required;
7. The Convenience Fee, a 3% surcharge assessed to customers paying by credit card, is not authorized as it is not included in a tariff approved by the Tennessee Public Utility Commission;
8. Tennessee Wastewater Systems, Inc. shall immediately cease assessing and collecting

- the Convenience Fee or file a proposed tariff on or before September 14, 2017 if it is to continue offering credit card payment to its customers for a fee;
9. Tennessee Wastewater Systems, Inc. failed to meet its burden of proof to show that its requested increase to base service rates is just and reasonable;
 10. The *Petition* of Tennessee Wastewater Systems, Inc. is rejected in its entirety;
 11. Tennessee Public Utility Commission Staff is directed to conduct a compliance review of the billing and accounting records and practices of Tennessee Wastewater Systems, Inc. and to report the results of the examination to the Commission;
 12. All other issues, including, but not limited to, rate design and proposed changes to service regulations, are pretermitted;
 13. Any party aggrieved by the Commission's decision in this matter may file a Petition for Reconsideration with the Commission within fifteen days from the date of this Order.
 14. Any party aggrieved by the Commission's decision in this matter has the right to judicial review by filing a Petition for Review in the Tennessee Court of Appeals, Middle Section, within sixty days from the date of this Order.

Chairman David F. Jones, Vice Chairman Robin L. Morrison and Director Kenneth C. Hill concur.

ATTEST:



Earl R. Taylor, Executive Director