

**IN THE TENNESSEE PUBLIC UTILITY COMMISSION  
AT NASHVILLE, TENNESSEE**

<b>IN RE:</b>	)	
	)	
<b>PETITION OF KINGSPORT POWER</b>	)	
<b>COMPANY d/b/a AEP APPALACHIAN</b>	)	
<b>POWER FOR APPROVAL OF ITS</b>	)	
<b>TARGETED RELIABILITY PLAN,</b>	)	<b>Docket No. 17-00032</b>
<b>AND ITS TRP &amp; MS RIDER, AN</b>	)	
<b>ALTERNATIVE RATE MECHANISM AND</b>	)	
<b>MOTION FOR A PROTECTIVE ORDER</b>	)	

---

**RESPONSES OF THE CONSUMER ADVOCATE  
TO DISCOVERY REQUESTS OF  
EAST TENNESSEE ENERGY CONSUMERS**

---

Comes the Consumer Protection and Advocate Division (Consumer Advocate or CPAD) in the above-referenced Tennessee Public Utility Commission (TPUC) docket and hereby responds to the Discovery Requests of East Tennessee Energy Consumers (ETEC). With respect to these responses, Mr. Novak is the responsible witness.

**ETEC-1. Please provide copies of all discovery responses and information provided by the CPAD in this case to Kingsport Power Company (KPC), the Staff or other party. This should be considered a continuing request covering all such CPAD's responses.**

**RESPONSE:** No discovery responses have been made by the Consumer Advocate to KPC or the TPUC.

**ETEC-2. Please provide electronic copies, in excel format with all formulas intact, of each exhibit, figure and table contained in the testimony of CPAD's witness Mr. Novak.**

**RESPONSE:** See Attachments 1-2a and 1-2b.

**ETEC-3. Please provide all supporting workpapers used to develop the exhibits and tables contained in Mr. Novak's testimony.**

**RESPONSE:** See response to ETEC-2.

**ETEC-4. Please reference Mr. Novak's testimony commencing at page 6, line 11, where he testifies that the CPAD and Kingsport Power Company d/b/a AEP Appalachian Power Company (KgPCo [or Company]) "engaged in numerous meetings to discuss KgPCo's potential refile of a number of the original VCR proposals. After these discussions, KgPCo made a determination to only include vegetation management, system improvement and major storm costs in the rider proposed in this Docket."**

- A. Is there a memorandum, email (or email "string") or other document that reflects any agreement between CPAD and KgPCo, including any agreement that KgPCo will "only include vegetation management, system improvement and major storm costs in the rider proposed in this Docket"? If so, please provide a copy.**
- B. Is it Mr. Novak's understanding that KgPCo has determined that it will forego seeking to include other types of costs -- i.e., costs not listed in the quoted portion of his testimony -- in future riders to be proposed by KgPCo in future dockets?**

**RESPONSE:**

- A. No. Further, other than as addressed in the settlement agreement in Docket 16-00001, there has been no agreement between CPAD and KgPCo on the subject matter of this Docket 17-00032.**

- B. Mr. Novak has no such understanding and, further, has had no communication with the Company concerning the Company including or not including other types of costs in future riders in future dockets.

**ETEC-5. Please reference Mr. Novak's testimony at page 2, line 17 regarding his testimony in prior KgPCo dockets.**

- A. From the following dockets listed by Mr. Novak, please identify those in which Mr. Novak's testimony addressed cost allocations and rate design: U-86-7472, 89-02126, 90-5735, 92-04425.
- B. Please provide a copy Mr. Novak's pre-filed testimony identified in response to A.

**RESPONSE:**

- A. All of the dockets listed contain testimony referring to cost allocations of some type performed by Mr. Novak. However, not all of Mr. Novak's testimony in these dockets necessarily addresses cost allocations involving rate design.
- B. See Attachments 1-5a, 1-5b, 1-5c and 1-5d.

RESPECTFULLY SUBMITTED,



---

WAYNE M. IRVIN (BPR #30946)  
Assistant Attorney General  
Office of the Attorney General  
Consumer Protection and Advocate Division  
P.O. Box 20207  
Nashville, Tennessee 37202-0207  
(615) 532-5512  
wayne.irvin@ag.tn.gov

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served via U.S. Mail or electronic mail upon:

William K. Castle, Director, Regulatory Services VA/TN  
Appalachian Power Company  
Noelle J. Coates, Esq.  
American Electric Power Service Corporation  
Three James Center  
1051 E. Cary Street, Suite 1100  
Richmond, VA 23219-4029  
wkcastle@aep.com  
njcoates@aep.com

James R. Bacha, Esq.  
American Electric Power Service Corporation  
P.O. Box 16637  
Columbus, OH 43216  
jrbacha@aep.com

William C. Bovender, Esq.  
Joseph B. Harvey, Esq.  
Hunter, Smith & Davis, LLP  
P.O. Box 3740  
Kingsport, TN 37664  
bovender@hdsdlaw.com  
jharvey@hdsdlaw.com

Michael J. Quinan  
Christian & Barton, LLP  
909 East Main St., Suite 1200  
Richmond, VA 23219  
mquinan@cblaw.com

This the 24th day of July, 2017.

  
Wayne M. Irvin

Before The  
PUBLIC SERVICE COMMISSION  
Of The  
STATE OF TENNESSEE

in re:  
KINGSPORT POWER COMPANY  
(Docket No. U-86-7472)

\*\*\*\*\*

Testimony  
of  
William H. Novak

\*\*\*\*\*

May 1987

1 Q. Would you state your name for the record, please?

2 A. My name is William H. Novak.

3 Q. By whom are you employed, Mr. Novak, and what is your  
4 position?

5 A. I am employed by the Tennessee Public Service  
6 Commission as a Financial Analyst.

7 Q. How long have you been employed by the Commission?

8 A. Approximately five years. Prior to my employment by  
9 this Commission, I was employed as an auditor with the  
10 Tennessee Department of Audit.

11 Q. What is your educational background and what degrees  
12 and licenses do you hold?

13 A. I have a Bachelors degree in Business Administration  
14 from Middle Tennessee State University with a major in  
15 Accounting. I am also licensed to practice as a  
16 Certified Public Accountant in Tennessee, and am a  
17 member of the American Institute of Certified Public  
18 Accountants.

19 Q. Mr. Novak, have you ever testified previously in a  
20 case involving Kingsport Power Company?

21 A. Yes. I previously presented testimony before this  
22 Commission in docket U-84-7308.

23 Q. What is the purpose of your testimony in this case?

24 A. The purpose of my testimony is to present information  
25 to the Commission on what the Staff considers to be  
26 the appropriate test period and test period adjustment  
27 methodology. I am also responsible for the theory for

1 all of the accounting adjustments made by the Staff in  
2 arriving at our estimate of the Company's rate of  
3 return under present rates.

4 Q. Would you please explain the overall procedures used  
5 by the Staff in this case?

6 A. We first reviewed the Company's financial exhibits and  
7 underlying workpapers. In addition, we prepared  
8 information requests for data that were not included  
9 in the Company's exhibits or workpapers. We also made  
10 an on-site audit during which we reviewed the  
11 Company's financial records.

12 Our normal approach is to adjust the historical test  
13 period to compensate for the net effects of all known  
14 and reasonably anticipated changes which might occur.  
15 The primary concern of the Commission in setting rates  
16 is to set rates which are just and reasonable, i.e.,  
17 rates which are sufficient to cover the operating  
18 expenses of a utility and to allow a reasonable return  
19 on its investments used in providing services to its  
20 customers. The Staff normally analyzes a twelve month  
21 historical period of operations called a "test period"  
22 based on the company's books, to test a utility's  
23 earnings under present rates. The revenues, expenses,  
24 and rate base may then be adjusted as necessary to  
25 properly reflect the Company's historical earnings.  
26 Since rates are set for the future, the Staff then  
27 tries to determine what future events are likely to

1 transpire which will change or alter the historical  
2 test year results. Changes can occur which cause  
3 either an increase, or a decrease, in earnings.  
4 Changes also occur which cause the company's  
5 investment to increase or decrease. The historical  
6 test period is therefore adjusted to try to compensate  
7 for the net effects of all known and reasonably  
8 anticipated changes which might occur.

9 Q. What test period and adjusted test period have you  
10 adopted for this case?

11 A. We have accepted the 12 months ended June 30, 1986  
12 test period as proposed by the Company, and have made  
13 adjustments to reflect known and reasonably  
14 anticipated changes. Throughout my testimony, I will  
15 refer to an "adjusted test period". The adjusted test  
16 period represents the time period through which we  
17 have made these known and reasonably anticipated  
18 changes. In this case, we have used as an adjusted  
19 test period the 12 months ending May 31, 1988, since  
20 this is the first year any new rates granted by the  
21 Commission would be in effect.

22 Q. Have you caused to be filed a multi-page document  
23 consisting of 14 schedules?

24 A. Yes. (Introduce Exhibit #-- with 14 schedules).

25 Q. Would you explain Schedule 1 of the Staff's Exhibit  
26 and summarize the Staff's findings in this case?

27 A. Schedule 1 shows the Staff's results of operations



1 under presently approved rates. The Staff's net  
2 operating income is \$2,467,699, or \$60,652 more than  
3 the Company's net operating income of \$2,407,047. The  
4 Staff's rate base is \$27,857,142, or \$166,909 more  
5 than the Company's rate base of \$27,690,233. The  
6 Staff's return on rate base is 8.86% or 0.17% higher  
7 than the Company's return of 8.69%. The Company has  
8 requested a \$1,800,218 increase in rates to produce a  
9 15% return on equity. The Staff's analysis indicates  
10 that an increase of \$1,077,995 will be necessary to  
11 produce a 12.4% return on equity as adopted by Dr.  
12 Klein. This analysis excludes the effect of the  
13 wholesale purchased power "pass through" adjustment  
14 which the Company is also seeking from this  
15 Commission. This concludes the summary of the Staff's  
16 analyses; a detailed explanation follows.

17 Q. Mr. Novak, will you explain the components, and the  
18 adjustments to these components, which make up your  
19 rate base as calculated on Schedules 2 and 3.

20 A. Line 1, Utility Plant in Service \$43,010,883.

21 This item represents the average amount of utility  
22 plant for the adjusted test year on which the Staff  
23 feels the Company should be allowed the opportunity to  
24 earn a return. To compute plant in service both the  
25 Company and the Staff have taken a 13 month average of  
26 the test period balances and have used this amount for  
27 the adjusted test period.

1       Line 2, Completed Plant not Classified \$1,402,146.

2       This item represents the average amount of work orders  
3       for utility plant which has been completed and placed  
4       in service but which work orders have not been  
5       classified for transfer to the detailed utility plant  
6       accounts.

7       Line 3, Construction Work in Progress \$347,762.

8       This item represents the average balance of  
9       construction work in progress that the Commission has  
10      traditionally included in rate base. Both the Company  
11      and the Staff have taken a 13 month average to compute  
12      the test period amount. The Staff then reduced this  
13      balance by \$7,706, shown as Adjustment #1, to reflect  
14      an overbooking in June and July of 1985.

15      Line 4, Plant Held for Future Use \$0.

16      The Commission has historically allowed a utility to  
17      include utility property held for future use as an  
18      addition in computing rate base. The per books amount  
19      of \$78,622 represents land which has been on the  
20      Company's books over two years, that the Company has  
21      no immediate plans for. As a general principle, the  
22      acquisition of property for future use must be a  
23      reasonable one and the need for the property must be  
24      reasonably imminent. Since the Company has no  
25      immediate plans for this property, the Staff has  
26      excluded the entire amount from rate base as  
27      Adjustment #2.

1       Line 5, Working Capital \$713,156.

2       Working Capital consists of various items such as  
3       Cash, Inventories, and Incidental Collections. This  
4       amount represents the average amount of capital  
5       provided by investors in the company over and above  
6       the investment in plant and other specifically  
7       identified rate base items, to bridge the gap between  
8       the time expenditures are required to provide service  
9       and the time collections are received for that  
10      service.

11      Line 7, Accumulated Depreciation \$13,894,654.

12      This item represents the amount of depreciation which  
13      has accumulated over the life of the various plant  
14      items included in utility plant in service.  
15      Capitalized leases have been left out of rate base for  
16      rate-making purposes and the related lease expense has  
17      been included in the operation and maintenance expense  
18      accounts. The Staff has reduced the test period  
19      Accumulated Depreciation by \$10,397 as Adjustment #3  
20      to remove the effect of Capitalized Leases on  
21      Accumulated Depreciation.

22      Line 8, Customer Deposits \$479,883.

23      This item represents amounts advanced by customers to  
24      the Company for the privilege of obtaining service.  
25      These deposits represent a source of non-investor  
26      supplied funds which the Company has available to  
27      finance a portion of its investment. In the past,

1 when the customer deposits have been deducted from  
2 rate base, an amount of interest on these deposits has  
3 been included in the operating expenses and the Staff  
4 has followed that procedure in this case also.

5 Line 9, Customer Advances \$42,880.

6 This account represents non-investor supplied funds  
7 that the Company has used to finance a portion of its  
8 investment and should be included as a deduction in  
9 computing rate base. The entire balance relates to  
10 one customer and is being refunded by \$9,387 per  
11 month. The Staff has reduced the test period balance  
12 by \$9,387 per month through the adjusted test period  
13 resulting in a decline in this account of \$215,282,  
14 shown as Adjustment #4.

15 Line 10, Accumulated Deferred FIT \$896,472.

16 This account represents the amount of income tax that  
17 the Company has deferred payment on due to the use of  
18 accelerated depreciation methods to compute tax  
19 depreciation expense. It is also composed of the sale  
20 and leaseback of the Company's service center, and  
21 excess pension payments made in prior years. Since  
22 the going-level excess pension payment and the  
23 amortization of the deferred gain on the sale of the  
24 service center are known changes, I adjusted them by  
25 \$17,296 as Adjustment #5.

26 Line 11, Accumulated Deferred ITC \$2,082,203.

27 This item represents the average adjusted test year

1 level of unamortized investment tax credits generated  
2 on property additions. This Credit has been repealed  
3 for plant placed in service after December 31, 1985,  
4 however the unamortized portion of these credits still  
5 remains as a deduction in computing rate base. I have  
6 extended the monthly amortization of this item out  
7 through the end of the adjusted test year, and then  
8 have taken a 13 month average, giving \$2,082,203 which  
9 results in a decrease in the amount shown per books by  
10 \$200,256 and is shown as Adjustment #6.

11 Line 12, Deferred Gain on Service Center \$220,713.

12 This item represents the net gain after taxes which  
13 occurred as a result of the Company selling its  
14 service center and then leasing it back. The gain is  
15 being amortized by \$1,250 per month. I have extended  
16 this amortization out through the end of the adjusted  
17 test year giving \$220,256 and resulting in a \$20,700  
18 decrease from the amount shown per books as Adjustment  
19 #7.

20 After considering all of the above items, the Staff  
21 computed rate base as shown on Schedule 2 to be  
22 \$27,857,142 which is \$166,909 greater than the  
23 Company's amount. This rate base represents the  
24 investment on which the Company should be allowed the  
25 opportunity to earn a fair rate of return.

26 Q. Mr. Novak, does this complete your discussion of rate  
27 base?

1 A. Yes it does.

2 Q. Mr. Novak, please explain the two different types of  
3 adjustments you have made to operating income as shown  
4 on Staff Exhibit, Schedule 4.

5 A. The Staff has made both going-level and tax reform  
6 adjustments to the income statement. Going-level  
7 adjustments represent known or reasonably anticipated  
8 changes to the test period amounts. Tax reform  
9 adjustments represent adjustments necessitated because  
10 of the Tax Reform Act of 1986. Both the Company and  
11 the Staff have made various tax reform act adjustments  
12 in preparing their cases.

13 Q. Mr. Novak, will you explain the components, and the  
14 adjustments to these components, which make up your  
15 adjusted operating income as shown on Schedules 4, 5  
16 and 6.

17 A. Line 1, Electricity Sales \$60,270,472.

18 This item includes the net billing for all electricity  
19 sales for each tariff. The Staff has increased  
20 revenues by \$310,052 over the test period amount  
21 through three adjustments as follows:

22 Adjustment #8 was made to reflect additional revenue  
23 that will occur from the additional load to be added  
24 by an existing I.P. tariff customer. The customer has  
25 notified the Company that they will be adding the  
26 additional load in June, 1987.

27 Adjustment #9 was made to reflect a credit given to a

1 I.P. tariff customer in the July, 1985 billing. The  
2 credit related to an error in the demand calculation  
3 for the months of April and May 1985, and should be  
4 removed from the test period as an out-of-period  
5 adjustment.

6 Adjustment #10 was made to recognize the effect of  
7 annualizing the test period revenues. As pointed out  
8 by Company witness Bethel, this adjustment is  
9 necessary because of the migration between tariffs by  
10 certain customers during the test period. As a result  
11 it was necessary to annualize each customer's  
12 purchases based on the tariff under which they are  
13 presently being served.

14 Line 2, Other Revenues \$230,578.

15 This item represents the test period amount of  
16 forfeited discounts and miscellaneous service revenues  
17 the Company receives in addition to electricity  
18 revenues.

19 Line 4, Purchased Power \$47,269,516.

20 This item includes the cost at point of receipt by the  
21 utility of electricity purchased for resale. The  
22 Staff has made as Adjustment #11 an increase in  
23 purchased power of \$291,949 to reflect the additional  
24 load that relates to the increase in sales as  
25 explained in Adjustment #8 above.

26 Line 5, Salary and Wages \$2,487,180

27 This item represents the salaries and wages that are

1 charged to Operations and Maintenance (O&M) for the  
2 adjusted test period. The Staff has increased  
3 Salaries and Wages by \$270,199 for the adjusted test  
4 period as Adjustment #12. This adjustment was  
5 computed by individually pricing out the projected  
6 salary for every Kingsport Power employee.

7 The Staff's adjustment is \$8,148 greater than the  
8 Company's Salaries and Wages projection. This  
9 difference is due to the availability of more current  
10 information at the time the Staff put the rate case  
11 together. The Staff was able to use the actual 1987  
12 salary increases approved by Kingsport's parent  
13 company, American Electric Power, while the Company  
14 had to estimate the 1987 salary increases since this  
15 information was not available at the time the Company  
16 prepared its case.

17 Line 6, Transmission Expense \$426,792.

18 This item includes all of the expenses incurred in the  
19 operation of the Company's transmission system,  
20 excluding salaries and wages and automotive expense.  
21 The Staff has increased this expense by \$18,658 over  
22 the test period amount as Adjustment #13 to reflect an  
23 adjustment for inflation which will be explained later  
24 in my testimony.

25 Line 7, Distribution Expense \$1,072,843.

26 This item includes all of the expenses incurred in  
27 connection with the Company's distribution operations,



1 with the exception of salaries and wages and  
2 automotive expense. Three adjustments, totaling  
3 \$70,110, were made which increased the test period  
4 amount as follows:

5 Adjustment #14 was made for \$46,113 to normalize a  
6 Work In Progress transfer that was incorrectly  
7 recognized as a Distribution Expense in a prior period  
8 and then reversed during the test period.

9 Also, Adjustment #15 was made to decrease the test  
10 period amount by \$26,019 in order to remove the sales  
11 tax on pole attachments. This is the result of an  
12 amendment to Tennessee Code Annotated 67-6-102 by the  
13 Tennessee Legislature that reverses an earlier ruling  
14 by the Tennessee Department of Revenue requiring that  
15 sales tax be paid on pole attachments.

16 Finally, Adjustment #16 was made to increase the test  
17 period amount by \$50,016 for inflation. This  
18 adjustment will be explained later in my testimony.

19 Line 8, Customer Accounting \$357,344.

20 This expense includes all of the costs incurred for  
21 customer accounting and collecting activities. The  
22 Staff has made as Adjustment #17 a \$9,040 increase for  
23 inflation, which will be discussed later in my  
24 testimony.

25 Line 9, Customer Service \$43,966.

26 This item includes the expenses incurred for customer  
27 service activities, including sales expense. The

1 Staff has made as Adjustment #18, a \$2,050 increase  
2 for inflation.

3 Line 10, Automotive Expense, \$243,128.

4 This expense includes all of the costs incurred for  
5 maintenance and repair of Company vehicles. The Staff  
6 has increased this expense by \$17,606 over the test  
7 period amount as Adjustment #19 for new auto service  
8 rates that were put into effect on December 1, 1986.

9 Line 11, Admin. and General Expense \$1,271,325.

10 This account includes all of the expenses incurred for  
11 utility operations that are not chargeable to a  
12 particular operation. However it does not include  
13 salaries and wages or automotive expense. The Staff  
14 has made four adjustments to Administrative and  
15 General (A&G), totaling a \$143,023 increase for the  
16 adjusted test period as follows:

17 Adjustment #20 was made to increase by \$56,649 the  
18 test period amount for the additional costs of  
19 employee benefits due to rising insurance rates and  
20 the increase made to salaries and wages discussed  
21 above in Adjustment #12.

22 A&G was also increased by \$30,412 from the test period  
23 amount as Adjustment #21 to remove all entries to  
24 pension expense during the test period. Pension  
25 expense was shown as a negative amount during the test  
26 period since the Company received annuity dividends  
27 that are not anticipated to occur during the adjusted

1 test period. In addition, the Company does not expect  
2 to make any contributions to the pension fund during  
3 the adjusted test period.

4 Adjustment #22 was made for \$15,295 to reflect the  
5 additional newspaper advertising that the Company  
6 plans for the adjusted test period. This advertising  
7 is to be informative in nature.

8 The last adjustment to A&G Expense is \$40,667 as  
9 Adjustment #23 to increase the test period amount for  
10 inflation, as described later in my testimony.

11 Q. Mr. Novak, will you now explain how the Staff computed  
12 its adjustments for inflation?

13 A. Yes. The inflation Adjustments (13, 16, 17, 18 and  
14 23) described above were computed by determining all  
15 of the O&M expenses that are affected by inflation and  
16 adjusting them by a 23 month inflation factor of  
17 4.89%. Twenty-three months represents the length of  
18 time between the end of the test period and the  
19 adjusted test period. The Company, on the other hand,  
20 used an inflation factor of 5.57%.

21 Both the Staff and the Company used the Gross National  
22 Product Price Deflator Index for determining the  
23 inflation factors. However, the Staff used an average  
24 of eight different economic forecasts of this index  
25 while the company used only a single economic  
26 forecast. As a result, the Staff's adjustment is a  
27 total of \$23,606 less than the Company's adjustment.

1 Q. Please continue with your discussion of the remaining  
2 items on the income statement.

3 A. Line 12, Depreciation Expense \$1,421,119.

4 This item includes the amount of depreciation expense  
5 for all classes of depreciable utility plant in  
6 service except such depreciation expense as is  
7 chargeable to clearing accounts. Both the Staff and  
8 the Company have used the historical test period  
9 amount as appropriate for the adjusted test period.

10 Line 13, Other Taxes, \$2,811,794.

11 This account includes the amounts paid for property  
12 taxes, gross receipts tax, franchise tax, FICA tax,  
13 PSC fee and all other taxes assessed by governmental  
14 authorities except for Federal Income Tax. The Staff  
15 has made five adjustments to Other Taxes, totaling a  
16 \$107,989 increase for the adjusted test period as  
17 follows:

18 Adjustment #24 was made to increase FICA tax by  
19 \$26,724 in conjunction with the increase in salaries  
20 and wages as discussed above in Adjustment #12.

21 Adjustment #25 was made to increase Other Taxes by  
22 \$990 for the difference between the 1986 Franchise Tax  
23 paid and the amount of Franchise Tax recorded on the  
24 books during the test period.

25 Adjustment #26 was made to increase Other Taxes by  
26 \$46,315 to reflect the difference between the property  
27 taxes paid for 1986 and the amount of property tax

1 recorded on the books during the test period.

2 Adjustment #27 was made to increase Other Taxes by  
3 \$44,016 to reflect the new PSC inspection fee that  
4 will be effective during the adjusted test period.

5 Adjustment #28 was made to decrease Other Taxes by  
6 \$10,056 to reflect the difference between the actual  
7 amount of Gross Receipts tax that will be paid during  
8 the adjusted test period and the test period amount.  
9 The adjusted test period amount is based on the actual  
10 gross receipts for the 12 months ended December 31,  
11 1986.

12 Line 14, Federal Income Taxes \$623,420.

13 This item includes the amount of federal income taxes  
14 properly accruable during the adjusted test period to  
15 meet the actual tax liability. I have reduced the  
16 historic test period amount by \$208,057 as Going Level  
17 adjustment #29, and have increased it by \$128,756 as  
18 Tax Reform Adjustment #32. I will explain the  
19 specifics to both of these adjustments later in my  
20 testimony.

21 Line 17, Charitable Donations \$(22,002).

22 This item is shown net of tax. Therefore, the Staff  
23 has made Tax Act Adjustment #33 for \$4,001 to reflect  
24 the decline in FIT rates from 46% to 34%.

25 Line 18, AFUDC \$35,755.

26 This amount represents the income effect of interest  
27 charged to construction for borrowed and other funds.

1 The amount is then capitalized and amortized over the  
2 life of the plant. The Staff has made as Adjustment  
3 #30, a \$59,990 increase to the test period amount.  
4 This is necessary to match the AFUDC with the average  
5 amount of CWIP as shown on Staff Exhibit, Schedule 2.  
6 Line 19, Interest on Customer Deposits \$(18,677).

7 This item is also shown net of tax. Interest on  
8 Customer Deposits is calculated by multiplying the  
9 average historical balance in active customer deposits  
10 by the 6.0% effective interest rate paid in 1986.  
11 Since the deposits are deducted in calculating rate  
12 base on Schedule 2, the interest is treated as an  
13 operating expense for ratemaking purposes. The Staff  
14 has made as Adjustment #31, a \$363 decrease to the  
15 test period amount to exclude inactive customer  
16 deposits from the calculation. I have also made as  
17 Adjustment #34, a \$3,396 increase to reflect the  
18 decline in FIT rates from 46% to 34%.

19 Q. Please explain your FIT calculation as shown on Staff  
20 Exhibit, Schedule 7.

21 A. Staff Exhibit, Schedule 7 was prepared to provide for  
22 the proper ratemaking treatment of federal income  
23 taxes. All of the going-level adjustments previously  
24 discussed have an effect on federal income tax, but in  
25 addition adjustments are necessary to adjust federal  
26 income taxes to a current year condition. Staff  
27 Exhibit, Schedule 7 is a complete portrayal of the

1 calculation of current FIT, deferred FIT, and Deferred  
2 ITC as currently practiced and allowed, plus the  
3 provisions made necessary by the Tax Reform Act of  
4 1986.

5 Q. Please explain the "Schedule M" adjustments which were  
6 made to the calculation of Current FIT as shown on  
7 Staff Exhibit, Schedules 8, 9, and 10.

8 A. Line 10, Tax Over Book Depreciation \$160,000.

9 On its 1985 tax return, the Company made the election  
10 to switch from the declining balance method of  
11 depreciation to the straight line method for property  
12 acquired before 1971. This change increases tax  
13 depreciation expense and, therefore, reduces the  
14 Schedule M addback for Excess Tax Over Book  
15 Depreciation by \$160,000 shown as Adjustment #35.  
16 This Schedule M was also affected by a year-to-date  
17 accrual adjustment made in October 1985. Of the  
18 accrual adjustment, \$47,520 related to the first six  
19 months of 1985, and was therefore removed as  
20 Adjustment #36. Also, since the repeal of Investment  
21 Tax Credit for assets placed in service after December  
22 31, 1985, the Staff has made as Adjustment #46 a  
23 \$1,000 decrease in the historical amount to reflect  
24 the elimination of the basis reduction on property  
25 which had qualified for ITC under prior law.

26 Line 11, ACRS Depreciation \$(601,500).

27 The Schedule M deduction for ACRS Depreciation has

1        been reduced by \$12,000 as Adjustment #37. This  
2        adjustment relates to certain accrual adjustments for  
3        the first half of 1985, which were recorded in October  
4        1985, and must be removed from the test period amount.  
5        Also, as with Tax Over Book Depreciation, Adjustment  
6        #47 has been made to reduce the test period amount by  
7        \$1,500 for the elimination of the basis reduction on  
8        property which had qualified for ITC under prior law.  
9        Line 12, AFUDC \$(35,755).

10       Since a deduction on Allowance for Funds Used During  
11       Construction (AFUDC) is not permitted for FIT  
12       purposes, it is necessary to make a \$59,990 reduction  
13       as Adjustment #38 to eliminate the going-level  
14       adjustment on Line 7.

15       Line 13, Overheads Capitalized \$(11,543).

16       Under the old law, taxes, pensions, savings plans and  
17       overhead costs associated with construction of a  
18       capital asset were deducted currently. The new tax  
19       law requires capitalization of these costs, as part of  
20       the tax basis of the assets to which they apply. This  
21       results in a \$75,040 increase to the test period  
22       amount as Adjustment #48.

23       Line 14, Excess Pension Payments \$0.

24       This is a nonrecurring item and was therefore  
25       eliminated by a \$43,736 addition as Adjustment #39.

26       Line 15, Unbilled Revenues \$565,030.

27       Prior to the Tax Reform Act of 1986, unbilled revenue



1 was not included in taxable income. Now the income  
2 must be recognized in the taxable year the services  
3 are provided. As a result, Adjustment #40 was  
4 necessary to bring the test period growth in Unbilled  
5 Revenues of \$125,244 into income. In addition, the  
6 act provides for bringing the balance of unbilled  
7 revenues as of December 31, 1986, into taxable income  
8 over a four-year period. This results in a \$565,030  
9 increase to the test period amount as Adjustment #49.

10 Line 16, Removal Costs \$(200,000).

11 This Schedule M deduction is being reduced by \$65,000  
12 as Adjustment #41 to remove accrual adjustments that  
13 relate to the first half of 1985.

14 Line 18, Repair Allowance \$(100,000).

15 The Percent Repair Allowance deduction is being  
16 adjusted for two reasons. First, the accrual for 1985  
17 is being deducted as Adjustment #42 to remove a  
18 \$96,000 adjustment that does not pertain to the test  
19 period. Secondly, \$100,000 is being set up in  
20 Adjustment #43, as the Company's estimate of the  
21 deduction for the adjusted test period.

22 Line 22, Tax Provision for Bad Debts \$(46,131).

23 Under prior law, companies claimed a tax deduction for  
24 annual additions to a reserve for bad debts. The new  
25 tax law allows a deduction for bad debts only when  
26 they are actually written off and requires the balance  
27 of the reserve previously deducted to be brought back

1 into income ratably over a four-year period beginning  
2 in 1987. This was done as Adjustment #50, to bring  
3 \$37,869 or 25% of the total reserve into income.

4 Line 24, Membership Dues \$0.

5 This item is not related to operating income and was  
6 therefore eliminated by Adjustment #44 for \$(5,192).

7 Line 25, Capitalized Interest \$22,431.

8 Interest incurred to construct property must be  
9 capitalized beginning in 1987 under a variety of  
10 conditions specified in the new tax law, resulting in  
11 an increase in taxable income. Therefore, the Staff  
12 has made Adjustment #51 for \$22,431 to recognize this.

13 Line 26, Contributions in Aid of Const. \$133,300.

14 Under prior tax law, Contributions in Aid of  
15 Construction were excludable from taxable income.  
16 Under the Tax Act, Contributions in Aid of  
17 Construction received after December 31, 1986 are  
18 fully taxable as income. Therefore, the Staff has  
19 made Adjustment #52 to recognize this change.

20 Line 27, AEP Loss Allocation \$(5,724).

21 The Company's parent American Electric Power (AEP)  
22 allocates for tax purposes, each subsidiary's share of  
23 the parent loss. For the test period, the Company's  
24 share of this loss was \$(5,724) and Adjustment #45 for  
25 \$(6,627) was necessary to bring the per books amount  
26 to this level.

27 The above items resulted in a total of \$40,767 in

1 going-level adjustments and \$408,465 in Tax Act  
2 adjustments giving an adjusted test period amount of  
3 \$440,512 for current FIT.

4 Q. Please explain the adjustments to Deferred Federal  
5 Income Taxes shown on Staff Exhibit, Schedules 11, 12  
6 and 13.

7 A. Schedule 11 shows the detail of the components which  
8 make up Deferred Federal Income Taxes. I will now  
9 discuss each adjustment to this schedule.

10 Line 1, ACRS \$204,510.

11 This item represents current taxes deferred because of  
12 accelerated depreciation. The historic test period  
13 amount was increased by Adjustment #53 for \$6,179 to  
14 reverse an out of period adjustment related to the  
15 Company's 1984 tax return. Also, the test period  
16 amount was decreased by \$5,520 as Adjustment #54 to  
17 record the deferred taxes resulting from Adjustment  
18 #37 described above. These two adjustments resulted  
19 in a net increase to the test period amount of \$659 as  
20 a going-level adjustment. I have also made as  
21 Adjustment #59, a \$72,000 decrease to reflect the  
22 decline in FIT rates from 46% to 34%, and Adjustment  
23 #60 for a \$510 increase to record the deferred taxes  
24 resulting from Adjustment #47 described above.

25 Line 2, Repair Allowance \$19,520.

26 This item represents current deferred taxes because of  
27 a repair allowance permitted for income tax purposes.

1 The historic test period amount was decreased by  
2 Adjustment #55 for \$98,162 to reverse an out of period  
3 adjustment related to the Company's 1984 tax return.  
4 Also, the test period amount was increased by \$89,392  
5 as Adjustment #56 to record the deferred taxes  
6 resulting from Adjustments #42 and #43 described  
7 above. These two adjustments resulted in a net  
8 decrease to the test period amount of \$8,770 as a  
9 going-level adjustment. I have also made as  
10 Adjustment #61, a \$14,444 decrease to reflect the  
11 decline in FIT rates from 46% to 34%.

12 Line 3, Service Center Gain \$4,200.

13 This item represents current deferred taxes related to  
14 the Company's gain on the sale of its service center.  
15 The historic test period amount was increased by  
16 Adjustment #57 for \$130 to reverse an out of period  
17 adjustment related to the Company's 1984 tax return.

18 Line 4, Excess Pension Payment \$0.

19 This is a nonrecurring item and was therefore  
20 eliminated by a \$20,119 deduction as Adjustment #58.

21 Line 5, Contribution in Aid of Construction \$(45,322)

22 This item represents the current deferred piece of  
23 Adjustment #52 described above. I have taken the new  
24 FIT rate of 34% and applied it to the estimated  
25 contributions of \$133,300 resulting in a \$45,322  
26 decrease as Adjustment #62.

27 The above items resulted in a total of \$28,100 in

1       going-level adjustments and \$131,256 in tax act  
2       adjustments giving an adjusted test period amount of  
3       \$182,908 for deferred FIT.

4       Q. Would you now discuss the Staff's revenue conversion  
5       factor as shown on Staff Exhibit, Schedule 14?

6       A. Yes. The revenue conversion factor of 1.516592 should  
7       be applied to any net operating income deficiency the  
8       Commission might find in this case to gross the  
9       revenues up to cover the additional taxes which will  
10      result from additional revenues.

11      Q. Mr. Novak, does this conclude your testimony?

12      A. Yes, it does.

13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27

Before The  
PUBLIC SERVICE COMMISSION  
Of The  
STATE OF TENNESSEE

in re:  
KINGSPORT POWER COMPANY  
(No. 89-02126)

\*\*\*\*\*

Testimony

of

William H. Novak

\*\*\*\*\*

March 1989

1 Q. Would you state your name for the record, please?

2 A. My name is William H. Novak.

3 Q. By whom are you employed, Mr. Novak, and what is your  
4 position?

5 A. I am employed by the Tennessee Public Service  
6 Commission as a Financial Analyst.

7 Q. How long have you been employed by the Commission?

8 A. Approximately six years. Prior to my employment by  
9 this Commission, I was employed as an auditor with the  
10 Tennessee Department of Audit.

11 Q. What is your educational background, and what degrees  
12 and licenses do you hold?

13 A. I have a Bachelors degree in Business Administration  
14 from Middle Tennessee State University with a major in  
15 Accounting. I am also licensed to practice as a  
16 Certified Public Accountant and as a Certified  
17 Managerial Accountant in Tennessee, and am a member of  
18 the American Institute of Certified Public  
19 Accountants.

20 Q. Mr. Novak, have you ever testified in a case involving  
21 Kingsport Power Company?

22 A. Yes. I previously presented testimony before this  
23 Commission in Docket No. U-86-7472.

24 Q. Why did the Commission Staff (Staff) recommend that  
25 the Commission issue a Show Cause Order directed  
26 toward Kingsport Power Company (Company)?

27 A. In the monthly reports that the Company has filed with

1 the Commission, the Staff has noticed that the  
2 Company's actual rate of return has been exceeding its  
3 authorized rate of return since June, 1987. The Staff  
4 has normalized the actual rate of return in preparing  
5 Exhibit WHN-1 for the effects of abnormal weather and  
6 has discovered that the Company would have earned an  
7 excessive rate of return even if the weather had been  
8 normal. According to the November, 1988, monthly  
9 report, the latest on file with the Commission, the  
10 Company's actual rate of return was 14.45% and its  
11 normalized rate of return was 13.74%. The Company's  
12 authorized rate of return is 11.41%, as decided in  
13 Docket No. U-86-7472. This has resulted in the  
14 Company's earning over \$900,000 in excess revenues  
15 from June 1, 1987, through November 30, 1988.

16 Q. Has the Staff reviewed the case filed by the Company  
17 concerning its excessive rate of return?

18 A. Yes, we have.

19 Q. Would you briefly summarize the Company's filing?

20 A. Yes. The Company has made 24 adjustments to the  
21 actual per book amounts as of December 31, 1988. The  
22 Staff has summarized the Company's adjustments in  
23 Exhibit WHN-2. This summary shows that the Company  
24 has a revenue deficiency of \$294,614; however, the  
25 Company has proposed no changes in its rates.

26 Q. Would you briefly summarize the Staff's filing?

27 A. The Staff has updated its case from June 30, 1988, as



1 originally proposed to the Commission, to December 31,  
2 1988, to coincide with the same test year used by the  
3 Company. The Staff basically agrees with the  
4 Company's adjustments as outlined in Exhibit WHN-2  
5 with the exception of the adjustments for growth and  
6 cost of capital. Some other minor differences also  
7 exist, but do not warrant discussion. The Staff has  
8 prepared a summary of the its position in Exhibit  
9 WHN-3, which includes these adjustments. This summary  
10 shows that the Company has a revenue surplus of  
11 \$1,149,834.

12 Q. What is the purpose of your testimony in this  
13 proceeding?

14 A. I will discuss the Staff's growth adjustment. Dr.  
15 Klein will present testimony regarding the Staff's  
16 position on the cost of capital.

17 Q. Would you briefly summarize the Staff's calculation of  
18 growth?

19 A. Yes. First, I should point out that both the Company  
20 and the Staff have calculated the growth in rate base,  
21 depreciation expense, revenues, and purchased power  
22 expense. The Staff has also calculated the growth in  
23 accumulated deferred federal income taxes. As shown  
24 on Exhibit WHN-4, the differences in the calculations  
25 for growth in rate base and depreciation expense are  
26 immaterial; therefore, I will limit my discussion to  
27 the calculations of growth in revenues and purchased

1 power expense.

2 To calculate the growth in revenues, the Staff  
3 adjusted the 1987 revenues for the rate increase that  
4 the Commission awarded the Company effective July 1,  
5 1987. Then the Staff subtracted the adjusted 1987  
6 revenues from the 1988 revenues. This annual growth  
7 was then multiplied by 1.25 to give the growth from  
8 December 31, 1989, to March, 31, 1990, which is the  
9 end of the attrition year as proposed by the Company.

10 To calculate the growth in purchased power expense,  
11 the Staff subtracted the 1987 purchased power expense  
12 from the 1988 purchased power expense. This annual  
13 growth was then multiplied by 1.25 to give the growth  
14 from December 31, 1989, to March 31, 1990.

15 The growth in purchased power expense was then  
16 subtracted from the growth in revenues described above  
17 giving growth in gross income of 6.4%. These  
18 calculations are shown in Exhibit WHN-4.

19 Q. What growth rates did the Company use in their  
20 calculation?

21 A. Company Exhibit LRJ-4 shows that the Company increased  
22 residential revenues by 1.4%, commercial revenues by  
23 3.2% and the corresponding purchased power by 4.16%.  
24 This resulted in growth to gross income of 1.8%.

25 Q. How did the Company compute its growth rates?

26 A. The Company used the average growth in sales to  
27 residential and commercial customers since 1981. This

1 is where the basic difference between the Staff and  
2 the Company lies. The Staff has used the most recent  
3 growth rate as representative of what will happen  
4 during the attrition year, while the Company has used  
5 a seven-year average.

6 Q. Mr. Novak, is the growth that is being experienced  
7 today normal for the Company?

8 A. No. The growth that the Company is now experiencing  
9 is above average compared with previous periods.  
10 However, it is not reasonable to use an average growth  
11 rate as the Company has done, since the growth rate  
12 that the Company is now experiencing is likely to  
13 continue on in the short term, i.e., the attrition  
14 period ending March 31, 1990.

15 Q. Will the current growth rate ever decrease from where  
16 it is now?

17 A. The growth that the Company is experiencing today  
18 cannot be maintained for an indefinite period of time.  
19 Eventually this growth rate will decline, possibly to  
20 a point closer to the Company's seven-year average.  
21 However, this decline will not take place overnight as  
22 the Company has assumed in their calculations. In  
23 other words, the growth rate that the Company will  
24 experience during the attrition period will not be  
25 materially different from today's growth.

26 Q. How does the Staff propose that the rate reduction be  
27 implemented?

1 A. Considering the magnitude of the rate reduction, the  
2 Staff would recommend that the reduction be  
3 implemented to all customers evenly.

4 Q. Considering that the reduction is approximately equal  
5 to the last rate increase, would the Staff agree to  
6 reduce the current rates to the levels that were in  
7 effect before the last increase?

8 A. Yes. The Staff believes that this would be an  
9 acceptable method; there should be no major rate  
10 shifts.

11 Q. Does this conclude your testimony?

12 A. Yes, it does.

Before The  
PUBLIC SERVICE COMMISSION  
Of The  
STATE OF TENNESSEE

in re:  
KINGSPORT POWER COMPANY  
(Docket No. 90-05735)

\*\*\*\*\*

Testimony  
of  
William H. Novak

\*\*\*\*\*

November, 1990

1 Q. Would you state your name for the record, please?

2 A. My name is William H. Novak.

3 Q. By whom are you employed, Mr. Novak, and what is your  
4 position?

5 A. I am an Accounting Division Manager for the Tennessee Public  
6 Service Commission.

7 Q. How long have you been employed by the Commission?

8 A. Approximately eight years. Prior to my employment with the  
9 Commission, I was employed as an auditor with the Tennessee  
10 Department of Audit.

11 Q. What is your educational background, and what degrees and  
12 licenses do you hold?

13 A. I have a Bachelors degree in Business Administration from  
14 Middle Tennessee State University with a major in Accounting.  
15 I am also licensed to practice as a Certified Public  
16 Accountant and as a Certified Managerial Accountant in  
17 Tennessee, and am a member of the American Institute of  
18 Certified Public Accountants, and the National Association of  
19 Accountants.

20 Q. Mr. Novak, have you ever testified in a case involving  
21 Kingsport Power Company?

22 A. Yes. I previously presented testimony before this Commission  
23 in dockets U-86-7472 and 89-02126.

24 Q. What is the purpose of your testimony in this case?

25 A. The purpose of my testimony is to present information to the  
26 Commission on the Staff's investigation of Kingsport Power  
27 Company's petition to increase rates by \$2,016,172 including

1 the purchased power pass through.

2 Q. Would you please explain the overall procedures used by the  
3 Staff in this case?

4 A. Yes. We first reviewed the Company's financial exhibits and  
5 underlying workpapers. In addition, we prepared information  
6 requests for data that was not included in the Company's  
7 exhibits or workpapers. We also conducted an on-site audit  
8 at the Company's office in Kingsport, during which we  
9 reviewed the Company's financial records.

10 Q. Please explain the purchased power pass through component of  
11 the Company's rate request.

12 A. Approximately \$386,049 of the Company's total rate request of  
13 \$2,016,172 relates to an anticipated increase in the  
14 Company's purchased power costs beginning in August of 1990.  
15 The Federal Energy Regulatory Commission (FERC) has approved  
16 this increase subject to refund, and this increase is  
17 currently being billed to Kingsport. However, the final  
18 amount of increase is not expected to be known until the  
19 Summer of 1991, when the FERC issues its final decision. At  
20 this time, Kingsport may receive a refund of some or all of  
21 the increase in purchased power expense paid since August,  
22 1990, depending on how the FERC decides.

23 Q. How does the Staff propose to treat this increase in  
24 purchased power expense?

25 A. The Staff and the Company have reached an agreement in which  
26 this expense increase will be deferred until actually known.  
27 Under this agreement, the Company will record amounts paid

1 for the increase in purchased power expense as a receivable  
2 (Miscellaneous Deferred Debits, Account No. 186), and accrue  
3 interest on these amounts on a monthly basis equal to the  
4 overall cost of capital approved by the Commission in this  
5 case. When the final amount of the increase is known,  
6 Kingsport will surcharge or refund the amount in this account  
7 (net of any refunds including interest received) to its  
8 customers. Also, Kingsport will include the new purchased  
9 power expense in its Fuel Clause Adjustment (FCA) factor  
10 which it files with the Commission. By structuring the  
11 purchased power increase in this manner and deferring  
12 \$386,049 of the Company's case, we were able to avoid the  
13 possibility of increasing rates today when a reduction may be  
14 in order for this specific item.

15 Q. After conducting the review of the Company's records, did the  
16 Staff prepare an initial case?

17 A. Yes. The Staff's case showed a revenue surplus of  
18 \$31,760.

19 Q. What was the revenue settlement agreed upon by the Staff and  
20 the Company?

21 A. The Staff and the Company agreed upon a revenue deficiency of  
22 \$500,000 that will go into effect on January 1, 1991. This  
23 amount is \$531,760 more than the Staff's adjusted case, but  
24 \$1,130,124 less than the Company's revenue deficiency per the  
25 Company's filing. The Staff feels that this settlement is  
26 fair and equitable to both the Company and the customers.

27 Q. Why did the Staff agree to settle on a \$500,000 revenue



1        deficiency, when its own case showed a revenue surplus of  
2        \$31,760?

3        A. Much of the Staff's case, as well as the Company's, is based  
4        on forecasted events which may or may not come to pass.  
5        Other parts of the case, such as return on equity, are based  
6        on a range of reasonableness. In the interest of presenting  
7        a fair & reasonable settlement to the Commission for this  
8        case, both the Staff and the Company have agreed to negotiate  
9        from their original positions.

10       Q. Has the Staff prepared a set of exhibits outlining the  
11       various components of Rate Base, Income, and Results of  
12       Operations, that equates to a \$500,000 revenue deficiency?

13       A. No. The \$500,000 revenue deficiency was a negotiated amount  
14       between the Company and the Staff without regard for the  
15       individual amounts. The Staff has prepared schedules showing  
16       the elements of Rate Base, Income and Results of Operation  
17       for the test period, the Staff's revised case, and the  
18       Company's case excluding the purchased power pass through as  
19       shown on Staff Exhibit, Schedules 1 through 3.

20       Q. What is the Staff's recommendation regarding rate design?

21       A. Dr. Klein will address the issue of how this deficiency  
22       should be allocated to the individual tariffs. However, in  
23       conjunction with his proposal to place the increase on  
24       residential customers only, the \$500,000 revenue deficiency  
25       should be spread over the Staff's calculation of annual  
26       resident KWH sales of 595,910,373 for 1991. The Staff will  
27       present a late filed exhibit detailing the proposed rates

1 prior to the hearing.

2 Q. Has the Staff entered into an agreement regarding the terms  
3 of the settlement with the Company?

4 A. Yes. A signed settlement agreement will be presented to the  
5 Commission prior to the hearing.

6 Q. Does this complete your testimony?

7 A. Yes, it does.

Before The  
PUBLIC SERVICE COMMISSION  
Of The  
STATE OF TENNESSEE

in re:  
KINGSPORT POWER COMPANY  
(Docket No. 92-04425)

\*\*\*\*\*

Testimony  
of  
William H. Novak

\*\*\*\*\*

October 1992

1 Q. Would you state your name for the record, please?

2 A. My name is William H. Novak.

3 Q. By whom are you employed, Mr. Novak, and what is your  
4 position?

5 A. I am employed by the Tennessee Public Service Commission  
6 as an Accounting Division Manager. In this capacity, I  
7 directly supervise two other analysts, both of whom are  
8 CPA's.

9 Q. How long have you been employed by the Commission?

10 A. Approximately ten years.

11 Q. What is your educational background, and what degrees and  
12 licenses do you hold?

13 A. I have a Bachelors degree in Business Administration from  
14 Middle Tennessee State University with a major in  
15 Accounting. I am also licensed to practice as a  
16 Certified Public Accountant and as a Certified Managerial  
17 Accountant in Tennessee. In addition, I am a member of  
18 the American Institute of Certified Public Accountants,  
19 and the National Association of Accountants.

20 Q. Mr. Novak, have you ever testified in a case involving  
21 Kingsport Power Company?

22 A. Yes. I previously presented testimony before this  
23 Commission in dockets U-86-7472, 89-02126, and 90-05735.  
24 I have also prepared and presented information for the  
25 Commission's consideration on a number of issues  
26 regarding Kingsport Power Company (Kingsport) that were  
27 not part of a formal rate case.

1 Q. What is the purpose of your testimony in this case?

2 A. The purpose of my testimony is to present information to  
3 the Commission on the Staff's investigation of Kingsport  
4 Power Company's petition to increase rates by \$5,463,716  
5 including the purchased power pass through.  
6 Specifically, I will present testimony on the computation  
7 of the Staff's revenues, expenses, income taxes, and  
8 revenue conversion factor. Mr. Bustin will testify on  
9 the Staff's calculation of rate base, depreciation  
10 expense, and taxes other than income taxes. Dr. Klein  
11 will testify on the Staff's cost of capital and rate  
12 design. As the manager of the audit team conducting the  
13 investigation of this rate case, I am also responsible  
14 for the theory of all adjustments made by the Staff in  
15 arriving at our estimate of the Company's rate of return  
16 under present rates.

17 Q. Would you please explain the overall procedures used by  
18 the Staff in this case?

19 A. Yes. We first reviewed the Company's financial exhibits  
20 and underlying workpapers. In addition, we prepared  
21 information requests for data that was not included in  
22 the Company's exhibits or workpapers. We also conducted  
23 an on-site audit at the Company's office in Kingsport,  
24 during which we reviewed the Company's financial records.  
25 Based on the information obtained through this process,  
26 we then developed financial workpapers and exhibits to  
27 test the reasonableness of the Company's current rates.

1 We then adjusted the historical test period to compensate  
2 for the net effects of all known and reasonably  
3 anticipated changes which might occur.

4 The primary concern of the Commission in setting rates is  
5 to set rates which are just and reasonable, i.e., rates  
6 which are sufficient to cover the operating expenses of a  
7 utility, and to allow a reasonable return on its  
8 investments used in providing services to its customers.  
9 The Staff normally analyzes a twelve month historical  
10 period of operations called a "test period." This test  
11 period is based on the Company's books to determine a  
12 utility's earnings under present rates. The revenues,  
13 expenses, and rate base may then be adjusted as necessary  
14 to properly reflect the Company's historical earnings.  
15 Since rates are set for the future, the Staff then  
16 attempts to determine what future events are likely to  
17 transpire which will change or alter the historical test  
18 year results. Changes can occur which cause the  
19 Company's investment to increase or decrease. Changes  
20 can also occur that may cause the Company's operating  
21 income to increase or decrease. The historical test  
22 period is therefore adjusted to compensate for the net  
23 effects of all known and reasonably anticipated changes  
24 which might occur.

25 Q. What test period and adjusted test period have you  
26 adopted for this case?

1 A. The Company has used the twelve months ended December 31,  
2 1991, as its test period with adjustments through the 12  
3 months ending December 31, 1993, since this is the first  
4 year any new rates granted by the Commission would be in  
5 effect. The Staff has reviewed the Company's test period  
6 and adjusted test period, and adopted it into our case.

7 Q. Have you caused to be filed a multi-page document  
8 consisting of 13 schedules?

9 A. Yes. (Introduce Exhibit #\_\_ with 13 schedules).

10 Q. Would you explain Schedule 1 of the Staff's Exhibit and  
11 summarize the Staff's findings in this case?

12 A. Schedule 1 shows the Staff's calculation of the Company's  
13 results of operations under presently approved rates.  
14 The Staff's attrition average rate base is \$37,125,643 or  
15 \$818,685 less than the Company's amount of \$37,944,328.  
16 The Staff's attrition net operating income is \$1,117,496  
17 or \$2,173,678 more than the Company's calculation of  
18 \$<1,056,182> after the purchased power pass through. The  
19 Staff's return on rate base under present rates is 3.01%  
20 or 586 basis points higher than the Company's return of  
21 <2.85%> after the purchased power pass through. The  
22 Company has requested a \$5,463,716 increase in rates to  
23 produce an 11.26% overall return. The Staff's analysis  
24 indicates that a increase of \$4,323,650 will be necessary  
25 to produce a 10.24% return as recommended by Dr. Klein.

26 Q. Please explain the purchased power pass through component  
27 of the Company's rate request.

- 1     A.   Approximately \$4,920,871, or 90%, of the Company's total  
2         rate request of \$5,463,716 relates to an anticipated  
3         increase in the Company's purchased power costs beginning  
4         September 15, 1992.     The Federal Energy Regulatory  
5         Commission (FERC) has approved this change subject to  
6         refund, and the increase is currently being billed to  
7         Kingsport.   However, the ultimate amount of the increase  
8         will not be known until the FERC issues its final  
9         decision.   At that time, Kingsport may receive a refund  
10        of some or all of the increase in purchased power expense  
11        paid since September 15, 1992, depending on how the FERC  
12        decides.
- 13    Q.   Did Kingsport's customers begin paying this purchased  
14         power increase on September 15, 1992?
- 15    A.   No.   Kingsport had asked the Commission for emergency  
16         rate relief so that they could begin charging the  
17         increase in purchased power costs to their customers on  
18         September 15, 1992.   However, after taking notice of  
19         Kingsport's current earnings, the Commission refused to  
20         grant any emergency rate relief.
- 21    Q.   At what time will Kingsport's customers pay the increase  
22         in purchased power costs?
- 23    A.   The Staff has included the costs for the purchased power  
24         increase in its case.   The rates resulting from this  
25         increase will begin to be passed on the Kingsport's  
26         customers on the effective date of the Commission's Order



1 in this case. Again, this increase will be put into  
2 effect subject to any refund ordered by the FERC.

3 Q. Please explain the major areas of difference between the  
4 Company's and the Staff's calculation of revenues and  
5 expenses?

6 A. The Staff has reviewed the Company's filing and, for the  
7 most part, has adopted Kingsport's calculation of  
8 revenues and expenses into its own analysis. However,  
9 the Staff has adjusted the Company's case for SFAS 106  
10 costs.

11 SFAS 106 costs concern the accounting for post-retirement  
12 benefits other than pensions. The Commission is  
13 considering this issue in a generic docket for all  
14 utilities which the Commission regulates. The Staff has  
15 therefore excluded the Company's adjustment of \$335,000  
16 for SFAS 106. The Staff has also excluded \$218,555 in  
17 test period costs for corporate owned life insurance  
18 expense (COLI) that are related to SFAS 106, and were  
19 already booked in the test period. These costs are  
20 specifically addressed by Company witness McCoy.

21 Q. How were the Staff's income taxes calculated?

22 A. The Tennessee Excise Tax and Federal Income Tax is  
23 computed based on the adjusted test year revenues and  
24 expenses as developed by the Staff. These calculations  
25 are shown on Staff Exhibit, Schedule 11. The Staff has  
26 based its FIT calculation on the tax laws that will be in  
27 effect during the attrition period.

1 Q. Would you now discuss the Staff's revenue conversion  
2 factor as shown on Staff Exhibit, Schedule 13?

3 A. Yes. The revenue conversion factor of 1.610796 should be  
4 multiplied by any net operating income deficiency the  
5 Commission might find in this case. This is necessary to  
6 gross up the revenues required to cover the additional  
7 taxes which will result from additional revenues. Unlike  
8 the Company however, the Staff has excluded Gross  
9 Receipts Taxes and TPSC Inspection Fees from its revenue  
10 conversion calculation. The reason for this is that  
11 since these are prepaid taxes, any rate change made by  
12 the Commission in this case will have no effect on the  
13 amounts to be paid in 1993.

14 Q. Are there any other issues which need to be discussed at  
15 this time?

16 A. Yes. In the Company's last rate case (Docket 90-05735),  
17 the Company and the Staff agreed to defer a purchased  
18 power increase, effective August 4, 1990, until a final  
19 FERC order has been issued. To date, the FERC has still  
20 not issued a final order on this matter. The Staff  
21 believes that this Commission's previous order still  
22 stands regarding this deferral and would continue to  
23 require the Company to make a refund or surcharge  
24 adjustment in their rates when the FERC does issue its  
25 final order.

26 Q. Does this complete your testimony?

27 A. Yes, it does.


## Affidavit

State of Tennessee )


County of Davidson )

William H. Novak, being first duly sworn, deposes and says that he is the same William H. Novak whose prepared testimony accompanies this affidavit.

William H. Novak further states that, to the best of his knowledge and belief, his answers to the questions contained in such prepared testimony are true and accurate to the best of his knowledge and belief.

  
William H. Novak

Sworn to and subscribed before me,  
a Notary Public, on this the 16th  
day of October, 1992.

  
My Commission Expires:

September 25, 1993