

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

IN RE:

**CHATTANOOGA GAS COMPANY)
PETITION FOR APPROVAL OF AN)
ADJUSTMENT IN RATES AND)
TARIFF; THE TERMINATION OF THE)
AUA MECHANISM AND THE)
RELATED TARIFF CHANGES AND)
REVENUE DEFICIENCY RECOVERY;)
AND AN ANNUAL RATE REVIEW)
MECHANISM)**

DOCKET NO. 18-00017

DIRECT TESTIMONY

OF

DAVID DITTEMORE

July 3, 2018

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

IN RE:

CHATTANOOGA GAS COMPANY)
PETITION FOR APPROVAL OF AN)
ADJUSTMENT IN RATES AND)
TARIFF; THE TERMINATION OF THE)
AUA MECHANISM AND THE)
RELATED TARIFF CHANGES AND)
REVENUE DEFICIENCY RECOVERY;)
AND AN ANNUAL RATE REVIEW)
MECHANISM)

DOCKET NO. 18-00017

AFFIDAVIT

I, David N. Dittemore, Financial Analyst, on behalf of the Consumer Advocate Division of the Attorney General's Office, hereby certify that the attached Direct Testimony represents my opinion in the above-referenced case and the opinion of the Consumer Protection and Advocate Division.


David N. Dittemore
DAVID N. DITTEMORE

Sworn to and subscribed before me this 5th day of July, 2018.

Emil Knigge
NOTARY PUBLIC

My commission expires: May 6, 2019

CONTENTS

I. OVERVIEW OF THE SOUTHERN COMPANY.....	3
II. ATTRITION PERIOD O&M COSTS	5
III. ATTRITION PERIOD TAXES OTHER THAN INCOME TAXES.....	16
IV. ATTRITION PERIOD CASH WORKING CAPITAL	17
V. ACCUMULATED DEFERRED INCOME TAXES AND TCJA AMORTIZATION .	20
VI. ACCOUNTING POLICY CONCERNS AND RECOMMENDATIONS	31
VII. FAILURE TO PROVIDE CLEAR METHODS OF CALCULATING RATE COMPONENTS	35

ATTACHMENTS

David N. Dittemore Vitae
CPAD Operations and Maintenance Expense

Exhibit DND-1
Attachment DD-1

1 **Q1. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND**
2 **OCCUPATION FOR THE RECORD.**

3 **A1.** My name is David N. Dittmore. I am a Financial Analyst employed by the
4 Consumer Protection and Advocate Division within the Office of the Tennessee
5 Attorney General (Consumer Advocate). My business address is Office of the
6 Tennessee Attorney General, UBS Tower, 315 Deaderick Street, Nashville, TN
7 37243.

8 **Q2. PLEASE PROVIDE A SUMMARY OF YOUR BACKGROUND AND**
9 **PROFESSIONAL EXPERIENCE.**

10 **A2.** I received a Bachelor of Science Degree in Business Administration from the
11 University of Central Missouri in 1982. I am a Certified Public Accountant
12 licensed in the state of Oklahoma (#7562). I was previously employed by the
13 Kansas Corporation Commission (KCC) in various capacities, including Managing
14 Auditor, Chief Auditor, and Director of the Utilities Division. For approximately
15 four years, I was self-employed as a Utility Regulatory Consultant representing
16 primarily the KCC Staff in regulatory issues. I also participated in proceedings in
17 Georgia and Vermont, evaluating issues involving electricity and
18 telecommunications regulatory issues. Additionally, I performed a consulting
19 engagement for Kansas Gas Service (KGS), my subsequent employer during this
20 time frame. For eleven years, I served as Manager and subsequently Director of
21 Regulatory Affairs for KGS, the largest natural gas utility in Kansas, serving
22 approximately 625,000 customers. KGS is a division of One Gas, a natural gas
23 utility serving approximately two million customers in Kansas, Oklahoma, and
24 Texas. I joined the Office of the Tennessee Attorney General in September, 2017
25 as a Financial Analyst. In total, I have over thirty years' experience in the field of
26 public utility regulation. I have presented testimony as an expert witness on
27 numerous occasions. Attached as Exhibit 1 is a detailed vita of my professional
28 background.

1 **Q3. HAVE YOU PREVIOUSLY PROVIDED TESTIMONY BEFORE THE**
2 **TENNESSEE PUBLIC UTILITY COMMISSION (TPUC)?**

3 A3. Yes. I have submitted testimony in TPUC Docket Nos. 17-00014, 17-00108, 17-
4 00138, 17-00124, and 17-00143.

5 **Q4. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**
6 **PROCEEDING?**

7 A4. My testimony will support and address the Consumer Advocate's positions with
8 respect to the attrition period Operating and Maintenance (O&M) Expenses,¹
9 Taxes Other than Income, Cash Working Capital, and Accumulated Deferred
10 Income Tax (ADIT) balances, including the impacts of the Tax Cuts and Jobs Act
11 (TCJA). I will also identify and discuss certain accounting concerns regarding
12 cost allocation processes and make recommendations for enhancing the quality
13 and transparency of these costs within regulatory filings. Finally, I will address
14 how Chattanooga Gas Company (CGC or the Company) has not demonstrated it
15 has in place sufficient controls over its cost allocation processes that would
16 demonstrate the necessary practices and procedures for determining on-going
17 O&M costs.

18 **I. OVERVIEW OF THE SOUTHERN COMPANY**

19 **Q5. PLEASE PROVIDE AN OVERVIEW OF THE SOUTHERN COMPANY,**
20 **INCLUDING THE AFFILIATES OF CGC.**

21 A5. The Southern Company provides retail electricity and natural gas at the retail level
22 to more than nine million customers. In addition to its regulated electricity and
23 natural gas service, The Southern Company also engages in significant non-
24 regulated operations. For example, The Southern Company conducts operations

¹ Consumer Advocate witness Mr. Hal Novak is sponsoring the adjustment to amortize rate case costs.

1 through affiliated entities in the areas of wholesale competitive power generation,
2 digital communications, and investments in leveraged leases.

3 **Q6. WHICH AFFILIATED ENTITY CONDUCTS RETAIL NATURAL GAS**
4 **DISTRIBUTION OPERATIONS?**

5 A6. The Southern Company's natural gas operations are conducted by Southern
6 Company Gas (SCG). In July 2016, The Southern Company acquired the assets of
7 SCG, the owner of AGL Resources Inc., which provides natural gas distribution
8 service in seven states. Regulated natural gas operations within SCG include, but
9 are not limited to, Virginia Natural Gas, Atlanta Gas Light Company, and Nicor
10 Gas.

11 **Q7. WOULD YOU PROVIDE A SENSE OF THE SCOPE OF SCG'S NON-**
12 **REGULATED ACTIVITIES AND AFFILIATES?**

13 A7. SCG also conducts a number of non-regulated commercial activities, including gas
14 marketing, home protection services, gas storage, arbitrage activities, and mid-
15 stream activities. In total there are 82 entities that operate within the SCG
16 organization.² The entities do not include other Southern Company affiliates that
17 are not within the SCG umbrella. Corporate services are provided within SCG by
18 its affiliate, Atlanta Gas Service Company (AGSC).

19 In 2017, AGSC incurred costs in excess of \$274 million that were charged to
20 various SCG affiliates.³ Of this amount, over \$5.2 million was charged to CGC,
21 representing approximately 40% of CGC's 2017 total non-purchased gas O&M
22 costs.

² Determined by counting the entities listed in Consumer Advocate Discovery Request No. 1-15.

³ Response to Consumer Advocate Discovery Request No. 1-41.

Table 1	
Adjustments to O&M	Amount
Test Period O&M	12,067,184
Adjustment 5 Rate Case Amortization	115,718
Attrition Period O&M	10,964,177

I am recommending the Commission approve adjustments on lines 1-4 and 6 above. Mr. Novak, in his testimony describes and recommends the Commission approve the adjustments on line 5.

Q11. PLEASE SUMMARIZE YOUR ADJUSTMENT CONCERNING INCENTIVE COMPENSATION COST, AS SHOWN ON TABLE 1, ADJUSTMENT 1.

A11. This adjustment eliminates \$ [REDACTED] in O&M costs associated with Incentive Compensation costs. The components of this adjustment include [REDACTED] of Incentive Compensation associated with direct CGC labor costs, and [REDACTED] in Bonus and Long-Term Incentive Compensation allocated to CGC from its affiliate AGSC.

Q12. WERE YOU SURPRISED AT THE LEVEL OF INCENTIVE COMPENSATION IN THIS CASE?

A12. Yes. The magnitude of allocated Incentive Compensation is surprisingly large given the relatively small size of CGC's operations. The CGC Test Period unadjusted O&M charges, excluding gas costs, are just over \$12 million. Therefore, the Incentive Compensation costs represent over [REDACTED] % of the total CGC O&M charges.

1 **Q13. AS BACKGROUND, PLEASE DESCRIBE THE TYPES OF INCENTIVE**
2 **COMPENSATION AND THE BASIS UPON WHICH SUCH COSTS ARE**
3 **PAID OUT TO EMPLOYEES.**

4 A13. The Southern Company has two types of Incentive Compensation, short-term and
5 long-term.⁵ The short-term program is referred to as the Performance Pay
6 Program and is available to all employees. The Long-Term Incentive
7 Compensation program is available to employees in a certain pay grade.⁶ The split
8 of the total Incentive Compensation recorded on CGC books in the Test Period
9 split between Short-Term and Long-Term is:

10 Short-Term: \$ [REDACTED]

11 Long-Term: \$ [REDACTED]

12 **Q14. WHAT IS YOUR RATIONALE FOR YOUR RECOMMENDATION TO**
13 **REMOVE INCENTIVE COMPENSATION EXPENSE FROM TEST**
14 **PERIOD O&M?**

15 A14. A significant portion of the Short-Term Incentive Compensation payouts are
16 driven by corporate and business unit financial performance that directly benefits
17 The Southern Company shareholders and therefore such costs should not be borne
18 by CGC ratepayers. These corporate and business unit financial performance
19 goals include metrics that measure The Southern Company's Earnings Per Share
20 (EPS)⁷ and those that measure SCG's net income. Further, all Long-Term
21 Incentive Compensation is designed to encourage eligible employees to enhance
22 per-share increases in The Southern Company stock price. The higher the stock
23 price relative to its group of peer electric utilities, the greater the employee payout.

⁵ Response to Consumer Advocate Discovery Request No. 1-117a and b.

⁶ Apparently, there are no Tennessee-based employees eligible for Long-Term Incentive Compensation as there are no Long-Term Incentive Compensation costs incurred directly by CGC.

⁷ Given the scope and scale of The Southern Company's electricity operations, most of The Southern Company EPS goals will be driven by the financial performance of its electric utility operations. CGC Earnings contribute less than \$.01/share for The Southern Company.

1 Such compensation is designed to benefit shareholders and is not the type of cost
2 that is appropriate to include in the CGC revenue requirement. The adjustment to
3 CGC Labor costs totals \$ [REDACTED] while the adjustment to Allocated Costs totals
4 \$ [REDACTED]. This adjustment is set forth in Consumer Advocate Schedule No. 4-1.
5 My recommendation to remove these costs is consistent with the TPUC Order
6 approving the Stipulation and Agreement in Docket No. 14-00146, in which
7 Atmos Incentive Compensation costs were removed.⁸

8 **Q15. PLEASE CONTINUE WITH A DISCUSSION OF THE SECOND**
9 **ADJUSTMENT YOU ARE SUPPORTING REGARDING PENSION AND**
10 **OPEB COSTS, AS SHOWN ABOVE ON TABLE 1, ADJUSTMENT 2.**

11 A15. This adjustment increases O&M expense for cash pension contributions⁹ and
12 reduces O&M for accrued pension and Other Post Employment Benefit (OPEB)
13 costs. The net adjustment reduces O&M costs \$ [REDACTED] as set forth in Consumer
14 Advocate Schedule No. 4-2.

15 **Q16. WHAT IS THE RATIONALE FOR THIS ADJUSTMENT TO PENSION**
16 **AND OPEB COSTS?**

17 A16. This adjustment is consistent with a prior TPUC decision involving a Tennessee
18 American Water Company (TAWC) rate case in Docket No. 08-00039.¹⁰ In that
19 case, TPUC adopted the Cash Contribution Approach to defining Pension Expense
20 rather than the accrued accounting costs proposed by TAWC. More recently,
21 TPUC also adopted the Cash Contribution Approach to determining pension and
22 OPEB costs in Docket No. 14-00146, Atmos' general rate case.

23 **Q17. PLEASE SUMMARIZE YOUR RECOMMENDATION CONCERNING**
24 **YOUR ADJUSTMENT TO REMOVE GOVERNMENTAL AFFAIRS**

⁸ TPUC Order 14-00146 dated November 4, 2015.

⁹ When asked in Consumer Advocate Discovery Request No. 1-308, CGC only referenced cash contributions to its pension plan and did not identify any cash contributions to its OPEB plan.

¹⁰ TPUC Order dated January 13, 2009.

1 **LABOR CHARGES AND CERTAIN RELATED CHARGES FROM THE**
2 **COMPANY'S PROPOSED O&M COSTS, AS SHOWN ON TABLE 1,**
3 **ADJUSTMENT 3.**

4 A17. This Adjustment eliminates \$ [REDACTED] (Marked by the Company as Confidential)
5 in Governmental Affairs labor charges from the Test Period O&M costs, as well as
6 associated benefit costs and a small portion of organizational dues that relate to
7 lobbying. Of the total adjustment amount, \$ [REDACTED]¹¹ is allocated from AGSC;
8 \$ [REDACTED]¹² is allocated to CGC through AGSC from Southern Company Services;
9 \$ [REDACTED] is benefit costs associated with the above allocated labor; and \$ [REDACTED]
10 relates to the portion of organizational dues related to lobbying.¹³ This adjustment
11 is set forth and supported in Consumer Advocate Schedule No. 4-3.

12 **Q18. PLEASE EXPLAIN YOUR RATIONALE FOR ELIMINATING COSTS**
13 **ASSOCIATED WITH CGC'S AND AGSC'S GOVERNMENTAL AFFAIRS**
14 **FUNCTION.**

15 A18. The job descriptions associated with these charges were provided by CGC in
16 Consumer Advocate Discovery Request No. 1-41 and were identified by CGC as
17 Confidential.

18 [REDACTED]
19 [REDACTED]
20 [REDACTED]
21 [REDACTED]
22 [REDACTED]
23 [REDACTED]
24 [REDACTED]
25 [REDACTED]
26 [REDACTED]
27 [REDACTED]
28 [REDACTED]
29 [REDACTED]

¹¹ Response to Consumer Advocate Discovery Request No. 1-141.

¹² Response to Consumer Advocate Discovery Request No. 1-119.

¹³ Response to Consumer Advocate Discovery Request No. 1-154.

1 [REDACTED]
2 [REDACTED]
3 [REDACTED]
4 These tasks are consistent with the Federal Energy Regulatory Commission's
5 (FERC) definition of Account 426.4 "Expenditures for certain civic, political and
6 related activities".¹⁴ This account is considered 'below the line' for ratemaking
7 purposes and therefore should be excluded from the determination of CGC's
8 revenue requirement.

9 **Q19. PLEASE SUMMARIZE YOUR RECOMMENDED ADJUSTMENT TO**
10 **REFLECT CHANGES TO AGSC'S CORPORATE COST ALLOCATIONS,**
11 **AS SHOWN ON TABLE 1, ADJUSTMENT 4.**

12 A19. This adjustment reduces the Company's proposed O&M charges, \$[REDACTED], by
13 modifying AGSC's Composite Allocation Ratio. The use of a general allocator is
14 a common practice within the utility industry to assign costs that cannot be
15 allocated using a more specific allocator.

16 While AGSC's Composite Ratio uses four factors (identified and discussed
17 below), I modify the ratio to exclude one of the four factors AGSC uses in the
18 computation of the ratio, resulting in a reduction in costs allocated from AGSC to
19 CGC.

20 **Q20. WOULD YOU DESCRIBE THE COMPOSITE RATIO AND HOW IS IT**
21 **USED BY AGSC TO ALLOCATE COSTS?**

22 A20. The AGSC Composite Ratio is a general allocator that is applied to the residual
23 costs of AGSC that are not assigned to affiliates using a more specific allocation

¹⁴ The FERC definition for account 426.4 is as follows: This account shall include expenditures for the purpose of influencing public opinion with respect to the election or appointment of public officials, referenda legislation or ordinances, or approval, modification or revocation of franchises; or for the purpose of influencing the decisions of public officials, but shall not include such expenditures which are directly related to appearances before regulatory or other governmental bodies in connection with the reporting utility's existing or proposed operations.

¹⁸ Code of Federal Regulations Chapter 1, Subchapter F, Part 201.

ratio. In this sense it is a 'general' allocator that is applied to those costs that AGSC believes cannot be assigned using another method.

Q21. HOW DOES AGSC CALCULATE THE COMPOSITE RATIO?

A21. The Composite Ratio is the average factors for the following four categories as defined by the ratio of CGC data to total SCG's data: a) total assets, less receivables, b) full time equivalent employees, c) Operating Margin, and d) Operating Expenses.

Q22. PLEASE IDENTIFY WHICH OF THE FACTORS YOU HAVE EXCLUDED.

A22. I have excluded the Operating Expense portion of the Composite Ratio.

Q23. WHY HAVE YOU EXCLUDED THIS FACTOR?

A23. This factor includes a significant level of allocated charges since it is based upon total operating expenses, therefore this allocator is circular in nature. In other words, Operating Expenses include allocated costs and I do not believe it is appropriate to then allocate costs subject to the composite allocator which in part are based upon total allocated costs for the prior quarter. Therefore, I have excluded the operating expense allocator and recalculated the Composite Ratio based upon the average of the three factors for each of the four quarters in 2017.

Q24. DESCRIBE YOUR APPROACH AFTER EXCLUDING THE OPERATING EXPENSE ALLOCATOR.

A24. After excluding the operating expense allocator, I applied the revised Composite Ratio to the total AGSC charges that were subject to the Composite Ratio. The result is a reduction in O&M costs of \$ [REDACTED] as set forth on Consumer Advocate Schedule No. 4-4. The recalculated Composite Ratio is shown below in Table 2.

1 ** Note: Chart has been marked Confidential by the Company per Protective
2 Order.

Table 2				
Calculation of Composite Ratio				
A/ 2017	Assets Less Receivables	Full Time Employees	Operating Margin	Average
A/	CONFIDENTIAL CPAD-1-347h,i,j,&k			

3
4 **Q25. WERE YOU ABLE TO VERIFY THE ACCURACY OF THE COMPOSITE**
5 **RATIO USED BY AGSC?**

6 A25. No. I have not able to confirm the accuracy of AGSC Composite Ratio.

7 **Q26. WHY WERE YOU UNABLE TO CONFIRM THE ACCURACY OF**
8 **AGSC'S COMPOSITE RATIO?**

9 A26. A number of SCG's entities have been excluded from the development of the
10 Composite Ratio, due to very little or no commercial operations according to
11 CGC.¹⁵

12 **Q27. ARE YOU CONCERNED WITH THE NUMBER OF ENTITIES**
13 **EXCLUDED FROM THE DEVELOPMENT OF THE COMPOSITE**
14 **RATIO?**

15 A27. Yes. My concern is that SCG (or AGSC) may exclude certain competitive
16 enterprises in the development of allocation ratios to assign more costs to

¹⁵ See response to Consumer Advocate Discovery Request No 1-347.

1 regulated entities, including CGC. Entities that are excluded from AGSC's
2 Composite Ratio are not assigned common costs, therefore leaving more costs
3 assigned to regulated entities such as CGC.¹⁶

4 To illustrate my concern, in response to Consumer Advocate Request No. 1-356, a
5 sample of seven nonregulated entities were selected and their financial statements
6 requested to determine whether in fact they had little or no commercial activity.
7 After an initial objection and much discussion, the requested information was
8 provided on June 11, 2018. [REDACTED]

9 [REDACTED]
10 [REDACTED]
11 [REDACTED] This concern then
12 extends to the other non-regulated (competitive) entities that are also excluded
13 from receiving composite cost allocations. I will discuss additional deficiencies
14 related to the Company's Cost allocation process later in my testimony.

15 ** Note: Chart was marked Confidential by the Company per Protective Order.

Table 3	
	Affiliate Sampled
[REDACTED]	

16 **

¹⁶ I specifically reserve the right to amend my testimony given the late filing of compelled responses to Consumer Advocate Discovery Request No. 1-400.

1 **Q28. PLEASE DESCRIBE YOUR ADJUSTMENT TO O&M COSTS RELATED**
2 **TO THE ATTRITION PERIOD, AS SHOWN ON TABLE 1,**
3 **ADJUSTMENT 6.**

4 A28. This adjustment increases O&M costs \$ [REDACTED] to move the Consumer Advocate
5 adjusted Test Period costs to the Attrition Period.

6 **Q29. PLEASE EXPLAIN HOW YOU CALCULATED THE ATTRITION**
7 **PERIOD FACTORS USED WITHIN YOUR ADJUSTMENT.**

8 A29. Three inflation factors were developed, including labor, customer growth and a
9 composite growth factor. The labor growth factor was calculated based upon the
10 two-year average growth in CGC O&M labor costs. This factor was then doubled
11 to reflect the estimated growth in the two-year period between 2017 to the 2019
12 Attrition Period. The customer growth factor was developed by Mr. Novak and
13 described in his testimony. The Consumer Advocate's Composite Factor was
14 developed based upon the annual average 2018 CPI factors developed by CGC in
15 Minimum Filing Guidelines (MFG) No. 43. This annual factor was then doubled
16 to reflect the two-year period between the Test Period and the Attrition Period.

17 **Q30. HOW DID YOU APPLY TEST PERIOD COSTS TO THE ATTRITION**
18 **PERIOD FACTORS?**

19 A30. The Test Period O&M costs were classified into one of the three categories, the
20 labor factor was then applied to CGC direct labor, the customer growth factor was
21 applied to Customer related O&M costs, and the composite growth factor was
22 applied against the remainder of the Consumer Advocate adjusted Test Period
23 O&M expenses. The result is an increase in O&M costs of [REDACTED] to estimate
24 the Attrition Period O&M costs based upon the Consumer Advocate adjusted Test
25 Period.

Q31. IN ADDITION TO THE ADJUSTMENTS YOU RECOMMENDED EARLIER, ARE THERE ANY OTHER SIGNIFICANT DIFFERENCES BETWEEN YOUR ATTRITION PERIOD COSTS AND THOSE PROPOSED BY CGC?

A31. Yes. One significant difference is the CGC assumption that it would increase its Tennessee-based employee count by 25% between the Test Period and its Attrition Period. Table 4 below shows the difference between the Consumer Advocate's adjusted Attrition Period and that included by CGC in this filing:

Table 4 - Summary of Attrition Period Payroll Expense					
	A/		CPAD Attrition Period FYE 12-31-19	B/	CPAD - CGC Difference
	CPAD Test Period FYE 12-31-17			CGC Attrition Period FYE 6-30-19	
Payroll Expense	\$ 3,010,584		\$ 2,929,318	\$ 3,537,716	\$ (608,398)
A/ CPAD Exhibit, Schedule 9-12					
B/ CGC TPUC MFG 25 All Attachments and Tucker Exhibits Rev 6-1-2018, Tab O&M					

History suggests the 25% increase in CGC labor is an unrealistic assumption and one that appears to be an attempt to increase the revenue requirement without any real substance. CGC points to the aging work force; however, gas utilities have faced this issue for some time now without such a large increase. Further, new employees tend to be compensated less than retiring employees.¹⁷ The situation of an aging workforce may be a temporary challenge, but not one that justifies an extraordinary permanent increase in the forecasted CGC labor count significantly in excess of historic employment levels.

Table 5 as shown below highlights the consistent employment levels of CGC contrasted with the number of budgeted employees assumed as of December 31, 2018.¹⁸

¹⁷ For a comparison of the per employee costs associated with new hires compared with retirees, compare the Company's responses to Consumer Advocate Discovery Request Nos. 1-139. and 1-140.

¹⁸ The Consumer Advocate would point out that utilities have strong incentives to inflate budgeted costs within its Attrition Period in the context of a rate case.

Table 5		
Comparison of Actual and Budgeted Employee Count		
A/		
Period	Actual Employees	Budgeted Employees
12/31/2012	39	41
12/31/2013	40	42
12/31/2014	39	40
12/31/2015	38	39
12/31/2016	39	39
12/31/2017	40	45
12/31/2018	N/A	50
A/	Response to CPAD DR 1-122	

III. ATTRITION PERIOD TAXES OTHER THAN INCOME TAXES

Q32. PROVIDE A SUMMARY OF YOUR RECOMMENDATIONS REGARDING TAXES OTHER THAN INCOME TAXES.

A32. The Test Period balances of taxes were determined, and appropriate factors were applied to calculate the Attrition Period balances. The majority of Taxes Other than Income Taxes are comprised of Property Taxes. Other components include TPUC Inspection Fees, Payroll Taxes, Franchise Taxes and Gross Receipts Tax.

Q33. EXPLAIN HOW YOU ARRIVED AT THE ATTRITION YEAR BALANCES.

A33. The Test Period balances of Taxes Other than Income Taxes were determined as set forth on Consumer Advocate Schedule No. 10-1. The Test Period balances were increased using growth factors related to each tax item. Property Taxes were increased over the two-year period based upon the forecasted growth in plant. State Gross Receipts Taxes and State Franchise Taxes were increased based upon the growth in forecasted Attrition Period revenue compared to Test Period revenue. Net Payroll Taxes were increased based upon the forecasted growth in

1 payroll over the two-year period, and the TPUC Inspection Fees were increased
2 using the composite attrition period factor based upon CGC's CPI factors. The
3 resulting adjustment in Test Period costs is \$293,184 as identified in Consumer
4 Advocate Schedule No.10-1.

5 **IV. ATTRITION PERIOD CASH WORKING CAPITAL**

6 **Q34. PLEASE PROVIDE A SUMMARY OF YOUR RECOMMENDATIONS**
7 **CONCERNING CASH WORKING CAPITAL.**

8 A34. My Cash Working Capital (CWC) calculation excludes the Return on Equity from
9 the balance of Operating Expenses subject to calculating the Daily Cost of Service.
10 The Daily Cost of Service is then applied to the Net Lag Days to determine the
11 CWC required for Operating Expenses. My adjustment also incorporates the test
12 period average balance of Tax Collections Withheld.

13 **Q35. PLEASE PROVIDE AN OVERVIEW OF CWC, HOW IT IS**
14 **DETERMINED AND HOW IT IMPACTS THE DETERMINATION OF A**
15 **UTILITIES' REVENUE REQUIREMENT.**

16 A35. CWC is a measurement of the amount of cash a company requires to have on hand
17 to fund day-to-day operations. The most precise method of determining CWC is
18 through the use of a lead-lag study, such as the one presented by CGC witness
19 Adams in this case. A CWC study measures the timing between when revenue is
20 earned and when it is received, when cash expenses are incurred and when they are
21 paid. These measurements are netted to determine the amount of funding required
22 to provide utility service. This level of funding, or investment is appropriately
23 included as a component of Rate Base. The level of CWC in Rate Base may be
24 positive or negative depending upon the outcome of the study.

1 **Q36. WHAT IS THE AMOUNT OF CWC YOU ARE SUPPORTING AS AN**
2 **ADJUSTMENT TO CGC RATE BASE?**

3 A36. Consumer Advocate Schedule No. 5 sets out the Net CWC required of \$150,702.
4 This compares with a CGC request to increase Rate Base \$1,521,871.

5 **Q37. YOU MENTION ABOVE THAT YOU HAVE REMOVED RETURN ON**
6 **EQUITY IN THE CALCULATION OF DAILY OPERATING EXPENSES**
7 **THAT THEN ARE USED TO COMPUTE THE BALANCE OF CWC –**
8 **PLEASE EXPLAIN YOUR RATIONALE.**

9 A37. First, Return on Equity is a non-cash expense that does not generate a cash
10 requirement on behalf of CGC or The Southern Company. The payment of
11 shareholder dividends is optional, and the vast majority of Net Income is retained
12 by the Company. If dividends are paid, they are done so in arrears, with a
13 significant expense lag. This lag has not been factored into Mr. Adams' analysis,
14 assuming a conclusion that some aspect of Return on Equity represented a
15 requirement to outlay cash to fund operations. Finally, investors recognize that the
16 receipt of cash associated with Return on Equity is not instantaneous and that any
17 such delays are already factored into shareholder expectations.

18 The purpose of a lead lag study is to determine the cash necessary to fund
19 operating expenses. The Return on Equity is neither a cash item, nor an operating
20 expense and it does not qualify as a component of the cash working capital
21 study.¹⁹

22 **Q38. HAS TPUC ADOPTED A CWC CALCULATION EXCLUDING EQUITY**
23 **FROM THE CALCULATION OF DAILY OPERATING EXPENSES?**

24 A38. Yes. The Commission adopted a Stipulation and Agreement in Docket No. 12-
25 00049, a Tennessee American Water Company rate case that excluded Return on

¹⁹ I have not excluded other non-cash items from the CWC study, such as Depreciation Expense and Deferred Taxes, and I believe the exclusion of these items may be warranted in future studies after further consideration.

Equity costs from the calculation of Daily Operating Expenses, and therefore it was completely excluded from determination of CWC in that case.

Q39. ARE YOU AWARE OF OTHER STATE REGULATORS' ORDERS SUPPORTING THE EXCLUSION OF RETURN ON EQUITY FROM THE DETERMINATION OF THE CWC CALCULATION?

A39. Yes. The Return on Equity component was not included in lead lag study, by the Illinois Commerce Commission in a Nicor Gas Company rate case.²⁰ Likewise, the Return on Equity component was not included in the CWC calculation of Kansas Gas Service in Docket No. 06-KGSG-1209-RTS.

In a case before the Hawaii Public Utilities Commission²¹, the Commission found:

Return on common equity does not represent any expenses incurred in providing service to which any revenue relates. Thus, **return on common equity is excluded from consideration in computing working cash.** (emphasis added.)²²

Q40. IS THERE ANY OTHER SIGNIFICANT DIFFERENCE BETWEEN CGC'S CALCULATION OF CASH WORKING CAPITAL REQUIREMENTS AND THE METHOD SUPPORTED IN CONSUMER ADVOCATE SCHEDULE NO. 5?

A40. Yes. The other area of difference is in the determination of the working capital provided from Franchise, Sales and Use taxes. These are items that are collected from CGC ratepayers and later remitted by the Company to appropriate taxing authorities. The retention of these funds prior to remittance provides a source of ongoing working capital for the Company. I have relied upon the use of the Test Period average balance of these liability accounts to quantify the amount of funds available to CGC. This method is identical to that used to determine the gas

²⁰ Illinois Commerce Commission Docket No. 17-0124.

²¹ *In Re Hawaii Electric Light Company, Inc.*, 120 P.U.R. 4th 427 (Haw. Pub. Util. Comm'n, March 6, 1991).

²² The Process of Ratemaking, Vol. II, Leonard Saul Goodman, Public Utilities Reports, Inc.

1 inventory portion and Materials and Supplies components of rate base and
2 therefore provides for consistency.

3 **V. ACCUMULATED DEFERRED INCOME TAXES AND TCJA AMORTIZATION**

4 **Q41. PLEASE SUMMARIZE YOUR RECOMMENDATION REGARDING**
5 **ACCUMULATED DEFERRED INCOME TAXES, THE TCJA AND**
6 **ITS IMPLICATIONS ON THE REVENUE REQUIREMENT OF CGC.**

7 A41. I am recommending that the Tax Savings accruing for the period January 1,
8 2018 through September 30, 2018 resulting from the reduction in the federal
9 tax rate from 35% to 21% be amortized and returned to CGC ratepayers over a
10 three-year period. Similarly, the excess ADIT resulting from the tax rate
11 reduction should be returned to CGC ratepayers over a three-year period. The
12 amortization of the balances of both the tax savings and the excess ADIT
13 should not begin until new base rates in this case become effective.

14 **Q42. PLEASE BEGIN BY PROVIDING SOME BACKGROUND**
15 **INFORMATION ON THE TAX CUTS AND JOBS ACT.**

16 A42. In December, 2017 the President signed the Tax Cuts and Jobs Act into law. The
17 new legislation lowered the federal tax rate for corporations from 35% to 21%
18 effective January 1, 2018. This reduction in the federal tax rate has significant
19 implications for balances of Accumulated Deferred Income Taxes (ADIT), an
20 important source of cost-free capital for utilities. These deferred income taxes
21 arise from the difference in determination of taxable income compared with book
22 income calculated consistent with Generally Accepted Accounting Principles

1 (GAAP). The single largest difference²³ in these two measures of income is the
2 determination of depreciation. Accelerated tax depreciation, including the use of
3 bonus depreciation,²⁴ is used to reduce taxable income, while book income
4 incorporates much lower depreciation rates.

5 **Q43. HOW DOES THIS DIFFERENCE BETWEEN BOOK INCOME AND**
6 **TAXABLE INCOME AFFECT THE CALCULATION OF ADIT?**

7 A43. This cumulative²⁵ difference between taxable and book income is then applied
8 against the composite federal and state income tax rate,²⁶ and the result is the
9 balance of ADIT²⁷. Income tax expense included in regulated utility rates is
10 determined based upon the higher level of book income, therefore the balance of
11 deferred taxes reflects amounts of expense incurred by the utility and collected
12 from ratepayers, but which will not be paid in the form of current tax expense until
13 some point in the future. Thus, deferred taxes are a source of cost-free capital that
14 utilities may use to fund capital investment and is used to reduce rate base in the
15 rate-setting process.

²³ There are other differences in the measurement of the two income levels. Generally, taxable income relies more on cash expenses, while book income incorporates accrued expenses.

²⁴ Bonus depreciation has been in effect for a number of years; however, the TCJA prohibits the use of bonus depreciation for utilities beginning in 2018.

²⁵ The cumulative difference is measured as a running total of these book and tax differences.

²⁶ The composite tax rate is 26.135% and reflects the 6.5% state tax rate and the 21% statutory federal tax rate. Since state taxes are deductible for purposes of calculating federal tax expense, the composite rate is less than the sum of the two rates.

²⁷ The cumulative book and tax differences are multiplied by the composite tax rate in arriving at the balance of ADIT.

1 **Q44. WHAT EFFECT DOES THE REDUCTION IN THE FEDERAL TAX RATE**
2 **HAVE ON THE BALANCE OF ADIT?**

3 A44. The balance of ADIT is a function of the composite federal/state tax rates.
4 Therefore, since the federal tax rate was significantly reduced, the balance of
5 ADIT is reduced accordingly. However, the ADIT balance (pre-TCJA) reflects
6 the collection of income tax expense accrued by utilities, but which will not be
7 paid until some point in the future. Ratepayers fund these tax pre-payments and
8 therefore have a claim on the balance of ADIT that is reduced as a result of the
9 reduction in the federal income tax rate.

10 **Q45. HAS THE TENNESSEE PUBLIC UTILITY COMMISSION IDENTIFIED**
11 **THE REDUCTION IN ADIT ARISING FROM THE TCJA AS A**
12 **REGULATORY ISSUE IN ANY DOCKET?**

13 A45. Yes. TPUC addressed this point in Docket No. 18-00001 when it required utilities
14 to calculate the excess deferred tax reserve caused by the reduction in the
15 corporate federal income tax rate.²⁸ TPUC further required this excess balance be
16 captured as a deferred liability on the books of Tennessee's largest investor-owned
17 utilities, in order to accurately measure the ongoing cost-free capital provided by
18 ratepayers.²⁹ This excess ADIT reflects the reduction in the liability balance that
19 results from the reduction in the composite rate due to the federal tax rate change.

²⁸TPUC Docket No. 18-00001, TPUC Order Opening an Investigation and Requiring Deferred Accounting Treatment, Order dated February 6, 2018.

²⁹ TPUC Docket No. 18-0001.

1 **Q46. IS THERE A SPECIFIC DOCKET SET UP TO ADDRESS REGULATORY**
2 **ISSUES SURROUNDING THE TCJA FOR CGC?**

3 A46. Yes. TPUC Docket No. 18-0035 was initiated to address the regulatory
4 implications of the TCJA on CGC.

5 **Q47. DID CGC SUPPORT THE CONCEPT OF ADDRESSING ALL TCJA**
6 **IMPACTS IN ITS PENDING RATE CASE?**

7 A47. Yes.

8 **Q48. HAS CGC COMPLIED WITH THIS PORTION OF THE TPUC**
9 **REQUEST?**

10 A48. CGC has only partially complied with this requirement. Effective with the TCJA
11 implementation in late December, 2017, CGC has identified its excess ADIT
12 balance and moved it to a regulatory liability balance. However, at least for
13 purposes of this case, CGC has begun to amortize its excess ADIT balance,³⁰
14 which is not in compliance with the TPUC order and which has negative
15 implications for CGC ratepayers which I will discuss later in my testimony.

16 **Q49. DOES THE TCJA CONTAIN REQUIREMENTS FOR HOW**
17 **REGULATORS MUST TREAT EXCESS ADIT WITHIN THE**
18 **RATEMAKING PROCESS?**

19 A49. The TCJA requires specific treatment for the portion of excess ADIT, known as
20 “Protected”. “Protected” excess ADIT relates to property-related book and tax
21 timing differences and the TCJA requires that such excess be amortized over the
22 life of the collective assets giving rise to the ADIT using one of two amortization

³⁰ It is unclear whether CGC has begun the amortization on its books that is reflected in its Amended MFG 69-13.

1 methods³¹. Excess ADIT balances related to timing differences other than
2 property, referred to as “Unprotected”, may be addressed at the discretion of state
3 regulatory commissions, including TPUC. “Unprotected” ADIT is essentially all
4 other book and tax timing differences other than those related to property.

5 **Q50. DO YOU BELIEVE THE IMPACTS OF THE TCJA MAY BE ADDRESSED**
6 **FOR CGC WITHIN THIS RATE CASE FILING?**

7 A50. Yes.

8 **Q51. CAN YOU PLEASE LIST THE REVENUE REQUIREMENT**
9 **IMPLICATIONS OF THE TCJA?**

10 A51. Yes. Implications of the TCJA on the CGC revenue requirement include:

- 11 1. Reduction in the federal income tax rate from 35% to 21% effective
12 with the implementation of new base rates.
- 13 2. Identification of Excess ADIT further split between the “Protected” and
14 “Unprotected” categories.
- 15 3. Annual Amortization expense calculation of the “Protected” excess
16 ADIT associated with property-related book tax timing differences.
- 17 4. Period used to amortize excess “Unprotected” ADIT as a reduction to
18 Operating Expenses.
- 19 5. The timing of amortizing all excess ADIT, which impacts the Attrition
20 Period balance of unamortized ADIT as a rate case component.

³¹ The two methods are the Average Rate Assumption Method and the Reverse South Georgia Method. In both approaches the objective is to amortize the “Protected” Excess ADIT over the life of the remaining assets.

1 6. The proposal by CGC to retain tax expense saving for the period
2 between January 1, 2018 and the date new rates become effective.

3 **Q52. REFERRING TO THE ABOVE LIST, ARE THERE ASPECTS OF THE**
4 **TCJA FOR WHICH YOU AGREE WITH THE METHODS USED BY**
5 **CGC?**

6 A52. Yes. I agree with CGC's treatment of the following aspect of the TCJA:

7 1. Reduction in the federal income tax rate from 35% to 21% effective
8 with the implementation of new base rates. This issue is the single most
9 significant aspect of the TCJA and I agree with the use of the lower tax rate as
10 used by CGC within its Income Tax Expense calculations for purposes of setting
11 rates on a going forward basis.

12 2. Identification of Excess ADIT further split between the "Protected" and
13 "Unprotected" categories. I have reviewed the determination of excess ADIT and
14 have no objection with CGC's calculation of the deferred liability and the resulting
15 lower ADIT balance.³² I further have no objection with the CGC calculated
16 determination of the "Protected" and "Unprotected" portions of the excess ADIT
17 (deferred regulatory liability).

18 3. Annual Amortization expense calculation of the "Protected" excess
19 ADIT associated with property-related book tax timing differences. I have no
20 objection with CGC's amortization of excess "Protected" ADIT. This
21 amortization results in a credit to pro-forma Income Tax Expense over the life of
22 the assets, thus reducing the revenue requirement.³³ However, I disagree with the

³² Supplemental Response to Consumer Advocate Discovery Request No. 1-374.

³³ Of the total Amortization of Deferred Tax Liability per CGC of \$897,742 as shown on RDJ No.1-3 (revised in MFG No. 25), \$397,482 relates to "Protected" Excess ADIT (MFG No. 69-13 revised).

1 timing of this amortization as CGC has initiated amortization in advance of
2 approval by TPUC as I will discuss below.

3 **Q53. AGAIN, REFERRING TO THE LIST ABOVE, ARE THERE ASPECTS OF**
4 **CGC IMPLEMENTATION OF THE TCJA WITH WHICH YOU**
5 **DISAGREE?**

6 A53. Yes. Identified below are aspects of CGC's implementation of the TCJA with
7 which I disagree.

8 1. Period used to amortize excess "Unprotected" ADIT as a reduction to
9 Operating Expenses. CGC proposes to amortize its balance of "Unprotected"
10 ADIT to the cost of service over a five-year period. Ironically, CGC has proposed
11 a five-year amortization period for the amortization of rate case expense, an item
12 that increases the revenue requirement. I propose using a three-year amortization
13 period. These amounts belong to ratepayers, justifying a shorter amortization
14 period. Further, the three-year period is consistent with the period used to
15 amortize rate case costs. The use of a three-year amortization period reduces
16 O&M costs \$253,143 as shown on Consumer Advocate Schedule No. 11-1.2,
17 compared with the use of a five-year amortization period.

18 2. The timing of amortizing all excess ADIT, which impacts the Attrition
19 Period balance of unamortized ADIT as a rate case component. CGC has reflected
20 its Attrition Period balance of its unamortized excess ADIT balance. I do not
21 object to the proposal that the unamortized excess ADIT balance reflects cost-free
22 capital that is properly included as a rate base deduction. However, CGC has
23 prematurely begun amortizing and retaining these benefits as of December,

1 2017,³⁴ thus reducing its unamortized balance. Rather than initiating the
2 amortization of the excess ADIT³⁵ as of December, 2017, I recommend TPUC
3 require initiating of the amortization to begin as of the effective date of new base
4 rates in this case. In this way, CGC ratepayers receive the full benefit of the
5 excess ADIT. CGC has begun amortizing ADIT which translates to retention of
6 the benefits of the TCJA for its shareholders to the detriment of its ratepayers.
7 Further, such amortization of excess ADIT balances is not provided for in the
8 TPUC order initiating an investigation in Docket No. 18-00001. The amortization
9 of both components of excess ADIT should commence with the implementation of
10 base rates. In this manner, the ratemaking impact of TCJA is synchronized with
11 new base rates. CGC should not be permitted to retain any portion of the excess
12 ADIT, which would occur if this adjustment is not adopted.

13 3. The proposal by CGC to retain tax expense saving for the period
14 between January 1, 2018 and the date new rates become effective. TPUC
15 established Docket No. 18-00035 as the federal tax reform compliance docket for
16 CGC. On March 29, 2018, CGC submitted comments indicating that since it has
17 historically underearned its authorized return on equity it should be permitted to
18 retain the tax savings resulting from the reduced federal income tax rate effective
19 January 1, 2018. I take exception to this proposal for several reasons. First, the
20 tax savings at issue are generated in 2018. CGC argues³⁶ that its financial results
21 for the prior twelve-month average were below its authorized rate of return, thus it

³⁴ See CGC MFG No. 69-13 revised May 31, 2018.

³⁵ As discussed above the "Protected" portion of excess ADIT is to be amortized over the life of the assets, while CGC is amortizing its excess "Unprotected" ADIT over a five-year period.

³⁶ CGC Compliance Filing and Report, TPUC Docket No. 18-00035, page 2.

1 should be permitted to retain the tax savings. The attribution of 2018 tax savings
2 to 2017 financial results represents a mismatch of accounting periods. Further, the
3 application of savings accruing in 2018 due to financial results occurring in 2017
4 implies rates were unjust and unreasonable. The CGC proposal to attribute 2018
5 savings to 2017 financial results could be interpreted as retroactive ratemaking,³⁷
6 which is the setting of rates to permit a regulated entity from recovering past
7 losses.

8 Secondly, as evidenced by this filing, there is a broad difference of opinion on the
9 regulatory earnings of CGC. Putting aside the potential problem with the
10 retroactive application of 2018 tax savings to 2017 results, I do not believe there is
11 clear evidence that CGC was under-earning during the period in question. The
12 Consumer Advocate has presented evidence in this Docket that CGC has not
13 justified the need for a rate increase.³⁸

14 Finally, the retention of tax savings in 2018 was not provided for within the TPUC
15 Order opening its investigation. There is no language in the Order providing for
16 the retention of 2018 tax savings if a showing of under-earnings was demonstrated.

17 **Q54. WHAT IS YOUR RECOMMENDATION FOR THE REGULATORY**
18 **TREATMENT THAT SHOULD BE AFFORDED CGC'S INCOME TAX**
19 **EXPENSE SAVINGS ACCRUING IN 2018?**

³⁷ One example of retroactive ratemaking is the recovery of past losses in rates charged in the future. This is consistent with the argument made by CGC to apply 2018 tax savings to (alleged) 2017 earnings deficiencies.

³⁸ Please see Mr. Novak's testimony with respect to CGC's claim of over-earning and related data.

1 A54. I believe such savings should be estimated and returned to CGC ratepayers over a
2 three-year period through a credit to a specific Regulatory Amortization Expense.
3 The unamortized balance of these tax savings represents a source of cost-free
4 capital and should be used to reduce rate base. I have estimated the amount of tax
5 savings accruing through September, 2018 at \$560,961.³⁹

6 **Q55. HOW DID YOU ESTIMATE THE AMOUNT OF TAX SAVINGS**
7 **ACCRUING DURING 2018?**

8 A55. I obtained the Income Tax Expense component included in base rates in the last
9 CGC base rate proceeding, TPUC Docket No. 09-00183. This Income Tax
10 Expense component was dependent upon the composite tax rate in effect during
11 that period. Using both the Income Tax Expense component and the composite
12 tax rate I was able to compute the taxable income amount incorporated within the
13 revenue requirement. I then applied the new composite tax rate to the computed
14 taxable income to arrive at a pro-forma level of Income Tax Expense. The
15 difference between the previously authorized Income Tax Expense component and
16 the pro-forma amount of Income Tax Expense reflects an annual level of Income
17 Tax Expense savings attributed to the reduced federal income tax rate. For
18 purposes of this Docket, I assumed new tariff rates as ordered by the Commission
19 would become effective on October 1, 2018, which would then include the
20 reduced federal income tax rate, therefore I reduced the annual tax savings to
21 reflect over-collection of Income Tax Expense for nine months of 2018. I then

³⁹ If rates resulting from this case are implemented on a different date, this tax savings calculated would change accordingly.

amortized the resulting balance over a three-year period to calculate the appropriate credit to the revenue requirement.

The calculation is summarized in Table 6 below.

Table 6			
Line No.	Calculation of 2018 Tax Savings Estimated Through September, 2018		
1	Income Tax Expense Component built into Base Rates Docket 09-00183	\$2,241,272	
2	Total State and Federal Effective Rate - Docket 09-00183	39.225%	
3	Calculated Taxable Income from Docket 09-00183		\$5,713,887
4	Current Composite Federal and State Income Tax Rate	26.135%	
5	Pro-Forma Income Tax Expense - 2018 (Line 3 * Line 4)		\$1,493,324
6	Current Annualized Tax Savings (Line 1 - Line 5)	\$ 747,948	
7	Estimated Portion of Savings - January - September, 2018 (Line 6 * 9 / 12)	\$ 560,961	

This calculation is also shown on Consumer Advocate Schedule No. 11-3.

Q56. HOW DID YOU DETERMINE THE APPROPRIATE REDUCTION TO RATE BASE ASSOCIATED WITH THE UNAMORTIZED TAX SAVINGS DEFERRAL?

A56. Once the total tax savings were determined, I amortized the balance over a three-year period, starting with the estimated date of new base rates, October 1, 2018.

My adjustment to reduce rate base was based upon the average unamortized balance during the 2019 Attrition Period. This balance is reflected on Consumer Advocate Schedule No. 11-1.

Q57. ARE YOU SUPPORTING ANY ADJUSTMENTS TO THE BASE LEVEL OF ADIT PROPOSED BY CGC IN ITS ATTRITION PERIOD?

1 A57. No.

2 **VI. ACCOUNTING POLICY CONCERNS AND RECOMMENDATIONS**

3 **Q58. AT THE OUTSET, PROVIDE SOME CONTEXT ON THE MAGNITUDE**
4 **OF COSTS ALLOCATED TO CGC RELATIVE TO ITS TOTAL O&M**
5 **COSTS.**

6 A58. In 2017, CGC incurred affiliate charges of \$5,229,945,⁴⁰ compared with total 2017
7 O&M costs of \$12,067,183,⁴¹ excluding purchased gas costs.⁴² Therefore, these
8 affiliate charges are a major component of total CGC O&M charges.

9 **Q59. WHAT ENTITY PROVIDES THESE AFFILIATE SERVICES TO CGC**
10 **AND WHAT IS THE SCOPE OF COSTS INCURRED BY THIS**
11 **AFFILIATE?**

12 A59. In 2017, AGSC allocated a total of \$274,687,176⁴³ to affiliates of SCG, including
13 CGC.

14 **Q60. COULD YOU PLEASE SUMMARIZE YOUR CONCERNS WITH THE**
15 **PROCESS USED TO ALLOCATE COSTS TO CGC?**

16 A60. There is a significant lack of transparency and documented processes supporting
17 the cost allocation methodology that I would expect from a very large regulated
18 entity such as The Southern Company. This shortcoming has driven the need for a

⁴⁰ Response to Consumer Advocate Discovery Request No. 1-41.

⁴¹ See Consumer Advocate Schedule No. 9-13.

⁴² Purchased gas expense is not an element of the revenue requirement calculation and therefore is not included in base rates.

⁴³ Response to Consumer Advocate Discovery Request No. 1-41.

1 significant amount of discovery in this Docket. The lack of transparency prevents
2 the Consumer Advocate from drawing conclusions on the reasonableness of the
3 allocated charges. The lack of emphasis in maintaining necessary documentation
4 supporting affiliate transactions within a company the size of SCG⁴⁴ appears to be
5 a corporate strategy designed to prevent the Consumer Advocate and regulators
6 from fully evaluating these charges.

7 **Q61. DOES SOUTHERN COMPANY GAS HAVE A COST ALLOCATION**
8 **MANUAL (CAM) WHICH DOCUMENTS THE PROCESSES AND**
9 **METHODOLOGIES USED IN ALLOCATING COSTS TO ITS ENTITIES?**

10 A61. No.⁴⁵

11 **Q62. WHAT IS THE PURPOSE OF A CAM?**

12 A62. The purpose of a CAM for a regulated entity is two-fold. First, it provides formal
13 specific guidance to employees on the procedures to follow in tracking costs and
14 allocating such costs to the appropriate organization. The existence of the manual,
15 along with periodic training and reinforcement, signifies that compliance with
16 documented procedures is a priority. Secondly, the CAM should be used to
17 support the reasonableness of such allocation methodologies and processes before
18 state regulators. The lack of a CAM raises questions as to whether either of these
19 objectives is a priority within SCG.

20 **Q63. WHAT IS YOUR RECOMMENDATION TO TPUC CONCERNING THE**
21 **LACK OF DOCUMENTATION SUPPORTING THE PROCEDURES**

⁴⁴ My comments are focused on SCG as the vast majority of costs allocated to CGC are incurred at the AGSC level. There are some costs flowing from the Southern Company Services entity that flow to AGSC and then on to CGC, but these costs are relatively minor at the CGC level.

⁴⁵ Response to Consumer Advocate Discovery Request No. 1-12.

1 **RELIED UPON BY AGSC IN ALLOCATING COSTS TO ITS**
2 **AFFILIATES?**

3 A63. I recommend TPUC require future CGC cost allocations to be supported by a fully
4 transparent and documented CAM.

5 **Q64. WHAT IS THE REGULATORY CONCERN REGARDING AFFILIATED**
6 **TRANSACTIONS WITHIN AN ORGANIZATION THAT HAS**
7 **SIGNIFICANT NON-REGULATED ENTITIES?**

8 A64. Entities of the size and scope of the Southern Company (and separately SCG) can
9 maximize overall corporate profitability by adopting cost allocation methods and
10 processes that limit the amount of common costs assigned to competitive, non-
11 regulated entities, resulting in relatively more costs assigned to entities providing
12 monopoly services to captive customers. This concern is heightened as a result of
13 the number of non-regulated entities within SCG.

14 **Q65. WHAT ARE THE ESSENTIAL COMPONENTS OF A CAM THAT YOU**
15 **ARE RECOMMENDING?**

16 A65. The CAM should contain the following sections:

17 1. Corporate organization chart identifying all entities within the overall
18 corporate organization. Each listed entity should have a description of the scope
19 of business operations. There should be a complete explanation supporting the
20 reason not to allocate costs to certain affiliate entities.

21 2. Method used to assign costs; specifically, that costs should be direct
22 charged whenever possible. For those costs that cannot be direct charged, such as
23 those associated with a customer call center should be assigned based upon causal

1 allocators. Finally, those costs that cannot be neither directly assigned, nor
2 causally allocated should be allocated based upon a composite allocation factor.

3 3. Matrix that matches cost centers or accounts and the method(s) used to
4 allocate costs by cost allocation method.

5 4. Quarterly update to allocation ratios. The allocation ratios should be
6 updated quarterly as updated and revised data becomes available that is then used
7 to recalculate the associated allocation ratios.

8 As mentioned in item 4, the CAM is a document that is constantly changing and
9 being updated. Maintaining and ensuring compliance with a CAM requires focus;
10 however, given the magnitude of corporate costs subject to allocation such effort is
11 necessary to ensure accuracy and provide assurance that such material cost
12 assignments between affiliates are justified.

13 **Q66. ARE YOU AWARE OF ANY OTHER TENNESSEE JURISDICTIONAL**
14 **UTILITIES THAT HAVE A CAM?**

15 A66. Yes. Atmos Energy Corporation maintains a CAM provided in response to
16 Consumer Advocate Request No. 3-13 provided in TPUC Docket No. 17-00091.
17 While the Atmos CAM does not contain all of the reference material listed above,
18 it does contain some of the information and the existence of such an updated⁴⁶
19 Service Agreement indicates such cost allocation processes are a corporate
20 priority.

21 **Q67. DID CGC PROVIDE A SERVICE AGREEMENT WHICH IT INDICATED**
22 **GUIDED THE COST ALLOCATION PROCESS?**

⁴⁶ The date of the Atmos CAM is April 1, 2017.

1 A67. Yes. The response to Consumer Advocate Request No. 1-13 indicated that such
2 affiliate services were provided by AGSC to CGC through a Service Agreement.

3 **Q68. DID YOU FIND THE REFERENCED SERVICE AGREEMENT TO BE**
4 **SUFFICIENT TO PROVIDE CONFIDENCE IN THE COST**
5 **ALLOCATION PROCESS?**

6 A68. No. First, the Service Agreement was entered in 2006, a time when the corporate
7 structure that CGC operated in is significantly different than today. The Service
8 Agreement (Agreement) contains none of the information listed above that should
9 be contained in a CAM. Further, there is a lack of identification of methodologies
10 that are consistently used and documented in the cost allocation process

11 **Q69. DID YOU EVALUATE COMPLIANCE WITH THE AGREEMENT?**

12 A69. Yes. CGC was unable to document communication between the parties as is
13 required in the Agreement,⁴⁷ nor is it using types of allocators identified in the
14 Agreement.⁴⁸ The age of the Agreement, including the fact that it had not been
15 updated, coupled with the lack of compliance with the Agreement suggests the
16 Agreement is not being relied upon by Southern Company Gas employees and is
17 not serving a useful purpose.

18 **VII. FAILURE TO PROVIDE CLEAR METHODS OF CALCULATING RATE**
19 **COMPONENTS**

20 **Q70. DO YOU HAVE OTHER CONCERNS WITH RESPECT TO THE**
21 **COMPANY'S ALLOCATIONS, AND SUPPORT SET OUT IN THIS**
22 **GENERAL RATE CASE?**

⁴⁷ See response to Consumer Advocate Discovery Request No. 1-348.

⁴⁸ See response to Consumer Advocate Discovery Request No. 1-355.

1 A70. Yes. I have concerns about whether CGC's accounting data may be reasonably
2 relied upon given the lack of sufficient documentation. The complexity of The
3 Southern Company organization, the lack of transparency regarding the scope of
4 unregulated operations, and the lack of CAM documentation coupled with the
5 magnitude of affiliate cost allocations is an additional source of concern. In view
6 of these issues, in my opinion CGC has failed to set forth the necessary practices
7 and procedures for determining ongoing O&M costs. The lack of documentation
8 does not demonstrate that CGC and SCG has sufficient controls in place to provide
9 assurance that cost allocations to regulated operations are reasonable.

10 **Q71. DOES THIS CONCLUDE YOUR TESTIMONY?**

11 A71. Yes, but I reserve the right to amend or clarify my testimony if additional
12 information or facts become available.

David Dittmore

Experience

Areas of Specialization

Approximately thirty-years experience in evaluating and preparing regulatory analysis, including revenue requirements, mergers and acquisitions, utility accounting and finance issues and public policy aspects of utility regulation. Presented testimony on behalf of my employers and clients in natural gas, electric, telecommunication and transportation matters covering a variety of issues.

Tennessee Attorney General's Office; Financial Analyst September, 2017 – Current

Responsible for evaluation of utility proposals on behalf of the Attorney General's office including water, wastewater and natural gas utility filings. Prepare analysis and expert witness testimony documenting findings and recommendations.

Kansas Gas Service; Director Regulatory Affairs 2014 – 2017; Manager Regulatory Affairs, 2007 - 2014

Responsible for directing the regulatory activity of Kansas Gas Service (KGS), a division of ONE Gas, serving approximately 625,000 customers throughout central and eastern Kansas. In this capacity I have formulated strategic regulatory objectives for KGS, formulated strategic legislative options for KGS and led a Kansas inter-utility task force to discuss those options, participated in ONE Gas financial planning meetings, hired and trained new employees and provided recommendations on operational procedures designed to reduce regulatory risk. Responsible for the overall management and processing of base rate cases (2012 and 2016). I also played an active role, including leading negotiations on behalf of ONE Gas in its Separation application from its former parent, ONEOK, before the Kansas Corporation Commission. I have monitored regulatory earnings, and continually determine potential ratemaking outcomes in the event of a rate case filing. I ensure that all required regulatory filings, including surcharges are submitted on a timely and accurate basis. I also am responsible for monitoring all electric utility rate filings to evaluate competitive impacts from rate design proposals.

Strategic Regulatory Solutions; 2003 -2007

Principal; Serving clients regarding revenue requirement and regulatory policy issues in the natural gas, electric and telecommunication sectors

Williams Energy Marketing and Trading; 2000-2003

Manager Regulatory Affairs; Monitored and researched a variety of state and federal electric regulatory issues. Participated in due diligence efforts in targeting investor owned electric utilities for full requirement power contracts. Researched key state and federal rules to identify potential advantages/disadvantages of entering a given market.

MCI WorldCom; 1999 - 2000

Manager, Wholesale Billing Resolution; Manage a group of professionals responsible for resolving Wholesale Billing Disputes greater than \$50K. During my tenure, completed disputes increased by over 100%, rising to \$150M per year.

Kansas Corporation Commission; 1984- 1999

Utilities Division Director - 1997 - 1999; Responsible for managing employees with the goal of providing timely, quality recommendations to the Commission covering all aspects of natural gas, telecommunications and electric utility regulation; respond to legislative inquiries as requested; sponsor expert witness testimony before the Commission on selected key regulatory issues; provide testimony before the Kansas legislature on behalf of the KCC regarding proposed utility legislation; manage a budget in excess of \$2 Million; recruit professional staff; monitor trends, current issues and new legislation in all three major industries; address personnel issues as necessary to ensure that the goals of the agency are being met; negotiate and reach agreement where possible with utility personnel on major issues pending before the Commission including mergers and acquisitions; consult with attorneys on a daily basis to ensure that Utilities Division objectives are being met.

Asst. Division Director - 1996 - 1997; Perform duties as assigned by Division Director.

Chief of Accounting 1990 - 1995; Responsible for the direct supervision of 9 employees within the accounting section; areas of responsibility included providing expert witness testimony on a variety of revenue requirement topics; hired and provided hands-on training for new employees; coordinated and managed consulting contracts on major staff projects such as merger requests and rate increase proposals;

Managing Regulatory Auditor, Senior Auditor, Regulatory Auditor 1984 - 1990; Performed audits and analysis as directed; provided expert witness testimony on numerous occasions before the KCC; trained and directed less experienced auditors on-site during regulatory reviews.

Amoco Production Company 1982 - 1984

Accountant Responsible for revenue reporting and royalty payments for natural gas liquids at several large processing plants.

Education

- B.S.B.A. (Accounting) Central Missouri State University
- Passed CPA exam; (Oklahoma certificate # 7562) – Not a license to practice

PUBLIC

ATTACHMENT DD-1
CPAD Operations and
Maintenance Expense

Line No.	Detail	CPAD Adjustments							CPAD Attribution Period PYE 12-31-19
		A/ CPAD Test Period PYE 12-31-17	B/ Adjustment 1 - To Remove Insurance Costs	C/ Adjustment 2 - To Reflect Cash Basic Pension / OFFER	D/ Adjustment 3 - To Remove Leasing Costs	E/ Adjustment 4 - To Reduce Corp Allocated Costs	F/ Adjustment 5 - To Reflect Rate Case Amortization Expense	G/ Adjustment 6 - To Forecast Attribution Period Costs	
1	Payroll Expense	\$ 3,010,584							\$ 2,983,448
2	Employee Benefits	750,528							\$ 728,437
3	Benefits Capitalized	(87,884)							\$ (103,075)
4	Fleet Services and Facilities Expense	781,488							\$ 822,931
5	Outside Services	1,783,744							\$ 1,878,336
6	Bad Debt Expenses	137,836							\$ 121,863
7	Sales Promotion Expense	51,966							\$ 52,574
8	Customer Service and Account Expense	4,775							\$ 4,831
9	Administrative and General Expenses	678,172							\$ 829,853
10	Admin & Gen. Salaries & Exp. Capitalized	(66,180)							\$ (69,690)
11	Other Distribution and Storage Expense	567,215							\$ 557,294
12	AGL Service Company Allocations	4,457,091							\$ 3,117,375
13	Total O&M Expense	\$ 12,067,184							\$ 10,964,177

- A/ CPAD Worksheet, Attachment DD 9-13
B/ CPAD Worksheet, Attachment DD 4-1
C/ CPAD Worksheet, Attachment DD 4-2
D/ CPAD Worksheet, Attachment DD 4-3
E/ CPAD Worksheet, Attachment DD 4-4
F/ CPAD Worksheet, Attachment DD 4-5
G/ CPAD Worksheet, Attachment DD 4-6
H/ CPAD Worksheet, Attachments DD 9-1, 9-2, 9-3, 9-4, 9-5, 9-6, 9-7, 9-8, 9-9, 9-10, and 9-11
I/ CPAD Rate Base Worksheet 88-462.00.

Chattanooga Gas Company
Calculation of Test Period Operations and Maintenance Expenses

Dkt No. 18-00017
 CPAD Workpaper
 Attachment DD 9-13

Expense Classification	Company Test Period FYE 6-31-17	CPAD Test Period FYE 12-31-17	
Payroll Expense	\$ 3,028,489	\$ 3,010,584	A/
Employee Benefits	933,858	758,528	B/
Benefits Capitalized	(72,402)	(97,884)	C/
Fleet Services and Facilities Expense	803,695	781,488	D/
Outside Services	1,823,532	1,783,744	E/
Bad Debt Expense	129,715	137,686	F/
Sales Promotion Expense	34,077	51,966	G/
Customer Service and Account Expense	8,533	4,775	H/
Administrative and General Expenses	663,355	678,172	I/
Admin & Gen. Salaries & Exp. Capitalized	(73,550)	(66,180)	J/
Other Distribution and Storage Expense	735,624	567,215	K/
AGL Service Company Allocations	4,106,553	4,457,090	L/
Total O&M	\$ 12,121,478	\$ 12,067,184	

- A/ CPAD Workpaper, Attachment DD 09-13.01
 B/ CPAD Workpaper, Attachment DD 09-13.02
 C/ CPAD Workpaper, Attachment DD 09-13.03
 D/ CPAD Workpaper, Attachment DD 09-13.04
 E/ CPAD Workpaper, Attachment DD 09-13.05
 F/ CPAD Workpaper, Attachment DD 09-13.06
 G/ CPAD Workpaper, Attachment DD 09-13.07
 H/ CPAD Workpaper, Attachment DD 09-13.08
 I/ CPAD Workpaper, Attachment DD 09-13.09
 J/ CPAD Workpaper, Attachment DD 09-13.10
 K/ CPAD Workpaper, Attachment DD 09-13.11
 L/ CPAD Workpaper, Attachment DD 09-13.12

Chattanooga Gas Company
Adjustment to Remove Incentive Compensation

Dkt No. 18-00017
CPAD Workpaper
Attachment DD 4-1

CGC Direct Charged

Sub Acct Account Name

670590 AIP Bonus

670591 LTI Awards - Other

CGC Allocated

670590 AIP Bonus

670591 LTI Awards - Other

Total Incentive Comp charged to O&M

A/

A/

B/

B/

A/ CPAD Workpaper, Attachment DD 09-13.01

B/ CPAD Workpaper, Attachment DD 09-13.12

Chattanooga Gas Company
Adjustment to Remove Accrual Pension & OPEB Benefits

Dkt No. 18-00017
CPAD Workpaper
Attachment DD 4-2

CGC Direct Charged	Sub Acct	Account Name	
	670451	Non-Qualified Pension Plan	A/
	670450	Pensions	A/
	670503	Other Post Retirement Benefits	A/
	670512	Pensions-Capitalized	A/
		Cash Basis Pension Contrib.	C/
Allocated SERP	670451	Non-Qualified Pension Plan	B/
	670450	Pensions	B/
	670503	Other Post Retirement Benefits	B/
	670512	Pensions-Capitalized	B/
Total Adjustment			

A/ CPAD Workpaper, Attachment DD 09-13.02
B/ CPAD Workpaper, Attachment DD 09-13.12
C/ CPAD Discovery Request 1-308

Chattanooga Gas Company
Adjustment to Remove Lobbying/Govt Affairs Charges

Dkt No. 18-00017
CPAD Workpaper
Attachment DD 4-3

CGC Allocated			
Ferc	Sub Acct	Account Name	
920	600120	Pay - A and G Salaries	A/
920	600201	Pay-Telecommuting	A/
926	670505	Flex Vacation Deductions	A/
926	670525	Miscellaneous Benefits	A/
920	670594	Other/Sales Bonusus	A/
926	670596	Prevenetive Care Incentives	A/

Subtotal Lobbying/Governmental Affairs Charges
Fixed Compensation Benefit Rate
Benefit Costs

CGC Allocated			
Ferc	Sub Acct	Account Name	
923	672556	Allocated Legal Lobbying - SCS	B/

Subtotal
Fixed Compensation Benefit Rate
Benefit Costs

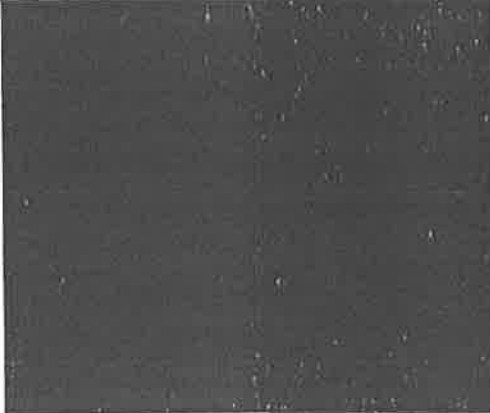
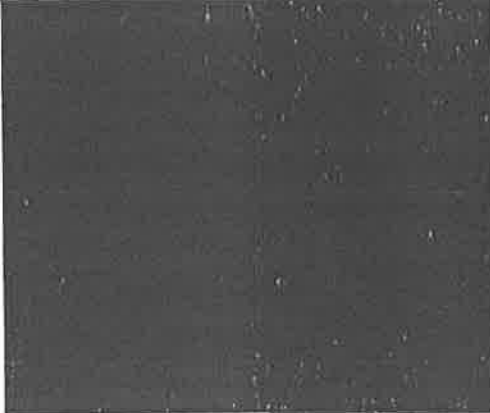
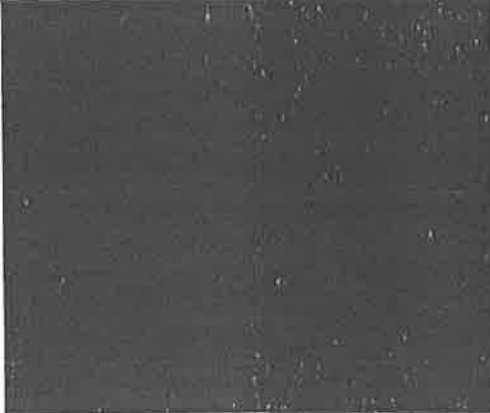
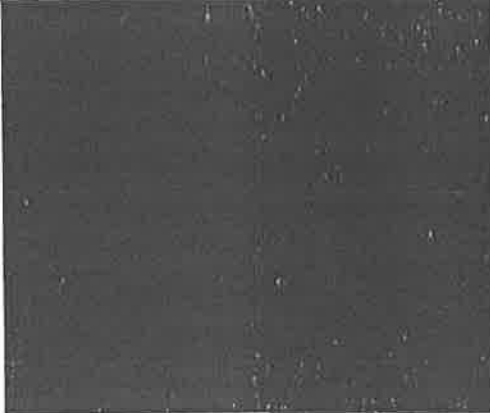
Total Labor Costs
Total Benefit Costs

CGC Allocated			
Ferc	Sub Acct	Account Name	
930	670800	Lobbying Portion of Organization Dues	C/
		Lobbying Labor	
		Benefit Costs	
		Organization Dues	
		Grand Total Lobbying	

A/ CPAD Discovery Request 1-141 (CONFIDENTIAL)
B/ CPAD Discovery Request 1-119
C/ CPAD Discovery Request 1-154

Chattanooga Gas Company
Adjustment of Corporate Costs Allocation

Dkt No. 18-00017
CPAD Workpaper
Attachment DD 4-4

Detail	A/ CGC Allocation 2017	B/ CPAD Pro-Forma 2017
1Q		
2Q		
3Q		
4Q		
Average		
Composite Rate Charges		
Comp. Rate Charges/ Avg		
Com Rate Charges/Avg * CPAD 3 factor avg		
CPAD Allocation Adjustment (line 13-line 9)		

A/ CONFIDENTIAL Discovery Request CPAD-1-347h, CPAD-1-347i, CPAD-1-347j, CPAD-1-347k
B/ CPAD Workpaper, Attachment DD 4-4.1
C/ CPAD-1-347c 2017

WHN Consulting

Chattanooga Gas Company

Analysis of Other Rate Base - Deferred Rate Case Summary

RB-45-1.00

6/9/18 12:44 PM

Month	Amortization	Deferred Balance
September, 2018		A/
October		
November		
December		
January, 2019		
February		
March		
April		
May		
June		
Midpoint		
July		
August		
September		
October		
November		
December		
Attrition Year Amortization Expense		

A/ CPAD Rate Base Workpaper RB-45-2.00.

Chattanooga Gas Company
Calculation of Attrition Period CGC Operations and Maintenance Expense

Dkt No. 18-00017
CPAD Workpaper
Attachment PD 4-6

Detail	A/ CPAD Adjusted Test Period FYE 12-31-17	B/ Attrition Period Costs	CPAD Attrition Period FYE 12-31-19
Payroll Expense			\$ 2,983,448
Employee Benefits			728,437
Benefits Capitalized			(103,075)
Fleet Services and Facilities Expense			822,931
Outside Services			1,878,336
Bad Debt Expenses			C/ 121,863
Sales Promotion Expense			52,574
Customer Service and Account Expense			4,831
Administrative and General Expenses			D/ 829,853
Admin & Gen. Salaries & Exp. Capitalized			(69,690)
Other Distribution and Storage Expense			597,294
AGL Service Company Allocations			3,117,375
Total O&M Expense			<u>\$ 10,964,177</u>

A/ CPAD Workpaper, Attachment DD 9

B/ CPAD Workpaper, Attachments DD 9-1, 9-2, 9-3, 9-4, 9-5, 9-6, 9-7, 9-8, 9-9, 9-10, and 9-11

C/ CPAD Rate Base Workpaper RB-46-2.00.

D/ Includes CPAD Adjustment 5 to reflect amortization of rate case expense