

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

August 3, 2018

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**

REBUTTAL TESTIMONY OF

MICHAEL J. ADAMS

ON BEHALF OF

CHATTANOOGA GAS COMPANY

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1 **I. INTRODUCTION AND WITNESS QUALIFICATIONS**

2 **Q. Please state your name and business address.**

3 A. My name is Michael Adams. My business address is 293 Boston Post Road West,
4 Suite 500, Marlborough, Massachusetts 01752.

5 **Q. On whose behalf are you providing this rebuttal testimony?**

6 A. I am providing this rebuttal testimony on behalf of Chattanooga Gas Company.

7 **Q. Are you the same Michael Adams that prepared and filed direct testimony in**
8 **this proceeding?**

9 A. Yes, I am.

10 **II. PURPOSE AND SCOPE**

11 **Q. What is the purpose of your rebuttal testimony?**

12 A. The purpose of my rebuttal testimony is to respond to the direct testimony of
13 Consumer Advocate witness David Dittmore pertaining to his proposed
14 adjustment to the Company's lead-lag study.

15 **Q. Prior to addressing Mr. Dittmore's proposed adjustments can you elaborate**
16 **on the purpose of a lead-lag study?**

17 A. Yes. A regulated utility's revenues are comprised of the sum of all expenses
18 (operations and maintenance, taxes, debt service, plus the recovery of an authorized
19 return). While some revenues may be recovered via riders, trackers or other
20 approved mechanisms, the vast majority of revenues are recouped via rates, such
21 as those that will be established in this proceeding. The purpose of a lead-lag study
22 is to analyze the timing of the cash flows, both into and out from the company. The

1 Company is required to have sufficient cash on-hand to meet its financial
2 commitments while awaiting payment for services provided to its customers.

3 **Q. To set the table for the discussion of the Company's cash working capital**
4 **requirements, besides the payments made by customers, what other source of**
5 **funds does the company have to pay its expenses?**

6 A. Absent debt borrowings or investor cash infusions, the payments made by its
7 customers for gas service is the only source of funds by which the Company is able
8 to pay its expenses (including debt service), and monetize the return on invested
9 capital (i.e., rate base).

10 **III. CONSUMER ADVOCATE PROPOSED ADJUSTMENTS**

11 **Q. What modifications did Mr. Dittemore propose to the Company's lead-lag**
12 **study?**

13 A. Consumer Advocate witness Dittemore has proposed two adjustments to the lead-
14 lag study that I sponsored in my direct testimony. First, he proposes to exclude the
15 return on equity from the determination of the cash working capital calculation.
16 Second, he proposes an alternative method of determining the level of cash working
17 capital related to Franchise, Sales and Use taxes. I will address each of Mr.
18 Dittemore's adjustments below.

19 **A. Inclusion of Return on Equity in Determination of Cash Working**
20 **Capital**

21 **Q. Does Mr. Dittemore propose the exclusion of return on equity from the**
22 **determination of the cash working capital?**

23 A. Yes, he does.

1 **Q. What is Mr. Dittimore’s rationale for the proposed exclusion of return on**
2 **equity from the determination of the Company’s cash working capital**
3 **requirement?**

4 A. Mr. Dittimore opines that return on equity is a non-cash expense and therefore does
5 not qualify as a component of the cash working capital study.¹

6 **Q. Did the Company include return on equity in the determination of its cash**
7 **working capital requirement in its last rate case?**

8 A. Yes. The return on equity was included in the prior study with net zero lag days,
9 which required no cash working capital requirement.²

10 **Q. Are you proposing a different treatment of return on equity in the cash**
11 **working capital study in this proceeding?**

12 A. No. The method that I am supporting in this proceeding is identical to what the
13 Company filed, and that the Commission approved, in the Company’s most recent
14 rate case.

15 **Q. Is there a single approach used by state regulatory commissions for the**
16 **determination of regulated utilities’ working capital requirements?**

17 A. No. The Federal Energy Regulatory Commission determines companies working
18 capital requirement by multiplying the companies’ total operations and
19 maintenance expenses (“O&M”) by one-eighth. Many state regulatory
20 commissions rely upon the lead-lag study such as the one that I prepared and
21 sponsored in my direct testimony. There are, however, varied ways in which lead-

¹ Direct Testimony of David Dittimore., July 3, 2018, p. 18, lines 9-20.

² Docket No. 09—00183, Prepare Direct Testimony of Ronald D. Hanson, Exhibit RDH-6, Schedule 3.

1 lag studies are performed across the various regulatory jurisdictions that use lead-
2 lag studies to determine a companies' cash working capital requirement. In fact, I
3 have filed testimony in a number of jurisdictions on the topic of cash working
4 capital requirements, including and excluding different components of the cash
5 working capital requirement in a manner consistent with each State's precedence.

6 **Q. Mr. Dittmore cites rate proceedings from three other state jurisdictions that**
7 **have excluded return on equity from lead-lag studies.³ How do you respond?**

8 A. As I mentioned, it is not unusual that there is not a consistent treatment of issues
9 across regulatory jurisdictions. A majority of states include some form of working
10 capital in rate base. Based upon the research that I performed for a client, there is
11 no single approach of how a regulated utility's cash working capital requirement is
12 determined, although a lead-lag study is the predominant method. Mr. Dittmore's
13 citation of three jurisdictions that exclude return on equity from the determination
14 of a utility's cash working capital requirement is not surprising but should have no
15 influence on this Commission's decision. The facts of each case are different and
16 this Commission's decision should be based upon the evidence in this case and its
17 own precedence on the issue.

18 **Q. Does Mr. Dittmore cite a rate proceeding in Illinois to support his position**
19 **that return on equity should not be included in the determination of the**
20 **Company's cash working capital requirement?**

21 A. Yes, he does.⁴

³ Id., p. 19, lines 6-14.

⁴ Dittmore Direct, p. 19, lines 6-7.

1 **Q. Do you agree with his statement that the Illinois Commerce Commission**
2 **entered an Order supporting the exclusion of return on equity from the**
3 **determination of the company's cash working capital requirement?**

4 A. No. The company in the referenced Illinois Commerce Commission ("ILCC")
5 proceeding did not include return on equity in its requested level of cash working
6 capital. The question of whether return on equity should be included or excluded
7 from the utility's cash working capital requirement was not decided by the ILCC
8 and was not an issue in the proceeding cited by Mr. Dittemore. While I would agree
9 that the level of cash working capital approved by the ILCC in the docket
10 referenced by Mr. Dittemore did not include return on equity, the company did not
11 request that return on equity be included in its determination of cash working
12 capital.

13 **Q. In your opinion, is Mr. Dittemore's citation of decisions in three other**
14 **regulatory jurisdictions relevant to this proceeding?**

15 A. No. As discussed with regards to the ILCC proceeding, without a complete
16 examination of the record in the proceeding, it is inappropriate to rely on a ruling
17 by another regulatory agency, as suggested by Mr. Dittemore, without fully
18 understanding what was proposed and adopted in each proceeding. Mr. Dittemore
19 has not provided such context for the commission rulings that he cites. Further, I
20 find it interesting that Mr. Dittemore fails to acknowledge that the Tennessee Public
21 Utility Commission has previously accepted the treatment of return on equity in the
22 determination of cash working capital in CGC's last rate case similar to the
23 treatment that I am proposing in this proceeding.

1 **Q. Mr. Dittmore references a water company’s rate case in Tennessee as support**
2 **for his position. Do you view that case as reflecting the Tennessee Public**
3 **Utility Commission’s position on the treatment of equity in a cash working**
4 **capital study?**

5 A. No. The decision cited by Mr. Dittmore was a stipulated agreement approved by
6 the Commission. A stipulated agreement, in my opinion, is a negotiated outcome
7 as opposed to a fully litigated rate case the outcome of which is determined by the
8 Commission. Therefore, I do not view the water case as precedential on the
9 Commission’s position on this issue.

10 **Q. Are there state regulatory jurisdictions that have allowed the inclusion of**
11 **return on equity in the determination of the cash working capital**
12 **requirement?**

13 A. Yes. The North Carolina Utilities Commission (“NCUC”) initiated a general
14 docket focused on the proper method of determining the cash working capital
15 requirements of the utilities in North Carolina. The NCUC recognized that its
16 decision in a rate case may change the methodology used to calculate the cash
17 working capital provision not only for the one utility but could also affect the
18 methodology used to calculate cash working capital for other jurisdictional electric
19 utilities, as well as for natural gas utilities. Thus, the NCUC found cause to seek
20 comments and reply comments regarding this issue in the context of a generic
21 proceeding.

22 The docket was conducted as an investigation of certain aspects of lead-lag
23 studies used in general rate case proceedings for major electric and natural gas

1 utilities. In the proceeding, the regulated utilities commented that consistent with
2 their approaches to developing their lead-lag studies in their respective recent rate
3 cases, income available for common equity should be included as a component of
4 the lead-lag study that contributes to the development of the cash working capital
5 provision in order to allow investors the opportunity to earn a fair return on all
6 capital invested in utility operations. According to the North Carolina Electric
7 Companies, investor capital is required to finance the lag in the recovery of the
8 entire cost of service including income available for common equity. Therefore, the
9 cash working capital calculation must include the lag in the recovery of the entire
10 cost of service including income available for common equity.⁵

11 In its final Order, the NCUC concluded that “the return on equity (or, stated
12 alternatively, income available for common equity) component of the approved
13 test-period cost of service, in total (i.e., under approved rates), shall be included in
14 all future lead-lag studies and said component shall be assigned zero lead (or lag)
15 days for the purpose of determining the test-period cash working capital
16 requirement.”⁶

17 **Q. Is CGC’s proposed treatment of return on equity in the determination of its**
18 **cash working capital requirement the same as that studied and approved by**
19 **the NCUC?**

20 A. Yes. The Company has included the return on equity in the lead lag study with a
21 zero day lead similar to the approach examined and adopted by the NCUC.

⁵ North Carolina Utilities Commission, Docket No. M-100, Sub 137, Order Ruling on
Lead-Lag Study Procedure, p. 3.

⁶ Id, p. 34.

1 **Q. Would the Company’s proposed inclusion of return on equity in the cash**
2 **working capital requirement result in a double recovery of any costs?**

3 A. No, it would not.

4 **Q. Why is return on equity a cash flow that should be considered in a lead-lag**
5 **study?**

6 A. Similar to other funds, the Company is entitled to a return of and on the costs of
7 providing services to its customers. The Company is entitled to the funds
8 associated with the return on equity established in this proceeding from the point in
9 time when gas service is provided to its customers, the same as is reflected for all
10 other expenses. Excluding the return on equity from the determination of the
11 Company’s cash working capital requirement would fail to consider the timing of
12 the receipt of the return on equity.

13 **Q. Would the return on equity established in this proceeding include a component**
14 **to account for the difference in timing between when the Company is entitled**
15 **to the return and when it is actually collected?**

16 A. No, it would not.

17 **Q. You previously stated that the return on equity was included in the lead-lag**
18 **study with zero expense days. Why is that appropriate?**

19 A. As I have stated in my direct testimony, the lead-lag study examines the lag time
20 between the date customers receive service and the date customers’ payments are
21 available to the company. This lag is offset by a lead time during which the
22 company receives goods and services but pays for them at a later date.⁷ Revenues

⁷ CGC Direct Testimony, Michael Adams, pp. 3-4.

1 include the return on equity, as well as all expenses. The revenue lag is applied to
2 all revenues to reflect the timing of the collection of the revenues from the
3 Company's customers.

4 On the expense side of the equation, the Company has no outlay of monies
5 associated with the return on equity, therefore the item is included in the calculation
6 of cash working capital with zero lag days.

7 **B. Franchise, Sales and Use Taxes**

8 **Q. Does Mr. Dittmore propose an adjustment to the Company's cash working**
9 **capital requirement to reflect the timing of payments associated with**
10 **franchise, sales and use taxes?**

11 A. Yes, he does. Mr. Dittmore states:

12 "These items are collected from CGC ratepayers and later remitted by
13 the Company to appropriate taxing authorities. The retention of these
14 funds prior to remittance provides a source of ongoing working capital
15 for the Company. I have relied upon the use of the Test Period average
16 balance of these liability accounts to quantify the amount of funds
17 available to CGC. This method is identical to that used to determine
18 the gas inventory portion and Materials and Supplies components of
19 rate base and therefore provides for consistency."⁸

20 **Q. How do you respond to Mr. Dittmore's proposed adjustment to franchise,**
21 **sales and use taxes?**

⁸ Direct Testimony of David Dittmore, pp. 19-20, beginning at line 20.

1 A. I agree with Mr. Dittmore that the franchise, sales and use taxes should be
2 considered when determining the Company's cash working capital requirement. In
3 fact, the taxes in question have already been reflected in the Company's analysis.
4 The tax collections reduce the Company's cash working capital requirement by
5 \$203,593, as shown on Exhibit 2-3, Schedule 3 – Lead Lag as sponsored by
6 Company witness Tucker.

7 **IV. CONCLUSION**

8 **Q. What is your recommendation?**

9 A. I recommend that the Commission adopt the Company's cash working capital study
10 as filed. Including return on equity as a component of the determination of the
11 Company's cash working capital requirements is appropriate and consistent with
12 past Tennessee Public Utility Commission Orders, and the taxes other than income
13 taxes have properly reflected in the cash working capital analyses.

14 **Q. Does this conclude your rebuttal testimony?**

15 A. Yes, it does.