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IN THE TENNESSEE PUBLIC UTILITY COMMISSION
AT NASHVILLE, TENNESSEE

IN RE:	)	
	)	
CHATTANOOGA GAS COMPANY	)	
PETITION FOR APPROVAL OF AN	)	**DOCKET NO. 18-00017**
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	)	

CONSUMER ADVOCATE'S POST-HEARING BRIEF

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Herbert H. Slatery, III, Attorney General and Reporter for the State of Tennessee, by and through the Consumer Protection and Advocate Division of the Office of the Attorney General (Consumer Advocate), respectfully submits this Post-Hearing Brief in Tennessee Public Utility Commission (TPUC or Commission) Docket No. 18-00017, 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 (Petition).

I. INTRODUCTION

Chattanooga Gas Company (CGC, Company or Chattanooga Gas) is a public utility regulated by the Commission and is in the business of transporting, distributing, and selling natural gas in the greater Chattanooga and Cleveland, Tennessee areas within Hamilton and Bradley counties.[1] The Company's principal office and place of business is 2207 Olan Mills Drive, Chattanooga, Tennessee 37421.[2]

In this Docket, in broad terms, the Company seeks a rate **increase** of about $6.13 million[3] and the ability to recover about $1.4 million[4] in amounts that have resulted from a cap imposed on a conservation-encouraging mechanism in the Company's last rate case. The Company originally sought in its Petition to opt into an annual rate review mechanism and to receive

[1] Petition, page 2. Chattanooga Gas is a wholly owned subsidiary of Southern Company Gas, a natural gas holding company that owns and operates regulated gas utilities in seven States, including Chattanooga Gas in Tennessee. Southern Company Gas, formerly AGL Resources, was acquired by the Southern Company in 2016. *Id.*

[2] Petition, page 3.

[3] The Company's original request with respect to base rates sought about $7 million, but that amount has been reduced as a result of the discovery of certain errors in the original filing and other positions taken by the Company. See Rebuttal Testimony of Gary A. Tucker on behalf of Chattanooga Gas Company, filed on August 3, 2018, in this Docket No. 18-00017 (Tucker Rebuttal Testimony), page 2, line 19, through page 3, line 8.

[4] Transcript of the Hearing on the Merits in this Docket No. 18-00017, August 20-22, 2018 (Transcript), Vol. II C, page 209, lines 20-24. The Company's original request in its Petition was for about $2 million, but that amount has been reduced as a result of the reversal of related deferrals by the Company. As used in this Post-Hearing Brief, "Hearing on the Merits" refers to the Hearing on this Docket No. 18-00017 held in Nashville, Tennessee on August 20-22, 2018.

approval for an economic development rider under Tennessee's alternative regulation statute. After the filing of the Petition, the Company withdrew the requests for an economic development rider and annual rate review mechanism. The only remaining related request is one for the adoption of methodologies by the Commission that would enable the Company to opt into an annual rate review mechanism in the near future.

In the course of making its general rate case requests, the Company asks the Commission essentially to modify the Commission's prior consistent application of certain ratemaking principles – such as double leverage and cash basis pension and other post-employment benefits. Some of these principles have been applied consistently in Tennessee for decades. Also, the Company asks the Commission, in applying general ratemaking principles, to use the Company's June 30th ending test and attrition years and the Company's 2019 budget, treat the Company as a stand-alone utility, recognize changes to special contracts and accounting conventions made without approval by the Commission, allow virtually unlimited rate case costs, and allow operations and maintenance costs to include allocated incentive compensation costs, accrued pension and other post-employment benefit costs, government affairs labor charges, and a four-factor composite allocation ratio. The Company also asks the Commission to allocate its requested increase in rates in accordance with a class cost of service analysis.

In contrast, the Consumer Advocate contends that the Company's base rates should **decrease** by about $2.6 million,[5] and that the recovery of the estimated $1.4 million[6] that resulted from the cap imposed on a conservation-encouraging mechanism in the Company's last rate case should be denied. With respect to the adoption of methodologies that could be used in

[5] Revised Exhibit of the Consumer Advocate, filed in Docket No. 18-00017, on August 24, 2018 (Revised CPAD Exhibit), Schedule 1.
[6] Transcript, page 209, lines 20-24.

an annual rate review mechanism, the Consumer Advocate asserts that the Company's books, records, and data presented in this case are in such a condition that would not readily permit the implementation and ongoing review and analysis of any methodologies to be adopted and used in an annual rate review mechanism.

Further, the Consumer Advocate notes that the Company's case was filed without adequate supporting detail and a virtually complete lack of documentation or audit trail as to the source of that supporting information – in other words, the Company's response to the Commission's minimum filing guidelines indicated that all workpapers had been included when they clearly had not been provided. Specifically, there were no workpaper numbers and only minimal footnote support documenting the source for the Company's workpapers. Further, many of the Company's workpapers only included hard-coded numbers without any documentation leaving no audit trail to the source data. In short, the Consumer Advocate believes that the Company did not give the minimum filing guidelines of the Commission appropriate, serious consideration.

As to the specific application of methodologies in this general rate case, the Consumer Advocate urges the continued use of long-standing Commission ratemaking principles – such as the use of double leverage and cash basis pension and other post-employment benefits – in determining the Company's rates. Further, the Consumer Advocate asks the Commission, in applying general ratemaking principles, to use the Company's fiscal year ending December 31, 2017, as its test year and its fiscal year ending December 31, 2019 as its attrition year, treat the Company as a part of the larger Southern Company Gas and The Southern Company corporate system, not permit changes to special contracts and accounting conventions without approval by the Commission, allow limited rate case costs, and address operations and maintenance costs to

not include allocated incentive compensation costs, to include cash basis accrued pension and other post-employment benefit costs, to deny recovery for government affairs labor charges, and to use a three-factor composite allocation ratio. The Consumer Advocate also asks the Commission to allocate its requested adjustment in rates using a pro-rata approach to all customer classes.

II. BACKGROUND

A. Chattanooga Gas Company's Prior General Rate Case

The Company's last rate case was TPUC Docket No. 09-00183. In that Docket, the Company requested a rate increase of $2,600,000 and the Commission approved an increase of only $60,068.[7] It must be noted that although the Company only received a modest adjustment to rates, it was able to exceed its authorized rate of return in 2011 by over $1 million by modifying the budgeted expenses and capital investment approved by the Commission in Docket 09-00183.[8] Docket No. 09-00183 followed a number of dockets in which the Commission approved amounts far less that the amount originally requested by Chattanooga Gas.[9]

With the examples of the Company's prior inflated requests noted, the primary background relevance of Docket No. 09-00183 to the current Docket No. 18-00017 stems from the Commission approving a series of conservation measures proposed by Chattanooga Gas, including an Alignment & Usage Adjustment (AUA) Mechanism, as a surcharge for two customer classes.[10] The AUA was approved for a three-year experimental period and was to take the place of the weather normalization adjustment (WNA) that existed prior to the AUA. In

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[7] Commission Order filed on November 8, 2010 (2010 Order) at page 66 at paragraph 6.
[8] See Transcript Vol. II C, page 239, lines 1-3.
[9] See Direct Testimony of William H. Novak on behalf of the Consumer Advocate (Novak Direct Testimony), page 4, line 20, through page 5, line 2 and the incorporated Table 1 (Summary of Prior CGC Rate Case Awards).
[10] 2010 Order, page 66, paragraph 7. The Commission also approved a conservation plan consisting of a residential free programmable thermostat program and a limited community outreach and customer education program.

addition, the Commission placed a cap of 2% of the revenues for the applicable rate schedules on annual increases to the AUA surcharge.[11]

The AUA was extended by Commission Order in Docket No. 09-00183 on November 6, 2013 (2013 Order), which also provided for an evaluation of the experimental program. According to a report prepared by the National Regulatory Research Institute (NRRI), presented to the Commission on January 10, 2017, "...the program intent might have been reasonable, but the plan itself turned out to be shortsighted."[12] A TPUC Staff Report, on September 19, 2017, essentially reviewed and affirmed the results of the NRRI Report.[13] Further, those reports generally observed that while the program may result in savings, that savings may be difficult to achieve[14] and, as a result, in general terms, the Commission's intent to address specific conservation measures for Chattanooga Gas' customers fell short of their stated goals.

Chattanooga Gas issued its report on the AUA mechanism on September 26, 2017, and requested that the AUA mechanism be discontinued and replaced with a weather normalization adjustment (WNA) mechanism. Chattanooga Gas also requested that it be allowed to recover the then-current balance of approximately $1.9 million in deferred AUA surcharges.

The Consumer Advocate filed testimony on October 24, 2017, recommending that (a) Chattanooga Gas' request to establish or reinstate a WNA mechanism to two classes of customers outside of a rate case should be denied; (b) Chattanooga Gas' request for recovery of the deferred AUA balance should be denied; (c) a financial audit of the AUA surcharges and

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[11] 2010 Order, page 66, paragraph 8. See Direct Testimony of Archie R. Hickerson on behalf of Chattanooga Gas Company, pages 11-12.

[12] NRRI Report *Evaluating Chattanooga Gas Company's 2012-13 Energy Efficiency Programs and Ideas for Evaluating Future Energy Efficiency Programs in Tennessee*, Report No. 16-09, Tom Stanton, December 2016, page 15.

[13] TPUC Staff Report in Docket No. 09-00183, pages 7-10.

[14] TPUC Staff Report in Docket No. 09-00183, pages 10-11 (referring to the relationship between the NRRI Report and TPUC Staff Report).

refunds should be conducted by Commission Staff; and (d) the AUA mechanism should be terminated.

At a status conference on December 1, 2017, and by subsequent Order, the Hearing Officer accepted the recommendations of the Parties that certain conservation programs be permitted to expire and that issues related to the AUA mechanism, WNA reinstatement, and deferral of the amount of AUA should be moved from Docket No. 09-00183 and incorporated into the Company's next rate case.[15]

B. Chattanooga Gas Company's Rate Case in this Docket No. 18-00017

On February 15, 2018, the Company filed the current Petition, which the Company describes as having three parts.[16]

The General Increase in the Company's Rates. The Company characterizes the first part as "seeking approval for an adjustment in rates for natural gas service, along with approval for the corresponding tariff revisions."[17] In this part, the Company seeks approval of an increase in revenues of approximately $7 million,[18] which has since been reduced to about $6.13 million. The Company indicates in the Petition that the increase in base rates to the residential customer class would be approximately 31.39%.[19] The requested revenue increase, according to the Company, would provide a projected overall rate of return of 7.83% on a projected total rate base

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[15] For a description of the evaluation process and the Hearing Officer's determinations, see Order Moving Outstanding Issues into New Docket and Administratively Closing the Docket, filed on January 5, 2018, in TPUC Docket No. 09-00183.

[16] Petition, page 1, *et seq.* This amount has subsequently adjusted by the Company to approximately $6.13 million at the time of the Hearing on the Merits.

[17] *Id.*

[18] Direct Testimony of Wendell Dallas on behalf of Chattanooga Gas Company (Dallas Direct Testimony), page 17.

[19] Direct Testimony of Daniel P. Yardley on behalf of Chattanooga Gas Company (Yardley Direct Testimony), Exhibit DPY-2, page 1 *et seq.* This is derived by dividing the increase in rates (proposed residential R-1 rates of $18,831,300 less present residential R-1 rates of $14,332,359) by the present residential R-1 rates. The multi-family (R-4) and small commercial (C-1) classes would face similar increases. *Id.* While the increases for the other classes (for example, industrial) would not be as dramatic, those classes would face significant increases as well. *Id.*

of $159,856,710,[20] and a rate of return of 11.25% on common equity.[21] Chattanooga Gas asserts that, using current rates during the attrition period in this rate case (July 1, 2018 to June 30, 2019) would earn a net operating income of $7,364,092, on a projected rate base of $159,856,710, and thus would earn an overall rate of return of 4.61%.[22] Chattanooga Gas adds that, without the rate increase requested in this Docket, it would incur a revenue deficiency during the attrition period of about the requested increase of $7 million at the requested overall rate of return.[23]

With respect to rate design, Chattanooga Gas proposes to adjust the current percentages that the various customer classes would pay based on the current traditional (i.e., pro rata) approach to an approach based on a class cost of service model.[24] This adjustment would result in a higher proportion of the revenue increase being borne by the residential, multi-family, and small commercial rate classes.[25]

Termination of the AUA and Recovery of Deferred Amounts. In the second part of its Petition, Chattanooga Gas seeks to "terminate the AUA, return [two classes of] customers back to the WNA mechanism, and recover the unpaid AUA customer revenue deficiency, nearly $2 million, through an interruptible margin credit rider."[26] This second part essentially reflects the movement of these issues from an earlier docket into this current Docket for consideration as a part of Chattanooga Gas' rate case.[27] On those issues, the Company asserts in the Petition that "the AUA has not worked out as intended and has led to significant under-recoveries where

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[20] Petition, pages 5-6.
[21] *Id.*
[22] Petition, page 5.
[23] *Id.*
[24] See, generally, Yardley Direct Testimony.
[25] Yardley Direct Testimony, page 16.
[26] Petition, page 9.
[27] See Order Moving Issues into New Docket and Administratively Closing the Docket, as filed in TPUC Docket 09-00183 on January 5, 2018.

customers have not fully paid for the service that they have consumed."[28] Specifically, Chattanooga Gas claims that the AUA has resulted in a significant cumulative deficiency in revenue from two customer classes in the aggregate amount of $1,788,194 as of May 31, 2017,[29] with unlikely prospects of recovering that amount because of the 2% annual cap.[30] To resolve the Company's issues with the AUA, Chattanooga Gas seeks a mechanism to recover what it characterizes as "the unpaid customer revenues deficiency[,]"[31] and to implement a WNA that would make rate adjustments contemporaneously with the weather-related events that result in the WNA surcharge or refund.[32]

The Annual Rate Review Mechanism and Methodologies. The Petition's third part, which has been generally withdrawn by the Company,[33] reflected the desire of the Company to opt into an annual rate review mechanism (ARM) under Tenn. Code Ann. § 65-5-103(d)(6). In that part of the Petition, Chattanooga Gas stated that it "believes that adoption of the annual review mechanism will provide the Commission and [Chattanooga Gas'] customers with greater transparency regarding its operations and how the Company's business operations translate into the rates charged customers."[34] In its Notice of Withdrawal, The Company stated its intent to re-file the ARM and, consequently, requested that "the Commission in its final order in this rate case clearly identify the approved rate case methodology required by T.C.A. §65-5-

[28] Petition, page 12.
[29] *Id.*
[30] Petition, page 13.
[31] Petition, page 15.
[32] Petition, page 14.
[33] Chattanooga Gas Company Notice of Withdrawal from Further Consideration in this Docket of its Requests for Approval of its Proposed Alternative Regulatory Methods (Notice of Withdrawal), as filed in Docket No. 18-00017 on April 10, 2018. The Notice of Withdrawal also withdrew a proposed System Expansion and Economic Development-Tennessee (SEED) Rider under Tenn. Code Ann. § 65-5-103(d)(3)(A).
[34] Petition, page 17.

103(d)(6)(A)."[35]

III. CRITERIA FOR ESTABLISHING PUBLIC UTILITY RATES

Under Tennessee law, the Commission has the power to fix just and reasonable rates.[36] When any public utility seeks to increase an existing rate the utility has the burden of proof to show such an increase is just and reasonable.[37]

Just and reasonable rates should provide a utility with the opportunity to earn a rate of return on used and useful property commensurate with the returns on alternative investments with similar risks.[38] As a general rule, the Commission examines investments by a utility to determine whether such investments were "prudent."[39]

In prior cases, the Commission has stated that it considers petitions for a rate increase, filed pursuant to Tenn. Code Ann. § 65-5-103(a),[40] in light of the following criteria:

1. The investment or rate base upon which the utility should be permitted to earn a fair rate of return;
2. The proper level of revenues for the utility;
3. The proper level of expenses for the utility; and
4. The rate of return the utility should earn.[41]

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[35] Notice of Withdrawal, paragraph 4.
[36] Tenn. Code Ann. § 65-5-101(a).
[37] Tenn. Code Ann. § 65-5-103(a).
[38] *Bluefield Water Works & Improvement Co. v. West Virginia Public Service Commission*, 262 U.S. 679, 692-3 (1923); *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591 (1944).
[39] *Missouri ex rel. Southwestern Bell Telephone Co. v. Public Serv. Comm'n of Mo.*, 262 U.S. 276, 291 (1923); *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 309 (1989).
[40] Previously codified as Tenn. Code Ann. § 65-5-203.
[41] *In Re: Petition Of Tennessee American Water Company to Change and Increase Certain Rates and Charges So as to Permit It to Earn a Fair and Adequate Rate Of Return on Its Property Used and Useful in Furnishing Water Service to Its Customers*, Commission Order, Docket 06-00290, at 20 (June 10, 2008).

The Commission has further stated that it "is obligated to balance the interests of the utilities subject to its jurisdiction with the interests of Tennessee consumers, i.e., it is obligated to fix just and reasonable rates."[42]

In determining rates, the Commission should also ensure that expenses and costs charged to consumers are not so high as to constitute, in effect, capital contributions to the utility:

> But if the amounts charged to operating expenses and credited to the account for depreciation reserve are excessive, to that extent subscribers for the telephone service are required to provide, in effect, capital contributions, not to make good losses incurred by the utility in the service rendered and thus to keep its investment unimpaired, but to secure additional plant and equipment upon which the utility expects a return.[43]

Finally, Tennessee law prohibits any utility from making unjust discriminatory charges or unreasonable preferences in its charges.[44]

IV. THE CONSUMER ADVOCATE'S TEST PERIOD AND ATTRITION PERIOD SHOULD BE ADOPTED BY THE COMMISSION BECAUSE THEY ARE MORE UP-TO-DATE THAN THE PERIODS PROPOSED BY THE COMPANY AND REFLECT THE USE OF THE COMPANY'S FISCAL YEAR.

Neither the Commission nor the intervening parties are confined by law or regulatory practice to accepting the test year proposed by the regulated utility seeking a rate increase. Tennessee courts have never required the Commission to use a specific test period methodology for setting rates; indeed, the courts have stated repeatedly that the Commission has the discretion to choose its own test period.[45]

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[42] *Id.*; *see* also *Tennessee Cable Television Ass'n v. Tennessee Public Service Comm'n*, 844 S.W.2d 151, 159 (Tenn. Ct. App. 1992) (rates should take into consideration the interests of both the consumer and the utility).
[43] *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 607 n. 10 (1944).
[44] Tenn. Code Ann. § 65-4-122.
[45] *CF Industries v. T.P.S.C.* 599 S.W. 2d 536, 542 (Tenn.1980); *Powell Telephone v. T.P.S.C.*, 660 S.W.2d 44, 46 (Tenn.1983); *Tennessee Cable Tel. v. T.P.S.C.* 844 S.W. 2d 151, 159 (Tenn.Ct.App. 1992) (cert.denied); *AARP v.*

The only limit placed on a ratemaking body is the statutory requirement that rates be just and reasonable. Rates therefore need not be determined using definite rules or precise formulas.[46] Thus, the Commission is not bound by any specific means by which rates are set so long as the end result produces just and reasonable rates.

In setting rates, the Commission has unfettered discretion to select the test year period.[47] A "test year" is a measure of a utility's financial operations and investment over a specific twelve-month period. It is the "raw material" for developing an attrition year measure of the utility's financial operations and investment (that is, the utility's Rate Base, Operations and Maintenance Expense, Depreciation Expense, and Taxes). Therefore, as pointed out by Mr. Novak in his Direct Testimony, the selection of the test year is quite important:

> The Company has proposed the twelve months ended June 30, 2017 as its test period with attrition adjustments through the twelve months ending June 30, 2019. These proposed dates appear somewhat stale given that any new rates adopted by the Commission are now anticipated to become effective on October 1, 2018. As a result, I have updated the Company's proposed test period to the twelve months ended December 31, 2017 and the proposed attrition period to the twelve months ending December 31, 2019.[48]

It is essential that a test year contain and/or be updated with the most accurate and current information available. The test year is used to analyze historical data and to make known and reasonably anticipated changes to arrive at an attrition year. An "attrition year," also known as a forecast period, is the "finished product" and is the chief determinant in whether a revenue

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T.P.S.C., 896 S.W. 2d 127, 133 (Tenn.Ct.App.1994) (cert.denied); and *TAWC v. Commission*, No. M2009-00553-COA-R12-Filed, at 20, January 28, 2001 (see Attached Exhibit TP-1).

[46] *Tennessee Cable Tel. v. T.P.S.C.* 844 S.W. 2d 151, 159 (Tenn.Ct.App. 1992) (cert.denied).

[47] See *Order,* Docket No. 06-000187 (November 27, 2008), pp.5-6 for a clear example of the Commission's conclusions as to its discretion in selecting a test year period. See also *Powell Telephone v. T.P.S.C.*, 660 S.W.2d 44, 46 (Tenn.1983) (citing *CF Industries v. T.P.S.C.*, 599 S.W. 2d 536, 542 (Tenn.1980)).

[48] Novak Direct Testimony, page 4, lines 1-9.

deficiency or surplus exists such that rates must be adjusted. And while the attrition year could be viewed as the first year during which the Commission's rate order will be applied, it would be a stretch to assert, as Company witness Dallas did in his rebuttal testimony and at the Hearing on the Merits in this Docket, that an attrition year determines when rates must go into effect.[49] The Consumer Advocate would respectfully note that the effective date of new rates going into effect need not coincide with the beginning of an attrition year. In this Docket, as noted by Mr. Novak above, the Consumer Advocate has forecasted an attrition year period ending December 31, 2019, while the Company has forecasted an attrition year ending June 30, 2019.

The Company has proposed an historical test year period ending June 30, 2017, which as Mr. Novak notes, is a bit stale.[50] In this Docket, as it commonly has done in others, the Consumer Advocate has applied a more up-to-date historic test year, ending in December 31, 2017. The use of a bit more up-to-date test year is essential to test the veracity of the Company's proposed rate increase. There is ample precedent for the Commission to adopt an updated test year.[51]

The Consumer Advocate's methodology of applying a more recent test year has the advantage of providing more accurate and current information for the forecast of the attrition year.[52] Indeed, the final decision of the Commission in TAWC's last rate case explicitly adopts portions of the Consumer Advocate's attrition period forecast, based upon the Consumer Advocate's historic test year which was more current than that of TAWC -- and the Commission

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[49] Rebuttal Testimony of Wendell Dallas filed in this Docket No. 18-00017 on August 3, 2018 (Dallas Rebuttal Testimony), page 4, line 22, through page 5, line 8; Transcript, Vol. I A, page 43, line 22, through page 44, line 1.
[50] Novak Direct Testimony, page 4, lines 5-7.
[51] See Direct Testimony of William Novak filed in Docket No. 10-00189 on January 5, 2011, page 4, lines 5-13.
[52] The Consumer Advocate's approach has been approved in at least one recent general rate case. See, for example, Docket 16-00001 (compare the Stipulation and Settlement Agreement filed in that Docket, as approved by the Commission, page 3, with the Direct Testimony of William H. Novak filed in that Docket, page 6.

has specifically adopted the Consumer Advocate's forecast on the grounds that it was "based on the most current information available."[53]

The use of the Consumer Advocate's proposed test period and attrition period would cause those periods to coincide with the Company's fiscal year. This could have the added benefits of the incorporation of year-end adjustments that may not be available if the Company's proposed June 30 year-end periods were used. Further, at least one utility has argued that the use of a non-fiscal year amounts or calculations could result in serious tax implications that could be avoided through the use of a utility's fiscal year in certain contexts.[54]

Accordingly, the Consumer Advocate recommends that the Commission accept the Consumer Advocate's use of a test year ending December 31, 2017 for purposes of forecasting the attrition year ending December 31, 2019.

V. THE CONSUMER ADVOCATE'S ATTRITION PERIOD REVENUE REQUIREMENT SHOULD BE ADOPTED BY THE COMMISSION BECAUSE IT FOLLOWS METHODOLOGIES ESTABLISHED IN PRIOR COMMISSION ORDERS, IS BASED ON HISTORICAL ANALYSIS AND REASONABLY ANTICIPATED ADJUSTMENTS, IS AUDITABLE AND SUPPORTED BY THE RECORD, AND REFLECTS REASONABLE ALLOCATIONS OF COSTS INCURRED WITHIN THE SOUTHERN COMPANY SYSTEM.

Using the Consumer Advocate's attrition period in its most recent filing, the difference at present rates between the Company's Gas Sales and Transportation Revenue ($71,157,128) and the Consumer Advocate's Gas Sales and Transportation Revenue ($75,755,428) is about $4,598,300.[55] The comparable difference using the Company's attrition period would be

[53] Order, Commission Docket 06-00290, p. 40, June 10, 2008.
[54] See Atmos Energy Docket Nos. 17-00091 and 18-00003.

[55] Revised CPAD Exhibit, Schedule 7, line 1.

$5,158,441 ($75,415,214 less $70,256,773).[56] With that noted, as may be seen on the Consumer Advocate's Exhibit and workpapers and as developed at the Hearing on the Merits, there are a substantial number of issues that divide the Consumer Advocate and the Company in their respective forecasting of revenue at present rates using the Consumer Advocate's attrition period.

A. The Consumer Advocate's Weather Normalization Adjustment Methodology Follows the Methodology Established in Prior Commission Orders and Contains a Clear and Supported Audit Trail

The Company and Consumer Advocate used weather data from the Chattanooga weather station to normalize sales data for abnormal usage.[57] In terms of methodology, though, the Consumer Advocate's expert used a simple linear regression calculation of heating degree days to sales per bill. The methodology used by the Consumer Advocate is the same weather normalization methodology adopted by the Commission in the last general rate cases for Atmos Energy Corporation, Kingsport Power Company and Piedmont Natural Gas Company.[58] The Consumer Advocate's expert used this same weather normalization adjustment methodology to compute the Consumer Advocate's proposed WNA factors. A summary of the Consumer Advocate's weather adjustments, as well as the detailed calculations, are included on Attachment WHN-3 to Mr. Novak's Direct Testimony for WNA tracking purposes.

In contrast, the Company chose to use a multi-linear regression methodology using a proprietary software program that is based on multiple variations of the measurement for heating

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[56] Company's Updated Response to TPUC's Workbook Request, filed in Docket No. 18-00017, on August 28, 2018 (Company's Updated Workbook Response), Schedule 3, line 1.
[57] Novak Direct Testimony, page 7, lines 17-18.
[58] Respectively, TPUC Docket Nos. 14-00146, 16-00001 and 11-00144.

degree days.[59] The Company's approach resulted the Company's weather normalization adjustments being convoluted and lacking in a clear audit trail detailing how its results were determined. To complicate the process further, the Company calculated a separate regression equation to compute its proposed WNA factors.[60] Mr. Novak's noted that he was unable to confirm the Company's weather adjustment calculation.[61]

Notwithstanding the use of these different methods and the use of an overly complicated approach, Company witness Brooks at the Hearing on the Merits admitted that he had not even reviewed the WNA methodologies used in the most recent Piedmont, Atmos Energy, Kingsport Power, or even some of the Company's prior cases to determine if there was a long-standing Commission WNA methodology.[62] Company witness Brooks was unable to say that the Company's complicated WNA methodology had been adopted – or even if a decision had been made about its adoption – in other jurisdictions.[63]

In this Docket, the Company has requested the reactivation of the WNA along with the termination of the AUA.[64] The Consumer Advocate recommends that the Commission grant the

[59] Novak Direct Testimony, page 7, line 18 through page 8, line 3.
[60] Transcript, Vol. I B, page 189, line 25, through page 190, line 4.
[61] Novak Direct Testimony, page 8, lines 5-6.
[62] Transcript, Vol. I B, page 190, line 18, through page 192, line 4.
[63] Transcript, Vol. I B, page 196, line 11, through page 198, line 17.
[64] Direct Testimony of Archie Hickerson, Page 3, Lines 14 – 21. It also must be noted that in the Company's last rate case, Docket No. 09-00183, the Commission approved an Alignment and Usage Adjustment (AUA) for the R-1 and C-1 tariffs only, as discussed in more detail in Mr. Novak's Direct Testimony. See Commission Order in Docket No. 09-00183, Page 57 (November 8, 2010). The AUA took the place of the previous WNA. Although there was no mention of a WNA mechanism in the Commission's Order in Docket No. 09-00183, CGC has continued to file a WNA reconciliation for the R-4 and C-2 tariffs. Further, the Commission Staff has continued to audit these WNA reconciliations for the past several years without any apparent approval by the Commission for its authorization. See, for example, Docket No. 17-00062. Without any acknowledgement in the Commission's Order of a WNA that clearly lays out the particular WNA factors approved, it would be reasonable to surmise that a WNA was not approved for any of CGC's customer classes. See Novak Direct Testimony, page 9, lines 1-14.

Company's request and implement the WNA factors shown in Attachment WHN-3 to Mr. Novak's Direct Testimony.[65]

B. Transferee Owners of a Plant Should Not Receive the Special Contract Rate Discount Approved for Transferor Owners Because the Circumstances Under Which the Special Contract Was Approved are Not the Same

On July 18, 2000, the Commission approved a Special Contract with E.I. du Pont de Nemours (du Pont) in Docket No. 99-00908.[66] Since approval of this contract with du Pont, CGC has assigned the rates to subsequent owners of this plant without Commission approval.[67] The Consumer Advocate's expert questioned, through discovery, the assignment of this Special Contract, and the Company responded that the "[a]ssignment of the contract and/or the rates, terms, and conditions contained therein does not require the approval of the TPUC."[68]

The Consumer Advocate contends that the unique conditions that were present with the original owner of the plant that required a Special Contract rate do not necessarily exist for the subsequent owners.[69] As a result, the Consumer Advocate believes that Company should have requested and obtained Commission approval before applying the Special Contract rate to the current owner.[70] With that said, as Mr. Novak notes, the existing contract is set to expire on October 31, 2019,[71] and with that in mind the anticipated volumes have been included for the current owner at the Special Contract rate. The Consumer Advocate recommends, however, that

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[65] As Mr. Novak notes, "the implementation of this WNA would be redundant with the implementation of an Alternative Rate Mechanism (ARM), since the ARM trues up actual costs to those approved in the last rate case. Therefore, I would recommend that the WNA be terminated if and when the Commission should determine that an ARM can be implemented for CGC." Novak Direct Testimony, page 9, line 21, through page 10, line 4.

[66] Novak Direct Testimony, page 12, lines 12-20.

[67] It appears that the rate was first assigned to "Invista" and then to "Kordsa" the current owner.

[68] See Novak Direct Testimony, page 12, lines 14-20 and the Company's response to CPAD Discovery Request 1-365.

[69] The Consumer Advocate is likewise not aware of a Commission action authorizing or allowing this transfer.

[70] Novak Direct Testimony, page 13, lines 3-8.

[71] See Company response to CPAD Discovery Request No. 1-18a.

the Commission clearly state that any and all assignments of special contracts to new owners requires Commission approval before the existing special contract rate can be charged.

C. Since the Gas Cost Associated with LNG Sales is Kept on the Company's Books, Then the Margin from Such Sales Should Also Be Kept on the Company's Books

For background, Chattanooga Gas owns and operates a liquefied natural gas (LNG) facility in Chattanooga that allows natural gas to be compressed, for storage, into a liquid state.[72] The Consumer Advocate's expert determined that the "cost of this LNG facility is included in rate base, and the cost of gas stored in the LNG facility is recovered through the purchased gas adjustment (PGA) mechanism."[73]

Through an Interruptible Margin Credit Rider (IMCR) in the Company's tariff, the Company is allowed to share, on a 50/50 basis, the margin from off-system sales with its customers.[74] Off-system sales are, in the ordinary course, considered to be natural gas sales outside of the Company's jurisdiction.[75] However, the Company also sells physical LNG that is transported in trucks to off-system customers.[76]

Prior to July 2010, the margin from these off-system sales of LNG were recorded on the books of CGC.[77] Starting in July 2010, however, an accounting change was made by which only the gas cost of LNG was kept on the Company's books while the margin from these sales was kept on an affiliate's books and later shared with the Company's customers on a 50/50 basis through the IMCR.[78]

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[72] Novak Direct Testimony, page 13, lines 20-21.
[73] Novak Direct Testimony, page 13, line 21, through page 14, line 2.
[74] Novak Direct Testimony, page 14, lines 4-6.
[75] Novak Direct Testimony, page 14, lines 6-7.
[76] Novak Direct Testimony, page 14, lines 7-8.
[77] Novak Direct Testimony, page 14, lines 10-11.
[78] See Company response to CPAD Discovery Request No. 2-19. The Consumer Advocate is not aware of a Commission action authorizing this change.

The Consumer Advocate contends that if the gas cost of LNG sales is kept on the Company's books, then the margin from such sales should also be kept on the Company's books.[79] Thus, the Consumer Advocate recommends that the Commission order the Company to maintain the accounting for the gas cost as well as the margin from LNG sales on the Company's books. This would reflect the same accounting methodology used by the Company prior to July 2010.

D. The Sharing Arrangement for Margin for Off-System LNG Sales Should Be Updated Because the Customer Bears a Disproportionate Risk to the Sharing Percentage it Receives

As described in the previous section, the current sharing arrangement for all margin from off-system sales, including LNG sales, is a 50/50 basis between the Company and the customers of CGC. CGC's customers bear all the risk and cost associated with these LNG sales.[80] The Company only acts as a sales agent to make the transaction happen.[81] With this relationship in mind, the Consumer Advocate recommends that the Commission update this sharing arrangement for off-system sales with 75% of the proceeds going to customers and the Company retaining 25% as a finder's fee for making the transaction happen.[82] Although the margin received from off-system sales is not a component of this rate case, the Consumer Advocate believes that changes to the structure of the Company's tariff are best handled in a rate case setting. The Consumer Advocate therefore recommends that this change in sharing be considered at this time.

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[79] In addition, the margin transfer to an affiliate's books appears to assume that the affiliate of CGC will always be the asset manager that would control the sales of LNG. The Consumer Advocate would point out that this will not always be true since competitive bids are made for the asset manager role.

[80] Novak Direct Testimony, page 15, lines 10-12.

[81] *Id.*

[82] This is the same sharing arrangement that the Commission has already approved for off-system sales by Piedmont Natural Gas Company.

E. The Consumer Advocate's Attrition Period Rate Base Should be Adopted by Commission Because It Is Based On a Historical Analysis and Reasonably Anticipated Adjustments.

Rate Base represents the net investment in utility plant upon which the Company should be allowed the opportunity to earn a fair rate of return.[83] To compute attrition period Rate Base, the Consumer Advocate's expert began with the Consumer Advocate's test period balance for both the direct and indirect plant and then increased this amount by the five-year average of historical plant additions.[84] In contrast, the Company has calculated its attrition year Rate Base by taking its end of test period balance and adding amounts reflecting its budget for the attrition period.

Using the Consumer Advocate's attrition period, in its most recent filing, the difference between the Consumer Advocate's Rate Base of $139,109,931 and the Company's Rate Base of $157,443,028) is $18,333,097.[85] The comparable difference using the Company's attrition period is $18,685,356.[86] The Consumer Advocate asserts that the Company's budget-based approach to forecasting Utility Plant in Service is incorrect because it relies solely upon the Company's anticipated budget expenditures as opposed to the actual experience that has historically taken place.

There are two primary issues within the overall category of rate base – with these issues defining the specifics of the divide between the Consumer Advocate and the Company in their respective forecasting of rate base.

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[83] Novak Direct Testimony, page 16, lines 6-8.
[84] This five-year average was consistently used to develop a normalized level for all Rate Base items.
[85] Revised CPAD Exhibit, Schedule 3, line 21.
[86] Company's Updated Workbook Response, Schedule 2, line 13.

1. The Consumer Advocate's Calculation of Utility Plant in Service Should be Adopted Because It Is Based on an Analysis of the Company's Historical Expenditures and Reasonably Anticipated Adjustments.

Utility Plant in Service is the largest component of rate base and represents the average amount of utility assets for the attrition year upon which the Company should be allowed the opportunity to earn a return.[87] This attrition period Utility Plant in Service contains two different components – direct plant located in Chattanooga and indirect plant that is allocated to the Company.[88] The breakdown of these two components of plant is shown the table below (as it was set out in Table 4 in Mr. Novak's Direct Testimony).[89]

Components of Plant in Service			
Plant Component	**Consumer Advocate[90]**	**CGC[91]**	**Difference**
Direct Plant in Service	$299,137,680	$298,834,883	$302,797
Indirect Plant in Service	1,561,797	2,580,142	-1,018,345
Total	**$300,699,477**	**$301,415,025**	**$-715,548**

[87] Novak Direct Testimony, page 16, lines 9-14.
[88] *Id.*
[89] See Novak Direct Testimony, page 16, line 15, and the table following. It also should be noted that a portion of the Company's incentive compensation is capitalized and included within Utility Plant in Service. See Novak Direct Testimony, page 16, footnote 16. Because the Commission has traditionally disallowed incentive compensation in setting rates, the cumulative capitalized portion of this incentive compensation should also be deducted from Plant in Service. See, for example, the Stipulation and Settlement Agreement in Docket No. 14-00146, including Attachment H to that Agreement entitled "Disallowance Subaccounts" with the first six of such subaccounts expressly removing incentive compensation. Later Atmos Energy filings under its annual rate review mechanism expressly removed capitalized incentive compensation. However, as Mr. Novak notes in his Direct Testimony, "my review of capitalized incentive compensation revealed that it was not material relative to the Company's total plant in service, and I am not proposing such an adjustment for this case."
[90] Consumer Advocate Rate Base Workpapers RB-10.00 and RB-11-1.00.
[91] Company Response to MFG No. 69-1.

To compute attrition year Utility Plant in Service, Mr. Novak began with the test period balance for both the direct and indirect plant and then increased this amount by the five-year average of historical plant additions.[92]

In contrast, the Company has calculated attrition year Utility Plant in Service by taking the test period balance and then adding its budgeted capital expenditures for 2017, 2018 and 2019.[93] The Consumer Advocate asserts that CGC's budget-based approach to forecasting Utility Plant in Service is incorrect because it relies solely upon the Company's anticipated budget expenditures as opposed to the actual experience that has historically taken place.[94]

Further, the Consumer Advocate asserts that the regulatory paradigm works by the Company investing in utility plant and then receiving a return on that investment. Using that paradigm, in a rate case such as this Docket, the amount of plant that the Company has historically been placing in service would essentially be extended in order to arrive at a reasonable attrition year forecast for setting rates. By contrast, the Company has proposed a budget-based investment amount, far in excess of historical additions, that would allow the Company to receive a return on plant before that plant has been placed in service. The Consumer Advocate recommends the Commission follow the more traditional paradigm and not permit the Company to increase rates on customers through a speculative budget prepared by the Company.

With respect to the allocation of indirect common plant to Chattanooga, the Consumer Advocate's expert used an average of the service company affiliate[95] throughput volumes and

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[92] This five-year average was consistently used to develop a normalized level for all Rate Base items.
[93] Novak Direct Testimony, page 17, lines 5-10.
[94] *Id.*
[95] In addition to Chattanooga Gas Company, these affiliates include Atlanta Gas Light Company, Virginia Natural Gas, Florida City Gas, Elkton Gas Services, Elizabethtown Gas Company and Nicor Gas.

number of customers for 2016 and 2017 which produced an allocation factor of 1.63%.[96] In addition to the merits of the methodology, the Consumer Advocate is unaware of any other instance in which a utility has proposed to allocate indirect common plant based on indirect expenses charged to the utility. In contrast, the Company has used a 1.90% factor to allocate common plant to Chattanooga that is based upon the percentage of expenses charged to CGC relative to the total expenses allocated to all affiliates.[97] In fact, Company witness Morley confirmed that expenses is the only factor used to allocate common plant to the Company.[98] Mr. Morley also admitted to not looking at any recent Commission orders or authority with respect to allocation methodologies.[99]

The Consumer Advocate asserts that the use of charged expenses is a poor measure to allocate indirect common plant since it is based on currently charged activity.[100] At the Hearing on the Merits, Company witness Morley admitted that he "did not go through all the expenses, to determine whether or not they were properly charged to CGC, but Mr. Tucker did."[101] But Mr. Morley then backtracked to say that he did not think Mr. Tucker reviewed the actual invoices, but that he only reviewed the general ledger balances.[102] Mr. Morley confirmed that the expenses were not "audited in any way by a third party or internally," and that the Consumer Advocate would just be trusting the Company that the expenses are accurate.[103]

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[96] Novak Direct Testimony, page 17, lines 14-18; Consumer Advocate Rate Base Workpaper RB-11-5.00.
[97] Novak Direct Testimony, page 17, lines 15-18; CGC Response to MFG No. 71.
[98] Transcript, Vol. II A, page 12, lines 16-23.
[99] Transcript, Vol. II A, page 15, line 17, through page 16, line 18.
[100] Novak Direct Testimony, page 17, lines 16-19.
[101] Transcript, Vol. II A, page 13, lines 14-19.
[102] Transcript, Vol. II A, page 13, line 20, through page 14, line 2.
[103] Transcript, Vol. II A, page 14, lines 3-14.

2. The Consumer Advocate's Calculation of Construction Work in Progress Should be Adopted Because It Is Based on an Analysis of the Company's Historical Expenditures and Reasonably Anticipated Adjustments.

Construction Work in Progress (CWIP) represents plant currently under construction that will soon become used and useful in providing utility service to the Company's customers.[104] To project CWIP, the Consumer Advocate's expert used a five-year historical average of the annual balances in this account for direct and indirect costs.[105] Mr. Novak then allocated the indirect CWIP costs using the same allocation rate of 1.63% that was used for Plant in Service.[106]

In contrast, the Company has calculated its attrition year CWIP of $12,457,439[107] from its projected capital expenditures for 2017, 2018 and 2019.[108] As with Utility Plant in Service, the Consumer Advocate contends that the Company's budget-based approach to forecasting Construction Work in Progress is incorrect because it relies solely upon the Company's anticipated budget expenditures as opposed to the actual experience that has historically taken place.[109] Further, it must be noted that the Company's attrition period capital budget anticipates expenditure levels far more than what has been historically spent.[110] While the Consumer Advocate's expert does not opine as to whether this level of spending is prudent, he does state his belief that it would be inappropriate to set rates on a speculative budget that is materially more than the historical expenditure amounts.[111]

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[104] Novak Direct Testimony, page 18, lines 3-8.
[105] *Id.*
[106] *Id.*
[107] Company's Updated Workbook Response, Schedule 2, line 2.
[108] Novak Direct Testimony, page 18, lines 12-21; CGC Response to MFG No. 69-2.
[109] See *id.*
[110] See *id.*
[111] Further, Mr. Novak notes that if an ARM is ultimately approved for CGC, then rates would be adjusted to reflect the actual level of investment.

3. The Consumer Advocate's Calculation of the Pension and Other Post-Employment Benefit Asset Should be Adopted Based on the Consistent Application of Commission Ratemaking Principles.

Pension & Other Post-Employment Benefit (OPEB) Assets represent the accrued asset values of the Company's employee retirement benefits.[112] The attrition period amounts forecasted by the Company and the Consumer Advocate, as well as the amount recognized by the Commission in the Company's last general rate case in Docket No. 09-00183 is shown in the table below (as shown in Table 5 of Mr. Novak's Direct Testimony).[113]

Components of Pension & Other Post-Employment Benefits			
	Consumer Advocate[114]	**CGC[115]**	**TPUC Order 09-00183[116]**
Pension Assets	$0	$6,631,181	$0
Other Post-Employment Benefits	0	2,374,783	257,596
Total	**$0**	**$9,005,964**	**$257,596**

In this Docket, the Company proposes to recover the net accrued asset values for pension expense.[117] In contrast, the Commission has a long-established policy of only allowing rate recovery of the minimum required contribution for pension and other post-employee benefits expenses.[118] Consequently, the Consumer Advocate recommends that pension expense on the

[112] Novak Direct Testimony, page 19, lines 3-8.
[113] *Id.*
[114] Consumer Advocate Rate Base Workpapers RB-20-1.00.
[115] CGC Response to MFG No. 25, Exhibit RDJ 2-1.
[116] TPUC Order in Docket No. 09-00183, Page 35 (November 8, 2010).
[117] Novak Direct Testimony, page 19, lines 9-10, citing the Direct testimony of Gary Tucker substituting for the Direct Testimony of Rachael D. Johnson, filed May 11, 2018, Page 13, Lines 3 – 8;
[118] See specifically Commission Docket No. 92-14631, Investigation of Proper Regulatory Treatment of Other Post-Employment Benefits for Utilities Regulated by the Tennessee Public Service Commission.

income statement be limited to cash contributions, which results in no accrued assets in rate base.[119]

4. The Consumer Advocate's Calculation of Materials and Supplies Should be Adopted Because It Is Based on an Analysis of the Company's Historical Expenditures.

Materials and Supplies represents the carrying value of miscellaneous materials and inventories and represents an investment on which the Company should be allowed to earn a reasonable return. To project the attrition period balance of Materials and Supplies, the Consumer Advocate's expert used a five-year historical average of the annual balances in this account while the Company has only taken the average balance in this account for 2017.[120] As a result, the Consumer Advocate's forecast is based on a normalized level of activity in this account, rather than merely the test period amount.

5. The Consumer Advocate's Calculation of Prepayments Should be Adopted Because It Is Based on an Analysis of the Company's Historical Expenditures.

Prepayments represent the carrying value of certain expenses that are paid in advance and then amortized over their useful life and represents an investment on which the Company should be allowed to earn a reasonable return. To project the attrition period balance of Prepayments, the Consumer Advocate's expert used a five-year historical average of the annual balances in this account while the Company has only taken the average balance in this account for 2017. As a result, the Consumer Advocate's forecast is based on a normalized level of activity in this account, rather than just the test period amount.

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[119] Novak Direct Testimony, page 19, lines 12-14.
[120] Novak Direct Testimony, page 21, line 19 through page 22, line 6.

6. The Consumer Advocate's Calculation of Gas Inventory Should be Adopted Because It Is Based on an Analysis of the Company's Historical Expenditures.

Gas Inventory represents the carrying value of gas in storage to serve the Company's customers. As this gas is consumed, it is charged to the customer through the Purchased Gas Adjustment. However, the carrying value of gas in storage represents an investment on which the Company should be allowed to earn a reasonable return. To project the attrition period balance of Gas Inventory, as with most other Rate Base calculations, the Consumer Advocate's expert used a five-year historical average of the annual balances in this account. In contrast, the Company has attempted to forecast the injections and withdrawals to gas inventory at forecasted New York Mercantile Exchange (generally referred to as NYMEX) prices through the end of the attrition year.[121] It is worth noting that even though the Consumer Advocate's forecast of Gas Inventory is slightly higher that the Company's ($10,168,496 vs. $9,710,633),[122] the Consumer Advocate recommends the adoption of its forecast for consistency with the calculation of other rate base components.

7. The Consumer Advocate's Determination of Deferred Rate Case Expense Should Be Adopted Because It Is Based on a Reasonable Approach to Allowing the Recovery of the Costs of Rate Cases, Including the Sharing of Expenses Between Shareholders and Ratepayers

Deferred Rate Case Expense represents the forecasted unamortized balance during the attrition year of the Company's cost of preparing, presenting and defending this rate case filing

[121] Direct testimony of Gary Tucker substituting for the Direct Testimony of Rachael D. Johnson, filed May 11, 2018, Pages 14-15.
[122] Revised CPAD Exhibit, Schedule 3, line 6.

before the Commission.[123] The Company is proposing to defer these expenses and recover them over the next three years.[124] The Consumer Advocate agrees with a three-year amortization.[125]

After reviewing CGC's proposed rate case expense, Consumer Advocate witness Novak removed certain expenses on the ground that they were unreasonable, i.e. imprudent or insufficiently supported by records or testimony.[126] In addition, Mr. Novak split certain rate case costs between ratepayers and shareholders since a portion of the rate case was for the benefit of shareholders.[127] The following chart sets forth Mr. Novak's rate case expense calculation.[128]

Components of Deferred Rate Case Expense			
Component	**Consumer Advocate[129]**	**CGC[130]**	**CGC Update[131]**
Depreciation Study	$46,832	$46,832	$57,119
Rate Design	0	60,000	68,940
Legal Cost	200,000	550,000	667,850
Lead Lag Study	50,320	50,320	82,715
Cost of Equity	50,000	50,000	0
Consultants	0	157,995	115,511
Total	**$347,152**	**$915,147**	**$992,135**

[123] Novak Direct Testimony, page 23, lines 7-13 and including the table following line 13.
[124] *Id.*
[125] Novak Direct Testimony, page 25 line 16.
[126] Novak, Direct Testimony, pages 23-25.
[127] Novak, Direct Testimony, page 24, lines 20-21 – page 25, lines 1-2.
[128] Novak, Direct Testimony, page 23, Table 6.
[129] Consumer Advocate Rate Base Workpaper RB-45-2.00.
[130] CGC Response to MFG No. 69-4.
[131] Actuals through May 2018 contained in CGC updated response of June 13, 2018 to CPAD-1-175.

As shown on the above table, the Consumer Advocate's expert accepted the Company's estimate for the consultant costs related to the depreciation study, the lead-lag study, and the cost of equity witness.[132] However, the consultant costs related to rate design were rejected because these costs were for the class cost of service study (CCOSS) because, to the knowledge of the Consumer Advocate and its expert, the Commission has never accepted or set utility rates on a CCOSS.[133] These expenditures, consequently, appear to be imprudent and as such should be removed from the Consumer Advocate's projection of rate case expense.[134] The Company's estimate of rate case costs related to "Consultants" was rejected because the Company has never identified the need or purpose for these costs.[135]

For the legal expense portion of rate case costs, the Consumer Advocate was surprised by the Company's original estimate of $550,000.[136] That surprise became even greater at the Company's actual record of legal costs incurred to date for $667,850 (as of the date of the Consumer Advocate's testimony), since the only apparent legal costs involved to that point would be reviewing the filing and cataloging the discovery responses.[137] Among the surprising aspects of the case was the Company's decision to retain two separate law firms in this docket.[138] To the Consumer Advocate, this seemed out of the norm for recent rate cases – especially

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[132] Novak Direct Testimony, page 24, lines 1-5.
[133] Novak Direct Testimony, page 24, lines 5-8. *See also* Transcript, Vol. III A, August 22, 2018, page 32, lines 9-12.
[134] Novak Direct Testimony, page 24, lines 8-9.
[135] Novak Direct Testimony, page 24, lines 10-11.
[136] Novak Direct Testimony, page 24, lines 13-14.
[137] Novak Direct Testimony, page 24, lines 14-17. However, by the time of the Hearing on the Merits, the Company's rate case costs were $1.2 million. Putting this in context, Mr. Novak explained that "[t]his is well over twice the cost of the last Atmos rate case even though Chattanooga only has about half as many customers. It's almost the most in rate case costs ever for any gas, electric, and water utility." Transcript, Vol. III A, August 22, 2018, page 31, lines 24-25 - page 32, lines 1-5.
[137] Transcript, Vol. III A, August 22, 2018, page 32, lines 6-9.
[138] Novak Direct Testimony, page 24, lines 17-18.

general rate cases – and consequently seemed duplicative and imprudent.[139] As a result, it seemed appropriate to eliminate half of the estimated legal costs.[140] Further, Mr. Novak noted that in a prior case, the Commission recognized in an Order that at least some portion of rate case expense should be borne by stockholders and allocated only 50% of rate case expense to ratepayers.[141] As a result, the Consumer Advocate's expert only included $200,000 as the appropriate legal costs for this case.[142]

During his testimony Mr. Novak acknowledged that the Commission Order he referenced as supporting a sharing of rate case expenses between shareholders and ratepayers was overturned on appeal but pointed out that the court's ruling was based on insufficient support in the record for such a sharing between ratepayers and shareholders in that case, not on the invalidity of the principle of sharing expenses.[143]

The appellate case addressing the sharing of expenses referred to by Mr. Novak is *Tennessee American Water Co. v. TRA*, 2011 WL 334678 (Tenn. Ct. App. Jan. 28, 2011). In that case, the court held as follows:

> The TRA goes on to justify its decision to allow only one-half of the rate case expenses proposed by TAWC and leave the remaining half to be paid by the company's shareholders by providing details of the costs of the "four labor-intensive utility cases [filed] in the five years spanning 2003 through 2008".
>
> However, the record and Final Order are devoid of the foregoing accusations made by the TRA about TAWC. The record and Final Order do not explain what specific expenses the TRA deemed unnecessary, improvident, or improper or that the Authority closely examined the costs associated with the rate case to determine the portion to be recovered from rate payers and the portion to be born by the shareholders. Such an

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[139] *Id.* Transcript, Vol. III A, August 22, 2018, page 32, lines 6-9.
[140] Novak Direct Testimony, page 24, lines 17-18.
[141] Novak Direct Testimony, page 24, line 20 – page 25, line 1. *See also* Commission's Order in Docket No. 08-00039, page 24, January 13, 2009.
[142] Novak Direct Testimony, page 25, lines 1-2.
[143] Transcript, Vol. III A, August 22, 2018, page 36, line 21 – page 37, line 8.

> examination should have taken place and its results included in the record and Final Order. Based on the lack of such findings, the TRA's decision to only include one half of the cost of the rate case in the rate was arbitrary.[144]

Thus, Tennessee American establishes the principle that upon a proper showing, it is within the sound discretion of TPUC to share case expenses between shareholders and ratepayers.

The sharing of rate case expenses between ratepayers and shareholders "is rooted in fundamental fairness, as both shareholders and ratepayers benefit from a rate case proceeding".[145] In this Docket, Mr. Novak explained the benefits to both shareholders and ratepayers at the Hearing on the Merits under the examination of Mr. Foster:

> Q. Continuing with the discussion of rate case expenses, can you kind of discuss whether or not there's benefits to both shareholders and ratepayers and maybe what those benefits are?
>
> A. Certainly. Whenever there's a rate case, obviously, the utility's earnings are going to increase because its going to get recognition of plant that it has placed in service. It's going to get recognition of its current level of expenditures. So that is certainly to the benefit of stockholders. The – it's also to the benefit of ratepayers to have the most current cost of service reflected in rates and to provide encouragement for the extension of utility service as well. So there is accommodation for both sides, company and the customer, sharing in the burden of rate case expenses.[146]

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[144] Tennessee American at *27.

[145] *I/M/O Suez Water Arlington Hills Inc. for Approval of an Increase in Rates for Wastewater Service*, New Jersey BPU Docket No. WR1606510, Order (10/20/17) (https://www.state.nj.us/bpu/pdf/boardorders/2017/20171020/10-20-17-5D.pdf) in New Jersey, for example, the sharing is 50/50; *See also , I/M/O The Petition of Suez Water Arlington Hills, Inc. for Approval of an Increase in Rates for Wastewater Service and Other Tariff Changes*, New Jersey BPU Docket No. WR16060510, Initial Brief on Behalf of the Division of Rate Counsel, pages 21-22 (4/13/17)(https://www.state.nj.us/rpa/docs/PUC09261-2016%20Suez_Water_Arlington_Hills%20Rate_Counsel_Initial_Brief.pdf).

[146] Transcript, Vol. IIIA, August 22, 2018, page 40, line 14 – page 41, lines 1-4.

In addition, the Company is seeking an increase in the return on equity (ROE) from 10.05% to 11.25%.[147] Since such a large increase in the ROE was clearly for the benefits of shareholders it is only appropriate that they should share in the cost of the case.[148]

Furthermore, sharing the rate case expense between shareholders and ratepayers gives shareholders an interest in settlement and a motivation to hold down costs.[149] Otherwise, if ratepayers bear all the costs, companies would have every incentive to "roll the dice" since there would be no risk to even the most speculative claims.[150]

In determining the reasonableness of CGC's legal expense, CGC did not provide any copies of attorney's bills to be reviewed by the Consumer Advocate or TPUC staff (the Consumer Advocate requested such bills in Request 2-45 but CGC objected). Furthermore, the person who was responsible for reviewing the attorney's bills, Elizabeth Wade, did not testify at the Hearing on the Merits or present any affidavit.[151] Mr. Dallas of CGC testified that while he reviewed certain non-legal contracts, he did not review legal bills.[152]

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[147] Note that the ROE was reduced from 10.3% (as originally ordered) as a result of the adoption of the AUA. TPUC Order in Docket No. 09-00183, page 66, paragraph 4.

[148] The New Jersey Rate Counsel also recognized that a return on equity issue is one that "benefits shareholders exclusively. Ratepayers receive nothing from a higher ROE except higher bills." *I/M/O The Petition of Suez Water Arlington Hills, Inc. for Approval of an Increase in Rates for Wastewater Service and Other Tariff Changes*, New Jersey BPU Docket No. WR16060510,Reply Brief on Behalf of the Division of Rate Counsel, pages 14 (5/14/17) (https://www.state.nj.us/rpa/docs/WR16060510_Suez_Water_Arlington_Hills_Rate_Counsel_Reply_Brief.pdf). *See also I/M/O Suez Water Arlington Hills Inc. for Approval of an Increase in Rates for Wastewater Service*, New Jersey BPU Docket No. WR1606510, page 15, Initial Decision (8/16/17) (Attached to Commission Order at https://www.state.nj.us/bpu/pdf/boardorders/2017/20171020/10-20-17-5D.pdf).

[149] Initial Brief on Behalf of the Division of Rate Counsel, New Jersey BPU Docket No. WR16060510, page 22 (4/13/17). .

[150] The Administrative Law Judge in *I/M/O Suez Water Arlington Hills Inc.* noted that "[w]hile there is no doubt that the Company took major steps to avoid this litigation by employing substantial mitigating measures, the harm resulting from a failure to settle this matter should not be heaped on the ratepayer for a decision they did not make." *I/M/O Suez Water Arlington Hills Inc. for Approval of an Increase in Rates for Wastewater Service*, New Jersey BPU Docket No. WR1606510, Initial Decision (8/16/17).

[151] Transcript, Vol. I B, August 21, 2018, page 96, line 19 – page 97, line 7.

[152] *Id.*

Finally, as noted by the Consumer Advocate's expert, the Consumer Advocate believes that some boundaries should be applied to rate case costs that are ultimately borne by customers.[153] In this Docket, it appears that rate case costs have become a "runaway" item for CGC without any limits.[154] Recall that in Docket No. 09-00183 the Company's rate case costs were $632,002.[155] That amount was more than double the previous rate case cost in Docket No. 06-00175.[156] Without any restrictions, it appears that the Company's rate case cost will double again in this current Docket.[157] As a result, the Commission may want to consider severing this item from the rate case and setting up a separate docket to determine the appropriate and prudent expenditure for rate case expense.[158]

8. The Consumer Advocate's Determination of Cash Working Capital Should be Adopted Because It Is Based on a Reasonable Approach to Amount of Cash the Company Should Require on a Day-to-Day Basis.

Cash Working Capital (CWC) is a measurement of the amount of cash a company needs to have on hand to fund day-to-day operations.[159] The most precise method of determining CWC is through the use of a lead-lag study, such as the one presented by CGC witness Adams in this case.[160] Essentially, a CWC study measures the timing between when revenue is earned and when it is received, when cash expenses are incurred and when they are paid.[161] These measurements are netted to determine the amount of funding required to provide utility service.

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[153] Novak Direct Testimony, page 25, lines 4-5.
[154] Novak Direct Testimony, page 25, lines 5-6.
[155] Novak Direct Testimony, page 25, lines 7.. *See also* Commission's Order in Docket No. 09-00183, page 24, November 8, 2010.
[156] Novak Direct Testimony, page 25, lines 8-9. *See also* Direct Testimony of Michael J. Morley, Docket 06-00175, page 11, lines 16-19, May 30, 2006.
[157] Novak Direct Testimony, page 25, lines 9-10.
[158] Transcript, Vol. III A, August 22, 2018, page 31, lines 21-24.
[159] Direct Testimony of David N. Dittemore, on behalf of the Consumer Advocate (Dittemore Direct Testimony), page 17, lines 16-24.
[160] *Id.*
[161] *Id.*

This level of funding or investment is appropriately included as a component of Rate Base and may be positive or negative depending upon the outcome of the study.[162]

The Consumer Advocate's expert has two proposed adjustments to the calculation of CWC in this Docket.[163] First, Return on Equity is excluded from the balance of Operating Expenses subject to calculating the Daily Cost of Service.[164] Second, the test period average balance of tax collections withheld is incorporated into Consumer Advocate's adjustments.[165]

Since the purpose of a lead lag study is to determine the cash necessary to fund operating expenses, the Consumer Advocate notes that Return on Equity is neither a cash item, nor an operating expense.[166] In other words, Return on Equity does not require that the Company have available cash to be used on behalf of CGC or The Southern Company.[167] As the Consumer Advocate's expert states:

> The payment of shareholder dividends is optional, and the vast majority of Net Income is retained by the Company. If dividends are paid, they are done so in arrears, with a significant expense lag. This lag has not been factored into Mr. Adams' analysis, assuming a conclusion that some aspect of Return on Equity represented a requirement to outlay cash to fund operations Finally, investors recognize that the receipt of cash associated with Return on Equity is not instantaneous and that any such delays are already factored into shareholder expectations.[168]

This view has been adopted in an earlier Commission docket. In Docket No. 12-00049, the Commission excluded Return on Equity costs from the calculation of Daily Operating Expenses, and therefore it was completely excluded from determination of CWC. Other

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[162] *Id.*
[163] See CPAD Exhibit, Schedules 4 and 5. Consumer Advocate Schedule No. 5 sets out the Net CWC required of $150,702. This compares with a CGC request to increase Rate Base $1,521,871.
[164] Dittemore Direct Testimony, page 17, lines 8-9.
[165] Dittemore Direct Testimony, page 17, lines 11-12.
[166] Mr. Dittemore also indicates that he has not excluded other non-cash items from the CWC study, such as depreciation expense and deferred taxes, though he believes that the exclusion of these items may be warranted in future studies after further consideration.
[167] See Dittemore Direct Testimony, page 18, lines 9-10.
[168] Dittemore Direct Testimony, page 18, lines 10-15.

commissions have likewise not included a Return on Equity component in a lead lag study. For example, the Illinois Commerce Commission did not include return on equity in this context in a Nicor Gas Company rate case.[169] Likewise, the Return on Equity component was not included in the CWC calculation of Kansas Gas Service in Docket No. 06-KGSG-1209-RTS. And in a case before the Hawaii Public Utilities Commission,[170] the Hawaii 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)[171]

Thus, the Consumer Advocate asserts that there is ample support for excluding return on equity in calculating the CWC component of rate base.

The Consumer Advocate's second proposed adjustment to the calculation of CWC concerns the determination of the working capital provided from Franchise, Sales and Use taxes.[172] Generally, these are items that are collected from CGC ratepayers and later paid by the Company to appropriate taxing authorities.[173] As is apparent, the retention of these funds prior to remittance provides a source of ongoing working capital for the Company.[174] To quantify the amount of funds available to CGC, the Consumer Advocate's expert relied upon the use of the Test Period average balance of these liability accounts.[175]

9. The Consumer Advocate's Determination of Accumulated Depreciation Should be Adopted Because It Is Based the Allocation Factor that Was Used for Allocated Plant.

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[169] Illinois Commerce Commission Docket No. 17-0124.
[170] *In Re Hawaii Electric Light Company, Inc.*, 120 P.U.R. 4th 427 (Haw. Pub. Util. Comm'n, March 6, 1991).
[171] The Process of Ratemaking, Vol. II, Leonard Saul Goodman, Public Utilities Reports, Inc.
[172] Dittemore Direct Testimony, page 19, line 19, through page 20, line 2.
[173] *Id.*
[174] *Id.*
[175] *Id.* It also is worth noting that, for consistency as to methodology, this method is identical to that used to determine the gas inventory portion and Materials and Supplies components of rate base.

Accumulated Depreciation represents the amount of depreciation which has accrued over the life of the various capital assets included within Utility Plant in Service previously.[176] Like Plant in Service, Accumulated Depreciation is composed of two different components – accumulated depreciation related to direct plant located in Chattanooga and accumulated depreciation related to indirect plant that is allocated to CGC.[177] The breakdown of these two components of plant is shown below in the table below (as set out in Table 7 of Mr. Novak's Direct Testimony).

Components of Accumulated Depreciation			
Depreciation Component	**Consumer Advocate[178]**	**CGC[179]**	**Difference**
Direct Accumulated Depreciation	$131,439,768	$127,070,088	$4,369,680
Indirect Accumulated Depreciation	511,642	833,351	-321,709
Total	**$131,951,410**	**$127,903,439**	**$4,047,971**

In this case, the Company has proposed new depreciation rates for the Direct Plant located in Chattanooga.[180] As shown on Attachment WHN-4, the impact of these new depreciation rates will increase depreciation expense by $13,770 annually based on the asset values at December 31, 2017.[181] The proposed depreciation rates appear reasonable and have been reflected within the Consumer Advocate's calculation of depreciation expense for direct plant. The new depreciation rates also produced $7,848,702[182] in depreciation expense (after

[176] Novak Direct Testimony, page 26, lines 9-15.
[177] *Id.*
[178] Consumer Advocate Rate Base Workpapers RB-60.00 and RB-61-1.01.
[179] CGC Response to MFG No. 69-9.
[180] Novak Direct Testimony, page 26, line 16, through page 27, line 5.
[181] In addition, the Company's depreciation study recognized that certain assets had been over-depreciated by approximately $862,000. Consumer Advocate Rate Base Workpaper RB-60-3.03. The Company has proposed to amortize this excess depreciation over a five-year period. Company Exhibit DAW-2, Page 72.
[182] Revised CPAD Exhibit, Schedule 7, line 9.

amortization of the excess depreciation balance).[183] This $7,848,702 in net depreciation expense is reflected on the Income Statement in the Consumer Advocate's Exhibit.

In contrast, with respect to indirect plant, the Company has no authorized depreciation rates for indirect plant in service that is allocated to Tennessee. When asked about this in the discovery process, the Company responded as follows in CPAD 1-85:

> Provide the source for the current depreciation rates on common plant that are allocated to CGC from any affiliates.
>
> Response:
> The source for the depreciation rates is the judgement of management in the functional business units within AGL Services Company.

Since the Company has no approved depreciation rates for allocated plant, the Consumer Advocate contends that it would be inappropriate to include any depreciation expense on allocated plant in rates. While it would almost go without saying that the Company had resources at its disposal for consideration of depreciation rates on allocated plant, the Company chose not to make any provision for this deficiency. From the Consumer Advocate's perspective, the Company could have easily expanded the depreciation study for CGC direct assets to encompass the service company. However, the Company chose to ignore the need for approved depreciation rates for plant costs allocated to CGC. With that said, instead of accruing new depreciation expense on indirect plant, the Consumer Advocate's expert took the test period balance of accumulated depreciation and allocated it to CGC using the same 1.63% allocation factor that was used for allocated plant. This produced $511,642 in accumulated depreciation for indirect plant for the attrition period.[184]

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[183] Consumer Advocate Rate Base Workpaper RB-60.00.
[184] Consumer Advocate Rate Base Workpaper RB-61-1.01 and RB-1-1.00.

10. The Consumer Advocate's Determination of Customer Advances for Construction Should be Adopted Because It Is Based on a Reasonable Approach to Amount of Cash the Company Should Require on a Day-to-Day Basis.

Customer Advances for Construction typically represent non-investor supplied funds from customers for extending utility service that the Company has used to finance a portion of its utility investment and should therefore be included as a deduction in computing Rate Base. In 2017, the Company determined that the balance in this account should be credited against plant in service as a permanent adjustment. As a result, the attrition period balance for Customer Advances for Construction is $0.[185]

11. The Consumer Advocate's Determination of Reserve for Uncollectibles; Reserve for Health Insurance; and Other Reserves Should be Adopted Because It Is Based on an Analysis of the Company's Historical Balances.

These items represent the accumulation of prior period expenditures that are recorded as a reserve for abnormal conditions.[186] Consistent with other Rate Base calculations, the Consumer Advocate's expert used a five-year historical average of the annual balances in these accounts as an appropriate normalized balance for the attrition period.[187]

A five-year average of the expense component of the Reserve for Uncollectibles was also calculated, resulting in an attrition period forecast of $121,863.[188]

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[185] Revised CPAD Exhibit, Schedule 2, line 14.
[186] Novak Direct Testimony, page 29, lines 5-14.
[187] *Id.* Note that a four-year average was taken for the Reserve for Health Insurance as this was a relatively new account.
[188] Revised CPAD Exhibit, Schedule 9, line 6.

12. The Consumer Advocate's Determination of Customer Deposits and Interest on Customer Deposits Should be Adopted Because It Is Based on an Analysis of the Company's Historical Balances.

Customer Deposits are amounts advanced by customers to the Company for the privilege of obtaining utility service.[189] These deposits therefore represent a source of non-investor supplied funds which the Company has available to finance a portion of its utility investment and should therefore be included as a deduction in computing Rate Base.[190] Consistent with other Rate Base calculations, the Consumer Advocate's expert used a five-year historical average of the annual balances in these accounts as an appropriate normalized balance of $114,315[191] for the attrition period.

Interest on Customer Deposits represents the interest accrued on Customer Deposits and owed to the customer when the deposit is refunded.[192] Since this accumulated interest is owed to the customer, it represents a source of non-investor supplied funds which the Company has available to finance a portion of its utility investment and should therefore be included as a deduction in computing Rate Base.[193] Consistent with other Rate Base calculations, the Consumer Advocate's expert used a five-year historical average of the annual balances in these accounts as an appropriate normalized balance for the attrition period.[194]

F. The Consumer Advocate's Attrition Period Operations and Maintenance Costs Should be Adopted by Commission Based On Principles Established in Prior Commission Orders and Consistently Applied Thereafter.

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[189] Novak Direct Testimony, page 29, line 16, through page 30, line 15.
[190] *Id.*
[191] Revised CPAD Exhibit, Schedule 7, line 10.
[192] *Id.*
[193] *Id.*
[194] *Id.*

The Consumer Advocate recommends total O&M costs in this Docket of $10,964,177.[195] In contrast, the Company has proposed an amount of $13,453,586.[196] The difference between the amounts calculated by the Company and the Consumer Advocate, is $2,489,409, and primarily results from adjustments made by the Consumer Advocate in six specific areas, as summarized by the table below (as originally set out in Table 1 of Mr. Dittemore's Direct Testimony).

Table 1		
	Adjustments to O&M	**Amount**
	Test Period O&M	**12,067,184**
Adjustment 1	Elimination of Incentive Compensation	(1,368,574)
Adjustment 2	Elimination of Benefits Accrual and OPEB	(68,091)
Adjustment 3	Elimination of Lobbying Costs	(273,467)
Adjustment 4	Corporate Cost Allocations	(82,136)
Adjustment 5	Rate Case Amortization	115,718
Adjustment 6	Attrition Period Adjustment	573,543
	Attrtition Period O&M	**10,964,177**

The Consumer Advocate asserts that the above adjustments are reasonable and more accurately reflect the O&M expenses of the Company in this rate case.

1. The Consumer Advocate's Elimination of Incentive Compensation Should be Adopted Based On Principles Established in Prior Commission Orders and Consistently Applied Thereafter.

At the outset, the Consumer Advocate notes its surprise at the magnitude of allocated Incentive Compensation, especially in view of the relatively small size of CGC's operations.[197] The unadjusted O&M charges for the Company's test period, excluding gas costs, are just over

[195] Revised CPAD Exhibit, Schedule 6, line 6-7.
[196] Company's Updated Workbook Response, Schedule 4.
[197] See Dittemore Direct Testimony, at page 6, lines 15-19.

$12 million.[198] Therefore, the Incentive Compensation costs represent over 13% of the total CGC O&M charges.[199]

In response to discovery and in testimony, the Company describes two general types of incentive compensation for employees of The Southern Company, short-term and long-term.[200] The short-term program is referred to as the Performance Pay Program and is available to all employees. The Long-Term Incentive Compensation program is available to employees in a certain pay grade. The total Incentive Compensation recorded on CGC books in the Test Period for short-term and long-term is split as $811,005 for short term and $557,569 as long term.[201]

To put this in the context of this case and the Company's Tennessee service territory, there appear to be no Tennessee-based employees eligible for Long-Term Incentive Compensation.[202] With that in mind, the Consumer Advocate asserts that a significant portion of the Short-Term Incentive Compensation payouts are driven by corporate and business unit financial performance that directly benefits The Southern Company shareholders and therefore such costs should not be borne by CGC ratepayers. These corporate and business unit financial performance goals include metrics that measure The Southern Company's Earnings Per Share (EPS)[203] and those that measure SCG's net income. Further, all Long-Term Incentive Compensation is designed to encourage eligible employees to enhance per-share increases in The Southern Company stock price. The higher the stock price relative to its group of peer electric utilities, the greater the employee payout. Such compensation is designed to benefit shareholders

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[198] *Id.*
[199] *Id.*
[200] Response to CPAD Discovery Request No. 1-117a and b.
[201] Consumer Advocate Attachments DD 9 & 10, CPAD Workpaper Attachment DD 4-1.
[202] as there are no Long-Term Incentive Compensation costs incurred directly by CGC.
[203] 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.

and is not the type of cost that is appropriate to include in the CGC revenue requirement. As if to support this point, at the Hearing on the Merits, Company witness Dallas had no response to the question: "Why should the customers of Chattanooga pay you a bonus when the earnings per share of the Southern Company goes up?"[204] Mr. Dallas was given time to respond, but had no response.[205] The adjustment to CGC Labor costs totals $228,786 while the adjustment to Allocated Costs totals $1,139,788. This adjustment is set forth in Consumer Advocate Attachment DD-9.

Recent Commission orders, for example, in Docket No. 14-00146, have essentially eliminated incentive compensation in its entirety.[206] Thus, the Consumer Advocate asserts that incentive compensation should be eliminated based on established Commission principles and policy.

2. The Consumer Advocate's Elimination of Pension Benefits Accrual and OPEB Should be Adopted Based On Principles Established in Prior Commission Orders and Consistently Applied Thereafter.

The Commission has long held that a cash contribution methodology applied in general rate cases. For example, in a Tennessee American Water Company (TAWC) rate case in Docket No. 08-00039,[207] the Commission adopted the cash contribution methodology to defining Pension Expense, rather than the accrued accounting costs proposed by TAWC. More recently, TPUC approved – and thereby affirmed its long-standing principle -- the cash contribution

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[204] Transcript Vol. I A, page 74, line 25, through page 75, line 2.
[205] Transcript Vol. I A, page 75, line 3.
[206] See, for example, the Stipulation and Settlement Agreement in Docket No. 14-00146, including Attachment H to that Agreement entitled "Disallowance Subaccounts" with the first six of such subaccounts expressly removing incentive compensation. Later, Atmos Energy filings under its annual rate review mechanism expressly removed capitalized incentive compensation.
[207] TPUC Order dated January 13, 2009.

methodology in determining pension and OPEB costs in Docket No. 14-00146, Atmos' general rate case.

In this Docket, the adjustment the Consumer Advocate proposes implements the cash contribution methodology. This adjustment would increase O&M expense for cash pension contributions[208] and reduce O&M for accrued pension and OPEB costs. The net adjustment reduces O&M costs $68,091 as set forth in Consumer Advocate Schedule No. 4-2.[209]

The Company, in contrast, argues for the use of an accrual calculation of its pension and OPEB expense. The Company essentially records an accrual amount that was provided by its actuary, while citing generally accepted accounting principles (GAAP) for that treatment.[210]

In response to the Company's GAAP argument, the Consumer Advocate's expert testified that public utility commissions generally have broad latitude in setting the accounting methodology for public utilities under their jurisdiction.[211] Financial Accounting Standard No. 71 (FAS 71), as re-codified in ASC 980-340-25, recognizes that regulatory bodies may set rates using a methodology that departs from other accounting pronouncements.[212] Specifically, FAS 71 reads:

> This Statement may require that a cost be accounted for in a different manner from that required by another authoritative pronouncement. In that case, this Statement is to be followed because it reflects the economic effects of the rate-making process—effects not considered in other authoritative pronouncements.[213]

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[208] When asked in CPAD 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.

[209] As noted in the rate base section of this Post-Hearing Brief, the Consumer Advocate also recommends in this Docket that OPEB expense also be limited to cash contributions on the income statement, resulting in no accrued assets in rate base. See also Consumer Advocate Attachment DD-9.

[210] See Tucker Rebuttal Testimony, page 18, lines 8-10.

[211] Novak Direct Testimony, page 20, lines 12-18

[212] *Id.*

[213] Financial Accounting Standards Board, Statement of Financial Accounting Standards No. 71 – Accounting for the Effects of Certain Types of Regulation (December 1982).

Therefore, the Consumer Advocate asserts that the accounting methodology for pension and OPEB costs is completely within the Commission's discretion and that the FAS 71 methodology represents GAAP. As noted earlier, the Commission has exercised this discretion in setting a principle that only recognizes the cash contribution methodology for pension and OPEB costs.

Beyond recognizing that precedent, there are a number of reasons that this policy should be extended to the Company. First, adopting the minimum required contribution most closely matches today's cost with today's customer.[214] Second, the minimum required contribution is also generally not subject to the same changes in assumptions for market conditions as the actuary's recommended contribution.[215] Finally, the minimum required contribution is typically a more stable and consistent amount and therefore more appropriate for setting rates for the near-term future.

Thus, based on the Commission's long-standing principles and sound policy reasons, the Consumer Advocate recommends that the Commission adopt the Company's current funding requirement of zero ($0) as the appropriate level of pension and OPEB expense for the attrition year.

3. The Consumer Advocate's Elimination of Lobbying Costs Should be Adopted Based On a Reasonable Application of Ratemaking Accounting Pronouncements.

Regulatory accounting pronouncements do not permit recovery for costs related to influencing public opinion in the course of the political or regulatory process. Specifically, the

[214] Novak Direct Testimony, page 21, lines 11-18.
[215] *Id.* Note that these assumptions include discount rates, inflation rates for health care services, the level and type of health care benefits offed to future employees, employment levels, employee turnover and retirement rates, disability rates, eligibility dates, the mix by age and sex of employees, and the expected return earned on plan assets.

relevant Federal Energy Regulatory Commission (FERC) pronouncement on account 426.4, which is titled "Expenditures for certain civic, political, and related activities" states:

> 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.[216]

This account is considered 'below the line' for ratemaking purposes and therefore should be excluded from the determination of CGC's revenue requirement.[217]

In the course of discovery, the Consumer Advocate identified two job descriptions, for positions for which the Company sought recovery, that fell within the above definitions – a Senior Analyst Public Policy position and a Director of Public Policy position.[218] With respect to the Senior Analyst Public Policy the responsibilities include: overseeing the work of contract lobbyists, tracks and evaluates state and local election outcomes, responsible for assisting Director of Public Policy to draft amendment language for federal and state legislation, positively impact legislation to further the business interests of AGLR.

With respect to the Director of Public Policy, the following responsibilities were included: Accountable for drafting amendment language for federal and state legislation, works with Regulatory Affairs to assure coordination of regulatory, legislative and agency public policy positions, Communicates with AGLR governmental affairs and state lobbyists in utility presidents' regions to track legislation, compile reports, and disseminate updates to senior management on a timely basis.

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[216] Code of Federal Regulations Chapter 1, Subchapter F, Part 201.
[217] Dittemore Testimony, page 10, Lines 4-8.
[218] Response to CPAD Discovery Request No. 1-41

The duties described above for the two positions are the types of duties that indicate that costs related to those positions should be excluded from recovery. Consequently, the Consumer Advocate recommends the elimination of $273,467 in Governmental Affairs labor charges from the Test Period O&M costs, as well as associated benefit costs and a small portion of organizational dues that relate to lobbying. Of the total adjustment amount, [redacted]*[219] is allocated from AGSC; [redacted]*[220] is allocated to CGC through AGSC from Southern Company Services; $59,329 is benefit costs associated with the above allocated labor; and $2,250 relates to the portion of organizational dues related to lobbying.[221] This adjustment is set forth and supported in Consumer Advocate Schedule No. 4-3.

4. The Consumer Advocate's Corporate Cost Allocations Should be Adopted Based On a Reasonable Application of Ratemaking Principles.

The Company uses the Atlanta Gas Service Company (AGSC)[222] Composite Ratio as a general allocator that is applied to the residual costs of AGSC that are not assigned to affiliates using a more specific allocation ratio. In other words, it is a 'general' allocator that is applied to those costs that AGSC believes cannot be assigned using another method. The use of a general allocator is a common practice within the utility industry to assign costs that cannot be allocated using a more specific allocator. The AGSC Composite Ratio is the average factors for the following four categories as defined by the ratio of CGC data to total Southern Company Gas (SCG) data: a) total assets, less receivables, b) full time equivalent employees, c) operating margin, and d) operating expenses.

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[219] Response to CPAD Discovery Request No. 1-141. Amount designated as Confidential by the Company. See also Consumer Advocate Schedule DD 4-3.
[220] Response to CPAD Discovery Request No. 1-119. Amount designated as Confidential by the Company. See also Consumer Advocate Schedule DD 4-3.
[221] Response to CPAD Discovery Request No. 1-154. See also Consumer Advocate Schedule DD 4-3.
[222] AGSC provides services to the Company and the costs of those services are then allocated to the Company.

A threshold concern of the Consumer Advocate is whether the AGSC Composite Ratio is accurate. In short, the Consumer Advocate was not able to confirm the accuracy of the AGSC Composite Ratio that was used to allocate corporate costs to the Company.[223] According to the Company, there was very little or no commercial operations in certain entities that were excluded from the AGSC Composite Ratio, so the Company was unwilling to provide the relevant data.[224] This raises the concern, according to the Consumer Advocate's expert, "that SCG (or AGSC) may exclude certain competitive enterprises in the development of allocation ratios to assign more costs to regulated entities, including CGC. Entities that are excluded from AGSC's Composite Ratio are not assigned common costs, therefore leaving more costs assigned to regulated entities such as CGC."[225]

With respect to the factors and calculation within the AGSC Composite Ratio, the Consumer Advocate's expert noted in his analysis that the use of operating expenses in the AGSC Composite Ratio creates a circular calculation in that ratio.[226] In other words, operating expenses include allocated costs and it would be inappropriate to then allocate costs subject to the composite allocator which in part are based upon total allocated costs for the prior quarter.[227] To remedy that, the Consumer Advocate recommends the exclusion of the operating expense factor and the recalculation of the revised Composite Ratio based upon the average of the three

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[223] Dittemore Direct Testimony, page 12, lines 4-6.
[224] Response to CPAD Discovery Request No 1-347.
[225] Dittemore Direct Testimony, page 12, line 15, through page 13, line 3. In his testimony, Mr. Dittemore illustrates his concern with reference to the Response to CPAD Request No. 1-356, a sample of seven nonregulated entities were selected and their financial statements requested to determine whether in fact they had little or no commercial activity. After an initial objection by the Company and much discussion, the requested information was provided. Of the seven entities sampled, three had some level of operational activity, as shown on Table 3 in the Confidential version of Mr. Dittemore's testimony as filed in this Docket. The information shown on Table 3 raises the question of whether these entities are appropriately excluded from the development of AGSC's Composite Ratio. This concern then extends to the other non-regulated (competitive) entities that are also excluded from receiving composite cost allocations.
[226] Dittemore Direct Testimony, page 11, lines 12-18.
[227] *Id.*

factors for each of the four quarters in 2017.[228] Consequently, while AGSC's Composite Ratio uses four factors, the modification of the ratio to exclude one of those four factors results in a reduction in costs allocated from AGSC to CGC.[229]

After excluding the operating expense allocator, the Consumer Advocate's expert applied the revised Composite Ratio to the total AGSC charges that were subject to the Composite Ratio.[230] The result is a reduction in O&M costs of $82,136 as set forth on Consumer Advocate Schedule No. 4-4 (with the recalculated Composite Ratio being shown as Table 2 in the Confidential version of Mr. Dittemore's Direct Testimony.[231]

5. The Consumer Advocate's Amortization of Rate Case Costs Should be Adopted Based On a Reasonable Application of Ratemaking Principles.

As discussed above in connection with Deferred Rate Case Expense, the Consumer Advocate's recommendation with respect to the calculation of an unamortized balance of deferred rate case expense, based on a 36-month amortization period, would be an unamortized balance of $260,365[232] during the attrition year that is included in rate base. This results in an annual amortization of $115,718[233] that the Consumer Advocate has included in the calculation of net operating income.

6. The Consumer Advocate's Attrition Period Adjustment for O&M Expenses Should be Adopted Based On a Reasonable Application of Ratemaking Principles.

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[228] *Id.*
[229] Dittemore Direct Testimony, page 11, lines 12-18.
[230] Dittemore Direct Testimony, page 11, lines 21-24.
[231] *Id.*
[232] Revised CPAD Exhibit, Schedule 2, line 7.
[233] Consumer Advocate Schedule DD 9.

The Consumer Advocate's Attrition Period Adjustment essentially moves the Consumer Advocate's Test Period O&M costs to the Consumer Advocate's Attrition Period.[234] To do this, the Consumer Advocate's expert developed three inflation (or growth) factors, including labor, customer growth and a composite growth factor.[235] The labor growth factor was calculated based upon the two-year average growth in CGC O&M labor costs.[236] This factor was then doubled to reflect the estimated growth in the two-year period from the Consumer Advocate's 2017 Test Period to the 2019 Attrition Period.[237] The customer growth factor was developed by Mr. Novak and is described in his Direct Testimony and workpapers.[238] The Consumer Advocate's Composite Factor was developed based upon the annual average 2018 CPI factors developed by CGC in Minimum Filing Guidelines (MFG) No. 43.[239] This annual factor was then doubled to reflect the two-year period between the Test Period and the Attrition Period.[240]

To apply the growth factors, the Test Period O&M costs were classified into one of the three categories. As applied in each category, the labor factor was applied to CGC direct labor, the customer growth factor was applied to Customer related O&M costs, and the composite growth factor was applied against the remainder of the Consumer Advocate adjusted Test Period O&M expenses. The application of the Consumer Advocate's growth factors results in an increase in O&M costs of $573,543,[241] which serves as a reasonable estimation of Attrition Period O&M costs based upon the Consumer Advocate's adjusted Test Period.

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[234] Dittemore Direct Testimony, page 14, lines 4-5.
[235] Dittemore Direct Testimony, page 14, lines 8-25.
[236] *Id.*
[237] *Id.*
[238] Novak Direct Testimony, page 7, Lines 6-15.
[239] Dittemore Direct Testimony, page 14, lines 8-25.
[240] *Id.*
[241] Consumer Advocate Schedule DD-9.

7. The Consumer Advocate's Assumption Concerning CGC Employee Count and Payroll Expense Should be Adopted Based On a Historical Analysis of CGC's Headcount and a Reasonable Application of Ratemaking Principles.

In its analysis of the Company's proposed rate case, a concern arose about the assumptions used by the Company with respect to its projected headcount increase between the Test Period and the Attrition Period. This has a direct impact on the payroll expense calculations in the rate case.

In its case, the Company projects that it would increase its Tennessee-based employee count by 25% between the Test Period and the Attrition Period. To support its projection, CGC points to an aging work force.

The Consumer Advocate, referring to a comparison of data provided by the Company and reflected in Table 5 of Mr. Dittemore's Direct Testimony, points out that "[h]istory 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."[242]

[242] Dittemore Direct Testimony, page 15, lines 10-17.

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	

Further, the Consumer Advocate's expert notes that while the situation of an aging workforce may be a temporary challenge, it is not one that justifies an extraordinary permanent increase in the forecasted CGC labor count that is significantly in excess of historic employment levels.[243] In the Consumer Advocate's view, gas utilities have faced this issue for some time now without such a large permanent increase.[244] And the Consumer Advocate would respectfully point out that new employees tend to be compensated less than retiring employees.[245]

G. The Consumer Advocate's Attrition Period Taxes Other Than Income Taxes Should be Adopted Based on a Reasonable Application of Ratemaking Principles.

[243] *Id.*
[244] *Id.*
[245] For a comparison of the per employee costs associated with new hires compared with retirees, compare the Company's responses to CPAD Discovery Request Nos. 1-139 and 1-140.

The category of Taxes other than Income Taxes is primarily Property Tax.[246] Other components include TPUC Inspection Fees, Payroll Taxes, Franchise Taxes and Gross Receipts Tax. To calculate the Attrition Period balances for these taxes, the Test Period balances were determined and appropriate factors were applied to calculate the Attrition Period balances.

In terms of methodologies, as described on Consumer Advocate Schedule No. 10-1, the Test Period balances were increased using growth factors related to each tax item. Specifically, Property Taxes were increased over the period from the Test Year to the Attrition Year 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 payroll over the two-year period, and the TPUC Inspection Fees were increased using the composite attrition period factor based upon CGC's CPI factors. The resulting adjustment in Test Period costs is $305,424.[247]

VI. THE CONSUMER ADVOCATE'S METHODOLOGIES FOR RETURNING EXCESS ACCUMULATED DEFERRED INCOME TAXES AND AMORTIZING TAX SAVINGS REALIZED AS A RESULT OF THE TAX CUTS AND JOBS ACT SHOULD BE ADOPTED BY THE COMMISSION BASED ON A REASONABLE APPLICATION OF RATEMAKING PRINCIPLES

There are significant issues concerning the implementation of the Tax Cut and Jobs Act (TCJA), as enacted in December 2017.[248] One issue is the period of time over which the tax

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[246] Dittemore Direct Testimony, page 16, lines 5-8.

[247] This amount was inadvertently described as $293,184 in Mr. Dittemore's Direct Testimony at page 17, line 3. The $305,424 amount was accurately carried through the Consumer Advocate's workpapers. See Consumer Advocate Schedule DD 10-1.

[248] The Consumer Advocate would note that one of the issues raised by Company witness Tucker in his Rebuttal Testimony on page 40 was addressed by Mr. Dittemore in his summary of his Direct Testimony. Specifically, with respect to pension and OPEB expense, Mr. Dittemore adjusted the deferred tax liability related to the Company's calculation of pension and OPEB expense to account for the methodology used by the Consumer Advocate, and historically by the Commission, to calculate pension and OPEB expense. See Transcript Vol. III A, page 45, line 3, through page 46, line 15, and Hearing Exhibit 26.

savings accruing for the period January 1, 2018 through September 30, 2018 resulting from the reduction in the federal tax rate from 35% to 21% should be amortized and returned to CGC ratepayers. Another issue is the time period for returning the amounts already paid by ratepayers – and already owed to them – that is characterized as "unprotected" excess Accumulated Deferred Income Taxes (ADIT). And a final issue in this rate case is when the amortization the balances for the tax savings and the "unprotected" excess ADIT should be effective in rates.

The Consumer Advocate recommends that the tax savings accruing for the period January 1, 2018 through September 30, 2018 resulting from the reduction in the federal tax rate from 35% to 21% be amortized and returned to CGC ratepayers over a three-year period. Similarly, the excess ADIT resulting from the tax rate reduction should be returned to CGC ratepayers over a three-year period. The amortization of the balances of both the tax savings and the excess ADIT should not begin until new base rates in this case become effective.

A. Background

As described by the Consumer Advocate's expert in his Direct Testimony,[249] in December, 2017, the TCJA became law. The new tax legislation lowered the federal tax rate for corporations from 35% to 21%, effective on January 1, 2018. This reduction in the federal tax rate has significant implications with respect to ADIT balances on utilities books. In general, ADIT arises from the difference in determination of taxable income compared with book income calculated in accordance with GAAP. The single largest difference[250] in these two ways to determine income concerns the determination of depreciation. Accelerated tax depreciation,

[249] Dittemore Direct Testimony, pages 20-24.

[250] 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.

including the use of bonus depreciation,[251] is used to reduce taxable income, while book income incorporates much lower depreciation rates – generally straight-line depreciation – allowed for utility ratemaking purposes.

Income tax expense included in regulated utility rates is determined based upon the higher level of book income, therefore the balance of deferred taxes reflects amounts of expense incurred by the utility and collected from ratepayers, but which will not be paid in the form of current tax expense until some point in the future. In calculating ADIT, the cumulative[252] difference between taxable and book income is then applied against the composite federal and state income tax rate,[253] and the result is the balance of ADIT.[254]

Thus, the balance of ADIT is a function of the composite federal/state tax rates and since the federal tax rate has been significantly reduced by the TCJA, the balance of ADIT has been reduced accordingly. On a utility's books, though, the ADIT balance (pre-TCJA) reflected the collection of income tax expense that had been accrued by utilities, but which would not be paid until some point in the future. And from a ratepayer's perspective, ratepayers have already funded these tax pre-payments and therefore have a claim on the balance of ADIT that is reduced as a result of the TCJA's reduction in the federal income tax rate.

To address this claim, the TCJA requires specific treatment for the portion of excess ADIT, known as "protected" excess ADIT, which is essentially excess ADIT that relates to property-related book and tax timing differences. The TCJA requires that such "protected"

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[251] 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.

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

[253] 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.

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

excess ADIT be amortized over the life of the collective assets giving rise to the ADIT using one of two amortization methods.[255] In contrast, excess ADIT balances related to timing differences other than property – referred to as "unprotected" – may be addressed at the discretion of the Commission. Basically, "unprotected" excess ADIT is all other book and tax timing differences other than those related to depreciation.

B. Docket No. 18-00001

As its first docket in 2018, the Commission opened Docket No. 18-00001 and required utilities to calculate the excess deferred tax reserve caused by the reduction in the corporate federal income tax rate.[256] TPUC further required this excess deferred tax reserve balance be captured as a deferred liability on the books of Tennessee's largest investor-owned utilities, in order to accurately measure the ongoing cost-free capital provided by ratepayers.[257] This excess ADIT reflects the reduction in the liability balance that results from the reduction in the composite rate due to the federal tax rate change.

C. Docket No. 18-00035

To address the regulatory implications of the TCJA on CGC, the TPUC initiated Docket No. 18-0035. With respect to the timing of resolving these regulatory implications, the Company generally has supported the concept of addressing all TCJA impacts in this rate case. But in the Consumer Advocate's view, the Company has only partially complied with the concept of addressing all the TCJA issues. While CGC has identified its excess ADIT balance and moved it to a regulatory liability balance concurrent with the TCJA implementation in late

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[255] 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.
[256] TPUC Docket No. 18-00001, TPUC Order Opening an Investigation and Requiring Deferred Accounting Treatment, Order dated February 6, 2018.
[257] TPUC Docket No. 18-0001.

December, 2017, CGC has begun to amortize its excess ADIT balance[258] prior to the effective date of new rates. This means, in the view of the Consumer Advocate, that CGC is not in compliance with the TPUC order and which ratepayers will not receive the full benefit of the reduction in rates to which they are entitled.

D. The Consumer Advocate's Attrition Period Taxes Other Than Income Taxes Should be Adopted Based on a Reasonable Application of Ratemaking Principles.

While the Consumer Advocate's expert has expressed agreement – or at least a non-objection position – on a number of issues related to the TCJA,[259] there are a number of issues that divide the Company and the Consumer Advocate with respect to taxes. Specifically, the Consumer Advocate has issue with the period to amortize excess "unprotected" ADIT as a reduction to operating expenses, the timing of amortizing all excess ADIT (which impacts the Attrition Period balance of unamortized ADIT as a rate case component), and the proposal by

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

[259] These issues are noted by Mr. Dittemore on page 25 of his Direct Testimony, as follows:

1. Reduction in the federal income tax rate from 35% to 21% effective with the implementation of new base rates. This issue is the single most significant aspect of the TCJA and Mr. Dittemore agree with the use of the lower tax rate as used by CGC within its Income Tax Expense calculations for purposes of setting rates on a going forward basis.
2. Identification of Excess ADIT further split between the "Protected" and "Unprotected" categories. Mr. Dittemore reviewed the determination of excess ADIT and had no objection with CGC's calculation of the deferred liability and the resulting lower ADIT balance. See Supplemental Response to CPAD Discovery Request No. 1-374. He further had no objection with the CGC calculated determination of the "protected" and "unprotected" portions of the excess ADIT (deferred regulatory liability).
3. Annual Amortization expense calculation of the "Protected" excess ADIT associated with property-related book tax timing differences. Mr. Dittemore had no objection with CGC's amortization of excess "protected" ADIT. This amortization results in a credit to pro-forma Income Tax Expense over the life of the assets, thus reducing the revenue requirement. Note 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). However, as noted, Mr. Dittemore disagrees with the timing of this amortization as CGC has initiated amortization in advance of approval by TPUC.

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

1. The Consumer Advocate's Recommendation of a Three-Year Amortization Period for "Unprotected" Excess ADIT Should be Adopted Based On a Reasonable Application of Ratemaking Principles.

The Company proposes to amortize its balance of "Unprotected" excess ADIT to the cost of service over a five-year period. Perhaps coincidently, CGC has proposed a five-year amortization period for the amortization of rate case expense, an item that increases the revenue requirement. The Consumer Advocate recommends using a three-year amortization period. As described in more detail above, these amounts belong to ratepayers, justifying a shorter amortization period. Further, the three-year period is consistent with the period used by the Consumer Advocate to amortize rate case costs. The use of a three-year amortization period reduces O&M costs $253,143 as shown on Consumer Advocate Schedule No. 11-1.2, compared with the use of a five-year amortization period.

2. The Consumer Advocate's Recommendation of Beginning the Amortization of Excess ADIT as of the Effective Date of New Base Rates in this Docket Should be Adopted Based On a Reasonable Application of Ratemaking Principles.

The Company has prematurely begun amortizing its excess ADIT and retaining these benefits as of December, 2017,[260] thus reducing its unamortized balance. Rather than initiating the amortization of the excess ADIT[261] as of December, 2017, the Consumer Advocate's expert recommends that the Commission require the amortization to begin as of the effective date of

[260] See CGC MFG No. 69-13 revised May 31, 2018.
[261] 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" excess ADIT over a five-year period.

new base rates in this case. In this way, CGC ratepayers receive the full benefit of the excess ADIT. CGC has begun amortizing ADIT which translates to retention of the benefits of the TCJA for its shareholders to the detriment of its ratepayers. Further, the Company's amortization of excess ADIT balances is not provided for in the Commission order initiating an investigation in Docket No. 18-00001. The Consumer Advocate asserts that the amortization of both components of excess ADIT should commence with the implementation of base rates. In this manner, the ratemaking impact of TCJA is synchronized with new base rates. The Company should not be permitted to retain any portion of the excess ADIT, which would occur if this adjustment is not adopted.

3. The Consumer Advocate's Recommendation to Not Permit the Company to Retain the Tax Savings for the Period Between January 1 and the Date New Rates Become Effective Should be Adopted Based On a Reasonable Application of Ratemaking Principles.

The Commission established Docket No. 18-00035 as the TCJA compliance docket for the Company. On March 29, 2018, CGC submitted comments indicating that since it has historically underearned its authorized return on equity it should be permitted to retain the tax savings resulting from the reduced federal income tax rate effective January 1, 2018.

The Consumer Advocate asserts that the Company's proposal lacks merit for several reasons. First, while CGC argues[262] that its financial results for the prior twelve-month average were below its authorized rate of return, and thus it should be permitted to retain the tax savings, the Consumer Advocate notes that the tax savings at issue are generated in 2018. The proposed attribution of 2018 tax savings to 2017 financial results represents a mismatch of accounting

[262] CGC Compliance Filing and Report, TPUC Docket No. 18-00035, page 2.

periods. Further, the application of savings accruing in 2018 due to financial results occurring in 2017 could imply rates were unjust and unreasonable. The CGC proposal to attribute 2018 savings to 2017 financial results could be interpreted as retroactive ratemaking,[263] which is the setting of rates to permit a regulated entity from recovering past losses.

Secondly, as evidenced by this filing, there is a broad difference of opinion on the regulatory earnings of CGC. Putting aside the potential problem with the retroactive application of 2018 tax savings to 2017 results, there is not clear evidence that CGC was under-earning during the period in question. The Consumer Advocate has presented evidence in this Docket that CGC has not justified the need for a rate increase.[264]

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

Contrary to the Company's argument, the Consumer Advocate recommends that the savings from the Company's income tax expense accruing in 2018 should be estimated and returned to CGC ratepayers over a three-year period through a credit to a specific Regulatory Amortization Expense. The unamortized balance of these tax savings represents a source of cost-free capital and should be used to reduce rate base. The Consumer Advocate's expert estimated the amount of tax savings accruing through September, 2018 at $560,961.[265]

VII. THE CONSUMER ADVOCATE'S RATE ALLOCATION AND RATE DESIGN SHOULD BE ADOPTED BECAUSE IT FOLLOWS METHODOLOGIES

[263] 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.
[264] See Novak Direct Testimony, pages 39-40.
[265] The calculation is summarized in Table 6 of Mr. Dittemore's Direct Testimony, at discuss in more detail at pages 29-30. See also Consumer Advocate Schedule DD 11-3.

ESTABLISHED IN PRIOR COMMISSION ORDERS AND LONG-STANDING COMMISSION PRINCIPLES.

The Consumer Advocate recommends that the proposed revenue deficiency/(surplus) of $-2,608,560[266] be allocated evenly across-the-board to all customer classes including Special Contract customers based upon the ratio of each customer class' attrition period margin to total attrition period margin. This follows methodologies established in prior Commission orders and long-standing Commission principles. As to specific tariff rates, the Consumer Advocate's expert recognized that the decline in customer usage has impaired the Company's ability to earn a fair rate of return. For that reason, he proposed that the entire deficiency/(surplus) of $-2,608,560 in this case be recovered through decreased commodity charges. In other words, under the deficiency presented here, the Consumer Advocate recommends that the existing monthly customer charges remain at their current levels.

In contrast, the Company has proposed using a Class Cost of Service Study (CCOSS) to set rates for each of its tariffs. To the knowledge of the Consumer Advocate and its expert, the Commission has never adopted a CCOSS for any of the utilities that it regulates. Company witness Hickerson appears to agree, though he indicates his belief, without citing any example, that such studies may have been the beginning point of considering rate design.[267] To be clear, the purpose of any CCOSS is to arrive at the cost of serving each customer class and present a systematic approach to allocating this cost (or total revenue requirement) to the different classes of customers. In theory, the CCOSS would then provide a measure of guidance for the Commission to consider how to adjust individual rates for each customer class to produce the total revenue requirement.

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[266] Revised CPAD Exhibit, Schedule 1, line 8, and Schedule 15, lines 1-11.
[267] See Rebuttal Testimony of Archie R. Hickerson, page 18, lines 22-25.

In practice, as noted by the Consumer Advocate's expert, the Company has developed a CCOSS that classifies each element of rate base and income to its different tariffs using 41 separate allocation factors.[268] The result of the Company's CCOSS proposes an increase in base rates of 31.39% for residential and small commercial customers while only proposing a 9.87% increase in base rates for all other customers.[269]

The Consumer Advocate asserts that the assignment of 41 individual allocation factors to each element of the Company's cost of service is inherently judgmental, and the Company has not introduced any evidence to fully explain its rationale for each individual allocation assignment.[270] For example, the Company has allocated a significant portion of its costs based upon peak day consumption, meaning that almost all of these costs will be allocated to residential and small commercial customers without any discussion or evidence as to why such an allocation is appropriate.[271] The Consumer Advocate's expert indicates that he could easily justify allocating many of these same costs based upon the total throughput of each customer class which would then allocate a majority of the costs to industrial customers.[272] Since the Company has not provided any rationale for its individual allocation choices it is impossible to determine its rationale for cost allocation.

Finally, in the Consumer Advocate's view, other factors beyond just the cost of service need to also be considered in allocating costs.[273] These other factors include value of service, product marketability, encouragement of efficient use of facilities, broad availability of service

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[268] Novak Direct Testimony, pages 31-33.
[269] *Id.* Note Consumer Advocate Revenue Workpaper R-90-1.00.
[270] See Novak Direct Testimony, pages 31-33.
[271] *Id.*
[272] *Id.*
[273] *Id.*

functions, and a fair distribution of charges among users.[274] Since it is impossible to properly consider each of these other factors, it follows that no mechanical or mathematical formula can ever be applied to the cost of service that would translate it directly into rates. Thus, the Consumer Advocate recommends the Commission allocate any adjustment in rates evenly across-the-board to all customer classes, including Special Contract customers, based upon the ratio of each customer class' attrition period margin to total attrition period margin, as calculated in Schedule 15 of the Revised CPAD Exhibit.

VIII. RECOVERY OF DEFERRED ALIGNMENT AND USAGE ADJUSTMENT REVENUE SHOULD BE DENIED BASED ON THE ABSENCE OF AUTHORITY.

On November 8, 2010, in Docket No. 09-00183, the Commission approved a rate increase of approximately $60,000 for CGC which was completely allocated to the residential customer class.[275] Along with this increase in rates, the Commission also approved a series of conservation measures proposed by CGC including a revenue decoupling mechanism known as the Alignment & Usage Adjustment (AUA) for the R1 and C1 residential and commercial customer classes.[276]

According to the 2010 Order, the AUA was approved for a three-year experimental period and was to take the place of the WNA (that existed prior to the AUA) for the R1 and C1 customer classes. The AUA works by first computing the actual monthly revenue per customer class and then comparing this amount with the benchmark monthly revenue per customer class recognized in the rate case. The difference between these two rates is multiplied by the actual

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[274] *Id.*

[275] 2010 Order at Page 66 at paragraph 6.

[276] 2010 Order at Page 66 at paragraph 7. The Commission also approved a conservation plan consisting of a residential free programmable thermostat program and a limited community outreach and customer education program.

number of customers billed and then either surcharged or refunded (with interest) to each customer class. In addition, the Commission placed a cap of 2% of margin on annual increases to the AUA surcharge.[277]

On November 6, 2013, the Commission issued the 2013 Order extending the existing AUA mechanism until an evaluation of the experimental program could be prepared. The Commission Staff then contracted with NRRI to evaluate CGC's conservation measures and to prepare a report of its findings.

The NRRI Report on CGC's conservation measures was presented to the Commission on January 10, 2017. According to the NRRI Report, "...the program intent might have been reasonable, but the plan itself turned out to be shortsighted."[278] The Commission Staff Report, on September 19, 2017, essentially reviewed and affirmed the results of the NRRI Report. The Commission Report noted, among other things, that there appeared to be insufficient customer data available to properly evaluate the results from CGC's conservation measures.[279] Further, the reports generally observe that while the program may result in savings, that savings may be difficult to achieve.[280] As a result, in general terms, the Commission's intent to address specific conservation measures for CGC's customers fell short of their stated goals.

On September 26, 2017, CGC issued the CGC Report on the AUA mechanism. In its report, CGC requested that the AUA mechanism now be discontinued and replaced with a WNA mechanism. CGC also requested that it be allowed to recover the then-current balance of approximately $1.9 million in deferred AUA surcharges. On October 20, 2017, CGC made a

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[277] 2010 Order at page 66, paragraph 8.
[278] NRRI Report *Evaluating Chattanooga Gas Company's 2012-13 Energy Efficiency Programs and Ideas for Evaluating Future Energy Efficiency Programs in Tennessee*, Report No. 16-09, Tom Stanton, December 2016, Page 15.
[279] TPUC Staff Report, pages 7-8.
[280] TPUC Staff Report, pages 10-11 (referring to the relationship between the NRRI Report and TPUC Staff Report).

formal tariff filing to terminate the AUA mechanism. Finally, after the hearing officer's suspension of its proposed tariff filing, CGC agreed to address the termination of the AUA and recovery of the deferred balance within the current rate case. The Commission accepted this resolution and in its January 5, 2018 Order, moved these outstanding issues into this current rate case.

As mentioned above, the AUA was subject to a 2% margin cap on the annual increases to the surcharge. This means that CGC could not increase the AUA surcharge by more than 2% of the existing base rate no matter what the actual AUA deficiency might have been. As a result, CGC has been required to defer (with interest) the cumulative AUA balance on its books. As of May 31, 2017, the cumulative deferred AUA balance was approximately $1.9 million as shown below on Table 9.[281]

TABLE 9 – CGC'S DEFERRED AUA BALANCE[282]

Deferred Balance at	Residential R-1 AUA Balance	Commercial C-1 AUA Balance	Total AUA Balance
May 31, 2010	$0.00	$0.00	$0.00
May 31, 2011	-283,469.21	121,387.42	-162,081.79
May 31, 2012	581,374.40	510,008.12	1,091,382.52
May 31, 2013	234,422.24	607,900.88	842,323.12
May 31, 2014	-642,496.01	337,691.02	-304,804.99
May 31, 2015	-859,571.75	260,387.38	-599,184.37

[281] These deferred balances reported by CGC have not been audited.

[282] AUA Balance Detail provided in a July 20, 2017 email from Archie Hickerson to Hal Novak included as Attachment WHN-6. Negative balances denote cumulative AUA funds below the 2% cap. Positive balances denote cumulative AUA funds above the 2% cap. Note also that these balances do not precisely match the values included in CGC's September 26, 2017 filing.

May 31, 2016	-88,171.99	590,360.24	502,188.25
May 31, 2017	871,831.03	992,885.87	1,864,716.90

The Consumer Advocate's witness was unable to find any authorization by which CGC could recover the Cumulative Deferred AUA Balance.

During this same time, CGC exceeded its authorized rate of return of 7.38%[283] by as much as $3.3 million as shown below on the table labeled Table 10. These overearnings were only reduced in 2015 and 2016 due to a significant increase of approximately $14 million in rate base.[284] Without this unexplained increase to its rate base, CGC would have continued exceeding its authorized rate of return during 2015 and 2016.[285]

TABLE 10 – CGC EARNINGS[286]

For the 12 Months Ended	Over/(Under) Authorized Earnings	Cumulative Over/(Under) Earnings
December 31, 2011	$1,115,548	$1,115,548
December 31, 2012	544,381	1,659,929
December 31, 2013	988,931	2,648,860
December 31, 2014	623,332	3,272,192
December 31, 2015	-842,454	2,429,738
December 31, 2016	-1,173,289	1,256,449

[283] The Consumer Advocate respectfully notes that while the Order in Docket 09-00183 states 7.41%, the rate base in that Order is stated as $93,818,504, with a net operating income of $6,923,840, which results in a calculated rate of return on 7.38%. 2010 Order at page 66, paragraph 3.

[284] This change represents an increase of approximately 14% to rate base.

[285] CGC's ability to earn well beyond its authorized rate of return is puzzling given the relative insignificant change in rates (approximately $60,000) that resulted from their 2010 rate case.

[286] Compiled from monthly financial reports filed with the TPUC and the Consumer Advocate and shown on Attachment WHN-7.

The Consumer Advocate recommends that the Commission reject CGC's proposal to recover the cumulative deferred AUA balance, since there does not appear to be any approved or otherwise authorized basis upon which it could be recovered. The Consumer Advocate's recommendation also is supported by the significant overearnings that CGC has captured and retained since its last rate case. In addition, Consumer Advocate recommends that the Commission audit the surcharges and collections from the AUA mechanism.

IX. THE COMPANY'S REQUEST THAT THE COMMISSION ADOPT METHODOLOGIES FOR PURPOSES OF TENN. CODE ANN. § 65-5-103(d)(6) SHOULD BE DENIED BECAUSE THE COMPANY'S RATEMAKING ACCOUNTING RECORDS LACK SUFFICIENT SUPPORT TO ENABLE THE REVIEW AND ANALYSIS OF AN APPROVED METHODOLOGY.

The third part of the Company's Petition, which has been generally withdrawn by the Company,[287] initially reflected the desire of the Company to opt into an ARM under Tenn. Code Ann. § 65-5-103(d)(6). To summarize its apparent goal, Chattanooga Gas stated that it "believes that adoption of the annual review mechanism will provide the Commission and [Chattanooga Gas'] customers with greater transparency regarding its operations and how the Company's business operations translate into the rates charged customers."[288] After discussions and discovery about aspects of the ARM in the context of this Docket, though, the Company filed a Notice of Withdrawal, in which it stated its intent to re-file the ARM and, consequently,

[287] Chattanooga Gas Company Notice of Withdrawal from Further Consideration in this Docket of its Requests for Approval of its Proposed Alternative Regulatory Methods (Notice of Withdrawal), as filed in Docket No. 18-00017 on April 10, 2018. The Notice of Withdrawal also withdrew a proposed System Expansion and Economic Development-Tennessee (SEED) Rider under Tenn. Code Ann. § 65-5-103(d)(3)(A).
[288] Petition, page 17.

requested that "the Commission in its final order in this rate case clearly identify the approved rate case methodology required by T.C.A. Section 65-5-103(d)(6)(A)."[289]

The Company's request to have the Commission adopt a rate case methodology places the burden on the Commission and its Staff not only to develop and specify the methodologies in this rate case, but also at least implicitly to assess and develop the ratemaking accounting books and records that the Commission and intervenors – such as the Consumer Advocate – could use in reviewing and analyzing those books and records to determine whether or not the Company has correctly implemented an ARM. Thus, assuming the Commission and Staff are inclined to develop and specify methodologies in this Docket, the burden on the Company in this Docket is to show that it has provided clear and auditable support for this rate case, and further that it has the capability and capacity to provide clear and auditable support in connection with the review and implementation methodologies as a part of an ARM. Unfortunately, from the perspective of the Consumer Advocate, the Company has failed on both counts.

There are, at this point, numerous examples of the Company's failure to provide clear and auditable support for this rate case and for a prospective ARM. The Consumer Advocate's expert summed up the condition in which the Consumer Advocate found itself early (and even later) in the Docket when he testified:

> The Company's case was filed with a bare minimum amount of supporting detail and a virtually complete lack of documentation or audit trail as to the source of that supporting information. Specifically, there were no workpaper numbers and only minimal footnote support documenting the source for the Company's workpapers. Further, many of the Company's workpapers only included hard-coded numbers without any documentation leaving

[289] Notice of Withdrawal, paragraph 4.

> no audit trail to the source data.[290] In addition, the Company's response to the Commission's minimum filing guidelines indicated that all workpapers had been included when they clearly had not been provided. As a result, it is apparent that the Company does not give the minimum filing guidelines of the Commission serious consideration.
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> This lack of documentation required the Consumer Advocate to issue nearly 500 data requests in this Docket. In addition, it seriously hampered and delayed our investigation. While the Company did cooperate in providing this information after the filing, it would be better for all parties if the minimum filing guidelines and other information that is usually requested in discovery were provided at the time of the initial rate case filing which would avoid delays for all parties in analyzing the case.[291]

The Company, in its rebuttal testimony, attempted to counter Mr. Novak's statements with conclusory statements by witnesses such as Mr. Hickerson, who testified that "the quality and quantity of data CGC has provided in this case is as good if not better than what I have seen in most cases, and certainly complies with the Company's obligation to support and document its rate request." But on cross examination, Mr. Hickerson admitted that he had not reviewed all of the Company's workpapers and supporting materials in this Docket,[292] that the workpapers and supporting materials in Excel format had hardcoded numbers,[293] that workpaper numbers were missing from workpapers,[294] that footnote documentation was missing from workpapers,[295] and that audit trails were missing.[296] Company witness Brooks likewise admitted that he had not included workpaper numbers[297] or footnotes,[298] and that his workpapers did not come close to

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[290] With these filing deficiencies in mind, it cannot be said that the Company has set out a ratemaking methodology that provides detailed, or any for that matter, practices, procedures and formulas for computing the various ratemaking components required to determine tariff rates.
[291] Novak Direct Testimony, page 5, line 5, through page 6, line 5.
[292] Transcript, Vol. II C, page 219, lines 11-14.
[293] Transcript, Vol. II C, page 219, lines 15-21, and page 220, lines 12-19.
[294] Transcript, Vol. II C, page 220, lines 6-8.
[295] Transcript, Vol. II C, page 220, lines 9-11.
[296] Transcript, Vol. II C, page 220, lines 12-17.
[297] Transcript, Vol. I B, page 192, lines 10-15.

providing a clear and concise audit trail to his calculations.[299] Mr. Brooks goes on to explain that he received the data that he used in hard coded format.[300] The Company, in neither rebuttal nor testimony on the Hearing on the Merits, adequately rebutted – much less offered meaningful evidence concerning – Mr. Novak's assertion about the lack of documentation and an audit trail by the Company.

The dearth of information described by Mr. Novak – especially with respect to the Company's initial filing – led him to recommend to the Commission that:

> To prevent this problem from recurring in the future, I am recommending that the Commission adopt a minimum filing **requirement** specifically for CGC and all large gas, electric and water utilities under the Commission's jurisdiction for future rate cases. This minimum filing **requirement** should also contain a provision that requires a determination by the Commission's hearing officer that the utility has materially complied with this requirement before the procedural schedule can begin.[301]

Other problems were identified by the Consumer Advocate's other witness, Mr. Dittemore. Mr. Dittemore summarized his concerns as:

> There is a significant lack of transparency and documented processes supporting the cost allocation methodology that I would expect from a very large regulated entity such as The Southern Company. This shortcoming has driven the need for a significant amount of discovery in this Docket. The lack of transparency prevents the Consumer Advocate from drawing conclusions on the reasonableness of the allocated charges. The lack of emphasis in maintaining necessary documentation supporting affiliate transactions within a company the size of SCG[302] appears to be a

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[298] Transcript, Vol. I B, page 192, lines 16-23.
[299] Transcript, Vol. I B, page 193, lines 14-19.
[300] Transcript, Vol. II C, page 193, line 25, through page 194, line 1.
[301] Novak Direct Testimony, page 6, lines 7-13 (emphasis in original). Mr. Novak added in a footnote to this part of his testimony that "it is my view is that this same requirement should apply to all utilities applying for alternative regulation." *Id.*
[302] In his footnote, Mr. Dittemore clarified that "[m]y 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." Dittemore Direct Testimony, page 31, line 16, through page 32, line 6.

> corporate strategy designed to prevent the Consumer Advocate and regulators from fully evaluating these charges.[303]

Thus, Mr. Dittemore focuses on the very practical aspects of a review of the Company's cost allocation methodologies in the contest of this rate case. But the implications of a non-transparent and undocumented allocation methodology – if not remedied – would have far broader implication in the contest of the review and analysis of a cost allocation methodology in an ARM process.[304]

To at least partially address these concerns, Mr. Dittemore proposed that the Company be required to adopt and use a cost allocation manual (CAM), which it does not currently have.[305] As described by Mr. Dittemore:

> The purpose of a CAM for a regulated entity is two-fold. First, it provides formal specific guidance to employees on the procedures to follow in tracking costs and allocating such costs to the appropriate organization. The existence of the manual, along with periodic training and reinforcement, signifies that compliance with documented procedures is a priority. Secondly, the CAM should be used to support the reasonableness of such allocation methodologies and processes before state regulators. The lack of a CAM raises questions as to whether either of these objectives is a priority within SCG.[306]

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[303] Dittemore Direct Testimony, page 32, line 4, and footnote 44 as it appears on Mr. Dittemore's Direct Testimony.

[304] Specifically, Mr. Dittemore testifies on page 33 of his Direct Testimony, at lines 8-13, that:

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

[305] Response to CPAD Discovery Request No. 1-12.

[306] Dittemore Direct Testimony, page 32, lines 12-19. Mr. Dittemore provided a number of the key elements of a CAM on his Direct Testimony as follows:

> 1. Corporate organization chart identifying all entities within the overall corporate organization. Each listed entity should have a description of the scope of business operations. There should be a complete explanation supporting the reason not to allocate costs to certain affiliate entities.
> 2. Method used to assign costs; specifically, that costs should be direct charged whenever possible. For those costs that cannot be direct charged, such as those associated with a customer call center should be assigned based upon causal

Acknowledging Mr. Dittemore's recommendation and perhaps admitting the inadequacy of the Service Agreement,[307] the Company indicated at the Hearing on the Merits that it would be willing to work with the Consumer Advocate to "see if we can't work out together what a cost – a formal cost allocation manual such as what Mr. Dittemore was talking about in his testimony, and bring that back to the [C]ommission for your approval and [the Company's] use."[308]

In view of the foregoing, the Company has failed to meet its burden to show that it has provided clear and auditable support for this rate case, and further that it has the capability and capacity to provide clear and auditable support in connection with the review and implementation methodologies as a part of an ARM. Thus, the Commission should not adopt methodologies that could be used in an ARM in the future.

X. THE CONSUMER ADVOCATE'S RECOMMENDATIONS FOR COST OF CAPITAL AND RATE OF RETURN SHOULD BE ADOPTED BY THE COMMISSION BECAUSE THEY UTILIZE THE COMMISSION'S LONG-STANDING APPROACH TO CALCULATE CAPITAL STRUCTURE AND

> allocators. Finally, those costs that cannot be neither directly assigned, nor causally allocated should be allocated based upon a composite allocation factor.
> 3. Matrix that matches cost centers or accounts and the method(s) used to allocate costs by cost allocation method.
> 4. Quarterly update to allocation ratios. The allocation ratios should be updated quarterly as updated and revised data becomes available that is then used to recalculate the associated allocation ratios.
>
> As mentioned in item 4, the CAM is a document that is constantly changing and being updated. Maintaining and ensuring compliance with a CAM requires focus; however, given the magnitude of corporate costs subject to allocation such effort is necessary to ensure accuracy and provide assurance that such material cost assignments between affiliates are justified.

And it is worth noting that Atmos Energy Corporation maintains a CAM (as provided in response to CPAD Request No. 3-13 in TPUC Docket No. 17-00091). While the Atmos CAM does not contain all of the reference material listed above, it does contain some of the information and the existence of such an updated document (dated as of April 1, 2017) indicates such cost allocation processes are a corporate priority. Dittemore Direct Testimony, page 34, lines 15-20, including footnote 46 referenced therein.

[307] For example, in the course of his testimony at the Hearing on the Merits, Company witness Morley admitted that there is nothing in the Services Agreement that identifies all the affiliates of AGSC, that identifies the affiliates of AGSC that are not charged for services, or that would confirm the reasonableness of AGSC's decision not to charge overhead costs to AGSC affiliates. Transcript, Vol. II A, page 28, line 12, through page 29, line 16.

[308] Transcript, Vol. III A, page 20, line 19-25.

RESULT IN BOTH A REASONABLE RETURN FOR INVESTORS AND REASONABLE RATES FOR CUSTOMERS.

Rate of Return is one of the major areas creating the significant divide in the Company's requested rate increase and the Consumer Advocate's proposed rate decrease. There are three components to the Rate of Return: (a) the authorized Return on Equity (ROE), (b) cost of capital, and (c) overall capital structure. Company witnesses Vander Weide, Tucker, and MacLeod discussed issues relating to rate of return and capital structure in their respective testimonies. The Consumer Advocate retained Dr. Christopher Klein to conduct an independent analysis and to offer recommendations on how the Commission should approach these issues.

The Company's expert, Dr. Vander Weide proposed that the Company should be allowed a "conservative" ROE of 11.25%.[309] He further concluded that the appropriate capital structure for the Commission to impute to CGC was 49.3% equity, 6.29% short term debt, and 44.41% long term debt.[310]

The Consumer Advocate's expert witness, Dr. Christopher Klein, contends that CGC should be allowed a ROE of 9%.[311] With respect to the capital structure, Dr. Klein recommends that the Commission adopt figures for CGC of [redacted][312] Dr. Klein also states that to properly set rates for consumers with respect to the ROE, the double-leverage approach to capital structure is

[309] Vander Weide Direct Testimony, page 4, lines 18-20. Additionally, Dr. Vander Weide concluded that his analysis actually suggested a ROE of 11.4%. *Id.*
[310] Vander Weide Direct Testimony, page 6, lines 6-8.
[311] Transcript Vol. III A, page 63, line 14.
[312] See Confidential Klein Direct Exhibit, page 2.

necessary.[313] Ultimately, Dr. Klein recommends that this commission adopt an overall weighted cost of capital of 5.93% for the Company.[314]

As discussed in detail below, the Consumer Advocate maintains that by adopting the Consumer Advocate's proposals, the Commission will authorize a reasonable rate of return for Chattanooga Gas based on economically sound and long-standing regulatory principles.

A. The Consumer Advocate's Capital Structure and Cost of Debt Proposals Should be Adopted by the Commission.

CGC witness Mr. Tucker suggests that the Commission look to the capital structure of CGC's parent company, Southern Company Gas, and then adjust those figures for non-ratemaking components. Dr. Klein concurs, in part, with the capital structure proposed by Mr. Tucker.[315] Using the Company's proposed capital structure, Dr. Klein then applies the double-leverage approach and substitutes The Southern Company's capital structure for the equity component of the Company's proposal.[316] This Commission should adopt Dr. Klein's approach because it results in a capital structure that accurately reflects the equity within CGC's financing and properly accounts for The Southern Company's role in its wholly-owned subsidiaries.

1. The double-leverage approach is the appropriate method to determine the Company's capital structure.

The double-leverage approach to capital structure has been effectively utilized by Tennessee regulators since at least the 1970s.[317] This approach is necessary to properly analyze regulated entities that are subsidiaries of larger holding companies. As Dr. Klein cites in his testimony, double-leverage "usually refers to a situation where a holding company raises debt

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[313] Transcript Vol. III A, page 67, lines 7-9.
[314] Klein Direct Testimony, page 6, lines 6-8.
[315] Klein Direct Testimony, page 5, lines 14-17.
[316] *Id.*
[317] Klein Direct Testimony, page 9, lines 9-12; *see also United Inter-Mountain Tel. Co., and Raytheon Co. v. Tenn. Pub. Serv. Comm'n., et al.*, Davidson County Chancery Court, No. 78-759-I (October 24, 1978).

and downstreams it as equity capital, or subordinated debt, to a subsidiary, *i.e.*, it is the use of debt by both the parent company and the subsidiary, in combination with the company's equity capital, to finance the assets of the subsidiary."[318] Thus, the double-leverage approach accounts for situations in which a company is financed and managed as a whole from which its subsidiaries cannot be separated.

With double-leveraging, the full capital structure of the parent company is substituted for the equity component of the subsidiary. This reflects the reality that equity investors must look at the total capital structure of the parent when analyzing whether to invest equity capital into the parent company, in this case, The Southern Company.

Chattanooga Gas is a wholly-owned subsidiary of Southern Company Gas, while Southern Company Gas (SGC) is a wholly-owned subsidiary of The Southern Company.[319] CGC's witnesses claim that for purposes of this rate case, the appropriate capital structure and cost of capital belong to SCG; however, the double-leverage approach to SCG's cost of equity mandates that any analysis should in turn look to the cost of capital of its parent, The Southern Company.

Dr. Vander Weide's approach does not utilize double-leverage. In his recommendation, he merely adopts SCG's point-in-time capital structure advocated by CGC witness Tucker and applies the rates he derives from his formulas to that structure, despite the fact that SCG has no equity shareholders aside from its parent, The Southern Company.[320] This approach, however, discounts the benefits touted by the Company of being a part of a large conglomerate.[321] Further,

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[318] Klein Direct Testimony, page 10, lines 1-6 (*citing* www.ventureline.com/accounting-glossary/D/double-leverage-definition/, accessed June 3, 2016); *see also* Transcript Vol. III A, p. 63, lines 18-25.
[319] Transcript Vol. I B, page 121, lines 15-23.
[320] Transcript Vol. I B, page 121, lines 21-23.
[321] See, *e.g.*, Dallas Revised Direct Testimony, page 14, line 21 through page 17, line 6.

it creates a fictitious standalone version of SCG that is not based in reality. Just as CGC has no freely-traded stock and is wholly-owned by its parent, SCG likewise is wholly-owned by The Southern Company. When SCG needs capital, it receives capital from The Southern Company, and The Southern Company includes CGC as "a significant risk factor for Southern Company and its subsidiaries."[322]

Despite this Commission's long-standing adoption of the double leverage approach as well as the sound reasoning behind it, the Company witnesses Dr. Vander Weide and Mr. MacLeod object to its use. Dr. Vander Weide argued on cross-examination that "[SCG] has been its own source of financing over the years." He further claimed that "the company has presented another witness in this proceeding that shows that [SCG] has not obtained a net equity infusion from The Southern Company, that is, [SCG] has its own capital structure, independently of The Southern Company."[323] When Mr. MacLeod testified, however, he admitted that not only is The Southern Company the parent of SCG, there have been equity transfers between The Southern Company and SCG that flow in both directions.[324] To put this into perspective, The Southern Company's net equity contributions to SCG totaled over $9 billion between July 2016 and December 2017.[325] Therefore, contrary to Dr. Vander Weide's assertion that SCG has been the source of its own financing, The Southern Company has in fact invested equity into SCG, and SCG therefore should not qualify as an independently financed, standalone entity.

Double-leverage recognizes circumstances in which a corporation is financed and managed as a whole from which the subsidiaries cannot be separated. Utilizing double-leverage allows this Commission to apply CGC's true capital structure as it determines the correct cost of

[322] Vander Weide Direct Testimony, page 17, lines 7-24.
[323] Transcript Vol. I B, page 124, lines 7-14.
[324] Transcript Vol. I B, page 146, lines 19-23.
[325] See Company response to CPAD Request No. 1-186.

capital that shareholders will be compensated through rates. If double-leverage is not applied, The Southern Company will be allowed to downstream debt to CGC, via SCG, but recover a higher return as if the debt were actually equity.

The capital structure of the parent company, The Southern Company, supports the financing of its subsidiaries, and as the parent of SCG, The Southern Company is the only entity in which outside investors may provide financing. Further, as Dr. Klein explained while providing a summary of his testimony, the double-leverage method puts companies that operate through subsidiary entities, as is the case here, in the same situation as firms that operate through divisions of one company.[326] This is a necessary distinction as double-leverage creates a level playing field in the market. "[The double-leverage approach is] necessary in order for regulations to be consistent with financial and economic principles."[327] For these reasons, the Commission should continue to employ the double-leverage approach as it has effectively done for decades.

2. The Southern Company must be taken into account for purposes of the double-leverage approach.

CGC witness Mr. Tucker recommends the use of the forecasted structure of SCG as of June 30, 2019.[328] Since The Southern Company's acquisition of AGL Resources (the former parent company of CGC), all of CGC's financing has been arranged through SCG.[329] Dr. Klein found Mr. Tucker's recommended capital structure for SCG to be reasonable, but Dr. Klein disagreed with CGC's proposal to ignore the parent-subsidiary relationship of SCG and The

[326] Transcript Vol. III A, page 65, lines 16 through page 67, line 6.
[327] Transcript Vol. III A, page 65, lines 12-15.
[328] Tucker Direct Testimony, page 2, lines 6-8.
[329] Klein Direct Testimony, page 8, lines 6-8.

Southern Company.[330] Because SCG is the wholly-owned subsidiary of The Southern Company, The Southern Company's capital structure must be applied to the equity portion of SCG's capital structure through double-leverage.

Mr. Tucker's testimony suggests that CGC is solely dependent upon SCG or other SCG subsidiaries for all of its debt and equity financing.[331] CGC also purchases inputs or services from other SCG subsidiaries or has costs allocated to it from other subsidiaries in the course of providing electricity to its customers, giving rise to several of the issues in this Docket. Obviously, CGC is not a mere arms-length investment for SCG. Moreover, SCG obtains its equity financing from its parent, The Southern Company.[332] In this context, it is inappropriate to view CGC independent of SCG and SCG independent of The Southern Company.

CGC is dependent on SCG for its financing and SCG is dependent on The Southern Company for equity financing. Thus, CGC is still ultimately dependent on The Southern Company. CGC recommends that the Commission ignore the subsidiary relationship between CGC and SCG for cost of capital purposes. By doing so, however, this makes the subsidiary relationship between SCG and The Southern Company the relevant one for double-leverage purposes.[333]

SCG, like its subsidiary CGC, has no independently traded stock.[334] All of SCG's shares are owned by its parent company.[335] While Dr. Vander Weide acknowledges this fact with respect to the relationship between CGC and SCG, he fails to acknowledge this same issue concerning the relationship between SCG and The Southern Company. But it would be

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[330] Klein Direct Testimony, page 8, line 17 through page 9, line 5.
[331] Tucker Direct Testimony, Section III; *See also* Company's responses to CPAD Requests Nos. 1-177 and 1-178.
[332] See Company response to CPAD Discovery Request No. 1-186.
[333] See, *e.g.*, Transcript Vol. III A, page 64, lines 1-10.
[334] Transcript Vol. I B, page 146, lines 10-12.
[335] *Id.*

intellectually dishonest to recognize, in the context of determining cost of equity, the important distinction of being a wholly-owned subsidiary in one circumstance but ignoring it in the next. Dr. Vander Weide's suggestion would allow the Company to ignore its true capital structure, create a fictional standalone SCG, and collect the higher return on equity figure on financing that is actually the parent company's debt; this Commission should reject that approach.

The Southern Company's paternal role in SCG and CGC is further illustrated in The Southern Company's own presentations to stockholders and investors this year.[336] In a quarterly earnings call on May 2, 2018, The Southern Company's management promises to downstream equity into "State-regulated Electric and Gas utilities with allowed ROEs between 9.5% and 12%".[337] Further, in a Southern Company investor conference call on May 21, 2018, management indicated that three non-regulated entities were to be sold for approximately $6.475 billion before tax.[338] These proceeds "will be used to significantly reduce debt across Southern Company."[339] The presentation also makes clear that approximately 80% of the funds will be invested in state-regulated utilities[340] and thereby downstreamed into these regulated entities, such as SCG and CGC, which possess "higher equity ratios".[341] These two presentations highlight the discrepancy between what The Southern Company reports to its investors and what it reports to regulators. While The Southern Company seeks to attract investment by promising to downstream financing into subsidiaries with high returns on equity, it would lead the

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[336] First Quarter 2018 Earnings Conference Call, May 2, 2018 (available publicly at https://s2.q4cdn.com/471677839/files/SO-2018-Q1-Earnings-Call-FINAL.pdf); Southern Company Conference Call, May 21, 2018 (available publicly at https://s2.q4cdn.com/471677839/files/doc_presentations/2018/Southern-Company-Florida-Asset-Sales-5-21-18-Final.reduced-file-size.pdf).
[337] First Quarter 2018 Earnings Conference Call, page 10.
[338] Southern Company Conference Call, page 3.
[339] *Id.*
[340] *Id.* at page 5 (within right-side chart).
[341] *See id.* at page 8.

Commission to believe in this case that SCG secures its financing entirely independent of The Southern Company. Again, this approach should be rejected.

In determining the appropriate capital structure to apply in this Docket, Dr. Klein utilized the forecast of The Southern Company's parent-only capital structure and cost rates for short-term and long-term debt for June 30, 2019,[342] and compared these to the historical figures for 2015, 2016, and 2017.[343] As Dr. Klein stated in his pre-filed testimony:

> The forecasted figures generally fall within the ranges established by [The Southern Company's] recent history. On this basis, I find the forecasted capital structure and cost rates reasonably representative of [The Southern Company's] parent-only long run capital structure. [I then] imputed [The Southern Company's] forecasted parent-only capital structure to the equity portion of Mr. Tucker's recommended capital structure for CGC/SCG. The result is the double-leverage capital structure for CGC shown on page 2 of my Exhibit.[344]

B. The Consumer Advocate's Cost of Equity Analysis Will Result In Just And Reasonable Rates.

As discussed in detail above, the Consumer Advocate recommends that the Commission continue to employ the double-leverage method in determining the appropriate capital structure for setting rates. The equity of the parent The Southern Company appears in CGC/SCG's capital structure. As a result of this structure, the cost of equity of the parent enterprise, The Southern Company, should also be factored into CGC/SCG's cost of equity financing. As Dr. Klein points out:

> This recognizes that the corporation is financed and managed as a whole from which the piece-parts, such as subsidiaries, cannot be separated. The capital structure of the parent company (not consolidated) supports the financing of all the subsidiaries. Moreover, [The Southern Company] is the only entity in which outside investors may invest.[345]

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[342] Klein Direct Testimony, page 9, lines 13-16; see also Company response to CPAD Discovery Request No. 1-178.
[343] Klein Direct Testimony, page 9, lines 13-16; see also Company response to CPAD Discovery Request No. 1-177.
[344] Klein Direct Testimony, page 9, lines 16-22.
[345] Klein Direct Testimony, page 11, lines 18-22.

In order to estimate The Southern Company's cost of equity, Dr. Klein joins Dr. Vander Weide in applying two methods: the Discounted Cash Flow (DCF) and the Capital Asset Pricing Model (CAPM).[346] However, TPUC should reject other variables utilized by Dr. Vander Weide – including his list of comparable firms, the risk premium method, and his adjustments based on other firms' weighted average cost of capital – as these factors are either inappropriate in relation to CGC's general rate case or are based on flawed reasoning. Instead, the Consumer Advocate urges TPUC to adopt the methods supported by Dr. Klein, which apply logic and long-standing Commission precedent and allow CGC to earn an appropriate rate of return while charging its customers just and reasonable rates.

1. The Commission should utilize the DCF Method as proposed by Dr. Klein.

Both Dr. Klein and Dr. Vander Weide utilize the DCF method to calculate the appropriate ROE for CGC. The DCF provides a measure of the value of a company's cash flow discounted for its present value. The formula for the DCF shows the rate of return an investor would expect on stock ownership by calculating the dividend yield (the expected dividend divided by the current price of the stock) plus the expected growth rate in that dividend.

For the DCF analysis, Dr. Klein looked for utilities that offer both electric and natural gas services are that are comparable in size to The Southern Company and then limited his findings to companies with total capital between 0.5 and 1.5 times that of The Southern Company.[347]

Because The Southern Company owns both electric and natural gas operations, Dr. Klein looked for utilities offering both electric and natural gas service among those covered by Value Line that were comparable in size to The Southern Company. He then limited the companies to

[346] Klein Direct Testimony, page 12, lines 1-2.
[347] Klein Direct Testimony, page 13, lines 4-7.

those with total capital between 0.5 and 1.5 times that of The Southern Company and eliminated companies that had significant unusual circumstances, such as those in the process of being acquired by other companies or those facing unusual liabilities.[348]

Dr. Klein also examined the "beta," a measure of relative risk, for these comparable companies.[349] Betas for these companies ranged from 0.60 to 0.80, all less than 1.0, and slightly above The Southern Company's beta of 0.5, which may indicate these firms have slightly higher risk than The Southern Company.[350]

As a result of this analysis, Dr. Klein concluded that the DCF cost of equity range for The Southern Company about 9.0%, while the comparable firms' DCF estimates range from 8.4% to over 14%, with an average of 10.50% to 10.60%.[351] In order to narrow this range, he next utilized the Capital Asset Pricing Model, or CAPM.

2. Dr. Klein's approach to the CAPM is the correct technique for setting rates in this case.

Dr. Klein and Dr. Vander Weide also use the Capital Asset Pricing Model (CAPM) in their calculations for ROE. Under this approach, an investor's required return on an investment is based on the relative riskiness of the investment.[352] The CAPM begins by estimating the risk premium required on a broad portfolio of common stocks relative to a risk-free asset.[353] This risk premium is then adjusted for a particular stock's riskiness relative to the market – that is, the broad portfolio of stocks. This is done by using the stock's beta, which measures the riskiness of

[348] Klein Direct Testimony, page 13, lines 6-9.
[349] Klein Direct Testimony, page 13, lines 12-14.
[350] Klein Direct Testimony, page 13, line 14.
[351] Klein Direct Testimony, page 13, lines 16-17.
[352] Klein Direct Testimony, page 13, lines 20-21.
[353] Klein Direct Testimony, page 13, lines 22-23.

the stock relative to the market. The resulting CAPM cost of equity consists of the risk-free return plus beta times the market risk premium.[354]

Dr. Vander Weide's use of current interest rates on Treasury bills (T-bills), which are at historically low levels, is inappropriate; rather, consideration for longer term bonds is proper. Dr. Klein points out that "the low level of interest rates generally also means that the choice of the risk-free rate makes less difference to the overall CAPM cost of equity estimate than when rates are high."[355] For these reasons, Dr. Klein proposes the Commission adopt the risk premium of stocks rather than the 20-year Treasury Bonds used by Dr. Vander Weide.[356]

The risk premium is adjusted using a stock's beta. Dr. Klein's approach uses betas for The Southern Company[357] and the four electric-gas utilities previously selected as reported by Value Line.[358] These companies are less risky than the average stock, so their betas range from 0.6 to 0.8, although they are slightly more risky than The Southern Company with a beta of only 0.5.[359] An average stock, or a broad portfolio of stocks representing the market return, has a beta of 1.0.[360] In the Exhibit sponsored by Dr. Klein's, he illustrates the resulting range of CAPM cost of equity estimates.[361] For The Southern Company, the CAPM cost of equity is 6.49%.[362] Since the CAPM for each company is determined by each company's beta, the comparable

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[354] Klein Direct Testimony, page 14, lines 1-4
[355] Klein Direct Testimony, page 15, lines 2-5.
[356] Klein Direct Testimony, page 15, lines 5-7.
[357] This sentence originally included AEP rather than The Southern Company. This was a typographical error that Dr. Klein corrected during his oral testimony. Transcript Vol. III A, page 62, lines 19-21.
[358] Klein Direct Testimony, page 15, lines 1-18.
[359] Klein Direct Testimony, page 15, lines, 9-12.
[360] Klein Direct Testimony, page 15, lines 12-13.
[361] *See* Klein Direct Exhibit, page 4.
[362] Klein Direct Testimony, page 15, lines 14-15.

electric-only utilities all have very similar CAPM cost of equity estimates between 7.14% and 8.56%.[363] The CAPM for a stock with a beta of one, the market average, is 9.94%.[364]

Dr. Klein explains his CAPM conclusion for cost of equity as follows:

> My CAPM cost of equity estimate for [The Southern Company] and the comparable firms averages 7.51%. This is likely a lower bound on the cost of equity due to the previously mentioned tendencies of the CAPM. The average of the DCF cost of equity estimates is around 10.5%. The midpoint of this range is about 9.0%, which is also the DCF estimate for [The Southern Company]. Further the CAPM estimate for the market (beta = 1) of 9.94% is above this estimate for [The Southern Company], as we expect for utilities that are less risky than the average stock. I recommend a cost of equity of 9.0% for [The Southern Company] in CGC's double-leverage capital structure.[365]

Dr. Vander Weide instead recommends a cost of equity of 10.3% for a separate group of firms he believes to be comparable to CGC.[366] He then adjusts for items which he claims accounts for CGC's higher risk capital structure.[367] He concludes that 11.25% is a fair rate of return on equity for CGC after this adjustment.[368] In order to come up with this heightened figure, he relies on several factors that Dr. Klein addressed and discredited in his direct testimony.

First, Dr. Vander Weide's choices of firms are all too large to be comparable to CGC. Since CGC proposes the use of SCG's capital structure, it should be SCG's cost of equity that is at issue, not CGC's cost of equity.[369] Further, Dr. Vander Weide's comparable firms are all-natural gas utilities. This selection thus fails to take into account Tennessee's long-standing and correct preference for the double-leverage approach, which in this case would look to the parent,

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[363] Klein Direct Testimony, page 15, lines 16-17.
[364] Klein Direct Testimony, page 15, lines 17-18.
[365] Klein Direct Testimony, page 16, lines 14-19.
[366] Vander Weide Testimony, page 4, lines 8-11.
[367] Vander Weide Testimony, page 4, lines 11-19.
[368] Vander Weide Testimony, page 4, lines 19-20.
[369] Klein Direct Testimony, page 17, lines 10-12.

The Southern Company, a combination electric-natural gas utility.[370] Dr. Klein correctly adopted double-leverage into his calculation and utilized electric and natural gas combination utilities for firms comparable to SCG.

Dr. Vander Weide also adjusted for flotation costs and quarterly dividend payments.[371] These adjustments are offsetting and should be ignored for ratemaking purposes. The quarterly dividend payment adjustment is an alteration to the DCF cost of equity based on the idea that the firm must pay these sums out over the course of the year, rather than all at once at the end, requiring the firm to borrow that money at a cost that should be recognized in its cost of equity. The problem with Dr. Vander Weide's approach is that it ignores the profits the firm will earn throughout the course of the year. As Dr. Klein states:

> a firm earning profits over the course of the year will have the money available to pay quarterly dividends out of those profits and still have profits left to invest to earn an additional return before the end of the year. The end result is that the firm earns higher profits, even after paying quarterly dividends, than those calculated for regulatory purposes when these timing issues are taken into account. [372]

In order to utilize Dr. Vander Weide's approach and to account for the time-value of profits earned over the course of the year, the Commission would need to decide how often to measure the profits (*i.e.*, whether to measure them daily, weekly, monthly, or quarterly). If the Commission adopted shorter periods, this would require much finer measurement of costs and revenues. The Commission would then need to determine the rate to value them over time. And the timing of rate cases could also become issues for companies affected by weather. As Dr. Klein explained in his direct testimony, "many of these timing effects will be offsetting, very

[370] Klein Direct Testimony, page 17, lines 12-14.
[371] Vander Weide Direct Testimony, page 28, lines 8-10; page 29, lines 16-17.
[372] Klein Direct Testimony, page 18, lines 8-13.

difficult to measure accurately, or to some degree arbitrary, making them best ignored for most purposes."[373]

Additionally, CGC and SCG do not issue stock to the public. The Southern Company has not even issued stock to the public in more than fifteen years.[374] Therefore, adjustment for flotation costs is unnecessary.

3. The Commission should utilize the Consumer Advocate's list of comparable firms.

Dr. Klein's choice of comparable companies properly accounts for the parent-subsidiary relationships between CGC, SCG, and The Southern Company. Because the Company recommends that the Commission utilize SCG's capital structure in this proceeding, SCG 's cost of equity is at issue. As discussed in more detail above, to examine SCG's capital structure, the double-leverage approach should be applied, and The Southern Company's parent-only debt-equity ratio should be imputed to SCG equity.[375]

Dr. Klein uses five companies in his group of proxy companies. Dr. Klein chose utilities that offer a combination of natural gas and electric services in order to accurately reflect The Southern Company's operations and role with respect to SCG. Dr. Vander Weide, however, still attempting to distance SCG from The Southern Company, utilized only natural gas firms. Dr. Klein also points out that Dr. Vander Weide's selected proxy companies are too large to be compared to CGC.[376] For these reasons, the Commission should reject Dr. Vander Weide's proxy group and instead adopt the group proposed by Dr. Klein.

4. The Commission should reject the Company's recommendation to implement a Risk Premium Method.

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[373] Klein Direct Testimony, page 18, lines 21-23.
[374] See Company response to CPAD Discovery Request No. 1-186.
[375] SCG receives all of its equity financing from The Southern Company. Transcript Vol. I B, page 146, lines 10-12.
[376] Dr. Vander Weide chooses firms more comparable to SCG. Klein Direct Testimony, page 17, lines 9-11.

Dr. Vander Weide also applies the risk premium method to equity returns compared to returns on corporate bonds.[377] The CAPM is a similar approach, but the CAPM measures the risk premiums of stocks in relation to government instruments that are risk-free, or in other words that have little chance of defaulting.[378] Moreover, short-term government bills are preferable for these purposes because the chance that inflation and interest rates will diverge from investor expectations over the life of a short-term bill is essentially non-existent. "The difference between stock or equity returns and a risk-free rate of return reflects *only* the added return required for the risk embodied in stocks over and above the return required to offset the time value of money."[379]

As Dr. Klein also point out in his testimony:

> The problem with Dr. Vander Weide's risk premium analyses is that the returns on corporate bonds do not embody only the time value of money, but also include some return for inflation or interest rate risk, as well as the risk of default. Stocks are not subject to inflation risk, because stock prices and stock returns will adjust for changes in inflation as firms adjust their prices for their products, nor are they subject to default risk in the same way that bonds are, since stocks returns can rise when profits far exceed default levels even if the probability of default does not change. Consequently, there is no reason to expect this difference in returns on corporate bonds and stocks, either utilities or the S&P 500, to be stable over time and this can introduce bias or inaccuracies into the risk premium estimates.[380]

5. The Commission should likewise reject the Company's various other adjustments to Weighted Average Cost of Capital.

Dr. Vander Weide also calculates the cost of equity necessary for CGC to attain the same weighted average cost of capital as his comparable firms. Dr. Klein notes that:

> This is apparently based on the idea that the weighted average cost of capital (WACC) must be equal for all firms with cash-flows of similar risk regardless of

[377] Vander Weide Direct Testimony, page 31, lines 4-10.
[378] Klein Direct Testimony, page 19, lines 14-16.
[379] Klein Direct Testimony, page 19, lines 18-20.
[380] Klein Direct Testimony, page 19, line 21 through page 20, line 7.

> their capital structures. This is equivalent to a method in which an unlevered cost of equity is calculated that accounts for the capital structure and debt cost of the comparable firms. This unlevered cost of equity is equal to each firm's weighted average cost of capital. To get a cost of equity based on comparable firms' WACC involves "levering" the unlevered cost of equity estimates (or WACC) using the specific capital structure and debt cost rates for the firm in question, CGC.[381]

Dr. Vander Weide's adjustment for a common WACC stems apparently from a theoretical analysis of the proper discount rate to apply to the so-called tax shield on debt. "This tax shield refers to business income tax that does not tax interest paid on debt, but does tax returns to equity, giving debt a tax advantage."[382] Dr. Klein, however, asserts that "the adjustment is somewhat controversial in the Finance community, because the issue of valuing the debt tax shield remains unresolved."[383]

Dr. Klein further explains:

> Even if one ignores this issue, the theory underlying the approach is untestable, because the unlevered cost of equity for a levered firm (one that has debt) is unobservable. Thus, even if one believes the theory underlying the calculation of the unlevered cost of equity as the WACC, there is no way to confirm it, because the true unlevered cost of equity is unknown . . . .
>
> There are several practical issues from a regulatory perspective. First, this approach to the cost of equity has never been adopted in Tennessee before. The companies regulated by the TPUC and its predecessors remain financially viable despite this. Hence, there seems to be no necessity for taking into account a common WACC and calculating an adjusted cost of equity as Dr. Vander Weide proposes.
>
> Secondly, his calculation of the WACC for his comparable firms requires some estimation of the capital structure and debt costs of these firms. To the extent these approximations are not accurate, his estimates of the WACC for his comparable firms may be inaccurate or biased. Consequently, Dr. Vander Weide's adjusted cost of equity for CGC is inaccurate.[384]

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[381] Klein Direct Testimony, page 20, lines 13-21.
[382] Klein Direct Testimony, page 21, lines 5-7.
[383] Klein Direct Testimony, page 21, lines 7-10 (*citing* Massimiliano Barbi, *On the risk-neutral value of debt tax shields*. 22 J. of Applied Finance 251-258 (2012)).
[384] Klein Direct Testimony, page 21, lines 11 through page 22, line 3.

Because Dr. Klein's methods in determining the cost of capital and capital structure are based on Tennessee precedent and are grounded in sound financial and economic principles, the Consumer Advocate's should be adopted by the Commission. This will result in not only a fair rate of return for The Southern Company's shareholders, it will lead to just and reasonable rates for customers in Hamilton and Bradley counties.

XI. CONCLUSION

For the foregoing reasons, the Commission should find that the Company's request to increase the rates of its customers is without merit. In light of the facts of this record, Chattanooga Gas has not carried its burden to prove that a rate increase would be just and reasonable at this time. The Commission therefore should deny the Company's proposed rate increase and, instead, reduce the rates charged to the Company's customers by $2.6 million as recommended by the Consumer Advocate. In addition, the Commission should find that the recovery of the estimated $1.4 million that resulted from the cap imposed on the AUA in the Company's last rate case should be denied as being without basis. Finally, with respect to the adoption of methodologies that could be used in an annual rate review mechanism, the Commission should find that the Company's books, records, and data presented in this case are in such a condition that would not permit the implementation and ongoing review and analysis of any methodologies to be adopted and used in an annual rate review mechanism.

RESPECTFULLY SUBMITTED,

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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:

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This the 10th day of September, 2018.

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