

BUTLER | SNOW

January 7, 2019

**VIA ELECTRONIC FILING**

Hon. David Jones, Chairman  
c/o Sharla Dillon  
Tennessee Public Utilities Commission  
502 Deaderick Street, 4<sup>th</sup> Floor  
Nashville, TN 37243

**RE: *Joint Petition of Tennessee-American Water Company, and Thunder Air, Inc. d/b/a Jasper Highlands Development, Inc. for Approval of a Purchase Agreement and for the Issuance of a Certificate of Convenience and Necessity***  
**TPUC Docket No. 18-00099**


Dear Chairman Jones:

Attached for filing please find *Tennessee-American Water Company's Rebuttal Testimony of Melissa Schwarzell* in the above-captioned matter.

As required, an original of this filing, along with four (4) hard copies, will follow. Should you have any questions concerning this filing, or require additional information, please do not hesitate to contact me.

Very truly yours,

BUTLER SNOW LLP

  
Melvin J. Malone

clw

Attachments

cc: Linda Bridwell, Tennessee-American Water Company  
Daniel Whitaker, Consumer Protection and Advocate Division  
William H. Horton, Counsel for Thunder Air, Inc.

**TENNESSEE-AMERICAN WATER COMPANY, INC.**

**DOCKET NO. 18-00099**

**REBUTTAL TESTIMONY**

**OF**

**MELISSA L. SCHWARZELL**

**ON**

**JOINT PETITION OF TENNESSEE-AMERICAN WATER COMPANY AND  
THUNDER AIR, INC. D/B/A/JASPER HIGHLANDS DEVELOPMENT, INC. FOR THE  
APPROVAL OF AN ASSET PURCHASE AGREEMENT AND FOR THE ISSUANCE OF  
A CERTIFICATE OF CONVENIENCE AND NECESSITY**

1    **Q.    PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2    A.    My name is Melissa L. Schwarzell, and my business address is 1 Water Street, Camden,  
3           NJ, 08102.

4    **Q.    BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

5    A.    I am employed by American Water Works Service Company, Inc. ("Service Company").  
6           Service Company is a wholly owned subsidiary of American Water Works Company,  
7           Inc. ("American Water") that provides services to Tennessee-American Water Company  
8           ("TAWC" of "Company") and its affiliates. My current role is Senior Director of  
9           Regulatory Services.

10   **Q.    HAVE YOU PREVIOUSLY FILED TESTIMONY BEFORE THIS OR ANY**  
11       **OTHER COMMISSION?**

12   A.    Yes. I have provided both oral and written testimony before the Kentucky Public Service  
13           Commission. I have also sponsored testimony before the Public Utilities Commission of  
14           Ohio and the Tennessee Public Utility Commission ("TPUC" or "Commission") in  
15           Docket No. 12-00049.

16   **Q.    PLEASE STATE YOUR EDUCATIONAL AND PROFESSIONAL**  
17       **BACKGROUND.**

18   A.    I earned a Bachelor of Science degree from Ohio State University. I am enrolled in  
19           Temple University's Master of Business Administration program. I have completed  
20           NARUC Utility Rate School and the IPU Advanced Regulatory Program.

21           I have been employed by Service Company since 2009. Prior to my current role,  
22           I served as Director of Investor Relations from February 2016 to January 2017. In this  
23           role, I supported American Water's relationship with its shareholders, by developing

1 public disclosures and communicating with institutional investors and equity analysts.  
2 From December 2014 to February 2016, I served as Manager of Regulatory Policy,  
3 providing research, communication, and business support on key water service issues and  
4 policy solutions. From February 2011 to December 2014, I held increasing levels of  
5 responsibility for rates and regulatory service to American Water's subsidiaries as a  
6 Financial Analyst Rates I, Financial Analyst Rates II, and Rates and Regulatory Analyst  
7 III. Prior to this, I began my career at American Water working as Executive Assistant to  
8 the Eastern Division Vice President of Finance. In this role, I provided labor budgeting,  
9 as well as analysis of labor costs, Service Company, revenues, and the general ledger.

10 Prior to joining American Water, I worked for the Bluegrass Area Agency on  
11 Aging, supporting social services programs for senior citizens in Central Kentucky.  
12 From 2001 to 2003, I worked as a Financial and Administrative Assistant, providing  
13 bookkeeping, as well as website and database development. In 2004 I was promoted to  
14 Program Specialist.

15 **Q. WHAT ARE YOUR DUTIES AS SENIOR DIRECTOR OF REGULATORY**  
16 **SERVICES?**

17 A. My duties in this position consist of reviewing, preparing and assisting in regulatory  
18 filings and related activities for the regulated subsidiaries of American Water. My  
19 responsibilities and my team's responsibilities include the preparation of written  
20 testimony, exhibits and work papers in support of rate applications and other regulatory  
21 filings as well as responses to data requests for Tennessee-American and its regulated  
22 utility affiliates.

1   **Q.    WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

2    A.    The purpose of my testimony is to respond to the direct testimony of William H. Novak  
3           on behalf of the Consumer Advocate Unit of the Office of the Tennessee Attorney  
4           General (“Consumer Advocate”). Specifically, I will address Mr. Novak’s three  
5           recommendations<sup>1</sup>, including

- 6           • the proposal of a \$730,000 negative acquisition adjustment below the price of the  
7                 system;
- 8           • the rejection of closing cost recovery; and
- 9           • the exclusion of capital and expense surcharges from the Thunder Air, Inc.  
10           customers.

11   **Q.    DOES THE COMPANY SUPPORT MR. NOVAK’S RECOMMENDATION TO**  
12   **RECORD A NEGATIVE \$730,000 ACQUISITION ADJUSTMENT?**

13   A.    No. Mr. Novak’s recommendation to record a negative acquisition adjustment would  
14           have a dramatic chilling effect on system acquisition in Tennessee, thereby undermining  
15           the public interest. It also has no merit from either a ratemaking or accounting  
16           standpoint.

17   **Q.    IN LIGHT OF MR. NOVAK’S RECOMMENDATION, PLEASE BRIEFLY**  
18   **DISCUSS WHY WATER SYSTEM ACQUISITION IS IN THE PUBLIC**  
19   **INTEREST?**

20   A.    The water industry in the United States is a remarkably fragmented network of more than  
21           50,000 community water systems.<sup>2</sup> Each of these separate systems must provide the  
22           most critical of services to its community. These services include drinking water, fire

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<sup>1</sup> TPUC Docket 18-00099, Direct Testimony of William H. Novak, page 4, lines 1 through 14

<sup>2</sup> U.S. EPA 3<sup>rd</sup> Quarter 2018 water system inventory.

1 protection, and sanitation, as well as water for other domestic, commercial and industrial  
2 purposes. Without safe, clean, reliable, affordable water service, the public and  
3 economic health of our communities can be compromised.

4  
5 Even with the most diligent management efforts, small stand-alone systems face  
6 significant hurdles that can be effectively addressed through acquisition by larger water  
7 providers. As discussed in the Company's direct testimony, consolidation of water and  
8 wastewater systems can offer economies of scale, and can provide professional  
9 management, long-term planning, and specialized water treatment and operations  
10 expertise often not available to smaller systems. It can also provide sustained investment  
11 and cost and operational efficiencies that might not otherwise be feasible for small stand-  
12 alone systems, as they can't leverage the buying power and capital market access that  
13 larger utilities can provide. The capital intensity of the water and wastewater sector,  
14 increasing water quality regulations, and the critical nature of water service for both the  
15 public and economic health of Tennessee communities all further underscore the need for  
16 the efficiencies, economies of scale, resources, and expertise available through  
17 consolidation of systems.

18 **Q. WHY WOULD MR. NOVAK'S UPAA RECOMMENDATIONS HAVE SUCH A**  
19 **NEGATIVE EFFECT ON ACQUISITIONS?**

20 A. Mr. Novak's proposal to assign a negative UPAA value to the transaction may be well  
21 intentioned, but it would create an unsupportive and unfavorable precedent in Tennessee  
22 and set a new, low-watermark for acquisition policy.

1 Mr. Novak proposes that the Company record the value of the system not only below  
2 book value of approximately \$4.4 million<sup>3</sup> but also below the arms-length negotiated  
3 price of \$1.5 million<sup>4</sup>. He recommends instead a value of less than \$0.8 million<sup>5</sup>, forcing  
4 a likely write-off of half of the Company's actual investment in the system. This kind of  
5 practice would make it almost impossible to negotiate a fair price and acquire systems,  
6 given that asset values would be so degraded through regulation. Consequently, it is very  
7 difficult to imagine how Tennessee could attract capital towards system acquisition if a  
8 draconian practice like this were adopted.

9  
10 **Q. IS THERE A REASONABLE RATEMAKING FOUNDATION FOR MR.**  
11 **NOVAK'S NEGATIVE UPAA?**

12 A. No. Mr. Novak suggests that the negative UPAA adjustment would prevent the potential  
13 for subsidization<sup>6</sup>. There is no reasonable ratemaking principle that would support a  
14 negative UPAA and the write-off of assets based on the mere possibility that revenues  
15 would be more deficient in one area than another.

16  
17 Additionally, Mr. Novak's adjustment actually inverts the ratemaking process. It  
18 arbitrarily degrades the value of assets, to allegedly prevent a deficiency in fair return  
19 following the acquisition<sup>7</sup>, rather than supporting just and reasonable rates to provide the  
20 very opportunity for a fair return on its investment. Mr. Novak's proposal is the opposite  
21 of what ratemaking is supposed to accomplish.

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<sup>3</sup> Company's response to Tennessee Public Utility Commission's first request for information, item 14

<sup>4</sup> Exhibit A of Petition, Asset Purchase Agreement, page 2, item 2.3

<sup>5</sup> Direct Testimony of William H. Novak, page 6, lines 13 through 14

<sup>6</sup> Direct Testimony of William H. Novak, page 7, lines 4 through 6

<sup>7</sup> Direct Testimony of William H. Novak, page 5, line 21, through page 6, line 2

1  
2 Additionally, the approval of this petition is not a formal rate case for Tennessee  
3 American Water Company. To specifically disallow rate base value for assets that are  
4 used and useful for providing service to the customers is simply inappropriate. The  
5 proposal to disallow the future recovery of those assets based simply on current customer  
6 revenues is nothing more than an effort to penalize TAW. The joint petitioners have  
7 provided information for the basis of the negotiated purchase price, which is well below  
8 the net book value of the assets. Mr. Novak has provided no evidence to demonstrate that  
9 the projected growth which was part of the basis of the negotiated purchase price is  
10 unreasonable or speculative at all. The Company stands behind its forecast as reasonable.

11  
12 This proposed regulatory treatment simply has no merit and is not in the long-term  
13 interest of our customers or the state of Tennessee.

14  
15 **Q. IS THERE ANY ACCOUNTING MERIT TO MR. NOVAK'S PROPOSAL ON**  
16 **UPAA?**

17 A. No. In addition to proposing inappropriate ratemaking treatment that can have a negative  
18 impact on consolidation in the state of Tennessee, Mr. Novak's proposal also lacks  
19 accounting merit. The Tennessee Public Utility Commission ("TPUC") recognizes the  
20 NARUC Uniform System of Accounts, which specifies accounting instructions for the  
21 purchase of assets. These accounting instructions, if applied to the Thunder Air, Inc.  
22 acquisition, would produce a utility plant in service value of approximately \$4.6 million,  
23 an accumulated depreciation value of approximately a negative \$200,000, and a negative



1 Utility Plant Acquisition Adjustment of approximately \$2.9 million, leaving a net rate  
2 base of approximately \$1.5 million if the UPAA were include in rates.<sup>8</sup> The Company's  
3 proposal is to simply record the value of the plant and depreciation at the \$1.5 million  
4 purchase price, resulting in the same rate base value. However, Mr. Novak recommends  
5 a significantly lower rate base, creating a UPAA for which there is simply no accounting  
6 basis.

7 **Q. DOES THE COMPANY AGREE WITH MR. NOVAK'S PROPOSAL TO**  
8 **DISALLOW RECOVERY OF TRANSACTION COSTS?**

9 A. No, the Company believes that its request to recover relevant transaction and closing  
10 costs is well founded, based on several grounds.

11  
12 First, the costs requested for recovery are operationally necessary. They relate to due  
13 diligence of the assets being acquired, including the research of property deeds to ensure  
14 the purchased assets are free of liens and issues. Additionally, the costs are incurred to  
15 ensure that all assets and property rights, including easements are transferred from  
16 Thunder Air, Inc. to the Company and filed on the land records to ensure the property  
17 transfers are legally undertaken and finalized. Per the Commission's adopted accounting  
18 instructions, the utility is to procure, if possible, all existing records relating to the  
19 property acquired. Researching the property deeds, liens, and easements associated with  
20 the purchased property is thus a necessary operating expense.

21  

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<sup>8</sup> Company's response to Tennessee Public Utility Commission's first request for information, item 14

1 Second, these acquisition costs will not be double-recovered. The costs the Company is  
2 seeking recovery for were or will be incurred for third party services specific to the  
3 completion of this acquisition. They are not currently included in the Company's base  
4 rates and this proceeding is the only effective way for the Company to recovery these  
5 prudently incurred costs.

6  
7 Finally, prudent transaction and closing costs benefit the customer base. Performing due  
8 diligence on property to be acquired is protective of the financial integrity of the utility  
9 and of the operational resources dedicated to customer service. Customers benefit when  
10 the utility is able to focus on water quality, infrastructure investment, service reliability  
11 and customer care, and performing adequate due diligence safeguards these benefits, as it  
12 prevents legal and other complications which could divert resources. The Company has  
13 also agreed to cap the deferral of costs at \$10,000 in this case. Also, as stated earlier,  
14 customers also fundamentally benefit from having a broader customer base served  
15 (through efficiencies, economies of scale, and the sharing of fixed costs, for example), so  
16 exercising basic care in expanding the customer base through smart acquisitions can have  
17 enduring benefit to our customers and their communities.

18  
19 For the foregoing reasons here, the recovery of these transaction costs is consistent with  
20 the requirements described by the Tennessee Public Utilities Commission in its order in  
21 Docket 12-00157.

1   **Q.   MR. NOVAK ALSO PROPOSES TO EXCLUDE THE THUNDER AIR, INC.**  
2       **CUSTOMERS FROM THE EXPENSE AND CAPITAL SURCHARGES. DO YOU**  
3       **AGREE WITH HIS PROPOSAL?**

4   **A.**   No. The Capital Recovery Riders and PCOP Rider are applicable to the entire customer  
5       base and don't vary across customer class or tariff group. Indeed, the tariff would have to  
6       be revised to make them work otherwise, as it currently reads that the charges will apply  
7       to all customers in all service territories.

8  
9       This uniform application provides benefits to the entire customer base by spreading out  
10      the cost of significant investments so that the entire system is maintained and upgraded in  
11      an efficient manner that avoids rate shock and is consistent with the streamlined  
12      regulatory methods permitted by the Tennessee General Assembly, all under the  
13      safeguard oversights set forth in the CRR tariffs. Additionally, the practice of applying  
14      these surcharges across the entire customer base has been in place since 2014. The  
15      surcharges were also applied to the customers of the Whitwell acquisition when that  
16      transaction was completed. Consequently, applying the capital and expense surcharges to  
17      the Thunder Air, Inc. acquisition would be consistent with past practice, thus maintaining  
18      stability and predictability in the Tennessee regulatory environment.

19  
20      Finally, Mr. Novak's objection to including these surcharges based on the age and source  
21      water of the Thunder Air, Inc. system are not valid reasons to deviate from the benefits of  
22      the uniform application of these tariffs. The Capital Riders include investment in more  
23      than just infrastructure replacement. They also cover safety and environmental

1 compliance investments, as well as economic development investments. Mr. Kruchinski  
2 described the investments expected for Thunder Air, Inc., such as AMR meter installation  
3 and SCADA improvements<sup>9</sup>. These would both likely fall within the Capital Rider  
4 eligible investments. Additionally, the revenues from Thunder Air, Inc. are subject to  
5 Tennessee Public Utility Commission Inspection fee expense and purchase water expense  
6 – both of which are components of the PCOP rider.

7  
8  
9 **Q. DOES MR. NOVAK ACCURATELY DESCRIBE HOW THE COMPANY**  
10 **WOULD IMPLEMENT THE CAPITAL AND EXPENSE SURCHARGES FOR**  
11 **JASPER HIGHLANDS CUSTOMERS.**

12 A. The Company is not certain that Mr. Novak's description is fully accurate. He describes  
13 a surcharge and a credit to base rates initially. However, the Company doesn't intend to  
14 charge a separate credit to Thunder Air, Inc. customers. To clarify, the proposed tariff is  
15 attached to my testimony. It shows the base rates of Thunder Air, Inc. reduced by the  
16 amount of the existing PCOP and Capital Rider surcharges, or 15.18%.

17  
18 **Q. CAN YOU SUMMARIZE WHY THE COMPANY'S RECOMMENDATIONS**  
19 **ARE IN THE PUBLIC INTEREST, AND WHY MR. NOVAK'S**  
20 **RECOMMENDATIONS ARE NOT?**

21 A. Consolidating the fragmented water and wastewater sector in Tennessee is in the public  
22 interest and is difficult to achieve without constructive regulatory treatment.

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<sup>9</sup> Direct testimony of Kevin Kruchinski, page 6, lines 4 through 8

1 Constructive acquisition policy can include the positions reiterated by the Company  
2 above, namely the recognition of a transaction's fair value as rate base (lower than net  
3 book value in this case), allowing recovery of closing and transaction costs, and merging  
4 acquired customers into existing rate structures. These policies can support fruitful  
5 negotiations, can provide fair regulatory treatment for prudent and reasonable transaction  
6 costs, and can speed acquisition benefits to the entire customer base.

7  
8  
9 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

10 **A. Yes.**

# ATTACHMENT

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CLASSIFICATION OF SERVICE

APPLICABILITY

For all residential, commercial, and other public authority customers of Jasper Highlands development in Kimball, TN. This rate applies to all customers regardless of meter size.

RATES:

Cost per 100 Gallons

| <u>Monthly Use</u>                 | <u>Jasper Highlands General<br/>Water Service</u> |     |
|------------------------------------|---|-----|
| First 2,500 gallons (minimum bill) | \$58.60   | (N) |
| Next 2,500 gallons                 | \$1.48 per 100 gallons                            | (N) |
| Next 2,500 gallons                 | \$1.31 per 100 gallons                            | (N) |
| Above 7,500 gallons                | \$1.17 per 100 gallons                            | (N) |

(N) Indicates New rate

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ISSUED: January 7, 2019

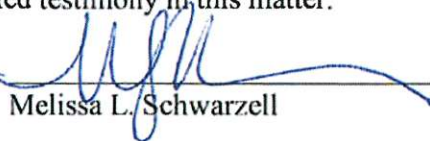
EFFECTIVE: January 22, 2019

BY: \_\_\_\_\_  
Valoria V. Armstrong, President  
109 Wiehl Street  
Chattanooga, Tennessee 37403

STATE OF New Jersey )  
 )  
COUNTY OF Camden )

BEFORE ME, the undersigned authority, duly commissioned and qualified in and for the State and County aforesaid, personally came and appeared Melissa L. Schwarzell, being by me first duly sworn deposed and said that:

She is appearing as a witness on behalf of Tennessee-American Water Company before the Tennessee Public Utility Commission, and if present before the Commission and duly sworn, her testimony would be as set forth in her pre-filed testimony in this matter.

  
\_\_\_\_\_  
Melissa L. Schwarzell

Sworn to and subscribed before me  
this 7<sup>th</sup> day of January, 2019.

  
\_\_\_\_\_  
Notary Public

My Commission Expires: 4/15/2020

ANN G. ALFANO  
NOTARY PUBLIC OF NEW JERSEY  
ID # 50014130  
My Commission Expires 4/15/2020



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:

Daniel Whitaker III  
Consumer Protection and Advocate Division  
Office of the Tennessee Attorney General  
P.O. Box 20207  
Nashville, TN 37202-0207  
Daniel.Whitaker@ag.tn.gov

This the 7<sup>th</sup> day of January, 2019.

  
Melvin J. Malone