

BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION

NASHVILLE, TENNESSEE

November 8, 2019

IN RE:)	
)	
PETITION OF TENNESSEE-AMERICAN WATER)	DOCKET NO.
COMPANY REGARDING THE 2019 INVESTMENT)	18-00120
AND RELATED EXPENSES UNDER THE QUALIFIED)	
INFRASTRUCTURE INVESTMENT PROGRAM)	
RIDER, THE ECONOMIC DEVELOPMENT)	
INVESTMENT RIDER, AND THE SAFETY AND)	
ENVIRONMENTAL COMPLIANCE RIDER)	

ORDER APPROVING *PETITION* AS AMENDED

This matter came before Vice Chair Kenneth C. Hill, Commissioner Herbert H. Hilliard, and Commissioner David F. Jones of the Tennessee Public Utility Commission (the “Commission” or “TPUC”), the voting panel assigned to this docket, at a regularly scheduled Commission Conference held on August 12, 2019 for consideration of the *Petition* filed by Tennessee-American Water Company (“TAWC”, “Tennessee-American” or the “Company”) on November 16, 2018.

BACKGROUND

TAWC provides residential, commercial, industrial, and municipal water service to customers in Tennessee and North Georgia. TAWC is a wholly-owned subsidiary of American Water Works Company, Inc. On November 16, 2018, TAWC filed a *Petition* requesting Commission approval to change the tariff percentage rates for the Qualified Infrastructure Investment Program Rider (“QIIP” or “QIIP Rider”), the Economic Development Investment

Program Rider (“EDI” or “EDI Rider”), and the Safety and Environmental Compliant Rider (“Safety Rider” or “SEC”). The QIIP, EDI, and SEC (collectively, “Capital Riders”) were previously approved by the Commission on April 14, 2014 in Docket No. 13-00130.¹

On December 21, 2018, the Consumer Advocate Unit in the Financial Division of the Office of the Tennessee Attorney General (“Consumer Advocate”) filed its *Petition to Intervene*. On January 8, 2019, the Hearing Officer granted the Consumer Advocate’s intervention.

PETITION

In accordance with the tariffs approved in TPUC Docket No. 13-00130, on or before December 1 of each year, the Company shall submit to the Commission an annual filing that calculates the tariff Rider percentage rates for the upcoming calendar year.² In Pre-Filed Testimony in support of the *Petition*, Ms. Melissa L. Schwarzell asserted the Capital Riders were calculated consistent with the modifications and clarifications ordered in TPUC Docket Nos. 14-00121 and 15-00029, and the corrections made to the calculations in TPUC Docket Nos. 15-00111, 16-00022, and 17-00020.³

The Company made three changes to its Excel workbook since its last capital rider filing. First, the workbook was updated for 2019 forecasted investments, actual 2017 capital expenditures from Commission Docket No. 18-00022, and certain formulas. Second, the revised federal income tax rates resulting from the 2017 Tax Cuts and Jobs Act (“TCJA”) have been used in this filing for both income tax expense and the forecasted Accumulated Deferred Income Taxes (“ADIT”). Third, the forecasted retirement and cost of removal is based upon the average

¹ See *In re: Petition of Tennessee-American Water Company for Approval of a Qualified Infrastructure Investment Program, an Economic Development Investment Rider, a Safety and Environmental Compliance Rider and Pass-Throughs for Purchased Power, Chemicals, Purchased Water, Wheeling Water Costs, Waste Disposal, and TRA Inspection Fee*, Docket No. 13-00130, *Order Approving Amended Petition* (January 27, 2016).

² See *Petition*, pp. 6-7 (November 16, 2018).

³ Melissa L. Schwarzell, Pre-Filed Direct Testimony, p. 3 (November 16, 2018).

actual retirements and cost of removal by account in 2015–2017, which the Company asserts is consistent with the methodology used in Commission Docket No. 17-00124.⁴

The Company anticipates filing a reconciliation by March 1, 2019 which will apply as a true-up for the actual 2018 calendar year investment and revenues, including any over/under collection of the reconciliation approved in Commission Docket No. 18-00022.⁵ As the Capital Recovery Rider Adjustment in Commission Docket No. 18-00022 is pending, no adjustment was included in the *Petition*.⁶ Ms. Schwarzell included exhibits for the calculation of the three Capital Riders, along with detailed workpapers supporting these exhibits. Additionally, Mr. Brent O'Neill and Mr. Kurt Stafford provide testimony detailing the proposed capital expenditures included within each Capital Rider.⁷

The Company applied the cost of capital, depreciation rates, and property tax rates that were approved in its last rate case in TPUC Docket No. 12-00049. The current federal income tax rate of 21% was applied. The Company asserted no operating expenses were included for recovery in this filing. The annual reconciliation filing will address any differences between the projections utilized in this filing and the actual amounts incurred or received. This reconciliation also includes an Earnings Test to ensure that the Company does not earn a rate of return above the authorized return granted by the Commission in its last rate case.⁸

With respect to the Commission's actions in TPUC Docket No. 18-00039, concerning the impact of the new federal tax rate of 21%, Tennessee-American has tracked and accumulated monthly, in a deferred account, the portion of its revenue representing the difference between the cost of service approved by the Commission in its last rate case at a federal tax rate of 35% and

⁴ *Id.* at. 8-9.

⁵ *Id.* at 16.

⁶ *Id.* at 14-16.

⁷ *Id.* at 18.

⁸ *Id.* at 21-23.

the cost of service that would have resulted had the Company been using the new federal tax rate of 21%. The balance is \$1,599,454 as of October 31, 2018.⁹ The Company has continued to defer tax savings and estimates the total deferral, for purposes of application in this docket, will be over \$2 million. While the methodology for calculating the amount of tax savings should continue in TPUC Docket No. 18-00039, the Company proposes in the *Petition* to apply the estimated \$2 million deferral to offset the \$2.1 million 2019 Capital Recovery Rider increase.¹⁰

According to Ms. Schwarzell, applying the tax deferral to the Capital Rider increase allows customers to benefit from over \$19 million of infrastructure investment without any bill increase in 2019.¹¹ Additionally, this allows the Company to maintain cash flows and financial stability. This offset process enables the Company to continue deferring revenue monthly while applying the deferral to the amount that would have been billed to customers for 2019 through a surcharge credit. Ms. Schwarzell asserted that the foregone capital recovery rider revenue could be tracked and a corresponding amount of TCJA Deferred Revenue could be amortized. If approved, the Company stated it would provide a notice on customers' bills explaining that the Capital Rider charge for 2019 is being offset by the tax savings from the 2017 TCJA. Without the offset, it is anticipated that customers' bills would increase \$0.99 per month or \$11.88 per year.¹² With the offset, the customers' bills will not increase as a result of the 2019 Capital Riders. Ms. Schwarzell attests the Capital Recovery Riders remain in the public's interest by reducing the need for rate cases, providing more timely installation of safety and reliability components, and supporting economic development and growth and job creation.¹³

⁹ *Id.* at 27.

¹⁰ *Id.* at 28.

¹¹ *Id.* at 29.

¹² *Id.* at 30.

¹³ *Id.* at 32.

In Pre-Filed Testimony, Mr. Brent O'Neill, the Company's Director of Engineering, discussed recurring projects included in the Capital Riders, including smaller main projects, hydrant and valve replacements, service line and meter setting replacements, security improvements, plant control improvements, projects to replace and maintain treatment, and new mains to assist with economic development. According to Mr. O'Neill, main projects are designed to deliver peak hour demand and to provide adequate fire pressure.¹⁴ The Capital Riders also include major investment projects which are greater than \$250,000. Projects are developed through a Comprehensive Planning Study ("CPS") and designed to meet the strategic intent of the business. Although the Company strives to minimize deviations from the budget, the QIIP, EDI, and SEC investment projects have exceeded the capital budget by 3.47% on a cumulative basis for the period of 2014 through 2018.¹⁵

According to Mr. O'Neill, the Company identified one major project for inclusion in the EDI Rider. The project is in Whitwell and includes installing a 12 inch 6,300 linear foot main along Highway 283 in Whitwell.¹⁶ This project was included in the EDI of the last Capital Rider filing but was delayed until 2019 in order to offset the cost of the Tennessee River Transmission main which was delayed until 2018. The capital budget also includes approximately \$132,000 for new hydrants and valves which are needed in order to provide a more efficient operation of the water system.¹⁷

The Company intends to invest approximately \$142,000 on its System Control and Data Acquisition ("SCADA") which is included in the SEC. This additional investment in the

¹⁴ Brent O'Neill P.E., Pre-Filed Direct Testimony, pp. 4-6 (November 16, 2018).

¹⁵ *Id.* at 6-7.

¹⁶ *Id.* at 11.

¹⁷ *Id.* at 12.

monitoring and control system enables the Company to meet safety and environmental requirements.¹⁸ Also included in the SEC is approximately \$135,000 for investment items associated with the security equipment and systems which allow the Company to maintain its security systems and comply with Homeland Security Directives. The Company included one other major investment of \$450,000 for repairing and replacing the North Travelling Screen and valve at the intake for the Citico Facility.¹⁹

Mr. O'Neill indicated Tennessee-American has also included a Chlorine Gas Conversion project in the SEC. This project will cost approximately \$3,374,646 during 2019 and will be placed in service by December 31, 2019.²⁰ Because of the safety risks associated with chlorine, the proposed project will replace the chlorine gas with sodium hypochlorite, a form of chlorine approved by the Environmental Protection Agency. Mr. O'Neill noted that although there is an increase in the cost, the industry is moving toward sodium hypochlorite due to it being easier and safer to use. It also reduces the risk of a chlorine gas release especially when the installations are close to surrounding metropolitan areas.²¹

In Pre-Filed Testimony, Mr. Kurt A. Stafford testified to the costs included for recovery from the QIIP. In response to the the City of Chattanooga enacting a Paving and Right-of-Way Ordinance, Tennessee-American has added a total of \$1,000,000 to several QIIP budget project lines where pavement restoration is required.²² The Company plans on spending approximately \$1,875,000 for the replacement of water mains within ten projects during 2019 to address the Company's aging infrastructure, including the removal of the cast iron and galvanized pipe.²³

¹⁸ *Id.* at 13-14.

¹⁹ *Id.* at 15-16.

²⁰ *Id.* at 17.

²¹ *Id.* at 19.

²² Kurt A. Stafford, P.E., Pre-Filed Direct Testimony, pp. 5-7 (November 16, 2018).

²³ *Id.* at 8-9.

Mr. Stafford states that Tennessee-American will spend approximately \$1,755,000 to replace water mains during unscheduled events, an expenditure comparable to the three-year average of \$1,289,776 for 2014–2017.²⁴ Tennessee-American has also included QIIP expenditures related to the relocation of existing water mains, including valves and other appurtenances occurring because of municipal or state agency projects. The Company budgeted \$275,000 for the costs associated with the relocations, an amount below the five-year average of \$1,062,566.²⁵ Mr. Stafford explains that Tennessee-American included \$442,000 to replace hydrants and valves.²⁶ Tennessee-American included \$697,000 to replace water services or the small diameter pipe that connects the Customer to the Company’s distribution main.²⁷ Mr. Stafford testifies that the Company included \$4,255,000 for replacement of 22,692 meters. This allows the Company to replace meters and meter settings that are nearing the end of their useful life and could cause service disruptions. It also includes the replacement of 12,125 meters in the system with Automatic Meter Reading (“AMR”) meters.²⁸

Tennessee-American included \$1,125,000 to rehabilitate Aldrich Unit 6 tank. This includes rebuilding the underdrain and rehabilitating the entire structure. An additional QIIP capital project is to replace Basin 1 & Plate Settlers with a cost of \$2,301,250. The existing sediment basin will be replaced with new technology, thereby increasing its capacity sufficiently so that Basin 2 may be taken out service.²⁹

²⁴ *Id.* at 11-13.

²⁵ *Id.* at 13-14.

²⁶ *Id.* at 15.

²⁷ *Id.* at 16.

²⁸ *Id.* at 16-18.

²⁹ *Id.* at 18-19.

SUPPLEMENTAL COMPANY TESTIMONY AND AMENDMENTS TO THE *PETITION*

On February 19, 2019, Elaine K. Chambers, the Company's Director of Rates and Regulation for Tennessee and Kentucky, filed Pre-Filed Direct Testimony adopting the Pre-Filed Testimony of Ms. Schwarzell.³⁰ In Pre-Filed Supplemental Testimony filed the same day, Ms. Chambers sought to support revisions in the Company's calculations to reflect the Commission's decision in TPUC Docket No. 18-00022 to include bonus depreciation and the repairs deduction while also recognizing the net operating loss carryforward, resulting in changes to ADIT to lower overall recovery in the present docket by \$287,675.³¹

On May 31, 2019, Ms. Chambers submitted additional Supplemental Testimony with the following revisions to the Capital Riders calculation due to the Commission's April 15, 2019 deliberations to include the Bonus and Repairs deduction in TPUC Docket No. 18-00022.³² The repair deduction percentages are applied to annual replacement investment for tax lives of twenty-five years and thirty-nine years, excluding meters. Secondly, TAWC added bonus percentages for 2014–2019 applied to annual investments with tax lives less than or equal to twenty-five years. Third, TAWC added the actual Net Operating Loss Carryforward ("NOLC") total balances for 2014–2019. Each year's NOLC amount in the Rider's ADIT balance is now the lesser of either the actual NOLC total or the Rider specific calculated amount.³³ Ms. Chambers stated the *Petition* still includes 2018 as estimated amounts. If specific annual CIAC amounts, either actual or estimated, are incorporated for years 2018 and forward, Ms. Chambers submitted that these amounts have been included as an ADIT offset due to the taxability change

³⁰ Elaine K. Chambers, Pre-Filed Direct Testimony, p. 1 (February 19, 2019).

³¹ Elaine K. Chambers, Pre-Filed Direct Supplemental Testimony, pp. 3-4 (February 19, 2019).

³² Elaine K. Chambers, Pre-Filed Direct Second Supplemental Testimony, p. 2 (May 31, 2019). *See also* Supplemental Exhibits, (June 3, 2019).

³³ *Id.* at 4-5.

from the TCJA. TAWC's supplemental testimony in Docket No. 19-00031 included these revised calculations.³⁴

As amended, the Company is proposing a QIIP Rider of 11.65% to recover \$5,482,911 and the EDI of 0.65% proposes to recover \$306,548. The SEC Rider of 6.88% proposes to recover \$3,236,635 which is a decrease of \$301,011 from the original filing and surcharge decrease of 0.64% from the original filing.³⁵ The Company, however, proposes that the savings from the TCJA be used to prevent any increases in customers' bills. In order to offset the 2.75% combined impact of the 2019 Riders, the Company is proposing a TCJA credit of -2.75%. Consequently, the Company is still proposing a 0% rate increase as a result of the 2019 Capital Rider infrastructure investment.³⁶ Ms. Chambers states that if the Commission authorizes the proposed offset, the impact to the average customer bill from the proposed Capital Recovery Riders will still be zero. Absent this offset the proposed Capital Recovery Riders would represent an increase in customers' bills of \$0.59 per month or \$7.08 per year.³⁷

POSITION OF THE CONSUMER ADVOCATE

Following discovery and exchanges of information with TAWC, Mr. David N. Dittmore submitted Pre-Filed Testimony on behalf of the Consumer Advocate which addressed the calculations of TAWC's proposed Capital Riders. Mr. Dittmore concluded that the Capital Riders produce rates that are unjust and excessive, primarily because the proposed Tariff produce a Rate Base that is higher than TAWC's actual Rate Base.³⁸ Mr. Dittmore offered a restructured tariff that he asserted would balance the interests of the Company and ratepayers while eliminating the return on an excessive or inflated rate base which is currently occurring with the

³⁴ *Id.* at 5.

³⁵ *Id.* at 5-6.

³⁶ *Id.* at 7-8.

³⁷ *Id.* at 7.

³⁸ David N. Dittmore. Pre-Filed Direct Testimony, p. 2 (April 23, 2019).

Company's Capital Riders calculation. He further touted the administrative benefits of moving from the framework of two filings a year to a single annual Capital Riders filing.

In summary, Mr. Dittmore asserted that the current framework of the tariffs approved for the Capital Riders allows the Company to earn a return on investment that was not funded by Company's stockholders. He testified that the existing rate base approved in Docket No. 12-00049 was \$132,015,472 and the sum of the average year-to-date investment levels for the reconciliation filed on March 1, 2019 was \$62,924,426.³⁹ The sum of these two amounts is \$194.9 million and represents the amount on which the Company's customers rates are based. Mr. Dittmore used the Company's 2018 Revised Reports to arrive at a calculation for the actual thirteen-month average rate base of \$173.5 million.⁴⁰ The \$21.4 million difference between the two demonstrates, in his opinion, that customers are not paying rates truly reflective of the shareholders actual investment.⁴¹

According to Mr. Dittmore's testimony, the two items causing the largest portion of the imbalance in rate base are the Accumulated Depreciation and ADIT.⁴² The two balances reflect customer-provided capital, and the balances are greater than what is reflected in rates paid by customers. Mr. Dittmore asserted customers have provided the Company with significant funding in terms of the increase in Accumulated Depreciation and ADIT on legacy plant which is not reflected with the Capital Riders Surcharge calculation.⁴³ The Capital Riders mechanism fully accounts for items that increase reported Capital Riders rate base, but fails to reduce rate base to reflect ratepayer-provided funding that is also put to use for capital investments. The

³⁹ *Id.* at 6.

⁴⁰ *Id.* at 7.

⁴¹ *Id.*

⁴² *Id.* at 8.

⁴³ *Id.*

Company, Mr. Dittemore concluded, is therefore provided a return on \$21 million of rate base that was not funded by the Company shareholders.⁴⁴

In addition, Mr. Dittemore advocated a single annual filing, structured to eliminate the excess Rate Base recovery, and provide administrative efficiency to the Company, the Commission and its Staff, and the Consumer Advocate.⁴⁵ In asserting its position, the Consumer Advocate welcomed the opportunity to work with the Company to resolve any potential issues related to a single filing. According to Mr. Dittemore, “the proposed filing would be based upon historic capital investment, thus avoiding the need to reconcile a budgeted level of capital expenditures with actual expenditures.”⁴⁶

As part of the proposed changes to the Capital Rider tariff, Mr. Dittemore introduced a rate base limitation factor to ensure the total compensated Rate Base does not exceed the actual rate base of the Company. This factor would determine a percentage of Capital Riders investment that may be recovered from ratepayers while ensuring it does not exceed the total level of investment made by shareholders in the provision of water service.⁴⁷ This percentage would be applied to the overall Capital Riders surcharge revenue requirement to arrive at the net revenue requirement to be collected from ratepayers. The calculation of the revenue requirement based upon historical data would be multiplied by a rate base limitation factor to arrive at the net revenue requirement upon which the surcharge percentage would be calculated.⁴⁸

In order to eliminate the regulatory lag, Mr. Dittemore proposed that the Capital Riders surcharge includes the calculation of a return on qualifying Capital Riders surcharge investment

⁴⁴ *Id.* at 9.

⁴⁵ *Id.*

⁴⁶ *Id.* at 11.

⁴⁷ *Id.*

⁴⁸ *Id.* at 11-12.

from the mid-point of the Attrition Period through the mid-point date of the collection year.⁴⁹ The collection of cash would not occur until the collection period, but the recognition of net income would be the same under this methodology as it would be under the existing Capital Riders surcharge and could be implemented through different options.⁵⁰

Mr. Dittmore argued that the current Earnings Test adjustment should not be considered a safety net, and it should not to be used to recover any shortfalls in earnings that the Company may experience in other operations.⁵¹ Mr. Dittmore asserted under the current tariff framework, the Company may continue to receive a positive reconciliation amount for prior year results even if it had excess earnings in the prior year. However, if a Company has excess earnings associated with 2018 operations, there should be no positive reconciliation charge associated with 2018 Capital Riders results. Mr. Dittmore's proposed modification of the Earnings Test language within the proposed Capital Riders Tariff reflects that no surcharge shall be necessary if the Company has earnings in excess of its authorized rate of return.⁵²

"Another proposed modification to the calculation of the Earnings Test Adjustment is to incorporate the Earnings of the Company to reflect the Non-Revenue Water Limiter as contained in the Company's Production Costs and Other Pass-Throughs Rider (PCOP)."⁵³ The Expenses excluded from recovery in the Company's PCOP calculation due to excess water loss should also be excluded from the calculation of the Company's expenses within the calculation of the Company's Earnings Test Adjustment for the Capital Riders. Mr. Dittmore asserts this proposed adjustment to the expense associated with excess water loss is necessary to ensure symmetry between the Commission's findings within the PCOP calculation and the determination of the

⁴⁹ *Id.* at 12.

⁵⁰ *Id.*

⁵¹ *Id.* at 13.

⁵² *Id.* at 13-14.

⁵³ *Id.* at 14.

Earnings Test within the Capital Riders Surcharge calculation. This modification affects the proposed Capital Rider Tariff as well as the reconciliation calculation currently submitted in Docket No. 19-00031.⁵⁴

According to Mr. Dittemore's testimony, the Company is anticipating an increase in Capital Riders investment in 2019 of \$78 million which is approximately \$15 million greater than its cumulative forecasted Capital Riders investment through 2018 of \$63 million.⁵⁵ Mr. Dittemore states there is no need to increase rates associated with the Capital Riders surcharge because the existing rate base imbalance of \$21 million exceeds the Company's estimate of Rate Base growth of \$15 million by over \$6 million. Mr. Dittemore submits the Capital Riders surcharge approved in this case should reflect the rates adopted in Docket No. 17-00124, modified for the results of the reconciliation Docket No. 18-00022, less income tax expense savings amount in Docket No.18-00039.⁵⁶

Mr. Dittemore asserted that TAWC should submit its Capital Riders filing in early 2020 reflecting its actual investment in qualifying Capital Riders investment, increased by the deferral mechanism, limited to the extent necessary by the Rate Base Limitation Factor.⁵⁷ This approach would permit the Company to recover its appropriate costs associated with 2019 investment subject to the Rate Base Limitation Factor contained in the proposed Tariff.⁵⁸ The reconciliation Docket No. 19-00031 continues to be necessary as it reconciles 2018 actual data.⁵⁹

Mr. Dittemore calculates the total Capital Riders surcharge adjustment for income taxes starting with \$2,035,031 in annual savings plus one-third of base rate tax savings of \$902,039

⁵⁴ *Id.*

⁵⁵ *Id.* at 15; Exhibit DND-7.

⁵⁶ *Id.* at 14-15.

⁵⁷ *Id.* at 15-16.

⁵⁸ *Id.*

⁵⁹ *Id.* at 15.

occurring from January 2018 through May 31, 2019, for a total Capital Riders surcharge offset of \$2,937,070.⁶⁰ Mr. Dittemore states the impact of the reconciliation docket should be incorporated into the rates of the current Docket. However, at the time the filing of his Pre-Filed Testimony, the necessary information and impact of the Commission's decision in Docket No. 18-00022 was unavailable. Mr. Dittemore's initial schedules contain a blank line item where this modification should be incorporated in arriving at the Consumer Advocate recommendation in this Docket.⁶¹ In Supplemental Pre-Filed Testimony, Mr. Dittemore provided Supplemental Exhibits DND-1 through DND-4 reflecting an updated total revenue requirement, net of tax savings of \$4,797,499 based upon new information provided by the Company and recognizes the increase of ADIT due to the Bonus Depreciation and Repair Deduction to qualifying capital expenditures.⁶²

REBUTTAL OF TENNESSEE-AMERICAN

On June 28, 2019, Ms. Elaine K. Chambers submitted Pre-Filed Rebuttal Testimony contesting many of Mr. Dittemore's conclusions and proposals. Ms. Chambers argues there is no defect in the current Capital Riders tariff, and Mr. Dittemore's Earnings Test is based on a false premise.⁶³ Mr. Dittemore's earnings calculation is derived by combining a rate approved six years ago in Docket No. 12-00049 with the current Riders Rate Base.⁶⁴ Ms. Chambers claims this is a misrepresentation of how revenue requirements are determined and how an Earnings Test should be calculated.

Ms. Chambers also states business conditions have changed since 2013, and rate base is only one of the components of the total revenue requirements to calculate rate base. Once base

⁶⁰ *Id.* at 16.

⁶¹ *Id.*

⁶² David N. Dittemore, Pre-Filed Supplemental Direct Testimony, p. 1 (June 14, 2019).

⁶³ Elaine K. Chambers, Pre-Filed Rebuttal Testimony, p. 4 (June 28, 2019).

⁶⁴ *Id.*

rates are established, they are not changed until the next general rate case. Like the other components of revenue requirements, TAWC's rate base balance grows or shrinks from an approved pro forma amount from the last base rate case.⁶⁵ Over time, new capital additions unrelated to the Riders add to this rate base, while depreciation and deferred income taxes reduce the base rate base balance.⁶⁶ Ms. Chambers states that revenue requirement components for base rates may go up while others may go down, which puts the Company at risk of under-or over-recovering its base revenue requirements until it files for new base rates.⁶⁷ In contrast, a rider such as the Capital Rider tariff is a stand-alone calculation subject to limitations and is set annually and separately from the base rates set in rate cases. By design, a rider ensures a recovery of a distinct and limited revenue requirement with an authorized return independent of base rates.⁶⁸ Ms. Chambers argues that Mr. Dittmore's calculations represent an overly simplistic complaint employed to "overthrow the reasonable results" delivered by the current Capital rider.⁶⁹

At the Hearing, Ms. Chambers testified that the Earnings Test utilizes the thirteen-month average for rate base of \$173 million upon which the Company is authorized to earn a return.⁷⁰ Ms. Chambers disagrees with Mr. Dittmore's proposed Rate Base Limitation because she claims it would reduce base rate revenue requirements even if the Company is not earning its allowed Rate Return Base ("ROR").⁷¹ Mr. Dittmore's proposed "Rate Base Limitation" does not account for higher Operating and Maintenance ("O&M") expenses, and declining consumption compared to what was included in the 2012 rate case. By focusing solely on rate

⁶⁵ *Id.* at 5-6.

⁶⁶ *Id.* at 5.

⁶⁷ *Id.*

⁶⁸ *Id.* at 5-6.

⁶⁹ *Id.*

⁷⁰ Transcript of Commission Conference, pp. 70-72 (August 12, 2019).

⁷¹ Elaine K. Chambers, Pre-Filed Rebuttal Testimony, p. 6 (June 28, 2019).

base, Mr. Dittmore ignores the changes that the Company experiences that can impact the Company's earnings.⁷²

Ms. Chambers disagrees with Mr. Dittmore's assertion that the Earnings Test is inadequate. The adopted Earnings Test was not proposed by the Company, but rather was submitted by the parties, including the Consumer Advocate, as part of the *Stipulation* in Docket No. 13-00130.⁷³ Mr. Dittmore ignores the fact that the Consumer Advocate signed on to a settlement agreement that resolved all of the outstanding issues related to the Riders proposed by TAWC.⁷⁴ Ms. Chambers points out in Docket No. 17-00020, Consumer Advocate Witness William H. Novak contended that TAWC should be compelled to apply the Earnings Test adjustment precisely as outlined in the tariffs.

Ms. Chambers asserts Mr. Dittmore's recommended changes to the Capital Riders mirror proposals from Mr. Novak six years ago in Docket No. 13-00130 and these proposals were not adopted by either party.⁷⁵ The Company opposes Mr. Dittmore's recommendation of using a historical test period over the current forward-looking test year period.⁷⁶ The Commission has utilized a forward-looking rate year for establishing rates for many years, including Dockets Nos. 12-00049, 10-00189, 08-00039, and 06-00290.⁷⁷ In Docket No. 13-00130, the Commission determined that TAWC's Amended Petition and the tariffs establishing the alternative rate mechanisms filed on March 25, 2014 met the requirements of Tenn. Code Ann. § 65-5-103(d), and that the proposed EDI and SEC and QIIP Riders were reasonable and in the public interest.⁷⁸ Ms. Chambers states that expenditures made in the historical period

⁷² *Id.* at 6-7.

⁷³ *Id.* at 7.

⁷⁴ *Id.* at 7-8.

⁷⁵ *Id.* at 10-11.

⁷⁶ *Id.* at 11.

⁷⁷ *Id.*

⁷⁸ *Id.* at 11-12.

represent real cash outlays by the Company. Mr. Dittmore's recommendation immediately introduces regulatory lag for any investment made in the historical year and when the return of those investments are based on a historical average, his recommendation further compounds this regulatory lag by at least six more months.⁷⁹

Ms. Chambers rejects Mr. Dittmore's remedy to regulatory lag which allow the Company to accrue interest on the unrecovered balance of actual capital spending made under the Riders. She also states Mr. Dittmore's proposed tariff does not seem to address recovery of depreciation expense or property tax expense which is a significant shortcoming.⁸⁰ Ms. Chambers states that the proposal does not address cash flow and the timely recovery of the cash is critical to funding additional investments in each subsequent attrition year.⁸¹ Ms. Chambers claims the Company may find that filing a general rate case is preferable to investing under the Consumer Advocate's proposal, particularly when the Company's forecasted Capital Rider eligible expenditures are growing.⁸²

Ms. Chambers testifies that there would not be administrative efficiencies gained by the parties involved in moving to a single annual filing as recommended by Mr. Dittmore. The current two-step process imparts regulatory oversight to planned capital additions before they are made, while under the Consumer Advocate's proposal all investments would be placed in service prior to Commission review.⁸³ Ms. Chambers continues that the reconciliation calculation provided in the annual reconciliation filing is "well-established, transparent, and trackable."⁸⁴ Ms. Chambers states that historic alternative rate mechanism filings would require all of the

⁷⁹ *Id.* at 13-14.

⁸⁰ *Id.* at 14.

⁸¹ *Id.* at 15.

⁸² *Id.*

⁸³ *Id.* at 16-17.

⁸⁴ *Id.* at 17.

detailed information up front to show what was spent and how it was spent.⁸⁵ The review process would take more time up front on a historic filing as the detailed information is reviewed for the actual investments made and require a reconciliation to ensure that the revenue requirement authorized has been collected.⁸⁶ Ms. Chambers claims that other states that use historical ratemaking for their capital riders often have semi-annual or quarterly filings to help mitigate regulatory lag and would increase the number of annual filings.⁸⁷

Ms. Chambers disagrees with Mr. Dittmore's assertion that no surcharge shall be necessary if the Company has earnings in excess of its authorized rate of return.⁸⁸ Ms. Chambers explains that at times there are extenuating circumstances that can cause the utility to earn above its authorized rate of return and has nothing to do with day-to-day operation of business.⁸⁹ She also mentions that an extremely hot summer could result in over earnings, while an unusually wet and cool summer could result in under earnings.⁹⁰

Ms. Chambers asserts that a slower replacement rate leads to increased loss in delivery efficiency as pipes continue to fail. TAWC contributes a reduction to main breaks due to the focus on replacing main with a chronic history of main breaks rather than the previous initiative of repairing mains.⁹¹ TAWC further believes that the reduction in the average number of main breaks between 2013 and 2015 of 305 per year compared to the average number of main breaks of 480 per year between 2004 and 2012 is directly correlated to the level of spending in the Unscheduled Main Replacement of Line C (qualified under the Riders).⁹²

⁸⁵ *Id.* at 17.

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ *Id.* at 18.

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ *Id.* at 20-21.

⁹² *Id.* at 21.

Ms. Chamber's states the Consumer Advocate's proposal would hinder its ability to attract needed capital for the program as the now-introduced regulatory cash flow lag would be viewed as a higher risk program.⁹³ Ms. Chambers proclaims the heightened level of investment increases the risk of under-recovery, or delayed recovery, of the invested capital, resulting in an inadequate return putting downward pressure on key credit metrics.⁹⁴ From a credit perspective, the additional pressure on cash flows associated with high levels of capital expenditures exerts corresponding pressure on credit metrics, and therefore, the company's credit ratings.⁹⁵ Ms. Chambers states that the Consumer Advocate's recommendations to both flow back tax reform savings to customers immediately as well as their recommendation to severely restrict the infrastructure rider would have a compounding negative effect on credit.⁹⁶

Ms. Chambers testifies that the Riders are working as intended.⁹⁷ The existence of the Commission-approved Capital Riders permitted the Company to implement significant and required non-optional solutions while avoiding regulatory lag and lessening rate shock to its customers, both of which were expressly cited by Commission in its approval of the Riders.⁹⁸ Ms. Chambers states that the total rate impact of the rider on customers has been very reasonable with a total impact of approximately \$0.80 per month each year on residential water customers.⁹⁹

AUGUST 12, 2019 HEARING AND APPEARANCES

A Hearing in this matter was held before the voting panel on August 12, 2019, as noticed by the Commission on August 2, 2019. Participating in the hearing were the following parties and their respective counsel:

⁹³ *Id.*

⁹⁴ *Id.* at 22.

⁹⁵ *Id.*

⁹⁶ *Id.* at 23.

⁹⁷ *Id.* at 24-25.

⁹⁸ *Id.*

⁹⁹ *Id.* at 25.

TAWC – Melvin J. Malone, Esq., Butler, Snow, O’Mara, Stevens & Cannada, PLLC, 1200 One Nashville Place, 150 Fourth Avenue North, Nashville, Tennessee 37219.

Consumer Advocate – Daniel P. Whitaker, III, Esq. and Vance Broemel, Esq., Office of the Tennessee Attorney General, P.O. Box 20207, Nashville, Tennessee 37202.

The Hearing panel of Commissioners heard testimony by Mr. Kurt A. Stafford, Mr. Brent O’Neill, and Ms. Elaine K. Chambers on behalf of the Company and Mr. David N. Dittmore on behalf of the Consumer Advocate. During the Hearing, the public was given an opportunity to offer comment, but no member of the public sought to comment on the *Petition*.

FINDINGS AND CONCLUSIONS

Upon review of entire evidentiary record in this matter, and consistent with the agreement of parties in Docket No. 18-00039, the panel found that the capital expenditures as filed by the Company are reasonable and the amended calculations presented by the Company comply with the terms and methodologies of the tariff. For the Qualified Infrastructure Investment Program, the panel unanimously approved of a bill surcharge of 11.65%, up from last year’s surcharge of 10.05%. The new surcharge will generate \$5,482,911 in annual revenues and represents a \$752,273 increase from the previous year. Thereafter, the panel voted unanimously to approve the following surcharges for the Capital Recovery Riders:

For the Safety and Environmental Compliance Program, the panel unanimously approved a bill surcharge of 6.88%, an increase over the previous surcharge of 5.97%. The new surcharge will generate \$3,236,635 in annual revenues and represents a \$427,250 increase from the previous year.

For the Economic Development Investment Rider, the panel unanimously approved a bill surcharge of 0.65%, an increase over the previous surcharge of 0.41%. The new surcharge will generate \$306,548 in annual revenues and represents an increase of \$112,003 from the previous

year. The panel further concluded that these three Capital Rider programs continue to benefit both consumers and the Company. The programs allow the utility timely recovery of investment related expenses to ensure safe and reliable drinking water and promote economic development while benefitting consumers through reduced rate case and legal expenses that would otherwise result through expensive rate case proceedings. Further, approval of these Capital Recovery Riders will result in a total cumulative surcharge of 19.18% since the inception of the mechanisms. However, consistent with the proceedings in Docket No. 18-00039, the panel found that the Capital Recovery Riders surcharge should be offset to return federal income tax expense savings of \$3,114,087 resulting from the 2017 Tax Cuts and Jobs Act. Therefore, the panel voted unanimously to approve a bill surcharge credit of 6.62% resulting from the Company's tax savings.

The Consumer Advocate has not alleged that the Company has failed to materially follow the tariff in this matter, but rather has contested the very structure and fundamental mechanics of a mechanism that the parties have both contributed to and shaped since it was first implemented. The Commission's approval of the Company's filing in this docket is not a rejection of the proposals made by the Consumer Advocate that would change the Capital Rider tariff. Rather, the panel concluded that the modifications proposed by the Consumer Advocate to the Capital Rider tariff represent a departure from the manner in which the tariff has been administered and approved in all previous Capital Rider filings with this Commission.

Instead of considering these issues in this docket for resolution, and in order to allow more time for the Commission and the parties to fully examine and analyze these issues without a hard and fast deadline clipping debate or public comment, the hearing panel voted unanimously to open a separate docket to address these issues and other potential issues relative to the Capital

Rider mechanisms in an effort to improve and implement a more streamlined and transparent review.

IT IS THEREFORE ORDERED THAT:

1. The *Petition*, as subsequently amended, first filed by Tennessee-American Water Company on November 16, 2018, is approved.

2. A Qualified Infrastructure Investment Rider of 11.65% is adopted.

3. An Economic Development Investment Rider of 0.65% is adopted.

4. A Safety and Environmental Compliance Rider of 6.88% is adopted.

5. A surcharge credit of 6.62% representing \$3,114.087 from tax savings from the 2017 Tax Cuts and Jobs Act is approved.

6. A Docket shall be opened to address potential issues and proposed modifications to improve, make more transparent, or streamline the collective Capital Riders, including the contested proposals in the present docket. The Consumer Advocate may participate in the new docket as a party without an additional petition to intervene.

7. Any person who is aggrieved by the Commission's decision in this matter may file a Petition for Reconsideration with the Commission within fifteen (15) days from the date of this Order.

8. Any person who is aggrieved by the Commission's decision in this matter has the right to judicial review by filing a Petition for Review in the Tennessee Court of Appeals, Middle Section, within sixty (60) days from the date of this Order.

Vice Chair Kenneth C. Hill, Commissioner Herbert H. Hilliard, and Commissioner David F. Jones concur.

ATTEST:



Earl R. Taylor, Executive Director