

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

IN RE:

**APPLICATION OF TENNESSEE
WATER SERVICE, INC. FOR
ADJUSTMENT OF RATES AND
CHARGES, AND MODIFICATIONS TO
CERTAIN TERMS AND CONDITIONS
FOR THE PROVISION OF WATER
SERVICE.**

DOCKET NO. 19-00028

**REBUTTAL TESTIMONY
OF
J. BRYCE MENDENHALL**

**ON BEHALF OF
TENNESSEE WATER SERVICE, INC.**

October 9, 2019

1 **Q. WOULD YOU PLEASE STATE YOUR NAME AND BUSINESS ADDRESS?**

2 **A.** My name is J. Bryce Mendenhall, and my business address is 4494 Parkway Plaza
3 Boulevard, Suite 375, Charlotte NC 28217.

4 **Q. ARE YOU THE SAME J. BRYCE MENDENHALL WHO SUBMITTED DIRECT,**
5 **REBUTTAL, AND SUPPLEMENTAL DIRECT TESTIMONY IN THIS**
6 **PROCEEDING?**

7 **A.** Yes, I am.

8 **Q. WHAT IS THE PURPOSE OF YOUR PRE-FILED REBUTTAL TESTIMONY IN**
9 **THIS PROCEEDING?**

10 **A.** The purpose of my testimony is to respond on behalf of Tennessee Water Service, Inc.
11 (“TWS” or “Company”) to certain aspects of the Second Supplemental Testimony
12 submitted by Mr. Hal Novak in this proceeding.

13 **Q. HOW DOES MR. NOVAK CHARACTERIZE THE COMPANY’S POSITION**
14 **WITH REGARD TO THE BASIS FOR ITS PROPOSED REGULATORY**
15 **LIABILITY?**

16 **A.** Mr. Novak states on Page 3, Question 7 of his testimony that the basis for adjusting the
17 amount of Mr. Novak’s proposed regulatory liability is that “disasters such as the
18 Gatlinburg wildfire can create a premium on the reconstruction of [damaged] assets due
19 to supply/demand pressures on contractor labor and materials.”

20 **Q. IS THIS A FAIR CHARACTERIZATION OF THE COMPANY’S POSITION?**

1 **A.** No, it is not. The Company has repeatedly accepted responsibility for its error in setting
2 a reasonable level of coverage for the assets destroyed in the Gatlinburg wildfire.¹ The
3 question at issue in the post-evidentiary hearing process of this proceeding is: What is the
4 extent to which the Company failed to reasonably insure its assets? This is a distinctly
5 separate question than the level of final reconstruction costs, which Mr. Novak does not
6 dispute as prudent and reasonable, and which were only known approximately two and a
7 half years after the coverage levels were set and thus cannot have been relied on in the
8 setting of coverage levels pre-wildfire.

9 **Q.** **ON PAGE 6, LINES 11-12 OF MR. NOVAK’S TESTIMONY, HE STATES “IT**
10 **WOULD BE NEITHER PRUDENT NOR REASONABLE FOR A UTILITY TO**
11 **INSURE ITS CRITICAL ASSETS FOR ANYTHING OTHER THAN**
12 **REPLACEMENT COST.” DO YOU AGREE?**

13 **A.** Yes. The Company has stated that a reasonable level of coverage would be based on an
14 estimate of replacement costs for the applicable assets. *See* Bryce Mendenhall August
15 16, 2019 Pre-Filed Rebuttal Testimony p. 6:7-8. However, the setting of replacement
16 cost coverage necessarily occurs before such replacement is warranted, and thus can be
17 based on only the information available to the insured at the time of policy renewal. The
18 information on hand in 2016 was the original cost and nature of the assets in question, as
19 well as comparable projects done within the Company’s regional affiliates for assets of a

¹ At the September 9, 2019 hearing, TWS witness Catherine Heigel repeatedly stated that the Company was accepting responsibility for the amount of insurance in place prior to the Gatlinburg wildfire and that the basis of the Company's proposed regulatory liability amount was what amount would have been foreseeable at the time of the 2016 insurance policy renewal. *See* September 9, 2019 Hearing Transcript pp. 41:5-7, 42:15-19, 42:22-43:4, 49:24-50:3, 50:3-7, 53:6-10, 55:18-23, 63:20-64:1, 69:23-70:2.

1 similar nature. As the original cost of TWS's assets were significantly stale and did not
2 reflect the current construction cost environment, a proxy project was identified that was
3 sufficiently comparable and provides a reasonable basis for preplacement cost estimation.

4 **Q. WHY HAS THE COMPANY NOT CITED ANY "REGULATORY PRINCIPLES"**
5 **OR "LITERATURE", AS NOTED BY MR. NOVAK IN QUESTION #10 OF HIS**
6 **TESTIMONY?**

7 **A.** The Company is not aware of a defined standard for how regulated utilities must insure
8 their assets. The Company does not believe that citing "literature" is necessary to support
9 what the Company asserts to be reasonable business practices. It should also be noted
10 that Mr. Novak has not put forth any such documentation.

11 **Q. WHY IS USING A PROXY OR COMPARABLE PROJECT A REASONABLE**
12 **BASIS FOR ESTIMATING REPLACEMENT COST?**

13 **A.** Replacement cost is a widely recognized method for setting insurance coverages for
14 physical assets such as buildings and equipment. Replacement costs can be estimated by
15 identifying materials, labor, and other costs such as engineering and design that would be
16 relevant for such a rebuild. Identifying a comparable asset that was recently constructed
17 provides a strong consolidated basis for these relevant costs, as it is likely to reflect the
18 current market pricing for comparable construction requirements.

19 **Q. MR. NOVAK STATES IN FOOTNOTE 14 ON PAGE 7 OF HIS TESTIMONY**
20 **SOME FACTORS THE COMPANY SHOULD HAVE CONSIDERED IN**
21 **OBTAINING INSURANCE. DO YOU AGREE?**

1 **A.** Mr. Novak does cite in Footnote 14 on Page 7 of his testimony that “replacement cost set
2 by TWS when it obtained insurance should have considered geography and potential
3 challenges that a reasonable utility could foresee in replacing its critical assets”. I agree
4 that the Company must consider such aspects as geography and construction challenges.
5 That is why I cited them, among others in the selection criteria for proxy projects in my
6 Pre-Filed Direct Testimony, submitted September 16, 2019, Page 4, lines 1-13.

7 **Q. IS IT REASONABLE TO CONCLUDE THAT THE COMPANY SHOULD HAVE**
8 **INSURED ITS ASSETS FOR THE EVENTUAL REPLACEMENT COSTS OF**
9 **THE DAMAGED ASSETS?**

10 **A.** No, it is not. As stated above, the key question in determining the appropriate level of a
11 regulatory liability for the Company is: What is the extent to which the Company failed
12 to reasonably insure its assets? Utilizing the eventual replacement costs of the assets,
13 approximately 2 and a half years after the policy coverages were set, is classic 20/20
14 hindsight bias. TWS should only be held responsible to the extent the Company had
15 information in-hand at the time of the policy renewal and did not appropriately utilize it
16 in the setting of insurance coverages.

17 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

18 **A.** Yes, it does. However, I reserve the right to update or amend my testimony as new data
19 or information becomes available.