

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

IN RE:)	
)	
RULEMAKING TO PROMULGATE RULES RELATED TO EXTENSION OF SERVICE TO UTILITY ACQUISITIONS))))	DOCKET NO. 20-00025

**REPLY COMMENTS OF THE CONSUMER ADVOCATE
CONCERNING PROPOSED ACQUISITION RULES**

Herbert H. Slatery III, Attorney General and Reporter for the State of Tennessee, by and through the Consumer Advocate Unit in the Financial Division of the Office of the Attorney General (“Consumer Advocate”), pursuant to Tenn. Code Ann. § 65-2-102(a)(4), respectfully submits its *Reply Comments* to the Tennessee Public Utility Commission’s (TPUC or the “Commission”) *Rulemaking to Promulgate Rules Related to Extension of Service to Utility Acquisitions*. The Consumer Advocate’s *Reply Comments* are submitted to the Commission in response to comments and redlined rules filed by Atmos Energy Corporation¹ (“Atmos Energy”) and comments submitted by Tennessee-American Water Company² (TAWC). The Consumer Advocate will briefly address seven topics (1) public interest criteria; (2) gain on sale; (3) rate base determination (i.e. embedded costs and Replacement Cost New Less Depreciation (RCNLD)); (4) Atmos Energy’s comments and redlines to proposed rules; and (5) TAWC’s comments and revisions to proposed rules. The details of the Consumer Advocate’s comments are as follows:

¹ *Comments by Atmos Energy Corporation*, TPUC Docket No. 20-00025 (July 1, 2020) and *Atmos Energy Corporation’s Redlines to Proposed Rules*, TPUC Docket No. 20-00025 (July 1, 2020).

² *Comments by Tennessee American Water Company*, TPUC Docket No. 20-00025 (July 8, 2020), and *Tennessee American Water Company’s Substitute Filing*, TPUC Docket No. 20-00025 (July 20, 2020).

I. PUBLIC INTEREST CRITERIA

The comments submitted by Atmos Energy and TAWC exclusively focus on the implications of the purchase price on the determination of Rate Base. Neither party addresses the appropriate criteria the Commission should consider in its evaluation of the public interest, which is the fundamental question that must be answered within an acquisition docket. Absent a clear identification of such principles by the Commission³, applications for approval of acquisitions will not address key issues possibly resulting in significant discovery and controversy. Without an evaluation of the likely impact of the transaction on customers, the public interest cannot be adequately considered. To the extent unique rate base valuation techniques are appropriate, they should only be applied to small systems that often suffer from a shortage of capital. There is no evidence that the rules supported by the utility commenters are needed within a request to acquire a large utility system.

II. GAIN ON THE SALE OF UTILITY ASSETS

The utility comments also fail to address the policy issue of which stakeholder should retain the gain on the sale of utility assets. The Commission has previously addressed this issue.⁴

III. RATE BASE DETERMINATION

Both sets of utility comments support two methods for determining the Rate Base impact of acquisitions: (1) embedded cost and (2) RCNLD. At the outset, the Consumer Advocate emphasizes that any modification to the Commission's long-standing policy of limiting rate base values for acquired systems to that of original cost⁵ should be applied exclusively to acquisitions

³ *Comments by the Consumer Advocate*, pp. 3-5, TPUC Docket No. 20-00025 (July 20, 2020).

⁴ *Order on Remand, In re A+ Communications, Inc.*, TPSC Docket No. 92-1398 (May 18, 1994) and *Order, In re Kingsport Power Company*, TPSC Docket No. U-84-7308 (November 15, 1984).

⁵ *Order Approving Purchase Agreement, Franchise Water Agreement and Certificate of Public Convenience and Necessity*, p. 16, TRA Docket No. 12-00157 (October 15, 2013) and *Final Order Setting Rates*, p. 15, TRA Docket No. 15-00042 (March 10, 2016).

of small utility systems. Purchases of investor-owned systems should continue to be recorded at original cost. Our comments below relate only to the acquisition of small utility systems.

A. Embedded Costs

The acquisition of small systems at the average embedded cost of the acquiring system may provide the proper balance to incentivize qualified utilities to purchase troubled small systems, and simultaneously providing some protection for ratepayers. Under the Atmos Energy comments, the potential cost impact of the acquisition on both its legacy customers and the newly acquired customers is reduced. This is because the rate base of both entities is placed on the same footing: the embedded cost of the larger acquiring system. However, the extent of necessary improvement of the acquiring system should be considered when determining whether the embedded-cost approach is appropriate. If the acquired system requires substantial upgrades on a per-customer basis, the embedded-cost approach may not be appropriate. In summary, the embedded-cost approach is worthy of consideration; however, it should not be accepted without considering the condition of the acquired system. The Commission should have the flexibility to determine whether the embedded-cost approach is appropriate based upon the unique facts of the case.

B. Replacement Cost New Less Depreciation Valuation Methodology

The utility comments support the RCNLD valuation methodology; however, both ignore the practical challenges of adopting such an approach. The calculation assumes the vintage and material type of the acquired system is known and well-documented. The RCNLD method takes the original cost of the system by material type and vintage and applies Handy Whitman Index factors⁶. It is the experience of the Consumer Advocate that investor-owned utilities do not always

⁶ *Tennessee American Water Company's Substitute Filing*, pp. 5-6, TPUC Docket No. 20-00025 (July 8, 2020).

have complete and accurate data on the quantity and material type within its own system. However, accurate RCNLD values may only be determined with accurate material type and vintage data. It would be interesting to evaluate the calculation of the existing TAWC system using the RCNLD methodology.⁷ Both utilities ignore the practical challenges of the calculation and instead ask the Commission to simply accept this unique approach without even one hypothetical calculation applied to actual data.

Finally, neither utility commenter addresses the implication of the balance of Accumulated Deferred Income Taxes (ADIT) upon the acquired entities rate base. It is reasonable to assume the hypothetical transactions will be taxable, thus it is likely that deferred taxes will become due. In this scenario, all other things being equal, rate base will increase since the deferred tax liability (ADIT) would be eliminated within the transaction. Neither utility commenter addresses the regulatory implications of this issue, nor its impact on ratepayers. The elimination of ADIT poses an increased cost to ratepayers without any offsetting benefit. If either valuation method supported by the utility commenters is adopted, there should be a separate determination of the lost ADIT and such balance should be used to reduce the initial value of plant in service, and thus rate base. Importantly this balance would not be identified as ADIT on the books of the acquiring entity; instead, it would simply be used as an offset amount in determining the recorded value of acquired assets.

IV. ATMOS ENERGY'S COMMENTS AND REDLINES TO PROPOSED RULES

Atmos Energy also supports the RCNLD methodology, ignoring the complications of the calculation. As discussed above, the Consumer Advocate does not have confidence that an

⁷*Direct Testimony of Elaine K. Chambers on behalf of Tennessee American Water Company, Inc.* at 30:9-13, TPUC Docket No. 19-00105 (November 15, 2019).

accurate determination of RCNLD can be quantified. The Company relies upon the phrase “negotiated sales price” which carries the implication of a determination of an agreed-upon price by two parties through vigorous negotiations. In reality, the buyer and seller are simply determining a price that the ratepayers will pay. Therefore, utilities do not have an incentive to negotiate the lowest possible price under its proposed rules.

Atmos Energy attempts to establish rules governing the manner in which its annual ratemaking mechanism will incorporate the impact of the acquired system.⁸ This proposal attempts to supplant conditions of its existing mechanism which require new matters to be evaluated by the parties within the context of the annual review of its operating results.⁹ Atmos Energy seeks to bypass these requirements and instead ensure such costs are recoverable in the mechanism regardless of the specific circumstances of the acquisition. The Consumer Advocate recommends that the Commission uphold the terms of Atmos Energy’s annual rate review and indicate how such acquisition-related issues are evaluated within an annual rate mechanism be left to the appropriate annual docket or determined within the acquisition docket.

V. TAWC’S COMMENTS AND REVISIONS TO PROPOSED RULES

TAWC recommends the Commission promulgate rules favoring acquisitions by investor-owned utilities over non-investor-owned utilities.¹⁰ The Commission rules should not favor one type of ownership structure over another.

TAWC relies upon the term “current value” within its comments. In the context of regulated utilities, it is the regulatory authority that sets rates to produce revenue and cash flow,

⁸ *Atmos Energy Corporation’s Redlines to Proposed Rules*, p. 2, Rule 1220-04-01-16(3).

⁹ *Tennessee Regulatory Authority Gas Tariff of Atmos Energy Corporation*, Annual Review Mechanism (ARM), Sheet 34.1, Definition (F) and Sheet 34.5.1 § C. New Matters (Effective June 1, 2020). *See also Order Approving Stipulation and Settlement Agreement*, Exhibit 1, p. 3, ¶6(f), TPUC Docket No. 18-00112 (December 16, 2019).

¹⁰ *Tennessee American Water Company’s Substitute Filing* at p. 1.

which then determines value. The measurement of value is therefore determined by regulatory policy and methodologies used in the rate-setting process. Thus, arguing that the Commission should adopt policies which allow selling utilities to sell at current value fails to recognize the critical role that regulatory policy plays in determining value. Regulated utilities are entitled to the opportunity to earn a return on its net book value of assets, nothing more.

TAWC makes the unsupported statement that RCNLD valuations produce a more accurate value of the acquired system than the traditional net book value standard.¹¹ This statement is without foundation. It ignores that value is determined by regulatory methodologies used to set rates, which produce cash flows, which in turn produces value. TAWC's statement is only true if a utility convinces the Commission to adopt the RCNLD methodology, which would produce increased cash flows using the higher rate base valuation technique. The TAWC argument that the RCNLD method produces a better measure of value is premised upon an untested methodology that produces a higher rate base methodology than the straight-forward, unambiguous net book value approach.


TAWC now supports the concept that rates applied to customers of acquired systems be set at the level of the utility's existing customers.¹² Despite this concept, TAWC charges rates to customers of its recently acquired Whitwell and Jasper Highlands systems which are greater than those charged to its legacy Chattanooga customers.

The Consumer Advocate requests the Commission's consideration of its comments herein.

¹¹ *Id.* at p. 6.

¹² *Id.* at pp. 6-7.

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,
with a courtesy copy by electronic mail on April 8, 2021.

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