

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

IN RE:)	
)	
APPLICATION OF LIMESTONE)	
WATER UTILITY OPERATING)	
COMPANY, LLC FOR AUTHORITY TO)	DOCKET NO. 21-00053
SELL OR TRANSFER TITLE TO THE)	
ASSETS, PROPERTY AND REAL)	
ESTATE OF A PUBLIC UTILITY AND)	
FOR A CERTIFICATE OF)	
CONVENIENCE AND NECESSITY)	
)	

DIRECT TESTIMONY

OF

DAVID N. DITTEMORE

August 30, 2021

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- DND-1 Qualifications**
- DND-2 Impact of Limestone Accounting Entries**
- DND-3 Gain on the Sale Quantification (CONFIDENTIAL)**
- DND-4 National Regulatory Research Institute Survey on Gain on the Sale Treatment**
- DND-5 Kingsport Order (Gain on the Sale)**
- DND-6 A+ Communication Order (Gain on the Sale)**
- DND-7 Cartwright Creek Regulatory Obligations**
- DND-8 Testimony of Jennifer Nelson; Case No. 2020-00290**
- DND-9 Evaluation of O&M Costs (CONFIDENTIAL)**
- DND-10 Affiliate Rate Increase Request**

1 **I. Background**

2 **Q1. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND OCCUPATION FOR**
3 **THE RECORD.**

4 **A1.** My name is David N. Dittmore. My business address is 609 Regent Park Dr., Mt Juliet,
5 TN 37122. I am a self-employed consultant working in the utility regulatory sector.

6 **Q2. PLEASE PROVIDE A SUMMARY OF YOUR BACKGROUND AND**
7 **PROFESSIONAL EXPERIENCE.**

8 **A2.** I received a Bachelor of Science Degree in Business Administration from the University
9 of Central Missouri in 1982. I am a Certified Public Accountant licensed in the state of
10 Oklahoma (#7562). I was previously employed by the Kansas Corporation Commission
11 (“KCC”) in various capacities, including Managing Auditor, Chief Auditor, and Director
12 of the Utilities Division. I was self-employed as a Utility Regulatory Consultant for
13 approximately four years, representing primarily the KCC Staff in regulatory issues. I also
14 participated in proceedings in Georgia and Vermont, evaluating issues involving electricity
15 and telecommunications regulatory matters.

16 Additionally, during this time frame, I performed a consulting engagement for Kansas Gas
17 Service (“KGS”), my subsequent employer. For eleven years, I served as Manager and
18 subsequently Director of Regulatory Affairs for KGS, the largest natural gas utility in
19 Kansas serving approximately 625,000 customers. KGS is a division of One Gas, a natural
20 gas utility serving approximately two million customers in Kansas, Oklahoma, and Texas.
21 I joined the Tennessee Attorney General's Office in September 2017 as a Financial Analyst.
22 In July 2021, I began my consulting practice. Overall, I have thirty years of experience in

1 the field of public utility regulation. I have presented testimony as an expert witness on
2 many occasions. Attached as Exhibit DND-1 is a detailed overview of my background.

3 **Q3. HAVE YOU PREVIOUSLY PROVIDED TESTIMONY BEFORE THE**
4 **TENNESSEE PUBLIC UTILITY COMMISSION (TPUC OR THE**
5 **“COMMISSION”)?**

6 **A3.** Yes. I have submitted testimony in many TPUC dockets.

7 **Q4. ON WHOSE BEHALF ARE YOU APPEARING?**

8 **A4.** I am appearing on behalf of the Consumer Advocate Unit of the Financial Division of the
9 Tennessee Attorney General’s Office.

10 **II. Purpose of Testimony**

11 **Q5. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

12 **A5.** The purpose of my testimony is to provide recommendations regarding the request of
13 Limestone Water Utility Operating Company, LLC (“Limestone”) and Central States
14 Water, Inc. (“Central States”) to acquire the assets of Cartwright Creek, LLC (“Cartwright
15 Creek”).¹ My testimony addresses public-interest considerations of the proposed
16 transaction. I also identify regulatory conditions the Commission should adopt in the event
17 the transaction closes.

18 **Q6. PLEASE IDENTIFY THE SCOPE OF CUSTOMERS AFFECTED BY THIS**
19 **PROPOSED TRANSACTION.**

¹ *Petition* at pp. 1, 5-6. Central States and Cartwright Creek entered into a “binding Agreement for Sale of the Utility System on March 15, 2021.” *Id.* at p. 5 and Exhibit 7. At closing, Central States will assign all its rights to Limestone. *Id.* at p. 5 and Exhibit 8.

1 **A6.** The customer count according to the Cartwright Creek 2020 annual report is listed below:

Customer Count as of 12/31/2020	
System Name	Customer Count
Grasslands	549
Arrington Retreat	215
Hideaway	75
Hardeman Springs	22
Total	861

2

3 **Q7. WHAT IS THE SCOPE OF OPERATIONS OF CENTRAL STATES WATER**
4 **RESOURCES, LLC (CSWR)?**

5 **A7.** CSWR, an “upstream parent”² company of Limestone, operates water and wastewater
6 utilities in Missouri, Arkansas, Kentucky, Tennessee, Texas, and Louisiana.³ Central
7 States and CSWR have recently filed acquisition petitions with the Florida Public Service
8 Commission.⁴

² *Limestone’s Response to Consumer Advocate*, DR No. 2-1, TPUC Docket No. 21-00053 (August 11, 2021). Limestone identifies CSWR as an “upstream parent” and “U.S. Water” also as an upstream parent for equity needs. *Id.* In a previous docket, Limestone explained that [REDACTED]

[REDACTED] *Limestone’s Response to Consumer Advocate DR No. 1-1*, TPUC Docket No. 19-00062 (February 14, 2020) (CONFIDENTIAL). Central [REDACTED] *Limestone’s Response to Consumer Advocate DR No. 1-4b*, TPUC Docket No. 19-00062 (February 14, 2021) (CONFIDENTIAL).

³ *Amended and Restated Joint Application of Aqua Utilities Company, Inc. and Limestone Water Utility Operating Company, LLC, for Authority to Sell or Transfer Title to the Assets, Property, and Real Estate of a Public Utility and for a Certificate of Public Convenience and Necessity*, Exhibit 5, TPUC Docket No. 19-00062 (December 13, 2019).

⁴ *In re: Application for transfer of water and wastewater facilities and Certificate Nos. 517-W and 450-S from Aquarina Utilities, Inc. to CSWR-Florida Utility Operating Company*, Florida Public Service Commission, Docket No. 2021-0093 (May 10, 2021); *In re: Application for transfer of water Certificate No. 363-W from Sunshine Utilities of Florida, Inc. to CSWR-Florida Utility Operating Company*, Florida Public Service Commission, Docket No. 2021-0093 (May 10, 2021); and *In re: Application for transfer of North Peninsula Utilities Corporation and wastewater Certificate Nos. 249-S to CSWR-Florida Utility Operating Company*, Florida Public Service Commission, Docket No. 2021-0133 (August 9, 2021). These documents can be accessed at www.psc.state.fl.us/ClerkOffice/Docket.

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III. Executive Summary

2 **Q8. CAN YOU PROVIDE AN EXECUTIVE SUMMARY OF YOUR**
3 **RECOMMENDATIONS?**

4 **A8.** I recommend approval of the transaction subject to the following conditions:

- 5 1. The Commission should require Limestone to adhere to the conditions
6 outlined in the Commission's Order in TPUC Docket No. 19-00097
7 regarding the appropriate treatment of capital rider surcharge collections.
8 (Testimony at p. 15.)
- 9 2. The balance of Contributions in Aid of Construction (CIAC) on the books
10 of Cartwright Creek should be the same balance recorded on the books of
11 Limestone. This balance shall not be amortized until authorized by the
12 Commission. The Commission should reaffirm the validity of historic
13 Cartwright Creek accounting practices to prevent the write-up of the assets
14 Limestone is acquiring. (Testimony at p. 21.)
- 15 3. Accounting entries should be submitted to the Commission prior to closing
16 for review as a condition of Commission approval. (Testimony at p. 21.)
- 17 4. Separate asset and operating cost records should be maintained for each
18 operating system of Cartwright Creek. (Testimony at p. 22.)
- 19 5. The Acquisition Premium, in this case, should be set aside in a separate
20 account and its ultimate disposition determined in a future proceeding.
21 (Testimony at p. 24.)
- 22 6. Regulatory and transaction costs should be deferred to a future rate
23 proceeding. (Testimony at p. 25.)
- 24 7. The transaction's Gain on the Sale should be assigned to the benefit of
25 Cartwright Creek customers. (Testimony at p. 30.)
- 26 8. The Commission should require Limestone to adhere to prior regulatory
27 obligations of Cartwright Creek. (Testimony at p. 32.)

28 I will discuss each of these points later in my testimony.

29
30
31

IV. Conclusions

30 **Q9. PLEASE IDENTIFY YOUR CONCERNS AND CONCLUSIONS REACHED IN**
31 **YOUR REVIEW OF THIS APPLICATION.**

1 **A9.** Listed below are my concerns and opinions drawn from my review of this case and other
2 proceedings involving the Joint Applicants.

- 3 1. The present application is the second request to approve a transaction
4 between the two parties.
- 5 2. Cartwright Creek is unwilling to invest in its system, a primary obligation
6 of a utility owner.
- 7 3. The Joint Applicants have not taken a position on whether the liability to
8 customers, resulting from their contribution of escrow funds, should be
9 eliminated due to this acquisition – a key issue in this proceeding.
- 10 4. Limestone has questioned the validity of Cartwright Creek’s accounting
11 records despite the fact that the Commission has reviewed such accounting
12 practices.
- 13 5. Limestone has not explicitly stated its willingness to comply with
14 Commission directives in prior Orders issued to Cartwright Creek.
- 15 6. Sworn testimony provided by a Limestone affiliate in Kentucky suggests
16 that its appropriate imputed debt cost is consistent with that of a financially
17 distressed entity.
- 18 7. The purchase price, which results in an acquisition premium, is excessive
19 given the nature and underlying funding of the system.
- 20 8. The transaction’s Gain on the Sale should be returned to ratepayers.
- 21 9. Limestone’s affiliates have requested significant rate increases in
22 surrounding states.
- 23 10. Limestone's operating costs will likely be lower than that of Cartwright
24 Creek.

25 **V. Acquisition History**

26 **Q10. BEGIN WITH A DISCUSSION OF YOUR FIRST OBSERVATION THAT THE**
27 **PRESENT APPLICATION IS THE SECOND ATTEMPT BY THE PARTIES TO**
28 **COMPLETE AN ACQUISITION TRANSACTION.**

29 **A10.** The present application is a second attempt to consummate a transaction between the
30 parties. The previous transaction was submitted on March 14, 2019 and was withdrawn

1 without explanation.⁵ This raises questions about how committed the two parties are to the
2 current transaction. To better review and analyze this current Petition, the Commission
3 and the Consumer Advocate need to understand why the parties did not complete the
4 previous transaction and how the current transaction has addressed the issues that caused
5 the withdrawal.

6 **VI. Cartwright Creek Operating History**

7 **Q11. WHAT IS THE BASIS FOR YOUR CONCLUSION THAT CARTWRIGHT** 8 **CREEK IS NOT MEETING ITS OBLIGATIONS AS A UTILITY OPERATOR?**

9 **A11.** One of Cartwright Creek's systems has significant environmental issues. Specifically, The
10 Grasslands System has been the subject of both state administrative actions⁶ and federal
11 litigation⁷ due to The Grasslands System's continuing non-compliance with environmental
12 laws. In my testimony in TPUC Docket No. 19-00097, I provided details from multiple
13 Tennessee Department of Environment and Conservation (TDEC) documents regarding
14 the specifics of Cartwright Creek's non-compliance.⁸ Although it appears Cartwright
15 Creek continues to work with TDEC regarding its non-compliance, a Notice of Violation
16 in 2019 highlights the dire situation of The Grasslands System requiring Cartwright Creek
17 to first address the Inflow and Infiltration (I&I) before making other upgrades to the
18 system.⁹ Cartwright Creek identified a project to address the majority of the I&I as

⁵ *Joint Application of Cartwright Creek, LLC and Limestone Water Utility Operating Company, LLC for Authority to Sell or Transfer Title to the Assets, Property, and Real Estate of a Public Utility and for a Certificate of Public Convenience and Necessity*, TPUC Docket No. 19-00035 (March 14, 2019). This application was later withdrawn by the Parties. *Withdrawal of Joint Application*, TPUC Docket No. 19-00035 (October 4, 2019).

⁶ *Director's Order, In re: Cartwright Creek, LLC*, TDEC, Division of Water Resources, Case No. WPC18-0100 (April 29, 2019).

⁷ *Complaint, Harpeth River Watershed Assoc. v. Cartwright Creek LLC*, No. 3:14-cv-01772 (M.D. Tenn. 2014).

⁸ *Direct Testimony of David N. Dittmore* at 7:3 - 9:23, TPUC Docket No. 19-00097 (November 19, 2019).

⁹ *Id.*

1 specified in the Collection System Infiltration Reduction Project (CSIRP) and requested
2 approval of the project from the Commission.¹⁰ The Commission approved the use of up
3 to \$550,000 from the Company's tap fee account and Capital Improvements Surcharge
4 (“Surcharge”) to rehabilitate The Grasslands System in addressing the I&I issue identified
5 in the CSIRP.¹¹ Significantly, the Company has refused to inject its own capital¹² to make
6 necessary repairs.

7 **Q12. DO YOU BELIEVE CARTWRIGHT CREEK HAS AN OBLIGATION TO**
8 **PROVIDE FINANCING TO MAKE NECESSARY SYSTEM IMPROVEMENTS?**

9 **A12.** Yes, this is a fundamental obligation of utility ownership. In exchange for providing an
10 essential service under a state-sanctioned franchise with no competition, the utility is
11 responsible for providing financing to ensure satisfactory service. In this regard,
12 Cartwright Creek has not met its obligation as a utility operator.

13 **Q13. WHAT HAS BEEN THE RESULT OF CARTWRIGHT CREEK’S**
14 **UNWILLINGNESS TO FINANCE NECESSARY SYSTEM IMPROVEMENTS?**

15 **A13.** The Commission has taken the unusual step of approving Surcharges to be exclusively
16 used to finance system improvements.¹³ The pre-funding of capital expenditures by

¹⁰*Petition of Cartwright Creek, LLC Requesting Approval of Proposed Capital Improvements*, TPUC Docket No. 19-00049 (May 13, 2019).

¹¹ *Order, In re: Petition of Cartwright Creek, LLC Requesting Approval of Proposed Capital Improvements*, pp. 4-8, TPUC Docket No. 19-00049 (August 25, 2020).

¹² *Petition* at p. 6 (May 5, 2021). See also *Joint Application of Cartwright Creek, LLC and Limestone Water Utility Operating Company, LLC for Authority to Sell or Transfer Title to the Assets, Property, and Real Estate of a Public Utility and for a Certificate of Public Convenience and Necessity*, p. 6, ¶11, TPUC Docket No. 19-00035 (March 14, 2019).

¹³ *Order Approving Rate Increase*, pp. 5-6, TRA Docket No. 16-00127 (January 10, 2017). The Commission approved an extension of the monthly surcharge for an additional 36 months. *Order Approving the Extension of the Surcharge*, TPUC Docket No. 19-00097 (August 25, 2020).

ratepayers comes with some precise accounting and cash management requirements. In pertinent part, the Commission found:

*The funds collected under the Capital Improvement Surcharge, as well as all cash contributions in aid of construction received by Cartwright Creek during the thirty-six (36) month collection period of the Capital Improvement Surcharge, shall be deposited and held in a separate FDIC insured state-authorized interest-bearing bank account ("Capital Account") from which the funds shall not be expended without Cartwright Creek seeking and obtaining from the Commission (in a specified amount and for a specified purpose), prior to expenditure of such funds, an order by the Commission specifically authorizing the expenditure of such funds in a specified amount and for a specified purpose; provided, however, that in exigent circumstances requiring expenditures of funds from the Capital Account, Cartwright Creek may expend funds from such account after obtaining the required approval in accordance with the exigent circumstances procedures described below. The Commission order authorizing expenditure(s) of funds from the Capital Account shall state the purpose(s) and amount(s) of such expenditure(s) and may impose additional restrictions upon such expenditure(s) in the discretion of the Commission.*¹⁴

Q14. HAS LIMESTONE EXPRESSED ITS WILLINGNESS TO FUND NECESSARY CAPITAL EXPENDITURES OF THE NEWLY ACQUIRED SYSTEMS?

A14. Yes.¹⁵

Q15. IF LIMESTONE IS WILLING TO PROVIDE THE NECESSARY FINANCING TO MAKE THE NEEDED IMPROVEMENTS WITHIN THE CARTWRIGHT CREEK SYSTEM, IS IT NECESSARY TO REVIEW OTHER IMPLICATIONS OF THIS TRANSACTION?

A15. Yes.¹⁶ A significant benefit of the transaction is Limestone's willingness to finance the necessary capital expenditures. However, I don't believe a regulatory review should be

¹⁴ Order Approving the Extension of the Surcharge, p. 7, TPUC Docket No. 19-00097 (August 25, 2020).

¹⁵ Petition at p. 6 (May 5, 2021).

¹⁶ *Id.*

1 limited to this one issue. The Commission must also consider other aspects of the
2 transaction and their potential costs.

3 **VII. Surcharge/Escrow Funding**

4 **Q16. TURN TO YOUR NEXT CONCLUSION CONCERNING THE ISSUE OF**
5 **ESCROW FUNDS. BEGIN BY PROVIDING A DISCUSSION OF HOW THESE**
6 **CUSTOMER-PROVIDED FUNDS WERE INITIALLY APPROVED.**

7 **A16.** The Commission first addressed the Surcharge issue in TRA Docket No. 16-00127, where
8 it adopted the Company's proposal as referenced in the following language:

9 *The \$7.50 capital surcharge for 36 months is essential in funding needed*
10 *facility improvements and upgrades and is, therefore, approved subject to*
11 *the terms found in the Joint Petition. These terms are sufficient to*
12 *adequately safeguard the funds collected as well as their disbursement.¹⁷*

13 Conditions contained in the Joint Petition and adopted by the Commission included:

14 *In addition to the proposed monthly wastewater service rates set forth*
15 *above, the Parties also propose to implement a Capital Improvements*
16 *Surcharge ("Surcharge") to include an additional charge of \$7.50 per*
17 *month for each customer for thirty-six (36) months for the sole purpose of*
18 *funding a capital improvements account under the following terms:*

19 *a. The Surcharge shall automatically and without further action of*
20 *the Authority terminate immediately after the thirty-sixth (36th)*
21 *month of collection of the \$7.50 monthly charge per customer;*

22 *b. Notwithstanding the foregoing, the Authority, in the exercise of*
23 *its discretion, may terminate the Surcharge upon the issuance of*
24 *a termination order;*

25 *c. The funds collected under the Surcharge, as well as all cash*
26 *contributions in aid of construction received by Cartwright*
27 *during the Surcharge's thirty-six (36) month collection period,*
28 *shall be deposited and held in a separate FDIC insured state*
29 *authorized interest-bearing bank account ("Capital Account")*

¹⁷ *Order Approving Rate Increase*, pp. 5, TRA Docket No. 16-00127 (January 10, 2017).

1 from which funds shall not be expended without Cartwright
2 seeking and obtaining from the Authority (in a specified amount
3 and for a specified purpose), prior to expenditure of such funds,
4 an order by the Authority specifically authorizing the
5 expenditure of such funds in a specified amount and for a
6 specified purpose; provided, however, that in exigent
7 circumstances requiring expenditures of funds from the Capital
8 Account, Cartwright may expend funds from such account after
9 obtaining the required approval in accordance with the exigent
10 circumstances procedures described below. The Authority order
11 authorizing expenditure(s) of funds from the Capital Account
12 shall state the purpose(s) and amount(s) of such expenditure(s),
13 and may impose additional restrictions upon such
14 expenditure(s) in the discretion of the Authority;

15 d. If, in the reasonable view of Cartwright, exigent circumstances
16 exist requiring the use of funds held in the Capital Account,
17 Cartwright shall, prior to the expenditure of such funds, seek
18 approval of the Chief of the TRA's Utilities Division or his/her
19 designee by submitting a letter request to the TRA (in a specified
20 amount and for a specified purpose) with appropriate support
21 and documentation for the request, including without limitation
22 an explanation of how any amount requested was calculated;

23 e. Cartwright will clearly and conspicuously state on each bill sent
24 to its customer the Surcharge for capital improvements as a
25 separate line item; and

26 f. Cartwright shall file with the TRA on the 10th business day of the
27 month after the end of each calendar quarter a report on the
28 balance in the Capital Account, including copies of the bank
29 statements for such account for the prior three month period,
30 and the expenditure(s) of any amount(s) from such account.
31 Upon request, Cartwright shall provide additional information
32 related to the Capital Account, including documentation
33 supporting deposits to and withdrawals from such account.¹⁸

34 **Q17. HAS THE COMMISSION RENEWED ITS APPROVAL OF THE SURCHARGE**
35 **SUBSEQUENT TO TRA DOCKET NO. 16-00127?**

¹⁸ Joint Petition of Cartwright Creek, LLC and TRA Staff (as a Party) to Increase Rates and Charges, pp. 3-5, TRA Docket No. 16-00127 (November 10, 2016).

1 **A17.** Yes. The Commission adopted a 36-month extension of the collection of the Surcharge as
2 discussed above in TPUC Docket No. 19-00097.¹⁹ As mentioned earlier, there were
3 specific requirements to be met before the disbursement of the escrowed funds.

4 **Q18. DOES CARTWRIGHT CREEK HAVE A SIGNIFICANT SOURCE OF**
5 **CUSTOMER-PROVIDED CAPITAL IN ADDITION TO THE SURCHARGE?**

6 **A18.** Yes. The Company's tariff provisions allow, as approved by the Commission,²⁰ for the
7 collection of tap fees which represent a form of CIAC.

8 **Q19. WHAT IS THE BALANCE OF THESE CUSTOMER-PROVIDED FUNDS?**

9 **A19.** The balance of the Surcharge and the tap fees were \$70,468²¹ and \$191,181²², respectively,
10 as of June 30, 2021. The balances of the Surcharge and tap fees are significant given the
11 small customer base of Cartwright Creek. Cartwright Creek also has [REDACTED]²³ in
12 CIAC, inclusive of tap fees balance.

13 **Q20. HOW WOULD FUNDS BE TREATED IN FUTURE REGULATORY**
14 **PROCEEDINGS UNDER THE PARTIES' RECOMMENDATION?**

15 **A20.** The Petition is silent on this issue. Thus, it is not clear whether the selling entity,
16 Cartwright Creek, would simply keep these funds or whether they would transfer to the
17 buyer, Limestone. Further, the Sales Agreement does not offer any insight on this topic.²⁴

¹⁹ *Order Approving the Extension of the Surcharge*, p. 7, TPUC Docket No. 19-00097 (August 25, 2020).

²⁰ *Order Approving Increase in Tap Fee*, pp. 10-11, TPUC Docket No. 19-0034 (August 19, 2019).

²¹ *Cartwright Creek's Response to Consumer Advocate*, DR No. 1-1, TPUC Docket No. 21-00053.

²² *Id.*

²³ *Id.* at DR No. 1-5, Attachment 1-5A, (CONFIDENTIAL).

²⁴ *Limestone's Response to Consumer Advocate*, DR No. 2-2a, TPUC Docket No. 21-00053. "The transfer of escrow funds from Cartwright Creek to Limestone is not expressly addressed in the purchase agreement." *Id.*

**Q21. HOW HAVE THE PARTIES RESPONDED TO THIS CONCERN IN
DISCOVERY?**

A21. The parties provided similar responses to inquiries from the Consumer Advocate as follows:

Cartwright Creek

Cartwright Creek expects the Commission to determine whether tap fees and/or CRS funds should be transferred to Limestone and what conditions should apply to such a transfer.²⁵

Limestone

It cannot be determined at this time whether the Commission will require escrow funds recorded on the books of Cartwright Creek to be retained in escrow following a sale of Cartwright Creek's assets to Limestone and accordingly, Limestone is unable to answer how these funds should, or should not be recorded.²⁶

**Q22. DO YOU BELIEVE THE APPLICANTS HAVE AN OBLIGATION TO IDENTIFY
THEIR POSITION ON THE DISPOSITION OF THE ESCROW FUNDS?**

A22. Yes. The Joint Applicants made a decision to remain silent on this essential point. The application is incomplete without a transparent statement from the Joint Applicants on their position regarding the disposition of escrow funds.

**Q23. DO YOU HAVE A RECOMMENDATION REGARDING THE APPROPRIATE
ACCOUNTING FOR THE ESCROW FUNDS?**

A23. Yes. The Commission should require Limestone to adhere to the identical conditions adopted for Cartwright Creek in its Order in TPUC Docket No. 19-00097.²⁷ These conditions from the Commission's Order are set forth below:

²⁵ *Cartwright Creek's Response to Consumer Advocate*, DR No. 1-2, TPUC Docket No. 21-00053.

²⁶ *Limestone's Response to Consumer Advocate*, DR No. 1-8, TPUC Docket No. 21-00053.

²⁷ *Order Approving the Extension of the Surcharge*, pp. 7-10, TPUC Docket No. 19-00097 (August 25, 2020).

1 *As agreed upon by the parties, the panel found that the Capital*
2 *Improvements Surcharge is subject to the following terms and conditions:*

- 3 *a. The Surcharge shall automatically and without further action of the*
4 *Commission terminate immediately after the thirty-sixth (36th)*
5 *month of collection of the \$7.50 monthly charge per customer;*
- 6 *b. Notwithstanding the foregoing, the Commission, in the exercise of*
7 *its discretion, may terminate the Capital Improvements Surcharge*
8 *upon the issuance of a termination order;*
- 9 *c. The funds collected under the Capital Improvements Surcharge, as*
10 *well as all cash contributions in aid of construction received by*
11 *Cartwright Creek during the thirty-six (36) month collection period*
12 *of the Capital Improvements Surcharge, shall be deposited and held*
13 *in a separate FDIC insured state authorized interest-bearing bank*
14 *account ("Capital Account") from which funds shall not be*
15 *expended without Cartwright Creek seeking and obtaining from the*
16 *Commission (in a specified amount and for a specified purpose),*
17 *prior to expenditure of such funds, an order by the Commission*
18 *specifically authorizing the expenditure of such funds in a specified*
19 *amount and for a specified purpose; provided, however, that in*
20 *exigent circumstances requiring expenditures of funds from the*
21 *Capital Account, Cartwright Creek may expend funds from such*
22 *account after obtaining the required approval in accordance with*
23 *the exigent circumstances procedures described below. The*
24 *Commission order authorizing expenditure(s) of funds from the*
25 *Capital Account shall state the purpose(s) and amount(s) of such*
26 *expenditure(s), and may impose additional restrictions upon such*
27 *expenditure(s) in the discretion of the Commission;*
- 28 *d. If, in the reasonable view of Cartwright Creek, exigent*
29 *circumstances exist requiring the use of funds held in the Capital*
30 *Account, Cartwright Creek shall, prior to the expenditure of such*
31 *funds, seek approval of the Chief of the Commission's Utilities*
32 *Division or his/her designee by submitting a letter request to the*
33 *TPUC (in a specified amount and for a specified purpose) with*
34 *appropriate support and documentation for the request, including*
35 *without limitation an explanation of how any amount requested was*
36 *calculated;*
- 37 *e. Cartwright Creek will clearly and conspicuously state on each bill*
38 *sent to its customer the Capital Improvements Surcharge for capital*
39 *improvements as a separate line item; and*
- 40 *f. Cartwright Creek shall file with the TPUC on the 10th business day*
41 *of the month after the end of each calendar quarter a report on the*
42 *balance in the Capital Account, including copies of the bank*
43 *statements for such account for the prior three (3) month period,*
44 *and the expenditure(s) of any amount(s) from such account. Upon*

1 *request, Cartwright Creek shall provide additional information*
2 *related to the Capital Account, including documentation supporting*
3 *deposits to and withdrawals from such account.*

4 *In addition, the parties agreed to adopt overspending protections as generally set*
5 *forth in the Stipulation and Settlement Agreement filed in Docket No. 16-00096.*
6 *The overspending protection language in that matter contains specifics applicable*
7 *to Tennessee Wastewater Systems, Inc. construction projects, but also contains*
8 *general principles setting spending triggers, required accounting procedures, and*
9 *required filings.²⁰ The panel directed the parties to draft and file in this docket*
10 *agreed overspending protections specific to Cartwright Creek's Grassland System*
11 *projects.*

12 *The panel noted that the long-standing problems with inflow and infiltration at the*
13 *aging Grassland System are well documented and in need of major repair. In*
14 *response to TDEC order, Cartwright Creek has worked with TDEC to develop*
15 *plans to address the system's problems. The panel recognized that the funds*
16 *collected through the Capital Improvements Surcharge and the Company's escrow*
17 *surcharge will not be sufficient to cover the estimated cost to fully repair the system.*
18 *Therefore, the panel voted unanimously to open a docket for the purpose of*
19 *developing a long-term plan for funding the replacement or refurbishment of the*
20 *Grassland facility²⁸*

21 **VIII. Proposed Modification to Cartwright Creek's Accounting Records**

22 **Q24. PLEASE TURN TO YOUR NEXT CONCERN, RELATED TO LIMESTONE**
23 **QUESTIONING THE VALIDITY OF THE BOOKS OF CARTWRIGHT CREEK.**

24 **A24.** Limestone “does not have sufficient detailed information to prepare acquisition accounting
25 entries.”²⁹ The annual reports and other financial information in Limestone’s possession
26 “lack the necessary detail to determine the appropriate accounting entries.”³⁰ Limestone
27 describes Cartwright Creek’s data in its annual reports to the Commission as “unreliable

²⁸ *Id.*

²⁹ *Limestone's Response to Consumer Advocate*, DR No. 1-10, TPUC Docket No. 21-00053.

³⁰ *Id.*

1 data.”³¹ Subsequently, Limestone indicated it received updated financial information it
2 then used to recalculate the CIAC balance.³²

3 **Q25. WHAT IS YOUR REACTION TO THAT STATEMENT?**

4 **A25.** I would expect that a close review of the financial records of the target utility would occur
5 before making a [REDACTED]³³ offer to acquire the assets of the system.

6 **Q26. DO YOU HAVE A SPECIFIC CONCERN WITH THE FINANCIAL**
7 **PROJECTIONS OF LIMESTONE THAT ARE PROVIDED IN THIS**
8 **PROCEEDING?**

9 **A26.** Yes. My concern with the forecast is Limestone’s calculation of depreciation expense and
10 its proposed adjustment to CIAC. Limestone forecasts [REDACTED] of depreciation expense.³⁴
11 This depreciation expense is derived from applying various depreciation rates to Cartwright
12 Creek’s plant in service balances. In a normal situation, this manner of calculating
13 depreciation expense would be entirely appropriate. However, due to the unwillingness of
14 Cartwright Creek’s ownership to inject capital into the system, unique regulatory treatment
15 has been adopted, which Limestone has either ignored or was unaware of when it submitted
16 its application and prepared its financial forecast. The Commission has rejected the
17 recording of depreciation expense for Cartwright Creek in computing the revenue
18 requirement.³⁵ Mr. Joe Shirley, Deputy Chief of Utilities, stated the following:

19 *Q. ARE YOU FORECASTING ANY DEPRECIATION EXPENSE FOR*
20 *UTILITY PLANT DURING THE ATTRITION PERIOD?*

³¹ *Id.* at DR No. 2-7.

³² *Id.*

³³ *Petition* at Exhibit 7, p. 3, ¶ 4 (CONFIDENTIAL).

³⁴ This estimate was later modified to [REDACTED]. *Limestone’s Response to Consumer Advocate*, DR No. 2-6, TPUC Docket No. 21-00053 (CONFIDENTIAL). However, the precise number is not important for our purposes here.

³⁵ *Order Approving Rate Increase*, p. 6, TRA Docket No. 16-00127 (January 10, 2017).

1 A. *No. The annual depreciation expense for the Attrition Period is*
2 *forecasted to be zero. The Company's utility plant has been either*
3 *fully depreciated (as in the case of the Grasslands System) or*
4 *contributed to the utility by the developers (as in the case for the*
5 *Arrington Retreat and Hideaway systems). Thus, for purposes of*
6 *utility rate-making in this case, there is no depreciation expense to*
7 *be recognized for the attrition period.*³⁶

8 **Q27. HAS CARTWRIGHT CREEK RECORDED DEPRECIATION EXPENSE ON ITS**
9 **BOOKS AND RECORDS IN THE RECENT PAST?**

10 **A27.** No. Cartwright Creek has not recorded depreciation expense since 2010.³⁷ The lack of
11 depreciation expense recording is understandable given Cartwright Creek's situation.
12 Cartwright Creek developed a negative rate base as of 2010, which would have only been
13 exacerbated by the continued recording of depreciation expense. Therefore, Cartwright
14 Creek ceased recording depreciation expense in 2011.³⁸ Recent capital expenditures have
15 either been funded with CIAC or through the use of escrow funds. The non-recording of
16 depreciation expense was endorsed by Commission Staff in its testimony submitted in TRA
17 Docket No. 16-00127 as mentioned above.³⁹

18 **Q28. WHAT ARE THE PRACTICAL IMPLICATIONS ON CUSTOMERS IF**
19 **LIMESTONE MODIFIED THE HISTORIC ACCOUNTING BALANCES OF**
20 **CARTWRIGHT CREEK AS IMPLIED WITHIN ITS CONFIDENTIAL**
21 **FINANCIAL EXHIBITS?**

³⁶ *Direct Testimony of Joe Shirley* at 4:7-12, TRA Docket No. 16-00127 (November 10, 2016).

³⁷ *Cartwright Creek's Response to Consumer Advocate*, DR No. 1-15, TPUC Docket No. 21-00053.

³⁸ *Id.*

³⁹ *Direct Testimony of Joe Shirley* at 4:7-12, TRA Docket No. 16-00127 (November 10, 2016).

1 **A28.** Limestone intends to restate the [REDACTED] balance of Cartwright Creek's CIAC ⁴⁰ in a
2 very significant way. In its Proforma Financials, Limestone ignored the current balance of
3 CIAC⁴¹ and in its place, recalculated the account balance from 2010 forward. Limestone
4 subsequently obtained updated financial statements and now states that the appropriate
5 CIAC balance, net of its newly calculated Accumulated Amortization Balance as of
6 December 31, 2020, is \$2.24 million.⁴² This represents a reduction in CIAC of [REDACTED]
7 [REDACTED], which increases rate base by the same amount.

8 Limestone also proposes to increase the balance of Accumulated Depreciation on the books
9 of Cartwright Creek from \$968,952 to \$1,880,452 based upon December 31, 2020 data.⁴³

10 The modification to the Cartwright Creek balance of Accumulated Depreciation has the
11 effect of reducing rate base. This modification results from a recalculation of depreciation
12 expense that Limestone states should have been recorded on the books of Cartwright Creek.

13 **Q29. WHAT IS THE NET EFFECT ON RATE BASE FROM THE PROPOSED**
14 **ACCOUNTING ENTRY OF LIMESTONE?**

15 **A29.** Exhibit DND-2 compares key account balances of Cartwright Creek with the proposed
16 acquisition accounting entry made by Limestone based upon December 31, 2020 data. The
17 accounting entries submitted by Limestone have the effect of increasing rate base by
18 approximately \$1.75 million.

19 **Q30. WHAT IS CIAC AND WHY IS IT IMPORTANT?**

⁴⁰ *Cartwright Creek's Response to Consumer Advocate*, DR No. 1-5, *Attachment 1-5A*, TPUC Docket No. 21-00053 (CONFIDENTIAL).

⁴¹ *Petition at Exhibit 11* (CONFIDENTIAL).

⁴² *Limestone's Response to Consumer Advocate*, DR No. 2-7 and Attachment "2-7 CIAC Assumptions, TPUC Docket No. 21-00053.

⁴³ *Id.*

1 **A30.** CIAC represents either funds or the value of the property provided by a third party to the
2 utility, which is then used in utility operations. CIAC represents proceeds received from
3 others (not provided by owners or shareholders) and thus is treated as an offset to rate base.
4 Receipt of property from a third party with no compensation is recorded as CIAC and plant
5 in service, thus netting to a zero impact to rate base.

6 **Q31. CAN CIAC BE AMORTIZED?**

7 **A31.** Yes. In most situations, CIAC in the form of contributed property is amortized (reduced)
8 as the asset financed by CIAC is depreciated. The amortization is accounted for by debiting
9 Accumulated CIAC amortization and crediting depreciation expense.⁴⁴

10 **Q32. WHAT WOULD HAVE BEEN THE IMPACT ON O&M COSTS HAD**
11 **CARTWRIGHT CREEK AMORTIZED ITS CIAC BALANCE AS PROPOSED TO**
12 **BE ADJUSTED BY LIMESTONE?**

13 **A32.** The O&M costs of Cartwright Creek would have been lower by \$2.6 million, offset by the
14 approximate \$900,000 increase in depreciation expense Limestone states should have been
15 recorded. The net effect would have been a reduced level of O&M costs that should have
16 been used to reduce legacy rates in the amount of \$1,747,771.

17 **Q33. DO YOU BELIEVE THE LIMESTONE SHOULD BE PROHIBITED FROM**
18 **RESTATING CARTWRIGHT CREEK'S HISTORIC BALANCE OF CIAC AND**
19 **ACCUMULATED DEPRECIATION?**

20 **A33.** Yes. The Commission should not permit an acquiring utility to go back and recreate the
21 historical accounting records of the selling utility. There is no justification for Limestone

⁴⁴ This accounting is contained in the NARUC Uniform System of Accounts for wastewater utilities.

1 making such revisions given the Commission's review of Cartwright Creek's books within
2 their 2016 rate proceeding. Cartwright Creek had no net rate base, justifying the
3 termination of depreciation expense, which also justified the lack of CIAC amortization.
4 The Commission did not object to Cartwright Creek's accounting for CIAC and fully
5 depreciated plant in service in TRA Docket No. 16-00127.

6 **Q34. WHAT IS YOUR RECOMMENDATION REGARDING THE ACCOUNTING**
7 **TREATMENT OF CIAC AND ACCUMULATED DEPRECIATION ON THE**
8 **BOOKS OF LIMESTONE?**

9 **A34.** The balance of CIAC and Accumulated Depreciation on the books of Cartwright Creek
10 should be the same balances recorded on the books of Limestone. The balance of CIAC
11 on the books of Limestone shall not be amortized until authorized by the Commission. The
12 Commission should reaffirm the validity of historic Cartwright Creek accounting practices
13 to prevent the write-up of asset balances.

14 **Q35. DO YOU RECOMMEND THAT COMMISSION APPROVAL OF THE**
15 **TRANSACTION BE CONTINGENT UPON THE SUBMISSION AND APPROVAL**
16 **BY THE COMMISSION OF LIMESTONE'S INITIAL ACCOUNTING ENTRIES?**

17 **A35.** Yes. Accounting entries should be submitted to the Commission before closing for review
18 as a condition of the Commission's approval of the transaction. The Commission, its Staff,
19 and the Consumer Advocate should have the opportunity to review Limestone's proposed
20 accounting entries used to record the acquisition.

21 **IX. Separate Accounting Records**

1 **Q36. IS LIMESTONE WILLING TO MAINTAIN SEPARATE ACCOUNTING**
2 **RECORDS FOR EACH OF ITS SYSTEMS?**

3 **A36.** Yes. Limestone stated its intention of maintaining separate accounting records to
4 differentiate operating results and plant assets among its systems.⁴⁵

5 **X. Reasonableness of the Purchase Price**

6 **Q37. WHAT IS THE PURCHASE PRICE ASSOCIATED WITH THIS TRANSACTION?**

7 **A37.** The purchase price is [REDACTED].⁴⁶

8 **Q38. HAVE YOU CONSIDERED THE REASONABLENESS OF THE PURCHASE**
9 **PRICE?**

10 **A38.** Yes. I believe the price is excessive given Cartwright Creek's rate base and level of
11 profitability. Further, a portion of the purchase price is based upon an erroneous conclusion
12 by Limestone.

13 **Q39. WHAT IS THE BASIS FOR YOUR OPINION?**

14 **A39.** The net book value of the acquired assets is negative, resulting from the significant amount
15 of CIAC on the books of Cartwright Creek. The June 30, 2021 balance of its fixed assets
16 is [REDACTED], while its CIAC balance is [REDACTED], thus producing a negative rate base.⁴⁷
17 The only other Cartwright Creek assets of any significance are several types of cash. The
18 majority of the cash balances are either tap fees or Surcharge collections, and both balances

⁴⁵ *Limestone's Response to Consumer Advocate*, DR No. 23, TPUC Docket No. 21-00053.

⁴⁶ *Petition*, Exhibit 7 at p. 3, ¶ 4 (CONFIDENTIAL).

⁴⁷ *Cartwright Creek's Response to Consumer Advocate*, DR No. 1-5, Attachment 1-5A, TPUC Docket No. 21-00053 (CONFIDENTIAL).

reflect customer-provided capital, a regulatory liability for ratemaking purposes. Limestone is paying a substantial amount above the net book value of acquired assets.

XI. Treatment of the Acquisition Premium

Q40. WHAT IS AN ACQUISITION PREMIUM, AND WHY IS IT IMPORTANT?

A40. An Acquisition Premium represents the acquisition costs of utility assets in excess of their net book value. The Acquisition Premium, in this Docket, is the difference between the negative net book value of assets acquired and the proposed purchase price, or approximately [REDACTED] as of June 30, 2021.⁴⁸ Acquiring utilities typically seek recovery of acquisition premiums in rate cases, subjecting ratepayers to increased costs associated with a change in ownership.

Q41. DO YOU BELIEVE RECOVERY OF AN ACQUISITION PREMIUM IS JUSTIFIED IN THIS SITUATION?

A41. No. As mentioned earlier, Cartwright Creek has a negative rate base and is not particularly profitable. A company with a robust cash flow may justify the payment of an acquisition premium, but that is not the case with Cartwright Creek.

Q42. IS LIMESTONE REQUESTING RECOVERY OF AN ACQUISITION PREMIUM IN THIS PROCEEDING?

A42. No.

⁴⁸ The Acquisition Premium is estimated at [REDACTED].

1 **Q43. ARE YOU RECOMMENDING THE COMMISSION RULE ON THE**
2 **APPROPRIATE REGULATORY TREATMENT OF THE ACQUISITION**
3 **PREMIUM IN THIS PROCEEDING?**

4 **A43.** No.

5 **Q44. WHAT ARE YOU RECOMMENDING REGARDING ACCOUNTING FOR THE**
6 **ACQUISITION PREMIUM?**

7 **A44.** The Acquisition Premium, in this case, should be set aside in a separate account and its
8 ultimate disposition determined in a future proceeding. There should be no assumption
9 that this balance will be recoverable in a subsequent rate case proceeding. The burden to
10 justify the recovery of this balance rests with Limestone.

11 **Q45. IS THIS RECOMMENDATION CONSISTENT WITH THE COMMISSION'S**
12 **RULING ON ACQUISITION PREMIUM ACCOUNTING IN TPUC DOCKET NO.**
13 **19-00062?**

14 **A45.** Yes. In that order, the Commission found:

15 *Limestone is not requesting an acquisition premium and the Commission is*
16 *not approving any acquisition adjustment related to the purchase of Aqua's*
17 *assets; accordingly, Limestone's beginning value of the acquired assets for*
18 *ratemaking purposes shall be the value recorded in Aqua's books and*
19 *records at the date of the acquisition. Further, Limestone is not authorized*
20 *to book an above-the-line regulatory asset for rate-making purposes for any*
21 *portion of the amount by which the purchase price exceeds the value of the*
22 *acquired assets as reflected in Aqua's books and records at the date of*
23 *acquisition. In any future rate proceeding, Limestone may present evidence*
24 *and argument concerning the value of assets used and useful for*
25 *provisioning public utilities services, and the Consumer Advocate or other*

1 *interested parties may oppose such values or present their own evidence*
2 *and argument concerning the value of such assets.*⁴⁹

3 **Q46. EARLIER, YOU INDICATED A PORTION OF THE PURCHASE PRICE IS**
4 **BASED UPON AN ERRONEOUS CONCLUSION OF LIMESTONE. WHAT IS**
5 **THE BASIS FOR YOUR CONCLUSION?**

6 **A46.** The Consumer Advocate requested the justification for the increase in the purchase price
7 of the assets from that embedded in TPUC Docket No. 19-00035.⁵⁰ Limestone explained
8 that the difference in the purchase price is due to the additional capital invested by the
9 current owner since the initial proposed acquisition.⁵¹ This contradicts the statement of
10 Cartwright Creek wherein they acknowledge the owners of Cartwright Creek have not
11 injected any capital into the wastewater system since January 2019.⁵²

12 **XII. Accounting for Transaction Costs**

13 **Q47. DO YOU HAVE A RECOMMENDATION CONCERNING THE APPROPRIATE**
14 **ACCOUNTING FOR REGULATORY AND TRANSACTION COSTS**
15 **ASSOCIATED WITH THE ACQUISITION?**

16 **A47.** Yes. I recommend that the Commission authorize that these costs be recorded in a separate
17 asset account that may be considered for recovery in a future proceeding. Limestone
18 should have the burden of proof to demonstrate that such costs are appropriate to recover

⁴⁹ *Order Approving Sale of Assets, Property, and Real Estate and Certificate of Public Convenience of Aqua Utilities Company, LLC Subject to Conditions and Requirements of the Tennessee Public Utility Commission*, pp. 17-18, TPUC Docket No. 19-0-0062 (December 7, 2020).

⁵⁰ The purchase price contained in the original sales agreement was [REDACTED], while the current acquisition price is [REDACTED].

⁵¹ *Limestone's Response to Consumer Advocate*, DR No. 2-3, TPUC Docket No. 21-00053.

⁵² *Cartwright Creek's Response to Consumer Advocate* DR No.1-8, TPUC Docket No. 21-00053.

1 from its customers. There should be no presumption that such costs are recoverable from
2 customers.

3 **Q48. ARE THERE OTHER ACCOUNTING REQUIREMENTS YOU BELIEVE**
4 **SHOULD BE REQUIRED OF LIMESTONE GOING FORWARD?**

5 **A48.** Yes. The systems owned by Cartwright Creek differ in terms of their future capital needs.
6 The Grasslands system for example, needs significant capital investment.⁵³ I recommend
7 the costs to operate each system be maintained separately, including identifying operating
8 and maintenance expenses and plant in service. The purpose of this recommendation is to
9 preserve the option to keep separate rate designs of the systems in future rate proceedings.
10 This recommendation is not intended to prejudge rate consolidation; however, preservation
11 of different system accounting records will allow the parties to better analyze the rate
12 design issue in the future.

13 **XIII. Treatment of Gain on the Sale**

14 **Q49. IS THERE A GAIN ON THE SALE OF THESE ASSETS ACCRUING TO THE**
15 **OWNERS OF CARTWRIGHT CREEK?**

16 **A49.** Yes. Confidential Exhibit DND-3 calculates the estimated Gain on the Sale of Cartwright
17 Creek assets based upon values as of May 31, 2021. As identified on line 8, the Gain on
18 the Sale resulting from this transaction is estimated at [REDACTED].

19 **Q50. WHY IS THE GAIN GREATER THAN THE PURCHASE PRICE?**

⁵³ *Id.* at DR 2-5 and Exhibit A and *Petition of Cartwright Creek, LLC to Extend the Capital Improvement Surcharge*, TPUC Docket No. 19-00097 (October 21, 2019).

1 **A50.** The gain is greater than the purchase price because Cartwright Creek has a negative net
2 book value, resulting from its liabilities exceeding its assets.

3 **Q51. FOR PURPOSES OF ASSIGNING THE GAIN ON THE SALE PROCEEDS FROM**
4 **THIS TRANSACTION, DO YOU PROPOSE LIMITING THE GAIN TO THE**
5 **PURCHASE PRICE?**

6 **A51.** Yes. I recommend the Gain on the Sale be limited to the [REDACTED]⁵⁴ purchase price for
7 purposes of considering the amount of gain that should flow to ratepayers.

8 **Q52. DOES THE COMMISSION HAVE AUTHORITY OVER THE DISPOSITION OF**
9 **THE GAIN ON THE SALE OF UTILITY ASSETS?**

10 **A52.** Yes.

11 **Q53. SHOULDN'T THE GAIN ON THE SALE AUTOMATICALLY ACCRUE TO THE**
12 **BENEFIT OF THE OWNER OF THE ASSET?**

13 **A53.** No.

14 **Q54. WHAT IS THE RATIONALE FOR ATTRIBUTING THE GAIN ON THE SALE**
15 **TO UTILITY RATEPAYERS?**

16 **A54.** Utility owners/shareholders are entitled to an opportunity to earn their authorized return
17 through the rate-making process. Utilities are granted the right to the provision of a
18 monopoly service within a given service territory. This governmental permit to exclusively
19 provide utility service is of great value to the holder of the right. The utility owner is
20 protected from competition for the services they offer. Utility shareholders do not assume
21 the level of risk that accrues to shareholders of competitive companies. In exchange for

⁵⁴ *Petition*, Exhibit 7 at p. 3, ¶ 4 (CONFIDENTIAL).

operating in a very low-risk environment, the profits of utility owners/shareholders are limited. Utility owners/shareholders are not entitled to additional profit once they transfer their Certificate of Convenience and Necessity (CCN) to a third party. Captive utility ratepayers provide a financial safety net for utility owners/shareholders. Therefore, the ratepayers should benefit from any Gain on the Sale resulting from the government-provided monopoly franchise transfer. The Gain on Sale represents excess profits beyond those required to provide the utility owner a reasonable opportunity to earn its authorized return.

Q55. HAVE OTHER REGULATORY COMMISSIONS ADDRESSED THE GAIN ON THE SALE ISSUE?

A55. Yes. Exhibit DND-4 is a study published by the National Regulatory Research Institute (NRRI) from 1994, which compiles the results of surveys submitted by state utility regulatory commissions on the Gain on the Sale issue. There is great diversity among states in the regulatory treatment of the Gain on the Sale issue. However, overall, a number of states allocate some or all of the Gain on the Sale to ratepayers. Interestingly, Tennessee is listed as a state in which the gain is exclusively assigned to ratepayers.⁵⁵

Q56. WHAT CRITERIA SHOULD BE CONSIDERED IN ASSIGNING THE GAIN ON THE SALE?

A56. I believe the following factors should be considered when determining the portion of the Gain on the Sale that should be assigned to ratepayers:

1. Will the related Acquisition Premium be recoverable from ratepayers?
2. Has the selling utility provided quality service to ratepayers?

⁵⁵ Exhibit DND-4, p. 5, Table 4.

1 3. Has the selling utility invested necessary capital into the system?

2 4. Will rates increase as a result of the proposed transaction?

3 **Q57. CAN YOU APPLY THE CRITERIA LISTED ABOVE TO THE FACTS OF THIS**
4 **ACQUISITION?**

5 **A57.** Yes. First, the recovery of the Acquisition Premium in a future docket is uncertain. This
6 criterion is neutral as it doesn't give weight to the assignment of the gain between either
7 Cartwright Creek's owners or its customers due to the uncertainty of the future regulatory
8 treatment of the acquisition premium.

9 **Q58. ADDRESS THE NEXT TWO CRITERIA, TO THE EXTENT TO WHICH THE**
10 **INCUMBENT UTILITY HAS PROVIDED QUALITY SERVICE TO ITS**
11 **CUSTOMER AND INVESTED IN THE SYSTEM.**

12 **A58.** As discussed earlier in my testimony, Cartwright Creek has not provided quality service to
13 its customers, primarily due to its unwillingness to invest capital into the system. In fact,
14 whatever capital has been recently injected into the system has come from ratepayers via
15 surcharges for escrow funds in order to address and/or prevent environmental problems.
16 The Commission is confronted with a transaction where a Gain on the Sale of utility assets
17 is accruing to the benefit of a utility operator that has performed poorly and not met its
18 obligations to provide satisfactory and efficient service. Cartwright Creek's owners have
19 no entitlement to the Gain on the Sale resulting from this transaction based upon its
20 operating performance.

21 **Q59. ADDRESS THE FINAL CRITERIA RELATED TO THE IMPACT THE**
22 **TRANSACTION MAY HAVE ON RATES.**

1 **A59.** The impact of the transaction on the rates of current Cartwright Creek customers is unclear.
2 The Joint Applicants have not addressed the extent that operating efficiencies may be
3 achieved from the transactions. It is possible that operating efficiencies may occur under
4 the new ownership based upon the operating results of other Limestone affiliates.
5 However, these efficiency gains may be offset in whole or in part with extremely high
6 financing costs. The impact of the transaction on future rates is uncertain.

7 **Q60. DOES THE COMMISSION HAVE A PRECEDENT FOR ASSIGNING THE GAIN**
8 **ON THE SALE OF ASSETS TO RATEPAYERS?**

9 **A60.** Yes. On at least two occasions, the Commission has assigned the Gain on the Sale of utility
10 assets to ratepayers.⁵⁶ Attached as Exhibits DND-5 and DND-6 are Commission orders in
11 Kingsport Power Company and A+ Communications dockets, respectively, in which the
12 Commission ruled on the Gain on the Sale issue. In the Kingsport case, the Commission
13 deducted the deferred Gain on the Sale from rate base,⁵⁷ while in the A+ Communications'
14 case, the Gain on the Sale was amortized as a credit in setting rates, amortized over a five-
15 year period.

16 **Q61. WHAT IS YOUR RECOMMENDATION REGARDING THE REGULATORY**
17 **TREATMENT OF THE GAIN ON THE SALE ISSUE?**

18 **A61.** I recommend that one hundred percent of the Gain on the Sale from this transaction be
19 attributed to ratepayers.

⁵⁶ *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).

⁵⁷ *Order, In re Kingsport Power Company*, p. 6 (Schedule), TPSC Docket No. U-84-7308 (November 15, 1984). It is unknown whether the amortization of the deferred gain was recognized as a credit to operating expenses.

1 **Q62. WILL YOUR RECOMMENDATION RESULT IN SIGNIFICANT BENEFITS TO**
2 **RATEPAYERS ON A PER-CUSTOMER BASIS?**

3 **A62.** Yes. A majority of the infrastructure of Cartwright Creek has been provided by developers,
4 with some portion also provided directly from customers through the Surcharge.⁵⁸ It is
5 safe to assume the costs of developer-provided infrastructure were recovered through real-
6 estate proceeds paid by homeowners (now customers). Homeowners, not Cartwright Creek
7 owners, ultimately financed the underlying assets now being sold for a substantial gain. It
8 is only reasonable to assign the gain to the group that funded the infrastructure.

9 **Q63. WHAT ARE THE OPTIONS AVAILABLE TO THE COMMISSION TO ASSIGN**
10 **THE GAIN ON THE SALE FROM THIS TRANSACTION TO CARTWRIGHT**
11 **CREEK RATEPAYERS?**

12 **A63.** The Commission could require the issuance of bill credits to customers as a condition of
13 the transaction. However, I do not favor this approach as it is clear that significant capital
14 investment is needed in The Grasslands system, which will likely require substantial rate
15 increases. Instead, I recommend the Commission require the establishment of a regulatory
16 liability on the books of Limestone. The amortization of this balance should be credited
17 as an operating expense, and the unamortized balance should be reflected as a reduction to
18 rate base in future proceedings if the Commission adopts the rate base/Rate of Return
19 model to set rates.

⁵⁸ This is borne out by a comparison of the balance of CIAC to Plant in Service on the books of Cartwright Creek.

1 **Q64. IF THE COMMISSION ADOPTS THIS RECOMMENDATION, COULD THIS**
2 **CAUSE THE PARTIES TO GO BACK AND RENEGOTIATE THE SALES**
3 **PRICE?**

4 **A64.** It's possible the parties may reconsider the adequacy of the purchase price if the
5 Commission adopts this recommendation.

6 **XIV. Compliance with Commission Orders**

7 **Q65. NOW, TURN TO YOUR NEXT FINDING CONCERNING LIMESTONE'S**
8 **WILLINGNESS TO ADHERE TO PRIOR COMMISSION RULINGS**
9 **REGARDING CARTWRIGHT CREEK.**

10 **A65.** The application is noticeably silent regarding Limestone's willingness to adhere to prior
11 Commission orders pertaining to Cartwright Creek operations.

12 **Q66. DO YOU HAVE A LISTING OF THE CARTWRIGHT CREEK OPERATING**
13 **REQUIREMENTS ORDERED BY THE COMMISSION?**

14 **A66.** Yes. I have attached a listing of regulatory requirements ordered by the Commission
15 pertaining to Cartwright Creek operations identified as Exhibit DND-7.

16 **Q67. DO YOU RECOMMEND THAT THE COMMISSION REQUIRE THAT**
17 **LIMESTONE ADHERE TO PRIOR REGULATORY OBLIGATIONS OF**
18 **CARTWRIGHT CREEK AS A CONDITION OF APPROVAL OF THE**
19 **TRANSACTION?**

20 **A67.** Yes. The Commission should require Limestone to adhere to these requirements as
21 outlined in Exhibit DND-7, the majority of which relate to the collection and treatment of
22 capital rider surcharge funds.

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1 significantly higher financing costs than this Commission has seen recently from other
2 utilities. The proposal in Kentucky raises questions about the financial strength of
3 Limestone and its owners and whether the rate base rate of return model is the most
4 efficient approach to setting rates for Limestone.

5 **XVI. Evaluation of O&M Costs**

6 **Q69. HAVE YOU EVALUATED THE POTENTIAL IMPACT OF THE TRANSACTION**
7 **ON THE O&M COSTS OF THE CURRENT CARTWRIGHT SYSTEMS?**

8 **A69.** Yes. Confidential Exhibit DND-9 provides three sets of data, comparing operating
9 expenses per customer for Limestone affiliates, the current operations of Cartwright Creek,
10 and finally, the projected O&M costs of the Cartwright Creek systems under Limestone
11 ownership. As reflected on line 16, affiliate entities have a weighted average O&M cost
12 per customer of [REDACTED]. The actual Cartwright Creek O&M costs for 2020 were \$992.31
13 per customer, as reflected on line 17. Finally, Limestone's projected O&M costs per
14 customer are [REDACTED]. Limestone's forecasted O&M costs were included in Confidential
15 Exhibit 11 of the Petition. Based upon this information, it appears there is an opportunity
16 for O&M cost reductions as a result of the ownership change.

17 **XVII. Affiliate Rate Increase**

18 **Q70. HAVE YOU REVIEWED THE REGULATORY ACTIVITY OF LIMESTONE'S**
19 **AFFILIATE IN KENTUCKY?**

1 **A70.** Yes. Limestone's affiliate, Bluegrass Water, just completed a rate case in Kentucky.⁶² One
2 noteworthy item is the scope of increase sought by Bluegrass. Exhibit DND-10 sets out
3 the requested increase for each Bluegrass system. The proposed monthly increases ranged
4 from \$37/month to \$83/month. I reference this information simply to point out that the
5 Commission should expect CSWR, Limestone's upstream parent company, to aggressively
6 pursue proposed rate increases.⁶³ Videos of the proceedings before the Kentucky Public
7 Service Commission are publicly available on its website.⁶⁴

8 **Q71. DOES THIS CONCLUDE YOUR TESTIMONY?**

9 **A71.** Yes, although I reserve the right to update my testimony if new information becomes
10 available.

⁶² Order, In Re: Electronic Application of Bluegrass Water Utility Operating Company, LLC for an Adjustment of Rates and Approval of Construction, Case. No. 2020-00290 (August 2, 2021). A copy of this Order can be accessed at [20210802_PSC_ORDER.pdf \(ky.gov\)](https://psc.ky.gov/Case/ViewCaseFilings/2020-00290/Hearings).

⁶³ *Id.*

⁶⁴ <https://psc.ky.gov/Case/ViewCaseFilings/2020-00290/Hearings>.

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

IN RE:

**APPLICATION OF LIMESTONE
WATER UTILITY OPERATING
COMPANY, LLC FOR AUTHORITY TO
SELL OR TRANSFER TITLE TO THE
ASSETS, PROPERTY AND REAL
ESTATE OF A PUBLIC UTILITY AND
FOR A CERTIFICATE OF
CONVENIENCE AND NECESSITY**

DOCKET NO. 21-00053

AFFIDAVIT

I, David Dittmore, on behalf of the Consumer Advocate Unit of the Attorney General's Office, hereby certify that the attached Direct Testimony represents my opinion in the above-referenced case and the opinion of the Consumer Advocate Unit.

David N. Dittmore
DAVID N. DITTEMORE

Sworn to and subscribed before me
this 30th day of August, 2021.

Terra Allen
NOTARY PUBLIC

My commission expires:

September 28, 2022



David Dittimore

Experience

Areas of Specialization

Approximately thirty-years experience in evaluating and preparing regulatory analysis, including revenue requirements, mergers and acquisitions, utility accounting and finance issues and public policy aspects of utility regulation. Presented testimony on behalf of my employers and clients in natural gas, electric, telecommunication and transportation matters covering a variety of issues.

Self-Employed; **Consultant July 1 - Current**; Responsible for providing evaluation of utility ratemaking issues on behalf of clients. Prepare analysis and expert witness testimony.

Tennessee Attorney General's Office; **Financial Analyst September, 2017 – June 2021**; Responsible for evaluation of utility proposals on behalf of the Attorney General's office including water, wastewater and natural gas utility filings. Prepare analysis and expert witness testimony documenting findings and recommendations.

Kansas Gas Service; **Director Regulatory Affairs 2014 - 2017; Manager Regulatory Affairs, 2007 - 2014**

Responsible for directing the regulatory activity of Kansas Gas Service (KOS), a division of ONE Gas, serving approximately 625,000 customers throughout central and eastern Kansas. In this capacity I have formulated strategic regulatory objectives for KOS, formulated strategic legislative options for KOS and led a Kansas inter-utility task force to discuss those options, participated in ONE Gas financial planning meetings, hired and trained new employees and provided recommendations on operational procedures designed to reduce regulatory risk. Responsible for the overall management and processing of base rate cases (2012 and 2016). I also played an active role, including leading negotiations on behalf of ONE Gas in its Separation application from its former parent, ONEOK, before the Kansas Corporation Commission. I have monitored regulatory earnings, and continually determine potential ratemaking outcomes in the event of a rate case filing. I ensure that all required regulatory filings, including surcharges are submitted on a timely and accurate basis, I also am responsible for monitoring all electric utility rate filings to evaluate competitive impacts from rate design proposals.

Strategic Regulatory Solutions; 2003 -2007

Principal; Serving clients regarding revenue requirement and regulatory policy issues in the natural gas, electric and telecommunication sectors

Williams Energy Marketing and Trading; 2000-2003

Manager Regulatory Affairs; Monitored and researched a variety of state and federal electric regulatory issues. Participated in due diligence efforts in targeting investor owned electric utilities for full requirement power contracts. Researched key state and federal rules to identify potential advantages/disadvantages of entering a given market.

MCI WorldCom; 1999 - 2000

Manager, Wholesale Billing Resolution; Manage a group of professionals responsible for resolving Wholesale Billing Disputes greater than \$500K. During my tenure, completed disputes increased by over 100%, rising to \$150M per year.

Kansas Corporation Commission; 1984- 1999

Utilities Division Director - 1997 - 1999; Responsible for managing employees with the goal of providing timely, quality recommendations to the Commission covering all aspects of natural gas, telecommunications and electric utility regulation; respond to legislative inquiries as requested; sponsor expert witness testimony before the Commission on selected key regulatory issues; provide testimony before the Kansas legislature on behalf of the KCC regarding proposed utility legislation; manage a budget in excess of \$2 Million; recruit professional staff; monitor trends, current issues and new legislation in all three major industries; address personnel issues as necessary to ensure that the goals of the agency are being met; negotiate and reach agreement where possible with utility personnel on major issues pending before the Commission including mergers and acquisitions; consult with attorneys on a daily basis to ensure that Utilities Division objectives are being met.

Asst. Division Director - 1996 - 1997; Perform duties as assigned by Division Director.

Chief of Accounting 1990 - 1995; Responsible for the direct supervision of 9 employees within the accounting section; areas of responsibility included providing expert witness testimony on a variety of revenue requirement topics; hired and provided hands-on training for new employees; coordinated and managed consulting contracts on major staff projects such as merger requests and rate increase proposals;

Managing Regulatory Auditor, Senior Auditor, Regulatory Auditor 1984 - 1990; Performed audits and analysis as directed; provided expert witness testimony on numerous occasions before the KCC; trained and directed less experienced auditors on-site during regulatory reviews.

Amoco Production Company 1982 - 1984

Accountant Responsible for revenue reporting and royalty payments for natural gas liquids at several large processing plants.

Education

- B.S.B.A. (Accounting) Central Missouri State University
- Passed CPA exam; (Oklahoma certificate # 7562) - Not a license to practice

Limestone Acquisition of Cartwright Creek

Summary of Proposed Acquisition Accounting Entries
Docket No. 21-00053

Exhibit DND-2

Key Balances	Cartwright Creek December 31, 2020 Balances 1/	Limestone Proposed Acquisition Accounting Entries w/ December 31, 2021		Difference
		Balances	Post Closing 2/	
Utility Plant in Service	\$ 5,422,867	5,422,867		\$ -
Less: Accumulated Depreciation	968,952	1,880,452		911,500
Net Plant in Service	4,453,915	3,542,415		(911,500)
Contributions in Aid of Construction (CIAC)	4,903,993	4,903,993		-
Less: Accumulated Amortization - CIAC	-	2,659,271		2,659,271
Net CIAC	4,903,993	2,244,722		(2,659,271)
Calculated Rate Base	(450,078)	1,297,693		\$ 1,747,771
Increase in Rate Base due to Accounting Entry	1,747,771			

1/ Per Cartwright Creek Annual Report submitted to
TPUC

2/ Response to Consumer Advocate Request 2-7

**Limestone Acquisition of Cartwright Creek
Calculation of Gain on the Sale
Docket No. 21-00053
Based upon Data as of May 31, 2021**

Confidential

Exhibit DND-3

Acquisition Price

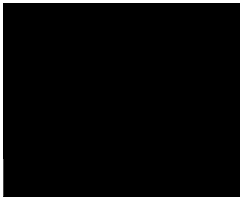
 1/

Less: Net Book Value of Assets Acquired

Plant in Service

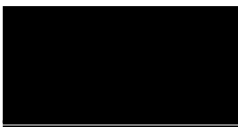
Less: Accumulated Depreciation

Net Plant in Service

 2/
2/
2/

Less: Contributions in Aid of Construction

Net Assets Acquired



Gain on the Sale

1/ Joint Petition, Confidential Exhibit 7

2/ Confidential Response of Cartwright Creek to Consumer Advocate Request 1-5.

NRRI 94-17

**STATE PUBLIC SERVICE COMMISSION DISPOSITION
OF THE GAIN ON SALE OF UTILITY ASSETS**

**David W. Wirick
Associate Director
Administration and Special Projects**

August 1994

The views and opinions expressed by the author are not necessarily those of The National Regulatory Research Institute, The National Association of Regulatory Utility Commissioners, or any particular state public utility commission.

Introduction and Background

Fairly frequently, regulated utilities dispose of assets once regarded as necessary to the provision of utility service. Examples of circumstances that might cause utilities to sell assets are:

- A utility outgrows its headquarters office space. It builds elsewhere and sells the former headquarters.
- A utility sells land previously held for future use after it determines that the land will not be necessary for utility service.
- A utility sells productive assets or office space to an unregulated subsidiary with the intention of purchasing the services from the subsidiary or entering into a lease agreement for the use of the space.
- An electric utility sells excess generating capacity to another utility and enters into an agreement with it to share that capacity.
- A telecommunications utility sells rural exchanges to another provider.
- A gas company sells a gas field and storage facility to another gas utility.

In each of these instances and others, the disposition of the gain on the sale (or, in rare circumstances, the loss) is of concern to regulatory commissions and is the subject of intense debate. The gain, which is measured as the difference between the book value of the asset (the original cost less accumulated depreciation) and its selling price, could be allocated to ratepayers, to utility shareholders, or split between the two. Particularly if the asset has been held for a long period, the gain can be substantial. In a recent California case, the after-tax gain to a utility on the sale of a headquarters building exceeded \$24 million.

State public utility commissions across the country have treated gains on the sale of utility assets differently and have utilized a wide range of arguments to support their disposition of the gain. Recently, the California Public Utilities Commission (PUC) asked the National Regulatory Research Institute (NRRI) to survey states and determine how they had treated the gain on sale of utility assets. A total of forty-nine state commissions responded to the survey (out of a total of fifty two possible--fifty states, the District of Columbia, and an extra commission in New Mexico

where jurisdiction is split between two commissions).¹ This report presents the results of that survey and summarizes the arguments used to support alternatives to the disposition of the gain.² The survey instrument and a listing of the respondents are included as appendices.

The commission policies and actions described in this report for the most part deal with what could be regarded as extraordinary gains and losses by utilities on the disposition of assets. There is less controversy over "normal retirements" of assets which have outlived their usefulness. In the case of normal retirements, accumulated depreciation is adjusted for the gain or loss and the difference is commonly passed on to ratepayers.

The Prevalence of Gain-on-Sale Issues

Gain-on-sale issues are considered by state public utility commissions with surprising frequency. As Table 1 indicates, the issue most frequently arises with electric utilities, followed by telecommunications and gas utilities.³ In part because of limited state commission jurisdiction over water utilities, only eighty-eight gain-on-sale issues were reported for water utilities. Overall, respondents to this survey question (forty-three states) indicated that their state commissions had considered nearly 600 gain-on-sale issues in the past ten years.

TABLE 1
NUMBER OF GAIN-ON-SALE CASES HANDLED BY
STATE COMMISSIONS IN THE PAST TEN YEARS
BY UTILITY SECTOR

¹ The responses to specific questions may not tally to the total because some respondents did not answer all the questions asked. The Georgia PSC responded by letter indicating gain-on-sale issues have not been significant. The Utah PSC responded by phone and indicated that three gain-on-sale issues had arisen but had been deferred to rate cases which had not yet been heard.

² Where specific state commission actions are cited, the state citation is listed if it was provided by the respondent.

³ In those cases where a state commission provided a range rather than a specific number of cases, the lower limit of the range was used.

Electricity	238
Telecommunications	145
Gas	121
Water	88

Source: 1994 NRRI Survey, Question 1

In the near future, the incidence of gain-on-sale issues is likely to increase as utilities facing competitive pressures attempt to divest themselves of unproductive assets. As utility markets are segmented into competitive and non-competitive markets, the gain-on-sale issue will likely become more difficult as utilities sell assets to their affiliates that may not be subject to rate regulation. For utilities that are not subject to rate-base, rate-of-return regulation, regulators will still need to consider gain-on-sale issues to determine if the gains are to be regarded as exogenous or endogenous variables.

State Commission Policies on Gains on Sale by Regulated Utilities

Procedurally, state public utility commissions have two choices for dealing with gain-on-sale issues. They can develop a generic policy or they can respond to gain-on-sale issues on a case-by-case basis. As Table 2 indicates, the majority of state commissions (thirty-seven of the forty-seven commissions which responded to this question) deal with gain-on-sale issues on a case-by-case basis. Those states that have established a generic policy are listed in Table 3.⁴

TABLE 2

**NUMBER OF REPORTING COMMISSIONS WITH GENERIC
GAIN-ON-SALE POLICIES AND NUMBER THAT HANDLE
GAIN-ON-SALE ISSUES ON A CASE-BY-CASE BASIS**

⁴ Though the Georgia PSC did not directly respond to this question, it provided a copy of a state statute that mandates the treatment of gains on sale for electric utilities.

Generic Policy	10
Case-by-Case Basis	37

Source: 1994 NRR Survey, Questions 2 and 4

<p>TABLE 3</p> <p>STATES WHICH HAVE ESTABLISHED A GENERIC POLICY ON THE GAIN-ON-SALE OF UTILITY ASSETS</p>	
<ul style="list-style-type: none"> ● Connecticut (electric utilities) ● Illinois ● Maine ● Tennessee ● Washington 	<ul style="list-style-type: none"> ● Georgia ● Iowa ● Massachusetts ● Virginia ● Wisconsin

Source: 1994 NRR Survey, Question 2⁵

Table 4 identifies to whom the gain is allocated by those states with generic policies--to utility shareholders, ratepayers, or a split between the two. Descriptions of several of the generic policies follow the table.

<p>TABLE 4</p> <p>ALLOCATION OF GAIN-ON-SALE BY STATES WITH GENERIC POLICIES</p>	
Allocate the Gain to Ratepayers:	CT, IL, ME, MA, TN, WI
Allocate the Gain to Shareholders:	IL, IA, WI
Split the Gain:	VA, WA

⁵ The Missouri PSC response indicated that the Commission has maintained a consistent policy over time, but that it retains the right to examine each case on its own merits.

Source: 1994 NRRI Survey, Question 3⁶

The Iowa Utilities Board's generic policy allocates the gain to shareholders by placing the gain in an account that falls "below the line" unless the Board finds good cause for allocating the gain differently.⁷ The Wisconsin Public Service Commission's (PSC) generic policy allocates the gain to shareholders if the gain was related to an operating unit and to ratepayers if it was related to a non-operating unit. (For that reason, it was included in two categories in Table 4.) Like others, the Illinois Commerce Commission's generic policy is the result of consistent decisions rather than the result of a generic proceeding on the treatment of gains on sale. The Illinois policy is to allocate the gain on the sale of a depreciable asset to ratepayers by increasing the reserve for accumulated depreciation, which, in turn, reduces the ratebase and rates. The gain on non-depreciable assets is allocated to shareholders by recording the gain as non-utility income. Though the Ohio PUC did not report having a generic policy, it did indicate that it follows the requirements of the applicable Uniform Systems of Accounts (USOAs).

The Virginia State Corporation Commission and the Washington Utilities and Transportation Commission (UTC) have generic policies that split the gain between ratepayers and shareholders. The Virginia policy splits the gain 50/50 between ratepayers and shareholders, though ratepayers have been held harmless for losses on sales between affiliates. The Washington UTC, in a recent case dealing with the sale of former utility assets, split the gain in proportion to the time assets were in the ratebase and the time they were in non-utility accounts.

The other state commissions with generic policies allocate the gain entirely to ratepayers. For those states with a generic policy of allocation of the gain exclusively to ratepayers or those states that award a portion of the gain to ratepayers, Table 5 shows how the gain specifically impacts rates--through a reduction of ratebase or an offset against revenue requirements.

⁶ The survey question also asked if the allocation of the gain was based on specific criteria enumerated in the commission policy or if the gain was retained within utility operations. Neither question was responded to by a significant number of states and can be regarded as duplicating other questions. States are listed in two categories if the gain is allocated to ratepayers under some circumstances and to shareholders under others.

⁷ The Iowa survey response also indicated that it responds on a case-by-case basis because the accounting treatment does not necessarily dictate the ratemaking treatment.

<p>TABLE 5</p> <p>ALLOCATION OF GAIN TO RATEPAYERS BY STATES WITH GENERIC POLICIES</p>	
Through Reduction of Ratebase	IL, TN, WA, WI
Through Offset Against Revenue Requirements	CT, MA, ME, TN

Source: 1994 NRRI Survey, Question 3

Both methods have the effect of reducing customer rates. A reduction of rate base decreases the amount on which the utility earns its allowed rate of return (i.e., it reduces rates by an amount equal to the gain times the allowed percentage rate of return). An offset against revenue requirements to reflect the gain directly reduces the amount of revenue the utility is allowed to collect in rates (i.e., it reduces rates by an amount equal to the gain). For those states with generic policies that allocate the gain to ratepayers, the methods applied are fairly evenly split, or a combination of the two is used (e.g., the Tennessee PSC uses either or both methods to apportion the gain to ratepayers.). The Connecticut Department of Public Utility Control, which has a generic policy for electric utilities, reported that it reduced rate year cost of service and revenue requirements for projected rate year gains on utility assets that are (or ever were) in the rate base.

As was indicated earlier, the majority of reporting state commissions handle gain-on-sale issues on a case by case basis. Table 6 identifies to whom the gain was allocated in the most recent commission action on gain on sale for those states without a generic policy.⁸ As was the case for those states with a generic policy, most states allocate the gain to ratepayers. Table 7 identifies the method used to allocate the gain to ratepayers by states without a generic policy. Though most either reduced ratebase or revenue requirements, several other methods of allocating the gain to ratepayers were employed. The Kansas Corporation Commission reported using a direct refund to customers, and the Maryland PSC amortized the gain to net income. The North Dakota PSC reported that no gain-on-sale issues had been dealt with but that a number of

⁸ Those states which deal with gain-on-sale issues on a case-by-case basis were asked how they responded in their most recent commission order. The most recent commission order may or may not be representative of all commission actions.

cases involving acquisition premiums had been encountered. An acquisition premium, the purchase of assets by a utility for a price in excess of the book value based on original cost, is the flip side of a gain on sale. The North Dakota PSC authorized the premium as an above-the-line cost to be reviewed later by comparing the cost of the premium to purchased gas adjustment reductions (PU-400-93-534). The Oklahoma Corporation Commission allocated a portion of the gain in a case to ratepayers by reducing the company's

TABLE 6 ALLOCATION OF GAIN-ON-SALE BY STATES THAT HANDLE GAIN-ON-SALE ISSUES ON A CASE-BY-CASE BASIS (MOST RECENT COMMISSION ACTION)	
Allocate the Gain to Ratepayers	AK, DC HI, ID, LA, MD, MI, MS, NY, OH, OR, RI, VT
Allocate the Gain to Shareholders	FL, KY, MO, NH, PA, SC
Split the Gain	AZ, CO, KS, NM(PSC), NC, ND, OK, SD, TX

Source: 1994 NRRI Survey, Question 5⁹

TABLE 7 ALLOCATION OF GAIN TO RATEPAYERS BY STATES THAT HANDLE GAIN-ON-SALE ISSUES ON A CASE-BY-CASE BASIS (MOST RECENT COMMISSION ACTION)	
Through Reduction of Ratebase	DC, HI, MD, NC, OH, SD, VT
Through Offset Against Revenue Requirements	AK, HI, ID, LA, MI, MS, NY, OH, OR, RI, SD

⁹ A fourth alternative, "Retain the gain within utility operations," was included in the survey instrument. Few states responded to that alternative, which was unclear and duplicated the other options. As a result, the responses to that alternative have not been included in this summary report. Some respondents, who had split the gain, treated the three options as not being mutually exclusive and, as a result, checked all three options. For the sake of simplicity, their responses have been listed in the "Split the Gain" category only. The Texas PUC provided an oral response by phone.

Other	AZ, KS, MD, ND
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Source: 1994 NRRI Survey, Question 5¹⁰

revenue deficiency over two years. The remainder of the gain was granted to shareholders (Cause #29562, 12-20-85).

Two state commissions reported that they allowed the utility to retain the gain in return for investments in service or plant upgrades. The Montana PSC allowed the utility to retain the gain in return for an investment of a similar amount over three years in an expanded service program. The Wyoming PSC made retention of the gain conditional on investment of an equal amount in plant upgrades.

Table 8 and Table 9 combine the states with generic policies and those which deal with gain-on-sale issues on a case-by-case basis. As Table 8 indicates, of the three options, state public utility commissions allocated the gain exclusively to ratepayers most

TABLE 8 ALLOCATION OF GAIN-ON-SALE ALL REPORTING STATES	
Allocate the Gain to Ratepayers	19
Allocate the Gain to Shareholders	9
Split the Gain	11

Source: 1994 NRRI Survey, Questions 3 and 5

TABLE 9 ALLOCATION OF GAIN-ON-SALE TO RATEPAYERS ALL REPORTING STATES	
Through Reduction of Ratebase	11

¹⁰ This table includes the responses of those states which split the gain as well as those which allocate the gain exclusively to ratepayers where enough information was provided to determine the method used to allocation the portion of the gain to ratepayers.

Through Offset Against Revenue Requirements	14
Other	4

Source: 1994 NRRI Survey, Questions 3 and 5

often. However, in slightly over half of the responses, shareholders were provided with at least a part of the gain. Table 9 shows that, of the states that allocate the gain to ratepayers, slightly more do so through an offset to revenue requirements rather than through a reduction of the ratebase.

Rationale for Disposition of Gain on Sale

Table 10 lists a number of potential rationales for allocation of the gain on sale of a utility asset and identifies those states that indicated that the specific rationale influenced the development of the commission's generic policy or the commission's case-by-case decisions.¹¹

TABLE 10 RATIONALE INFLUENCING COMMISSION ACTION	
a. Gains accrue to ratepayers for property in ratebase?	AK, CA, CT, DE, FL, HI, ID, KS, LA, ME, MD, MA, MI, MN, MS, MT, NE, NV, NH, NY, NC, OH, OK, OR, RI, SC, SD, TN, VT, WA
b. Different treatment of depreciable and non-depreciable assets?	DE, ID, IL, KS, KY, OK, MA, MS, MO, NH, NY, TN, VT
c. The obligation of the utility to provide on-going service (enduring enterprise principle)?	DE, HI, ID, KS, OK, NE, PA, SC, SD, WA, WY
d. Constraints embedded in a Uniform System of Accounts?	AK, DE, HI, IL, MD, MA, MI, MN, MS, NH, NY, OH, SC, TN, VT, WA, WI

¹¹ A positive response for any of the rationales should not be taken to mean that that rationale has influenced every commission decision on gain-on-sale issues.

e.	Intergenerational equity?	DE, KS, LA, ME, MD, MS, ND, OK, OR, SC, VT, WA
f.	Allocation/symmetry of risk?	AZ, CA, CO, DE, KS, LA, ME, MA, MN, MS, MT, NY, NC, ND, OK, OR, PA, SD, TN, WA
g.	The specific nature of the sale?	AZ, DE, MI, MO, ND, OR, PA, WA, WY
h.	Judicial or commission precedent?	AK, AZ, CA, CT, DE, FL, ID, IL, IA, KS, KY, MA, MI, MN, MT, NH, NY, ND, OK, PA, RI, TN, VT, VA, WA, WI
i.	Utility opportunity cost?	CA, DE, FL, ID, MO, MT, NH, NY, PA, WI
j.	Ownership interest (or lack thereof) by ratepayers in utility property?	AZ, CA, DE, ID, IL, MD, MI, MN, MO, MT, NH, NY, OK, OR, PA, SC, VA, WA, WI
k.	Level of need for investment in infrastructure improvements?	AZ, DE, KS, MI, MS, MT, NE, NH, OK, PA, SD, WA, WY
l.	Provision of incentives to company to invest wisely and sell at the financially appropriate time?	CA, DE, MI, MS, OK, OR, PA, VT, VA, WA
m.	Prudence of the utility investment and timing of the sale?	AZ, CA, FL, LA, MI, NH, NY, OK, OR, PA, SD, VT, WA

Source: 1994 NRRI Survey, Question 6

The rationale most frequently cited (thirty respondents) was "a," that gains should accrue to ratepayers for property included in the ratebase, though in at least one case (Pennsylvania), it was noted that the issue is still unresolved. As was noted earlier, the Washington Utilities and Transportation Commission allocated a gain in proportion to the time that the property that generated the gain was in ratebase. Similarly, the District of Columbia PSC noted in its response to the survey that it "has dealt with gains on the sale of property in rate base differently that it has dealt with gains on the sale of property that has been removed from rate base" and that "if ratepayers contribute to the cost...they should share in any profits..."

The Florida PSC's Digest of Regulatory Philosophies states that "Gains or losses on the sale of utility property or property that was formerly utility property should be amortized above the line over five years and should be considered in determining net operating income." The

Michigan PSC response to this survey stated that if assets were ever in the ratebase, the gain accrues to ratepayers. In a 1982 rate case (Boston Gas Company, D.P.U. 1100), the Massachusetts Department of Public Utilities stated that:

The Company and its shareholders have received a return on the use of these parcels while they have been included in rate base, and are not entitled to any additional return as a result of their sale. To hold otherwise would be to find that a regulated utility company may speculate in...utility property and, despite earning a reasonable rate of return from its customers on that property, may also accumulate a windfall through its sale.

The second most frequently cited rationale was commission or judicial precedent. Over half (twenty-six) respondents cited those precedents as having influenced development of commission policy on the disposition of gains on sale of utility assets.

The third most frequently cited rationale (twenty respondents) influencing commission decisions in gain-on-sale issues was the symmetry of risk (i.e., does the utility benefit from gains due to its own risk or do ratepayers benefit from gains because they have protected investors from the normal risks of owning property? Was the gain apportioned based on risk and incentive analysis?) Several commissions cited the Democratic Central Committee of the District of Columbia v. Washington Metropolitan Area Transit Commission (485 F. 2d 786 (D.C. Cir. 1973)) in support of the symmetry of risk argument. With regard to the allocation of risk, Commissioner Frederick Duda of the California PUC stated in a 1990 concurring opinion (A.87-07-041, D.90-11-031):

Ratepayers rightfully benefit because they bore most of the risk associated with the Flower Street headquarters. As the decision notes, ratepayers paid all operations and maintenance expenses, depreciation, and taxes associated with the headquarters property while it was in rate base, provided a fair return on the capital invested in the headquarters, and bore the risk the headquarters would be prematurely retired and that they would nonetheless have to pay depreciation and a return on the buildings until they were fully depreciated.

Shareholders, he continued, bore only the risk that the "value of the land component of the headquarters property would decrease in value between the date it was purchased and the date it was sold."

A Colorado PUC decision (No. C94-206) cited the Commission's opinion in that case that

"the Commission remains unconvinced that the Company has carried all the risk of its investments..." And the Delaware response to this survey cited a Federal Communications Commission order (Docket No. 20188, 11-6-1980):

...Thus, the ratepayers bear the risk both in terms of the return they pay the investors for the use of their capital and in the reimbursement of the investors for the decline in value (depreciation) of the assets used to provide service...Thus when such a piece of property is retired and disposed of and a gain results, the equities of the situation would suggest that the ratepayer should receive the benefit of that gain.

A 1991 letter (quoted in #93-06946) from the Tennessee PSC's Deputy Director of the Utility Rate Division to a utility president said that, "...It is a well established principle, adopted by the Courts and this Commission, that gains as the result of the removal of utility assets from regulated service go to the interest of those who bore the risk over the regulated life of the assets."

Of course, the symmetry of risk argument does not always lead to the conclusion that all gains must be allocated to ratepayers. The North Carolina PUC concluded in a water and sewer case (Docket No. W-354) that, "The Commission...is not persuaded that the entire risks associated with the utility is assumed by either CWS (the utility) or its ratepayers."

Nineteen commissions cited their consideration of the issue of ownership interest (or lack thereof) by ratepayers in utility property. The preponderance of the case materials submitted with the survey responses indicated that state commissions generally conform to the doctrine that ratepayers pay for the use of assets but not the assets themselves.

The fifth most frequently cited argument (seventeen respondents) was the impact of constraints embedded in a Uniform System of Accounts (USOA) on allocation of the gain on sale (i.e., Does the required accounting treatment of gains under the Federal Energy Regulatory Commission (FERC) or Federal Communications Commission (FCC) USOAs or other systems affect the commission finding?). In a case before the New Hampshire Supreme Court (No. 80-384), that court affirmed the ability of the New Hampshire PUC to apply accounting rules for the disposition of gains on sale.

The FERC and FCC systems of accounts have been adopted by most states. The FERC and the FCC systems differ, however, on the allocation of the gain on sale. The general FERC

policy, which is subject to deviation in some circumstances, allocates the gain on sale to shareholders. The FCC general policy allocates the gain on the sale of land to ratepayers if the land was in the ratebase. The water and sewer USOAs, promulgated by NARUC, also allocate the gains on land sales to ratepayers. Though the required accounting treatment is often used as a guide, it does not, as the Iowa response to this survey points out, mandate ratemaking treatment.

The Iowa Utilities Board attempted to avoid inconsistent treatment of gains and losses by promulgating an administrative rule (#16.2(10)) that prescribes the accounting for gains and losses. As was noted earlier, Iowa administrative rule (199-16.2(9)) also allocates the gain to the shareholder unless the Board can show good cause for an exception.

Another rationale, which was cited by thirteen commissions, for the disposition of gains on sale was the difference between depreciable and non-depreciable property. As was stated by the Missouri PSC (Case Nos. EO-85-185 and EO-85-224), "The argument for passing through the profit to the ratepayer is less persuasive in the case of nondepreciable property, since the shareholder has not received a multiple recovery of the investment through depreciation and again through the sale of the property." The Illinois CC also treats depreciable and non-depreciable property differently. The gain on depreciable property is recorded as a credit to accumulated depreciation, and ratepayers receive the benefit of the gain. For non-depreciable property (land), the gain is recorded as a credit to non-utility income and shareholders receive the benefit of the gain. The Arizona CC response indicated that ratepayers are entitled to a portion of the gain if depreciation expense had been included in rates.

Several commissions cited the use of rationales related to the specifics of the sale, the benefit to ratepayers, the need for investments in infrastructure, and the provisions of incentives to utilities to buy and sell property wisely. In an Arizona case (Docket #U-1345-90-269), in rendering its decision the Commission considered the system reliability after the sale of assets. The North Carolina PUC response cited the fact that it had allowed water and sewer utilities to retain fifty percent of the gain on sale as an incentive to sell systems to municipalities. The Iowa Utilities Board considered allocating gains such that utilities would not have the incentive to place excess capacity on the market with the expectation that ratepayers would pick up any loss (Docket No. RPU-83-22).

In a Montana PSC declaratory ruling, the utility agreed to reinvest the amount of an after-tax gain in a utility program and to reduce rates. The Wyoming PSC ordered a utility to reinvest

an after-tax gain in facility upgrades (Docket No. 70000-TA-93-150 et al.). The Colorado PUC traded the gain on the sale of an asset for other regulatory concessions.

For the other rationales cited in Table 10, no specific documentation was identified.

Summary

It is obvious from a review of the responses to the NRRI survey that gains on sale of utility property are treated in a wide variety of ways. Overall, however, it can be inferred from the survey responses that:

- gain-on-sale issues arise with some frequency at state regulatory commissions;
- the majority of states deal with those issues on a case-by-case basis;
- the gain is more often than not allocated to ratepayers, though shareholders are allocated some portion of the gain in about half of the commission responses;
- for allocating a gain to ratepayers, offsetting revenue requirements was the method employed slightly more frequently than reducing the ratebase;
- and that the prior ratebase treatment of the asset is the most important consideration used by state commissions to allocate the gain, although other rationales are also employed.

1984 WL 1028458 (Tenn.P.S.C.), 63 P.U.R.4th 524

Re Kingsport Power Company
Intervenor: Kingsport Power Users Association

No. U-84-7308

Tennessee Public Service Commission

November 15, 1984

Before Bissell, chairman, and Cochran, commissioner.

By the COMMISSION:

Order

This matter is before the Tennessee Public Service Commission upon the filing of a petition by Kingsport Power Company on May 15, 1984, requesting a rate increase of \$2,044,592.

This docket was set for hearing and was heard by Chairman Keith Bissell and Commissioner Jane G. Eskind at the National Guard Armory, West Stone Drive, Kingsport, Tennessee, on October 13, 1984.

The following appearances were entered at the hearing: Thomas Arthur Scott, Jr., Kingsport, Kevin F. Duffy, Columbus, Ohio, both appearing on behalf of the petitioner, Kingsport Power Company; Bruce Shine, Kingsport, appearing on behalf of intervenor, Kingsport Power Users Association; Henry Walker, Nashville, appearing on behalf of the commission's staff.

I. Statement of Facts

Kingsport Power Company, a wholly owned subsidiary of American Electric Power Company (AEP), serves approximately 35,000 customers living in a 220 square mile area in the counties of Sullivan, Hawkins, and Washington, Tennessee, and including the city of Kingsport and the town of Mount Carmel. Kingsport Power Company has no poweroperating facilities of its own and merely distributes electric power which it purchases from Appalachian Power Company (APCO), another subsidiary of AEP whose wholesale rates are regulated by the Federal Energy Regulatory Commission (FERC).

In its petition, Kingsport Power Company requested a revenue increase of 3.7 per cent or \$2,044,592 to offset increased operating expense and to provide the company with an adequate return on its investment. The proposed tariffs as filed with the petition allocates substantially all of the increase to the residential and small commercial customers of Kingsport Power Company.

Prefiled testimony on behalf of the petitioner was entered by John E. Faust, president of Kingsport Power Company; Bruce Barber, vice president, finance, American Electric Power Service Corporation, New York, New York; Clifford M. LaGraw, supervisor of regulatory and statistics section, Roanoke, Virginia; John Soper, consultant with the utility regulatory and advisory services group of Coopers and Lybrand; Dennis W. Bethel, senior rate analyst with the American Electric Power Service Corporation (AEPSC), a wholly owned subsidiary of American Electric Power Company, and Louis R. Jahn, manager-rate research and rate design, division of American Electric Power Service Corporation.

The staff presented prefiled testimony through its witnesses Athan Gibbs, David Hood, Hal Novak, and Archie Hickerson.

At the outset of the hearing, company president John Faust testified that the company was willing to accept the staff's accounting adjustments in the areas of rate base, revenues, and expenses and the company was willing to accept a return on rate base of 13.37 per cent (16 per cent on equity), which is within the range recommended by the staff. Mr. Faust pointed out that the return was lower than the 13.52 per cent return that the commission awarded in the last rate case, two years prior. A

return of 13.37 per cent would require a rate increase of \$1,086,203.

In light of the fact that the company accepted the adjustments as set forth by the staff the company did not offer any additional witnesses but did ask that all of the company's witnesses' prefiled testimony and exhibits be entered into the record as if read.

Staff witness Hickerson summarized the adjustments the staff made to the rate case as filed by the company. He stated that as a result of the investigation the staff recommend that the commission adopt a rate base of \$27,291,925 and a level of operating revenues and expenses that produce a net operating income of \$3,085,408. Mr. Hickerson went further to recommend that the company be allowed to earn 15.75 per cent on its common equity, resulting in a rate increase of \$1,038,859.

The commission's statutory duty in this proceeding is to determine just and reasonable rates of the company as provided by TCA Par 65-5-203. It shall be the duty of the commission to approve any such proposed increase in rates upon being satisfied after full hearing that the same is just and reasonable. The traditional approach utilized by this commission has been to examine the evidence presented and discuss the issues that evolve during the course of the hearing. These issues normally include the *selection of a test period* and the determination of the proper amounts of *revenues, expenses, and rate base* which are projected during the test period. The commission must also decide upon the fair rate of return which the company will be allowed to earn on its investment.

ii. Findings

A. Test Period

'Test period' is a term peculiar to regulation. It refers to a period of time, usually twelve months, during which the commission examines a company's revenues and expenses under existing rates and calculates the company's rate of return on its investment in rate base during that period.

There are generally two types of test periods that are accepted in rate-making proceeding: historical and forecast. Regardless of the approach used, the ultimate goal of a test period is to approximate the interrelationship between revenues, expenses, net operating income, and rate base which can be expected to exist during the initial period the new rates will be in effect.

In the present case, both the company and the staff adopted the 12-month period ended December 31, 1983, adjusted for known and anticipated changes through December, 1985. It is our opinion that this period is appropriate for evaluating the company's rates and we therefore also adopt it for this case.

B. Revenues and Expenses

The major adjustment proposed by the staff to operating revenues and expenses as presented by the company was for additional revenues and expenses related to the projected increase of electricity for the adjusted test year. These adjustments were summarized by Mr. Hickerson in his direct testimony at the hearing. Mr. Hickerson stated that the staff increased revenues by \$6,821,730, which was primarily to reflect additional sales to industrial and large commercial customers. He stated that the adjustment was made after contacting these customers and that the staff had discussed their projection of purchases for 1985 with Kingsport Power. Mr. Hickerson also stated that corresponding adjustments were made to reflect the increase in purchased power costs and the additional investment needed to serve these customers.

In summarizing the staff's adjustments, Mr. Hickerson pointed out that the staff increased other expenses and taxes by \$601,628. He pointed out that \$215,000 of this amount resulted from including the projected cost of an additional overhead line maintenance crew and a tree trimming crew. Mr. Hickerson further stated that an additional \$37,741 was included to reflect additional salaries and wages for the adjusted test year.

The staff also increased other operating taxes by \$300,917. Of this amount, \$253,910 was allocated for gross receipt taxes that the company will incur during 1985. In addition, Mr. Hickerson stated that the staff made an adjustment to reduce federal income tax by \$506,118. Approximately \$480,000 of this amount resulted from the staff's excluding the amortization of federal income tax on unbilled revenue as of December 31, 1983.¹

It is our opinion that the level of revenue and expenses developed by the staff and adopted by the company as shown on the following page, is approximate for evaluating the company's revenue requirement for 1985.

C. Rate Base

The company submitted a proposed rate base of \$27,078,606, while the staff proposed a rate base of \$27,291,925. The reason for the difference is the fact that the staff included additional projected electric plant that will be needed to serve certain customers during 1985. The projected additional revenue from these customers was also included by the staff. The staff also made an adjustment to increase the company's working capital by \$292,206. Additional adjustments were made to increase the company's accumulated deferred federal income tax and to include as a deduction the deferred gain related to the sale of the company's service building.

We have considered all of the adjustments made by the staff to the rate base as presented by the company, together with the fact that the company has adopted the rate base as adjusted by the staff. We find that the rate base of \$27,291,925 as developed by the staff and as shown on the following page, is approximate and should be used in evaluating the company's future revenue requirements.

KINGSPORT POWER COMPANY

INCOME STATEMENT FOR THE TWELVE MONTHS ENDED DECEMBER 31, 1983, AS ADJUSTED

Company		Adjustments	Staff
Operating Revenues:			
Sales of Electricity.....	\$54,705,538	\$6,821,730	\$61,527,268
Other	203,361	0	203,361
Total Operating Revenues.....	\$54,908,899	\$6,821,730	\$61,730,629
Operating Expenses:			
Purchase Power.....	\$43,226,672	\$6,297,420	\$49,524,092

Operation and Maintenance.....	4,620,180	259,228	4,879,408
Depreciation.....	1,258,815	8,629	1,267,444
Taxes Other Than FIT and Tn Excise	2,340,898	300,917	2,641,815
Tennessee Excise Tax.....	0	32,854	32,854
Federal Income Tax--Current	630,184	-606,762	23,422
--Def. FIT.....	54,622	109,850	164,472
--Def. ITC	142,000	-9,274	132,726
Total Federal Income Tax	\$826,806	-506,185	\$320,621
Total Operating Expenses	\$52,273,371	\$6,392,862	\$58,666,233
Operating Income.....	\$2,635,528	\$428,868	\$3,064,396
Contributions (net of taxes)	-5,607		-5,607
AFUDC	41,717		41,717
Interest on Customer Deposits.....	-15,098		-15,098
Adjusted Operating Income.....	\$2,656,540	\$428,868	\$3,085,408

KINGSPORT POWER COMPANY

AVERAGE RATE BASE FOR THE TWELVE MONTHS ENDED DECEMBER 31, 1983, AS ADJUSTED

Company		Adjustment	Staff
Additions:			
Electric Plant in Service.....	\$39,818,673	\$257,719	\$40,076,392
Completed Const. not Class	297,827		297,827
Construction Work in Progress	560,564		560,564
Plant Held for Future Use	24,193		24,193
Working Capital Requirement.....	510,246	292,206	802,452
Total Additions	\$41,211,503	\$549,925	\$41,761,428
Deductions:			
Accumulated Depreciation	\$11,780,676	\$4,315	\$11,784,991
Customer Deposits.....	468,601		468,601
Contributions in Aid of Const	497,199		497,199
Customer Advances for Const.....	517,382		517,382
Accum. Deferred FIT	61,620	74,304	135,924

Accum. Deferred ITC.....	807,419		807,419
Accum. Deferred Gain	0	257,987	257,987
Total Deductions.....	\$14,132,897	\$336,606	\$14,469,503
Average Rate Base	\$27,078,606	\$213,319	\$27,291,925

D. Depreciation Rates

The company presented through its witness, John S. Soper, a depreciation study of its electric plant in service as of December 31, 1983. The purpose of the study was to review and recommend appropriate annual depreciation accrual rates for the company to use in computing annual book depreciation. Both the staff and the company adopted the proposed rates as a basis for revenue requirement and incorporated such rates in the company's cost of service. The commission finds that such rates are appropriate and approves the company's use of such rates in keeping its books. Said revised depreciation accrual rates shall be made effective on the first day of the month following the date of this order.

E. Rate of Return and Rate Design

Having determined the appropriate rate base, expense and revenue levels for the test period, we will now consider what rate of return the company should earn on its investment. The supreme court of Tennessee has directed that the company must be given a reasonable opportunity to earn in return [sic] that is within the 'range of reasonableness' in light of evidence in the record and the commission's independent evaluation of the current economic climate. [CF Industries v Tennessee Pub. Service Commission \(Tenn Sup 1980\) 599 SW2d 536](#).

The determination of a rate of return within a 'zone of reasonableness' is a highly subjective decision and among the most difficult of this commission's regulatory responsibilities. Highly qualified expert witnesses studying the same data often reach radically different conclusions as to a utility's cost of capital. It is our duty, however, not simply to choose one expert's opinion or another but to examine the foundations of that opinion, apply our own expertise and judgment, and arrive at a cost of capital which balances the needs of the commission [sic] and its investors with the public interest. See Re [Area Rate Proceeding for Permian Basin \(1968\) 390 US 747, 791, 75 PUR3d 257, 20 L Ed 2d 312, 88 S Ct 1344](#).

In this case, company president John Faust stated at the outset of the hearing that the company would be willing to accept in this case a return on equity of 16 per cent even through [sic] the company's expert witness had recommended a return of 17 per cent. Mr. Faust also asked that the resulting rate increase be imposed primarily on residential users in accordance with the company's cost-of-service studies which indicated that those customers are presently subsidized, to varying degrees, by industrial and commercial customers. Staff witness Hickerson recommended a return on equity of 15.75 per cent based on the same capital structure used by the company (38 per cent equity and 62 per cent debt). Mr. Hickerson also stated that a return of 16 per cent would be within his recommended range and a 'fair' result in this case. Mr. Hickerson offered no testimony on rate design. Arthur Smith, testifying on behalf of Kingsport Power Users Association, said that the association recommended that the commission award the company a 16 per cent return on equity as long as the resulting rate increases were spread evenly across all customer classes. Mr. Smith also pointed to a number of questionable assumptions underlying the company's cost-of-service study and recommended that the commission, at the time of the company's next rate filing, hire an independent consultant to conduct a new such study specifically applicable to Tennessee ratepayers. The staff, in its

posthearing brief, recommended in light of the testimony of Mr. Faust, Mr. Hickerson, and Mr. Smith that the commission adopt Mr. Smith's proposed compromise on the issues of rate-of-return and rate design which would result in a revenue award of \$1,086,203.

It is apparent from the testimony and briefs that all parties to this case have reached substantial agreement on these two issues. This agreement is not binding on the commission, however, which must make an independent determination of whether or not a 16 per cent return on equity is fair and reasonable. After examining the testimony of witnesses Hickerson and Barber, the commission finds that a return of 15.75 per cent is more consistent with the earnings of comparable utility companies and a more accurate estimation of the cost of equity capital during the coming year than 16 per cent. The determination of a fair return is hardly an exact science and Mr. Hickerson candidly admitted that a 16 per cent return is a 'fair' result since it falls within the upper limit of his own recommended range. We see no reason, however, to depart from his recommended return of 15.75 per cent merely because the company and intervenors are willing to agree to a 16 per cent return. If 16 per cent is within the 'range of reasonableness,' a return of 15.75 per cent, or 25 basis points less, is not beyond that range. We therefore adopt Mr. Hickerson's recommendation on the cost of equity which results in a revenue award of \$1,038,859.

On the issue of rate design, we agree with Mr. Smith that the company's cost-of-service study--which was not based on actual operations in Tennessee-- is based on several questionable assumptions concerning the allocation of plant costs. While the commission has stated in the past that we will move toward the implementation cost-based rates, we must be assured that those costs are properly allocated among customer classes. We will therefore adopt Mr. Smith's recommendation that, until these questions can be settled by an independent investigation of the company's costs in Tennessee, we direct that the rate increase awarded in this case be spread evenly among the various tariffed groups. We agree and adopt, however, the other tariff changes which were recommended by the company and not opposed by any party.

The company has filed with the commission revised rates consistent with this order. The commission staff has reviewed these tariffs and recommends that we approve them. We therefore will accept the company's tariffs for filing, for service rendered on and after the date of this order.

Footnotes

- 1 In its filing, the company requested a provision for the tax effect of the test-year balance of unbilled revenue to be collected over a three-year period. The company included this adjustment because the Internal Revenue Service (IRS) has established a strong position to include unbilled revenue in taxable income and the company's ratepayers have received the benefits associated with the exclusion from taxable income of unbilled revenue since 1974. The staff has rejected this adjustment on the grounds that resolution of these disallowances by the IRS may not occur for at least three to five years and because it is merely a proposed revenue agent's adjustment. This commission agrees with the staff's elimination of this adjustment at this time. However, this commission recognizes that the company's ratepayers have enjoyed the rate-making benefit of the exclusion from taxable income of unbilled revenue and will consider such an adjustment if this issue is resolved in favor of the IRS position.

1994 WL 610165 (Tenn.P.S.C.)

Re A+ Communications, Inc.

Docket No. 92-1398

Tennessee Public Service Commission

May 18, 1994

ORDER ON REMAND

This matter is before the Tennessee Public Service Commission upon (A) the Petition of Bell South Telecommunications, Inc. d/b/a South Central Bell Telephone Company ('Bell') to withdraw its tariff for paging services within the State of Tennessee and transfer its assets and authority to provide paging services within the State of Tennessee to A+ Communications, Inc. ('A+') and (B) the application of A+ to acquire Bell's assets and landline authority to provide paging services in Tennessee. This matter was set for hearing and heard on April 20, 1994, before Ralph B. Christian, II, Administrative Judge. On May 6, 1994 the Administrative Judge issued his Initial Order recommending that the application for transfer of Bell's landline paging authority be approved and that Bell's petition to withdraw its tariffs for paging services be granted. No exceptions to the Initial Order were filed.

The Commission considered this matter at the Commission Conference held on May 18, 1994. It was concluded after careful consideration of the entire record, including the Administrative Judge's Initial Order and all applicable laws and statutes, that the Administrative Judge's Initial Order should be approved and the authority should be transferred. The Commission further ratifies and adopts the findings and conclusions of the Administrative Judge as its own. IT IS THEREFORE ORDERED:

1. The transfer of Bell's paging assets and operating authority within every area in the State of Tennessee in which Bell currently has general landline local exchange telephone service authority to A+ shall be, and it is here, approved;
2. The terms and conditions of this transfer as set forth in an Asset Purchase Agreement entered into by Bell and A+ on June 15, 1992, and subsequently amended, on November 16, 1992, and, on August 20, 1993, are hereby approved;
3. Upon consummation of such transfer, Bell shall be allowed to withdraw its one-way paging tariffs; cease providing paging service in Tennessee; and shall thereafter have no certificated authority to provide paging services pursuant to its general landline local exchange telephone service authority anywhere within the State of Tennessee. This sale and transfer shall not impair, alter, affect or modify South Central Bell's rights and authority to offer existing or future telecommunications services in local exchanges throughout Tennessee except for one-way paging services;
4. Upon consummation of the transfer, Bell shall account for the sale by recognizing a gain on the sale in accordance with Uniform System of Accounts (USOA) Part 32 accounting requirements. This gain shall be recognized in the intrastate regulated results via an amortization of the gain over a period of five years beginning on January 1, 1994, and therefore, be included in results in setting rates;
5. Upon consummation of such transfer, A+ shall thereafter have the authority to erect and operate transmitters emitting one-way radio paging signals and to provide paging services in every area within the State of Tennessee in which Bell is currently authorized to serve as a general landline local exchange telephone service provider;
6. A+ shall file tariffs with the Commission for all service areas in which it proposes to provide paging services;
7. Any party aggrieved with the Commission's decision in this matter may file a Petition for Reconsideration with the Commission within ten (10) days from and after the date of this Order; and
8. Any party aggrieved with the Commission's decision in this matter has the right of judicial review by filing a Petition for Review in the Tennessee Court of Appeals, Middle Section, within sixty (60) days from and after the date of this Order.

ATTEST:

Paul Allen EXECUTIVE DIRECTOR

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CARTWRIGHT CREEK REGULATORY OBLIGATIONS

Docket No. 09-00056 (Order dated 03/02/10)

- Cartwright Creek authorized to increase tap fees from \$2,750 to \$5,000.
- Tap fees to be booked as revenue for regulatory purposes.
- Tap fees to be deposited into an escrow account
- Cartwright Creek must seek Commission pre-approval before funds can be disbursed from the escrow account.
- Cartwright Creek ordered to perform a feasibility study concerning changing to volumetric billing (study to be completed by 06/14/10).
- Per approved stipulation with the Consumer Advocate, Cartwright Creek to establish and implement a budget re-payment plan for past-due customer bills, and a process to permit waiver of fees associated with late payment.

Docket No. 09-00173 (Order dated 12/15/09)

- Cartwright Creek ordered to defer for consideration in a future proceeding revenues and expenses related to the Waterbridge residential community.
- Cartwright Creek ordered to file petition for approval of rates before commencing service to Waterbridge customers.

Docket No. 16-00127 (Order dated 01/10/17)

- Cartwright Creek authorized to implement Capital Improvement Surcharge of \$7.50/month for 36 months to fund future utility infrastructure improvements.

Docket No. 19-00034 (Order dated 08/19/19)

- Cartwright Creek authorized to increase tap fee from \$5,000 to \$10,000.
- Tap fees no longer to be treated as revenue for regulatory purposes; instead, tap fees to be recorded as CIAC. Existing escrow balance to be reclassified as CIAC.
- Tap fees to be recorded in escrow account established in Docket No. 09-00056 and disbursed for wastewater system repairs, rehabilitations, and upgrades after prior approval by the Commission.

Docket No. 19-00049 (Order dated 08/25/20)

- Cartwright Creek's request for disbursement from tap fee escrow account granted in part and denied in part.
- Authorized disbursement of \$223,589.53 to Insituform Technologies even though work was performed and funds disbursed without obtaining prior Commission approval.
- Note: Verbiage in the order indicates the Capital Improvements Surcharge expired at the end of December 2019 but was re-authorized during a June 15, 2020, Commission conference.

- Commission Staff directed to examine escrow account deposits, disbursements, and balances and file a report in the docket.

Docket No. 19-00097 (Order dated 08/25/20)

- Per approved stipulation and agreement with the Consumer Advocate, Cartwright Creek authorized to continue the Capital Improvements Surcharge (originally authorized in Docket No. 16-00127) for additional 36-month period. Upon expiration of that period, the surcharge automatically will terminate.
- Funds collected will continue to be deposited in an escrow account and all disbursements are subject to prior Commission approval.
- The Commission approved an “exigent circumstances” exception to prior approval requirement.
- Before the end of the 10th business day following the expiration of each calendar quarter, Cartwright Creek required to file a report on the escrow account balance, all related bank statements, and records regarding any disbursements.
- Stipulation obligates Cartwright Creek to adopt overspending protections previously approved by the Commission in Docket No. 16-00096.

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of

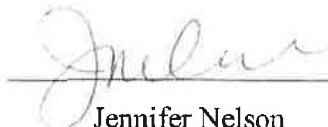
Electronic Application of Bluegrass)
Water Utility Operating Company, LLC)
for an Adjustment of Rates and Approval)
of Construction)
)

Case No. 2020-00290

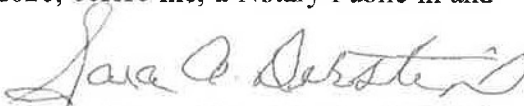
Direct Testimony of Jennifer Nelson

COMMONWEALTH OF MASSACHUSETTS
COUNTY OF WORCESTER

I, Jennifer Nelson, being duly sworn, state that the attached is my Direct Testimony in the above styled matter, that I would respond in the same manner to the questions if so asked upon taking the stand, and that my testimony is true and correct to the best of my knowledge, information, and belief formed after reasonable inquiry.


 Jennifer Nelson

Subscribed and sworn to this 28th day of September 2020, before me, a Notary Public in and before said County and State.



Notary Public

(SEAL)

My Commission Expires:



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I. WITNESS IDENTIFICATION AND QUALIFICATIONS

1 **Q. Please state your name, affiliation, and business address.**

2 A. My name is Jennifer E. Nelson. I am a Director at ScottMadden, Inc. My business address
3 is 1900 West Park Drive, Suite 250, Westborough, Massachusetts, 01581.

4 **Q. On whose behalf are you submitting this testimony?**

5 A. I am submitting this direct testimony (“Direct Testimony”) before the Public Service
6 Commission of Kentucky (“Commission”) on behalf of Bluegrass Water Utility Operating
7 Company, LLC (“Bluegrass Water” or the “Company”).

8 **Q. Please describe your educational background.**

9 A. I hold a Bachelor’s degree in Business Economics from Bentley College (now Bentley
10 University) and a Master’s degree in Resource and Applied Economics from the University
11 of Alaska.

12 **Q. Please describe your experience in the energy and utility industries.**

13 A. I have worked in the energy industry for over ten years, having served as a consultant and
14 energy/regulatory economist for state government agencies. Since 2013, I have provided
15 consulting services to utility and regulated energy clients on a range of financial and
16 economic issues including rate case support (*e.g.*, cost of capital and integrated resource
17 planning) and policy and strategy issues (*e.g.*, alternative ratemaking and natural gas
18 distribution expansion). Prior to consulting, I was a staff economist at the Massachusetts
19 Department of Public Utilities, where I worked on regulatory filings related to energy
20 efficiency, renewable power contracts, smart grid and electric grid modernization, and

1 retail choice. A summary of my professional and educational background, including a list
2 of my testimony filed before regulatory commissions, is included as Attachment A to my
3 Direct Testimony.

4 **Q. Have you previously testified before the Commission?**

5 A. No, I have not. However, I have previously filed testimony before the Arkansas Public
6 Service Commission, the Maine Public Utilities Commission, and the New Mexico Public
7 Regulation Commission. I have also provided live testimony before the Alaska State
8 Legislature in my role as a petroleum economist for the State of Alaska. During my time
9 as a consultant, I have supported the development of expert witness testimony and analyses
10 regarding the Return on Equity and capital structure in more than 100 proceedings filed
11 before numerous U.S. state regulatory commissions and the Federal Energy Regulatory
12 Commission.

13 **Q. What is the purpose of your Direct Testimony?**

14 A. The purpose of my Direct Testimony is to present evidence and provide the Commission
15 with a recommendation regarding the appropriate capital structure and cost of long-term
16 debt to be used for ratemaking purposes for Bluegrass Water in this proceeding. My
17 analyses and conclusions are supported by the data presented in Exhibit JEN-1 through
18 Exhibit JEN-3, which have been prepared by me or under my direction.

Q. What are your conclusions regarding the appropriate ratemaking capital structure and cost of debt for the Company?

A. My analyses indicate that a capital structure consisting of 50.00% equity and 50.00% long-term debt, as well as a cost of long-term debt of 9.50%, are reasonable and should be approved for Bluegrass Water.

II. CAPITAL STRUCTURE

Q. What is the overall rate of return requested in this proceeding?

A. As explained in detail below, I recommend the Commission authorize a capital structure consisting of 50.00% equity and 50.00% long-term debt to be used for ratemaking purposes for Bluegrass Water. I also recommend a cost of long-term debt of 9.50%. Company witness Mr. Dylan W. D'Ascendis recommends a cost of equity of 11.80%. Those cost rates combined with my recommended capital structure result in an overall rate of return of 10.65%, as shown in Table 1 below.

Table 1: Overall Rate of Return

	Capital Structure	Cost Rate	Return
Long-Term Debt	50.00%	9.50%	4.75%
Equity	<u>50.00%</u>	<u>11.80%</u>	<u>5.90%</u>
	100.00%		10.65%

Q. How does the capital structure affect the rate of return?

A. It is well understood that from a financial perspective, there are two general categories of risk: business risk and financial risk. Business risk includes operating, market, regulatory, and competitive uncertainties, while financial risk is the incremental risk to investors associated with additional levels of debt. As such, the capital structure relates to a

1 company's financial risk, which represents the risk that a company may not have adequate
2 cash flows to meet its financial obligations, and is a function of the percentage of debt (or
3 financial leverage) in its capital structure. In that regard, as the percentage of debt in the
4 capital structure increases, so do the fixed obligations for the repayment of that debt.
5 Consequently, as the degree of financial leverage increases, the risk of financial distress
6 (*i.e.*, financial risk) also increases.¹ In essence, even if two firms face the same business
7 risks, a company with meaningfully higher levels of debt in its capital structure is likely to
8 have a higher cost of both debt and equity. Since the capital structure can affect the subject
9 company's overall level of risk, it is an important consideration in establishing a just and
10 reasonable rate of return.

11 **Q. Is there support for the proposition that the capital structure is a key consideration**
12 **in establishing an appropriate rate of return?**

13 A. Yes. The U.S. Supreme Court ("Supreme Court") and various utility commissions have
14 long recognized the role of capital structure in the development of a just and reasonable
15 rate of return for a regulated utility. In particular, a utility's leverage, or debt ratio, has
16 been explicitly recognized as an important element in determining a just and reasonable
17 rate of return:

18 Although the determination of whether bonds or stocks should be
19 issued is for management, the matter of debt ratio is not exclusively
20 within its province. Debt ratio substantially affects the manner and
21 cost of obtaining new capital. It is therefore an important factor in
22 the rate of return and must necessarily be considered by and come
23 within the authority of the body charged by law with the duty of

¹ See, Roger A. Morin, New Regulatory Finance, Public Utility Reports, Inc., 2006, at 45-46.

fixing a just and reasonable rate of return.²

Perhaps ultimate authority for balancing the issues of cost and financial integrity is found in the Supreme Court's statement in *Hope*:

The rate-making process under the Act, i.e., the fixing of "just and reasonable" rates, involves a balancing of the investor and the consumer interests.³

As the U.S. Court of Appeals, District of Columbia Circuit found in *Communications Satellite Corp. et. al. v. FCC*:

The equity investor's stake is made less secure as the company's debt rises, but the consumer rate-payer's burden is alleviated.⁴

Consequently, the principles of fairness and reasonableness with respect to the allowed rate of return and capital structure are considered at both the federal and state levels.

Q. What is the Company's actual capital structure?

A. Based on information provided to me by the Company, I understand its actual capital structure as of the end of 2019 consisted of all or nearly 100.00% equity.⁵ Because its actual capital structure is disproportionately leveraged in favor of equity, it deviates substantially from standard utility practice. I also understand that CSWR, LLC's (Bluegrass Water's parent) actual capital structure is heavily leveraged in favor of equity, consisting of approximately 2.00% long-term debt, and 98.00% equity. As such, neither

² *New England Telephone & Telegraph Co. v. State*, 98 N.H. 211, 97 A.2d 213, (1953), citing *New England Tel. & Tel. Co. v. Department of Pub. Util.*, (Mass.) 327 Mass. 81, 97 N.E. 2d 509, 514; *Petitions of New England Tel. & Tel. Co.* 116 Vt. 480, 80 A2d 671, at 6.

³ *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S., at 603 (1944).

⁴ *Communications Satellite Corp. et. al. v. FCC*, 198 U.S. App. D.C. 60, 63-64611 F.2d 883.

⁵ Case No. 2019-00360, Compliance Filing, Plan Re: Capital Structure, March 16, 2020, at 1.

the Company's nor its parent's actual capital structures are appropriate for ratemaking purposes.

Q. Is there financial literature that supports the use of a hypothetical capital structure for companies with atypical capital structures?

A. Yes. In the Cost of Capital Manual, a fundamental textbook for the Certified Rate of Return Analyst designation, the authors discuss the circumstances where a hypothetical capital structure would be appropriate:

There are circumstances where a hypothetical capital structure is used for a utility, rather than the utility's own capital structure. The most common reasons for utilizing a hypothetical capital structure are:

1. The utility's capital structure is deemed to be substantially different from the typical or "proper" utility capital structure.

2. The utility is funded as part of a diversified organization whose overall capital structure reflects its diversified nature rather than its utility operations only.

In both cases, a "reasonableness test" is generally applied in order to determine if the actual capital structure is unreasonable or produces an excessive cost of capital.⁶

In addition, Charles F. Phillips in The Regulation of Public Utilities (1993)⁷ discusses the applicability of hypothetical capital structures for ratemaking purposes:

The Colorado Commission said that it "could adopt a hypothetical structure for rate making in the event that applicants' actual financial structure is not in the long run public interest"

The Florida Commission held that capital structures "fall within the prerogatives of management" and that "invasion of the field of management in such a sensitive area is justified only when the public interest requires the exercise of extreme measures for its protection

⁶ Parcell, David C., The Cost of Capital – A Practitioner's Guide, 2010, at 47.

⁷ Phillips, Charles F., The Regulation of Public Utilities, Public Utilities Reports, Inc., 1993, pp. 389-391.

1 and benefit.”

2 *****

3 A hypothetical capital structure is used only where a utility’s actual
4 capitalization is clearly out of line with those of other utilities in its
5 industry or where a utility is diversified.

6 **Q. Is the requested capital structure consistent with the Company’s target capital**
7 **structure?**

8 A. Yes. I understand that in Case No. 2019-00104, the Commission approved the Company’s
9 acquisition of several wastewater assets in eight counties,⁸ which included a proposed
10 capital structure consisting of 50.00% long-term debt and 50.00% common equity.⁹ I
11 further understand that in a subsequent asset acquisition proceeding, Case No. 2019-00360,
12 the Company proposed the same capital structure. In approving the acquisition, and with
13 it the Company’s proposed capital structure, the Commission directed the Company to file
14 a capital structure plan within 30 days of the Commission’s order in Case No. 2019-00360.
15 On March 16, 2020, the Company filed its capital structure plan reiterating its “goal is to
16 have a 50/50 capitalization structure on average over time.”¹⁰

17 **Q. Have you performed analyses to assess the reasonableness of the requested capital**
18 **structure?**

19 A. Yes, I have. In general, it is important to consider the capital structure in light of industry
20 norms and investor requirements. As such, it is appropriate to review the proxy companies’

⁸ The application sought approval of the transfer of wastewater treatment plants, collection systems, and other assets of P.R. Wastewater, Marshall County Environmental, LH Treatment, Kingswood, Airview, Brocklyn, Fox Run, and Lake Columbia to Bluegrass Water, representing approximately 1,300 sewer customers in Bullitt, Franklin, Hardin, Madison, Marshall, McCracken, Scott, and Shelby counties. Case No. 2019-00104, Order at 1 (August 14, 2019).

⁹ Case No. 2019-00104, Order at 6, 18 (August 14, 2019).

¹⁰ Case No. 2019-0360, Compliance Filing, Plan Re: Capital Structure, March 16, 2020, at 1. Emphasis added.

1 actual capital structures as a means of assessing whether my recommended capital structure
2 is consistent with industry practice.

3 To make that assessment, I calculated the average capital structure for each of the
4 proxy group companies over the last eight quarters (*see* Exhibit JEN-1). The mean of the
5 proxy group actual capital structure is 55.23% common equity and 44.77% long-term debt;
6 the common equity ratios range from 43.13% percent to 67.12%.¹¹ Similarly, the median
7 capital structure for the proxy group is 55.44% common equity and 44.56% long-term debt.

8 **Q. What is the basis for using average capital components rather than a point-in-time**
9 **measurement?**

10 A. Measuring the capital components at a particular point in time can skew the capital
11 structure by the specific circumstances of a particular period. Therefore, it is logical to
12 normalize the relative relationship between the capital components over a period of time.

13 **Q. What is the projected capital structure for the proxy group?**

14 A. To gain another perspective, I also considered the capital structure projected by *Value Line*
15 *Investment Survey* in 2023-2025 for each proxy company. As shown in Exhibit JEN-2,
16 *Value Line* projects the proxy group to have an average common equity ratio of 56.29%
17 and a long-term debt ratio of 43.79% in the next three to five years (median of 59.50%
18 common equity and 40.50% long-term debt). Consequently, the requested capital structure
19 is consistent with, albeit slightly more leveraged than, the proxy group companies' actual
20 and projected capital structures.

¹¹ Source: S&P Global Market Intelligence.

1 **Q. What is your conclusion regarding an appropriate capital structure to be used for**
2 **ratemaking purposes in this proceeding?**

3 A. I conclude that a capital structure consisting of 50.00% equity and 50.00% long-term debt
4 is consistent with the Company's previously stated capital structure target, as well as with
5 actual and projected capital structures in place at the proxy companies. As such, I conclude
6 a capital structure consisting of 50.00% equity and 50.00% long-term debt is reasonable
7 and should be approved.

III. COST OF DEBT

8 **Q. What is your recommendation regarding the appropriate cost of debt to be used for**
9 **ratemaking purposes for Bluegrass Water?**

10 A. In this proceeding, I recommend the Commission authorize Bluegrass Water a cost of long-
11 term debt of 9.50% to be used for ratemaking purposes. I understand the Company is
12 currently negotiating the terms for a loan and expects the rate to be in the range of 9.00%
13 to 10.00%. As such, I believe a cost of debt at the midpoint of the expected debt cost range
14 is reasonable until the terms of the financing are finalized and the actual rate is known.

15 **Q. In your opinion, is a cost of long-term debt in the range of 9.00% to 10.00%**
16 **reasonable for Bluegrass Water?**

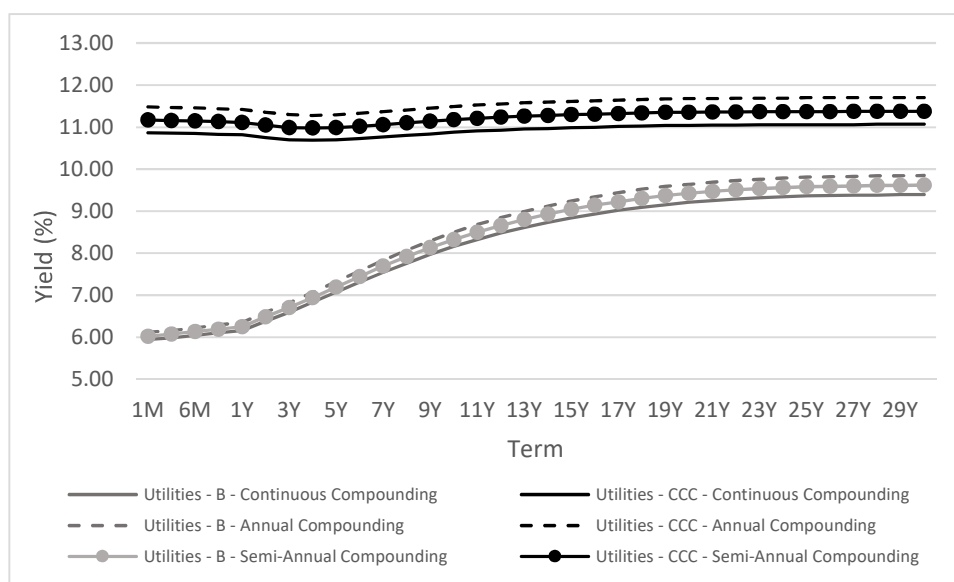
17 A. Yes, it is. I understand that operations of small, distressed water utilities such as Bluegrass
18 Water cannot attract traditional financing from commercial lenders. Simply, there is no
19 established market for financing small, distressed utilities.

20 In order to assess the reasonableness of the 9.00% to 10.00% range of long-term
21 debt cost requested in this proceeding, I reviewed current yield curve data on B-rated and

Exhibit DND-8

CCC-rated utility debt from S&P Capital IQ as of September 23, 2020. B-rated and CCC-rated utility debt yields reflect higher risk, below-investment grade utility debt rate costs in the current market. While not identical to, or fully reflective of, the risks facing small, distressed water utilities such as Bluegrass Water, B-rated and CCC-rated utility debt yields are the closest proxy I could find to assess the reasonableness of the Company's requested cost of long-term debt. As Chart 1 below demonstrates, B-rated and CCC-rated utility debt yields for terms of 15 years or more, are currently within a range of approximately 9.00% to 11.70% (*see also* Exhibit JEN-3).

Chart 1: Yield Curve of B-Rated and CCC-Rated Utility Debt (September 23, 2020)¹²



Based on the data shown in Chart 1 above, a cost of long-term debt in the 9.00% to 10.00% range for Bluegrass Water is reasonable, conservative, and should be approved for ratemaking purposes. Within that range, the midpoint of 9.50% is reasonable.

¹² Source: S&P Capital IQ, accessed September 24, 2020. *See* Exhibit JEN-3.

IV. CONCLUSIONS

1 **Q. What is your conclusion regarding the appropriate capital structure and cost of debt**
2 **to be used for ratemaking purposes for Bluegrass Water?**

3 A. For the reasons explained in my Direct Testimony, a ratemaking capital structure consisting
4 of 50.00% equity and 50.00% long-term debt is reasonable and appropriate and should be
5 approved for Bluegrass Water. Further, a cost of debt of 9.50%— which is the midpoint of
6 the 9.00% to 10.00% range of the expected interest rate on the loan the Company is
7 currently negotiating – is reasonable and conservative and should be approved for
8 ratemaking purposes.

9 **Q. Does this conclude your Direct Testimony?**

10 A. Yes, it does.

Summary

Jennifer Nelson has more than ten years of experience in the energy industry, spanning the oil, natural gas, electric, and renewable energy segments. She has provided research and analysis on a variety of utility regulatory matters including cost of capital, ratemaking and regulatory policy, integrated resource planning, electric grid modernization, energy efficiency, and wholesale energy markets. Ms. Nelson has also provided analytical support for natural gas pipeline development and natural gas utility supply planning. She has extensive experience researching regulatory and energy market issues, performing statistical analyses and economic and financial modeling, and providing policy analyses and recommendations.

Prior to joining ScottMadden, Ms. Nelson was a managing consultant at Sussex Economic Advisors, LLC, and was formerly a staff economist at the Massachusetts Department of Public Utilities and a petroleum economist for the State of Alaska. Ms. Nelson holds a Bachelor of Science degree in Business Economics from Bentley College, where she graduated *magna cum laude*, and a Master of Science degree in Resource and Applied Economics from the University of Alaska.

Areas of Specialization

- Utilities
- Regulation and rates
- Regulatory strategy and rate case support
- Analytics
- Natural gas
- Utility benchmarking
- Markets and RTOs

Recent Assignments

- Submitted expert testimony on behalf of an electric utility before the New Mexico Public Regulation Commission regarding the cost of capital.
- Submitted expert testimony on behalf of a water utility before the Arkansas Public Service Commission regarding the utility's proposed Formula Rate Plan.
- Co-sponsored expert testimony on behalf of a natural gas utility before the Maine Public Utilities Commission regarding the utility's proposed capital investment cost recovery mechanism.
- Supported expert testimony regarding the cost of capital for ratemaking purposes before numerous state utility regulatory commissions and the FERC on behalf of electric and natural gas utilities through state and company-specific research and analysis, financial analysis and modeling, and testimony development.
- Supported expert testimony and performed research and analysis on alternative ratemaking frameworks.
- Supported expert testimony on the reasonableness of utility resource supply portfolio decisions.
- Assisted in a benchmarking analysis on behalf of a Northeast natural gas utility regarding its supply planning standards and design day demand forecast process.
- Developed a dynamic natural gas demand forecast model for in-state use for the State of Alaska, which included forecasting demand from both existing and anticipated natural gas utilities, power consumption, and large commercial operations.
- Conducted research and prepared analyses for a natural gas pipeline Open Season.
- Performed research and financial analysis to evaluate the benefits, costs, and policy options associated with natural gas expansion by Massachusetts natural gas utilities as part of a prepared report for the Massachusetts Department of Energy Resources.
- Supported the development of a New Hampshire electric utility's Integrated Resource Plan filed with the New Hampshire Public Utility Commission.
- Performed buy-side benchmarking and regulatory analysis for a utility acquisition.
- Performed statistical analyses to support a utility's natural gas forecast and supply plan.
- Provided research and analytical support estimating financial damages incurred as a result of construction delays for an electric transmission company.
- Prepared a Feasibility Study for an electric cooperative utility supporting a utility-owned solar project.

Sponsor Company	Date Filed	Docket No.	Subject Matter
Arkansas			
Liberty Utilities (Pine Bluff Water)	10/2018	18-027-U	Sponsored testimony supporting Liberty Utility's proposed Formula Rate Plan and tariff
Maine			
Unitil Corporation (Northern Utilities, Inc.)	6/2019	19-00092	Co-sponsored testimony supporting Northern Utilities proposed CIRA capital tracking mechanism
New Mexico			
El Paso Electric Company	7/2020	20-00104-UT	Cost of Capital

Exhibit DND-8

EXHIBT JEN-1

Exhibit DND-8

Proxy Group Actual Capital Structure

Company	Ticker	% Common Equity								
		2020Q1	2019Q4	2019Q3	2019Q2	2019Q1	2018Q4	2018Q3	2018Q2	Average
American Water Works Company, Inc.	AWK	42.00%	41.47%	41.74%	41.09%	43.96%	43.65%	43.63%	47.48%	43.13%
American States Water Company	AWR	68.27%	68.16%	67.96%	67.32%	66.64%	66.51%	66.35%	65.74%	67.12%
California Water Service Group	CWT	48.98%	49.78%	48.41%	47.24%	50.12%	50.70%	49.92%	62.33%	50.94%
Essential Utilities, Inc.	WTRG	49.38%	56.87%	57.13%	58.18%	44.72%	45.59%	47.44%	47.89%	50.90%
Middlesex Water Company	MSEX	58.24%	58.39%	54.71%	61.90%	61.83%	61.94%	63.70%	62.66%	60.42%
SJW Group	SJW	40.15%	40.95%	63.70%	63.64%	63.49%	67.33%	52.41%	51.90%	55.44%
The York Water Company	YORW	58.96%	58.67%	58.32%	57.33%	57.47%	57.49%	61.05%	60.14%	58.68%
Mean		52.28%	53.47%	56.00%	56.67%	55.46%	56.17%	54.93%	56.88%	55.23%
Median		49.38%	56.87%	57.13%	58.18%	57.47%	57.49%	52.41%	60.14%	55.44%

Company	Ticker	% Long-Term Debt								
		2020Q1	2019Q4	2019Q3	2019Q2	2019Q1	2018Q4	2018Q3	2018Q2	Average
American Water Works Company, Inc.	AWK	58.00%	58.53%	58.26%	58.91%	56.04%	56.35%	56.37%	52.52%	56.87%
American States Water Company	AWR	31.73%	31.84%	32.04%	32.68%	33.36%	33.49%	33.65%	34.26%	32.88%
California Water Service Group	CWT	51.02%	50.22%	51.59%	52.76%	49.88%	49.30%	50.08%	37.67%	49.06%
Essential Utilities, Inc.	WTRG	50.62%	43.13%	42.87%	41.82%	55.28%	54.41%	52.56%	52.11%	49.10%
Middlesex Water Company	MSEX	41.76%	41.61%	45.29%	38.10%	38.17%	38.06%	36.30%	37.34%	39.58%
SJW Group	SJW	59.85%	59.05%	36.30%	36.36%	36.51%	32.67%	47.59%	48.10%	
The York Water Company	YORW	41.04%	41.33%	41.68%	42.67%	42.53%	42.51%	38.95%	39.86%	
Mean		47.72%	46.53%	44.00%	43.33%	44.54%	43.83%	45.07%	43.12%	44.77%
Median		50.62%	43.13%	42.87%	41.82%	42.53%	42.51%	47.59%	39.86%	44.56%

Source: S&P Global Market Intelligence

Exhibit DND-8

EXHIBT JEN-2

Proxy Group Projected Capital Structure

Company	Ticker	Common Equity Projected 2023-2025
American Water Works Company, Inc.	AWK	41.00%
American States Water Company	AWR	51.50%
California Water Service Group	CWT	56.50%
Essential Utilities, Inc.	WTRG	59.50%
Middlesex Water Company	MSEX	60.50%
SJW Group	SJW	61.00%
The York Water Company	YORW	64.00%
Mean		56.29%
Median		59.50%

Company	Ticker	Long-Term Debt Projected 2023-2025
American Water Works Company, Inc.	AWK	59.00%
American States Water Company	AWR	49.50%
California Water Service Group	CWT	43.50%
Essential Utilities, Inc.	WTRG	40.50%
Middlesex Water Company	MSEX	39.00%
SJW Group	SJW	39.00%
The York Water Company	YORW	36.00%
Mean		43.79%
Median		40.50%

Source: Value Line as of August 31, 2020

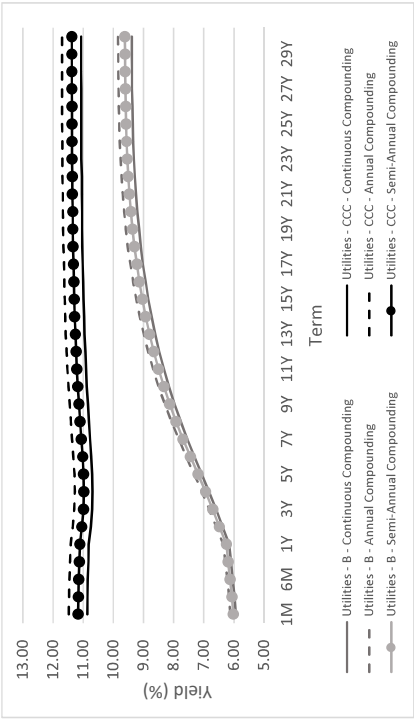
Exhibit DND-8

EXHIBT JEN-3



Accessed: September 24, 2020

Term	USD - Utilities - USD - Utilities -					
	CCC - All In			CCC - All In		
	Yield - Semi-			Yield - Semi-		
	Annual	Compounding	Annual	Annual	Compounding	Annual
09/23/2020	09/23/2020	09/23/2020	09/23/2020	09/23/2020	09/23/2020	09/23/2020
1M	11.48	11.17	10.87	6.12	6.02	5.94
3M	11.47	11.16	10.86	6.16	6.07	5.98
6M	11.46	11.15	10.85	6.22	6.13	6.04
9M	11.44	11.13	10.83	6.29	6.19	6.1
1Y	11.42	11.11	10.82	6.35	6.25	6.16
2Y	11.35	11.05	10.75	6.59	6.48	6.38
3Y	11.3	10.99	10.7	6.82	6.7	6.59
4Y	11.28	10.98	10.69	7.06	6.94	6.83
5Y	11.29	10.99	10.7	7.32	7.19	7.07
6Y	11.33	11.02	10.73	7.58	7.44	7.31
7Y	11.37	11.06	10.77	7.83	7.69	7.54
8Y	11.41	11.1	10.81	8.07	7.92	7.76
9Y	11.45	11.14	10.84	8.29	8.13	7.97
10Y	11.49	11.18	10.88	8.5	8.32	8.16
11Y	11.53	11.21	10.91	8.68	8.5	8.32
12Y	11.55	11.24	10.93	8.85	8.66	8.48
13Y	11.58	11.26	10.96	8.99	8.8	8.61
14Y	11.6	11.28	10.97	9.12	8.93	8.73
15Y	11.61	11.3	10.99	9.24	9.04	8.84
16Y	11.63	11.31	11	9.34	9.14	8.93
17Y	11.64	11.32	11.02	9.44	9.22	9.02
18Y	11.66	11.34	11.03	9.52	9.3	9.09
19Y	11.67	11.35	11.04	9.59	9.37	9.15
20Y	11.68	11.35	11.04	9.64	9.42	9.21
21Y	11.68	11.36	11.05	9.69	9.47	9.25
22Y	11.69	11.36	11.05	9.73	9.51	9.29
23Y	11.69	11.37	11.06	9.76	9.54	9.32
24Y	11.69	11.37	11.06	9.79	9.56	9.34
25Y	11.7	11.37	11.06	9.81	9.58	9.36
26Y	11.7	11.37	11.06	9.82	9.59	9.37
27Y	11.7	11.38	11.06	9.83	9.6	9.38
28Y	11.7	11.38	11.07	9.84	9.61	9.38
29Y	11.7	11.38	11.07	9.84	9.61	9.39
30Y	11.7	11.38	11.07	9.85	9.62	9.39



CSWR
Operating Companies by State
2020 O&M Expenses by Customer
Docket 21-00053

Confidential

Exhibit DND-9

a/

b/

Line No.

State	Operating Company	Connections	2020 O&M	2020 O&M per Connection	2020 Operating Revenue	2020 Op Rev per Connection
AR	Eagle Ridge	254				
AR	Flushing Meadows	295				
AR	Hayden's Place	122				
AR	Oak Hill	198				
AR	Sebastian Lake	219				
AR	St. Joseph Glen	451				
KY	Bluegrass	3,408				
LA	Magnolia	35,994				
MO	Confluence Rivers	4,899				
MO	Elm Hills	817				
MO	Hillcrest	499				
MO	Osage	764				
MO	Raccoon Creek	529				
MO	Indian Hills	669				
TX	CSWR - Texas	2,497				
	Total	51,615	\$ 11,139,144	\$ 215.81	\$ 13,523,339	\$ 262.00

17	TN	Cartwright Creek	849	\$ 841,979	\$ 992.31	\$ 767,228	\$ 904.22
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"Connections" for CC represent avg of beg & end customers, per 2020 fin'l rpt.

18		Limestone Forecast	849				
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Note: 2020 audited financial statement Note 13 (subsequent events) indicates that nearly \$3.5 million was spent to acquire certain operating assets providing water and wastewater services in MO, TX, KY, and LA.

a/ TPUC Docket 21-00053, Petition Exhibit 6.

b/ TPUC Docket 21-00053, Confidential Exhibit 10 - 2020 Audited Financials.pdf, pages 23-24.

Bluegrass Water Utility Operating Company, LLC
Case No. 2020-00290
Typical Bill Comparison

Exhibit DND-10

Data: X Base Period X Forecast Period
Version: _ Original _ Updated X Revised

Exhibit 21, Schedule N
#VALUE!
Witness: B. Thies

Type of Charge	Service Area	Current Rates (per month)	Proposed Rates (per month)	Change Requested			
				\$	%		
Total Monthly Sewer – Single Residential per unit	Airview Estates	\$41.36	\$95.46	\$54.10	130.8%		
	Brocklyn Subdivision- Single Family	\$40.00	\$95.46	\$55.46	138.7%		
	Fox Run Estates	\$55.85	\$95.46	\$39.61	70.9%		
	Great Oaks Subdivision	\$28.84	\$95.46	\$66.62	231.0%		
	Golden Acres Subdivision	\$39.57	\$95.46	\$55.89	141.3%		
	Kingswood Development	\$38.84	\$95.46	\$56.62	145.8%		
	Lake Columbia Estates	\$50.32	\$95.46	\$45.14	89.7%		
	Longview and Homestead Subdivisions	\$30.00	\$95.46	\$65.46	218.2%		
	Persimmon Ridge Subdivision	\$35.00	\$95.46	\$60.46	172.8%		
	City of River Bluff and environs	\$58.16	\$95.46	\$37.30	64.1%		
	Timberland Subdivision	\$34.71	\$95.46	\$60.75	175.0%		
	Arcadia Pines Subdivision	\$25.00	\$95.46	\$70.46	281.9%		
	Carriage Park Subdivision	\$16.00	\$95.46	\$79.46	496.7%		
	Marshall Ridge Subdivision	\$15.00	\$95.46	\$80.46	536.4%		
	Randview Subdivision	\$25.00	\$95.46	\$70.46	281.9%		
	I-75 & Delaplain Road interchange area (Scott County)	\$12.50	\$95.46	\$82.96	663.7%		
	Herrington Haven and Woodland Estates	\$49.66	\$95.46	\$45.80	92.2%		
	Springcrest Sewer (Jessamine County)	\$27.43	\$95.46	\$68.03	248.0%		
	Woodland Acres	\$19.47	\$95.46	\$75.99	390.3%		
	Total Monthly Sewer – Mulit Residential per unit	Brocklyn Subdivision – Multi Family	\$30.40	\$71.60	\$41.20	135.5%	
		Randview Subdivision - Duplex	\$25.00	\$72.11	\$47.11	188.4%	
	Total Monthly Sewer Bill – Commercial	Flat Rate	Persimmon Ridge Subdivision ¹	\$35.00 per residential equivalent of 12,000 gallons	\$238.66	\$205.36	616.6%
			Randview Subdivision	\$25.00	\$240.36	\$215.36	861.4%
	Total Monthly Sewer – Industrial/Commercial (Metered)	I-75 & Delaplain Road interchange area (Scott County)	\$755.33	\$2,179.28	\$1,423.95	188.5%	
Total Monthly Water Bill - Residential							
	Center Ridge	\$22.79	\$108.27	\$85.48	375.1%		

¹ Persimmon Ridge Current Average Bill is \$35/month