

BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION

NASHVILLE, TENNESSEE

December 2, 2022

IN RE:

JOINT REQUEST OF TENNESSEE-AMERICAN
WATER COMPANY AND WALKER COUNTY
WATER AND SEWERAGE AUTHORITY FOR
EXPEDITED APPROVAL OF A SPECIAL
CONTRACT

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DOCKET NO.
22-00049

ORDER INITIALLY DENYING SPECIAL CONTRACT AND,
UPON VERBAL REQUEST FOR RECONSIDERATION BY THE PARTIES, GRANTING
APPROVAL OF AN AMENDED SPECIAL CONTRACT,
CONTINGENT UPON FILING THAT CONFORMS TO PANEL DECISION

This matter came before Chairman Herbert H. Hilliard, Vice Chairman David F. Jones, Commissioner Clay R. Good, Commissioner Kenneth C. Hill, and Commissioner John Hie of the Tennessee Public Utility Commission (the “Commission” or “TPUC”), the voting panel assigned to this docket, during a regularly scheduled Commission Conference held on October 10, 2022 for consideration of the *Joint Petition of Tennessee-American Water Company and Walker County Water and Sewerage Authority for Expedited Approval of a Special Contract* (“*Petition*”) filed on June 13, 2022.

BACKGROUND AND PETITION

On June 13, 2022, Tennessee-American Water Company (“TAWC” or “Company”) and Walker County Water and Sewerage Authority (“WCWSA” or “Customer”) (together “the Joint Petitioners”) filed a *Petition* with the Commission requesting expedited approval of a special contract pursuant to Commission Rules 1220-04-03-.05 and 1220-04-01-.07.¹ The Joint Petitioners attached a copy of the Water Purchase Agreement (“Agreement” or “Contract”) as an exhibit to the *Petition*.² In support of its *Petition*, the Joint

¹ *Petition*, p. 1 (June 13, 2022).

² *Id.* at Exh. A.

Petitioners submitted the Pre-Filed Direct Testimony of Grady Stout, Director of Engineering for TAWC.³ WCWSA filed a letter expressing its full and complete support of the *Petition*.⁴

TAWC provides residential, commercial, industrial, and municipal water service, including public and private fire protection service to approximately 83,874 customers in the City of Chattanooga, Tennessee and surrounding areas, including certain areas in Georgia. Additionally, TAWC provides water services for Whitwell, Powell's Crossroads, Suck Creek, and Jasper Highlands.⁵ TAWC is a wholly owned subsidiary of American Water Works Company, the largest water holding company in the United States, providing water and wastewater services to fifteen (15) million customers in over thirty (30) states. TAWC is regulated by the Commission and official records support TAWC's technical, managerial, and financial ability to provide water services within its service territory.⁶

WCWSA was established in 1977 and serves approximately 11,000 customers. Although a former customer, WCWSA is not a current TAWC customer. WCWSA advised that it knows that former TAWC customers have bypassed TAWC and that it is in the process of building its own water facilities. The Joint Petitioners represent that, absent good faith negotiations for a special contract with TAWC, WCWSA is prepared to bypass. Thereafter, negotiations led to the execution of an agreement between the Parties in February 2022.⁷

In the *Petition*, the Joint Petitioners state that the terms of the Agreement provide that TAWC will provide potable water to WCWSA in quantities specifically delineated in the Agreement and that WCWSA may not reduce the purchase amount during the three (3) year term of the Agreement. WCWSA may only use the purchased water for resale to its customers within its service area. WCWSA will pay a rate of \$1.75

³ Grady Stout, Pre-Filed Direct Testimony (June 13, 2022).

⁴ Letter to Chairman Herbert Hilliard Re: Support of Joint Petition of Tennessee-American Water Company and Walker County Water and Sewerage Authority (August 19, 2022).

⁵ *Petition*, pp. 1-2 (June 13, 2022).

⁶ *Id.* at 4-5.

⁷ *Id.* at 2.

per 1000 gallons including the Tax Cuts and Jobs Act (“TCJA”) impacts and the existing Capital Recovery Riders or other mechanisms approved by the Commission.⁸

Finally, the Joint Petitioners assert that it is in the best interests of WCWSA, its customers, and the Walker County community for them to enter into the Agreement, as well as in the best interest of TAWC and its customers to enter into the Agreement.⁹ Further, the Joint Petitioners allege that the rates are the highest that could be negotiated and are fair, just, and reasonable and are not unduly preferential or discriminatory.¹⁰

The Consumer Advocate Unit in the Financial Division of the Office of the Tennessee Attorney General (“Consumer Advocate”) sought to intervene in the proceedings by a petition filed on July 18, 2022.¹¹ The Hearing Officer granted the Consumer Advocate’s intervention by order entered on August 23, 2022.¹² On August 31, 2022, the Consumer Advocate submitted the Pre-Filed Direct Testimony of its witness, William H. Novak. In his testimony, Mr. Novak states that is not appropriate to apply the TCJA Rider (or “Tax Rider”) to the proposed special contract as it is a credit flowing back to existing TAWC customers to recognize the impact from previously deferred taxes at higher rates. He clarifies that the total billing rate would continue to be \$1.75 per 1000 gallons under his recommendation.¹³

The parties engaged in discovery through data requests and responses. In addition, the Joint Petitioners submitted the Rebuttal Testimony of its witness, Grady Stout. In his rebuttal testimony, Mr. Stout agrees with the Consumer Advocate’s proposal not to apply the tax credits of the TCJA Rider to WCWSA. He also clarifies that the special contract rate will remain \$1.75 per 1000 gallons.¹⁴ Mr. Stout further testified that upon acceptance of the Consumer Advocate’s proposal, there are no contested issues

⁸ *Id.* at 3-4.

⁹ *Id.* at 3.

¹⁰ *Id.* at 5.

¹¹ *Consumer Advocate Petition to Intervene* (July 18, 2022).

¹² *Order Granting the Petition to Intervene Filed by the Consumer Advocate* (August 23, 2022).

¹³ William H. Novak, Pre-Filed Direct Testimony, p. 6 (August 31, 2022).

¹⁴ Grady Stout, Pre-Filed Rebuttal Testimony, pp. 1-2 (September 20, 2022). *See also* Tennessee-American Water Company Filing of Substitute Page to Rebuttal Testimony of Grady Stout Which Was Filed September 20, 2022 (September 23, 2022).

in this docket.¹⁵ Following discovery and the filing of testimony, TAWC filed a letter indicating that “there are no contested issues between the parties on the merits of the Joint Petition, and it is the position of the parties that this matter should be resolved in favor of the positions set forth in the Joint Petition, consistent with the pre-filed testimony of the parties.”¹⁶

STANDARD FOR COMMISSION APPROVAL

TPUC Rule 1220-04-01-.07, states:

Special contracts between public utilities and certain customers prescribing and providing rates, services and practices not covered by or permitted in the general tariffs, schedules or rules filed by such utilities are subject to supervision, regulation and control by the Commission. A copy of such special agreements shall be filed, subject to review and approval.

In general, a special contract providing for discounted transportation rates to avoid a potential customer bypass of the utility’s system is subject to additional scrutiny, in which the Commission must find, based upon criteria established by precedent, that:

1. Customer bypass is imminent;
2. Customer bypass would be uneconomic;
3. Special contract rates and terms are just and reasonable and such terms are not unjustly preferential or unduly discriminatory; and,
4. The special contract rates are the highest that could be negotiated.¹⁷

THE HEARING

The hearing in this matter was held before the voting panel of Commissioners during the regularly scheduled Commission Conference on October 10, 2022, as noticed by the Commission on September 30, 2022. Participating in the hearing were:

Tennessee-American Water Company – Melvin J. Malone, Esq., Butler Snow, LLP, The Pinnacle at Symphony Place, 150 Third Avenue South, Suite 1600, Nashville, TN 37201; Grady Stout, Director of Engineering, 1500 Riverside Drive, Chattanooga, Tennessee 37406.

¹⁵ *Id.* at 3.

¹⁶ Letter to Chairman Herbert H. Hilliard Re: No Outstanding Procedural Matters from Melvin J. Malone, Butler Snow LLP, p. 1 (September 23, 2022).

¹⁷ See *In re: Petition of Atmos Energy Corporation for Approval of Agreement with Brown-Forman Corporation, d/b/a Jack Daniel Distillery*, Docket No. 19-00072, *Order Approving Agreement*, p. 3 (January 22, 2020); *In re: Joint Request of Chattanooga Gas Company and Kordsa, Inc. for Approval of a Special Contract*, Docket No. 21-00094, *Order Approving Special Contract, As Modified*, p. 6 (May 13, 2022).

Walker County Water and Sewerage Company – Brandon Whitley, 4665 Happy Valley Road, P.O. Box 248, Flintstone, Georgia 30725.

Consumer Advocate – Karen Stachowski, Esq., Office of the Tennessee Attorney General, P.O. Box 20207, Nashville, TN 37202-0207; William H. Novak, 19 Morning Arbor Place, The Woodlands, TX 77381.

During the hearing, Mr. Stout ratified and summarized his Pre-Filed Direct and Rebuttal Testimony submitted on behalf of TAWC and was subject to cross examination and questions from the panel and Commission Staff. Mr. Stout reiterated that the special contract is fair, just, and reasonable for both WCWSA and TAWC and urged approval of the *Petition*. The Commission then invited members of the public to offer comments on this docket, but no one sought recognition to offer comment.

FINDINGS AND CONCLUSIONS

In its *Petition*, TAWC and WCWSA have requested that the Commission approve a special contract pursuant to TPUC Rule 1220-04-01-.07. The Commission analyzes the special contract request, as modified by the agreement among the Joint Petitioners and the Consumer Advocate to remove the application of the TCJA Rider, utilizing the established precedential criteria:

1. Customer bypass is imminent;
2. Bypass would be uneconomic for the Company;
3. The proposed contract rates are just and reasonable; and
4. The proposed rates are the highest that could be negotiated.

Considering whether the bypass is imminent, the Joint Petitioners acknowledge that WCWSA is not a current customer of TAWC. However, Mr. Stout testifies that WCWSA approached TAWC about the possibility of obtaining a special contract in 2020, aware that TAWC had recently lost Walden's Ridge as a sale for resale customer. Walden's Ridge was a sale for resale customer of TAWC for approximately twelve years, but upon unsuccessful special contract negotiations, entered into an agreement to receive water from Hixson Utility District. Mr. Stout states that WCWSA represented to him that it was willing to take measures similar to Walden's Ridge in the event negotiations were unsuccessful.¹⁸ Based upon Mr.

¹⁸ Grady Stout, Pre-Filed Direct Testimony, pp. 4-5 (June 13, 2022).

Stout's testimony and information contained in the *Petition*, the voting panel unanimously found that a bypass of WCWSA as a potential customer was imminent.

In determining whether WCWSA's bypass of the TAWC system is uneconomic, the Commission must consider the effect that such bypass would have on the remaining TAWC ratepayers. Mr. Stout testifies that sale for resale customers, like Walden's Ridge, contributes to common overhead and fixed costs. When such a customer is lost that contribution to overhead and fixed costs is lost, negatively impacting the rates of all other TAWC customers. Adding a new sale for resale customer alleviates the negative impact upon the other TAWC customers. In addition, existing ratepayers benefit from the additional water sales gained, which helps to offset the declining use currently experienced by TAWC.¹⁹ TAWC currently has special contracts to provide wholesale potable water service to the Town of Signal Mountain,²⁰ the City of Fort Oglethorpe,²¹ and Catoosa Utility District.²² In these cases, the Commission determined that "the use of special contracts in dealing with large-usage customers ... serves the public interest because it provides greater flexibility to the Company than is available under its tariff" and that such special contracts "benefit the Company and its ratepayers by providing a long-term source of revenue and by helping control the Company's production costs during peak usage periods."²³ In addition, the Commission further held that the special contracts would provide these communities and their residents with a dependable supply of water at fair and affordable prices. Based upon this evidence, the panel unanimously found that the economic benefits to adding WCWSA as a customer to TAWC makes a WCWSA bypass uneconomic.

Reserving the third factor for final consideration, the Commission next considers whether the proposed rates are the highest that could be negotiated. The Joint Petitioners state in their *Petition* and Mr.

¹⁹ *Id.* at 6.

²⁰ *In re: Petition for Approval of Extension of Water Purchase Agreement Between Tennessee American Water Company and the Town of Signal Mountain*, Docket No. 09-00175, *Order Granting Approval of Special Contract* (December 4, 2009).

²¹ *In re: Special Contract Water Purchase Agreement Between Tennessee American Water Company and the City of Fort Oglethorpe, Georgia*, Docket No. 00-01124, *Order Approving Extension of Water Purchase Agreement* (June 21, 2001).

²² *In re: Special Contract Between Tennessee-American Water Company and the Catoosa Utility District*, Docket No. 98-00885, *Order Approving Special Contract* (April 16, 1999).

²³ *In re: Petition for Approval of Extension of Water Purchase Agreement Between Tennessee American Water Company and the Town of Signal Mountain*, Docket No. 09-00175, *Order Granting Approval of Special Contract*, p. 2 (December 4, 2009).

Stout testified that the parties negotiated in good faith. It is generally presumed that whenever two independent parties negotiate an arms-length transaction, the negotiated rate is the highest that could be achieved. There is no evidence that the parties have colluded or that the parties are affiliated in some manner. Therefore, the panel unanimously found that the proposed rates are the highest that could be negotiated.

Finally, the Commission must determine whether the Contract's proposed rates are just and reasonable. TAWC and WCWSA have negotiated a requirements contract for the purchase of wholesale potable water at a rate of \$1.75 per 1000 gallons, inclusive of the TCJA and Capital Riders surcharges. Specifically, Section 2.b of the Agreement states:

WCWSA shall pay a rate of \$1.75 per 1000 gallons, inclusive of Tax Cuts and Jobs Act ("TCJA") and Capital Riders (the "Purchased Water Rate"). The Purchase Water Rate shall be adjusted, to the extent necessary, to reflect the then applicable Capital Riders approved by the Tennessee Public Utility Commission ("TPUC").²⁴

As written, the Agreement does not identify a base rate for wholesale water service; but instead reflects a base rate that must be computed by deducting applicable rider surcharges from the inclusive contract rate of \$1.75 per 1000 gallons. Mr. Novak points out that the proposed inclusive rate operates differently from TAWC's other special contracts, which provide a specific base rate and applies all applicable riders to that base rate.²⁵

This inclusive rate design is problematic because the result is that the Commission would not be approving a specific base water rate. Instead, because the rate is inclusive and fixed for a three (3) year term, the base rate then becomes subject to change each year depending on the potential adjustment to surcharges in annual filings. Further, a water service rate inclusive of applicable surcharges is contrary to the terms of surcharge programs established in TAWC's tariffs. TAWC has applied surcharges to all current special customer contracts, including Capital Riders surcharges (collectively, the Qualified Infrastructure

²⁴ *Petition*, Exh. A, p. 2 (June 13, 2022).

²⁵ William H. Novak, Pre-Filed Direct Testimony, pp. 4-5 (August 31, 2022).

Improvement Program (“QIIP”), the Environmental Development Incentive (“EDI”) Program, and the Safety and Environment Compliance (“SEC”) Program); the Production Cost and Other Pass-throughs (“PCOP”) Rider; and the Capital Recovery Rider for TCJA Savings. Consistent with TAWC tariffs, these surcharges are applied as a percentage adjustment to a specific base water rate for all customer classes, including special contract rates. By utilizing the inclusive rate design proposed in the *Petition*, applicable surcharges are not applied to a base rate but rather incorporated, thereby removing the impact of applicable surcharges from the inclusive rate; essentially insulating WCWSA from future surcharge increases over the term of the contract. Such calculation is contrary to the surcharge programs established under the Company’s tariffs and would result in an annual change to the base water rate without specific Commission review or approval.

In his Pre-Filed Testimony on behalf of the Consumer Advocate, Mr. Novak argues that it is not appropriate to include the Tax Rider credit in the proposed Special Contract.²⁶ He asserts that the purpose of the Tax Rider credit is to flow deferred taxes, levied at higher rates, back to existing customers, concluding that since WCWSA was not a customer at the time the higher tax rates were in effect, application of the Tax Rider credit is not appropriate and should be excluded from the Agreement.²⁷ Mr. Stout submitted Pre-Filed Rebuttal testimony on behalf of TAWC in which he stated that, “TAWC does not oppose the Consumer Advocate’s recommendation to not include the 2017 Tax Cuts and Jobs Act (“TCJA”) tax credit to the proposed Special Contract...”²⁸ Mr. Stout disagrees, however, with the Consumer Advocate’s rationale for exclusion of the Tax Rider credit, stating that the rider not only credits customers the impact from deferred taxes at higher rates, but also includes the impact of the tax reductions on an ongoing basis until base rates are adjusted to reflect then-currently effective tax rates.²⁹

²⁶ William H. Novak, Pre-Filed Direct Testimony, pp. 5-6 (August 31, 2022).

²⁷ *Id.*

²⁸ Grady Stout, Pre-Filed Rebuttal Testimony, pp. 1-2.

²⁹ *Id.*

In accordance with TAWC's tariff, the Tax Rider collectively refers to a TCJA Savings Offset and a TCJA Excess Accumulated Deferred Income Taxes ("ADIT") Offset. As Mr. Stout points out in his Pre-Filed Rebuttal Testimony, these are both applied to base rates on an ongoing basis to adjust the impact of tax reductions. When the base rate can be adjusted to properly account for the tax rate in effect at the time of the adjustment, then the Tax Rider credit can be adjusted or eliminated as appropriate. In addition, TAWC's other special contract customers would be in the same position as WCWSA, negotiating a base water rate for provision of wholesale water post-TCJA, at the conclusion of their respective contracts should they wish to continue their contracts. TAWC's current base water rates were computed on the cost of service determined in the Company's 2012 rate case; before the TCJA was passed by Congress.³⁰ Therefore, the voting panel found that the Consumer Advocate's argument to exclude the application of the Tax Rider to the special contract with WCWSA unpersuasive and rejects the proposal.

In addition, an inclusive water base rate design is inconsistent with the rate design for other TAWC special contract customers. The Joint Petitioners offer no explanation or justification for exempting WCWSA from future increases in surcharge percentages while TAWC's other special contract customers are not likewise exempted. Sound ratemaking policy reinforces the application of surcharge percentages to a base water rate, as is done in TAWC's other special contracts. To apply the surcharges differently for WCWSA is unfair and unduly preferential. As a result, the panel found that the proposed rates are not just and reasonable and not in the public interest.

Therefore, upon finding that Section 2.b of the Agreement is inconsistent with the Company's Capital Riders, PCOP Rider, and Capital Recovery Rider for TCJA Savings tariffs and, further, that application of these riders is inconsistent with how such riders are applied to TAWC's other special contract customers, the panel determined that the proposed special contract is not in the public interest. The voting

³⁰ *In re: Petition of Tennessee American Water Company for a General Rate Increase, Implementation of a Distribution System Infrastructure Charge and the Establishment of Tracking Mechanisms for Purchased Power, Pensions and Chemical Expenses*, Docket No. 12-00049, *Order Approving Settlement Agreement* (November 20, 2012).

panel unanimously voted to deny the proposed Agreement between TAWC and WCWSA. The panel further stated that should the parties wish to file a new or amended special contract, TAWC and WCWSA should identify a specific base water rate and apply approved surcharges consistent with TAWC's tariffs and other special contract arrangements, with analysis showing the proposed contract revenues, costs of service, and contribution margin.

HEARING RECONVENED TO CONSIDER ORAL REQUEST OF THE PARTIES

Before the Commission Conference adjourned, the parties requested to re-appear before the voting panel to request reconsideration of its denial and approval of the special contract, as modified to conform with the panel's initial findings and conclusions. Counsel for TAWC stated that the parties had discussed the Commission's prior deliberations. In light of WCWSA's immediate need to supplement its water supply, the parties proposed an oral modification to the proposed contract that "meets the requirements laid out by the Commission and that the rate will be calculated consistent with the other special contract rates."³¹ To that end, TAWC represented that in utilizing a base rate and the capital riders in place today, the margins will not be materially different than those established in response to discovery.³²

Based upon these representations, the Joint Petitioners requested a conditional approval of the special contract as orally modified, so that, "in the public interest, Walker County can get water as soon as possible."³³ TAWC stated that an amended contract consistent with the deliberations of the Commission and with the agreement of WCWSA and the Consumer Advocate will be filed in the docket file without undue delay. The Consumer Advocate and Commission Staff each concurred with the Joint Petitioners' request for conditional approval.³⁴

Thereafter, the Commission found that the parties' orally expressed agreement addressed the Commission's concerns with the Agreement's proposed rates. As amended in the agreement presented

³¹ Transcript of Hearing, p. 10 (October 10, 2022).

³² *Id.* at 11.

³³ *Id.*

³⁴ *Id.*

orally by the parties, the Commission found the rates to be consistent with TAWC's rider tariffs and with other TAWC special contract rates. Therefore, the panel found that the proposed rates, as modified by oral amendment, are just, reasonable, and in the public interest. As such, the voting panel voted unanimously to approve the special contract between TAWC and WCWSA, as modified, contingent upon the filing of a written amended contract consistent with the findings and conclusions of the panel.³⁵ The Commission directs Commission Staff to determine whether the amended contract complies with the contingent approval granted and to notify the parties accordingly.³⁶

IT IS THEREFORE ORDERED THAT:

1. The *Joint Petition of Tennessee-American Water Company and Walker County Water and Sewerage Authority for Expedited Approval of a Special Contract* filed on June 13, 2022 is denied as filed.
2. Upon reconsideration, the *Joint Petition of Tennessee-American Water Company and Walker County Water and Sewerage Authority for Expedited Approval of a Special Contract* as amended by oral presentation to the Tennessee Public Utility Commission on October 10, 2022 is approved, contingent upon the filing of a written Water Purchase Agreement consistent with the findings and conclusions of the Commission.
3. The special contract rates shall become effective on a prospective basis concurrent with the filing of an amended contract consistent with the Commission's decision in this Order. Commission Staff

³⁵ The parties have made certain filings in this docket file post-decision of the Commission. *See* Tennessee-American Water Company and Walker County Water and Sewerage Authority Amended Water Purchase Agreement along with TAWC Supplemental Responses to Second Discovery Requests of the Consumer Advocate and TAWC Post-Hearing Exhibit No. 1 (October 27, 2022); Tennessee-American Water Company and Walker County Water and Sewerage Authority Revised Amended Water Purchase Agreement along with TAWC Second Supplemental Response to Second Discovery Requests of the Consumer Advocate and TAWC Post-Hearing Exhibit No. 1 (November 1, 2022); Tennessee-American Water Company and Walker County Water and Sewerage Authority Revised Amended Water Purchase Agreement along with TAWC Third Supplemental Response to Second Discovery Requests of the Consumer Advocate and TAWC Post-Hearing Exhibit No. 1 (November 3, 2022); and Tennessee-American Water Company and Walker County Water and Sewerage Authority Executed Amended Water Purchase Agreement Consistent With the Tennessee Public Utility Commission October 10, 2022 Deliberations (November 17, 2022).

³⁶ Commission Staff acknowledged receipt of the Amended Water Purchase Agreement and indicated that the agreement complied with the order announced by the Commission during the October 10, 2022 Commission Conference. *See* Commission Staff Acknowledgement Receipt of the Amended Water Purchase Agreement Between Tennessee-American Water Company and Walker County Water and Sewerage Authority Filed on November 17, 2022 (November 18, 2022).

is directed to determine whether any amended contract filed in this docket is consistent with the Commission's decision and to notify the parties accordingly.

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

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

FOR THE TENNESSEE PUBLIC UTILITY COMMISSION:

**Chairman Herbert H. Hilliard,
Vice Chairman David F. Jones,
Commissioner Clay R. Good,
Commissioner Kenneth C. Hill, and
Commissioner John Hie concurring.**

None dissenting.

ATTEST:



Earl R. Taylor, Executive Director