

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

IN RE:)	
)	
TENNESSEE WATER SERVICE, INC.)	
PETITION TO ADOPT ANNUAL)	DOCKET NO. 23-00046
REVIEW MECHANISM AND TARIFF)	
PURSUANT TO TENN. CODE ANN. § 65-)	
5-103(d)(6))	
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**REBUTTAL TESTIMONY
OF
DANTE M. DeSTEFANO**

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

September 22, 2023

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

2 **A.** My name is Dante M. DeStefano, and my business address is 500 W. Monroe Street, Suite
3 3600, Chicago, Illinois 60661-3779.

4 **Q. ARE YOU THE SAME DANTE M. DESTEFANO WHO SUBMITTED DIRECT**
5 **TESTIMONY IN THIS PROCEEDING?**

6 **A.** Yes, I am.

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

9 **A.** The purpose of my testimony is to respond on behalf of Tennessee Water Service, Inc.
10 (“TWS” or “Company”) to the direct testimony of David Dittmore, filed on behalf of the
11 Consumer Advocate Division of the Tennessee Attorney General’s Office (“Consumer
12 Advocate”) in this proceeding.

13 **CONSUMER ADVOCATE RECOMMENDATIONS AND PROPOSED MECHANISM**

14 **Q. PLEASE SUMMARIZE YOUR RESPONSE TO MR. DITTEMORE’S DIRECT**
15 **TESTIMONY.**

16 **A.** Mr. Dittmore recommends rejecting the Company’s proposed Annual Review Mechanism
17 (“ARM”) under the proposed terms and proposes an alternative mechanism that he believes
18 better suits TWS and would be in the public interest. Should an ARM be approved by the
19 Tennessee Public Utility Commission (“TPUC” or “Commission”), Mr. Dittmore
20 recommends certain modifications to the annual filing and its support be adopted.

1 While the Company is amenable to several of Mr. Dittmore's recommended
2 modifications to its proposed ARM, we believe Mr. Dittmore's analysis fails to properly
3 consider and address the Company's rationale for proposing the mechanism, and thus falls
4 short of the Company's and its customers' needs. Mr. Dittmore's proposed alternative
5 mechanism would likely exacerbate the concerns of the Company - and its customers - that
6 the proposed ARM attempts to resolve. Mr. Dittmore's concerns over regulatory costs of
7 an ARM are mitigated by the benefits customers would receive from the ARM, and the
8 ARM is demonstrably more cost effective than the alternative of filing multiple rate cases.
9 I will address my specific concerns with Mr. Dittmore's testimony in more detail below.

10 **Q. CAN YOU PLEASE DESCRIBE THE RATIONALE FOR THE COMPANY'S**
11 **PROPOSED ARM?**

12 **A.** Yes. As explained in detail in my direct testimony, the Company has seen continued,
13 material revenue growth due to reconnections in the aftermath of the Gatlinburg Wildfire
14 of 2016. This increase in revenues, when coupled with the lack of rate base growth and
15 the Company's management of its expenses, has resulted in steady increases in earned
16 returns on rate base. As these drivers are expected to continue for the foreseeable future,
17 and the Company's rates were last set with a much lower customer base, there is potential
18 for significant overearnings. While a base rate case would allow for revenue requirement
19 and tariff recalibration at first, the ongoing material changes in customer count would
20 require follow up rate cases to maintain such controls. The ARM process would allow for
21 a continued review and recalibration of the Company's revenue requirement which

1 captures the changes in its components, realignment of rate design (which has been a
2 concern voiced by TWS customers since the last rate case), and increased transparency of
3 TWS's operating results.

4 **Q. DOES MR. DITTEMORE'S ALTERNATIVE MECHANISM ADEQUATELY**
5 **ADDRESS THE ABOVE CONCERNS?**

6 **A.** No, it does not. Mr. Dittemore proposes that an alternative mechanism, requested in a new
7 docket under § 65-5-103(d)(7), be proposed by the Company that would establish a
8 Consumer Price Index ("CPI")-based rate adjustment mechanism. The CPI mechanism
9 would simply apply an inflationary adjustment to existing tariff rates each year. Mr.
10 Dittemore believes this mechanism would allow for regular rate updates, incentivize cost
11 control, and limit regulatory costs.

12 The CPI mechanism annual rate updates would however not address increases in
13 customer count and the resulting revenue growth that is already occurring, but would
14 nonetheless increase rates to customers, exacerbating the risk of overearning. Additionally,
15 there would not be a natural avenue to address customer feedback with existing rate design,
16 and incrementally increasing the current fixed and volume charges would likely add to
17 customer concerns regarding the current fixed/variable mix. The Company would be
18 required instead to submit a separate request for a revenue-neutral rate design change,
19 which would inevitably incur incremental costs to process. A revenue-neutral rate design
20 request would contain the same limitation as a stand-alone rate case – namely, that the rate
21 design would be unable to be managed on a going basis as customers continue to reconnect,

1 and would require additional filings to allow for needed recalibration. Finally, the high-
2 level nature of the CPI mechanism would not include a review of the Company's operations
3 through extensive discovery as described by Mr. Dittmore, no increased transparency to
4 TWS's operating costs for customers or regulators, and thus provides limited incentive to
5 manage costs to only reasonable and prudent levels.

6 Any alternative mechanism should be tailored to the needs of the utility in carrying
7 out its duties to customers, not simply authorized because it is a least cost option. The
8 Company believes the above reasons support that a CPI mechanism would not be just and
9 reasonable and in the public interest to TWS customers.

10
11 **CONSUMER ADVOCATE REJECTION OF PROPOSED ARM**

12 **Q. WHAT IS THE PRIMARY BASIS FOR THE CONSUMER ADVOCATE'S**
13 **REJECTION OF TWS'S PROPOSED ARM?**

14 **A.** The Consumer Advocate's rejection of the TWS proposed ARM is based primarily on the
15 assumption that the mechanism's annual filings will incur significant, excessive regulatory
16 costs – potentially in excess of \$35,000 inclusive of legal, filing, travel, and incremental
17 internal costs - and passing such costs to TWS's customer base would be unreasonable.
18 Mr. Dittmore claims the ARM would produce annual filing costs that may outpace the
19 revenue requirement deficiency, and TWS's regulatory support staff would be better
20 allocated to work on matters more material to the larger CII operations. Mr. Dittmore is

1 also skeptical that the Company would, if an ARM is not authorized, file multiple rate cases
2 in the coming years.

3 **Q. HOW DO YOU RESPOND TO THE CONCERN THAT THE COMPANY'S**
4 **ANNUAL FILING COSTS WILL BE EXCESSIVE?**

5 **A.** First, the Company would like to clarify that there would be no expected incremental
6 regulatory costs charged to TWS as a result of the ARM. TWS's regulatory support is
7 generally supplied by Water Service Corporation ("WSC") Financial Planning and
8 Analysis employees who have a direct responsibility to support CII operating entities in its
9 South Region, including TWS, and thus an ARM process would be part of their ongoing
10 responsibilities.

11 Second, Mr. Dittmore's concern that annual filing costs will outpace the resulting
12 revenue deficiency calculation—besides overlooking the variability likely to occur in any
13 given deficiency calculation—fails to account for the benefits the costs would allow
14 customers to reap from the mechanism. As noted previously, the customer base of TWS
15 continues to grow materially each year, generating additional present rate revenues that
16 offset costs and provide a benefit to customers as accounted for in a revenue requirement
17 calculation. For example, in the Company's workpaper supporting Exhibit 2 – Schedule
18 B-1 and Exhibit 2 – Schedule B-2 in this docket,¹ TWS identified a growth in average
19 customer count of 38.67 residential connections, with an average usage of 4,483 gallons
20 per customer per month. With an average monthly bill of \$102.08 at this usage at present

¹ This Exhibit was filed confidentially in connection with the Company's response to Question 1-21 in the Consumer Advocate's First Set of Discovery Requests.

1 rates, a year of revenue growth would amount to \$47,364 in increased revenue to offset
2 filing costs and other revenue requirement changes. These added revenues would only
3 nominally be offset by variable costs such as chemicals, purchased water, and power
4 expenses, and the small amount of capital required to reconnect premises would be offset
5 by continued depreciation of existing plant. This supports the Company's contention that
6 capturing the full scope of revenue requirement changes is beneficial for customers, even
7 should it come with an offsetting filing cost.

8 Third, the Company has represented in this docket that annual ARM filing costs
9 would likely be much lower than the estimate for the current docket. This expectation is
10 reasonable as the current proceeding will develop a routine process, methodologies, and
11 expectations that allows for efficient preparation and processing of annual filings. This
12 efficient and straightforward process results in minimal need for outside counsel input,
13 increases likelihood of settlements, and decreases likelihood of contested hearings.
14 Therefore, compared to the potential of multiple rate cases in the coming years to reset the
15 Company's authorized revenue requirement components, the annual ARM filing process
16 is likely to cost less than the alternative while realizing benefits otherwise accruing for
17 customers.

18 **Q. MR. DITTEMORE NOTES SEVERAL FACTORS THAT CAN INCREASE**
19 **PROCESSING COSTS FOR ARMS. DOES THE COMPANY'S PROPOSED ARM**
20 **MITIGATE THESE CONCERNS?**

1 **A.** Yes. Below, I discuss the Company's commitment to limit hard-coded data in its
2 workpapers to only when necessary. Additionally, the Company's limited operational
3 complexity, few volatile cost categories, and broad use of a single Attrition Period
4 methodology (i.e., historic averages extrapolated to future customer count levels) lends to
5 the expected simplicity and efficiency of the annual filings.

6 **Q. MR. DITTEMORE IS SKEPTICAL THE COMPANY WOULD FILE MULTIPLE**
7 **RATE CASES IN THE COMING YEARS. DO YOU AGREE WITH THE BASIS**
8 **OF HIS SKEPTICISM?**

9 **A.** No. Mr. Dittmore assumes that TWS's relatively small place in the CII operating utility
10 landscape lends itself to minimal base rate case filings. However, CII and TWS understand
11 that they must maintain proper service to their customers at reasonable rates, and those
12 rates should best represent the costs to serve TWS's customers. In TWS's situation, there
13 is a confluence of factors that it believes must be remedied and take precedence from a
14 regulatory perspective. As my direct testimony explains, should an ARM not be adopted,
15 TWS will need to utilize base rate case filings to manage its revenue requirement and rate
16 design in the coming years as customers continue to reconnect to the system. A single rate
17 case will not resolve the concerns on a going basis, and thus multiple rate cases will be
18 required.

19 **Q. MR. DITTEMORE CALCULATES A POTENTIAL IMPACT TO TWS**
20 **CUSTOMERS OF \$86/CUSTOMER/YEAR FOR ARM FILING COSTS. DO YOU**
21 **AGREE WITH THIS CALCULATION?**

1 **A.** No. Aside from the misapplication of \$35,000 as an annual filing cost estimate as
2 explained above, Mr. Dittmore again fails to account for the material customer growth
3 that is expected to occur over time. That is, any level of annual filing costs included in the
4 Attrition Period Rate Reset will have a decreasing impact on customers over time as the
5 customer base grows. Additionally, the estimated revenue growth discussed above would
6 more than cover the estimated impact of filing costs – using the same 408 current customers
7 as Mr. Dittmore’s calculation, the revenue growth would generate \$116.08/customer/year
8 of cost offsets in the revenue requirement.

9
10 **MODIFICATIONS TO PROPOSED ARM**

11 **Q.** **SHOULD AN ARM BE APPROVED, WHAT MODIFICATIONS DOES MR.**
12 **DITTEMORE RECOMMEND BE MADE TO TWS’S PROPOSAL?**

13 **A.** I will summarize Mr. Dittmore’s recommended modifications to the proposed ARM
14 below:

- 15 1) The Company should eliminate any hard-coded data within its calculations.
- 16 2) The Commission should require that the Non-Revenue Water (“NRW”) Rate
17 calculation apply to both the Historic Base Period and the Attrition Period Rate
18 Reset.
- 19 3) The NRW Rate threshold for recovery of applicable costs should be set at 15%.
- 20 4) Should TWS be acquired by another entity, the ARM should not be transferred
21 to the new owner.

1 **Q. IS TWS AMENABLE TO ELIMINATING HARD-CODED DATA WITHIN ITS**
2 **FILING'S CALCULATIONS?**

3 **A.** Generally, the Company agrees to this requirement. However, there are certain instances
4 where hard-coded data is unavoidable and necessary to support the calculations. For
5 example, data extracted from a software or database source, such as billing information,
6 trial balances, or general ledger activity can only be shown as hard-coded data.
7 Additionally, the Company may supply data that is taken directly from another source
8 document, such as its Annual Report to the Commission or a rate case filing. Lastly, the
9 Company's practice is to avoid creating workpaper formulas that link between workpapers,
10 in order to avoid functionality issues or other potential errors. In all of these cases, the
11 Company can commit that, to the extent data in one workpaper is derived from another
12 workpaper or contains raw data extracted from another source or software, and formulas
13 are not practical, TWS shall properly cite or cross-reference within the workpaper the
14 source of the hard-coded data. TWS will otherwise provide ARM template schedules and
15 supporting workpapers for the annual ARM filings with formulas intact and limit hard-
16 coded data to the above exceptions.

17 **Q. IS TWS AMENABLE TO INCLUDING A NRW RATE THRESHOLD FOR THE**
18 **HISTORIC BASE PERIOD?**

19 **A.** The Company is amenable to applying a similar NRW Rate threshold to the Historic Base
20 Period as it proposed for the Attrition Period Rate Reset. Attached to my testimony is an
21 updated Schedule B-3 that presents the revised calculation. I am also supplying with this

1 testimony an update to Exhibit 1 – ARM Methodologies supporting the update in the NRW
2 Rate process. Exhibit 1A reflects the changes made pursuant to this revision, and Exhibit
3 1B is a clean copy incorporating the revisions.

4 **Q. IS TWS AMENABLE TO SETTING THE NRW RATE THRESHOLD AT 15%?**

5 **A.** As described in my direct testimony, the Company believes its proposed 20% NRW
6 threshold level is reasonable for its particular circumstances, which situate it uniquely from
7 other larger and more geographically diverse utilities. Mr. Dittmore states his belief that
8 the new plant investment included in the last rate case should “positively impact the water
9 loss ratio going forward”. However, the major capital improvements made in the last rate
10 case were related to pumping and production facilities, not the distribution system, which
11 is where the vast majority of water loss tends to occur in water systems.

12 In addition, Mr. Dittmore references the calculation of an authorized NRW Rate
13 of 14.83% in the last TWS rate case as a basis for the reasonableness of the 15%
14 recommendation. However, this conflates two distinct frameworks for Non-Revenue
15 Water: utilizing an “authorized level” for Non-Revenue Water for ratemaking is not
16 equivalent to setting a “threshold level” for Non-Revenue Water. The former is a
17 normalized level that, in the last rate case, was based on an average of actual results. The
18 latter would represent an upper bound on the reasonableness of a measure that will
19 inevitably vary from period to period (hence the use of an average to develop a normalized
20 level for ratesetting). The threshold level thus works as a cap on either the normalized
21 average or the inputs to the normalized average. Therefore, the Company does not believe

1 the “authorized level” of non-revenue water from its last rate case should be a basis for
2 setting the NRW Rate “threshold level” in its ARM. In its ARM request, the Company has
3 proposed that an authorized level would effectively be the three-year historical average,
4 updated per my above testimony to consistently utilize a threshold level of 20%, and the
5 Company believes this method best addresses NRW by accounting for TWS’s ongoing
6 performance with incentive to control NRW.

7 **Q. IS TWS AMENABLE TO PROHIBITING TRANSFERABILITY OF THE ARM**
8 **SHOULD TWS BE SOLD TO ANOTHER OWNER?**

9 **A.** Yes, the Company is amenable to prohibiting an approved ARM from being transferred to
10 any potential acquirer of a direct controlling interest in TWS.

11 **Q. DOES TWS HAVE ANY ADDITIONAL PROPOSED MODIFICATIONS TO THE**
12 **PROPOSED ARM, BEYOND THOSE RECOMMENDED BY MR. DITTEMORE?**

13 **A.** Yes. First, TWS recognizes that at some point its customer base will stabilize or a base
14 rate case may otherwise be needed, limiting or overriding the benefits or utility of the
15 ARM. TWS will commit that it shall submit a re-evaluation proposal, recommending
16 either continuation, modification, or termination of the ARM, with its fifth annual ARM
17 filing or its next base rate case filing, whichever is earlier. The Commission shall rule on
18 the re-evaluation proposal in its Final Order in such future proceeding. This will allow the
19 Company to make its case regarding disposition of the mechanism, and the Commission
20 can make its determination after a review of the presented evidence.

1 Additionally, while the Company does not believe a cap on recovery of annual
2 ARM filing costs is required, we recognize and hope to address the Consumer Advocate's
3 primary concern on potentially excessive filing costs. TWS is amenable to the Commission
4 imposing a cap on recovery of ARM filing costs in each annual proceeding, adjusted for
5 inflation, that is inclusive of external costs and any incremental internal costs.

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

7 **A.** Yes, it does. However, I reserve the right to update or amend this testimony upon receipt
8 of additional data or other information that may become available.

I. Annual Review Mechanism (“ARM”) Process

The Company’s proposed ARM shall incorporate an historical year review of its revenues, expenses, investments (rate base), and rate of return components to determine if the Company earned the authorized return on equity adopted in the most recent rate case. If the Company earned more than the authorized return on equity, the earnings excess (grossed up to determine excess revenues) shall be deferred in a regulatory liability and rates shall be reduced for this amount prospectively. If the Company earned less than its authorized return on equity, the Company shall defer expenses to a regulatory asset and rates shall be increased for this amount prospectively. Under both scenarios, the Company is proposing that any carrying charges be computed and accrued for on the simple average of the deferred balance. The simple average shall be determined based on the final year end deferred balance, assuming the balance accrued evenly throughout the year. The average balance shall then be multiplied by the authorized rate of return per the Company’s 2019 Rate Case Final Order (“Rate Order”)¹.

In addition to the review of the annual earnings deficiency or excess, rates shall be adjusted prospectively based on an adjusted historic base period (“Attrition Period”) so that the Company may earn its authorized return in the future, as well as include the recovery or refund of the deferred balance reflecting any earnings deficiency or excess.

The annual earnings deficiency or excess review and Rate Reset shall occur in one filing, made on or before April 30th of each year. The historic base period for the ARM filing shall align with the Company’s most recent fiscal year end, December 31st. In summary, there shall be one annual filing that shall include the determination of the earning deficiency or excess, based on a reconciliation of the historic base period, and the Rate Reset, based on an adjusted cost of service for the historic base period. Per TCA 65-5-103(d)(1)(B), the Commission shall make a final determination on the filing no later than 120 days from the initial filing. Therefore, the final determination shall be issued by August 28th, and adjusted rates shall go into effect on September 1st.

Finally, the methodologies detailed below have been ordered and are numbered consistent with the applicable corresponding sections and page numbers in the Rate Case Order. Based on the Commission’s rationale and discussions of the methodologies adopted in the Rate Order, the Company has determined that its proposed adjustment methodologies would be a reasonable basis for its ARM.

II. Methodologies

The below methodologies shall be utilized for determining the appropriate revenue requirement components for both the Attrition Period Rate Reset and the Historic Period Excess or Deficiency Calculation. For the Attrition Period, the Company may adjust certain expenses to reflect annualization of new or changed circumstances (e.g., a new rent expense due to an office move or new office being added).

¹ Order, *In Petition of Tennessee Water Service, Inc. for Adjustment of Rates and Charges, Approval of a Qualified Infrastructure Investment Program, and Modification to Certain Terms and Conditions for the Provision of Water Service*, Docket No. 19-00028, dated January 30, 2020.

A. Attrition Period (Page 9)

Defined as the year in which adjusted rates shall be in effect – September 1st to August 31st.

B. Historic Period (Page 9)

Defined as the most recently completed fiscal year ended December 31st as of the time of ARM filing.

C. Water Revenues (Page 10)

For the Attrition Period Rate Reset, the Company shall set its billing determinants based on projecting the average monthly customer counts in the Attrition Period and using the average per customer monthly consumption in the prior three calendar years. These billing determinants shall be applied to the applicable present tariff rates and usage blocks to determine Attrition Period present revenues.

For the Historic Period Excess or Deficiency Calculation, recorded revenues shall be used.

D. Other Revenues (Page 10)

For the Attrition Period Rate Reset, a rate of 1.4773% shall be used for late fees (forfeited discounts) per the Rate Order. For the remainder of Other Revenues, the Company shall use the actual Other Revenues per customer for the prior three calendar years, then multiply this value times the forecasted Attrition Period customer count per the Water Revenues methodology above.

For the Historic Period Excess or Deficiency Calculation, actual Other Revenues shall be used.

E. Expenses: Salaries and Wages (Page 17)

For the Attrition Period Rate Reset and the Historic Period Excess or Deficiency Calculation, the Company shall use the actual Salaries and Wages and capitalized labor as booked in the Historic Period.

F. Expenses: Purchased Power, Maintenance Testing, Transportation, Office Supplies, Benefits, Insurance, Maintenance and Repair, Chemicals, Office Utilities, Outside Services, Rent, and Miscellaneous, Purchased Water, Bad Debt (Page 11, 13, 14, 15, 16, 17)

For the Attrition Period Rate Reset in these expense line items, the Company shall use the actual expenses per customer for the prior three calendar years, then multiply this amount times the CPI Index – Water & Sewerage Maintenance² value for the end of the Historic Period, compounded by 20 months (midpoint of the Historic Period through midpoint of the Attrition Period). Then, this value is multiplied by the forecasted Attrition Period customer count per the Water Revenues methodology above.

For the Historic Period Excess or Deficiency Calculation, actual expenses for these line items shall be used.

² <https://www.bls.gov/news.release/cpi.t02.htm>, Unadjusted percentage change, last 12 months window.

G. Expenses: Non-Revenue Water

The Company shall calculate and supply a Non-Revenue Water ("NRW") rate for the Historic Period Excess or Deficiency Calculation and for the Attrition Period Rate Reset in Schedule B-3. The NRW rate is computed by subtracting Total Metered Consumption from Total Water Supplied, and dividing the resulting difference by Total Water Supplied. These inputs shall be derived, for the Historic Period calculation, from TWS's most recent calendar year Annual Report to the Commission. These inputs shall be derived, for the Attrition Period Rate Reset calculation, from the aggregation of the Company's prior three calendar year Annual Reports to the Commission.

If the NRW rate is above 20% for the Historic Period Excess or Deficiency Calculation or the Attrition Period Rate Reset, the Company shall proportionately adjust the following expenses for the corresponding Period calculation: Purchased Water Expense, Chemicals Expense, and Purchased Power Expense. For the Attrition Period Rate Reset, the procedure is as follows:

- The proportional adjustment for Purchased Power Expense shall be computed by dividing one plus the 20% threshold by one plus the aggregate NRW Rate for the prior three calendar years, with the resulting ratio then multiplied by the Attrition Period Rate Reset amount calculated per the methodology in Paragraph F above.
- A Purchased Water Ratio shall be calculated by dividing the T~~t~~otal P~~p~~urchased W~~w~~ater in aggregate for the prior three calendar years by the Total Water Supplied. The proportional adjustment for Purchased Water Expense shall be computed by dividing one plus the product of the 20% threshold and the Purchased Water Ratio by one plus the product of the aggregate NRW Rate for the prior three calendar years and the Purchased Water Ratio, with the resulting ratio then multiplied by the Attrition Period Rate Reset amount calculated per the methodology in Paragraph F above.
- A Well Water Ratio shall be calculated by dividing the T~~t~~otal ~~w~~ell ~~w~~ater in aggregate for the prior three calendar years by the Total Water Supplied. The proportional adjustment for Chemicals Expense shall be computed by dividing one plus the product of the 20% threshold and the Well Water Ratio by one plus the product of the aggregate NRW Rate for the prior three calendar years and the Well Water Ratio, with the resulting ratio then multiplied by the Attrition Period Rate Reset amount calculated per the methodology in Paragraph F above.

For the Historic Period Excess or Deficiency Calculation, the procedure is as follows:

- The proportional adjustment for Purchased Power Expense shall be computed by dividing one plus the 20% threshold by one plus the NRW Rate for the prior calendar year, with the resulting ratio then multiplied by the Historic Period Excess or Deficiency Calculation amount calculated per the methodology in Paragraph F above.
- A Purchased Water Ratio shall be calculated by dividing the Total Purchased Water for the prior calendar year by the Total Water Supplied. The proportional adjustment for Purchased Water Expense shall be computed by dividing one plus the product of the 20% threshold and the Purchased Water Ratio by one plus the product of the NRW Rate for the prior calendar year and the Purchased Water Ratio, with the resulting ratio then multiplied by the Historic Period Excess or Deficiency Calculation amount calculated per the methodology in Paragraph F above.

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- A Well Water Ratio shall be calculated by dividing the Total Well Water for the prior calendar year by the Total Water Supplied. The proportional adjustment for Chemicals Expense shall be computed by dividing one plus the product of the 20% threshold and the Well Water Ratio by one plus the product of the NRW Rate for the prior calendar year and the Well Water Ratio, with the resulting ratio then multiplied by the Historic Period Excess or Deficiency Calculation amount calculated per the methodology in Paragraph F above.

H. Depreciation Expense and CIAC Amortization Expense (Page 18, 19)

For the Attrition Period Rate Reset, the Company shall use the authorized depreciation and CIAC amortization rates as applicable to utility plant balances as of the end of the Historic Period.

For the Historic Period Excess or Deficiency Calculation, actual expenses for these line items shall be used.

I. Amortization of Investment Tax Credits, Excess Deferred Income Taxes, Regulatory Liabilities and Regulatory Assets (Page 19, 20, 21)

For the Attrition Period Rate Reset, the Company shall use the authorized amortization life applied to the authorized balances per the Rate Order. Should the amortization conclude during an Attrition Period, the Company shall reflect only the amount relevant for that Attrition Period in the Rate Reset calculation (i.e., not an annualized level).

For the Historic Period Excess or Deficiency Calculation, actual amortization for these line items shall be used. The Company shall expense the costs related to the processing of the annual ARM filing, and therefore recover such costs as part of the Excess or Deficiency Calculation in the normal course of the ARM process. The costs if this initial ARM filing shall be deferred and recovered over three ARM years.

J. Taxes Other than Income: Payroll Taxes, Real Estate Tax (Pages 22, 23)

For the Attrition Period Rate Reset and the Historic Period Excess or Deficiency Calculation, the Company shall use the actual Payroll Taxes as booked in the Historic Period.

K. Taxes Other than Income: Franchise Tax, Gross Receipts Tax, Property Tax (Page 22, 23)

For the Attrition Period Rate Reset in these tax line items, the Company shall use the actual expenses per customer for the prior three calendar years, then multiply this amount times the CPI Index – Water & Sewerage Maintenance value for the end of the Historic Period, compounded by 20 months (midpoint of the Historic Period through midpoint of the Attrition Period). Then, this value is multiplied by the forecasted Attrition Period customer count per the Water Revenues methodology above.

For the Historic Period Excess or Deficiency Calculation, actual expenses for these line items shall be used.

L. Inspection Fees (page 24)

For the Attrition Period Rate Reset, the Company shall use a level based on the Attrition Period's gross receipts, less Bad Debt Expense.

For the Historic Period Excess or Deficiency Calculation, actual Inspection Fees shall be used.

M. State Excise and Federal Income Taxes (Page 24)

For the Attrition Period Rate Reset, the Company shall use the applicable statutory rates.

For the Historic Period Excess or Deficiency Calculation, the statutory State Excise and Federal Income Tax rates as of the end of the Historic Period shall be used.

N. Utility Plant in Service, Accumulated Depreciation, CIAC, Accumulated Amortization of CIAC, Accumulated Deferred Income Taxes (Page 25, 31, 32)

For the Attrition Period Rate Reset, the Company shall use the balances for these line items as of the end of the Historic Period.

For the Historic Period Excess or Deficiency Calculation, the Company shall use the 13-month average (December to December) of the balances for these line items.

O. Cash Working Capital (Page 26)

For both the Attrition Period Rate Reset and Historic Period Excess or Deficiency Calculation, the Company shall use the applicable Period's total Operation and Maintenance Expenses and Taxes Other than Income, less Purchased Water, multiplied by $1/8^{\text{th}}$.

P. Deferred Operating Losses, Deferred Return on Incremental Plant Investment, Deferred Rate Case Costs, Regulatory Liability – Uninsured Property, Excess Deferred Income Taxes (Page 27, 28, 30, 33, 34)

For both the Attrition Period Rate Reset and Historic Period Excess or Deficiency Calculation, the Company shall use the applicable Period's 13-month average (December to December for Historic Period, September to August for Attrition Period) of the unamortized balances for these line items.

Q. Revenue Conversion Factor (Page 39)

For both the Attrition Period Rate Reset and Historic Period Excess or Deficiency Calculation, the Company shall use the approved conversion factor of 1.337392 per the Rate Order, adjusted as needed for any changes per the above methodologies. The excise and federal income tax components are subject to change to reflect the then-current rate.

R. Rate of Return (Page 40)

For both the Attrition Period Rate Reset and Historic Period Excess or Deficiency Calculation, the Company shall use the approved 50%/50% debt/equity ratio, 5.04% cost of debt, and 10.50% return on equity per the Rate Order.

S. Other Adjustments

Consistent with Commission Rules, costs not generally allowed for rate recovery shall be removed or excluded from both the Historic Period and Attrition Period. Removals and exclusions include, but are not limited to, the following categories: Advertising, Lobbying, Charitable Contributions, and Fines & Penalties. Any material one-time, non-recurring items impacting income or costs may be identified and adjusted for by the Company for either the Historic Period or Attrition Period.

T. New Matters

New Matters refers to any issue, adjustment, and/or ambiguity in or for any account, method of accounting or estimation, or ratemaking topic that would directly or indirectly affect the Annual ARM Filing for which there is no explicit prior determination by the Commission regarding the Company. The Company may reflect, for the Attrition Period, amortization expense and unamortized balances for new deferral amounts incurred since the Rate Order or for deferral amounts not yet authorized for amortization. The Attrition Period shall also reflect any other relevant changes since the Rate Order in GAAP or other regulatory pronouncements or tax law changes. The Company may include and present studies or other evidence supporting other necessary changes since the Rate Order, such as depreciation studies.

U. Rate Design and Tariff Changes

The Company may propose adjustments to the then-current rate design, miscellaneous terms, tariff language or provisions.

V. Excess or Deficiency Deferral

The Company shall defer any revenue excess or deficiency incurred in the Historic Period. The Company shall recover/credit over the Attrition Period any revenue deficiency/excess deferred. The deferral shall accrue carrying charges at the authorized rate of return of 7.77% per the Rate Order. Carrying charges shall be calculated based on a simple average of the starting and ending balance of the Historic Period.

W. Additional Alternative Rate Mechanisms

Authorization of the ARM process does not preclude the Company requesting or being approved to implement additional alternative rate mechanisms, as allowed pursuant to T.C.A. § 65-5-103(d).

X. Affidavit Certifying Filing

The Company shall include with its annual filings an affidavit signed by an officer of the Company, certifying that the information included within the filing is accurate and complete.

Y. Cost Allocation Manual

The Company shall include with its annual filings the most current iteration of its Cost Allocation Manual ("CAM"), which details the allocation methodologies for affiliate costs supporting operating companies such as TWS. The CAM shall be consistent with the terms of the active Affiliate interest Agreement for TWS.

III. Defined Terms

A. Excess or Deficiency Calculation

The Company shall calculate, based on the methodologies described above, any excess earnings or deficiency for the Historic Period. The excess earnings or deficiency shall be based on the comparison of the earned return on equity and the authorized 10.50%. This amount shall be used to calculate the Annual True-Up Rate Adjustment.

B. Annual True-Up Rate Adjustment

Defined as the revenue adjustment necessary to allow the Company to recover from or credit to customers the Historic Period deficiency or excess earnings. The Excess or Deficiency Calculation result shall be multiplied by the Revenue Conversion Factor, then shall incorporate any carrying charges, to determine the revenue adjustment required in setting the Attrition Period revenue requirement.

Commented [DD1]: This amount should be the same as the Excess or Deficiency Deferral.

C. Attrition Period Rate Reset

Defined as the adjustment of rates applicable to the Attrition Period, effective September 1st each year, that reflects the Attrition Period methodologies described above and incorporates the Annual True-Up Rate Adjustment into the revenue requirement.

D. Annual ARM Filing

By April 30th each year, the Company shall file with the Commission the schedules and workpapers that reflect 1) actual Historic Period amounts per its books and records, 2) any adjustments to the Historic Period actuals per the methodologies described above, 3) the Excess Earnings or Deficiency Calculation and resulting Annual True-Up Rate Adjustment, 4) the Attrition Period Rate Reset revenue requirement, inclusive of any recovery/credit from the Annual True-Up Rate Adjustment, calculated per the methodologies described above, 5) proposed tariff rates that support the Attrition Period Rate Reset revenue requirement, and 6) the most current version of the Company's Cost Allocation Manual ("CAM"). The list of schedules to be filed shall include, but need not be limited to:

SCHEDULE	NAME
A	Rate Base
B	Income Statement
C	Annual True Up Reconciliation and Attrition Period Rate Reset
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A-5	Regulatory Liability and EDIT
A-6	CIAC and CIAC Amortization Expense
B-1	Attrition Period Revenues and Rate Design
B-2	Bill Comparisons at Present Rates and Proposed Rates
B-3	Non-Revenue Water Rate

I. Annual Review Mechanism (“ARM”) Process

The Company’s proposed ARM shall incorporate an historical year review of its revenues, expenses, investments (rate base), and rate of return components to determine if the Company earned the authorized return on equity adopted in the most recent rate case. If the Company earned more than the authorized return on equity, the earnings excess (grossed up to determine excess revenues) shall be deferred in a regulatory liability and rates shall be reduced for this amount prospectively. If the Company earned less than its authorized return on equity, the Company shall defer expenses to a regulatory asset and rates shall be increased for this amount prospectively. Under both scenarios, the Company is proposing that any carrying charges be computed and accrued for on the simple average of the deferred balance. The simple average shall be determined based on the final year end deferred balance, assuming the balance accrued evenly throughout the year. The average balance shall then be multiplied by the authorized rate of return per the Company’s 2019 Rate Case Final Order (“Rate Order”)¹.

In addition to the review of the annual earnings deficiency or excess, rates shall be adjusted prospectively based on an adjusted historic base period (“Attrition Period”) so that the Company may earn its authorized return in the future, as well as include the recovery or refund of the deferred balance reflecting any earnings deficiency or excess.

The annual earnings deficiency or excess review and Rate Reset shall occur in one filing, made on or before April 30th of each year. The historic base period for the ARM filing shall align with the Company’s most recent fiscal year end, December 31st. In summary, there shall be one annual filing that shall include the determination of the earning deficiency or excess, based on a reconciliation of the historic base period, and the Rate Reset, based on an adjusted cost of service for the historic base period. Per TCA 65-5-103(d)(1)(B), the Commission shall make a final determination on the filing no later than 120 days from the initial filing. Therefore, the final determination shall be issued by August 28th, and adjusted rates shall go into effect on September 1st.

Finally, the methodologies detailed below have been ordered and are numbered consistent with the applicable corresponding sections and page numbers in the Rate Case Order. Based on the Commission’s rationale and discussions of the methodologies adopted in the Rate Order, the Company has determined that its proposed adjustment methodologies would be a reasonable basis for its ARM.

II. Methodologies

The below methodologies shall be utilized for determining the appropriate revenue requirement components for both the Attrition Period Rate Reset and the Historic Period Excess or Deficiency Calculation. For the Attrition Period, the Company may adjust certain expenses to reflect annualization of new or changed circumstances (e.g., a new rent expense due to an office move or new office being added).

¹ Order, *In Petition of Tennessee Water Service, Inc. for Adjustment of Rates and Charges, Approval of a Qualified Infrastructure Investment Program, and Modification to Certain Terms and Conditions for the Provision of Water Service*, Docket No. 19-00028, dated January 30, 2020.

A. Attrition Period (Page 9)

Defined as the year in which adjusted rates shall be in effect – September 1st to August 31st.

B. Historic Period (Page 9)

Defined as the most recently completed fiscal year ended December 31st as of the time of ARM filing.

C. Water Revenues (Page 10)

For the Attrition Period Rate Reset, the Company shall set its billing determinants based on projecting the average monthly customer counts in the Attrition Period and using the average per customer monthly consumption in the prior three calendar years. These billing determinants shall be applied to the applicable present tariff rates and usage blocks to determine Attrition Period present revenues.

For the Historic Period Excess or Deficiency Calculation, recorded revenues shall be used.

D. Other Revenues (Page 10)

For the Attrition Period Rate Reset, a rate of 1.4773% shall be used for late fees (forfeited discounts) per the Rate Order. For the remainder of Other Revenues, the Company shall use the actual Other Revenues per customer for the prior three calendar years, then multiply this value times the forecasted Attrition Period customer count per the Water Revenues methodology above.

For the Historic Period Excess or Deficiency Calculation, actual Other Revenues shall be used.

E. Expenses: Salaries and Wages (Page 17)

For the Attrition Period Rate Reset and the Historic Period Excess or Deficiency Calculation, the Company shall use the actual Salaries and Wages and capitalized labor as booked in the Historic Period.

F. Expenses: Purchased Power, Maintenance Testing, Transportation, Office Supplies, Benefits, Insurance, Maintenance and Repair, Chemicals, Office Utilities, Outside Services, Rent, and Miscellaneous, Purchased Water, Bad Debt (Page 11, 13, 14, 15, 16, 17)

For the Attrition Period Rate Reset in these expense line items, the Company shall use the actual expenses per customer for the prior three calendar years, then multiply this amount times the CPI Index – Water & Sewerage Maintenance² value for the end of the Historic Period, compounded by 20 months (midpoint of the Historic Period through midpoint of the Attrition Period). Then, this value is multiplied by the forecasted Attrition Period customer count per the Water Revenues methodology above.

For the Historic Period Excess or Deficiency Calculation, actual expenses for these line items shall be used.

² <https://www.bls.gov/news.release/cpi.t02.htm>, Unadjusted percentage change, last 12 months window.

G. Expenses: Non-Revenue Water

The Company shall calculate and supply a Non-Revenue Water ("NRW") rate for the Historic Period Excess or Deficiency Calculation and for the Attrition Period Rate Reset in Schedule B-3. The NRW rate is computed by subtracting Total Metered Consumption from Total Water Supplied, and dividing the resulting difference by Total Water Supplied. These inputs shall be derived, for the Historic Period calculation, from TWS's most recent calendar year Annual Report to the Commission. These inputs shall be derived, for the Attrition Period Rate Reset calculation, from the aggregation of the Company's prior three calendar year Annual Reports to the Commission.

If the NRW rate is above 20% for the Historic Period Excess or Deficiency Calculation or the Attrition Period Rate Reset, the Company shall proportionately adjust the following expenses for the corresponding Period calculation: Purchased Water Expense, Chemicals Expense, and Purchased Power Expense. For the Attrition Period Rate Reset, the procedure is as follows:

- The proportional adjustment for Purchased Power Expense shall be computed by dividing one plus the 20% threshold by one plus the aggregate NRW Rate for the prior three calendar years, with the resulting ratio then multiplied by the Attrition Period Rate Reset amount calculated per the methodology in Paragraph F above.
- A Purchased Water Ratio shall be calculated by dividing the Total Purchased Water in aggregate for the prior three calendar years by the Total Water Supplied. The proportional adjustment for Purchased Water Expense shall be computed by dividing one plus the product of the 20% threshold and the Purchased Water Ratio by one plus the product of the aggregate NRW Rate for the prior three calendar years and the Purchased Water Ratio, with the resulting ratio then multiplied by the Attrition Period Rate Reset amount calculated per the methodology in Paragraph F above.
- A Well Water Ratio shall be calculated by dividing the Total Well Water in aggregate for the prior three calendar years by the Total Water Supplied. The proportional adjustment for Chemicals Expense shall be computed by dividing one plus the product of the 20% threshold and the Well Water Ratio by one plus the product of the aggregate NRW Rate for the prior three calendar years and the Well Water Ratio, with the resulting ratio then multiplied by the Attrition Period Rate Reset amount calculated per the methodology in Paragraph F above.

For the Historic Period Excess or Deficiency Calculation, the procedure is as follows:

- The proportional adjustment for Purchased Power Expense shall be computed by dividing one plus the 20% threshold by one plus the NRW Rate for the prior calendar year, with the resulting ratio then multiplied by the Historic Period Excess or Deficiency Calculation amount calculated per the methodology in Paragraph F above.
- A Purchased Water Ratio shall be calculated by dividing the Total Purchased Water for the prior calendar year by the Total Water Supplied. The proportional adjustment for Purchased Water Expense shall be computed by dividing one plus the product of the 20% threshold and the Purchased Water Ratio by one plus the product of the NRW Rate for the prior calendar year and the Purchased Water Ratio, with the resulting ratio then multiplied by the Historic Period Excess or Deficiency Calculation amount calculated per the methodology in Paragraph F above.

- A Well Water Ratio shall be calculated by dividing the Total Well Water for the prior calendar year by the Total Water Supplied. The proportional adjustment for Chemicals Expense shall be computed by dividing one plus the product of the 20% threshold and the Well Water Ratio by one plus the product of the NRW Rate for the prior calendar year and the Well Water Ratio, with the resulting ratio then multiplied by the Historic Period Excess or Deficiency Calculation amount calculated per the methodology in Paragraph F above.

H. Depreciation Expense and CIAC Amortization Expense (Page 18, 19)

For the Attrition Period Rate Reset, the Company shall use the authorized depreciation and CIAC amortization rates as applicable to utility plant balances as of the end of the Historic Period.

For the Historic Period Excess or Deficiency Calculation, actual expenses for these line items shall be used.

I. Amortization of Investment Tax Credits, Excess Deferred Income Taxes, Regulatory Liabilities and Regulatory Assets (Page 19, 20, 21)

For the Attrition Period Rate Reset, the Company shall use the authorized amortization life applied to the authorized balances per the Rate Order. Should the amortization conclude during an Attrition Period, the Company shall reflect only the amount relevant for that Attrition Period in the Rate Reset calculation (i.e., not an annualized level).

For the Historic Period Excess or Deficiency Calculation, actual amortization for these line items shall be used. The Company shall expense the costs related to the processing of the annual ARM filing, and therefore recover such costs as part of the Excess or Deficiency Calculation in the normal course of the ARM process. The costs if this initial ARM filing shall be deferred and recovered over three ARM years.

J. Taxes Other than Income: Payroll Taxes, Real Estate Tax (Pages 22, 23)

For the Attrition Period Rate Reset and the Historic Period Excess or Deficiency Calculation, the Company shall use the actual Payroll Taxes as booked in the Historic Period.

K. Taxes Other than Income: Franchise Tax, Gross Receipts Tax, Property Tax (Page 22, 23)

For the Attrition Period Rate Reset in these tax line items, the Company shall use the actual expenses per customer for the prior three calendar years, then multiply this amount times the CPI Index – Water & Sewerage Maintenance value for the end of the Historic Period, compounded by 20 months (midpoint of the Historic Period through midpoint of the Attrition Period). Then, this value is multiplied by the forecasted Attrition Period customer count per the Water Revenues methodology above.

For the Historic Period Excess or Deficiency Calculation, actual expenses for these line items shall be used.

L. Inspection Fees (page 24)

For the Attrition Period Rate Reset, the Company shall use a level based on the Attrition Period's gross receipts, less Bad Debt Expense.

For the Historic Period Excess or Deficiency Calculation, actual Inspection Fees shall be used.

M. State Excise and Federal Income Taxes (Page 24)

For the Attrition Period Rate Reset, the Company shall use the applicable statutory rates.

For the Historic Period Excess or Deficiency Calculation, the statutory State Excise and Federal Income Tax rates as of the end of the Historic Period shall be used.

N. Utility Plant in Service, Accumulated Depreciation, CIAC, Accumulated Amortization of CIAC, Accumulated Deferred Income Taxes (Page 25, 31, 32)

For the Attrition Period Rate Reset, the Company shall use the balances for these line items as of the end of the Historic Period.

For the Historic Period Excess or Deficiency Calculation, the Company shall use the 13-month average (December to December) of the balances for these line items.

O. Cash Working Capital (Page 26)

For both the Attrition Period Rate Reset and Historic Period Excess or Deficiency Calculation, the Company shall use the applicable Period's total Operation and Maintenance Expenses and Taxes Other than Income, less Purchased Water, multiplied by $1/8^{\text{th}}$.

P. Deferred Operating Losses, Deferred Return on Incremental Plant Investment, Deferred Rate Case Costs, Regulatory Liability – Uninsured Property, Excess Deferred Income Taxes (Page 27, 28, 30, 33, 34)

For both the Attrition Period Rate Reset and Historic Period Excess or Deficiency Calculation, the Company shall use the applicable Period's 13-month average (December to December for Historic Period, September to August for Attrition Period) of the unamortized balances for these line items.

Q. Revenue Conversion Factor (Page 39)

For both the Attrition Period Rate Reset and Historic Period Excess or Deficiency Calculation, the Company shall use the approved conversion factor of 1.337392 per the Rate Order, adjusted as needed for any changes per the above methodologies. The excise and federal income tax components are subject to change to reflect the then-current rate.

R. Rate of Return (Page 40)

For both the Attrition Period Rate Reset and Historic Period Excess or Deficiency Calculation, the Company shall use the approved 50%/50% debt/equity ratio, 5.04% cost of debt, and 10.50% return on equity per the Rate Order.

S. Other Adjustments

Consistent with Commission Rules, costs not generally allowed for rate recovery shall be removed or excluded from both the Historic Period and Attrition Period. Removals and exclusions include, but are not limited to, the following categories: Advertising, Lobbying, Charitable Contributions, and Fines & Penalties. Any material one-time, non-recurring items impacting income or costs may be identified and adjusted for by the Company for either the Historic Period or Attrition Period.

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New Matters refers to any issue, adjustment, and/or ambiguity in or for any account, method of accounting or estimation, or ratemaking topic that would directly or indirectly affect the Annual ARM Filing for which there is no explicit prior determination by the Commission regarding the Company. The Company may reflect, for the Attrition Period, amortization expense and unamortized balances for new deferral amounts incurred since the Rate Order or for deferral amounts not yet authorized for amortization. The Attrition Period shall also reflect any other relevant changes since the Rate Order in GAAP or other regulatory pronouncements or tax law changes. The Company may include and present studies or other evidence supporting other necessary changes since the Rate Order, such as depreciation studies.

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