

# BUTLER | SNOW

October 22, 2024

## VIA ELECTRONIC FILING

Hon. David Jones, Chairman  
c/o Ectory Lawless, Docket Room Manager  
Tennessee Public Utility Commission  
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Electronically Filed in TPUC Docket Room  
on October 22, 2024 at 2:22 p.m.

**RE: *Petition of Tennessee-American Water Company to Modify Tariff, Change and Increase Charges, Fees, and Rates, and for Approval of a General Rate Increase, TPUC Docket No. 24-00032***

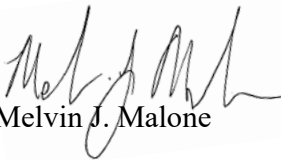
Dear Chairman Jones:

Attached for filing please find *Tennessee-American Water Company's Rebuttal Testimonies for (1) Heath Brooks; (2) Ann Bulkley; (3) Dominic J. DeGrazia; (4) Grant Evitts; (5) Nicholas Furia; (6) Larry Kennedy; (7) Bob Lane; (8) Robert V. Mustich; (9) Robert Prendergast; (10) Charles Rea; (11) Linda Schlessman; (12) Grady Stout; (13) Harold Walker, III; and (14) John Watkins* in the above-captioned matter.

As required, the original plus four (4) hard copies will follow. Should you have any questions concerning this filing, or require additional information, please do not hesitate to contact me.

Very truly yours,

BUTLER SNOW LLP



Melvin J. Malone

clw

Attachments

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**TENNESSEE-AMERICAN WATER COMPANY, INC.**

**DOCKET NO. 24-00032**

**REBUTTAL TESTIMONY**

**OF**

**NICHOLAS FURIA**

**ON**

**CAPITAL STRUCTURE**

**REBUTTAL TESTIMONY  
NICHOLAS FURIA  
TENNESSEE AMERICAN WATER COMPANY  
DOCKET NO. 24-00032**

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1     **I.     INTRODUCTION**

2     **Q.     PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3     A.     My name is Nicholas Furia. My business address is 1 Water St, Camden, NJ 08088.

4     **Q.     BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

5     A.     I am employed by American Water Works Service Company, Inc (“Service Company” or  
6           “AWWSC”) as Vice President and Treasurer. The Service Company is a subsidiary of  
7           American Water Works Company, Inc. (“American Water”) that provides support services  
8           to American Water’s subsidiaries, including Tennessee-American Water Company  
9           (“Tennessee-American,” “TAWC,” or the “Company”).

10    **Q.     DID YOU PREVIOUSLY SUBMIT DIRECT TESTIMONY IN THIS**  
11       **PROCEEDING ON BEHALF OF TENNESSEE-AMERICAN WATER COMPANY,**  
12       **INC. (“TAWC” OR THE “COMPANY”) IN THIS PROCEEDING?**

13    A.     Yes. I filed direct testimony on May 1, 2024.

14    **Q.     WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

15    A.     The purpose of my rebuttal testimony is to: (1) respond to recommendations of Office of  
16           the Tennessee Attorney General Consumer Advocate Division (“CAD”) witness Aaron  
17           Rothschild regarding TAWC’s capital structure; and (2) respond to the recommendations  
18           of City of Chattanooga (“COC”) witness Mark Garrett regarding TAWC’s capital structure.  
19           If and to the extent that I do not address a particular issue raised by these witnesses in my  
20           rebuttal testimony, it is not acceptance of that issue.

21    **Q.     WHAT IS THE COMPANY’S PROPOSED CAPITAL STRUCTURE?**

1 A. As discussed in my direct testimony,<sup>1</sup> the Attrition Year capital structure is comprised of  
2 1.99% short-term debt, 43.49% long-term debt (45.48% total debt), and 54.52% common  
3 equity.

4 **Q. ARE YOU SPONSORING ANY EXHIBITS WITH YOUR REBUTTAL**  
5 **TESTIMONY?**

6 A. No.

7 **II. RESPONSE TO CAD WITNESS AARON ROTHSCILD**

8 **Q. DOES MR. ROTHSCILD AGREE WITH TAWC'S PROPOSED ATTRITION**  
9 **YEAR CAPITAL STRUCTURE?**

10 A. No. He contends that "it has a significantly higher common equity ratio (54.52%) than the  
11 average common equity ratio used by other water utility companies in the country (50.9%)"  
12 and it is higher than "the consolidated capital structure being used by TAWC's parent  
13 American water Works Company, Inc. (about 44%)."<sup>2</sup> The average he refers to is the  
14 average of his selected proxy group companies.

15 **Q. WHAT CAPITAL STRUCTURE DOES MR. ROTHSCILD RECOMMEND?**

16 A. He recommends a capital structure consisting of 50.90% equity, 47.11% long-term debt  
17 and 1.99% short-term debt.

18 **Q. MR. ROTHSCILD STATES THAT "THE UTILITY HAS THE BURDEN OF**  
19 **PROOF TO DEMONSTRATE THAT ITS REQUESTED CAPITAL STRUCTURE**

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<sup>1</sup> Direct Testimony of Nicholas Furia at 4:10-12.

<sup>2</sup> CAD witness Aaron Rothschild at 8:11-14; see also 78:10-11.

1       **FOR REGULATORY PURPOSES PRODUCES THE LOWEST, REASONABLE**  
2       **OVERALL COST OF CAPITAL.”<sup>3</sup> DO YOU AGREE?**

3       A.     No. The approach offered by Mr. Rothschild is not an appropriate way to assess TAWC’s  
4       proposed capital structure. The determination that a “capital structure for regulatory  
5       purposes produces the lowest, reasonable overall cost of capital” as Mr. Rothschild asserts,<sup>4</sup>  
6       is in practice impractical as it is “very difficult to pinpoint optimal capital structure ratios  
7       with any degree of accuracy.”<sup>5</sup> Rather, the rates set by the Commission must be “just and  
8       reasonable” and, under *Hope* and *Bluefield*, must allow the utility sufficient revenue to  
9       service its debt and to also provide a return commensurate with returns to companies with  
10      similar risks. As I stated in my direct testimony at page 3, lines 14-20, the capital structure  
11      is used along with the authorized ROE to compute the weighted average cost of capital  
12      (“WACC”), which in turn is used to calculate the revenue requirement and ultimately the  
13      rates. If the Commission required the “lowest” overall cost of capital, this would be  
14      contrary to the directives of *Hope* and *Bluefield*. Furthermore, as stated in the direct  
15      testimony of Company Witness Ann Bulkley, “The Company’s proposed equity ratio of  
16      54.52 percent is within the range of the actual capital structures of the utility operating  
17      subsidiaries of the proxy group companies.”<sup>6</sup> This aligns with the guidance provided in  
18      NARUC Cost of Capital and Capital Markets: A Primer for Utility Regulators, which  
19      states: “capital structure ratios cannot be deemed to be inappropriate unless the ratios  
20      greatly diverge from sound industry practice and cause a lack of financial flexibility that

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<sup>3</sup>       Rothschild at 5:22-6:3.

<sup>4</sup>       Rothschild at 5:22-6:3.

<sup>5</sup>       John D. Quackenbush, CFA, *Cost of Capital and Capital Markets: A Primer for Utility Regulators*, National Association of Regulatory Utility Commissioners (December 2019) at 12.

<sup>6</sup>       Direct Testimony of Ann Bulkley at 10:6-7.

1 may lead to higher overall costs.”<sup>7</sup> Thus, TAWC’s capital structure should be considered  
2 reasonable, satisfying the Company’s burden regarding its capital structure.

3 **Q. WHAT, IF ANY, IMPACT SHOULD THE SOURCE OF FINANCING, DEBT OR**  
4 **EQUITY, HAVE ON THE CAPITAL STRUCTURE USED TO ESTABLISH**  
5 **TAWC’S RATES?**

6 A. None. As explained by witness Bulkley,<sup>8</sup> the relevant consideration in determining the  
7 appropriate capital structure supporting the overall return on capital is the risk associated  
8 with the use of funds, not the source of those funds. As a more practical matter, Mr.  
9 Rothschild’s statement would have to rely on a determination of whether the funds invested  
10 by each investor were borrowed, which is an unreasonable and unworkable approach. And  
11 if the Commission considers the source of funds of American Water’s investment in TAWC,  
12 then by logical extension of this argument, the Commission would need to determine and  
13 consider how each AWK investor financed its purchase of AWK stock, an even more  
14 absurd exercise. American Water has invested in TAWC as an equity investor, putting its  
15 capital at risk just like any equity investor does when they make an investment in equity  
16 securities. And just like any equity investor, American Water requires an appropriate return  
17 that is consistent with investments of similar risk. It is widely accepted in finance that the  
18 source of the funds should not determine the return on those funds; rather, it is the risk  
19 posed by an investment that determines the return. The stand-alone ratemaking principle  
20 requires that rates be established for each jurisdictional entity on an independent basis. the  
21 cost of capital is determined using the subsidiary’s capital structure and cost of debt; and

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<sup>7</sup> John D. Quackenbush, CFA, *Cost of Capital and Capital Markets: A Primer for Utility Regulators*, National Association of Regulatory Utility Commissioners (December 2019) at 12.

<sup>8</sup> Direct Testimony Ann Bulkley at 82:6-85:14.

1 the cost of equity is estimated by reference to a proxy group of firms with comparable risk.  
2 Consistent with that principle, the source of the equity investment should not affect the  
3 operating company's capital structure or cost of equity. TAWC's proposal is consistent with  
4 the stand-alone ratemaking principle in that it relies on the actual and proposed debt and  
5 equity of the operating company in the return calculation.

6 **Q. MR. ROTHSCHILD STATES THAT "USING THE AVERAGE CAPITAL**  
7 **STRUCTURE OF THE PROXY GROUP IS CONSISTENT WITH THE TPUC'S**  
8 **DUTY TO SET REASONABLE RATES."**<sup>9</sup> **IS HIS STATEMENT ACCURATE?**

9 A. Only partially. The Tennessee Public Utility Commission ("TPUC") is responsible for  
10 balancing the interest of all stakeholders in the ratemaking process, which includes  
11 customers and investors. Imputing the capital structure of TAWC with a higher debt  
12 component simply to lower rates is not in keeping with TPUC's charge. Unless the  
13 proposed stand-alone capital structure is found to be unreasonable, the stand-alone capital  
14 structure should be used for ratemaking purposes as it is the capital structure that is used  
15 to operate the business and that appropriately reflects its distinct risk profile.

16 **Q. DOES THE COMPANY TAKE ISSUE WITH THE WATER UTILITY PROXY**  
17 **GROUP PRESENTED BY MR. ROTHSCHILD?**

18 A. Yes. Company witness Bulkley on pages 23 through 26 of her rebuttal testimony explains  
19 why Mr. Rothschild's small water-utility-only proxy group is inappropriate and why the  
20 appropriate proxy group is the one she presents.

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<sup>9</sup> Rothschild at 79:6-7.



1 **Q. DO YOU AGREE THAT HAVING A HIGHER COMMON EQUITY RATIO THAN**  
2 **THE AVERAGE COMMON EQUITY RATIO OF THE PROXY GROUP MAKES**  
3 **IT UNREASONABLE?**

4 A. No. Looking at a proxy group's average is one data point to help assess the reasonableness  
5 of a proposed capital structure, but simply being higher than the average does not make the  
6 proposed capital structure unreasonable. The proposed capital structure is within the range  
7 of the proxy group presented by Company Witness Bulkley.

8 **Q. WHAT IN ADDITION TO THE AVERAGE OF THE COMMON EQUITY RATIOS**  
9 **OF AN APPROPRIATE PROXY GROUP SHOULD BE CONSIDERED WHEN**  
10 **EVALUATING A COMMON EQUITY RATIO'S REASONABLENESS?**

11 A. In addition to the average, the range of common equity ratio values in the proxy group  
12 should be evaluated. If the proposed common equity ratio is higher than the average of the  
13 proxy group, but still within the range of values of the proxy group, it should be considered  
14 reasonable. Conversely, if the common equity ratio were below the average, it need not be  
15 increased for it to be considered reasonable.

16 **Q. WHAT IS THE RANGE OF THE APPROPRIATE PROXY GROUP PRESENTED**  
17 **BY COMPANY WITNESS BULKLEY AND HOW DOES THE CAPITAL**  
18 **STRUCTURE YOU PROPOSE COMPARE TO THAT RANGE?**

19 A. The range of the proxy group provided by Ann Bulkley has an equity ratio low of 46.25  
20 percent, a high equity ratio of 60.03 percent, and a median equity ratio of 54.06 percent.

1 TAWC's proposed equity ratio of 54.52 percent is well within the range for risk-comparable  
2 utilities and, thus, should be considered reasonable.<sup>10</sup>

3 **Q. DO YOU AGREE WITH MR. ROTHSCILD'S PROPOSED CAPITAL**  
4 **STRUCTURE?**

5 A. No. His recommendation should be rejected as he fails to provide evidence that the TAWC  
6 proposed capital structure is unreasonable.

7 **III. RESPONSE TO COC WITNESS MARK GARRETT**

8 **Q. DOES MR. GARRETT AGREE WITH TAWC'S PROPOSED ATTRITION YEAR**  
9 **CAPITAL STRUCTURE?**

10 A. No, he does not.

11 **Q. WHAT CAPITAL STRUCTURE DOES MR. GARRETT RECOMMEND?**

12 A. He recommends that the Commission apply the consolidated capital structure of American  
13 Water, or rather a derivative of it, as he makes two modifications to it to arrive at his  
14 recommended capital structure of 44.57% common equity, 53.44% long-term debt and  
15 1.99% short-term debt.

16 **Q. WHAT ARE THE TWO MODIFICATIONS HE MAKES?**

17 A. First, he adjusts the equity component to 44.57% based on the "bottom of the range" of  
18 Witness Bulkley's proxy group. Second, he arbitrarily adjusts short-term debt up to 1.99%  
19 from 0.81% he presents in his Table 5.

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<sup>10</sup> Witness Ann Bulkley Rebuttal Testimony at 76:5-19.

1 **Q. WHAT DOES MR. GARRETT CITE AS HIS RATIONALE FOR DISAGREEING**  
2 **WITH TAWC’S PROPOSED ATTRITION YEAR CAPITAL STRUCTURE?**

3 A. He states that the capital structure from the Company’s last rate order in 2012 included  
4 parent company debt. This is another way of saying that the last rate order imposed the  
5 American Water consolidated capital structure to the common equity portion of TAWC’s  
6 capital structure. He goes on to state his opinion that “this is appropriate when a parent  
7 company has low-cost debt to finance equity in a subsidiary’s capital structure” and that  
8 “some utility holding companies use lower cost debt to finance equity investments in their  
9 utility subsidiaries in order to increase their return on equity at the parent level.”<sup>11</sup>

10 **Q. MR. GARRETT CLAIMS THAT “LOW-COST DEBT” HAS BEEN USED TO**  
11 **FINANCE AWK’S EQUITY INVESTMENTS IN TAWC? IS IT PRUDENT FOR**  
12 **THE COMMISSION TO INVESTIGATE HOW AN INVESTOR FINANCED**  
13 **THEIR PURCHASE OF THE UTILITY’S EQUITY?**

14 A. No. As I stated above and as explained by witness Bulkley, the relevant consideration under  
15 the directives of *Hope* and *Bluefield* is the risk of the investment, not the source of funding  
16 for that investment. To treat all utilities fairly, the Commission would need to investigate  
17 every utility investor’s source of funding, an obviously impractical exercise. Rather, the  
18 stand-alone ratemaking principle compels an independent analysis of the risk of the  
19 investment through the use of a proxy group of risk-comparable companies.

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<sup>11</sup> City of Chattanooga (“COC”) witness Mark Garrett at 36:14-17.

1 **Q. IS THE SOURCE OF FUNDS A RELEVANT CONSIDERATION IN**  
2 **DETERMINING THE APPROPRIATENESS OF A UTILITY'S CAPITAL**  
3 **STRUCTURE?**

4 A. No. As I discuss above, the relevant consideration in determining the appropriate capital  
5 structure supporting the overall return on capital is the risk associated with the use of funds,  
6 not the source of those funds. When AWK makes an equity investment, it requires an  
7 appropriate return consistent with investments of similar risk and, like any other investor  
8 in a risk-comparable company, should be afforded the opportunity to earn a fair and  
9 reasonable return.

10 **Q. WHAT ELSE DOES MR. GARRETT SAY ABOUT TAWC'S RECOMMENDED**  
11 **CAPITAL STRUCTURE?**

12 A. He states that the "requested capital structure is much more expensive than the parent  
13 company consolidated capital structure."<sup>12</sup>

14 **Q. IS THIS AN APPROPRIATE CONSIDERATION FOR DETERMINING THE**  
15 **REASONABLENESS OF TAWC'S PROPOSED CAPITAL STRUCTURE?**

16 A. No, for several reasons. First, a simple comparison of "expensiveness" to another capital  
17 structure is not a test of appropriateness and/or reasonableness of the proposed capital  
18 structure. Second, as Company Witness Bulkley testifies, it does not consider the  
19 differences in the risk profiles of the underlying entities. Third, while customer  
20 affordability should be a consideration in the overall ratemaking process, as Company  
21 Witness Rea testifies,<sup>13</sup> the resulting rates from this case are affordable. Finally, the TPUC

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<sup>12</sup> Garrett at 38:63-5.

<sup>13</sup> Witness Charles Rea Direct Testimony at 6:14-16.

1 is charged with balancing the interests of all stakeholders in the ratemaking process. Mr.  
2 Garrett's one-sided view clearly demonstrates that he is not concerned with upholding this  
3 standard.

4 **Q. MR. GARRETT STATES THAT THE EQUITY COMPONENT OF CAPITAL**  
5 **SHOULD BE DETERMINED AT THE PARENT LEVEL INSTEAD OF AT THE**  
6 **SUBSIDIARY LEVEL BECAUSE TAWC DOES NOT ISSUE COMMON STOCK**  
7 **TO THE PUBLIC, IT OBTAINS ITS EQUITY INVESTMENT FROM THE**  
8 **PARENT COMPANY AND OTHER SUBSIDIARY COMPANIES OF AWK, AND**  
9 **THAT THE ACTUAL COST OF EQUITY CAPITAL TO SERVE TENNESSEE**  
10 **RATEPAYERS IS OBTAINED FROM THE PUBLIC THROUGH AWK AND NOT**  
11 **TAWC.<sup>14</sup> HOW DO YOU RESPOND?**

12 A. First, no other American Water subsidiary makes equity investments in TAWC, only AWK  
13 makes equity investments in TAWC. Second, the source of funds is not a relevant  
14 consideration for determining the appropriate common equity ratio and/or the  
15 reasonableness of the common equity ratio to be used for ratemaking purposes. Finally, as  
16 TAWC Witness Bulkley further testifies, the source of equity investments is not the relevant  
17 consideration in determining the return on equity, it is the use of the funds and the risks  
18 assumed that are the relevant considerations.

19 **Q. DO YOU AGREE WITH MR. GARRETT'S RECOMMENDED CAPITAL**  
20 **STRUCTURE?**

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<sup>14</sup> Garrett at 38:6-39:4.

1 A. No. His recommendation should be rejected. As noted above, the stand-alone ratemaking  
2 principle requires that rates be established for each jurisdictional entity on an independent  
3 basis. The cost of capital is determined using the relevant operating subsidiary's capital  
4 structure and cost of debt; and the cost of equity is estimated by reference to a proxy group  
5 of firms with comparable risk. Consistent with that principle, the source of the equity  
6 investment should not affect the operating company's capital structure or cost of equity.  
7 TAWC's proposal is consistent with the stand-alone ratemaking principle in that it relies  
8 on the actual and proposed debt and equity of the operating company in the return  
9 calculation. Not only is Mr. Garrett's recommendation inappropriate, but the use of  
10 consolidated capital structure for ratemaking purposes would continue to make TAWC an  
11 outlier among its peer utilities and therefore would run afoul of *Hope* and *Bluefield*.  
12 Relying on the consolidated capital structure for setting rates could limit the options for  
13 Tennessee-American to attract capital.

14 **IV. RESPONSE TO CAD WITNESS DAVID DITTEMORE**

15 **Q. MR. DITTEMORE HAS PROPOSED THAT TAWC ADOPT THE FLOW-**  
16 **THROUGH METHODOLOGY TO THE REPAIRS DEDUCTION FOR INCOME**  
17 **TAXES. WHAT IMPACT WOULD THIS HAVE ON THE ATTRITION YEAR**  
18 **CAPITAL STRUCTURE?**

19 A. If the current tax expense benefit of the repairs deduction is flowed through to customers,  
20 this reduces cash flows from operations which would require TAWC to replace that funding  
21 with a mix of debt and equity capital consistent with its proposed capital structure. The cost  
22 of these sources is comparatively greater than the "interest free" loan from the government

1           that the repairs deduction for income taxes represents, and this cost will ultimately make  
2           its way back into customer rates.

3   **Q.     DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

4   A.     Yes.

## CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served via U.S. Mail or electronic mail upon:

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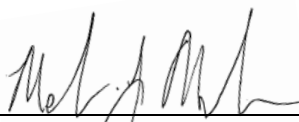
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This the 22<sup>nd</sup> day of October 2024.

  
\_\_\_\_\_  
Melvin J. Malone