

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

IN RE:)	
)	
PETITION OF TENNESSEE)	
AMERICAN WATER COMPANY TO)	
MODIFY TARIFF, CHANGE AND INCREASE)	DOCKET NO. 24-00032
CHARGES, FEES, AND RATES, AND FOR)	
APPROVAL OF A GENERAL RATE)	
INCREASE)	

CONSUMER ADVOCATE DIVISION'S POST-HEARING BRIEF

RESPECTFULLY SUBMITTED,

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CONSUMER ADVOCATE DIVISION’S POST-HEARING BRIEF

Jonathan Skrmetti, Attorney General and Reporter for the State of Tennessee, by and through the Consumer Advocate Division of the Office of the Attorney General (“Consumer Advocate”), hereby respectfully submits this post-hearing brief in the above-styled matter.

I. INTRODUCTION

Tennessee-American Water Company (“Tennessee-American,” “TAWC,” or the “Company”) is a public utility as defined in Tenn. Code Ann. § 65-4-101 and provides residential, commercial, industrial, and municipal water service, including public and private fire protection service, to Chattanooga and surrounding areas to more than 87,000 customers.¹ Tennessee-American is subject to the jurisdiction of the Tennessee Public Utility Commission (“TPUC” or “Commission”) pursuant to Chapter 4 and Chapter 5 of the Tennessee Code Annotated.² TAWC is a wholly-owned subsidiary of American Water Works Company, Inc., (“AWWC”) which is the largest water and wastewater holding company in the United States,

¹ *Petition of Tennessee American Water Company to Modify Tariff, Change and Increase Charges, Fees, and Rates, and For Approval of a General Rate Increase*, at 1, TPUC Docket No. 24-00032, May 1, 2024.

² *Id.*

providing water and wastewater services in 14 states and 18 military installations.³ TAWC's principal place of business is located at 109 Wiehl Street, Chattanooga, Tennessee 37403.⁴ On May 1, 2024, TAWC filed a petition to increase customer rates by \$14.9 million, or more than 19.7% and later revised that request to \$13.8 million.⁵

After careful investigation and analysis of TAWC's rate increase proposal in this case, the Consumer Advocate concludes that there is no just or reasonable basis for increasing TAWC's rates. Rather, for the reasons explained more fully below, the Consumer Advocate maintains that TAWC's water rates should be decreased by \$4.7 million.⁶

II. CRITERIA FOR ESTABLISHING PUBLIC UTILITY RATES

Under Tennessee law, the Commission has the power to fix just and reasonable rates.⁷ When any public utility seeks to increase an existing rate, the utility has the burden of proof to show such an increase is just and reasonable.⁸

Just and reasonable rates should provide a utility with the opportunity to earn a rate of return on used and useful property commensurate with the returns on alternative investments with similar risks.⁹ As a general rule, public utility commissions such as the Commission examine investments by a utility to determine whether such investments were "prudent."¹⁰

³ *Id.* at 2.

⁴ *Id.*

⁵ *Petition of Tennessee American Water Company to Modify Tariff, Change and Increase Charges, Fees, and Rates, and For Approval of a General Rate Increase*, at 3; *Rebuttal of Bob Lane* at 2:10-12, and at 3, Table 1 (Revised Rate Request).

⁶ *Letter Correcting Revised Direct Testimony of Alex Bradley* (Deficiency Amount from \$-4,730,764 to \$-4,657,302) (Nov. 14, 2024); *Revised Direct Testimony of Alex Bradley* at 3; and *Transcript of Proceedings*, Vol II (B) at 226:8-10, November 19, 2024.

⁷ Tenn. Code Ann. § 65-5-101(a).

⁸ Tenn. Code Ann. § 65-5-103(a).

⁹ *Bluefield Water Works & Improvement Co. v. West Virginia Public Service Commission*, 262 U.S. 679, 692-3 (1923); *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591 (1944).

¹⁰ *Missouri ex rel. Southwestern Bell Telephone Co. v. Public Serv. Comm'n of Mo.*, 262 U.S. 276, 291 (1923); *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 309 (1989).

In prior cases, TPUC has stated that it considers petitions for a rate increase, filed pursuant to Tenn. Code Ann. § 65-5-203 (now § 65-5-103(a)), in light of the following criteria:

1. The investment or rate base upon which the utility should be permitted to earn a fair rate of return;
2. The proper level of revenues for the utility;
3. The proper level of expenses for the utility; and
4. The rate of return the utility should earn.¹¹

The Commission has further stated that it “is obligated to balance the interests of the utilities subject to its jurisdiction with the interests of Tennessee consumers, i.e., it is obligated to fix just and reasonable rates.”¹²

In determining rates, the Commission should also ensure that expenses and costs charged to consumers are not so high as to constitute, in effect, capital contributions to the utility:

But if the amounts charged to operating expenses and credited to the account for depreciation reserve are excessive, to that extent subscribers for the telephone service are required to provide, in effect, capital contributions, not to make good losses incurred by the utility in the service rendered and thus to keep its investment unimpaired, but to secure additional plant and equipment upon which the utility expects a return.¹³

Finally, Tennessee law prohibits any utility from making unjust discriminatory charges or unreasonable preferences in its charges.¹⁴

III. TEST PERIOD AND ATTRITION PERIOD

Neither the Commission nor the intervening parties are confined by law or regulatory practice to accept the test year proposed by the regulated utility seeking a rate increase. Tennessee courts have never required the Commission to use a specific test period methodology

¹¹ *In Re: Petition Of Tennessee American Water Company To Change And Increase Certain Rates And Charges So As To Permit It To Earn A Fair And Adequate Rate Of Return On Its Property Used And Useful In Furnishing Water Service To Its Customers*, at 20, TPUC Order, Docket No. 06-00290, (June 10, 2008).

¹² *Id.*; see also *Tennessee Cable Television Ass’n v. Tennessee Public Service Comm’n*, 844 S.W.2d 151, 159 (Tenn. Ct. App. 1992) (rates should take into consideration the interests of both the consumer and the utility).

¹³ *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 607 n. 10 (1944).

¹⁴ Tenn. Code Ann. § 65-4-122.

for setting rates; indeed, the courts have stated repeatedly that the Commission has the discretion to choose the test period.¹⁵

The only limit placed on a ratemaking body is the statutory requirement that rates be just and reasonable. Rates need not be determined using definite rules or precise formulas.¹⁶ Thus, TPUC is not bound by any specific means by which rates are set so long as the end result produces just and reasonable rates.

In setting rates, TPUC has unfettered discretion to select the test period.¹⁷ A “test year” is a measure of a utility’s financial operations and investment over a specific twelve month period. It is the “raw material” for developing an attrition year measure of the utility’s financial operations and investments (the utility’s rate base, operations and maintenance expense, depreciation expense, and taxes).

Thus, it is essential that a test period contain and/or be updated with the most accurate and current information available. The test year is used to calculate and forecast the attrition year. An “attrition year,” also known as a forecast period, is the “finished product” and is the chief determinant in whether a revenue deficiency or surplus exists such that rates must be adjusted. The attrition year can also be viewed as the first year during which TPUC’s rate order will be applied. In this proceeding, both the Consumer Advocate and the Company have forecasted the same attrition year ending on December 31, 2025.

¹⁵ *CF Industries v. T.P.S.C.* 599 S.W. 2d 536, 542 (Tenn. 1980); *Powell Telephone v. T.P.S.C.*, 660 S.W.2d 44, 46 (Tenn. 1983); *Tennessee Cable Tel. v. T.P.S.C.* 844 S.W. 2d 151, 159 (Tenn. Ct. App. 1992) (cert. denied); *AARP v. T.P.S.C.*, 896 S.W. 2d 127, 133 (Tenn. Ct. App. 1994) (cert. denied); and *TAWC v. TPUC*, No. M2009-00553-COA-R12-Filed, at 20, January 28, 2001.

¹⁶ *Tennessee Cable Tel. v. T.P.S.C.* 844 S.W. 2d 151, 159 (Tenn. Ct. App. 1992) (cert. denied).

¹⁷ See *Final Order*, at 5-6, TPSC Docket No. 06-00187 (November 27, 2008), for a clear example of the Commission’s conclusions as to its discretion in selecting a test period. See also *Powell Telephone v. T.P.S.C.*, 660 S.W.2d 44, 46 (Tenn.1983) (citing *CF Industries v. T.P.S.C.*, 599 S.W. 2d 536, 542 (Tenn.1980)).

Tennessee-American has proposed a test period ending December 31, 2023.¹⁸ The use of an up-to-date test period is essential to test the veracity of the Company's proposed rate increase. The Consumer Advocate finds the test period ending December 31, 2023, to be acceptable and should be adopted by the Commission.¹⁹ Accordingly, the Commission should accept the use of a test period of January 1, 2023 - December 31, 2023, for purposes of forecasting the attrition year ending December 31, 2025.²⁰

IV. THE CONSUMER ADVOCATE'S ATTRITION PERIOD REVENUE REQUIREMENT SHOULD BE ADOPTED BY THE COMMISSION BECAUSE IT FOLLOWS METHODOLOGIES ESTABLISHED BY PRIOR COMMISSION ORDERS, IS BASED ON HISTORICAL ANALYSIS, REASONABLY ANTICIPATED ADJUSTMENTS, AND REFLECTS REASONABLE ALLOCATIONS OF COSTS INCURRED WITHIN THE COMPANY

TAWC's revenue requirement should be determined by applying the following generally recognized ratemaking formula: Revenue Requirement = (Rate Base x Rate of Return) + Operation and Maintenance Expense + Depreciation + Taxes. In applying this formula to the facts of this case, there are aspects of each of its components that are undisputed; however, there are also disputed areas by the Consumer Advocate.

The Consumer Advocate asserts that TAWC should collect the revised revenue of \$72,400,026 from its ratepayers during the projected attrition period.²¹ TAWC is projecting attrition year revenue at present rates of \$71,858,982.²² The Consumer Advocate revenue amount contains adjustments for customer usage and customer growth.²³ The total difference

¹⁸ *Petition*, at 7.

¹⁹ *Revised Direct Testimony of Alex Bradley* at 3:12-15.

²⁰ *Revised Direct Testimony of Alex Bradley* at 3:12-15.

²¹ *Rebuttal Testimony of Bob Lane* at 2:10-12, 3:1, Table 1.

²² *Id.* at 3:1, Table 1.

²³ *Direct Testimony of William H. Novak* at 17:8-9, Consumer Advocate Exhibit, Schedules 8.

between TAWC's attrition period revenue forecast and the Consumer Advocate's is \$541,044 or less than 1%.²⁴

A. TAWC's Revenue Forecast Uses a Multi-Linear Regression Model Which Produces an Unreasonable Result and Is Unreliable as a Known and Measurable Adjustment

There are no major differences in the total revenue forecast, but rather the differences in calculation methodologies resulted in modest variances in forecasted revenue.²⁵ The main reason why there are different amounts between the Consumer Advocate and the Company is a result of the calculation methodologies that have been used. The Company has used a multi-linear regression model to consider the impact of weather changes on water revenues which the Consumer Advocate has rejected.²⁶

The Company disagrees with the Consumer Advocate's revenue projections and claims that they are overstated for both industrial and water usage and special contracts.²⁷ However, the Consumer Advocate merely used a simple linear regression to calculate attrition year industrial usage. There is no need to use a multi-linear regression. A multi-linear regression utilizes multiple independent predictor variables such as precipitation and heating or cooling days.²⁸ For the four (4) special contracts that TAWC has, the Company relied on current contractual minimum usage amounts,²⁹ however, the preferred method would be to use actual data and the Consumer Advocate used actual usage for the four (4) special contract customers.³⁰

²⁴ *Rebuttal Testimony of Bob Lane* at 3:1, Table 1.

²⁵ *Direct Testimony of William H. Novak* at 17:16-18:1.

²⁶ *Direct Testimony of William H. Novak* at 18:1-3.

²⁷ *Rebuttal Testimony of Heath Brooks* at 3:14-15.

²⁸ *Id.* at 4:12-14.

²⁹ *Id.* at 5:16-17.

³⁰ *Direct Testimony of William H. Novak* at 18:3-6, Schedule 62.2b (Special Contract Usage).

The Company use of a multi-linear regression methodology results in adjustments being convoluted and lacking a clear audit trail detailing how its results were determined. The use of this method is an overly complicated approach that is unnecessary and improper.

B. The Consumer Advocate's Revenue Forecast Methodology for the Attrition Year Should Be Adopted Because It Reflects: (1) Prior Commission Precedent and (2) Current Usage Which is More Indicative of Usage During the Attrition Year

The Consumer Advocate submits that its revenue forecast methodology, at present rates, should be adopted in this case because it reflects prior Commission precedent that rejected the weather adjustment proposal and current usage more accurately reflects the actual amount TAWC collects from its customers during the attrition year.³¹ The Consumer Advocate, in this Docket, has forecasted revenues using a six-year trend analysis for all customer classes. Using trend analysis, the Consumer Advocate is able to forecast customer growth patterns as well as account for and reflect recent weather patterns and outside economic pressures, all of which should drive the revenue analysis in this case.

The Consumer Advocate forecasted revenues for all customer classes by first obtaining the 2023 test period billing determinants, then making adjustments for known and reasonably anticipated changes to bills and usage, and then pricing out this forecast at the Company's currently approved rates. TAWC has mischaracterized the Consumer Advocate's common-sense approach in an effort to discredit the Consumer Advocate's methodology.

1. The Consumer Advocate's Methodology Is More Appropriate and Reflective of Actual Company Results

The Consumer Advocate's methodology is clearly reasonable when compared to TAWC's actual Company results for the twelve months ending December 2023. The Consumer Advocate has forecasted attrition year revenues at \$72,400,026 using a six-year trending

³¹ *Id.* at 17:17-18 – 18:1-3, 18:5-6, WHN Revenue Workpaper 61.2b-OWV-Usage.

analysis.³² According to actual Company results filed with TPUC, TAWC generated \$69,327,193 in revenues for the twelve months ending December 31, 2023.³³ As such, the Consumer Advocate's attrition year forecast is only \$3,027,833 more than TAWC's actual results for 2023.³⁴ Whereas TAWC's attrition year forecast of \$71,858,982 is also greater by \$2,531,789 than the Company's actual 2023 results.³⁵

The Consumer Advocate asserts that not only is TAWC's forecast unsupported by verifiable data, the single 12-month period of time used in TAWC's forecast is not comparable to actual water usage. Thus, the Consumer Advocate would urge the Commission to refrain from adopting a revenue forecast that fails to take into consideration realistic trends in weather and economic conditions.

2. TAWC Only Considered Contractual Minimum Usage by Special Contract Customers

The Company only considered the contractual minimum usage by Special Contract customers, whereas the Consumer Advocate considered the current usage as a more accurate predictor of actual usage during the attrition year.³⁶ It is more appropriate and correct to consider the actual current usage to project usage amounts for the attrition year.

³² *Id.* at 19:9-11, Consumer Advocate Exhibit, Schedule 9.

³³ *Direct Testimony of Heath Brooks* <Petitioner's Exhibit REV-1-Revenue Summary-HB>.

³⁴ *Id.*

³⁵ *Id.*; *Rebuttal Testimony of Bob Lane* at 3, Table 1; and *Direct Testimony of William H. Novak*, Exhibit 3.0 (Revenues).

³⁶ *Direct Testimony of William H. Novak* at 18, Schedule 61.2b (Special Contract-Special Contract Usage).

C. The Consumer Advocate's Adjustments to Operations and Maintenance Costs Should be Adopted by Commission Based On Principles Established in Prior Commission Orders and Consistently Applied Thereafter

TAWC is forecasting \$31.7 million in operation and maintenance expense for the attrition year;³⁷ however, the Consumer Advocate asserts that \$27.10 million³⁸ is the more reasonable figure that should be adopted by the Commission.³⁹ The Company has stated that operating expenses have increased since the Company's last rate case in 2012 and the overall O&M expenses remain reasonable as TAWC has been successful in managing O&M costs.⁴⁰ The Consumer Advocate understands expenses generally rise over time, and it also understands TAWC has experienced some increases in expenses since the last rate case, with some increasing at a higher rate than others. But the Consumer Advocate maintains that total expenses must meet an overall test of reasonableness in light of prevailing business plans, economic conditions, and in comparison, to other utilities in Tennessee. In other words, not only does the methodology used to forecast each expense have to be reasonable, but these methodologies, when considered together, must also result in reasonable total expenses consistent with the current business and economic environment. The Consumer Advocate asserts that the proof in this case clearly establishes that TAWC's forecast of expenses fails to meet this overall test of reasonableness.

³⁷ *Direct Testimony of Grady Stout* at 26:10-11; *Transcript of Proceedings*, Vol 1, at 173:5-9, November 18, 2024.

³⁸ *Revised Direct Testimony of Alex Bradley* at 3:4-5; *Transcript of Proceedings*, Vol 1 at 226:11-12, November 18, 2024.

³⁹ *Transcript of Proceedings*, Vol I at 173:5-7, November 18, 2024.

⁴⁰ *Direct Testimony of Grady Stout* at 26:12-14. *Transcript of Proceedings*, Vol I at 173:5-9, November 18, 2024.

1. TAWC’s Attrition Year Forecast for Salaries and Wages Should Be Reduced for Employee Vacancies and Certain Incentive Pay

It is undisputed that the Company routinely has vacant employee positions.⁴¹ The Company wants to recover the salaries and wages associated with these vacant positions even though no one is actually on the payroll. “Accepting the Company’s assumption that it will be fully staffed on an ongoing basis is not reasonable and is not consistent with its actual historical results.”⁴² Since the last contested rate case, the Company has only achieved its authorized level of 110 employees twice, as shown in the table below.⁴³

Yearend Employment	Union	Non-Union Hourly	Exempt	Total
2012	71	4	20	95
2013	69	11	21	101
2014	68	10	23	101
2015	69	11	23	103
2016	68	12	24	104
2017	69	11	23	103
2018	74	12	27	113
2019	70	14	23	107
2020	73	13	25	111
2021	67	14	25	106
2022	64	14	24	102
2023	64	14	23	101

The Company has averaged only 104 employees⁴⁴ during a 12-year period despite being authorized to have 110 employees.

In this case, the Company has forecasted salaries and wages for 117 employee positions during the attrition year but had 16 vacancies as of April 20, 2024.⁴⁵ The Consumer Advocate based its salaries and wages on 101 existing employees due to the Company’s failure to maintain

⁴¹ *Direct Testimony of David N. Dittmore* at 22:1-4.; *Transcript of Proceedings*, Vol II (B) at 190:21-25, November 19, 2024.

⁴² *Id.* at 22:1-4.

⁴³ *Rebuttal Testimony of Robert Prendergast* at 4:13-5:1, Table at 4-5.

⁴⁴ *Id.* at 5:7-8.

⁴⁵ *Direct Testimony of David N. Dittmore* at 21:10-12.

its authorized employee levels.⁴⁶ The Company did provide an updated employee count in its rebuttal testimony, but failed to provide the financial details regarding the additional five employees.⁴⁷

While the average person will think that a vacant position has zero costs, this is not true for the beleaguered ratepayer. The practical implications of allowing the costs of budgeted positions in the revenue requirement affords the Company additional operating margin shouldered by ratepayers that the utility has not actually incurred in the attrition period.⁴⁸ This implication is a concern also shared by other intervenors in this Docket. UWUA Witness Garvey testified to the Union's concern with the same pattern of the Company's continual request for more funds at cost to consumers, which the Company does not intend to fill.⁴⁹ As a result, it is the Consumer Advocate's contention that rates should, at a maximum, be set on 101 filled positions as the appropriate number for the provision of water service, resulting in a reduction in attrition period O&M costs by \$1,200,409.⁵⁰ If the Commission orders an employee complement necessary to provide water service above 101, the Consumer Advocate requests that the Company provide a monthly report of employees by name and by position to the Commission.

a. The Company Provides No Basis to Deviate from the Commission's Precedent Regarding the Disallowance of Incentive Pay, Both Direct and Allocated

In addition to the salaries and wages issue, another payroll-related expense issue involves the incentive pay offered to its employees. The Company described two general types of incentive compensation for employees – short-term and long-term. The short-term program is

⁴⁶ *Id.* at 21:10-15.

⁴⁷ *Rebuttal Testimony of Robert Prendergast* at 2:17-19; *Rebuttal Testimony of Grady Stout* at 6:2-4; *Transcript of Proceedings*, Vol I at 186, November 18, 2024.

⁴⁸ *Direct Testimony of David N. Dittmore* at 22:8-17.

⁴⁹ *Direct Testimony of Shawn Garvey* at 3:22-4:1; *Transcript of Proceedings*, Vol II (B) at 186:14-23, November 19, 2024.

⁵⁰ *Direct Testimony of David N. Dittmore* at 21:8-15, Exhibit <DND-3>. This adjustment includes the elimination the labor, group insurance, benefits, and payroll taxes associated with vacancies.

referred to as the Annual Performance Plan (“APP”) compensation and is available to all employees.⁵¹ The Long-Term Performance Plan (“LTPP”) program is available to employees who are upper-management and executive employees.⁵² The Company is seeking “recovery of \$439,290 of TAWC direct-charged APP costs and \$105,679 in direct-charged LTPP costs.”⁵³ The Company also seeks recovery of \$621,676 in allocated APP costs and \$475,824 in allocated LTPP costs.”⁵⁴

The funding of any award to be provided through APP is dependent upon certain criteria, with the largest single criteria premised upon achieving a target level of earnings per share.⁵⁵ This APP metric of a 50% weighting of the earnings per share of AWWC “primarily benefits the Company’s shareholders and is the type of metric that was excluded from rate recovery in TPUC Docket No. 18-00017.”⁵⁶ In addition, 5% of APP is dependent upon meeting thresholds for women and ethnic representation in the workforce, which is not required in the provision of utility service.⁵⁷ Stock awards comprise the LTPP costs in this proceeding, and the criteria established for the payment of the awards “clearly benefit the shareholders.”⁵⁸ In fact, the purpose of the LTPP costs is to [REDACTED], which means it is Company shareholders and employees, not its ratepayers, that will receive the benefits of performing these financial benchmarks.⁵⁹ There is no reasonable basis for charging the financial portion of the incentive plan to ratepayers, as these plan benefits will inure entirely to TAWC’s employees and shareholders, whereas the associated burdens will

⁵¹ *Id.* at 23:13-18.

⁵² *Id.*

⁵³ *Id.* at 23:15-17.

⁵⁴ *Id.* at 23:17-18.

⁵⁵ *Id.* at 24:2-3.

⁵⁶ *Direct Testimony of David N. Dittmore.* at 25:9-12.

⁵⁷ *Id.* at 25:12-16;

⁵⁸ *Id.* at 26:2-5.

⁵⁹ *Id.* at 26:18 – 27:3.

fall directly on ratepayers. Following this reasoning and the Commission's precedent, the Consumer Advocate disallowed 55% of direct APP and 100% of direct LTTP costs resulting in an adjustment of \$200,307⁶⁰ and \$87,306,⁶¹ respectively.

The Company is also proposing to recover the incentive compensation costs allocated to it from its affiliate service company. As with direct incentive compensation, the Company has not provided any support for a deviation from the Commission's precedent and based it on the same rationale set out above for direct costs. Therefore, such allocated costs should be disallowed resulting in an adjustment of \$334,692 in APP and \$468,271 in LTTP costs.⁶²

b. The Company Should Not Recover Labor and Support Service Costs That Do Not Directly Benefit Tennessee Ratepayers

The Company seeks to recover the direct and allocated costs for Business Development, Lobbying, and Inclusion, Diversity & Equity ("ID&E"), all of which do not benefit Tennessee ratepayers. To begin, the Company seeks to recover the costs related to the Business Development function during the attrition year. While the Company has included the forecasted costs of the Business Development function, this discretionary expense is not offset by any implied growth in the system that would provide cost benefits for ratepayers.⁶³ Without a quantifiable benefit to ratepayers and consistent with Commission precedent,⁶⁴ the Consumer Advocate contends that the department costs for Business Development should be eliminated in its entirety, which amounts to an adjustment of \$72,052 from O&M.

⁶⁰ *Id.* at 26:8-14, Exhibit <DND-3>. This adjustment is net of \$75,095 in incentive costs removed from the attrition period associated with vacant positions.

⁶¹ *Direct Testimony of David N. Dittmore* at 26:17-18, <DND-3>.

⁶² *Id.* at 27:6-28:14, Exhibit <DND-5>. This adjustment is net of \$18,373 in incentive costs removed from the attrition period associated with vacant positions.

⁶³ *Id.* at 36:5-7.

⁶⁴ *Final Order, In re: Petition of Tennessee American Water Company for a General Rate Increase*, at 82, TRA Docket No. 10-00189 (Apr. 27, 2012).

Next, the Company seeks the recovery of costs associated with two categories of lobbying as follows: (1) Labor Cost (one position titled Manager of External Affairs,⁶⁵ whose job description [REDACTED]); and (2) Allocated Cost (seven positions that charge time to the American Water Works Service Company (“AWWC”) External Affairs and Public Policy Department,⁶⁶ and whose job descriptions include a significant portion of responsibilities related to shaping public opinion and overseeing the Company’s lobbying efforts). The Consumer Advocate contends that ratepayers should not be required to compensate the Company for lobbying and political influence activities, as it is unnecessary for the provision of water service. In fact, the Commission addressed this very issue in the Company’s previous contested rate case:

It is a well-established and long-standing policy of the TRA to disallow expenses related to lobbying when setting utility rates. Consistent with its own policy and precedent, and that of most other state regulatory commissions throughout this country, the majority finds that expenses related to lobbying are expended for the benefit of the Company first and foremost, and are not necessary for the provision of safe and adequate service.⁶⁷ (internal citation omitted)

Consistent with Commission precedent,⁶⁸ the Consumer Advocate contends that 25% of the costs associated with the Manager of External Affairs be disallowed and 20% of the External Affairs and Public Policy Department costs allocated to TAWC should be eliminated resulting in a reduction of \$38,202⁶⁹ and \$29,705,⁷⁰ respectively, in O&M.

Finally, the Company seeks to recover the costs for its ID&E Officer and two additional positions associated with AWSC’s ID&E function. The ID&E focus reflects a corporate goal,

⁶⁵ *Direct Testimony of David N. Dittmore* at 40:1-8.

⁶⁶ *Id.* at 37:1-38:20, Appendix 3.

⁶⁷ *Final Order, In re: Petition of Tennessee American Water Company for a General Rate Increase*, p. 62, TRA Docket No. 10-00189 (Apr. 27, 2012). In this Order, the Commission eliminated the full \$172,295 for External Affairs expense. *Id.*

⁶⁸ *Id.* at 82. In this Order, the Commission eliminated the full \$172,295 for External Affairs expense. *Id.*

⁶⁹ *Direct Testimony of David N. Dittmore* at 40:6-8, Exhibit <DND-12>.

⁷⁰ *Id.* at 35:17-18; 38:19-20.

but it is not necessary for the provision of safe and adequate service.⁷¹ Additionally, the Company cannot point to any quantifiable evidence that these corporate goals are necessary for the provision of water services.⁷² At hearing, Company Witness Stout alluded to the Company's strides and efforts to employ a more diverse workforce; however, when asked about evidence of the Company's attraction of a more diverse workforce, he again reiterated the Company's attempts.⁷³ Attempts are not evidence and are likewise not appropriate justifications of costs to be pushed on to consumers. As such, 50% of the costs associated with the ID&E Officer should be disallowed resulting in an adjustment of \$3,458.⁷⁴ Also, all costs for the two additional positions associated with AWSC's ID&E function should be disallowed in their entirety resulting in an adjustment of \$7,968.⁷⁵

2. Deferred Rate Case Expense Should Be Removed From This Docket and Addressed in a Separate Docket After This Rate Case Concludes

Regulatory Expense includes deferred rate case costs. The Consumer Advocate recommends the Commission consider developing a separate surcharge for recovery of these costs outside of base rates.⁷⁶ A separate surcharge would be more appropriate since its rate case costs would be known costs at the conclusion of this rate case instead of estimates.⁷⁷ A separate surcharge would restrict the Company to the recovery of known rate case costs and would then terminate the Company's ability to make a return on that cost as a base rate adjustment.⁷⁸ The Consumer Advocate recommends that the Commission omit the Company's rate case costs and the related amortization from base rates and set a separate surcharge to recover these costs in a

⁷¹ *Id.* at 25:14-16.

⁷² *Transcript of Proceedings*, Vol II(A) at 154:14-155:2, November 19, 2024.

⁷³ *Id.*

⁷⁴ *Direct Testimony of David N. Dittmore* at 39:4-5; <DND-1>.

⁷⁵ *Id.* at 39:13-14.

⁷⁶ *Direct Testimony of William H. Novak* at 10:9-11.

⁷⁷ *Id.* at 10:11-12.

⁷⁸ *Id.* at 10:13-15.

separate docket.⁷⁹ For these reasons, the Consumer Advocate submits the rate case expense should be addressed in a separate docket at the conclusion of this rate case.

3. Legal Cost From TPUC Docket 19-00103 Are Non-recurring Costs That Should Not Be Borne by the TAWC Ratepayers

The Company is seeking to recover non-recurring legal costs from a previous TAWC docket in which the capital riders were modified.⁸⁰ The parties to TPUC Docket No. 19-00103 spent 1304 days⁸¹ resolving outstanding issues about the capital riders.⁸² The time spent on this docket was out of the ordinary because the docket was convened as an ongoing investigation and modification of TAWC's capital riders. When one considers that a general rate case must be decided by the Commission within 270 days from the initial filing, or an alternative ratemaking mechanism must be decided by the Commission within 120 days from the initial filing, it is clear that docket was an anomaly. Since TPUC Docket No. 19-00103 is not a recurring docket and was extraordinary in timeframe, the significant legal cost should not be considered an ongoing charge. These costs should not be recurring and if they are recurring, they should not be borne by TAWC customers.⁸³ Also, the legal costs incurred in the future, resulting in the need to revise the Company's capital rider tariff, should not be incurred by customers. The Consumer Advocate contends that the legal costs associated with TPUC Docket No. 19-00103 are either non-recurring or not the type of costs that should continue to be recovered from customers in this Docket. Thus, this results in an adjustment in the test period of \$121,869.⁸⁴

⁷⁹ *Id.* at 10.

⁸⁰ *Direct Testimony of David N. Dittmore* at 29:4-11.

⁸¹ The days were calculated from the date the docket was opened on March 31, 2020 to the date the settlement agreement was filed on Oct. 26, 2023.

⁸² Notwithstanding the amount of time spent over the years, it is quite surprising that the Company incurred \$121,869 in legal costs in 2023 alone associated with this docket.

⁸³ *Direct Testimony of David N. Dittmore* at 29:7-8.

⁸⁴ The adjustment is based upon information provided in Consumer Advocate DR No. 1-74 and is outlined in Exhibit DND-6. *Id.* at 29:8-11.

While a test period adjustment of \$121,869 had been made by the Consumer Advocate to the attrition period,⁸⁵ TAWC revised the legal costs for rate case expense in TPUC Docket No. 19-00103 in the amount of \$56,368, however, this revised cost should also not be included in this rate case.⁸⁶ As stated above, TPUC Docket No. 19-00103 has been resolved and the parties spent considerable time resolving outstanding issues⁸⁷ and therefore this significant cost should not be an ongoing charge.⁸⁸

4. The Commission Should Eliminate the Costs for Community Partnerships Since the Costs Are Unnecessary for Water Service

TAWC seeks to recover costs from its ratepayers so that it can, in turn, “give back to the communities it serves.”⁸⁹ Perhaps the Company’s beleaguered ratepayers would prefer to keep their money so they can decide if they would like to make personal charitable and civic contributions. While the Consumer Advocate recognizes that these costs benefit the community and generate goodwill for the Company; these costs are unrelated and not essential to providing water service. As such these costs should not be built into base rates.⁹⁰ Accordingly, the Consumer Advocate contends that the Community Partnership costs be removed in their entirety, resulting in an attrition period adjustment of \$122,340.⁹¹

⁸⁵ *Id.* at 29:8-12.

⁸⁶ *Rebuttal Testimony of John Watkins* at 17.

⁸⁷ *Direct Testimony of David N. Dittmore* at 29:16-17.

⁸⁸ *Id.*; *Order Approving Stipulation and Settlement Agreement*, TPUC Docket No. 19-00103 (Jan. 31, 2024).

⁸⁹ *Direct Testimony of John Watkins* at 20:16-19 quoting *Direct Testimony of Grant Evitts* at 23:7-8.

⁹⁰ *Direct Testimony of David N. Dittmore* at 33:13-19.

⁹¹ *Id.* at 33:4-5.

5. The Commission Should Maintain the 15% Standard for Unaccounted-For Water Loss/Non-Revenue Water (“NRW”) and Should Reduce Chemicals, Fuel, and Power Expenses for TAWC’s Unaccounted-For Water Loss Above 15%

Consistent with the Commission’s decision in TAWC’s 2008 rate case,⁹² the Consumer Advocate applied a 15% cap to unaccounted for water⁹³ in its calculation of Chemical expense and Fuel and Power expense. The Company expects its ratepayers to bear the burden for the waste in power and chemical costs used to treat the millions of gallons of water that are lost through the Company’s lack of effort in maintaining an efficient water system. The Commission’s policy of applying the 15% unaccounted for water standard recognizes ratepayers should not be made to bear the cost of wasteful expenses. Accordingly, the Consumer Advocate eliminated \$243,209⁹⁴ of attrition period Purchase Power costs and \$190,816⁹⁵ of attrition period Chemical costs.

D. The Consumer Advocate’s Attrition Period Adjustment for O&M Expenses Should Be Adopted Based On a Reasonable Application of Ratemaking Principles

The Consumer Advocate’s Attrition Period Adjustment essentially moves the Test Period O&M costs to the Attrition Period.⁹⁶ Two Compound Annual Growth Rates (“CAGRs”) were developed by Mr. Bradley and are described in his Revised Direct Testimony and workpapers.⁹⁷

⁹² *Final Order, In re: Petition of Tennessee American Water Company to Change and Increase Certain Rates and Charges so as to Permit it to Earn a Fair and Adequate Rate of Return on its Property Used and Useful in Furnishing Water Service to its Customers*, at 17, TRA Docket No. 08-00039 (Jan. 13, 2009); and the Court of Appeals affirmed the Commission’s decision which included a 15% cap, *Tennessee American Water Co. v. TRA*, 2011 WL 334678 (Tenn. Ct. App. 2011).

⁹³ The terms Non-Revenue Water, Water Loss, and Unaccounted-For Water have been used interchangeably in filings with the Commission. The formula for “Non-Revenue Water-Unaccounted for Water %” can be found in the most recent PCOP filing by TAWC and the formula is [1- (Water Sales/System Delivery)]. *Petition*, Attachment, File <Petitioner’s Exhibit - PCOP CALC – RCL>, Tab “Support Workpaper,” Line 15 (Jan. 17, 2024).

⁹⁴ *Direct Testimony of David N. Dittmore* at 30:6-12; 32:4-8, <DND-7>.

⁹⁵ *Id.* at 32:13-17, <DND-8>.

⁹⁶ *Id.* at 14:4-5.

⁹⁷ *Direct Testimony of William H. Novak* at 7:6-15.

The two annual growth rates are: (1) 1.18% for Non-Production Cost; and (2) 3.26% for Support Services Allocation.⁹⁸

The use of CAGR is widely accepted for forecasting future values. The Company used a variety of Consumer Price Indices (“CPI”). Using CAGR for forecasting future costs provides a way to account for fluctuations in values over time and provides a smooth growth rate during an elapsed time period. The use of CAGR to determine a growth factor uses the results of the Company’s own operations unlike the Company’s proposal to use a variety of CPI indices. The Consumer Advocate used the CAGR to determine the growth rate of these Non-Production Costs and Support Services Allocations because they tend to be volatile year-over-year and were independent from production related expenses with known and measurable changes.⁹⁹

1. The Commission Should Adopt the Consumer Advocate’s Growth Factor for Non-Production Expenses

The Consumer Advocate’s attrition year forecast for non-production expenses is lower than TAWC’s forecast due to the Consumer Advocate’s use of a singular growth factor that is lower than the multiple growth factors used by the Company in their forecast. The Company has proposed using six different growth factors for forecasting attrition year level of non-production expenses; and relying on the three-year average change in annual consumer price index percentage, as presented by the U.S. Bureau of Labor Statistics, for certain specific cost categories. On the other hand, the Consumer Advocate has proposed using a singular growth factor, and a four-year compound annual growth factor, that was calculated using the Company’s own financial statements to determine the growth in these costs. The Consumer Advocate strongly believes that the best source of forecasting data for these costs should be done using the actual year-over-year changes experienced by the Company, not general inflationary datasets

⁹⁸ *Revised Direct Testimony of Alex Bradley* at 9:14-21.

⁹⁹ *Id.* at 13:12-14.

produced to cover large swathes of the country. Furthermore, the Consumer Advocate's use of a compound annual growth factor derived from outside a timeframe, that was not muddled by the chaos of the COVID-19 pandemic, provides a clearer perspective on what level these costs should be at in the future while also recognizing the level of change that these costs have experienced over the prior four years.

The Consumer Advocate made adjustments to TAWC's Proposed Attrition Period O&M Expenses to Maintenance, Chemicals, Contract Services, Labor, Group Insurance, Other Benefits, Other Insurance, Purchase Power, Rents, Support Services, Customer Accounting, Telecom, Transportation, Uncollectibles, and Miscellaneous.¹⁰⁰

Line	Item	TAWC Proposed Attrition Period A/	Consumer Advocate Proposed Attrition Period
1	Maintenance	\$ 1,691,431	\$ 1,599,432
2	Chemicals	2,307,000	2,116,184
3	Contract Services	966,015	815,810
4	Labor	6,961,854	5,739,414
5	Group Insurance	481,683	333,536
6	Other Benefits	643,491	562,861
7	Pension	619,489	619,489
8	Other Insurance	1,205,504	1,205,504
9	Purchased Power	3,062,540	2,809,231
10	Purchased Water	194,199	194,199
11	Rents	29,985	27,351
12	Support Services	8,636,676	7,631,522
13	Customer Accounting	577,105	87,229
14	Telecom	352,451	320,950
15	Transportation	428,594	428,594
16	Waste Disposal	749,830	749,830
17	Uncollectible	585,203	491,153
18	Miscellaneous	1,699,078	1,462,123
19	Regulatory Expense	518,000	-
		\$ 31,710,128	\$ 27,194,414

¹⁰⁰

Id. at 4:3-4, <AB-1 Attrition Adjustments 10-9-24>.

2. Support Services Growth Factor

In its initial filing with TPUC, TAWC requested \$8,636,676 for Support Services. This expense item contains charges allocated to TAWC from American Water Works Service Company (“AWWSC”). The makeup of these expenses includes Maintenance, Contract Services, Labor, Benefits, Other Benefits, Other Insurance, Rents, Transportation, Uncollectible, Miscellaneous and Non-O&M.¹⁰¹ The Consumer Advocate made adjustments to this expense and arrived at \$7,631,522.¹⁰²

Description	Company Proposed Attrition Period	CA Proposed Attrition Period	Difference
Maintenance	\$ 380,987	\$ 386,386	\$ 5,400
Contract Services	777,842	782,556	4,714
Labor	4,036,767	3,017,088	(1,019,678)
Benefits	641,045	630,734	(10,311)
Other Benefits	71,044	70,805	(240)
Other Insurance	469,153	464,357	(4,796)
Rents	136,781	133,785	(2,995)
Transportation	4,635	4,600	(35)
Uncollectible	(769)	(780)	(11)
Miscellaneous	1,715,947	1,757,625	41,677
Non O&M	403,268	384,366	(18,903)
Total	\$8,636,699	\$ 7,631,522	\$ (1,005,177)

The Consumer Advocate urges the Commission to carefully consider the parties’ operation and maintenance expense forecasts, as well as their competing forecasting methodologies, and decide upon a total O&M expense that is just and reasonable for ratepayers. The Commission therefore, should not approve a total O&M expense amount that exceeds the Consumer Advocate’s total expense forecast of \$27,194,414.

¹⁰¹ *Id.* at 6:20-22; *Direct Testimony of David N. Dittmore* <DND-1>.

¹⁰² *Id.* at 6:23-24; *Direct Testimony of David N. Dittmore* <DND-1>.

E. Taxes

1. Income Tax Expense: The Benefits from the Repair Deduction Should Flow Through Immediately to Consumers

Both Tennessee-American and the Consumer Advocate agree that under federal tax law Tennessee-American is entitled to an income tax deduction known as the “repair deduction.”¹⁰³ However, the Consumer Advocate and the Company disagree as to how consumers are to benefit from this reduction in the amount of income tax expense consumers must pay as part of their rates.

In essence, the Consumer Advocate believes the benefit from the repair deduction’s lowering of the Company’s income tax expense should flow through immediately to ratepayers. Tennessee-American, on the other hand, wants to delay the benefit far into the future, when many of the customers now paying the income tax in their rates may no longer be on the system.¹⁰⁴

In analyzing whether to flow through the benefits from the repair deduction, it should be borne in mind that, as Consumer Advocate witness Dittmore testified, the “[C]ompany . . . [is] seeking an income tax recovery from Tennessee ratepayers far in excess of what federal and state tax payments will actually be incurred by Tennessee on a pro rata basis.”¹⁰⁵

Furthermore, as the Company itself pointed out, many of Tennessee-American ratepayers are not in great financial shape. Mr. Grant Evitts, the President of Tennessee-American testified that “there are approximately 16,700 residential customers in our service areas with household incomes at or below 150 percent of the federal poverty level, which is approximately 25 percent

¹⁰³ *Rebuttal Testimony of Linda Schlessman* at 7:19-23; *Transcript of Proceedings*, Vol II (B) 215:10-13, November 19, 2024.

¹⁰⁴ *Id* at 8:19-9:4.

¹⁰⁵ *Transcript of Proceedings*, Vol II (B) 216:5-8, November 19, 2024.

of our residential water customer base.”¹⁰⁶ Such consumers could certainly benefit from a reduction now rather than at a point in the distant future.

Finally, it should be noted that the Consumer Advocate’s position with regard to flow-through to ratepayers is consistent with a TPUC decision in a case where the repair deduction and flow-through were also an issue. As Mr. Dittmore testified:

In Docket 18-00139, the Commission made a determination that the repair deduction was not protected and excess deferred taxes should flow back to rate-payers over a three-year period. This decision is consistent with my recommendation to apply the flow-through methodology to the repair deduction for purposes of computing income tax expense.¹⁰⁷

Therefore, the Commission should order the flow-through of the repair deduction consistent with the Consumer Advocate’s proposal.

2. The Commission Should Adopt the Property Tax Rates Recommended by the Consumer Advocate Because a 2026 Forecasted Expense Is Being Applied to the 2025 Attrition Period

The Company is sponsoring an adjustment to increase pro forma property tax expense by \$2,307,274 driven by a significant increase in the equalized assessment percentage.¹⁰⁸ The Company’s attrition period property tax expense is derived from applying the estimated assessed valuation to the equalized assessment percentage, and the product of those two factors is then applied to the property tax rate to arrive at the property taxes for the attrition period.¹⁰⁹

The appraisal increase driving the significant attrition period property tax increase will not be reflected as an expense on the books of TAWC until 2026, outside of the forecasted attrition period.¹¹⁰ The Consumer Advocate has eliminated the higher assessment rate, resulting

¹⁰⁶ *Transcript of Proceedings*, Vol I 47:5-9, November 18, 2024.

¹⁰⁷ *Transcript of Proceedings*, Vol II (B) 217:11-17, November 19, 2024.

¹⁰⁸ *Direct Testimony of David N. Dittmore* at 34:8-9.

¹⁰⁹ *Id.* at 34:9-13.

¹¹⁰ *Id.* at 34:15-17.

in a decrease in the Company's attrition period property tax of \$1,343,890.¹¹¹ Despite the fact that there is a large reduction in O&M costs in the attrition period, the property tax increase in the attrition period is approximately \$950,000 higher than the test period property tax reflected by the Company in Exhibit 22A.2.¹¹²

The property tax recorded each year is based upon the plant in service as of the prior year and the revised assessment will not be applicable until 2025, as reflected in the 2026 property tax expense. The Consumer Advocate does not support applying a 2026 forecasted expense within the 2025 attrition period. This would result in customers paying higher rates in 2025, while the Company would not incur the cost until 2026.¹¹³

a. The Consumer Advocate Used a Compound Annual Growth Rate to Determine the Appropriate Values for the Attrition Period for the Attrition Period Adjustments to the Allocated Charges from the Service Company to TAWC

The Consumer Advocate uses a compound annual growth factor ("CAGR") of 3.26% by comparing total Support Services allocations in 2019 to the Company's Proposed Adjusted Test Period for the above allocations.¹¹⁴ The use of CAGR is widely accepted for forecasting future values. The Company used a variety of Consumer Price Indices ("CPIs"). Using CAGR for forecasting future costs provides a way to account for fluctuations in value over time and provides a smooth growth rate during an elapsed time period. The use of CAGR to determine a growth factor uses the results of the Company's own operations unlike the Company's proposal to use a variety of CPI indices. The Consumer Advocate used the CAGR to determine the

¹¹¹ *Id.* at 34:17-19, <DND-10>.

¹¹² *Id.* at 34:19-22, <TAWC Exhibit 22A.2>.

¹¹³ *Direct Testimony of David N. Dittemore* at 35:6-8.

¹¹⁴ *Revised Direct Testimony of Alex Bradley* at 9:14-21.

growth rate of these Non-Production Costs because they tend to be volatile year-over-year and were independent from production related expenses with known and measurable changes.¹¹⁵

F. Rate Base

The Consumer Advocate asserts that the Commission should approve an attrition year rate base of \$297.8 million,¹¹⁶ as opposed to TAWC's projected rate base of \$305,126,373, which is \$7,320,512 million lower than TAWC's projected rate base.¹¹⁷

The appropriate methodologies for forecasting rate base, as well as the other components of the general ratemaking formula, are important; accordingly, TPUC may choose to address them in its decision of this case. The Consumer Advocate urges TPUC to refrain from selecting from the parties' opposing methodologies in a way that would result in a total rate base amount that is higher than the total being proposed by either of the parties. As noted previously, not only should the individual components of rate base be reasonable, but the methodologies used to forecast these components, when considered together, should produce an overall result that is also reasonable.

Utility Plant in Service ("UPIS") is the largest component of rate base and this is the average amount of utility assets for the attrition year on which the Company should be allowed the opportunity to earn a return. The Consumer Advocate determined the Company's plant addition forecast was both feasible and reasonable based on past activity.¹¹⁸ The Consumer Advocate adopts the Company's forecasted plant additions and retirements for 2024 and 2025 and agrees with the Company's attrition period UPIS of \$515,138,706.¹¹⁹

¹¹⁵ *Id.* at 13:12-14.

¹¹⁶ *Direct Testimony of William H. Novak* at 5:9-11, <Consumer Advocate Exhibit>, Schedules 2 and 3.

¹¹⁷ *Id.* at 6:1, Table 1; Consumer Advocate Exhibit, Schedules 2 and 3.

¹¹⁸ *Id.* at 7:15-8:2, <Consumer Advocate Exhibit>, Schedules 2 and 3.

¹¹⁹ *Id.* at 8:2-4.

Construction Work in Progress (“CWIP”) was not included by the Company. This represents the plant currently under construction that will soon become used and useful in providing utility service to the Company’s customers. The Commission has traditionally allowed CWIP as an addition to Rate Base, but the Company has chosen to omit this item because its plant has not yet become “used and useful.”¹²⁰ There is an interrelationship between Construction Work in Progress (“CWIP”) and Utility Plant in Service (“UPIS”). Capital spending projects are accounted for in CWIP as they are being constructed (such as the extension of a water main), but they are moved from CWIP to UPIS once the asset is placed into service (such as, when the water begins to flow through the new main to ratepayers). When a utility is not allowed to earn a return to cover their construction financing costs during the construction period, they typically can capitalize the financing costs for future recovery through an allowance for funds used during construction (“AFUDC”). This capitalized cost for AFUDC, which is added to the basis of utility plant under construction will ultimately be included in the Rate Case as a component of plant in service, thereby earning a return and being recovered through depreciation rates. In other words, the exclusion of CWIP in this rate case will result in an increase in AFUDC activity going forward. However, the Consumer Advocate has adopted the Company’s proposed \$0 balance for CWIP for this rate case.¹²¹

The Consumer Advocate further recommends the removal of Deferred Taxes, Depreciation/Amortization, and Net Income from the calculation of Cash Working Capital (“CWC”) because these are non-cash expenses.¹²² Mr. Dittmore defined CWC as the “amount of cash a company requires to have on hand to fund day-to-day operations.”¹²³ The most precise

¹²⁰ *Id.* at 8:11-14; TAWC Response to Consumer Advocate DR No. 3-3.

¹²¹ *Direct Testimony of William H. Novak* at 9:3-4, <Consumer Advocate Exhibit>, Schedules 2 and 3.

¹²² *Direct Testimony of David N. Dittmore* at 41:4-16.

¹²³ *Id.* at 41:11-12.

method of determining CWC is through the use of a lead-lag study, such as the one presented by TAWC witness Harold Walker III in this case.¹²⁴ Mr. Dittmore explained:

[A] CWC study measures the timing between when revenue is earned and when it is received, when cash expenses are incurred and when they are paid. These measurements are netted to determine the amount of funding required to provide utility service. This level of funding or investment is appropriately included as a component of Rate Base and may be positive or negative depending upon the outcome of the study.¹²⁵

“A cardinal principle of the working capital allowance is that it should exclude non-cash expenses, such as **depreciation, deferred income taxes and return on common equity**, among others.”¹²⁶ (emphasis added). However, in its *Petition*, the Company applied zero days of lag to non-cash expenses, yet incorporated them within the total balances for computing the daily average.¹²⁷

During the hearing, the Company’s witness admitted that he did not include the non-cash expenses in his testimony for two other jurisdictions due to the policy of those Commissions in excluding such expenses from the CWC calculation.¹²⁸ In Kentucky, however, the Company’s witness included these non-cash expenses in his CWC calculation based on previously approved methodology by the Kentucky Public Utility Commission.¹²⁹ In its decision, the Kentucky Public Utility Commission explained that it had recently reconsidered this issue in other rate cases and held that such non-cash expenses should be excluded from the CWC calculation.¹³⁰

¹²⁴ *Id.* at 41:12-13.

¹²⁵ *Id.* at 41:13-19.

¹²⁶ LEONARD SAUL GOODMAN, *THE PROCESS OF RATEMAKING*, Vol. II, at 829 (1998).

¹²⁷ *Direct Testimony of David N. Dittmore* at 42:4-7.

¹²⁸ *Petition*, ILAWC Exhibit 14.00, Direct Testimony of Harold Walker, II at 6:109-111, ICC Docket No. 24-0097 (Jan. 25, 2024) (<https://www.icc.illinois.gov/docket/P2024-0097/documents/347025>); and *Direct Testimony of Harold Walker, II*, Schedule HW-1, MPSC Case Nos. WR-2024-0320 & SR-2024-0321 (July 1, 2024) (<https://efis.psc.mo.gov/Document/Display/789210>).

¹²⁹ *Order, In re: Electronic Application of Kentucky American Water Company for an Adjustment of Rates, a Certificate of Public Convenience and Necessity for Installation of Advanced Metering Infrastructure, Approval of Regulatory Accounting Treatments and Tariff Revisions*, at 8-9, Case No. 2023-00191 (May 3, 2024).

¹³⁰ *Id.* at 9, FN28 citing Case No. 2021-00183, *Electronic Application of Columbia Gas of Kentucky, Inc. for an Adjustment of Rates; Approval of Depreciation Study; Approval of Tariff Revisions; Issuance of a Certificate*

This Commission has previously held that return on common equity is “a non-cash expense” not generating a cash requirement for the Company, and therefore, exclusion from working capital calculation is appropriate.”¹³¹ Additionally, the Commission previously held that depreciation expense is a non-cash expense and should be excluded from CWC.¹³²

Thus, the Consumer Advocate asserts that there is ample support for excluding the non-cash expenses including Deferred Taxes, Depreciation/Amortization, and Net Income from the calculation of the CWC component of rate base.

Finally, the Consumer Advocate asserts that 44.46 lead/lag days should be utilized in TPUC’s lead/lag study for TAWC.¹³³ The Company acknowledged an error in the revenue value used in the calculation. Correcting this issue results in modifying the overall revenue lag from 44.9 to 44.46 days. While this change may appear to be slight, it is material to the Cash Working Capital (“CWC”) calculation.

The second adjustment to the lead/lag component is to modify the Support Service lag days of negative (5) days of the Company to instead use the lag for Salaries and Wages of 10.5 days.¹³⁴ The negative five days used implies that TAWC is paying for affiliate charges before such charges are actually incurred. This is not a proper payment structure that would occur

of Public Convenience and Necessity; and Other Relief (Ky. PSC Dec. 28, 2021), Order at 14; Case No. 2021-00214, *Electronic Application of Atmos Energy Corporation for an Adjustment of Rates* (Ky. PSC May 19, 2022), Order at 20; Case No. 2022-00372, *Electronic Application of Duke Energy Kentucky, Inc. for (1) An Adjustment of Electric Rates; (2) Approval of New Tariffs; (3) Approval of Accounting Practices to Establish Regulatory Assets and Liabilities; and (4) All Other Required Approvals and Relief* (filed Oct. 12, 2023), Direct Testimony of Paul Norman at 6 and Attachment PMN-1 at 1; Case No. 2023-00159, *Electronic Application of Kentucky Power Company for (1) a General Adjustment of Its Rates for Electric Service; (2) Approval of Tariffs and Riders; (3) Approval of Accounting Practices to Establish Regulatory Assets and Liabilities; (4) a Securitization Financing Order; and (5) All Other Required Approvals and Relief* (filed June 29, 2023), Application, Section V, Exhibit 1 at 89.

¹³¹ *Amended Order, In re: Petition of Chattanooga Gas Company for Approval of an Adjustment in Rates and Tariff; The Termination of the AUA Mechanism and the Related Tariff Changes and Revenue Deficiency Recovery; and an Annual Rate Review Mechanism*, at 48, TPUC Docket No. 18-00017 (Jan. 15, 2019).

¹³² *Final Order Approving Rate Increase and Rate Design, In re: Petition of Aqua Utilities Company for Approval of Adjustment of Its Rates and Charges and Revised Tariff*, at 18, TRA Docket No. 06-00187 (Nov. 27, 2007).

¹³³ *Direct Testimony of David N. Dittmore* at 43:1-2 <DND-14>.

¹³⁴ *Id.* at 43:4-6.

between two unaffiliated entities and customers should not be expected to prepay for affiliate charges. The Consumer Advocate has imputed the lag associated with TAWC labor as the appropriate lead time associated with affiliate support services.¹³⁵

For these reasons, the Consumer Advocate urges the Commission to adopt its rate base forecast.

G. Electronic Payment Charges Should Not Be Included As a Base Operating Expense

1. Debit/Credit Card Processing Fees: Credit Card Users Should Bear the Cost of the Processing Fee

The Company proposes electronic payment fees be assessed to TAWC customers for credit card and electronic check be included within the attrition year.¹³⁶

Those customers who utilize those specialized methods of payment should pay the cost of the electronic payment related fees. Shifting the electronic payment charges to all customers, as proposed by Tennessee-American, imposes an unnecessary burden on other customers who are not utilizing these electronic methods, especially to those who are economically disadvantaged and those who do not have access to credit or debit cards.

These electronic processing costs should not be socialized to all customers but remain with the cost causer. Under the Company's proposal, customers who do not pay their bills with a credit card will see an increase in their bills. The Company has not shown that their proposal to socialize these costs would produce any increase in customer satisfaction, on-time payments, or disconnection avoidances. Furthermore, the Company failed to provide any evidence in the record that the costs of processing checks, such as the salary and benefits of the person(s)

¹³⁵ *Id.* at 43:9-11.

¹³⁶ *Direct Testimony of Robert Lane* at 15:11-19; *Transcript of Proceedings*, Vol. I at 100:16-25, November 18, 2024.

handling the checks, which is indeed spread among all customers, is in any way similar to the proposed debit/credit card fee.¹³⁷

In addition, it should be noted that since the credit card fee is on a percentage basis of the bill, it can rise significantly with the larger size of the bill. There is, however, no more electronic processing power is necessary for a \$30.00 bill versus a \$90.00 bill. The larger the bill, say for someone who can afford to fill a swimming pool, simply results in a greater cost to be borne by all customers.

The Consumer Advocate rejects Tennessee-American's proposal to shift the payment processing fees relating to debit and credit card transactions to all customers and believes that keeping with the status-quo provides appropriate price signals to customers by designing rates that are reflective of the cost being recovered.

2. Tariff Changes

The Company has proposed several changes to its existing tariff for miscellaneous rates.¹³⁸ In particular, the Consumer Advocate is concerned with the following changes:¹³⁹

- The establishment of an incremental after-hours charge of \$40.00.¹⁴⁰
- An increase in the Meter Tampering Fee from \$92.00 to \$250.00.

First, the Company has proposed establishing an after-hours charge that will be applicable when the customer has requested to re-establish service outside of normal business hours.¹⁴¹ The Consumer Advocate is opposed to this tariff change in its proposed form since the term "normal hours" is not defined. The Company should update its proposed tariff language to define "normal hours."

¹³⁷ *Transcript of Proceedings*, Vol I at 101:1-5, November 18, 2024.

¹³⁸ *Direct Testimony of William H. Novak*. at 31:3-4.

¹³⁹ *Id.* at 33:2-3.

¹⁴⁰ *Id.* at TAWC Tariff Sheet No. 12.

¹⁴¹ *Direct Testimony of Health Brooks* at 32:15-17.

Also, the Company is proposing to increase the meter tampering fee from \$92.00 to \$250.00 and impose a \$30 reconnection charge.¹⁴² The Company currently charges \$92 when a customer's water service has been discontinued for non-payment and then illegally turned back on by the customer. The Company has failed to establish a need for a change in this charge and the Company has not applied this charge to any customers during the Test Period.¹⁴³ Also, the Company has not provided a basis for how the proposed \$250 fee was calculated. The Company is proposing to add fees on top of fees by combining the \$250 meter tampering fee with a reconnection fee, which results in a total amount of \$280. There is no other utility under the Commission's jurisdiction with such a charge.¹⁴⁴ The Consumer Advocate recommends that the Meter Tampering charge in the Company's proposal for this tariff change be denied.

V. COST OF CAPITAL AND RATE OF RETURN

A. Recommendation for Cost of Capital and Rate of Return

The next general area of contention is TAWC's cost of capital and the overall Rate of Return ("ROR") the Company should be allowed to earn. Included within this section is a discussion of the appropriate capital structure for TAWC, Cost of Equity ("COE"), and the Company's allowable Return on Equity ("ROE"). While the ultimate positions of the parties lead to a difference in revenue required of several million dollars, a closer analysis shows that a few key differences driving the large variation in the result. The basic approaches of the parties are not that dissimilar. For example, both TAWC's expert Ann E. Bulkley and the Consumer Advocate's witness Aaron L. Rothschild both use the Discounted Cash Flow ("DCF") and Capital Asset Pricing Model ("CAPM") to estimate TAWC's market-based COE. However,

¹⁴² *Id.* at 33:12-15, TAWC Tariff Sheet No. 12.

¹⁴³ *Direct Testimony of William H. Novak* at 33:15-18, <WHN Revenue Workpaper 4.0-Revenues by Class>.

¹⁴⁴ *Id.* at 34:1-2.

model implementation differences between these two witnesses lead to significantly dissimilar results.

As a regulated monopoly, TAWC's authorized ROE should be consistent with the legal standards set by the United States Supreme Court for a fair rate of return in that (1) "...the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks"¹⁴⁵ and (2) "sufficient to . . . support its credit and . . . raise the money necessary for the proper discharge of its public duties."¹⁴⁶ TAWC's expert witness on cost of capital issues, Ann E. Bulkley, calls for the Company to be allowed an ROE of 10.75%, and she applies that ROE to the capital structure advanced by TAWC Treasurer, Nicholas Furia. That capital structure is essentially the capital structure of TAWC when this rate case was filed, without any adjustment for the fact that TAWC is a wholly owned subsidiary of AWWC.

On the other hand, Aaron Rothschild, the expert witness testifying on behalf of the Consumer Advocate recommends TAWC should receive an authorized ROE of 8.28% and this rate should be applied to a standalone capital structure 50.90% common equity, 47.11% long-term debt, and 1.99% short-term debt, which takes into account that TAWC has no equity investors other than its parent, AWWC.

Nevertheless, there are differences in the final opinions of Mr. Rothschild, Ms. Bulkley, and Mr. Furia, despite the many similarities in their approaches. The key driver in the disparity in their opinions on capital structure is whether TAWC is viewed as a standalone company, or whether the analysis must reflect the fact that TAWC is a wholly owned subsidiary of AWWC and that AWWC provides the capital for TAWC to use for its operations. The key driver in the

¹⁴⁵ *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 59, at 603 (1944).

¹⁴⁶ *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n of the State of W. Va.* 262 U.S. 679, at 692-693 (1923).

disparity in their opinions on the cost of equity is the concept of following market-based data and whether or not authorized ROEs are market-based data.

1. The Commission Should Reject TAWC's Requested Capital Structure Because Its Common Equity Ratio Is Significantly Higher Than Both the Common Equity Ratio Used by Other Utility Companies in the Country and the Consolidated Capital Structure Used by TAWC's Parent Company, American Water Works Corporation, Inc

TAWC requested a capital structure of 54.52% common equity, 43.49% long-term debt, and 1.99 % short-term debt.¹⁴⁷ It asserts this 54.52% common equity is *de facto* reasonable because it is within the actual capital structures of the utility operating subsidiaries of the proxy group companies.¹⁴⁸ However, the Company has failed to carry its burden of proof in its request because it can provide no other justification for a higher standalone capital structure other than the statement that its request “cannot be deemed inappropriate unless it diverges from sound industry practice and causes a lack of financial flexibility that may lead to higher overall costs.”¹⁴⁹ In fact, Company witness Furia went as far as to suggest that this requested capital structure was so infallibly reasonable that it was “not the Commission’s charge to balance interests by imputing higher debt ratios to the capital structure in order to lower rates” and that he would “not know of *any* test” that TPUC could employ to assess the overall reasonableness of the Company’s requested structure.¹⁵⁰ This statement flies in the face of the Commission’s long established charge to balance the interests in a rate case to make rates that are just and reasonable.¹⁵¹ With this statement the Company is essentially asking the Commission to

¹⁴⁷ *Direct Testimony of Ann Bulkley* at 62:2-4.

¹⁴⁸ *Rebuttal Testimony of Nicholas Furia* at 3:15-17 (quoting *Direct Testimony of Ann E. Bulkley* at 10:6-17); *Transcript of Proceedings*, Vol. I at 156:7-8, November 18, 2024.

¹⁴⁹ *Rebuttal Testimony of Nicholas Furia* at 3:19-4:1.

¹⁵⁰ *Id.* at 5:11-12; and *Transcript of Proceedings*, Vol. I at 158:23-159:3, November 18, 2024 (emphasis added).

¹⁵¹ *In Re: Petition Of Tennessee American Water Company To Change And Increase Certain Rates And Charges So As To Permit It To Earn A Fair And Adequate Rate Of Return On Its Property Used And Useful In Furnishing Water Service To Its Customers*, at 20, TPUC Order, Docket No. 06-00290, (June 10, 2008).

unquestioningly accept its request for a change in capital structure based on the sole fact that it picked a common equity number within the range dictated by its own expert's proxy group.¹⁵² The Company's 54.52% common equity request is confoundingly over 1% higher than the average of the proxy group companies proffered by Company witness Bulkley. However, the Company cannot point to a specific methodology or any other justification for picking a common equity percentage over the average of its own expert, other than that there were "a number of factors" that went into the decision-making process.¹⁵³ It has not conducted any analysis, nor has it otherwise stated that any other capital structure would be unreasonable because it would cause a lack of financial flexibility or lead to overall higher rates.¹⁵⁴ In fact, after the opportunity through rebuttal testimony and at the hearing to evaluate and respond to the Consumer Advocate's competing capital structure recommendation, the Company failed to provide additional analysis or reasoning on why the Consumer Advocate's recommendation was unreasonable, would lead to financial inflexibility, or would lead to higher overall rates. The Company has not fulfilled its burden of proof on this request.

Even more concerning in the Company's proposal to change the capital structure is the suggestion that there is no real avenue for any intervenor or the Commission to be able to determine the reasonableness of the request, apart from blindly following the range supplied by Ms. Bulkley. The Company's request begs the question: is the Commission supposed to simply take TAWC at its word in determining the reasonableness of this request? Certainly not. The opposite is true. The Commission's sole charge under §65-5-103 *et seq.*, is to ultimately determine just and reasonable rates. If there is no independent test of reasonableness that TPUC

¹⁵² It should be noted here that Mr. Rothschild and Ms. Bulkley disagree on the companies that comprise the relevant proxy group; however, both experts suggest numbers that are within the range of each other's proxy group.

¹⁵³ *Transcript of Proceedings*, Vol. I at 156:21-23, November 18, 2024.

¹⁵⁴ *Id.* at 154:8-12; 158:19-22; *Rebuttal Testimony of Nicholas Furia* at 3:17-19.

can employ, or if it is not allowed to reexamine a company's proposed capital structure to come to a more reasonable outcome, then how, if at all, is this Commission supposed to carry out its statutory duty?

The unquestioning acceptance of the Company's request would effectively eliminate the core, deliberative process of the Commission's statutory charge. This Commission should, therefore, take a close look at the recommendation of the Consumer Advocate to determine an appropriate capital structure that may produce differing or more reasonable outcomes than the Company's initial request.

2. The Consumer Advocate's Recommendation More Closely Reflects the Actual Cost of Equity, Is More Reasonable in Balancing Interests Between Consumers and the Company, and Will Continue to Allow the Company to Raise Sufficient Capital

While the Company simply expects the Commission to approve its proposed standalone capital structure, the Consumer Advocate has considered TAWC's request and conducted additional analysis to determine a more reasonable structure that better balances the interests of consumers and the Company. Mr. Rothschild's recommendation of a capital structure containing 50.90% common equity, and 47.11% long-term debt, and 1.99% short-term debt, is based on a review of TAWC's request for regulatory capital structure, the capital structure ratios of other water utility companies, and the capital structure of TAWC's parent, American Water Works Company, Inc. Mr. Rothschild explained in his testimony and again in his summary to the Commission at the hearing that the reported capital structure of a regulated subsidiary is often not representative of how the regulated utility was financed. He gave the example that the parent of a regulated utility can report funds raised through debt financing at the holding company level as equity financing on the books of its regulated utility subsidiary. For this reason, it is

important to ensure TAWC's requested capital structure would not overcharge consumers by including a higher common equity ratio than is appropriate.

The consolidated structure of TAWC's sole investor, AWWC, is 44.19% common equity.¹⁵⁵ The low end of Ms. Bulkley's range of proxy group companies is 44.57%.¹⁵⁶ And the low end of Mr. Rothschild's range of proxy group companies is 44.4%.¹⁵⁷ The current common equity ratio for AWWC, which is how TAWC is actually financed, is notably lower than the range of both experts' proxy group companies. Thus, the risk, as explained by Mr. Rothschild, that funds raised through debt financing at the AWWC level be reflected as equity financing on TAWC's books is ever present and should be considered when determining the reasonableness of the request to change capital structure.

In this case, Mr. Rothschild suggested adoption of a common equity ratio of 50.9%, instead of the requested 54.52%, to more accurately mirror the way that water utility companies are financed around the country, including for TAWC, and to avoid any unnecessary burden on the Company's ratepayers.¹⁵⁸ It is the Consumer Advocate's belief that this approach will better balance interests of the consumers while allowing the Company the added financial flexibility of a standalone capital structure increase in common equity.

B. The Commission Should Reject TAWC's Recommended Return on Equity ("ROE") of 10.75% Because It Is Higher Than TAWC's Market-Based Cost of Equity ("COE")

TAWC's lead ROE witness, Ann E. Bulkley, proposes a ROE of 10.75%, within a ROE range from 10.25% to 11.25%.¹⁵⁹ The Consumer Advocate's ROE witness, Aaron Rothschild, proposes a ROE of up to 8.28%, which he states is at the high end of his cost of equity model

¹⁵⁵ See TAWC MFG Q004_Attachment 03, at 112 of 200.

¹⁵⁶ Direct Testimony of Ann Bulkley at 63:9-12.

¹⁵⁷ Exhibit ALR-5, at 4.

¹⁵⁸ This common equity ratio was derived from the range of water only proxy groups determined by Mr. Rothschild and more fully explained in his direct testimony.

¹⁵⁹ Direct Testimony of Ann Bulkley at 10:2-3.

results.¹⁶⁰ Mr. Rothschild’s reasonable ROE range spans from 7.09% to 8.28% with a midpoint of 7.68%.¹⁶¹ As mentioned above, the key driver between Ms. Bulkley and Mr. Rothschild’s findings centers first and foremost on the determination of what is “market-based” data.

Both TAWC witness Bulkley and Consumer Advocate witness Rothschild agree that the cost of equity, by definition, is market-based and, therefore, must be estimated based on observable market data.¹⁶² Where the experts differ, however, is in determining what that observable market data includes. The Company’s position is that Mr. Rothschild’s 8.28% ROE recommendation is “inconsistent with the comparable return standard” because it is below authorized ROEs for other utilities in the United States since 2021. However, it is the Consumer Advocate’s position that authorized ROEs are not the same as market data. Even if it were assumed that all historical authorized ROEs of water utility companies in other proceedings are based on accurate market-based cost of equity calculations, they are from the past. The cost of equity should be based on current market conditions. Unless authorized ROEs are set based on investors’ current expectations as indicated by market data at the time of the proceeding, the resulting rates charged to consumers would either be too low to permit a utility to raise capital on reasonable terms or too high such that ratepayers would be overcharged.

Ms. Bulkley over relies on non-market data to determine her ROE recommendation. Additionally, she inappropriately uses previously authorized ROEs as a basis of comparison in her rebuttal testimony to falsely conclude that Mr. Rothschild’s 8.28% ROE recommendation is too low. The Consumer Advocate argues that Ms. Bulkley’s extensive use of non-market based data such as equity analyst forecasts, is problematic because it relies heavily on the personal

¹⁶⁰ *Direct Testimony of Aaron Rothschild* at 9:3-5; *Transcript of Proceedings*, Vol. I at 230:14-16, November 18, 2024.

¹⁶¹ *Id.*

¹⁶² *Direct Testimony of Ann Bulkley* at 32:21-22.

opinions of individuals. On the other hand, Mr. Rothschild's market-based methodology is more reliable because it relies on a much larger sample size of data than the narrow group of analysts' opinions. Thus, the Consumer Advocate posits that COE is, by definition, the market-based return investors expect to earn on the market value of any given stock. It can be seen in Table 4 of Mr. Rothschild's pre-filed direct testimony that major financial institutions are counseling clients to expect returns on the overall market¹⁶³ that are in the range of 6.2% to 7.9%. The Consumer Advocate argues that there is no good reason for TAWC's authorized ROE to be hundreds of basis points higher than those expected in a highly competitive and unregulated market. The Consumer Advocate's reasoning rests on the long-settled principle that regulation and the grant of a government sanctioned monopoly is the stand-in for competition in the marketplace.

1. Past Authorized ROEs Are Accounting Returns and Should Not Bear the Most Weight in Analyzing Market Data to Determine ROE

Consumer Advocate witness Rothschild categorizes authorized ROEs as "accounting returns" because authorized ROEs are nearly identical to return on book equity as they are applied to rate base. TAWC's witness Bulkley also discussed this principle at the hearing in clarifying that publicly traded companies, or companies included in her proxy group analysis that are traded on the open market, do not need a stand-in of regulation for competition, and do not have authorized ROEs.¹⁶⁴ Instead, investors look to the market as a whole when determining the cost of equity for these companies. The same principle should be applicable for regulated subsidiaries of these publicly traded companies.

¹⁶³ The S&P 500 includes companies operating in highly competitive and unregulated markets, like Amazon, Apple, and Tesla.

¹⁶⁴ *Transcript of Proceedings*, Vol. I at 135:6-13, November 18, 2024.

Although the analysis becomes more complicated when looking at these regulated subsidiaries,¹⁶⁵ the over-arching principle of looking to the capital markets as a whole to determine COE should remain. The Consumer Advocate's witness Rothschild advocates looking to the capital markets as a primary source for COE determination. However, TAWC has sought to over-complicate this analysis by conflating the market-based COE with authorized ROEs of similar subsidiaries and thus only points to a secondary source to determine COE. This analysis is problematic because such accounting information alone (e.g., revenue, net income, equity book value, or return on book equity) can only be established by capital markets (e.g., stocks, stock options). TAWC's method of looking to authorized ROEs first establishes an over-reliance on the backward-looking returns are to the investors versus what investors expect those returns will be in the future. To argue otherwise would be to argue that investors, when they purchase stock, do not care about how their purchase will fare in the future and only care about what the backward-looking return has been to that point of the investment.

Additionally, we have direct evidence that authorized ROEs, on average, are higher than the market-based cost of equity for water utility companies. In his 1970 book *The Economics of Regulation: Principles and Institutions*, regulatory economist Alfred Kahn wrote on why the cost of equity is lower than authorized returns when market to book ratios are significantly above one, saying:

[T]he sharp appreciation in the prices of public utility stocks, to one and half and then two times their book value during this period, reflected ... a growing recognition that the companies in question were in fact being permitted to earn considerably more than their cost of capital. ... The source of the discrepancy between market and book value has been that commissions have been allowing r 's [returns on equity] in excess of k [market cost of equity]; if instead they had set r equal to k , or proceeded at some point to do so ... the

¹⁶⁵ Because they are not publicly traded on the stock market, these subsidiaries have less accurate, comparable metrics to measure investor expectations, i.e., the need for proxy group analysis of COE in the first place.

discrepancy between market and book value ... would have disappeared, or would never have arisen.¹⁶⁶

As shown on Exhibit ALR-3, page 1 of Mr. Rothschild's testimony, the market-to-book ratios of water utility stocks are nearly 2.5 times greater than their book value. In taking Kahn's principle into consideration, investors have communicated through direct participation in capital markets based on the prices they are willing to pay for stocks that are 2.5 times greater than their book value. Thus, it is clear that there is a misalignment by TAWC in taking market-based COE and authorized ROE to be synonymous.

In sum, the Consumer Advocate urges the Commission to look at the market-based cost of equity, as the return investors expect to earn when they purchase the equity (or stock) of a company, which can come in the form of capital gains (stock price appreciation) or dividend payments, rather than authorized ROEs, which are more appropriately categorized as accounting returns. When investors buy and sell stock in the market, they convey all the necessary information about their return expectations and, therefore, the underlying cost of equity. This should be the core consideration in the COE discussion, as recommended by Mr. Rothschild.

2. The Company's Method of Looking to Other Authorized ROEs to Determine a New Authorized ROE Presents Several Ancillary Issues

Apart from the discussion above regarding the misalignment with the actual market-based cost of equity, the Company's focus on past authorized ROEs creates other ancillary issues including: (a) manufactured competition within the AWWC subsidiaries; (b) staleness or lag; and (c) and presumptions of the relevancy or accuracy of other Commissions and other jurisdictions.

¹⁶⁶ Alfred Kahn, *The Economics of Regulation: Principles and Institutions*, Mass. Inst. Tech. at 48 (fn. 69), 50 (1970).

a. Artificial Competition Between AWWC Subsidiaries Is Not a Valid Reason for an Increased Cost of Equity or Authorized ROE

TAWC President, Grant Evitts, submitted that the ROE proposal of the Consumer Advocate would be too low and would adversely impact the Company's ability to secure proactive investment funding.¹⁶⁷ However, it is important to keep in mind that the investment funding the Company is concerned with attracting is from a single source: its parent company, AWWC.¹⁶⁸ Mr. Evitts describes the Company's issue with attracting capital in the context of the AWWC landscape of subsidiaries, stating "American Water's subsidiaries are competing within the American Water system for proactive allocations of American Water's investment and financing capacity."¹⁶⁹ Mr. Evitts essentially is pressing the notion that the authorized ROEs of AWWC's other subsidiaries drive the need for TAWC to seek an increase in its own ROE in order to stay competitive internally to the greater AWWC system. This internal competition for higher ROEs simply does not square with the analysis of determining the appropriate cost of equity for TAWC. This is because, as discussed above, the cost of equity is market-based when looking to the capital markets.

Mr. Evitts is pointing to a manufactured market within the American Water system. Not only does this manufactured marketplace have no definitive correlation to the actual capital markets, but the Company also seems to suggest that this internal marketplace alone justifies an increased ROE.¹⁷⁰ Mr. Evitts even goes as far as to suggest that this internal marketplace competition for investment funding from a single parent source is "healthy" because it would force the utilities to produce the greatest benefits at the most reasonable cost.¹⁷¹ However, this

¹⁶⁷ *Rebuttal Testimony of Grant Evitts* at 5:18-20; *Transcript of Proceedings*, Vol. I at 50:9-15, November 18, 2024.

¹⁶⁸ *Transcript of Proceedings*, Vol. I at 51:19-23, November 18, 2024.

¹⁶⁹ *Rebuttal Testimony of Grant Evitts* at 5:21-6:2.

¹⁷⁰ *Id.* at 6:4-8, 13-14.

¹⁷¹ *Id.* at 7:22-8:2; and *Transcript of Proceedings*, Vol. I at 53:1-3, November 18, 2024.

type of internal competition does not necessarily lead to the greatest benefits at the most reasonable costs. In fact, looking to internal competition for parent company investment funding may artificially skew any cost analysis because the ends of providing safe and reliable service will always be justified. To be sure, the Company does state in a perfunctory fashion that it will remain committed to fulfilling its obligations to provide safe water if the Commission accepts the Consumer Advocate’s ROE recommendation, but not without adding a cryptic allusion to “unintended consequences” in the form of things costing more in the future.¹⁷²

It is germane that this characterization of “healthy” internal competition really amounts to nothing more than pressure by AWWC on its subsidiaries to continually up the authorized-ROE-ante and point the finger at other jurisdictions for the reason why they must do so. The Company provides no additional reasoning or analysis beyond the fact that other subsidiaries received a certain authorized ROE as to why Tennessee as a jurisdiction would need a similar ROE. Absent additional reasoning, the Company falls back on its flawed COE analysis which wrongly considers accounting returns of authorized ROEs and not capital market determinations.

b. Authorized ROEs May Be Stale and Thus Are Not the Best Source of Determining COE

As the Consumer Advocate has noted repeatedly, authorized ROEs are accounting returns that have already been decided by a Commission. In some cases, as with TAWC in this case, the authorized ROEs were approved by Commissions months, if not years, ago. That makes the information in those returns subject to staleness. In other words, the authorized ROEs do not effectively take into account the changing day-to-day capital market conditions such as looking to the stock prices of a company. What the lagging information of authorized ROEs does show us is how well a company is managing its investors’ money, not necessarily what those investors

¹⁷² *Rebuttal Testimony of Grant Evitts* at 8:12-13; *Transcript of Proceedings*, Vol. I at 80:9-15, November 18, 2024.

expect from future capital conditions. This is not overly helpful in illuminating the current COE in this case.

c. Authorized ROEs Overly Rely on the Presumptions of the Accuracy and Relevancy of Other Jurisdictions' Commission's Reasoning

Another problem in looking at authorized ROEs to determine COE is the need to look at what other jurisdictions have approved. Although other Commissions likely make similar determinations, their reasonings can vary vastly as to why they finally approved a certain ROE. The unfortunate reality is that other AWWC subsidiaries, regardless of the parent, are simply in different locations with different needs than TAWC. Thus, even within the AWWC system, it is not necessarily the most relevant lodestar to look to a jurisdiction even geographically close to Tennessee, like West Virginia or Pennsylvania,¹⁷³ both of which had Commissions that came out more than 25 basis points apart on ROE determinations, because those determinations carried their own unique considerations specific to that AWWC subsidiary.¹⁷⁴

Even if the Consumer Advocate were to agree with TAWC that it should look to other authorized ROEs, the authorized ROEs most readily relevant within the AWWC subsidiary landscape, as suggested by Company witness Evitts, do not support TAWC's proposal of 10.75%. In each jurisdiction that an AWWC subsidiary has had a rate case within the past two years, no Commission has authorized an ROE above 10% (which is TAWC's current authorized ROE from its last general rate case).¹⁷⁵

¹⁷³ See *Case No. 23-0383-W-42T*, 25-26, West Virginia Public Service Commission (February 23, 2024); See *R-2023-3043189*, 194, Pennsylvania Public Service Commission (July 11, 2024).

¹⁷⁴ The Consumer Advocate, here, will also note that in both jurisdictions mentioned the relevant TAWC subsidiary suggested an ROE of 10.5% and 10.95%, respectively, and both Commissions returned approvals of ROEs under 9.8%.

¹⁷⁵ *Final Order*, 43, Indiana Utility Regulatory Commission Docket No. 45870 (February 14, 2024); *Final Order*, 40, Kentucky Public Service Commission Case No. 2023-00191 (May 3, 2024); *Final Opinion and Order*, 194, Pennsylvania Public Service Commission Case Nos. R-2023-3043189 (water) R-2023-3043190 (wastewater) (July 11, 2024); *Final Order*, 53, Public Service Commission of West Virginia Case Nos. 23-0383-W-42T (water) 23-0384-S-42T (wastewater) (February 23, 2024); *Staff Proposed Order*, 248, Illinois Commerce Commission

3. TAWC's COE Models Are Not Sufficiently Supported by the Market Based Data to Justify a 10.75% ROE

Another key driver between Ms. Bulkley and Mr. Rothschild's findings focuses on the mechanics of the different COE models, specifically the growth rate components. Both experts use the DCF and CAPM methods as part of their calculation of the appropriate return on equity for TAWC. The DCF is a measure of the expected value of a company's cash flow to an investor, discounted for its present value. The formula for the DCF model shows the rate of return an investor in a stock can expect to receive by calculating the dividend yield (the expected dividend divided by the current price of the stock) plus the expected growth rate of that dividend.¹⁷⁶ The CAPM method derives the risk premium an investor would require for a specific stock by taking the risk free investment rate and adding to it the risk premium for a broad portfolio of stocks adjusted for the riskiness of the particular stock being measured.¹⁷⁷

The major point of contention in their uses of the DCF model are Mr. Rothschild's insistence on use of market-based projected ROE's from trusted sources for determining the growth rate component and Ms. Bulkley's reliance on projected earnings per share growth rates developed by the equity analysts.

TAWC witness Bulkley spent a fair amount of her rebuttal testimony describing the ways in which she and Mr. Rothschild's methods differ and, of course, why her method is superior. However, at hearing there were no questions asked on cross-examination of Mr. Rothschild of how his methods were inferior or otherwise unacceptable.¹⁷⁸ In fact, there were no questions at

Docket No. 24-0097 (October 24, 2024); *Stipulation Agreement* at 1 ¶2, Virginia State Corporation Commission Case No. PUR-2023-00194 (September 24, 2024).

¹⁷⁶ See generally *Direct Testimony of Aaron Rothschild* at 54-59.

¹⁷⁷ *Id.*

¹⁷⁸ *Transcript of Proceedings*, Vol. II (B) at 235:9-13 November 19, 2024.

all for Mr. Rothschild on his methods.¹⁷⁹ This is simply because Mr. Rothschild's methods are reasonable and reliable.

Mr. Rothschild's constant growth DCF model is used by major financial institutions.¹⁸⁰ J.P. Morgan Chase uses the sustainable growth form of the DCF method, as he does, in its 2019 Long-Term Capital Market Assumptions publication.¹⁸¹ His CAPM is based on methodologies used by Value Line, the Chicago Board of Options Exchange, and published in peer-reviewed academic journals (e.g., *The Review of Financial Studies*). Additionally, other Commissions have adopted his methodologies. In April 2020, the Public Service Commission of South Carolina stated the following:

Amongst the three witnesses, Consumer Affairs Rothschild's approach was unique in that he included the use of both historical and forward-looking, market-based data in his analysis. Based on the testimony and facts presented, the Commission therefore adopts the recommended ROE of 7.46% proposed by witness Rothschild.¹⁸²

In 2024, the California Commission found merit in Mr. Rothschild's analysis and used his COE methodology, including both CAPM and DCF methods to determine the authorized ROEs for ten regulated utility companies in a cost of capital proceeding.¹⁸³ Contrastingly, Ms. Bulkley does not point to any place in her testimony where her analysis or methodologies have been accepted or adopted in Commission specific language. In each jurisdiction that Ms. Bulkley has filed testimony on behalf of an AWWC subsidiary, no Commission has accepted or authorized her COE methodologies or ROE recommendations.

¹⁷⁹ *Id.*

¹⁸⁰ *Id.* at 231:15-20.

¹⁸¹ 23rd Annual Edition, *Long-Term Capital Market Assumptions—Time-Tested Projections to Build Stronger Portfolios*, at 62-63.

¹⁸² *Order Ruling on Application for Adjustment in Rates*, at 43, SC PSC Docket No. 2019-290-WS, Order No. 2020-306 (April 9, 2020).

¹⁸³ *Alternative Proposed Decision of Commissioner John Reynolds* at 19, CPUC Application No. 22-09-003 (August 5, 2024).

C. TAWC Has Presented Insufficient Evidence To Justify the Unprecedented Increase in the Return on Equity Approved in the Last TAWC Rate Case

TAWC was last before TPUC in 2012 when they sought an increase in rates in Docket 12-00049 (“2012 Rate Case”). The 2012 Rate Case was filed on June 1, 2012, and the Parties entered into a settlement agreement. The new rates went into in effect on November 1, 2012.¹⁸⁴ In that docket, TPUC approved the settlement agreement and allowed a return on equity (“ROE”) for TAWC of 10%.¹⁸⁵ While the basic structure and condition of TAWC and AWWC have not changed substantially in the intervening twelve years, the American economy has changed.

The evidence introduced in the 2012 rate case, including the analysis of comparable companies and expected investor returns, reflects those expectations when markets and investor confidence were at historic high points. Surely, the Company is not arguing that investors expect to receive returns on their equity investments today that are higher than those historic highs. Yet, that is exactly what TAWC proposes. Ms. Bulkley proposes a range of acceptable equity returns from 10.25% to 11.25%¹⁸⁶ and the Company is requesting that TPUC adopt an ROE of 10.75%.¹⁸⁷ TAWC applies this inflated rate to TAWC’s capital structure in effect at the time TAWC chose to file its rate case. TAWC ignores the relationship with AWWC that it touts as so beneficial in other situations for its AWWC affiliates.

Not only in this Docket, but around the country, AWWC and its affiliates routinely ask for an ROE far in excess of that last awarded by TPUC.¹⁸⁸ As has been examined above, Ms. Bulkley makes a series of assumptions and adjustments to bring in factors which are not

¹⁸⁴ *Order Approving Settlement Agreement* at 2, TRA Docket No. 12-00049 (November 20, 2012).

¹⁸⁵ *Id.*

¹⁸⁶ *Direct Testimony of Ann Bulkley*, <Exhibit AEB-2>.

¹⁸⁷ *Petition* at ¶8.

¹⁸⁸ *Order Approving Settlement Agreement* at 2, TRA Docket No. 12-00049 (Nov. 20, 2024).

appropriate for the circumstances of the TAWC/AWWC relationship and have the effect of driving up proposed rates of return. All of this flies in the face of the inescapable conclusion that nothing presented in this Docket justifies any increase in TAWC's allowed rates of return, much less the jump in ROE from the 10% ordered in the last rate case to the 10.75% sought in this Docket.

Mr. Rothschild's is the better analysis to find the true market-based cost of equity for TAWC, especially given that all equity capital is in fact raised by AWWC. He utilizes appropriately sized proxy companies that operate as water utilities and not in other areas of utility generation or delivery. He does not make any unnecessary adjustments to account for factors already compensated for by his methods. This results in a range of acceptable equity returns from 7.09 to 8.28% and his recommendation of an ROE of 8.28%.¹⁸⁹ After applying this to his capital structure he concludes that TAWC should receive an overall ROR of 6.46%.¹⁹⁰

Mr. Rothschild's analysis reflects the reality in the markets and in the American economy since TAWC was last before TPUC. The Consumer Advocate asks TPUC not to grant TAWC the unprecedented increase in returns they seek and, instead, to order the rational returns suggested by Mr. Rothschild and that they be applied to a capital structure which properly recognizes the reality of how TAWC raises its capital.

VI. REVENUE CONVERSION FACTOR

In his pre-filed testimony, Consumer Advocate witness Dittmore proposed two modifications to Tennessee-American's current Revenue Conversion Factors.¹⁹¹ In particular,

¹⁸⁹ *Direct Testimony of Aaron Rothschild* at 10:21-11:1.

¹⁹⁰ *Id.*

¹⁹¹ *Direct Testimony of David N. Dittmore* at 43:15 – 44:8.

Mr. Dittmore recommended “that the Company’s inclusion of the TRA utility fee factor and Gross Income (Receipts) factor be eliminated within the gross-up calculation.”¹⁹²

The TRA (TPUC) fee will not increase or decrease until 2026 associated with this rate change, and thus, it should not be considered within the context of the 2025 attrition period results under consideration in this proceeding.¹⁹³

Secondly, the Company’s most recent Gross Receipts Tax Return was supplied in response to Minimum Filing Guideline Question 47, Attachment 1. A review of this filing indicates that the Excise Tax and Franchise Tax payments are direct credits to the amount of Gross Receipts tax due. As a result, it would be inappropriate to include both factors in the gross-up calculation. Mr. Dittmore has eliminated the Gross Receipts gross-up factor consistent with the Commission determined the factor in TPUC Docket No. 18-00017.¹⁹⁴

In his pre-filed rebuttal testimony, Company witness Lane criticized Mr. Dittmore’s recommended changes.¹⁹⁵ However, at the Hearing Mr. Lane stated that he was not the witness who was able to testify on Revenue Conversion Factors:

Q. So you didn’t testify about the revenue requirement conversion factors?

A. No, I did not.¹⁹⁶

Thus, Mr. Lane disavowed any knowledge of what was written in his pre-filed testimony regarding the Revenue Conversion Factor. Based upon his inability or unwillingness to answer any questions regarding the conversion factor, the Commission should reject the arguments he set forth in his rebuttal testimony. Accordingly, the Commission should adopt the Revenue Conversion Factors proposed by the Consumer Advocate.

¹⁹² *Id.* at 43:1819.

¹⁹³ *Id.* at 43:19-20 – 44:1-2.

¹⁹⁴ *Id.* at 44:3-8; *Order*, at 103, TPUC Docket No. 18-00017 (Jan. 11, 2019).

¹⁹⁵ *Rebuttal Testimony of Bob Lane* at 5:20 – 6:10.

¹⁹⁶ *Transcript of Proceedings*, Vol. I at 100:5-7, November 18, 2024.

VII. REVENUE DEFICIENCY

Based on the foregoing, the Consumer Advocate concludes that the rates presently charged to TAWC's customers are more than sufficient to cover TAWC's expenses and taxes, as well as provide a fair rate of return to its investors. Indeed, the Consumer Advocate's accounting forecast, when coupled with its rate of return recommendation, supports a rate decrease of approximately \$4.7 million.¹⁹⁷

VIII. RATE DESIGN

With respect to rate design, TAWC is using a Class Cost of Service Study ("CCOSS") to set rates for each of its tariffs.¹⁹⁸ The Consumer Advocate is proposing that any increase or decrease in rates be spread evenly across the board to all ratepayer classes and locations.¹⁹⁹ The CCOSS is used to arrive at a cost of serving each customer class and then a systematic approach is taken to allocate the cost (or total revenue requirement) to the different classes of customers.²⁰⁰ The Company's CCOSS classifies each element of rate base and income to its different tariffs using 27 separate allocation factors.²⁰¹ The Company's CCOSS allocates \$13.6 million of the rate increase to Sale for Resale customers while allocating 49.88% to Residential customers.²⁰²

The Consumer Advocate does not agree with this methodology because it assigns 27 individual allocation factors to each element of the Company's cost of service and it is inherently judgmental. The Company has not fully explained its rationale of each individual allocation assignment²⁰³ and it is impossible to determine the rationale for the cost allocation.

¹⁹⁷ *Letter Correcting Revised Direct Testimony of Alex Bradley* (Deficiency Amount from \$-4,730,764 to \$-4,657,302) (Nov. 14, 2024); *Revised Direct Testimony of Alex Bradley* at 3; and *Transcript of Proceedings*, Vol II (B) at 226:8-10, November 19, 2024.

¹⁹⁸ *Direct Testimony of Heath Brooks* at 9:4-14.

¹⁹⁹ *Direct Testimony of William H. Novak* at 20.

²⁰⁰ *Id.* and *Direct Testimony of Heath Brooks* at 9:1-14.

²⁰¹ *Direct Testimony of William H. Novak* at 20.

²⁰² *Id.* at 20-21.

²⁰³ *Direct Testimony of William H. Novak* at 21:15 – 22:1-2.

Also, there are other factors that need to be considered in allocating costs.²⁰⁴ These other factors are value of service, product marketability, encouragement of efficient use of facilities, broad availability of service functions, and a fair distribution of charges among users.²⁰⁵ It is impossible to properly consider and quantify each of these other factors and, therefore, there is no mechanical or mathematical formula that can be applied to the cost of service that would directly translate into rates.²⁰⁶ More importantly, the Commission has never adopted CCOS for any regulated utility.²⁰⁷

The Consumer Advocate recommends the revenue deficiency/(surplus) of \$-4,848,207 be allocated evenly across the board to all customer classes based upon the ratio of each customer class' attrition period revenue to total attrition period revenue.²⁰⁸ The Consumer Advocate proposes allocating a 7.52% decrease to residential customers based upon an across-the-board distribution of attrition period margin under current rates.²⁰⁹ The rate decrease allocation should be allocated to each of the Company's seven geographic regions based on the existing margin and then allocated ratably between customer charges and usage charges after considering the existing usage charges for the Company's current PCOP and Capital Rider surcharges.²¹⁰ The current PCOP and Capital Rider Surcharge should be reset to 0.000% rate.

The best approach is an across-the-board plan for all customer classes that assures the benefits or burdens created by any rate adjustment in this case are shared proportionately by all customers. The Consumer Advocate's across-the-board plan is the most equitable plan and should be adopted by the Commission.

²⁰⁴ *Id.* at 22:4-10.

²⁰⁵ *Id.* at 22:5-7.

²⁰⁶ *Id.* at 22:7-10.

²⁰⁷ *Id.* at 22:14-15.

²⁰⁸ *Direct Testimony of William H. Novak* at 22:20-23; <Consumer Advocate Exhibit>, Schedule 1.

²⁰⁹ *Id.* at 23:4-6; Table II.

²¹⁰ *Id.* at 23:15-24 – 24:1-4.

A. The Consumer Advocate's Rate Allocation and Rate Design Should Be Adopted Because It Follows Methodologies Established in Prior Commission Orders and Long-Standing Commission Principles

The Consumer Advocate recommends that the proposed revenue surplus of \$-4,848,207²¹¹ be allocated evenly across-the-board to all customer classes including Special Contract customers based upon the ratio of each customer class's attrition period margin to total attrition period margin.²¹² This follows methodologies established in prior Commission orders and long-standing Commission principles.

In contrast, the Company has proposed using a CCOSS to set rates for each of its tariffs. To be clear, the purpose of any CCOSS is to arrive at the cost of serving each customer class and present a systematic approach to allocating this cost (or total revenue requirement) to the different classes of customers.

As noted by the Consumer Advocate's expert, the Company has developed a CCOSS that classifies each element of rate base and income to its different tariffs using 27 separate allocation factors.²¹³ The result of the Company's proposed CCOSS is a revenue increase impact of 20.82% for residential customers; 20.89% for commercial customers; 14.45% for industrial customers; 19.23% for other public authority service customers; 0.12% for sales for resale with special contract customers; and 9.65% for private fire service.²¹⁴

²¹¹ *Id.* at 23.

²¹² *Id.* at 23:12-15.

²¹³ *Direct Testimony of William H. Novak* at 21:6-7.

²¹⁴ *Direct Testimony of Health Brooks* at 26:1-3, Table 5; <WHN Revenue Workpaper 3.4-Revenues>.

1. The Commission Should Reject the Company’s Proposed Modifications to the PCOP About the 15% Unaccounted for Water Limiter, OPEB and Pensions Expense, and Rate Case Expense

a. The Commission Should Follow Its Precedent and Reject the Company’s New Definitions of Non-Revenue Water and Unaccounted for Water

Contrary to TAWC’s testimony, the Consumer Advocate is not proposing a new NRW limiter.²¹⁵ Mr. Dittmore simply seeks to apply the 15% NRW limiter and defines NRW as “the percentage of actual water loss sales to water system delivery,” which is the percentage limiter the Commission established in TRA Docket 08-00039²¹⁶ and is used in the annual PCOP filing.²¹⁷

On the other hand, it is the Company who is seeking to modify the “Non-Revenue-Unaccounted for Water” percent limiter.²¹⁸ The confusion is caused by differing testimony from the Company’s witnesses. At the Hearing, Mr. Lane stated that the Company was not proposing any adjustments to the current PCOP tariff:

Q. So again in your tariff, you’re not proposing any adjustments to amending the PCOP tariff at all?
A. No.²¹⁹

Mr. Stout argued that the Company was merely seeking a “clarification,” but it is clear he is seeking to change the percent limiter standard:

²¹⁵ *Rebuttal Testimony of Grady Stout* at 34:13-18.

²¹⁶ *Final Order, In re: Petition of Tennessee American Water Company to Change and Increase Certain Rates and Charges so as to Permit it to Earn a Fair and Adequate Rate of Return on its Property Used and Useful in Furnishing Water Service to its Customers*, p. 15, TRA Docket No. 08-00039 (Jan. 13, 2009). The Commission established the % limiter for the first time with Aqua and unaccounted for water was defined as the “comparison of water volumes purchased to water volumes sold. *Final Order Approving Rate Increase and Rate Design, In re Petition of Aqua Utilities Company for Approval of Adjustment of Its Rates and Charges and Revised Tariff*, pp. 8-9, TRA Docket No. 06-00187 (Nov. 27, 2007).

²¹⁷ *Direct Testimony of David N. Dittmore* at 30:12 – 31:11.

²¹⁸ The terms Non-Revenue Water, Water Loss, and Unaccounted-For Water have been used interchangeably in filings with the Commission. The formula for “Non-Revenue Water-Unaccounted for Water %” can be found in the most recent PCOP filing by TAWC and it is [1- (Water Sales / System Delivery). *Petition*, Attachment, File <Petitioner’s Exhibit - PCOP CALC – RCL>, Tab “Support Workpaper”, Line 15, TPUC Docket No. 24-00002 (Jan. 17, 2024).

²¹⁹ *Transcript of Proceedings Vol I* at 99:9-11; 184:14-25, Nov. 18, 2024.

Q. . . . Is that correct? Is the company not seeking to change that, or are they seeking to change it?

A. I think there is clarification needed in that is what we are asking for, that we have been held to an NRW definition of that, and we're asking to be held to an un-accounted-for definition.²²⁰

Stirring the pot of confusion even more, Mr. Stout sets out to distinguish between non-revenue water and unaccounted for water. But in distinguishing these two terms, the Company is seeking to change the formula of unaccounted for water established in TRA Docket No. 08-00039 which is the difference between water sales and water delivery. So, the Company wants to modify the existing formula as unaccounted for water (sales – delivery) to a new formula that “is the difference there of the total water produced or purchased minus what is accounted for.”

²²¹ The old formula for unaccounted for waters (sales – delivery) would now be called NRW.

²²² Mr. Stout confidently stated that the Company treats NRW and unaccounted for water as two separate terms.²²³ However, in its PCOP filings, TAWC used the term “Non-Revenue-Unaccounted for Water” for the water loss percentage limiter, of which Mr. Stout seemed unaware.²²⁴ So, there does seem to be confusion on the part of TAWC about terminology and formulae on water loss.

Contrary to TAWC testimony,²²⁵ the Commission did explain the reasonableness of its 15% unaccounted for water loss limiter by recognizing both the “importance of conserving water, which is one of the state’s most valuable natural resources” and the industry standard of

²²⁰ *Id.* at Vol I at 184:14-25.

²²¹ *Id.* at Vol I at 183:6-8.

²²² *Id.* Vol I, at 182:25 – 183:1.

²²³ *Id.* at Vol I at 182:18 – 183:8.

²²⁴ The formula for “Non-Revenue Water-Unaccounted for Water %” can be found in the most recent PCOP filing by TAWC and it is [1- (Water Sales / System Delivery)]. *Petition*, Attachment, File <Petitioner's Exhibit - PCOP CALC – RCL>, Tab “Support Workpaper.” Line 15, TPUC Docket No. 24-00002 (Jan. 17, 2024). Vol I at 180:6 – 183:3.

²²⁵ *Direct Testimony of Grady Stout* at 39:20-40:2.

15% water loss when it first established the 15 % limiter.²²⁶ The percentage limiter is not meant to punish TAWC but is instead designed to serve as an incentive for it to act as a good steward of the State's natural resources. Accordingly, the Commission should reject this proposed modification by the Company based upon precedent and the reasoning provided therein.

b. The Commission Should Reject the Company's Proposal to Enlarge the Categories of Expenses in the PCOP to Include Pension and OPEB Costs

The Company has proposed modifications to the current language of the PCOP Rider. Specifically, TAWC proposes to add "regulatory expense amortization, pension expenses, other postretirement employee benefits expenses" to the general description of the PCOP.²²⁷ The Company is attempting to "cherry pick" what components it wishes to update annually through its PCOP Rider. If the Company is seeking a more comprehensive annual mechanism, it can request an Annual Review Mechanism ("ARM") pursuant to Tenn. Code Ann. Section 65-5-103(a)(6). The ARM can address the Company's concerns regarding the volatility of all Company costs. Moreover, the Company's proposal would eliminate its risk of under-earning resulting from volatility in pension and OPEB costs. However, there has been no offsetting reduction in its proposed ROE to reflect this risk reduction, so the Company's proposal is one-sided. It is apparent from the Company's testimony that it would enjoy a reduction in the inherent risk from achieving its authorized return on equity. However, the company has ignored this obvious outcome in the requested return on equity.²²⁸ Therefore, the Consumer Advocate

²²⁶ *Final Order, In re: Petition of Tennessee American Water Company to Change and Increase Certain Rates and Charges so as to Permit it to Earn a Fair and Adequate Rate of Return on its Property Used and Useful in Furnishing Water Service to its Customers*, p. 15, TRA Docket No. 08-00039 (Jan. 13, 2009).

²²⁷ *Direct Testimony of Robert Lane* at 18:4-11; Exhibit -BL-2, Red Line Version of Tariff, Original Sheet No. 12-PCOP-2.

²²⁸ *Id.*

contends that the Commission should not authorize a new duplicative mechanism to one it already has available, thus avoiding piecemeal regulation.²²⁹

c. The Commission Should Reject the Company's Proposal to Enlarge the Categories of Expenses in the PCOP to Include Rate Case Expense

As previously explained, the Company proposes to revise the language in the PCOP so that it will now collect regulatory costs, like Rate Case Expense, in this annual filing. Beyond the Company's proposal for the Rate Case Expense to be amortized over three years and recovered through base rates, TAWC proposed that the "forecasted level of rate case expense be reconciled against the actual costs incurred with any differences in forecasted and actual amounts be refunded/recovered through the PCOP."²³⁰ As explained earlier, the Consumer Advocate recommends the Commission consider a separate surcharge for recovery of these costs outside of base rates, which would restrict the Company to just recovery of known rate case costs and then would terminate as opposed to be a continuing amount in base rate adjustment.²³¹

IX. RATE CONSOLIDATION

The Company currently has seven (7) rate zones, each with multiple customer classes, and four independent service contracts.²³² Each of these zones has its own rates and rate structure for the various customer classes with service charge rates, volumetric rates, and volumetric rate block structures varying across the zones.²³³ The Company has proposed a fixed service charge dependent on meter size and eliminating volumetric block structures.²³⁴ The Company has proposed combining the rates for all but one of their geographic territories into a

²²⁹ Direct Testimony of David Dittmore at 45:4-9.

²³⁰ Direct Testimony of Robert C. Lane at 17:13-19.

²³¹ Direct Testimony of Hal Novak at 10:9-11.

²³² Direct Testimony of Heath Brooks at 20:10-11.

²³³ Id. at 20:11-12.

²³⁴ Id. at 23:5-9.

consolidated rate structure.²³⁵ TAWC rate consolidation is an averaging of cost recovery and applies the same rates and rate structure for each customer class across multiple systems or zones. The proposed rates differ from existing rates for both meter size and volume of use. As a result, there is not a consistent impact across all customers and customer classes. Some customers will experience bill reductions and others will experience bill increases.²³⁶ There will be residential, commercial, and industrial bill impacts under varying usage parameters.²³⁷ This creates preferential treatment in assigning the rate increase for any single customer class or geographic location.²³⁸

While consolidating rates over multiple systems where customers from various rate schedules are moved to the same, new, rate schedule, it is not unusual to see smaller systems benefit from reduced rates, or smaller rate increases, while larger systems and those with higher population densities have rate increases.²³⁹ Smaller service areas may have higher cost of treatment and distribution per customer due to size and often lower population density.²⁴⁰ However, a decrease in bills for the majority of residential customers at or below average consumption levels is unexpected.²⁴¹ Thus, a full analysis, adjusting for factors such as inflation and changes in installation methods, technology, and materials, is necessary when trying to understand the variables that contribute to cost to serve differences between service areas.²⁴² Essentially, a careful cost review is necessary to fully understand the extent to which various

²³⁵ *Direct Testimony of William H. Novak* at 26:3-6.

²³⁶ *Direct Testimony of Clark Kaml* at 12:8-10.

²³⁷ *Direct Testimony of Heath Brooks* <Exhibit Rev-4-HB>, <Exhibit Rev-5-HB>, and <Exhibit Rev-6-HB>.

²³⁸ *Direct Testimony of William H. Novak* at 26:10-12.

²³⁹ *Direct Testimony of Clark Kaml* at 14:13-16.

²⁴⁰ *Id.* at 14:16-18.

²⁴¹ *Id.* at 14:18-19.

²⁴² *Id.* at 15:1-4.

factors contributed to, and the actual cost to serve, differences among various areas.²⁴³ While the Company suggests that over a long-term, the costs are likely to be similar, the Company fails to provide any substantive evidence or documentation.²⁴⁴

The Consumer Advocate has determined that the Company's proposal is inconsistent with any ratemaking practices.²⁴⁵ It is inconsistent with rate stability, rates based on cost causation, acceptability, and possibly fairness in view of undue discrimination.²⁴⁶ While the Company claims that its goal is rate stability, however, this proposal is not predictable or stable.²⁴⁷ Some industrial customers would see a 28% increase, Whitwell Commercial customers would see a 68% increase, some Jasper Highlands commercial customers would see a 32% decrease, and some Whitwell residential customers would see a 47.7% decrease and others would see a 62% increase.²⁴⁸

The Company's arguments for consolidated rates are primarily based on policy and have not justified rate consolidation from a cost perspective. There has been no evidence supporting an argument that the cost to serve the existing zones is the same or similar. It did not identify any cost savings, and there is no evidence that it would result in just and reasonable rates for customers.

X. UNIFORM AFFORDABILITY TARIFF

The Company has proposed a Multi-Tiered Universal Affordability Tariff ("UAT").²⁴⁹ This is a multi-tiered universal affordability tariff that offers discounts on both the basic 5/8" meter charge and the volumetric charges for water service to help the estimated 16,700

²⁴³ *Id.* at 15:10-11.

²⁴⁴ *Direct Testimony of Clark Kaml* at 16:13-14.

²⁴⁵ *Id.* at 19:5-6.

²⁴⁶ *Id.* at 19:7-9.

²⁴⁷ *Id.* at 19:10-12.

²⁴⁸ *Id.* at 19:18-22.

²⁴⁹ *Direct Testimony of Grant Evitts* at 19-22.

residential water service customers with household incomes at or below 150% of the Federal Poverty Level (“FPL”).²⁵⁰ FPL is a measurement set by the U.S. Department of Health and Human Services of the minimum amount of annual income that is needed for individuals and families to pay for essentials, such as room and board, clothes, and transportation.²⁵¹ FPL takes into account the number of people in the household, their income and the state they live in.²⁵² For Tennessee, the FPL guidelines for 2024 are set at \$15,060 for a household size of one and \$5,380 per year for each additional household member.²⁵³

The Company claims the proposed tariff will make water service more affordable for this group of customers by offering a 70% discount on applicable volumetric base rates for qualifying customers between 0% and 50% of the FPL, a 40% discount on such rates for qualifying customers between 51% and 100% of the FPL, and a 10% discount on such rates for qualifying customers between 101% and 150% of the FPL.²⁵⁴ The proposed tiered discounts under this tariff will provide customers at each interval of FPL the opportunity to have Basic Water Service bills in the 1% to 2% range of household income.²⁵⁵ Basic Water Service is defined as water usage level that reflects the level of water consumption for basic human services (cooking, cleaning, sanitation, and general health requirements) which is assumed to be constant from month-to-month and not subject to significant seasonality²⁵⁶ or weather conditions.²⁵⁷ This is expressed in terms of gallons per resident per day and is 40 gallons of water per household

²⁵⁰ *Id.* at 14:13-16; *Direct Testimony of Charles Rea* at 23:12-14.

²⁵¹ *Direct Testimony of Charles Rea* at 14:13-16.

²⁵² *Id.* at 16-17.

²⁵³ *Id.* at 17-19.

²⁵⁴ *Direct Testimony of Grant Evitts* at 15:1-5; *Direct Testimony of Charles Rea* at 21:12-16.

²⁵⁵ *Direct Testimony of Grant Evitts* at 15:5-7; *Direct Testimony of Charles Rea* at 25:3-5.

²⁵⁶ Discretionary seasonal water usage encompasses filling swimming pools, lawn irrigation, etc. *Direct Testimony of Charles Rea* at 13:4-17, 27:6-10.

²⁵⁷ *Id.* at 13:4-7; *Direct Testimony of Grant Evitts* at 17:11-14.

member per day.²⁵⁸ The Company did not consider customers who rent in multi-family buildings without individual meters.²⁵⁹ The Company's affordability analysis concentrates on customers that are direct customers of the Company and those that are directly responsible for payment of services to the Company.²⁶⁰

There are 16,700 residential water customers or 22% of TAWC customers that have incomes at or below 150% of the FPL and would qualify for the service.²⁶¹ The Company plans to contract with a third-party to administer the program.²⁶² The Company does not have an estimate of the number of customers that will be on the tariff for the five-year period.²⁶³ The Company indicated it would verify income through a third-party administrator, however, has no experience collecting income information from its customers.²⁶⁴ There will be costs associated with administering and managing the program and there will also be lost revenues associated with the discounts offered to customers under the UAT.²⁶⁵ The Company failed to include costs associated with administering the program or the amount of the discounts.²⁶⁶ The Company stated that the costs of implementing and managing the program cannot be projected because they will vary with participation rates, which are not yet known.²⁶⁷ The Company was unable to say who would manage the program, but indicated during the hearing that the other AWWC water affiliates use a vendor to manage the program and TAWC stated it plans to engage the same company as some of the other AWWC affiliates to administer and manage the UAT

²⁵⁸ *Direct Testimony of Charles Rea* at 13:14-15.

²⁵⁹ *Id.* at 18:1-7.

²⁶⁰ *Id.* at 3-5.

²⁶¹ *Direct Testimony of Grant Evitts* at 13:12-15.

²⁶² TAWC's Response to the City of Chattanooga's DR No. 1-30; *Transcript of Proceedings*, Vol. I, at 103:18-21, November 18, 2024.

²⁶³ TAWC's Response to the City of Chattanooga's DR No. 1-32; *Transcript of Proceedings*, Vol. II (B), at 223:6-9, November 19, 2024.

²⁶⁴ TAWC's Response to the City of Chattanooga's DR No. 1-30; *Transcript of Proceedings*, Vol. I, at 104:9-13, November 18, 2024.

²⁶⁵ *Direct Testimony of Clark Kaml* at 5:18-22.

²⁶⁶ *Id.* at 5:18-22; *Direct Testimony of Grant Evitts* at 17:11-14.

²⁶⁷ *Direct Testimony of Robert Lane* at 30:5-8.

program in Tennessee.²⁶⁸ However, TAWC has not engaged or contracted with this company. TAWC stated in its responses to the City of Chattanooga DR No. 1-35 that they did not have any documents that reflected, constituted, recorded, referred to, reported or related to analysis of or cost projections related to its UAT.²⁶⁹ TAWC has stated that the estimates of the monthly lost revenue at a 100% participation rate would be \$344,252.²⁷⁰

The Company has failed to include expenses associated with the UAT for the test year.²⁷¹ The Company proposes that every January 15th, it would provide a summary of the level of participation, amount of discounts provided, costs associated with administering the program, and annual and total amount of costs deferred through November of the previous year.²⁷² Another problem with the program is that TAWC has proposed to record and defer the actual costs associated with the discounts and administration of the UAT to a future regulatory proceeding.²⁷³ Administration costs associated with the UAT would be allocated to residential customers in a class cost of service study. Costs associated with reduced revenues would not be recovered from any specific customer class but would be generally recovered from all customers once authorized for recovery in rates.²⁷⁴

There are several problems with the proposed UAT proposal. First, the proposal has no cost estimates and it cannot be determined whether the project is cost justified.²⁷⁵ Second, preapproval of this proposal complicates a prudency review.²⁷⁶ If the Company is granted

²⁶⁸ *Transcript of Proceedings*, Vol. I at 18-21, November 18, 2024.

²⁶⁹ TAWC's Response to the City of Chattanooga's DR No. 1-35.

²⁷⁰ TAWC's Response to the City of Chattanooga's DR No. 1-33; *Direct Testimony of Clark Kaml* at 6:11-15.

²⁷¹ *Direct Testimony of Clark Kaml* at 6:16-18.

²⁷² *Direct Testimony of Robert Lane* at 30:13-16.

²⁷³ *Direct Testimony of Grant Evitts* at 15:15-17, 17:14-16; and *Direct Testimony of Robert Lane* at 30:11-12.

²⁷⁴ TAWC's Response to the City of Chattanooga's DR No. 1-34.

²⁷⁵ *Direct Testimony of Clark Kaml* at 7:19-20.

²⁷⁶ *Id.* at 7:21

approval of this program with authorization to defer the costs, it will be more difficult to determine the reasonableness of the costs.²⁷⁷ Third, there is no assurance of how the project will be administered, such as the oversight, selection of the third-party administrator, cost estimates, etc.²⁷⁸ Finally, The Company's proposal to allocate the costs to residential customers in a class cost of service study raises additional questions.²⁷⁹

Based on the Consumer Advocate's review, the Company has not thought out the critical components of the program. The Company has no plan in place for the UAT, no administrator, no estimates of revenue reduction, no estimates of rate impact on other customers, no explanation of verification of applicant's income, no cost estimates or other essential details concerning the UAT.²⁸⁰ As such, the Consumer Advocate has determined this program is unreasonable and does not recommend approval of the UAT.²⁸¹

XI. CONCLUSION

For the foregoing reasons, the Commission should find that TAWC's petition to increase water rates is without merit. In light of the facts of this record, TAWC has not carried its burden of proving that a rate increase would be just and reasonable at this time. The Commission therefore should deny TAWC's proposed rate increase and, instead, decrease TAWC revenues by \$4.7 million as recommended by the Consumer Advocate.

²⁷⁷ *Id.* at 7:21-24.

²⁷⁸ *Id.* at 7:26-27.

²⁷⁹ *Id.* at 8:1-2.

²⁸⁰ *Direct Testimony of Clark Kaml* at 9:7-16.

²⁸¹ *Id.* at 9:3-6.

RESPECTFULLY SUBMITTED,



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TPUC Docket No. 24-00032

Consumer Advocate's Post-Hearing Brief

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CERTIFICATE OF SERVICE

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