BUTLER | SNOW

January 13, 2025

VIA ELECTRONIC FILING

Hon. David Jones, Chairman
c/o Ectory Lawless, Docket Room Manager
Tennessee Public Utility Commission
502 Deaderick Street, 4th Floor
Nashville, TN 37243
TPUC.DocketRoom@tn.gov

RE: ***Petition of Limestone Water Utility Operating Company, LLC to Increase Charges, Fees and Rates and for Approval of a General Rate Increase and Consolidated Rates,*** **TPUC Docket No. 24-00044**

Dear Chairman Jones:

Attached for filing please find *Limestone Water Utility Operating Company, LLC's Rebuttal Testimony for (1) Dylan D'Ascendis; (2) Clare Donovan; (3) Mike Duncan; (4) Aaron Silas; (5) Brent Thies; and (6) Todd Thomas* in the above-captioned matter.

Hard copies will follow. Should you have any questions concerning this filing, or require additional information, please do not hesitate to contact me.

Very truly yours,

BUTLER SNOW LLP

Melvin J. Malone

clw
Attachments
cc: Russ Mitten, Limestone Water Utility Operating Company, LLC
Karen H. Stachowski, Consumer Advocate Division
Victoria B. Glover, Consumer Advocate Division
Shilina B. Brown, Consumer Advocate Division

The Pinnacle at Symphony Place
150 3rd Avenue South, Suite 1600
Nashville, TN 37201

MELVIN J. MALONE
615.651.6705
melvin.malone@butlersnow.com

T 615.651.6700
F 615.651.6701
www.butlersnow.com

BUTLER SNOW LLP

STATE OF TENNESSEE
BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION

IN RE:

LIMESTONE WATER UTILITY OPERATING COMPANY

DOCKET NO. 24-00044

REBUTTAL TESTIMONY

OF

MIKE DUNCAN

ON

WITNESS INTRODUCTION, REBUTTAL POLICY OVERVIEW, ACQUISITION ADJUSTMENTS, RATE CONSOLIDATION

FILED: January 13, 2025

TABLE OF CONTENTS

DIRECT TESTIMONY

OF

MIKE DUNCAN

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Mike Duncan. My business address is 1630 Des Peres Road, Suite 140, St. Louis, Missouri 63131.

Q. DID YOU PREVIOUSLY SUBMIT PRE-FILED DIRECT TESTIMONY IN SUPPORT OF THIS PETITION BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION?

A. Yes. My Direct Testimony was submitted on July 16, 2024, on behalf of Limestone Water Utility Operating Company, LLC. ("Limestone Water" or "Company").

Q. ARE YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE CONTAINED IN YOUR DIRECT TESTIMONY?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my Rebuttal Testimony is five-fold. ***First***, I will introduce the various Limestone Water witnesses that will be submitting rebuttal testimony in this matter. ***Second***, I will provide some overarching policy considerations in response to the Direct Testimony submitted by the Consumer Advocate Division of the Tennessee Attorney General's Office ("Consumer Advocate" or "CAD"). ***Third***, I will respond to the Pre-filed Testimony of Consumer Advocate Witness Mr. William Novak regarding his thoughts on Limestone Water's use of third-party O&M contractors. ***Fourth***, I will respond to the Pre-

filed Testimony of Consumer Advocate Witness Mr. Clark Kaml on the issue of recovery of acquisition adjustments. ***Fifth***, I will respond to the Pre-filed Testimony of Mr. Kaml regarding the Company's request to consolidate rates across all of its water and wastewater systems.

II. WITNESS IDENTIFICATION

Q. WOULD YOU IDENTIFY THE WITNESSES THAT ARE PROVIDING REBUTTAL TESTIMONY ON BEHALF OF THE COMPANY AND THE SUBJECTS EACH OF THOSE WITNESSES ADDRESS?

A. Yes. In addition to myself, five other witnesses will provide rebuttal testimony in response to the positions advanced by CAD. Those witnesses and the subjects they will cover in their respective testimonies are as follows:

- Todd Thomas – Vegetation Management.
- Brent Thies – Land and Land Rights, Transaction Costs, Financial Security Escrow Accounts, Retention of Billing Determinants, Recording of Tap Fees and Inspection Fees, Attrition Period Revenues and CAD's Inconsistent Test Year, and Income Taxes.
- Clare Donovan – Cartwright Creek Commercial Revenues, Operations and Maintenance ("O&M") Adjustments, and Rate Case Expense.
- Aaron Silas – Rate Design and Production Cost Cap.
- Dylan D'Ascendis – Capital Structure and Return on Equity.

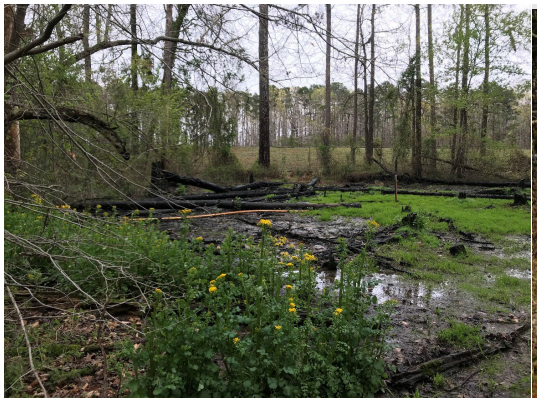
III. POLICY CONSIDERATIONS

Q. DO YOU BELIEVE THAT THERE ARE OVERARCHING POLICY CONSIDERATIONS THAT FRAME THE CAD TESTIMONY?

A. Yes. I believe that many of the positions reflected in CAD's testimony derive from its failure to see the "big picture," which appears to drive its outcome-driven positions. Specifically, in its testimony, CAD appears hyper-focused on the pursuit of the lowest possible rate without regard to whether its positions will discourage the future acquisition and rehabilitation of distressed systems and, thus, the eventual provision of "safe and adequate service" to Tennessee residents. This big picture, that CAD fails to recognize, is the reality that small water and wastewater infrastructure in Tennessee is in crisis and the singular focus on low rates will not address the problems.

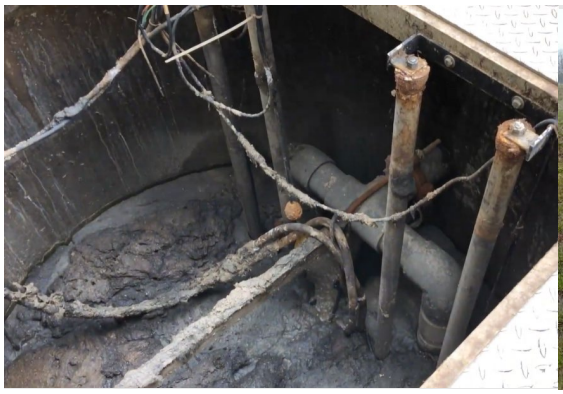
As indicated in my Direct Testimony, Limestone Water is the Tennessee operating utility of CSWR, LLC ("CSWR"). CSWR's mission statement, and that of each of its operating companies, is "to bring safe, reliable and environmentally responsible water resources to every community in the United States." In pursuit of this mission, before entering a state, CSWR analyzes the fragmentation (i.e., the number and size) of water and wastewater systems in the state as well as the compliance history of those many small systems. Based upon this analysis, CSWR believes that Tennessee is replete with small, distressed water and wastewater systems that are failing to comply with environmental standards. This is the big picture in Tennessee – numerous failing systems lacking technical, financial, and managerial expertise to comply with increasingly stringent environmental regulations. As reflected in the Direct Testimony of Limestone Water

Witnesses Mssrs. Thomas and Freeman, the systems acquired by Limestone Water all exhibited this lack of technical, financial and managerial expertise.

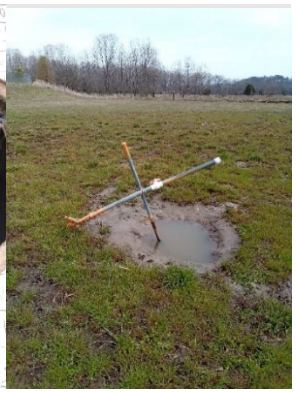


Shiloh Falls Spray Field

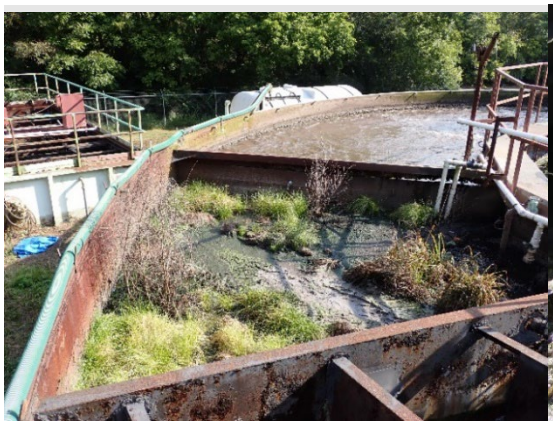
Aqua Utilities Site Security



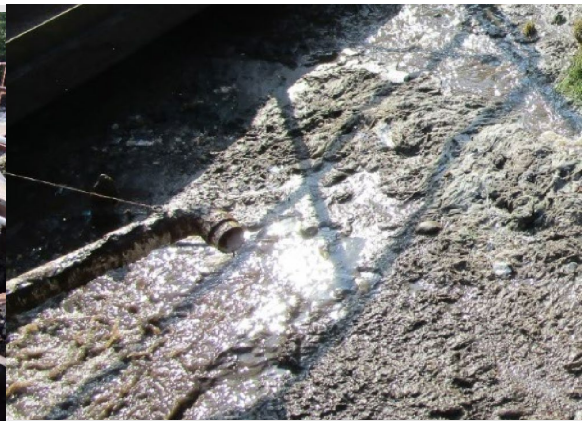
Aqua Utilities Wastewater



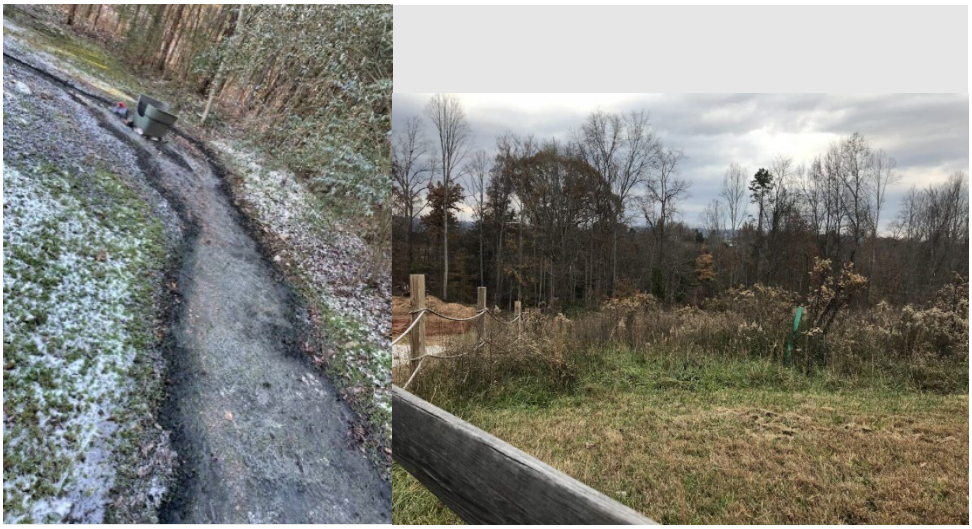
Arrington Retreat Spray Field



Grasslands



Grasslands



Chapel Woods Sludge Overflow *Lakeside Estates Drain Field*

While Limestone Water has taken steps to acquire and resolve some of the more troubled Tennessee systems, and there are still items left to address,[1] there are countless more failing systems that are incapable of providing safe and adequate service. Faced with a chronic problem of small failing Tennessee water and wastewater systems, CAD's response here is not to investigate positions that will attract well-capitalized and technically competent companies capable of acquiring and rehabilitating distressed systems. Rather, from its positions on acquisition adjustments[2] to transaction costs,[3] to consolidation[4] and return on equity,[5] CAD has taken positions that will dissuade such companies from considering Tennessee and, instead, push those companies to other states which encourage such efforts.

[1] *See Pre-filed Direct Testimony of Limestone Water Witness Mike Freeman*, pp. 31-42, TPUC Docket No. No. 24-00044 (July 15, 2024) (hereinafter "*Freeman Direct*") (discussion of Grassland Wastewater Rehabilitation at 31-35; Shiloh Falls Spray Field at 36-40; and Candlewood Lakes Redundant Well at 41-42).
[2] *Pre-filed Testimony of Consumer Advocate Witness Clark Kaml*, pp. 5-12, TPUC Docket No. 24-00044 (Dec. 19, 2024) (hereinafter "*Kaml Pre-filed*").
[3] *Kaml Pre-Filed* at pages 15-21.
[4] *Kaml Pre-Filed* at pages 32-47.
[5] *Pre-filed Testimony of Consumer Advocate Witness Aaron L. Rothschild*, TPUC Docket No. 24-00044 (Dec. 19, 2024) (hereinafter "*Rothschild Pre-filed*").

In its rebuttal testimony, Limestone Water has pointed out the technical problems with each of CAD's positions on these issues. Here, in response to the CAD's Pre-filed Testimony, I ask the Tennessee Public Utility Commission ("Commission" or "TPUC") to peer beyond the individual issues and to include in its considerations the difficult and complex issues that Tennessee, as well as other states across the country, are confronted with today, and will have to address in the future, regarding small and distressed water and wastewater systems. As outlined in its Pre-filed Testimony, the CAD's short-sighted approach will hinder the acquisition and rehabilitation of distressed, under-capitalized, and poorly managed water and wastewater systems.

IV. USE OF THIRD-PARTY O&M CONTRACTORS

Q. PLEASE DESCRIBE THE ISSUE WITH REGARD TO THE USE OF THIRD-PARTY O&M CONTRACTORS?

A. In its direct testimony the Company pointed out that due to the: (1) geographical dispersion of its systems across the state, (2) limited number of customers, and (3) cost of hiring, training, and retaining qualified operators, "it is more economical to retain third-party contractors who already have experienced operators and required state licenses."[6]

In its testimony, however, CAD questions the Company's assertion that the use of third-party operators is more economical. Specifically, at pages 15 of his testimony, Mr. Novak comments that the Company has not provided any type of quantitative analysis supporting this conclusion. Mr. Novak then analogizes to Tennessee Wastewater Systems, Inc. ("TWSI"), which relies upon an internalized operations team. Referencing the last

[6] Pre-filed Direct Testimony of Limestone Water Witness Todd Thomas, p. 7, TPUC Docket No. 24-00044 (July 16, 2024) (hereinafter "*Thomas Direct*").

TWSI last rate case, Mr. Novak notes that TWSI incurs approximately 62% of its costs for wages and only 38% for outside contractors.

Q. DO YOU AGREE WITH MR. NOVAK?

A. No. It is interesting that Mr. Novak blindly accepts the TWSI use of internalized operations as the best and most economical approach for procuring an operations staff for a geographically dispersed water/wastewater utility. Noticeably, while criticizing Limestone Water's failure to present any type of "quantitative analysis" to support its approach, Mr. Novak simultaneously admits that there was not a competing analysis to justify the TWSI paradigm.[7] Absent such a competing analysis, one must necessarily wonder whether it is the TWSI approach, and not the Limestone Water approach, which is faulty.

Q. HAVE YOU EVER CONDUCTED A "QUANTITATIVE ANALYSIS" OF THE COSTS AND BENEFITS OF AN INTERNALIZED OPERATIONS TEAM?

A. Yes. Similar to its Tennessee approach, CSWR's Missouri affiliate utilizes a third-party O&M contractor. As a result of a recent Missouri rate case, I conducted a comprehensive analysis of the costs of retaining and equipping an internalized operations team. That analysis concluded that the cost of an internalized operations team would be approximately 40% higher than the cost of third-party operations.

Similarly, I recently conducted an analysis for CSWR's Louisiana affiliate – Magnolia Water. Unlike Missouri, however, that analysis showed that for an area on the north shore of Lake Pontchartrain, Magnolia Water had reached a level of concentration that economically justifies the use of an internalized operations team. Given this, Magnolia

[7] Mr. Novak acknowledges that he "is not aware of any such analysis conducted in TWSI's last rate case." *Consumer Advocate's Response to Limestone Water's DR 1-26*, TPUC Docket No. 24-00044 (Jan. 6, 2025).

Water has recently migrated these north shore systems from third-party operations to an internalized operations team.

Q. YOU MENTIONED THAT YOUR MISSOURI AND LOUISIANA ANALYSES WERE "COMPREHENSIVE." PLEASE DISCUSS THE THOROUGHNESS OF THESE STUDIES.

A. In each instance, my analysis considered the location of each of the relevant systems and the drive time required to reach each location. The evaluation also considered the state-mandated number of weekly visits, the current preventative work order schedule and the average number of personnel and man hours required to complete each work order. Additionally, the study considered factors such as the skill level, certification, and working experience of personnel needed to complete the work orders, the amount of management and administrative personnel needed to support the operations team, Limestone Water's commitment to have personnel onsite within two hours of an emergency service call, the number of vehicles, equipment, tools, and facility requirements for the operations team, and the ability to scale an internalized team for future acquisitions and system growth.

Q. HAVE YOU CONDUCTED A SIMILAR ANALYSIS FOR TENNESSEE?

A. No. As can be deduced from the comprehensive nature of the analysis, the resources and time necessary to conduct such an analysis are daunting. Nevertheless, I believe that I can draw certain conclusions from the Missouri and Louisiana studies that can be applied to Limestone Water's operations. Specifically, as indicated by Limestone Water Witness Mr. Thomas in his Rebuttal Testimony, Limestone Water's operations have not reached a level of concentration, either state-wide or on a regional basis, that would justify the transition to an internalized operations team. I have no question, given the costs, not only wages and

benefits, but also capital costs associated with vehicles, tools, and warehouses, that a Tennessee-specific internalized operations team would be significantly more expensive than the current internalized operations model.

Q. WHAT IS YOUR RECOMMENDATION?

A. Given my past experience and the guidance derived from previous internalized operations studies, I recommend that the Commission disregard Mr. Novak's unsupported concerns regarding this issue. At an appropriate time in the future, Limestone Water can undertake a study similar to those performed for affiliates in Missouri and Louisiana.

V. ACQUISITION ADJUSTMENT RECOVERY

Q. IN LIGHT OF THE CAD'S TESTIMONY ON ACQUISTION ADJUSTMENT, INCLUDING ITS RECOMMENDATIONS, PLEASE DESCRIBE THE ACQUISITION ADJUSTMENT ISSUE?

A. As I described in my Direct Testimony, Tennessee Public Utility Commission Rule 1220-04-14-.04 states that "[t]he Commission may order an acquisition adjustment to be incorporated into the acquired rate base if the Commission determines such adjustment is warranted under the circumstances and will not result in unjust or unreasonable rates and charges for the acquiring utility or for the customers." The rule then sets forth six (6) factors to be considered by the Commission in its determination of whether to allow recovery of an acquisition adjustment.

Q. DID THE COMPANY ADDRESS THE FACTORS SET FORTH IN THE RULE?

A. Yes. The listed factors and the location in which they are addressed in Direct Testimony are as follows:

1. Cost savings or increases resulting from consolidation of the selling utility's system into the acquiring utility's operations: Thomas (pages 144-146).

2. Improvements in public utilities services resulting from the acquisition: Thomas Direct Testimony (pages 146-153); Silas Direct Testimony (pages 15-17); and Freeman Direct Testimony (pages 43-47).

3. Remediation of public health, safety and welfare concerns of the selling utility's system resulting from the acquisition: Duncan Direct Testimony (pages 38-39).

4. Incentives for acquisition of a financially or operationally troubled system, which may be demonstrated by bankruptcy, receivership, financial distress, notice of violation, order of abatement, or inability to continue as a going concern of the selling utility: Thies Direct Testimony (pages 16-18).

5. Amount of any assets contributed or donated to the selling utility included in the proposed acquisition transaction: Thies Direct Testimony (page 26).

6. Any other measurable benefits, costs, or service changes affecting acquired and/or existing customers resulting from the acquisition: Silas Direct Testimony (pages 15-17).

7. Will not result in unjust or unreasonable rates and charges for the acquiring utility or for the customers: Thies Direct Testimony (pages 18-19).

Beyond these factors, I also provided an extensive policy discussion in my Direct Testimony (pages 31-38) detailing the public policy considerations that justify the recovery of acquisition adjustments, especially as they regard the acquisition and rehabilitation of distressed water and wastewater systems such as those acquired by Limestone Water. I support my public policy opinions with reports drafted by the National Regulatory

Research Institute ("NRRI"), the research arm of the National Association of Regulatory Utility Commissioners ("NARUC"),[8] the *Accounting for Public Utilities* treatise,[9] as well as decisions and rules from the states of Arizona, Florida and Texas.[10] As I conclude in my Direct Testimony, capital available for the acquisition and rehabilitation of distressed utilities will naturally flow towards companies that are focused on states that minimize the risk associated with such a business model. In this regard, because of their regulatory policies, capital will naturally flow to states like Arizona, Florida, and Texas and, if CAD's positions on issues like acquisition adjustments are adopted, away from Tennessee.

Q. DID CAD ADDRESS THE FACTORS ENNUMERATED IN THE COMMISSION'S ACQUISITION ADJUSTMENT RULE?

A. No. Mr. Kaml's Pre-filed Testimony at pages 5-12 presents the entirety of CAD's position on the issue of acquisition adjustment recovery. While Mr. Kaml recites the six criteria contained in the Commission's rule,[11] CAD does not address the Commission's enumerated criteria.[12] Instead CAD advocates for "criteria that it recommends be used to determine whether a ***portion of the gain on the sale should be assigned as a benefit to utility customers***."[13]

Q. WHAT ARE THE CRITERIA PROPOSED BY CAD?

A. As set forth by Mr. Kaml, the four (4) preferred criteria advanced by CAD are:

1. Will the related Acquisition Premium be recoverable from ratepayers?

[8] *Pre-filed Direct Testimony of Limestone Water Witness Mike Duncan*, pp. 32-33, TPUC Docket No. No. 24-00044 (July 16, 2024) (hereinafter "*Duncan Direct*").
[9] *Id.* at 34.
[10] *Id.* at 36-37.
[11] *Kaml Pre-Filed at pages 8-9.*
[12] CAD acknowledges that it did not address the enumerated Commission-established criteria. *See Consumer Advocate's Response to Limestone Water's DR 1-12*.
[13] *Kaml Pre-filed* at page 9 ("emphasis added").

2. Has the selling utility provided quality service to ratepayers?

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

4. Will rates increase as a result of the proposed transaction?[14]

Q. HAVE CAD'S CRITERIA EVER BEEN ADOPTED BY THE COMMISSION?

A. No. When asked in discovery whether the Commission has accepted his specific criterion, Mr. Kaml acknowledged that he is simply proposing the suggested criteria and that he "is not aware of any proceedings in which the specific criteria have been adopted as specifically stated."[15]

Q. IS CAD'S PROPOSAL TO DEVIATE FROM THE COMMISSION'S ESTABLISHED CRITERIA DISCONCERTING?

A. Absolutely. Undoubtedly, the reason that the Commission issued a rule regarding the criteria for the recovery of acquisition adjustments is so that parties will know, in advance of an acquisition, the standard by which acquisition adjustments will be assessed. In this case, since the Commission has promulgated a rule on the matter, Limestone Water executed acquisitions believing that it had a clear understanding of the "lay of the land" with regard to this issue. It is certainly disconcerting for CAD to now disregard the Commission's established criteria. As mentioned previously, CAD's proposals in this case fail to recognize that there are a multitude of distressed water and wastewater systems in Tennessee that should be acquired and rehabilitated. CAD's proposal certainly introduces a great deal of regulatory uncertainty that undermines the willingness of companies to acquire such systems. Instead of making the standards governing the granting of an acquisition adjustment a continuing moving target, the Commission should focus on the

[14] *Id.*
[15] *See Consumer Advocate's Response to Limestone Water's DR 1-03*.

criteria included in its rule and should disregard any testimony offered by CAD that deviates from those criteria.

Q. WHAT IS THE PRACTICAL RATEMAKING EFFECT OF CAD'S ARGUMENT THAT THE GAIN ON THE SALE REALIZED BY THE SELLER SHOULD BE USED TO OFFSET THE REVENUE REQUIREMENT OF THE BUYER?

A. Ultimately CAD's proposal to assign the gain on sale realized by the seller to the buyer effectively neuters the entire purpose of the Commission's acquisition adjustment rule. As an example, if a seller realized a $100 gain on the sale of its utility system, CAD would preclude the Commission from allowing the buyer to recognize that acquisition adjustment by simultaneously creating an accounting entry that would offset the entirety of the acquisition adjustment with a "gain on sale" accounting entry – a gain the acquiring utility never realized. If adopted, the Commission's acquisition adjustment rule is entirely undermined. As the National Regulatory Research Institute has recognized, "[s]ometimes the best option is to get the existing owner / operator out of the water business, using whatever means are available under the commission's authority."[16] CAD's proposal to offset the acquisition adjustment with an equal gain on the sale of property would remove a significant tool from the Commission's ability to get the existing owner / operator out of the water business.

Q. HAS THE COMMISSION EVER ACCEPTED CAD'S PROPOSAL TO UTILIZE A GAIN ON THE SALE OF PROPERTY TO OFFSET AN ACQUISITION ADJUSTMENT EVER BEEN ADOPTED BY THE COMMISSION?

[16] *The Small Water Company Dilemma: Processes and Techniques for Effective Regulation, National Regulatory Research Institute*, at p. iii (Oct. 2011).

A. No. While Mr. Kaml points to two cases that he claims are "precedent for assigning the gain on the sale of assets to ratepayers," it is apparent that neither are used in the manner in which CAD now seeks to apply them.[17] Specifically, Mr. Kaml admits that unlike Limestone Water's situation in which it purchased the entirety of the selling entity's assets, these decisions address a situation in which a regulated utility sought to a sell a portion of its assets.[18] Rather, in those cases, since the utility sold a portion of its assets, that utility continued to be regulated by the Commission. So, since it continued to be regulated, the issue of how to handle the proceeds received by the seller from the sale of a portion of its assets becomes a viable issue.

For instance, in reference to the A+ Communications, Inc. decision referenced by Mr. Kaml, the regulated utility (South Central Bell Telephone) sought to sell to A+ Communications its assets related to paging services. In the order, however, the Commission recognized that South Central Bell would continue to provide "general local exchange telephone service." As such, the issue regarding the treatment of the gain on the sale of the paging assets was a viable issue. For this reason, the Commission ordered the seller, which remained a regulated entity, to recognize the gain in its intrastate regulated results. Noticeably, unlike the manner in which CAD wants to treat the issue in this case, the gain on the sale of property was applied against the seller and not the acquiring entity.

Similarly, in the referenced Kingsport Power Company case, Kingsport sold a service building. That said, as with South Central Bell, Kingsport remained a regulated

[17] It is worth point out that, while CAD proposed its gain on the sale of assets argument in Docket No. 19-00062, the Commission refrained from addressing this recommendation. *Order Approving Sale of Assets, Property, and Real Estate and Certificate of Public Convenience of Aqua Utilities Company, LLC Subject to Conditions and Requirements of the Tennessee Public Utility Commission*, TPUC Docket No. 19-00062 (Dec. 7, 2020).

[18] *See Consumer Advocate's Response to Limestone Water's DR 1-09* ("It is Mr. Kaml's understanding that these were partial sales.").

entity. For this reason, while the Commission order addressed "the deferred gain related to the sale of the company's service building", it applies that gain against the selling entity and not against the acquiring company.

Noticeably, contrary to CAD's assertions here, neither case stands for the proposition that the gain on the sale of utility assets should be used to offset the revenue requirement of the purchasing entity.[19]

Q. WOULD YOU FURTHER ADDRESS THE INAPPLICABILITY OF CAD'S PROPOSED CRITERIA?

A. As I mentioned previously, CAD's position on many issues in this case demonstrates a failure to see the big picture as it relates to the regulatory policy towards the acquisition and rehabilitation of distressed water and wastewater utilities. This failure is epitomized by its proposed criteria for the recording of a gain on sale to offset any acquisition adjustment.

Since CAD never expressly applies its proposed criteria, it is unclear how the answers to the specific criteria are supposed to inform the issue at hand. Rather than applying his proposed criteria, Mr. Kaml instead launches into a narrative that manifests CAD's steadfast opposition towards acquisition adjustments. "Rates should be set based on original cost, not on the acquiring price."[20]

In any event, many of CAD's criteria demonstrate that, given a focus on the "big picture," the Commission must provide recovery of the acquisition adjustment. For instance, two of CAD's criteria: (2) has the selling utility provided quality service to

[19] Based upon conversations with Company accountants, CAD's recommendation raises concerns with compliance with General Accepting Accounting Principles ("GAAP"). Specifically, it is unheard of under GAAP to record both the buyer's and seller's positions in an arms-length transaction on the buyer's books.
[20] *Kaml Pre-filed* at 9.

ratepayers and (3) has the selling utility invested necessary capital into the system, inform the matter here. In fact, in its direct testimony, Limestone Water provides indisputable proof that: (1) the selling utilities were not providing quality service, (2) were incapable of providing quality service, and (3) lacked the financial resources to invest necessary capital into the system. Rather than allowing for the recovering of an acquisition, which allows for the replacement of the previous owner with a competent provider, CAD would use these criteria to saddle customers with the same poor quality service which threatens their health and the environment.

As regards CAD's proposed criteria (4): will rates increase as a result of the proposed transaction, it is inevitable that for many systems, rates will increase following the transaction. In many cases, this rate increase is not entirely attributable to the transaction, but rather to the fact that prior owners failed to seek timely rate recovery as costs and investment increased. For instance, rates for Shiloh Falls have not changed since its last rate case before the Tennessee Regulatory Authority in April 2007. Thus, it is disingenuous for CAD to attempt to use past owner's failure to timely seek rate increases as a tool to disallow the acquisition of the system and the future recovery of the acquisition adjustment.

Q. HAS CAD PREVIOUSLY IMPLIED THAT ACQUISITION ADJUSTMENTS ARE APPROPRIATE FOR ACQUISITIONS SUCH AS THOSE MADE BY LIMESTONE WATER?

A. Yes. In Docket No. 20-00025, the Commission considered the promulgation of rules related to utility acquisitions. Among other rules considered therein, the Commission addressed the current rule related to acquisition adjustments (1220-04-14-.04). While CAD

did not deviate from its preference for original cost ratemaking, CAD did recognize that acquisition adjustments are appropriate for acquisitions such as those considered by the Commission in this docket. "To the extent unique rate base valuation techniques are appropriate, they should only be applied to small systems that often suffer from shortage of capital."[21]

Q. DO YOU HAVE PROBLEMS LIMITING ACQUISITION ADJUSTMENTS TO "SMALL SYSTEMS THAT OFTEN SUFFER FROM SHORTAGE OF CAPITAL?"

A. No. In my Direct Testimony, I referenced a National Regulatory Research Institute report titled *The Small Water Company Dilemma: Processes and Techniques for Effective Regulation*.[22] There, the authors agreed with CAD's position that the recovery of acquisition adjustments should apply to "special cases" including "troubled systems."

> Observation: Most commissions have an aversion to allowing recovery of an acquisition premium by the acquiring entity. Many jurisdictions will allow recovery of an acquisition premium in special cases. ***A classic special case in which premiums are allowed is the commission-mandated or commission-encouraged takeover of a troubled system***.
>
> Such a premium is typically not allowed in a takeover of a well-performing system. We would call this a perverse incentive. ***Small systems present an interesting conundrum that we think mandates a revisitation***.[23]

Q. DO YOU BELIEVE THAT THE ACQUISITIONS MADE BY LIMESTONE WATER AND CONSIDERED IN THIS DOCKET CONSTITUTE EITHER "TROUBLED SYSTEMS" OR "SMALL SYSTEMS THAT SUFFER FROM SHORTAGE OF CAPITAL?"

[21] *Reply Comments of the Consumer Advocate Concerning Proposed Acquisition Rules*, p. 2, TPUC Docket No. 20-00025, (April 8, 2021).
[22] *See Duncan Direct* at 33-34.
[23] *Id.* (emphasis added).

A. Yes. As documented throughout Limestone Water's direct testimony, the systems it acquired were all troubled systems. In fact, in their Direct Testimony, Messrs. Thomas and Freeman document the numerous operational problems faced by the systems acquired by Limestone Water.[24] Additionally, as Mr. Thies explains, customers of the Cartwright Creek and Lakeside Estates – DSH systems were paying a separate charge associated with a financial security escrow. The existence of such escrows epitomizes a troubled system as these escrows are only created for those utilities unable to fund capital improvements and extraordinary expenses.[25]

Q. WOULD YOU PROVIDE YOUR CLOSING THOUGHTS ON CAD'S POSITION REGARDING ACQUISITION ADJUSTMENT RECOVERY?

A. CAD doesn't hide its inviolate position that rates should be based upon original cost. As such, faced with the undeniable evidence presented by Limestone Water in its direct testimony, CAD instead proposes that a gain on the sale of assets received by the seller should be applied to the Company. As such, the gain on the sale of assets would exactly offset the acquisition adjustment. The clear implication of this position is that, despite the policy underlying the Commission's acquisition adjustment rule, CAD's position would neuter the single best tool used for the acquisition and rehabilitation of distressed water and wastewater utilities. Limestone Water strongly believes that if the Commission wants to address the chronic problem of non-compliant water and wastewater utilities, it must disregard positions like that suggested by CAD. Instead, faced with the evidence provided

[24] *See, e.g., Thomas Direct at 17-133; and Freeman Direct at 8-41.*
[25] *Pre-filed Direct Testimony of Limestone Water Witness Brent Thies*, pp. 30-31, TPUC Docket No. No. 24-00044 (July 16, 2024) (hereinafter "*Thies Direct*").

in Limestone Water's direct testimony, the Commission should authorize recovery of the Company's acquisition adjustments.

VI. RATE CONSOLIDATION

Q. IN LIGHT OF THE CAD TESTIMONY, INCLUDING ITS RECOMMENDATIONS, PLEASE DISCUSS THE ISSUE WITH REGARDS TO RATE CONSOLIDATION.

A. In my Direct Testimony, the Company proposes to consolidate rates across its water and wastewater systems. The Company supports this proposal by pointing to the numerous benefits associated with consolidation: (1) single tariff pricing helps to encourage the acquisition of small, troubled water and wastewater systems by spreading costs to a larger customer base, (2) consolidation of rates mitigates rate impacts and promotes affordability, (3) all Limestone Water systems share many of the same costs of service, generally use the same third-party operations firm, and are managed to the same service quality standards, (4) the development of a single set of tariffs provides for a heightened level of regulatory, administrative, and billing efficiency, (5) since all systems will eventually require large capital investments over the next number of years, any perceived inequities associated with system subsidization will be short-lived and will eventually balance out, and (6) since consolidated tariffs provide a more simplified approach to rates and rules, they are more consumer friendly than dozens of different rate sheets.[26] Additionally, in my Direct Testimony I referenced various NRRI Reports and Commission decisions that support the benefits associated with rate consolidation.

Q. DID CAD AGREE WITH THE COMPANY'S CONSOLIDATION PROPOSAL?

[26] *See Duncan Direct* at 15-16

A. No. At pages 32-47 of his Pre-filed Testimony, Mr. Kaml presents CAD's position on rate consolidation.[27] Mr. Kaml raises several concerns with the Company's rate consolidation proposal. I will address those concerns in my following testimony.

Q. MR. KAML CLAIMS THAT RATE CONSOLIDATION CREATES CONCERNS AMONG CUSTOMERS. DO YOU AGREE?

A. No. Mr. Kaml's argument is effectively an assertion that consolidation leads to rate consolidation among the various systems to be consolidated. Mr. Kaml's assertion is based upon short-term thinking. That is to say, in the short-term, one system (System A) may subsidize another (System B) because System B requires capital improvements that will paid for by all customers, including System A. Again, such an assertion is only true in the short term. In the long term, however, consolidation leads to benefits for all customers. Specifically, all systems will eventually require improvements. So, while System B may be helping to pay for improvements at System A today, System A will help pay for improvements at System B tomorrow. That said, however, consolidation is not a zero-sum gain. As the Arizona Commission has recognized, consolidation will ultimately lead to benefits for both systems through a lower cost of capital. "Consolidating systems can allow for greater and less expensive access to capital. . . . As a general policy, the Commission believes that the practical benefits from allowing rate consolidation involving small water and wastewater utilities far outweigh the benefits of a strict adherence to this [cost user pays] theoretical principle."[28]

Q. DESPITE HIS CONCERNS ABOUT SUBSIDIZATION BETWEEN SYSTEMS, DOES MR. KAML'S PROPOSED RATES LEAD TO SUBSIDIZATION?

[27] *Kaml Pre-filed*.
[28] Docket No. W-00000C-16-0151, Decision No. 75626, p. 18 (June 25, 2016) (*Duncan Direct*, Exhibit MD-2).

A. Absolutely. It is interesting that Mr. Kaml rejects the notion of consolidation due to a strict adherence to the notion of cost-based rates and elimination of subsidies between systems. Despite this steadfast belief, CAD's recommendations in this case actually result in subsidies. Specifically, CAD did not attempt to calculate rates on a system by system basis. Instead, CAD simply allocated its proposed rate increase "evenly across-the-board to all customer service areas." This inherent assumption, that all systems deserve the same "across-the-board increase" was shown to be false in my Direct Testimony. There, I pointed out that, if "wastewater rates were established on a system basis for Aqua Utilities, the monthly rates would be $149.82."[29] Instead, as Mr. Novak points out, his proposal that the rate increase be allocated evenly across-the-board and equally to all rate elements, leads to a monthly wastewater rate for Aqua Utilities of $48.47.[30] It seems disingenuous for CAD to reject all of the benefits associated with rate consolidation in favor of cost-based rates that eliminate all subsidies, but then perpetuate subsidies.

Q. IN HIS TESTIMONY MR. KAML REJECTS ALL OF THE REGULATORY SUPPORT THAT YOU PROVIDED IN YOUR DIRECT TESTIMONY. DO YOU HAVE ANY COMMENTS?

A. Yes. In my Direct Testimony, I provided citations to orders from the Arizona[31] and Kentucky Commissions.[32] Also I noted that Commissions in Louisiana, Mississippi, Texas, and Missouri, have each consolidated rates for CSWR affiliates.[33] Additionally, I pointed out that the Tennessee Commission had already engaged in some degree of rate

[29] *Duncan Direct* at 14.
[30] *Pre-filed Testimony of Consumer Advocate Witness William Novak,* Attachment WHN-2, TPUC Docket No. 24-00044 (Dec. 19, 2024) (Assumes monthly usage of 4,000 gallons. Flat charge of $29.91 + ($4.64 * 4) = $48.47).
[31] *Duncan Direct at* 19.
[32] *Id.* at 18.
[33] *Id.*

consolidation as regards the wastewater rates for three of the Cartwright Creek systems (Arrington Retreat, Hideaway, and Hardeman Springs).[34]

In his testimony, however, Mr. Kaml rejects the logic of these various regulatory bodies. Mr. Kaml points out that, without "documentation of the actual cost of service, what constitutes unreasonable and undue hardship, the rate impact on customers, or any other factors that need to be considered",[35] the guidance from these Commission is of little value.

I certainly agree that there are case by case factors that are relevant to each Commission's decision to consolidate rates. That said, what these references are designed to point out is that rate consolidation is the mainstream approach across the nation. As the Arizona Commission has stated:

> Small Utilities in rural areas have largely been treated as stand-alone entities by the Commission for ratemaking purposes. Traditionally, a strict interpretation of the "cost user pays" principle has inhibited small water systems that do not share common facilities from consolidating rate designs. As a general policy, the Commission believes that the practical benefits from allowing rate consolidation involving small water and wastewater utilities far outweigh the benefits of a strict adherence to this theoretical principle.

Q. IN HIS TESTIMONY, MR. KAML ASSERTS THAT RATE CONSOLIDATION IS NOT NEEDED TO ACHIEVE ECONOMIES OF SCALE. DO YOU AGREE?

A. While some economies of scale can be achieved simply through acquisitions, there are other economies of scale that are achievable through rate consolidation. For example, there are regulatory and accounting efficiencies that are achieved through rate consolidation. For instance, absent rate consolidation, Limestone Water must maintain certain accounting

[34] *Id.*
[35] *Kaml Pre-filed* at 37.

records on a system-by-system basis. Additionally, Limestone Water must maintain separate rates and effectuate billing that reflects those rates. As the CEO of Ford Motor Company explains, "[t]he costs of complexity are hard to see until they're gone."[36] Even in this case, CAD has attempted to replicate the efficiencies of consolidation by allocating its rate increase evenly, across-the-board. This is an implicit recognition that allocating a revenue requirement is much easier, and involves less cost, when rates are consolidated.

Q. IN THE ABSENCE OF RATE CONSOLIDATION, HOW DOES CAD PROPOSE TO ALLOCATE ITS PROPOSED REVENUE REQUIREMENT AMONG THE VARIOUS SYSTEMS?

A. In discovery, Mr. Novak readily admits that he has not undertaken an analysis to determine the appropriate manner to allocate costs among the service areas.[37] Given this, Mr. Novak instead simply proposes that the CAD revenue requirement "be allocated evenly across-the-board to all customer service areas based upon the ratio of the attrition period revenue in each area to total attrition period revenue."[38] CAD then simply increases the Mr. Novak's "attrition period revenues" by 52.21%.[39]

The reliance on an across-the-board increase is unusual given that that Mr. Kaml asserts that the Company's rate consolidation proposal "is inconsistent with some rate principles including. . . cost causation."[40]

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.

---

[36] https://hbr.org/2019/01/the-costs-of-complexity-are-hard-to-see
[37] *See Consumer Advocate's Response to Limestone Water's DR 1-27*.
[38] Novak Pre-filed at 20-21.
[39] *Id.* at 21. See the Rebuttal Testimony of Mr. Thies for a discussion regarding the inappropriate nature of Mr. Novak's calculation of attrition period revenues given that he did not simultaneously project attrition period rate base and expenses.
[40] *Kaml Pre-filed* at 38.

Electronically Filed in the TPUC Docket Room on July 20, 2020 at 11:08 a.m.

IN THE TENNESSEE PUBLIC UTILITY COMMISSION
AT NASHVILLE, TENNESSEE

IN RE:	)	
	)	
RULEMAKING TO PROMULGATE RULES RELATED TO EXTENSION OF SERVICE TO UTILITY ACQUISITIONS	)	**DOCKET NO. 20-00025**
	)	
	)	

COMMENTS OF THE CONSUMER ADVOCATE CONCERNING PROPOSED ACQUISITION RULES

Herbert H. Slatery III, Attorney General and Reporter for the State of Tennessee, by and through the Consumer Advocate Unit in the Financial Division of the Office of the Attorney General ("Consumer Advocate"), pursuant to Tenn. Code Ann. § 65-2-102(a)(4), respectfully submits its *Comments* to the Tennessee Public Utility Commission's ("TPUC" or "Commission") *Rulemaking to Promulgate Rules Related to Extension of Service to Utility Acquisitions*. A redlined version of the proposed rules with the Consumer Advocate's suggestions is attached as **Exhibit A** and a clean version is attached as **Exhibit B**.

The Consumer Advocate's comments are related to six parts of the rules: 1) Definitions; 2) Powers and Standards of Review; 3) Ratemaking Rate Base; 4) Acquisition Premium; 5) Regulatory, Transaction, and Closing Costs; and 6) Application for Acquisition and Filing Requirements. The Consumer Advocate contends that modifications to these portions of the rules are appropriate, will result in more efficient proceedings at the Commission, and are in the public interest. Moreover, because each situation will vary in circumstance, the Consumer Advocate's proposals are intended 1) to ensure that the Commission be allowed to consider as many factors as it deems necessary to review the action and 2) to allow reasonable flexibility for

the Commission to hear and consider proposals rather than binding TPUC's review.

Rule 1220-04-01-.14, Definitions and Rule 1220-04-01-.15, Powers and Standard of Review.

The initial sections provide important insight into both the intent of the rules as well as how the rules should be applied in specific cases. Therefore, it is vital that these sections be constructed in a manner that promotes accuracy and precision.

A. The definition for "Acquisition Premium" should be updated to accurately capture what an Acquisition Premium is and how it impacts regulatory proceedings.

As proposed, the definition indicates that an Acquisition Premium is essentially included in every rate base. This is not necessarily true. An Acquisition Premium is simply the amount paid in excess of the net book value of the assets, net of liabilities, being acquired by the purchasing utility. An Acquisition Premium may or may not then be included in Rate Base, and the Commission must be able to consider whether all, part, or none of the Acquisition Premium is appropriate to use for such a purpose. If a company pays in excess of net book value and the excess is not permitted to be included in Rate Base, the Company still has an Acquisition Premium, but it is simply recorded "below the line," meaning it is not eligible for inclusion in the ratemaking formula and is outside of rate base.

The Consumer Advocate proposes the following definition be inserted into the list of definitions and separate from rate base:

> *(2) "Acquisition Premium" means that portion of the purchase price in excess of the net book value of the (net) assets purchased from the selling utility. Whether the Acquisition Premium is recovered from ratepayers will be determined based upon considerations identified below.*

This change will accurately reflect the meaning of Acquisition Premium while ensuring that the Commission retains its ability to determine if public utility capture of the Acquisition Premium is in the public interest.

B. "Public Interest" should be expounded upon in the rules.

As with many topics presented to TPUC, the Commission must determine whether a proposal is or is not in the public interest. The proposed rules include items that the Commission may consider in determining whether an Acquisition Premium is appropriate.[1] The Consumer Advocate believes that a list of factors that relate to whether a proposal is in the public interest would likewise be useful. Doing so will help public utility companies present their initial pleadings in a way that identifies useful information from the outset and will further guide parties throughout the course of a docket on factors that should be included in pre-filed testimony.[2] Therefore, the Consumer Advocate proposes that this section include a list of factors that the Commission will consider in determining whether a proposal is in the public interest:

(2) Public Interest

Pursuant to these rules, the Commission will determine whether proposed ratemaking treatment is in the public interest. The public interest review shall include:

(a) An evaluation of the likely impact of the acquisition on customer rates subsequent to the acquisition relying upon the anticipated cost of the acquiring entity to provide service, notwithstanding the costs of any infrastructure necessary to enhance the provision of safe, reliable service or to comply with environmental requirements.

(b) An evaluation of the qualifications of the acquiring entity to provide safe, reliable service.

(c) An evaluation of the financial capability of the acquiring entity to provide safe reliable service.

(d) The benefits, if any, accruing to customers from an enhanced level of service under the acquiring entity contrasted with the legacy entity.

---

[1] *See* Proposed Rule 1220-04-01-.17(2).

[2] This is especially important in light of the proposed 120-day deadline.

The public interest review may also include:

(e) The impact of the transaction on the economy of Tennessee.

(f) Other factors presented during the course of a proceeding.

Other states include definitions or standards of review for the term "public interest" in rules. For instance, Iowa has the following provision that accounts for the public interest:

Iowa Admin. Code r. 199-32.4(476): "Proposal for Reorganization Requirements"

"Any person who intends to accomplish a reorganization shall file supporting testimony and evidence with its proposal for reorganization, which shall include, but not be limited to, the following information:"

. . .

32.4(4): Impact of Reorganization

"(c) An analysis of the effect on the public interest. Public interest means the interest of the public at large, separate and distinct from the interest of the public utility's ratepayers. The analysis should include a discussion of the reorganization's impact on the economy of the state and the communities where the utility is located."

Moreover, in Utah, that State's rules include the following:

Utah Admin. Code r. R746-420-3

(1) General Requirements of a Solicitation Process.

(a) All aspects of a Solicitation and Solicitation Process must be fair, reasonable and in the public interest.

(b) A proposed Solicitation and Solicitation Process must be reasonably designed to:

(i) Comply with all applicable requirements of the Act and Commission rules;

(ii) Be in the public interest taking into consideration:

(A) whether they are reasonably designed to lead to the acquisition, production, and delivery of electricity at the lowest reasonable cost to the retail customers of the Soliciting Utility located in this state;

(B) long-term and short-term impacts;

(C) risk;

(D) reliability;

(E) financial impacts on the Soliciting Utility; and

(F) other factors determined by the Commission to be relevant;

(iii) Be sufficiently flexible to permit the evaluation and selection of those resources or combination of resources determined by the Commission to be in the public interest."

Similar to these states' treatments of the issue, and analogous to the term public interest, the Tennessee Valley Authority has adopted a "Material Net Benefit" test to determine whether to approve a merger or acquisition. The TVA looks to the following in determining whether approval is appropriate: 1) overall long-term well-being of the LPC and its ratepayers; 2) financial terms and allocation of proceeds; 3) synergies and cost savings; 4) rates; 5) rate parity; 6) financial integrity and strength of LPC; 7) operational and reliability impacts, quality of service, and safety; 8) existing programs; and 9) other benefits and risks.[3]

The rule concerning the public interest as proposed by the Consumer Advocate to the Commission in this proceeding will provide discretion to the Commission as well as guidance to parties concerning pleadings, testimony, and argument. It will also provide acquiring utilities additional guidance during their negotiations with sellers of a system.

Rule 1220-04-01-.16, Ratemaking Rate Base

Proposed Rule 1220-04-01-.16(3) states that the "normal rules of depreciation shall apply to the acquiring utility's ratemaking rate base upon acquisition unless otherwise expressly approved by the Commission." While the ability for the Commission to address this issue separately is important, the Consumer Advocate contends that the phrase "normal rules of depreciation" is vague and can be better defined. Therefore, the Consumer Advocate proposes the following language be inserted to subsection (3):

[3] DETERMINATION AND DISPOSITION OF COMMENTS - ACQUISITION OF CITY OF MURFREESBORO ELECTRIC DEPARTMENT (MED) BY MIDDLE TENNESSEE ELECTRIC MEMBERSHIP CORPORATION (MTEMC), S&P Global

The Depreciation rates approved by the Commission applicable to the seller's assets shall be maintained by the acquiring entity. This may require maintaining separate asset records for the acquired assets from any legacy assets of the acquiring entity.

This will provide notice to parties in acquisition dockets that it is necessary to provide appropriate proposals within respective pre-filed testimonies concerning depreciation.

Rule 1220-04-01.17, Acquisition Premium

A. Background

The subject of an Acquisition Premium has been raised many times throughout the history of this Commission.[4] While public utilities often argue that they should be able to recover the full purchase price of a system, this purchase price can represent an amount paid above the net book value of the system. One troubling aspect of such treatment is that the dynamic between buyers and sellers, if left unchecked, changes drastically. While buyers in competitive markets negotiate to achieve the lowest price possible, when a public utility purchases a system and is allowed to utilize the negotiated purchase price to set raises for consumers, such a buyer suddenly has an interest in negotiating a high purchase price. Thus, the arm's length nature of a negotiation with a public utility buyer does not necessarily exist. Instead, both the buyer and seller have an incentive to set a higher price for a system. Regulation must address this dynamic and ensure that buyers and sellers do not share an incentive to drive up the price.[5]

Another issue stemming from the allowance of recovery for an Acquisition Premium is

---

Market Intelligence, June 2020.

[4] *See e.g.*, TPUC Docket No. 18-00099 (filed September 7, 2018); TPUC Docket No. 15-00042 (filed April 2, 2015).

[5] Indeed, the necessity for regulatory bodies like this Commission to ensure that monopolies operate as if there was normal competition goes to the fundamental core of the need for regulation. Regulators ensure that public utilities charge just and reasonable rates rather than monopoly rates. The principle here is the same. Public utilities who purchase an existing system should not have an incentive to drive up the purchase price. Instead, they should

that in instances where the seller is another public utility or municipal body, either ratepayers or taxpayers (depending on the type of entity operating the system) may have already compensated the seller for some or all of the system. For instance, in the case of a municipal-owned water system, customers may have entirely remunerated the municipality that built and operated the system through their water rates as well as taxes. If that system is then sold to an investor-owned public utility, these customers could find themselves paying for the water system a second time. As discussed previously, this Commission must retain the ability to consider a multitude of factors to ensure that regulatory treatment is in the public interest.

B. The standard for considering an Acquisition Premium should be changed, and the Commission must be able to consider a broad range of factors rather than simply those that may support recovery of an Acquisition Premium.

The proposed rules include the following standard for acquisition premiums:

> *Upon request by the acquiring utility, the Commission may allow the acquiring utility to recover an acquisition premium from acquired and/or existing customers if the Commission determines that such recovery will not result in unjust or unreasonable rates and charges.*

This appears to be a very easy standard for a public utility to meet. Instead, acquiring utilities should be required to demonstrate that the acquisition is in the public interest and will not result in unjust or unreasonable rates, including a demonstration that the inclusion of an Acquisition Premium is not unreasonable. The Consumer Advocate proposes the following language be inserted:

> *The Commission shall allow the acquiring utility to recover all or part of an acquisition premium from acquired and/or existing customers only if the acquiring utility can demonstrate that such rates (including the acquisition premium recovery) are not unreasonable.*

Such a requirement will put the burden appropriately on the acquiring utility, which is logical as

---

have an incentive to negotiate the lowest price possible, just as their counterparts do in competitive markets.

the acquiring utility is making the request. Intervening parties should not bear the burden to prove that proposed treatment by the acquiring utility is not in the public interest or that rates would not be just and reasonable. That burden clearly lies with the petitioner, as it does in any other docket before this Commission. Moreover, with this language the Commission maintains its discretion in reviewing a proposal rather than having its decision-making authority usurped. The Consumer Advocate has also proposed additions within these rules mandating that utilities provide specific types of proof alongside their requests, such as a demonstration that cost savings have been achieved if an entity makes such a claim in its petition or testimony.

This section should include an acknowledgement that the Commission may allow a portion of the Acquisition Premium to be recovered rather than only its entirety. As currently written, the rules seem to indicate an "all or nothing" approach, but it is feasible that some future proceedings may conclude that a portion of the Acquisition Premium may be recovered in rates. Further, the Consumer Advocate suggests that this section should include a provision affirming that the Commission may permit a return of and/or a return on the Acquisition Premium in rates.

Proposed Rules 1220-04-01-.17(2)(a) – (e) include a list of instances that an Acquisition Premium may be appropriate. But there are also many occasions that recovery of an Acquisition Premium is inappropriate. As discussed above, the burden of proving that a factor seeming to favor an Acquisition Premium must be explicitly noted as belonging to the acquiring utility. And even if such a factor is demonstrated by the acquiring utility, this Commission should still retain its authority to make a determination on whether recovery of the Acquisition Premium is in the public interest based on the totality of the evidence in a proceeding.

Demonstrable and verifiable cost savings should be a prerequisite to recovery of an Acquisition Premium, notwithstanding those situations involving the seller of a system with low

or deteriorating quality of service. Moreover, the party seeking to implement an Acquisition Premium in rates should bear the burden of proving that doing so is in the public interest. The Consumer Advocate recommends the following language be added to subpart (2)(a):

> *The acquiring entity shall have the burden of proof to demonstrate the likelihood of cost savings in the acquisition proceeding, and an after the fact analysis demonstrating that such cost savings were achieved.*

Such a clarification ensures fair outcomes in acquisition dockets.

C. Troubled systems are not appropriate candidates to earn a return on an Acquisition Premium.

Proposed Rules 1220-04-01-.17(4) includes the following:

> *Incentives for acquisition of a financially or operationally troubled system, which may be demonstrated by bankruptcy, receivership, financial distress, notice of violation, order of abatement, or inability to continue as a going concern of the selling utility.*

The Consumer Advocate proposes that this section be deleted. There is no justification for a financially or operationally troubled entity to sell a system for a price greater than book value. Such a situation would result in a failure to hold the incumbent utility accountable, and the entity that mismanaged the system would essentially be encouraged to receive unjust gains.

D. In reviewing a proposal concerning an Acquisition Premium, the Commission should consider assigning a portion of the gain-on-sale to the benefit of ratepayers.

If the Commission determines that it is appropriate for an acquiring utility to recover the costs of an Acquisition Premium from the ratepayers of a financially distressed or operationally troubled utility in some future rate proceeding, the Commission should consider attributing all or some portion of the resulting gain-on-sale to ratepayers. Utility owners are not entitled to returns in excess of those authorized by the Commission. And shareholder retention of gains on the sale of utility assets may result in such excessive returns. The gain-on-sale amount translates to an

Acquisition Premium on the buyer's side of the ledger, the costs of which will either be absorbed by the acquiring entity's shareholders or its ratepayers. Therefore, the Consumer Advocate proposes the following addition:

> *If the Commission determines that the acquiring utility may be eligible for recovery of the costs of the acquisition in a future ratemaking proceeding, it should then determine the appropriate treatment of the gain-on-sale proceeds within the acquisition docket.*

E. The Commission should retain the option to permit recovery of an Acquisition Premium over a period of time.

Last, the Consumer Advocate proposes to include a provision allowing the Commission to permit recovery of an Acquisition Premium to be amortized over a period of time, which will be at the discretion of the Commission. The Commission may determine that the remaining lives of the assets should constitute the appropriate Acquisition Premium amortization period. However, there may be situations in which assets are nearly fully depreciated, resulting in an abnormally short amortization period that is not in the public interest. The determination of the appropriate amortization period should therefore be determined on a case-by-case basis.

Rule 1220-04-01-.19 Regulatory, Transaction, and Closing Costs

The first portion of the proposed rules indicate that "[a]ll regulatory, transaction, and closing costs related to the acquiring utility's purchase of the selling utility shall be reasonable and prudent."[6] This seems to suggest that all such costs shall be deemed to be reasonable and prudent – and therefore recoverable from ratepayers – which may not be the case. Under the current construction of the rule, utilities again would have no incentive to keep costs down. They would simply submit any costs incurred, and the current construction of this rule seems to indicate that they would be automatically recovered. Instead, the Consumer Advocate proposes

[6] Proposed Rule 1220-04-01-.19(1).

language requiring that such costs will be *evaluated* for reasonableness and prudence. The Commission can then decide whether the petitioner has met its burden of proof and should be allowed to recover these costs.

In a similar vein, the Consumer Advocate proposes that subsection (3) read as follows:

> *If determined by the Commission that some portion of regulatory, transaction, and closing costs should be recovered from ratepayers, the Commission shall allow such costs to be deferred into a regulatory asset account and included as a regulatory asset on the acquiring utility's books and records unless such costs are to be recovered through another method approved by the Commission.*

This method allows parties to propose regulatory treatment to the Commission rather than binding the Commission to certain findings. It also continues to hold acquiring utilities accountable to a reasonable standard for transactions.

Rule 1220-04-01.21, Application for Acquisition and Filing Requirements

This section includes a 120-day review deadline for a final determination by this Commission. Because both sellers and acquiring utilities will have had months or even years to prepare for an acquisition filing, this timeline creates an undue burden on intervenors and Commission Staff. Moreover, if discovery disputes arise, this timeline could become untenable if there is no provision allowing for an extension.

While public utilities may desire to set short timeframes or have matters expedited, there must be consideration for proceedings that call for flexibility. In order to balance the utilities' desire for quick decisions while providing flexibility if a situation requires it, the Consumer Advocate proposes the following language:

> *(1) The Commission shall approve or deny an application for acquisition within 120 days of the filing of a complete application by the acquiring utility. Upon a showing of good cause, any party in a proceeding may request that the Commission extend this period by up to 60 days.*

This change is a modest one as the 120-day time period remains the baseline for acquisition dockets. And the Commission will retain the discretion to extend dockets in appropriate cases.

CONCLUSION

Commission rules provide guidance to parties. In crafting rules, it is necessary to ensure that they accurately reflect the subject matter addressed. And in regulatory dockets presented to this Commission for consideration, it is in the public interest that the Commission be allowed reasonable discretion in making decisions and issuing final orders. Each of the changes included in the Consumer Advocate's proposed rules is intended to allow for Commission discretion. Moreover, the Consumer Advocate believes that the changes make the rules more precise and better serve the public interest.

WHEREFORE the Consumer Advocate respectfully requests that this Commission consider and adopt these proposed rules.

RESPECTFULLY SUBMITTED,

HERBERT H. SLATERY III (BPR No. 09077)
Attorney General and Reporter
State of Tennessee

DANIEL P. WHITAKER III (BPR No. 035410)
Assistant Attorney General
OFFICE OF THE TENNESSEE ATTORNEY GENERAL
Economic and Regulatory Section
Financial Division, Consumer Advocate Unit
P.O. Box 20207
Nashville, Tennessee 37202-0207
Telephone: (615) 532-9299
Facsimile: (615) 532-2910
Email: Daniel.Whitaker@ag.tn.gov

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served via U.S. Mail or electronic mail on July 20, 2020.

Kelly Grams, General Counsel
Tennessee Public Utility Commission
Legal Division
502 Deaderick Street, 4th Floor
Nashville, TN 37243

DANIEL P. WHITAKER III
Assistant Attorney General

EXHIBIT A

Place substance of rules and other info here. Statutory authority must be given for each rule change. For information on formatting rules go to https://sos.tn.gov/products/division-publications/rulemaking-guidelines.

Rule 1220-04-01 *General Public Utilities Rules* is amended by adding the following language in its entirety:

Rule 1220-04-01-.14 Definitions.

(1) "Acquiring utility" means a public utility subject to the jurisdiction of the Commission.

(2) "Acquisition premium" means all or a portion of the purchase price in excess of the net book value of the assets purchased from the selling utility ~~that is added to the acquiring utility's ratemaking rate base~~. Whether the acquisition premium is recovered will be determined based upon considerations identified in these rules.

(3) "Acquired customers" means all customers of all classes served by the selling utility that will be served by the acquiring utility in the event the Commission approves the application for acquisition.

(4) "Existing customers" means all customers of all classes served by the acquiring utility immediately prior to the Commission's hearing and consideration of the application for acquisition.

(5) "Net book value" means the original cost of the selling utility's assets less accumulated depreciation less unamortized contributions in aid of construction.

(6) "Ratemaking rate base" means the value of the selling utility's assets that is incorporated into the acquiring utility's rate base for ratemaking purposes.

(7) "Selling utility" means any provider of public utilities services in Tennessee that is being purchased by an acquiring utility as a result of a voluntary arm's-length transaction.

Authority: T.C.A. §§ 65-2-102 and 65-5-101 *et seq.*

Rule 1220-04-01-.15 Powers and Standard of Review.

(1) The Commission retains its regulatory authority, jurisdiction, and discretion as provided under Title 65 including as follows:

(a) The Commission has the authority after public notice and hearing to approve an acquiring utility's purchase of a selling utility upon finding the acquisition to be in the public interest.

(b) The Commission shall maintain its existing statutory authority to set rates for the selling utility's system after it is purchased by the acquiring utility.

(c) The Commission shall have the discretion to classify the acquired system as a separate entity for ratemaking purposes if such classification is in the public interest.

(2) Public Interest

Pursuant to these rules, the Commission will determine whether proposed ratemaking treatment is in the public interest. The public interest review shall include:

(a) An evaluation of the likely impact of the acquisition on customer rates subsequent to the acquisition relying upon the anticipated cost of the acquiring entity to provide service, notwithstanding the costs of any infrastructure necessary to enhance the provision of safe, reliable service or to comply with environmental requirements.

(b) An evaluation of the qualifications of the acquiring entity to provide safe, reliable service.

(c) An evaluation of the financial capability of the acquiring entity to provide safe reliable service.

(d) The benefits, if any, accruing to customers from an enhanced level of service under the acquiring entity contrasted with the legacy entity.

The public interest review may also include:

(e) The impact of the transaction on the economy of Tennessee.

(f) Other factors presented during the course of a proceeding.

Authority: T.C.A. §§ 65-2-102 and 65-5-101 *et seq.*

Rule 1220-04-01-.16 Ratemaking Rate Base.

(1) The acquiring utility shall incorporate the acquired assets of the selling utility into the acquiring utility's rate base at the lesser of the purchase price or the net book value of the acquired assets.

(2) The Commission shall consider the addition of an acquisition premium to the acquiring utility's rate base in accordance with Rule 1220-04-01-.17 below.

(3) ~~The~~ The Depreciation rates approved by the Commission applicable to the seller's assets shall be maintained by the acquiring entity. This may require maintaining sperate asset records for the acquired assets from any legacy assets of the acquiring entity. ~~normal rules of depreciation shall apply to the acquiring utility's ratemaking rate base upon acquisition unless otherwise expressly approved by the Commission.~~

(3)

Authority: T.C.A. §§ 65-2-102 and 65-5-101 *et seq.*

Rule 1220-04-01-.17 Acquisition Premium.

(1) ~~Upon~~ The Commission shall only allow the acquiring utility to recover all or part of an acquisition premium from acquired and/or existing customers only if the acquiring utility can demonstrate that such rates (including the acquisition premium recovery) are not unreasonable. ~~request by the acquiring utility, the Commission may allow the acquiring utility to recover an acquisition premium from acquired and/or existing customers if the Commission determines that such recovery will not result in unjust or unreasonable rates and charges.~~

(2) The Commission may permit a return of and/or a return on the acquisition premium in revenue requirement of the acquiring utility. The Commission may consider the following factors, as well as other factors that counter an acquiring utility's recovery of an acquisition premium, when determining whether all or some portion of an acquisition premium should be allowed for recovery from ratepayers:

(a) Cost savings resulting from consolidation of the selling utility's system into the acquiring utility's operations *(The acquiring utility shall have the burden of proof to demonstrate the likelihood of cost savings in the acquisition proceeding, and an after the fact analysis demonstrating that such cost savings were achieved)*;

(b) Improvements in public utilities services resulting from the acquisition, which the acquiring utility shall demonstrate through verifiable metrics;

(c) Remediation of public health, safety, and welfare concerns of the selling utility's system resulting from the acquisition;- and

~~(d) Incentives for acquisition of a financially or operationally troubled system, which may be demonstrated by bankruptcy, receivership, financial distress, notice of violation, order of abatement, or inability to continue as a going concern of the selling utility; and~~

~~(e)~~(d) Any other known and measurable benefits inuring to the acquired and/or existing customers resulting from the acquisition.

(3) The acquiring utility shall have the burden of showing:

(a) The existence of one or more factors supporting the proposed acquisition premium;

(b) The reasonable value of each factor supporting the proposed acquisition premium; and

(c) that the proposed acquisition premium will not result in unjust or unreasonable rates and charges.

(4) The Commission may allow the acquiring utility to amortize (either above or below the line for ratemaking purposes) the acquisition premium over a period of time established by the Commission. The Commission may consider the remaining book lives of the acquired assets or may determine a definitive time period unrelated to the remaining book lives of the acquired assets if such remaining life results in an abbreviated amortization period that is not in the public interest. ~~The Commission shall allow the acquiring utility to amortize any acquisition premium over a reasonable period of time which shall not exceed the remaining useful life of the underlying assets acquired from the selling utility unless otherwise expressly approved by the Commission.~~

(4)(5) If the Commission determines that the acquiring utility may be eligible for recovery of the costs of the acquisition in a future ratemaking proceeding, it should then determine the appropriate treatment of the gain-on-sale proceeds within the acquisition docket.

Authority: T.C.A. §§ 65-2-102 and 65-5-101 *et seq.*

Rule 1220-04-01-.18 Post-Acquisition Capital Investments.

(1) Post-acquisition capital investments in property, plant, and equipment attributable to the selling utility's system or service area ~~shall~~ must be reasonable, prudent, and used and useful in the provisioning of public utilities services if being sought for recovery.

(2) Post-acquisition capital investments shall be depreciated over the economically useful lives of the assets placed in service using the straight-line depreciation method at the selling utility's approved depreciation rates unless another method is expressly approved by the Commission.

(3) In cases when the costs of necessary post-acquisition capital investments are too great to be recovered from customers due to rate shock or rate affordability concerns, the Commission may allow the acquiring utility to defer all or a portion of such costs into a regulatory asset account for probable future recovery.

(4) Upon request of the acquiring utility, the Commission shall allow cost recovery of post-acquisition capital investments through an alternative regulatory method pursuant to T.C.A. § 65-5-103(d) or through another alternative regulatory method that the Commission, after public notice and hearing, finds to be in the public interest.

(5) ~~The acquiring utility's return~~The Commission shall determine the appropriate rate of return on post-acquisition capital investments ~~shall be the rate of return approved by the Commission at the acquiring utility's most recent general rate case unless otherwise expressly approved by the Commission~~.

Authority: T.C.A. §§ 65-2-102 and 65-5-101 *et seq.*

Rule 1220-04-01-.19 Regulatory, Transaction, and Closing Costs.

(1) All regulatory, transaction, and closing costs related to the acquiring utility's purchase of the selling utility ~~shall~~ must be reasonable and prudent in order for them to be recovered from ratepayers, and the acquiring utility bears the burden to prove reasonableness and prudence.

(2) For purposes of setting post-acquisition rates and charges, the Commission may in the exercise of its lawful discretion allocate the regulatory, transaction, and closing costs between the acquiring utility's owners/shareholders and its customers in recognition of the relative benefits of the acquisition to each and in consideration of the affordability of post-acquisition rates.

(3) If determined by the Commission that some portion of regulatory, transaction, and closing costs should be recovered from ratepayers, t~~T~~he Commission shall allow ~~regulatory, transaction, and closing costs recoverable from customers~~such costs to be deferred into a regulatory asset account and included as a regulatory asset on the acquiring utility's books and records ~~in the acquiring utility's rate base for future recovery by the acquiring utility~~ unless such costs are to be recovered through another method approved by the Commission.

(4) The Commission shall allow the acquiring utility to amortize any deferred regulatory, transaction, and closing costs included as a regulatory asset in the acquiring utility's rate base over a reasonable period of time ~~which shall not exceed the remaining useful life of the underlying assets acquired from the selling utility unless otherwise expressly approved by the Commission~~.

(5) Regulatory, transaction, and closing costs related to an acquisition application that is withdrawn by the acquiring utility or denied by the Commission shall not be recoverable from the acquiring utility's existing customers.

Authority: T.C.A. §§ 65-2-102 and 65-5-101 *et seq.*

Rule 1220-04-01-.20 Post-Acquisition Rates and Charges.

(1) The Commission shall have the authority, after public notice and hearing, to fix post-acquisition rates and charges for acquired customers and existing customers.

(2) Post-acquisition rates and charges shall be just and reasonable.

(3) In fixing post-acquisition rates and charges, the Commission may in the exercise of its lawful discretion allocate the recovery of costs between the acquired customers and existing customers on a rational basis that may, among other things, consider the relative benefits, costs, and intrinsic value of service.

(4) Costs that may be rationally allocated between acquired and existing customers for purposes of fixing post-acquisition rates and charges include, but are not confined to the following:

(a) Cost of service;

(b) Return on post-acquisition capital investments;

(c) Acquisition premium; and

(d) Regulatory, transaction, and closing costs related to the acquisition.

(5) The Commission may in the exercise of its lawful discretion require the phase in of post-acquisition rates and charges over a reasonable period of time in circumstances when post-acquisition rates and charges are substantially higher than pre-acquisition rates and charges or in consideration of affordability concerns.

Authority: T.C.A. §§ 65-2-102 and 65-5-101 *et seq.*

Rule 1220-04-01-.21 Application for Acquisition and Filing Requirements.

(1) The Commission shall approve or deny an application for acquisition within 120 days of the filing of a complete application by the acquiring utility. Upon a showing of good cause, any party in a proceeding may request that the Commission extend this period by up to 60 days.

(2) An application for acquisition shall, at a minimum, contain all the following information prior to such application being deemed complete unless otherwise determined by the Commission:

(a) A fully executed acquisition agreement, including all attachments, reflecting the terms and provisions of the acquisition;

(b) Financial statements, including a balance sheet and income statement of the selling utility's three most recently completed fiscal years or reporting periods at the time the application for acquisition is filed;

(c) All tariffs, schedules, or lists detailing the rates, charges, and terms of service in effect for the selling utility at the time the application for acquisition is filed;

(d) A schedule detailing the number of customers by customer class served by the selling utility at the time the application for acquisition is filed;

(e) A statement and, if available, maps that comprehensively describe the service area of the selling utility;

(f) A forecasted income statement detailing the projected operating revenues, expenses, taxes, and net income attributable to the selling utility's operations for the twelve-month period following the estimated closing date of the acquisition transaction;

(g) Capital budgets detailing by project all projected post-acquisition capital investments in property, plant, and equipment attributable to the selling utility's system or service area for the three-year period following the estimated closing date of the acquisition transaction;

(h) A schedule detailing the computation of regulatory, transaction, and closing costs related to the proposed acquisition;

(i) A schedule detailing the computation of any proposed acquisition premium;

(j) A statement discussing the factor(s) supporting any proposed acquisition premium, including the particular benefits or cost savings, if any, that inure to the benefit of

1. Acquired customers and/or

2. Existing customers;

(k) A statement discussing the methodology and rate design used to recover any proposed

1. Acquisition premium and/or

2. Costs of post-acquisition capital investments and/or

3. Regulatory, transaction, and closing costs from

4. Acquired customers and/or

5. Existing customers;

(l) A schedule detailing the computation of the net book value of the assets being acquired from the selling utility as determined by the books and records of the selling utility or, if such books and records are unavailable or insufficient, by a study of the selling utility's plant in service performed by a consultant approved by the Commission;

(m) A schedule detailing the computation of the acquiring utility's post-acquisition ratemaking rate base;

(n) A schedule detailing the computation of post-acquisition rates and charges proposed for acquired customers by customer class;

(o) A schedule comparing the pre-acquisition and proposed post-acquisition rates and charges for acquired customers by customer class;

(p) A schedule detailing the computation of post-acquisition rates and charges proposed for existing customers by customer class; and

(q) A schedule comparing the pre-acquisition and proposed post-acquisition rates and charges for existing customers by customer class.

(3) The acquiring utility shall possess a Certificate of Public Convenience and Necessity (CCN) or demonstrate its eligibility for a CCN to operate the selling utility's system in accordance with applicable statutory law and Commission rules and regulations.

(4) The acquiring utility shall file a proposed tariff incorporating the acquired customers into the acquiring utility's rates, charges, and terms of provisioning public utilities services.

(5) The acquiring utility shall file a copy of a notice published in the area where the selling utility operates informing the public of the acquiring utility's proposed acquisition of the selling utility, the terms of the acquisition, and the date(s) and location(s) of the public meeting(s) scheduled to be held on the acquisition.

(6) The acquiring utility shall furnish any other pertinent information as determined and requested by the Commission.

(7) The Commission shall approve the acquiring utility's acquisition of the selling utility if, after public notice and hearing, the Commission finds the acquisition to be in the public interest.

Authority: T.C.A. §§ 65-2-102 and 65-5-101 *et seq.*

EXHIBIT B

Place substance of rules and other info here. Statutory authority must be given for each rule change. For information on formatting rules go to https://sos.tn.gov/products/division-publications/rulemaking-guidelines.

Rule 1220-04-01 *General Public Utilities Rules* is amended by adding the following language in its entirety:

Rule 1220-04-01-.14 Definitions.

(1) "Acquiring utility" means a public utility subject to the jurisdiction of the Commission.

(2) "Acquisition premium" means all or a portion of the purchase price in excess of the net book value of the assets purchased from the selling utility. Whether the acquisition premium is recovered will be determined based upon considerations identified in these rules.

(3) "Acquired customers" means all customers of all classes served by the selling utility that will be served by the acquiring utility in the event the Commission approves the application for acquisition.

(4) "Existing customers" means all customers of all classes served by the acquiring utility immediately prior to the Commission's hearing and consideration of the application for acquisition.

(5) "Net book value" means the original cost of the selling utility's assets less accumulated depreciation less unamortized contributions in aid of construction.

(6) "Ratemaking rate base" means the value of the selling utility's assets that is incorporated into the acquiring utility's rate base for ratemaking purposes.

(7) "Selling utility" means any provider of public utilities services in Tennessee that is being purchased by an acquiring utility as a result of a voluntary arm's-length transaction.

Authority: T.C.A. §§ 65-2-102 and 65-5-101 *et seq.*

Rule 1220-04-01-.15 Powers and Standard of Review.

(1) The Commission retains its regulatory authority, jurisdiction, and discretion as provided under Title 65 including as follows:

(a) The Commission has the authority after public notice and hearing to approve an acquiring utility's purchase of a selling utility upon finding the acquisition to be in the public interest.

(b) The Commission shall maintain its existing statutory authority to set rates for the selling utility's system after it is purchased by the acquiring utility.

(c) The Commission shall have the discretion to classify the acquired system as a separate entity for ratemaking purposes if such classification is in the public interest.

(2) Public Interest

Pursuant to these rules, the Commission will determine whether proposed ratemaking treatment is in the public interest. The public interest review shall include:

(a) An evaluation of the likely impact of the acquisition on customer rates subsequent to the acquisition relying upon the anticipated cost of the acquiring entity to provide

service, notwithstanding the costs of any infrastructure necessary to enhance the provision of safe, reliable service or to comply with environmental requirements.

(b) An evaluation of the qualifications of the acquiring entity to provide safe, reliable service.

(c) An evaluation of the financial capability of the acquiring entity to provide safe reliable service.

(d) The benefits, if any, accruing to customers from an enhanced level of service under the acquiring entity contrasted with the legacy entity.

The public interest review may also include:

(e) The impact of the transaction on the economy of Tennessee.

(f) Other factors presented during the course of a proceeding.

Authority: T.C.A. §§ 65-2-102 and 65-5-101 *et seq.*

Rule 1220-04-01-.16 Ratemaking Rate Base.

(1) The acquiring utility shall incorporate the acquired assets of the selling utility into the acquiring utility's rate base at the lesser of the purchase price or the net book value of the acquired assets.

(2) The Commission shall consider the addition of an acquisition premium to the acquiring utility's rate base in accordance with Rule 1220-04-01-.17 below.

(3) The Depreciation rates approved by the Commission applicable to the seller's assets shall be maintained by the acquiring entity. This may require maintaining sperate asset records for the acquired assets from any legacy assets of the acquiring entity.

Authority: T.C.A. §§ 65-2-102 and 65-5-101 *et seq.*

Rule 1220-04-01-.17 Acquisition Premium.

(1) The Commission shall allow the acquiring utility to recover all or part of an acquisition premium from acquired and/or existing customers only if the acquiring utility can demonstrate that such rates (including the acquisition premium recovery) are not unreasonable.

(2) The Commission may permit a return of and/or a return on the acquisition premium in revenue requirement of the acquiring utility. The Commission may consider the following factors, as well as other factors that counter an acquiring utility's recovery of an acquisition premium, when determining whether all or some portion of an acquisition premium should be allowed for recovery from ratepayers:

(a) Cost savings resulting from consolidation of the selling utility's system into the acquiring utility's operations (*The acquiring utility shall have the burden of proof to demonstrate the likelihood of cost savings in the acquisition proceeding, and an after the fact analysis demonstrating that such cost savings were achieved)*;

(b) Improvements in public utilities services resulting from the acquisition, which the acquiring utility shall demonstrate through verifiable metrics;

(c) Remediation of public health, safety, and welfare concerns of the selling utility's system resulting from the acquisition; and

(d) Any other known and measurable benefits inuring to the acquired and/or existing customers resulting from the acquisition.

(3) The acquiring utility shall have the burden of showing:

(a) The existence of one or more factors supporting the proposed acquisition premium;

(b) The reasonable value of each factor supporting the proposed acquisition premium; and

(c) that the proposed acquisition premium will not result in unjust or unreasonable rates and charges.

(4) The Commission may allow the acquiring utility to amortize (either above or below the line for ratemaking purposes) the acquisition premium over a period of time established by the Commission. The Commission may consider the remaining book lives of the acquired assets or may determine a definitive time period unrelated to the remaining book lives of the acquired assets if such remaining life results in an abbreviated amortization period that is not in the public interest.

(5) If the Commission determines that the acquiring utility may be eligible for recovery of the costs of the acquisition in a future ratemaking proceeding, it should then determine the appropriate treatment of the gain-on-sale proceeds within the acquisition docket.

Authority: T.C.A. §§ 65-2-102 and 65-5-101 *et seq.*

Rule 1220-04-01-.18 Post-Acquisition Capital Investments.

(1) Post-acquisition capital investments in property, plant, and equipment attributable to the selling utility's system or service area must be reasonable, prudent, and used and useful in the provisioning of public utilities services if being sought for recovery.

(2) Post-acquisition capital investments shall be depreciated over the economically useful lives of the assets placed in service using the straight-line depreciation method at the selling utility's approved depreciation rates unless another method is expressly approved by the Commission.

(3) In cases when the costs of necessary post-acquisition capital investments are too great to be recovered from customers due to rate shock or rate affordability concerns, the Commission may allow the acquiring utility to defer all or a portion of such costs into a regulatory asset account for probable future recovery.

(4) Upon request of the acquiring utility, the Commission shall allow cost recovery of post-acquisition capital investments through an alternative regulatory method pursuant to T.C.A. § 65-5-103(d) or through another alternative regulatory method that the Commission, after public notice and hearing, finds to be in the public interest.

(5) The Commission shall determine the appropriate rate of return on post-acquisition capital investments.

Authority: T.C.A. §§ 65-2-102 and 65-5-101 *et seq.*

Rule 1220-04-01-.19 Regulatory, Transaction, and Closing Costs.

(1) All regulatory, transaction, and closing costs related to the acquiring utility's purchase of the selling utility must be reasonable and prudent in order for them to be recovered from ratepayers, and the acquiring utility bears the burden to prove reasonableness and prudence.

(2) For purposes of setting post-acquisition rates and charges, the Commission may in the exercise of its lawful discretion allocate the regulatory, transaction, and closing costs between the acquiring utility's owners/shareholders and its customers in recognition of the relative benefits of the acquisition to each and in consideration of the affordability of post-acquisition rates.

(3) If determined by the Commission that some portion of regulatory, transaction, and closing costs should be recovered from ratepayers, the Commission shall allow such costs to be deferred into a regulatory asset account and included as a regulatory asset on the acquiring utility's books and records unless such costs are to be recovered through another method approved by the Commission.

(4) The Commission shall allow the acquiring utility to amortize any deferred regulatory, transaction, and closing costs included as a regulatory asset in the acquiring utility's rate base over a reasonable period of time.

(5) Regulatory, transaction, and closing costs related to an acquisition application that is withdrawn by the acquiring utility or denied by the Commission shall not be recoverable from the acquiring utility's existing customers.

Authority: T.C.A. §§ 65-2-102 and 65-5-101 *et seq.*

Rule 1220-04-01-.20 Post-Acquisition Rates and Charges.

(1) The Commission shall have the authority, after public notice and hearing, to fix post-acquisition rates and charges for acquired customers and existing customers.

(2) Post-acquisition rates and charges shall be just and reasonable.

(3) In fixing post-acquisition rates and charges, the Commission may in the exercise of its lawful discretion allocate the recovery of costs between the acquired customers and existing customers on a rational basis that may, among other things, consider the relative benefits, costs, and intrinsic value of service.

(4) Costs that may be rationally allocated between acquired and existing customers for purposes of fixing post-acquisition rates and charges include, but are not confined to the following:

(a) Cost of service;

(b) Return on post-acquisition capital investments;

(c) Acquisition premium; and

(d) Regulatory, transaction, and closing costs related to the acquisition.

(5) The Commission may in the exercise of its lawful discretion require the phase in of post-acquisition rates and charges over a reasonable period of time in circumstances when post-acquisition rates and charges are substantially higher than pre-acquisition rates and charges or in consideration of affordability concerns.

Authority: T.C.A. §§ 65-2-102 and 65-5-101 *et seq.*

Rule 1220-04-01-.21 Application for Acquisition and Filing Requirements.

(1) The Commission shall approve or deny an application for acquisition within 120 days of the filing of a complete application by the acquiring utility. Upon a showing of good cause, any party in a proceeding may request that the Commission extend this period by up to 60 days.

(2) An application for acquisition shall, at a minimum, contain all the following information prior to such application being deemed complete unless otherwise determined by the Commission:

(a) A fully executed acquisition agreement, including all attachments, reflecting the terms and provisions of the acquisition;

(b) Financial statements, including a balance sheet and income statement of the selling utility's three most recently completed fiscal years or reporting periods at the time the application for acquisition is filed;

(c) All tariffs, schedules, or lists detailing the rates, charges, and terms of service in effect for the selling utility at the time the application for acquisition is filed;

(d) A schedule detailing the number of customers by customer class served by the selling utility at the time the application for acquisition is filed;

(e) A statement and, if available, maps that comprehensively describe the service area of the selling utility;

(f) A forecasted income statement detailing the projected operating revenues, expenses, taxes, and net income attributable to the selling utility's operations for the twelve-month period following the estimated closing date of the acquisition transaction;

(g) Capital budgets detailing by project all projected post-acquisition capital investments in property, plant, and equipment attributable to the selling utility's system or service area for the three-year period following the estimated closing date of the acquisition transaction;

(h) A schedule detailing the computation of regulatory, transaction, and closing costs related to the proposed acquisition;

(i) A schedule detailing the computation of any proposed acquisition premium;

(j) A statement discussing the factor(s) supporting any proposed acquisition premium, including the particular benefits or cost savings, if any, that inure to the benefit of

1. Acquired customers and/or

2. Existing customers;

(k) A statement discussing the methodology and rate design used to recover any proposed

1. Acquisition premium and/or

2. Costs of post-acquisition capital investments and/or

3. Regulatory, transaction, and closing costs from

4. Acquired customers and/or

5. Existing customers;

(l) A schedule detailing the computation of the net book value of the assets being acquired from the selling utility as determined by the books and records of the selling utility or, if such books and records are unavailable or insufficient, by a study of the selling utility's plant in service performed by a consultant approved by the Commission;

(m) A schedule detailing the computation of the acquiring utility's post-acquisition ratemaking rate base;

(n) A schedule detailing the computation of post-acquisition rates and charges proposed for acquired customers by customer class;

(o) A schedule comparing the pre-acquisition and proposed post-acquisition rates and charges for acquired customers by customer class;

(p) A schedule detailing the computation of post-acquisition rates and charges proposed for existing customers by customer class; and

(q) A schedule comparing the pre-acquisition and proposed post-acquisition rates and charges for existing customers by customer class.

(3) The acquiring utility shall possess a Certificate of Public Convenience and Necessity (CCN) or demonstrate its eligibility for a CCN to operate the selling utility's system in accordance with applicable statutory law and Commission rules and regulations.

(4) The acquiring utility shall file a proposed tariff incorporating the acquired customers into the acquiring utility's rates, charges, and terms of provisioning public utilities services.

(5) The acquiring utility shall file a copy of a notice published in the area where the selling utility operates informing the public of the acquiring utility's proposed acquisition of the selling utility, the terms of the acquisition, and the date(s) and location(s) of the public meeting(s) scheduled to be held on the acquisition.

(6) The acquiring utility shall furnish any other pertinent information as determined and requested by the Commission.

(7) The Commission shall approve the acquiring utility's acquisition of the selling utility if, after public notice and hearing, the Commission finds the acquisition to be in the public interest.

Authority: T.C.A. §§ 65-2-102 and 65-5-101 *et seq.*

IN THE TENNESSEE PUBLIC UTILITY COMMISSION
AT NASHVILLE, TENNESSEE

IN RE:	)	
	)	
RULEMAKING TO PROMULGATE RULES RELATED TO EXTENSION OF SERVICE TO UTILITY ACQUISITIONS	)	**DOCKET NO. 20-00025**

REPLY COMMENTS OF THE CONSUMER ADVOCATE
CONCERNING PROPOSED ACQUISITION RULES

Herbert H. Slatery III, Attorney General and Reporter for the State of Tennessee, by and through the Consumer Advocate Unit in the Financial Division of the Office of the Attorney General ("Consumer Advocate"), pursuant to Tenn. Code Ann. § 65-2-102(a)(4), respectfully submits its *Reply Comments* to the Tennessee Public Utility Commission's (TPUC or the "Commission") *Rulemaking to Promulgate Rules Related to Extension of Service to Utility Acquisitions*. The Consumer Advocate's *Reply Comments* are submitted to the Commission in response to comments and redlined rules filed by Atmos Energy Corporation[1] ("Atmos Energy") and comments submitted by Tennessee-American Water Company[2] (TAWC). The Consumer Advocate will briefly address seven topics (1) public interest criteria; (2) gain on sale; (3) rate base determination (i.e. embedded costs and Replacement Cost New Less Depreciation (RCNLD)); (4) Atmos Energy's comments and redlines to proposed rules; and (5) TAWC's comments and revisions to proposed rules. The details of the Consumer Advocate's comments are as follows:

[1] *Comments by Atmos Energy Corporation*, TPUC Docket No. 20-00025 (July 1, 2020) and *Atmos Energy Corporation's Redlines to Proposed Rules*, TPUC Docket No. 20-00025 (July 1, 2020).
[2] *Comments by Tennessee American Water Company*, TPUC Docket No. 20-00025 (July 8, 2020), and Tennessee *American Water Company's Substitute Filing*, TPUC Docket No. 20-00025 (July 20, 2020).

I. PUBLIC INTEREST CRITERIA

The comments submitted by Atmos Energy and TAWC exclusively focus on the implications of the purchase price on the determination of Rate Base. Neither party addresses the appropriate criteria the Commission should consider in its evaluation of the public interest, which is the fundamental question that must be answered within an acquisition docket. Absent a clear identification of such principles by the Commission[3], applications for approval of acquisitions will not address key issues possibly resulting in significant discovery and controversy. Without an evaluation of the likely impact of the transaction on customers, the public interest cannot be adequately considered. To the extent unique rate base valuation techniques are appropriate, they should only be applied to small systems that often suffer from a shortage of capital. There is no evidence that the rules supported by the utility commenters are needed within a request to acquire a large utility system.

II. GAIN ON THE SALE OF UTILITY ASSETS

The utility comments also fail to address the policy issue of which stakeholder should retain the gain on the sale of utility assets. The Commission has previously addressed this issue.[4]

III. RATE BASE DETERMINATION

Both sets of utility comments support two methods for determining the Rate Base impact of acquisitions: (1) embedded cost and (2) RCNLD. At the outset, the Consumer Advocate emphasizes that any modification to the Commission's long-standing policy of limiting rate base values for acquired systems to that of original cost[5] should be applied exclusively to acquisitions

[3] *Comments by the Consumer Advocate*, pp. 3-5, TPUC Docket No. 20-00025 (July 20, 2020).
[4] *Order on Remand*, *In re A+ Communications, Inc.*, TPSC Docket No. 92-1398 (May 18, 1994) and *Order, In re Kingsport Power Company*, TPSC Docket No. U-84-7308 (November 15, 1984).
[5] *Order Approving Purchase Agreement, Franchise Water Agreement and Certificate of Public Convenience and Necessity*, p. 16, TRA Docket No. 12-00157 (October 15, 2013) and *Final Order Setting Rates*, p. 15, TRA Docket No. 15-00042 (March 10, 2016).

of small utility systems. Purchases of investor-owned systems should continue to be recorded at original cost. Our comments below relate only to the acquisition of small utility systems.

A. Embedded Costs

The acquisition of small systems at the average embedded cost of the acquiring system may provide the proper balance to incentivize qualified utilities to purchase troubled small systems, and simultaneously providing some protection for ratepayers. Under the Atmos Energy comments, the potential cost impact of the acquisition on both its legacy customers and the newly acquired customers is reduced. This is because the rate base of both entities is placed on the same footing: the embedded cost of the larger acquiring system. However, the extent of necessary improvement of the acquiring system should be considered when determining whether the embedded-cost approach is appropriate. If the acquired system requires substantial upgrades on a per-customer basis, the embedded-cost approach may not be appropriate. In summary, the embedded-cost approach is worthy of consideration; however, it should not be accepted without considering the condition of the acquired system. The Commission should have the flexibility to determine whether the embedded-cost approach is appropriate based upon the unique facts of the case.

B. Replacement Cost New Less Depreciation Valuation Methodology

The utility comments support the RCNLD valuation methodology; however, both ignore the practical challenges of adopting such an approach. The calculation assumes the vintage and material type of the acquired system is known and well-documented. The RCNLD method takes the original cost of the system by material type and vintage and applies Handy Whitman Index factors[6]. It is the experience of the Consumer Advocate that investor-owned utilities do not always

[6] *Tennessee American Water Company's Substitute Filing*, pp. 5-6, TPUC Docket No. 20-00025 (July 8, 2020).

have complete and accurate data on the quantity and material type within its own system. However, accurate RCNLD values may only be determined with accurate material type and vintage data. It would be interesting to evaluate the calculation of the existing TAWC system using the RCNLD methodology.[7] Both utilities ignore the practical challenges of the calculation and instead ask the Commission to simply accept this unique approach without even one hypothetical calculation applied to actual data.

Finally, neither utility commenter addresses the implication of the balance of Accumulated Deferred Income Taxes (ADIT) upon the acquired entities rate base. It is reasonable to assume the hypothetical transactions will be taxable, thus it is likely that deferred taxes will become due. In this scenario, all other things being equal, rate base will increase since the deferred tax liability (ADIT) would be eliminated within the transaction. Neither utility commenter addresses the regulatory implications of this issue, nor its impact on ratepayers. The elimination of ADIT poses an increased cost to ratepayers without any offsetting benefit. If either valuation method supported by the utility commenters is adopted, there should be a separate determination of the lost ADIT and such balance should be used to reduce the initial value of plant in service, and thus rate base. Importantly this balance would not be identified as ADIT on the books of the acquiring entity; instead, it would simply be used as an offset amount in determining the recorded value of acquired assets.

IV. ATMOS ENERGY'S COMMENTS AND REDLINES TO PROPOSED RULES

Atmos Energy also supports the RCNLD methodology, ignoring the complications of the calculation. As discussed above, the Consumer Advocate does not have confidence that an

[7] *Direct Testimony of Elaine K. Chambers on behalf of Tennessee American Water Company, Inc.* at 30:9-13, TPUC Docket No. 19-00105 (November 15, 2019).

accurate determination of RCNLD can be quantified. The Company relies upon the phrase "negotiated sales price" which carries the implication of a determination of an agreed-upon price by two parties through vigorous negotiations. In reality, the buyer and seller are simply determining a price that the ratepayers will pay. Therefore, utilities do not have an incentive to negotiate the lowest possible price under its proposed rules.

Atmos Energy attempts to establish rules governing the manner in which its annual ratemaking mechanism will incorporate the impact of the acquired system.[8] This proposal attempts to supplant conditions of its existing mechanism which require new matters to be evaluated by the parties within the context of the annual review of its operating results.[9] Atmos Energy seeks to bypass these requirements and instead ensure such costs are recoverable in the mechanism regardless of the specific circumstances of the acquisition. The Consumer Advocate recommends that the Commission uphold the terms of Atmos Energy's annual rate review and indicate how such acquisition-related issues are evaluated within an annual rate mechanism be left to the appropriate annual docket or determined within the acquisition docket.

V. TAWC'S COMMENTS AND REVISIONS TO PROPOSED RULES

TAWC recommends the Commission promulgate rules favoring acquisitions by investor-owned utilities over non-investor-owned utilities.[10] The Commission rules should not favor one type of ownership structure over another.

TAWC relies upon the term "current value" within its comments. In the context of regulated utilities, it is the regulatory authority that sets rates to produce revenue and cash flow,

[8] *Atmos Energy Corporation's Redlines to Proposed Rules*, p. 2, Rule 1220-04-01-16(3).
[9] *Tennessee Regulatory Authority Gas Tariff of Atmos Energy Corporation*, Annual Review Mechanism (ARM), Sheet 34.1, Definition (F) and Sheet 34.5.1 § C. New Matters (Effective June 1, 2020). *See also Order Approving Stipulation and Settlement Agreement,* Exhibit 1, p. 3, ¶6(f), TPUC Docket No. 18-00112 (December 16, 2019).
[10] *Tennessee American Water Company's Substitute Filing* at p. 1.

which then determines value. The measurement of value is therefore determined by regulatory policy and methodologies used in the rate-setting process. Thus, arguing that the Commission should adopt policies which allow selling utilities to sell at current value fails to recognize the critical role that regulatory policy plays in determining value. Regulated utilities are entitled to the opportunity to earn a return on its net book value of assets, nothing more.

TAWC makes the unsupported statement that RCNLD valuations produce a more accurate value of the acquired system than the traditional net book value standard.[11] This statement is without foundation. It ignores that value is determined by regulatory methodologies used to set rates, which produce cash flows, which in turn produces value. TAWC's statement is only true if a utility convinces the Commission to adopt the RCNLD methodology, which would produce increased cash flows using the higher rate base valuation technique. The TAWC argument that the RCNLD method produces a better measure of value is premised upon an untested methodology that produces a higher rate base methodology than the straight-forward, unambiguous net book value approach.

TAWC now supports the concept that rates applied to customers of acquired systems be set at the level of the utility's existing customers.[12] Despite this concept, TAWC charges rates to customers of its recently acquired Whitwell and Jasper Highlands systems which are greater than those charged to its legacy Chattanooga customers.

The Consumer Advocate requests the Commission's consideration of its comments herein.

[11] *Id.* at p. 6.
[12] *Id.* at pp. 6-7.

RESPECTFULLY SUBMITTED,

KAREN H. STACHOWSKI (BPR No. 019607)
Assistant Attorney General
OFFICE OF THE TENNESSEE ATTORNEY GENERAL
Economic and Regulatory Section
Financial Division, Consumer Advocate Unit
P.O. Box 20207
Nashville, Tennessee 37202-0207
Telephone: (615) 741-2370
Facsimile: (615) 532-2910
Email: Karen.Stachowski@ag.tn.gov

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served via U.S. Mail, with a courtesy copy by electronic mail on April 8, 2021.

Kelly Grams, General Counsel
Tennessee Public Utility Commission
Legal Division
502 Deaderick Street, 4th Floor
Nashville, TN 37243

Karen H. Stachowski

KAREN H. STACHOWSKI
Assistant Attorney General

BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION
NASHVILLE, TENNESSEE

PETITION OF LIMESTONE WATER UTILITY OPERATING COMPANY, LLC, TO INCREASE CHARGES, FEES AND RATES AND FOR APPROVAL OF A GENERAL RATE INCREASE AND CONSOLIDATED RATES	))))))	**DOCKET NO. 24-00044**

VERIFICATION

STATE OF MISSOURI)
)
COUNTY OF ST. LOUIS)

I, MIKE DUNCAN, being duly sworn, state that I am authorized to testify on behalf of Limestone Water Utility Operating Company, LLC in the above-referenced docket, that if present before the Commission and duly sworn, my testimony would be as set forth in my pre-filed testimony in this matter, and that my testimony herein is true and correct to the best of my knowledge, information, and belief.

MIKE DUNCAN

Sworn to and subscribed before me
this 7th day of January, 2025.

Notary Public

My Commission Expires: 04-10-2027

CERTIFICATE OF SERVICE

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

Karen H. Stachowski, Esq.
Deputy Attorney General
Office of the Tennessee Attorney General
Consumer Advocate Division
P.O. Box 20207
Nashville, TN 37202-0207
Karen.Stachowski@ag.tn.gov

Shilina B. Brown, Esq.
Senior Assistant Attorney General
Office of the Tennessee Attorney General
Consumer Advocate Division
P.O. Box 20207
Nashville, TN 37202-0207
Shilina.Brown@ag.tn.gov

Victoria B. Glover, Esq.
Assistant Attorney General
Office of the Tennessee Attorney General
Consumer Advocate Division
P.O. Box 20207
Nashville, TN 37202-0207
Victoria.Glover@ag.tn.gov

This the 13th day of January 2025.

Melvin J. Malone