BEFORE THE TENNESSEE REGULATORY AUTHORITY

Nashville, Tennessee

IN RE: PETITION OF TENNESSEE AMERICAN WATER COMPANY TO CHANGE AND INCREASE CERTAIN RATES AND CHARGES	))))	DOCKET NO. 03-00118

POST HEARING BRIEF OF CHATTANOOGA MANUFACTURERS ASSOCIATION

The Chattanooga Manufacturers Association ("CMA") submits the following post hearing brief concerning the above-captioned rate case brought by the Tennessee American Water Company ("TAWC" or "the Company").

Summary

As the TRA is aware, there are only two, unresolved issues remaining to be decided: (1) whether the Authority should reaffirm its decision of September 26, 2000, that the Company's stockholders, not its ratepayers, be required to absorb the costs of the Company's agreement with the City of Chattanooga to reduce fire hydrant fees by approximately $1.1 million a year and (2) what is the appropriate rate design for the Authority to adopt.

Regarding the issue of rate design, all parties have agreed that if the Authority continues to impute the fire hydrant revenues to the Company, the Authority should adopt the rate design shown in Exhibit 3. If, on the other hand, the Authority decides not to impute those revenues, there are two rate design proposals in the record. One proposal, which has been agreed to by CMA, the City of Chattanooga, and TAWC, is shown in Exhibit 4. The other proposal, urged by the Consumer Advocate Division ("CAD"), would allocate all of the additional revenue requirement back to the City in the form of increased hydrant fees, essentially repealing the rate reduction approved by the TRA three years ago.

Regarding the hydrant issue, CMA agrees with the City of Chattanooga and the Consumer Advocate that the Company's stockholders, not its ratepayers, should continue to absorb the costs of the reduction in hydrant rates. That was a promise made by the TRA to the ratepayers of Chattanooga, and that promise should be kept.

Argument

Since CMA has reached an agreement concerning rate design, this brief will address only whether the Authority should allocate the lost hydrant revenue to TAWC's stockholders, thereby saving Chattanooga ratepayers more than $1 million a year in water fees.

There is no question that, when the TRA approved the Company's proposed reduction in hydrant rates, the TRA did so with the express understanding, as stated in the Authority's Order, that the "lost contribution to [TAWC] resulting from the reduction in fire hydrant charges... shall be borne, in full, by the stockholders...[and the] Company's ratepayers shall not at any time...bear any of the cost resulting from this Tariff filing by [TAWC] to voluntarily reduce its fire hydrant charges to the City of Chattanooga." Order, at 5. The Order specifically noted that, in the Company's future rate filings, "lost revenues attributed to this Tariff filing would be imputed" to the Company "thus reflecting the Company and stockholders' decision to absorb the contribution loss." Order, at 3, n.6[1].

Both the majority's Order and the dissent by Director Greer noted that this proposed rate reduction was agreed to by the Company in order to bring an end to a long and expensive legal battle between the Company and the City of Chattanooga. The City had filed an eminent

[1]Writing in dissent, TRA Director H. Lynn Greer, Jr. said he agreed with the majority decision to place this revenue burden on the Company's stockholders but predicted the issue would likely arise in future rate cases and warned that the Authority's "eternal vigilance likely will be required to ensure the Company's ratepayers ultimately do not shoulder the burden of the lost revenues." Greer Dissent, at 3, n.5.

domain suit in order to take over and operate TAWC's water system. After TAWC had spent in excess of $5 million fighting the lawsuit, the parties finally agreed to settle the matter. According to the testimony of former Chattanooga Mayor Jon Kinsey, the City "agreed to dismiss its eminent domain suit in exchange for a significant reduction in the tariff charged for fire hydrants." Kinsey Direct Testimony, at 3.

The Authority agreed to the proposed tariff only upon the condition that the lost revenue not be recovered from ratepayers "now or at any time in the future." Order, at 4. While the Authority recognized the potential injury to the Company's stockholders, the Authority also recognized that it was not within the purview of the agency to "question the prudence" of the Company's decision to lose the hydrant revenue rather than continue fighting the eminent domain suit and risk losing the entire Company. Order, at 3; Greer Dissent, at 2-3. The Company did not appeal the Authority's decision nor seek clarification of the language of the Order.

Just as Director Greer predicted, the hydrant issue did not go away. In this rate case, the Company's first since the hydrant rate reduction, the Company asks to recover the $1.1 million in lost hydrant revenues by increasing prices to other ratepayers. The Company offers two arguments: (1) the prior Order does not mean what it says and (2) imputation of the hydrant revenue "in perpetuity" would "equate to untold millions" in lost revenue and "place the Company in a position where it would not have an opportunity in this case or any future rate cases to achieve a fair and reasonable return on its investments." Miller Rebuttal, at 19-20.

In light of the express, repeated statement made in the earlier Order, TAWC's efforts to re-interpret the Authority's intent do not merit further response. Similarly, the Company's argument that the imputation of revenue will forever prevent the Company from earning a fair return is both inaccurate and unsupported by evidence in the record

As CMA witness Mike Gorman testified, the TRA's decision to reduce hydrant rates at the expense of Company shareholders does not mean that the Company will never have the opportunity to earn a fair return. Once the Company accepts the fact the Authority intends to keep its commitment to Chattanooga ratepayers, the Company should reduce the book value of its Tennessee assets to reflect the fact that the Company is no longer allowed to earn a return on a portion of those assets. The Company estimated that this would require a one-time write off of approximately $8-9 million.[2] While this would result in a one-time loss for the Company's stockholders, the Company would thereafter be able to earn its prescribed rate-of-return on the Company's remaining assets. On a going forward basis, the Company's credit would not suffer, the stockholders will be able to earn the Authority's prescribed return, and this issue will disappear.

Even without the write-off of assets, there is no evidence to support the Company's contention that imputation of the hydrant revenue will deprive the Company of the opportunity to earn a fair return. Although the parties agreed in this case to allow the Company to earn a return on equity of 9.9%, there is no evidence in the record concerning what the Company will actually earn without the hydrant revenue or whether that return falls outside the range of what would be considered a fair return under current economic conditions.[3] Company witness Miller, who testified that the continued imputation of the hydrant revenue would result in confiscation of the

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[2] Mr. Gorman's proposal is not inconsistent with the parties' agreement concerning the size of the Company's rate base for purposes of calculating the Company's revenue requirement in this rate case. His proposal suggests how the Company should adjust its books on a going forward basis if the TRA declares in this case that the lost hydrant revenue should be imputed the Company for ratemaking purposes. In fact, as Mr. Gorman testified, the rules of accounting may well require the Company to write down its assets if the Authority reaffirms its decision on the hydrant revenue issue.

[3] CAD Witness Brown testified that a return on equity of as low as 7.5% would be a fair return. Brown Direct Testimony at p.56.

Company's property, was asked by the Consumer Advocate to estimate what return the stockholder would likely receive in this situation. Mr. Miller said he had not made that calculation and did not want to. Based on this record, there is no evidence that the Company's stockholders will earn less than a fair return without the hydrant revenue.

Conclusion

For these reasons, the Company's request that the Authority overturn its prior decision on the hydrant issue should be rejected, the Company's stockholders should shoulder the burden of the lost revenues and the agreed upon rate design should be adopted

Respectfully submitted,

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CERTIFICATE OF SERVICE

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