Before the

Tennessee Regulatory Authority

Docket No.: 04-00288

TENNESSEE-AMERICAN WATER COMPANY

Direct Testimony of

Jack Callaghan

In behalf of

Chattanooga Manufacturers Association

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Q. **Please state your name, business address and occupation.**

A. I am Jack Callaghan, Division President, of R. L. Stowe Mills, Inc. My business address is 1101 South Watkins Street, Chattanooga, Tennessee 37404.

Q. **What are your principal responsibilities as President of R. L. Stowe Mills, Inc.?**

A. I am principally responsible for the yarn dyeing and mercerizing divisions of R. L. Stowe Mills, Inc. I am in charge of establishing, setting and monitoring the operations and quality specifications for the production units and final product at our facility. I supervise all sales, marketing and production of the Chattanooga facility, as well as the managers and other personnel, and am directly responsible for our customers. I have significant knowledge of the effects of utility rates and other costs involved in our production processes.

Q. **Please outline your educational and professional training and experience.**

A. I was awarded a Bachelor of Arts degree from Rutgers University in 1966. I have also earned a Master's of Business Administration degree, in 1975, from Baldwin-Wallace College in Berea, Ohio. I have been at R. L. Stowe Mills since 1999 in my current capacity.

Q. **Have you previously submitted testimony for the Chattanooga Manufacturer's Association ("CMA") Intervention Group to this Authority?**

A. No; however, a representative of my Company presented testimony in last year's rate case.

Q. **What is the subject of your testimony?**

A. I will present information opposing the Tennessee-American Water Company's petition to again increase the water rates it charges customers.

Q. **Have you prepared any exhibits to accompany your testimony?**

A. No.

Q. **Does your company have a facility located in Hamilton County, Tennessee that utilizes water supplied by Tennessee-American Water Company (□TAWC□)?**

A. Yes. R. L. Stowe Mills has two facilities located in Hamilton County, Tennessee that employ over 450 people, both plants being inside the Chattanooga city limits. My company is in the business of mercerizing yarn and also in the business of applying color/dyes to natural yarn. R. L. Stowe Mills manufacturers and produces the colored yarn for the textile and apparel industries, and its customer base is primarily located in North America and Central America. The company□s facility on South Watkins Street in Chattanooga, Tennessee is arguably the most modern facility in the United States producing dyed yarn for resale.

Q. **Please describe your company□s use of water in its manufacturing and production processes in your Chattanooga plants.**

A. Water is a main component in the mercerizing and dyeing processes for yarn products. For example, the dyeing process requires our use of several gallons of water for every pound of yarn that is submitted to a series of processing steps in order to color natural yarn fibers for purposes of resale. In the mercerizing process, water is used to rinse the natural yarn both before and after mercerizing. Water is also used in our facilities to rinse/sanitize facilities, for drinking water and for employee lavatory purposes.

Q. **How much TAWC water is used in your Chattanooga production facilities?**

A. R. L. Stowe Mills utilizes approximately one million gallons per day at its current production levels. However, we have been operating at approximately 60% of our production capacity.

If production were to increase, our water usage would rise at least proportionately.

Q. **Does your company have an alternative supply for the production processes and other operations currently supplied by TAWC water?**

A. Yes, partially.

Q. **Please explain.**

B. R. L. Stowe Mills has a system of wells that have been installed at its facility. The company, and its predecessor, previously used blended water in some of its processes and production operations. Currently, well water or blended water is not being used. Blended water is not as efficient as a raw material because the level of "hardness" can vary and must be monitored. As the levels of hardness vary, recipes for dyes must be adjusted and the discrepancies are often times only noticed after a batch of off-quality product is produced, which requires us to re-dye that batch. I am not claiming it would be easy to reformulate recipes for dye colors, because the process of getting the right mix would be difficult and labor-intensive for the colors that our facility can produce, but reducing use of TAWC water becomes more economical as their water rates increase.

Q. **Are there adverse effects on your company that would be caused by switching over from TAWC water to well water or blended water, or from switching back and forth?**

A. Yes. As described previously, it would require the reformulation of recipes for dye colors. Also, we would anticipate that the level of off-quality product would increase.

Q. **Has your company demonstrated that it would consider utilizing its backup as a competitive alternative to TAWC water or otherwise invest in utilizing its well system?**

A. Yes. Our well system could be used again for at least 50% of the water necessary for our current production processes, and that amount might be increased after additional investigation. While it would require capital investment to utilize the well system again and also would require the modification of plant and procedures to implement the use of the well systems, our company's survival literally (not figuratively) is tied to the costs imposed upon us and our production processes.

Q. **Is there any material that could be used in the dye process or mercerizing process operations of R. L. Stowe Mills instead of water?**

A. No, there is no alternative.

Q. **Does R. L. Stowe Mills have the ability to bypass TAWC's water lines?**

A. Other than the well system described above, not to my knowledge.

Q. **Do you understand that the water company does not want you to reduce the amount of water usage, invest in a reduction technology, or implement capital improvements that will reduce the amount of TAWC water used in your production processes?**

A. Yes, that is my understanding. In fact, TAWC has visited our facility and inquired about the possibility to increase our TAWC water usage.

Q. **Describe the impacts on your facility or production processes that the Tennessee-American Water Company's proposed pricing will have if approved by the Tennessee Regulatory Authority.**

A. The impacts would be devastating. One must understand that the textile supply industry in the United States has not been operating as a monopoly (such as TAWC), and garnering a nearly 10% return over the past few years. Instead, the textile and apparel fiber supply

industry in which R. L. Stowe Mills is engaged has been fighting to stave off elimination imposed by increasing domestic costs and foreign competition. In 2005, trade barriers and quotas will be eliminated on a global basis, and we foresee significant usurpation of market share by artificially-priced Chinese imports. Some projections predict that the Chinese will overtake 50% or more of the textile and apparel market, domestically.

Q. **Had R. L. Stowe Mills specifically targeted any cost reductions as goals in its attempt to remain competitive?**

A. Yes, we had. There are three main costs (labor, water and power) in our manufacturing matrix. Since last year's rate case, R. L. Stowe Mills has been trying to reduce its water costs. The same was true when this petition was filed. Our goal was to reduce our water costs two-cents per pound of yarn processed; however, if the current petition is approved and when considering last year's rate increase as well, it appears that the cost per pound of yarn processed with TAWC water actually will rise.

Q. **If Tennessee-American Water Company's proposed price increase is implemented, would your Chattanooga facilities operate at a competitive disadvantage?**

A. Absolutely. In our industry, success or failure is gauged by looking at each penny per pound of yarn sold. As noted before, if the price increase is allowed as proposed, the variance in water costs alone will be dramatic. Frankly, our entire domestic industry is now selling yarn after production at similar price levels to the mid-1980's. The trend since the late- 1990's has been for the sales price of yarn after production to regress or retreat. It is a deflationary market that we are competing in from the United States' perspective, and we face competition from others that frankly do not appear to be recognizing costs as part of their

pricing structure (or they own the monopolies, such as water suppliers, integral to the industry). R. L. Stowe Mills, as a company, reflects the recent general trend in the United States for a zero percent (0%) profit margin in the textile industry. The Chattanooga facility has actually operated at a negative margin and, if unable to reverse that trend, either through cost control or increased sales - both of which are its target goals, is subject to being eliminated.

Q. **Anything else?**

A. Yes. R. L. Stowe Mills is proud of the Chattanooga facility, but must now seriously consider trying to reduce its water intake from TAWC 50% or more in order to remain operational. Scores of suppliers for the textile and apparel industries have been forced to close in the United States. As we noted just months ago, the situation simply is critical. Every penny per pound of yarn produced counts dramatically. Unfortunately, a pricing schedule that makes a textile firm in the United States uncompetitive would not result in jobs moving to another state's facility, it would result in the jobs simply being eliminated in this country. Of course, to the extent we allow that to occur, we will all suffer the adverse economic impacts that result.

Q. **Assuming that some rate increase is granted by the TRA to TAWC, how do you believe that increase should be allocated?**

A. Any increase, simply put, should result in the customer base causing the increase to pay its fair share for the provision of services to that type of customer. In today's business climate and for the companies that employ our citizens in jobs involving global market places, we cannot subsidize other customers.

Q. **How will the additional charges for fire protection services that are shifted to other customer classes from the municipalities affect your facility?**

A. That shift will simply compound the other issues described above. To the extent that the shifting of fire protection costs to customer classes is made, it should be made on a non-volumetric, per meter, basis (or a similarly equitable basis) so as not to unduly injure businesses and industry based upon the amount of water used in the daily production and operations of a facility. To try to allocate on a volumetric basis would be mixing apples and oranges when it comes to charges related to the fire protection, especially where most facilities (such as ours) already have privately-installed fire protection equipment.

Q. **Does this complete your testimony in this rate proceeding?**

A. Yes.

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