

**BEFORE THE TENNESSEE REGULATORY AUTHORITY  
NASHVILLE, TENNESSEE**

<b>IN RE:</b>	)	
	)	
<b>PETITION OF TENNESSEE AMERICAN WATER</b>	)	<b>DOCKET NO.</b>
<b>COMPANY TO CHANGE AND INCREASE CERTAIN</b>	)	<b>06-00290</b>
<b>RATES AND CHARGES SO AS TO PERMIT IT TO</b>	)	
<b>EARN FAIR AND ADEQUATE RATE OF RETURN</b>	)	
<b>ON ITS PROPERTY USED AND USEFUL IN FURNISHING</b>	)	
<b>WATER SERVICE TO ITS CUSTOMERS</b>	)	

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**THE CITY OF CHATTANOOGA'S MOTION TO COMPEL PETITIONER'S  
RESPONSE TO DISCOVERY REQUESTS**

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Intervenor, the City of Chattanooga ("Chattanooga"), by and through counsel, submits this Motion seeking an Order compelling the Petitioner, Tennessee American Water Company ("TAWC"), to respond fully to discovery requests submitted by Chattanooga.

The Authority's rules of procedure specify that discovery shall be sought and effectuated in accordance with the Tennessee Rules of Civil Procedure. Tenn.R.Civ.P., 26.02(1) specifies that parties may obtain discovery regarding any matter not privileged, which is relevant to the subject matter of the pending action. The Rule specifies that "it is not ground for objection that the information sought will be inadmissible at the trial if the information sought appears reasonably calculated to lead to the discovery of admissible evidence."

**I.**

**SUBJECT MATTER OF THIS PROCEEDING**

In this proceeding, the Petitioner seeks an extraordinary rate increase shortly before its German parent, RWE Aktiengesellschaft, seeks to sell its interest in TAWC and the other assets of American Water Works Company ("AWWC") through an initial public offering. The exit of RWE Aktiengesellschaft from the control of the water resources of Chattanooga will occur

barely five (5) years after the German company paid a premium to purchase AWWC and its operating companies, including TAWC. It follows several years of multi-billion dollar write-downs by RWE Aktiengesellschaft as that company acknowledged that it had vastly overstated the value on its books of TAWC and the other assets of AWWC. The exit by RWE Aktiengesellschaft follows intensive studies in which RWE Aktiengesellschaft's management and Board concluded that it could not expect more than a six percent (6%) rate of return, after tax, on its invested capital, even after it had written down the value of that investment by billions of dollars.

In this proceeding, Chattanooga seeks discovery to support testimony showing that TAWC has overstated the reasonable return that it is due on invested capital, that it has overstated the value of its capital expenditures, that management fees and costs and expenses are inflated and unjustified, and that excessive and often hidden fees being paid to TAWC parents and affiliates should be included in calculating the return on invested capital actually being charged to the ratepayers of Chattanooga.

## **II.**

### **TAWC'S UNJUSTIFIED GENERAL OBJECTIONS**

TAWC has, in its general objections, asserted that it is refusing to abide by definitions specified by Chattanooga. These include commonly accepted definitions of "Document" and "Communication" and definition of TAWC's "Parent and Affiliates". There is no legal basis for these objections, nor is any authority cited in support of TAWC's refusal to provide the requested information. Based upon these asserted objections, TAWC apparently has refused to provide information concerning other operating companies and concerning TAWC's parents and affiliated companies. A claim that TAWC cannot obtain the information sought is not credible.

### III.

#### TAWC'S UNJUSTIFIED REFUSAL TO ANSWER SPECIFIC QUESTIONS

TAWC has provided complete answers to virtually none of the 38 discovery requests propounded by Chattanooga. This Motion to Compel focuses on 25 of those requests, which fall into four categories of information critical to this proceeding. Each category of information is described, in turn, along with a description of the requests that are related to that category of information:

A. National Call Center Costs. In 2003, TAWC transferred its customer call functions to a national call center established by its parent or an affiliate company. TAWC has objected to requests concerning call center costs based on asserted burden and relevance. The relevance response is disingenuous. P. Baryenbrunch testifies in his prefiled testimony about the "reasonableness" of the charges for the call center on pages 2 (Q.5) and page 4 (Q.7). It appears from the response to Request No. 19 that TAWC is paying a parent or affiliate corporation almost \$900,000 per year for the operation of the call center. The Intervenor needs information about the cost of the call center not only to cross-examine Baryenbrunch, but also to evaluate whether to offer counter-testimony on this subject.

TAWC seeks to justify the very large sum that it is paying for this service by testimony claiming that the expense is comparable to the expense for certain customer service activities reported by investor-owned electric utilities in other states. The discovery submitted by Chattanooga seeks information concerning the actual cost of the call center services, which is the appropriate measure of the reasonableness of the amount paid for those services. The excess above the reasonable cost of call center services should be disallowed as an expense to be charged to Chattanooga ratepayers. Additionally, amounts already paid in excess of reasonable

costs should be accounted for as additional return to TAWC's parents, and the additional return should be considered in determining the allowable return during the test year.

Chattanooga requests that TAWC be compelled to provide answers to the following discovery requests relating to costs of call center activities:

- No. 1 (TAWC personnel costs of locally providing customer call services).
- No. 2 (changes in TAWC expense after customer call services were shifted to the call center).
- No. 13 (call center personnel cost information).

B. Capital Expenses. Chattanooga has propounded several requests that are designed to elicit more information on amounts reported as being expended for capital additions. These requests seek necessary information to determine the reasonableness of expenses incurred for capital additions and the proportion of the capital expenses that has, in fact, been paid to TAWC parents or affiliates. The information sought is relevant to the reasonableness of reported capital expenses, whether expenses reported directly related to capital assets used and useful, and whether a portion of the capital expenses constitute additional return to TAWC's shareholders.

The requests in question include:

- No. 11 (seeking justification for expenses incurred that were inconsistent with comprehensive planning studies).
- No. 14 (seeking a breakdown of the elements of the capital expenses).
- No. 15 (seeking identification of outside contractors that were involved in capital projects).
- No. 16 (seeking identification of the portion of reported capital expenses paid to any TAWC parent or affiliate and information concerning the nature of those payments).

- No. 20 (seeking information concerning the basis for the very large increase in the cost of connecting new customers reported by TAWC).

C. Management Fees. Data attached to the prefiled testimony of Mr. Baryenbrunch clearly shows that TAWC is overpaying for management services. Mr. Baryenbrunch reported in Schedule 1, page 1, that TAWC was paid \$3,580,292 for management services (which actually understates the directly identified management fees by more than \$500,000). He reported in Schedule 2, page 2, that the \$3,580,292 purchased 31,995 hours of "management services." Just this portion of the management fees and by TAWC could have financed 15 full-time equivalent employees, each of whom could have been paid \$162,900, plus thirty percent (30%) for fringe benefits.

TAWC's prefiled testimony provides inadequate cost justification for these management fees. Chattanooga's discovery requests are specifically designed to establish the details of management fees paid and the costs actually incurred by TAWC or the TAWC parent or affiliate providing the services. The requests also seek information relevant to the necessity of the services provided and the extent to which the excessive fees have increased the return received by TAWC's parents.

The Chattanooga discovery requests that relate to this subject are:

- No. 18 (seeking information about amounts paid by TAWC to any TAWC parent or affiliate for services, equipment, or materials).
- No. 19 (identification of the individuals providing services identified in No. 18, along with information about their hourly rate or salaries and descriptions of the services provided).

- No. 24 (requesting for the period since January 1, 2000, monthly and year-to-date budgets and analyses of actual expenses incurred. TAWC has provided this information only through years 2004 through 2006, which shows management fee payments consistently in excess of amounts budgeted, forcing reduction in other expenses).
- No. 30 (financial statements of TAWC parents or affiliates that have been paid any amount by TAWC. This information is important to track revenue being received by TAWC's shareholders, which may constitute excess return).
- No. 38 (seeking the cost basis for the automatic escalation of five percent (5%) per year in the management fee contract).

D. Effects of IPO. This extraordinarily large rate increase is being sought in the run-up to the sale by RWE Aktiengesellschaft of its interests in TAWC and the other assets of AWWC through an initial public offering. Chattanooga has propounded discovery requests dealing with the planned IPO. TAWC objects to several of these requests on the grounds of burden, broadness, relevance, attorney-client privilege, and work product privilege. It additionally objects to Request No. 9, asserting that the response might include information protected under federal securities laws dealing with the anticipated IPO. To the extent that the securities laws preclude divulging the information, TAWC should be required to respond more specifically as to what portions of the discovery request are subject to securities law anti-disclosure provisions.

The relevance of the IPO to this case cannot be disputed. TAWC in response to Request 34 says that in docket number 06-00119 it "provides assurances from TAWC, at paragraphs 45, 46, and 47, that the proposed transaction will not adversely impact the operations of TAWC nor will there be any material change to the financial position of TAWC." Chattanooga's discovery

requests are directed at testing the accuracy of TAWC's assertions. It is axiomatic that if the IPO has a material effect upon the financial condition of TAWC, then it will have a financial impact upon the rates that TAWC seeks to charge.

The direct testimony of Michael Miller, Q.16 and Q.17, page 4, further shows the direct relevance of this issue, as he attempts to explain the impact of the IPO on TAWC's debt. TAWC witness Michael J. Vilbert testifies extensively about the cost of capital and the cost of debt, both of which will be impacted by the IPO.

The overall financial health of affiliated companies will affect the quality, i.e., the cost of debt to be issued on behalf of TAWC. The payment of excessive dividends to a parent company is a common method of unjustly enriching the parent company with the impact ultimately borne by the ratepayers. These discovery requests about the IPO are all calculated to discover whether the cost of capital and cost of equity of TAWC are being adversely impacted by the IPO.

Questions are also designed to obtain information directly relevant to the accuracy and credibility of arguments made by TAWC and its witnesses. For example, RWE Aktiengesellschaft has written down its investment in TAWC and the other elements of AWWC's system by billions of dollars since 2002. Further, RWE Aktiengesellschaft concluded that a reasonable rate of return on those assets, even diminished by billions of dollars in write-downs, was no more than six percent (6%) after taxes. RWE Aktiengesellschaft's view of the value of TAWC and the other elements of the AWWC system is directly relevant to this proceeding, as are RWE Aktiengesellschaft's conclusions concerning what is a reasonable rate of return.

Chattanooga has propounded 12 questions that are designed to elicit information concerning the impact of the proposed sale by RWE Aktiengesellschaft of its stock, information directly relevant to this proceeding. These include:

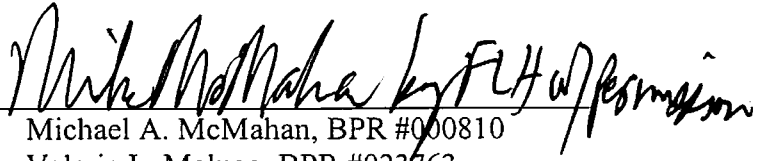
- No. 3 (seeking information concerning plans for or projections of rate increases by TAWC and other operating companies. Chattanooga is concerned that RWE Aktiengesellschaft has adopted a rate increase strategy that is not in the best interests of the ratepayers of Chattanooga in order to increase the IPO value, and send more money to Germany.)
- No. 4 (seeking information concerning the history of dividend payments by TAWC and other operating companies to TAWC parents and affiliates.)
- No. 5 (seeking information concerning debt ratings; TAWC has provided incomplete information that does not include information concerning TAWC parents and affiliates.)
- No. 7 (information concerning valuation of AWWC, which includes TAWC and other operating and affiliated companies.)
- No. 8 (seeking information concerning the write-offs taken by RWE Aktiengesellschaft or other TAWC parents or affiliates of investments in TAWC and the other elements of the AWWC system.)
- No. 9 (seeking information concerning the plans for the IPO and the effects it will have upon Chattanooga's ratepayers. It is anticipated that responsive documents will include discussion of plans to increase the revenue paid by TAWC and other operating companies to AWWC as part of efforts to increase the value of the IPO and send more money to RWE Aktiengesellschaft in Germany.)

- Nos. 26, 27 and 28 (seeking unredacted copies of records of the meeting of RWE Aktiengesellschaft's Supervisory Board on September 16, 2005, and other meetings of the Supervisory Board and the RWE Aktiengesellschaft's Presidium at which the acquisition or sale of AWWC was discussed. Chattanooga is in possession of a redacted copy of the minutes of the September 16, 2005, meeting, which contains discussions directly relevant to this proceeding, including admissions concerning reasonable rate of return and discussion of the failure of AWWC and its operating companies to make adequate investments in the integrity of their systems.)
- No. 32 (seeking information concerning the dividend policies of AWWC's operating companies. TAWC has refused to provide information concerning other operating companies policies, which are relevant to an evaluation of the reasonableness of the return sought by AWWC for TAWC.)
- No. 34 (seeking all documents relating to the impact of the IPO on the costs of operations of TAWC. It has already become apparent that one major impact will be to increase the cost of debt, as \$19 million in TAWC's 4.5% debt is replaced by debt with a higher cost. Other impacts of the IPO upon the costs of TAWC are critically important to this proceeding.)
- No. 36 (seeking the identification of all other AWWC operating companies that have applied for water rate increases since RWE Aktiengesellschaft made the decision to sell its interest in AWWC.)

Chattanooga respectfully requests that TAWC be compelled to respond to each of these requests fully. Chattanooga further requests that TAWC be required to state in writing by Monday, February 12, 2007, when each of its responses will be made available to Chattanooga.

Respectfully submitted,

CITY OF CHATTANOOGA, TENNESSEE  
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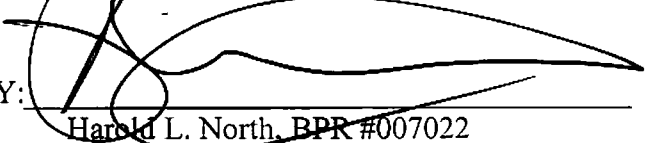
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## CERTIFICATE OF SERVICE

This is to certify that the undersigned has this day served a true and correct copy of the foregoing pleading by electronic mail and by depositing same in the United States mail, postage prepaid, and addressed to the following:

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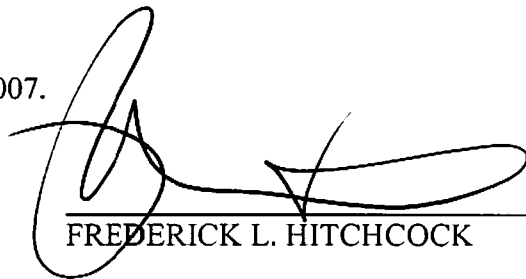
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This the 8th day of February, 2007.



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