

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

March 1, 2007

IN RE:

**PETITION OF TENNESSEE AMERICAN WATER
COMPANY TO CHANGE AND INCREASE CERTAIN
RATES AND CHARGES SO AS TO PERMIT IT TO
EARN A FAIR AND ADEQUATE RATE OF RETURN
ON ITS PROPERTY USED AND USEFUL IN FURNISHING
WATER SERVICE TO ITS CUSTOMERS**

)
)
)
)
)
)
)

**DOCKET NO.
06-00290**

**ORDER GRANTING MOTIONS TO COMPEL DISCOVERY RELATING TO
INITIAL PUBLIC OFFERING (IPO) INFORMATION AND MATERIALS**

This matter is before the Hearing Officer upon discovery objections filed by Tennessee American Water Company (“TAWC” or the “Company”) and motions to compel discovery filed by the Consumer Advocate and Protection Division of the Office of the Attorney General (“Consumer Advocate”), the City of Chattanooga (“Chattanooga”), and Chattanooga Manufacturers Association (“CMA”), as well as Chattanooga’s Supplemental Memorandum in Support of Motion to Compel and TAWC’s Response thereto. This Order specifically addresses the objections, motions and supplemental memorandum to compel discovery, seeking information and materials pertaining to the Initial Public Offering (“IPO”) referenced in the Company’s petition in Docket No. 06-00119. Other discovery objections raised by the Company and motions to compel relating thereto have been addressed in a separate Order issued on February 15, 2007.

RELEVANT PROCEDURAL HISTORY

On January 17, 2007, the Hearing Officer issued the *Order Granting Petitions to Intervene, Permitting Additional Discovery Requests and Establishing a Procedural Schedule* which set forth a schedule for propounding discovery requests, filing objections and motions to compel and setting status conferences for hearing discovery disputes. Pursuant to the procedural schedule for the first round of discovery, the Consumer Advocate and Chattanooga submitted discovery requests to the Company on January 22, 2007. CMA submitted its requests on January 23, 2007.

On February 6, 2007, the Company filed responses and objections to certain discovery and data requests submitted by the Consumer Advocate and Chattanooga. On February 8, 2007, the Company filed its responses and objections to CMA's discovery and data requests. The Consumer Advocate, Chattanooga and CMA filed motions to compel responses to discovery on February 8, 2007. In addition, following the February 9, 2007 status conference discussed below, Chattanooga filed its supplemental memorandum in support of its motion on February 12, 2007. TAWC filed its response to the supplemental memorandum on February 14, 2007.

FEBRUARY 9, 2007 STATUS CONFERENCE

On February 6, 2007, in accordance with the procedural schedule, the Hearing Officer issued a *Notice of Status Conference* setting a Status Conference for February 9, 2007 to hear and resolve discovery disputes. The Hearing Officer convened the Status Conference on that date with the following party representatives in attendance:

Tennessee American Water Company – R. Dale Grimes, Esq. and Ross I. Booher, Esq., Bass, Berry & Sims, PLC, 315 Deaderick Street, Suite 2700, Nashville, TN 37238-3001;

Consumer Advocate – Vance Broemel, Esq., Consumer Advocate and Protection Division of the Office of the Attorney General, Office of the Attorney General, 425 5th Ave. N, John Sevier Building, P.O. Box 20207, Nashville, TN 37243;

City of Chattanooga – Michael A. McMahan, Esq., Office of the City Attorney, 801 Broad Street, Suite 400, Chattanooga, TN 37402; Frederick L. Hitchcock, Esq., Chambliss, Bahner, & Stophel, P.C., 1000 Tallan Building, Two Union Square, Chattanooga, TN 37402; and

Chattanooga Manufacturers Association – Henry Walker, Esq., Boulton, Cummings, Conners & Berry, PLC, 1600 Division Street, Suite 700, Nashville, Tennessee 37203; David C. Higney, Esq., Grant, Konvalinka & Harrison, P.C., Ninth Floor, Republic Centre, 633 Chestnut Street, Chattanooga, Tennessee 37450-0900.

After convening the status conference, the Hearing Officer permitted the parties to meet in an attempt to resolve as many of the outstanding discovery issues as possible. Following a lengthy recess, the parties informed the Hearing Officer that while many of the discovery disputes had been resolved, a significant number of requests remained unresolved because of a disagreement regarding the discoverability of information and materials relating to the anticipated IPO. After addressing the discovery objections that were resolved by mutual agreement, the Hearing Officer heard oral arguments from the parties regarding the motions to compel discovery relating to the IPO.

DISCOVERY REQUESTS AND OBJECTIONS RELATED TO THE IPO

I. CITY OF CHATTANOOGA REQUEST NOS. 3, 5, 7, 8, 9, 26, 27, 28, 34, and 36

During the February 9, 2007 Status Conference, Chattanooga and TAWC met regarding the objections to Chattanooga's discovery requests. After the meeting, ten of twelve discovery requests relating to the IPO remained unresolved. In its Motion to Compel, Chattanooga argues that

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.¹

¹ *The City of Chattanooga's Motion to Compel Petitioner's Response to Discovery Requests*, p. 1 (February 8, 2007).

Chattanooga states that these questions “are designed to elicit information concerning the impact of the proposed sale by RWE Aktiengesellschaft of its stock, information directly relevant to this proceeding.”² Chattanooga seeks responses to the following requests:³

No. 3 – “seeking information concerning plans for or projections of rate increases by TAWC and other operating companies.”

No. 5 – “seeking information concerning debt ratings.” (Chattanooga argues that TAWC’s response is incomplete information because it does not include information concerning TAWC parents and affiliates.)

No. 7 – “seeking 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.”

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.”

No. 34 – “seeking all documents relating to the impact of the IPO on the costs of operations of TAWC.”

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.”

TAWC objects to the above referenced requests in general on the grounds that they are overbroad, unduly burdensome, not relevant to this proceeding nor reasonably calculated to lead to the discovery of admissible evidence, and violate attorney-client privilege and the work product doctrine. Specifically as to Request No. 9, TAWC asserts that a response may include

² *Id.* at 8.

³ *Id.* at 8-9.

information protected under federal securities laws. TAWC further argues the action of the Authority in TRA Docket No. 06-00119 resolved all issues relating to the IPO, and therefore, the IPO has no relevance to the instant rate case.

Additionally, TAWC contends that valuations, comments or conclusions of RWE Aktiengesellschaft (“RWE”), the ultimate parent company of TAWC, concerning American Water Works Company (“AWWC”), the direct parent of TAWC, have no bearing on or relevance to the rate case filed by TAWC. TAWC argues that because the TRA regulates TAWC and sets rates based on the original cost of rate base, not on value, the opinions or conclusions of RWE on those issues have no relevance in this docket. TAWC asserts that the structure of the anticipated IPO has no relevance except as to the capital structure of AWWC at the time of the IPO and, on that point, TAWC agrees to provide a projected pro forma capital structure of AWWC in conjunction with a protective order specifically addressing the highly confidential nature of such a document and information.⁴ TAWC further states that RWE has committed to make its subsidiaries, including TAWC, whole for any increase in interest rates on notes held by RWE that are called before maturity prior to the IPO. TAWC argues that this commitment made by RWE should satisfy any outstanding concerns of the parties related to any potential effect the IPO may have on TAWC ratepayers.

Chattanooga responds to TAWC’s objections by categorizing its questions related to the possible impact or effects of the IPO on these issues into the following three sections: 1) RWE analysis and valuation of AWWC and its subsidiaries; 2) planned changes in the operations and finances of the subsidiaries of AWWC; and 3) the structure of the IPO itself as a vehicle to

⁴ The Company was directed at the February 9, 2007 Status Conference to submit a proposed supplemental protective order governing the production of such highly confidential information and circulate among the parties for comment and agreement. The Company first circulated a proposed second protective order on or about February 12, 2007 to which the Intervenor would not agree. The Company then filed its proposed protective order on February 16, 2007, after which the Intervenor filed objections. The Hearing Officer is entering a Supplemental Protective Order at the same time as this order.

maximize the return on sale to RWE. Chattanooga counters TAWC's objections by asserting that the discovery requests related to the IPO are reasonably calculated to discover whether the cost of capital and cost of equity of TAWC are being adversely affected or impacted by the IPO. Further, Chattanooga's questions are designed to obtain information directly relevant to the accuracy and credibility of arguments made by TAWC and its witnesses. Chattanooga contends that RWE's view of the value of TAWC, and other elements of the AWWC system, as well as RWE's conclusions regarding rates of return, are relevant to the subject matter of this proceeding because RWE is the ultimate parent of TAWC and its opinions may affect its subsidiary.

II. CONSUMER ADVOCATE REQUEST NOS. 5, 6, 7, AND 8

The Consumer Advocate initially points out in its Motion that in TRA Docket No. 06-00119 the Tennessee Regulatory Authority approved TAWC's petition for a change of control. TAWC represented in its petition filed on April 21, 2006 in that docket, "The Proposed Transaction will not impair the ability of the Petitioner to maintain a reasonable capital structure that is representative of other utilities."⁵ The Consumer Advocate states that its discovery requests are connected to the approval of TAWC's petition in Docket No. 06-00119 which referenced the merger of Thames Water Aqua US Holdings, Inc. ("TWAUSHI") and American Water Works Company, Inc. ("AWWC") by way of the IPO, leaving AWWC as the surviving company, and which included a description of "the marketing effort" for the IPO. Part III of the Consumer Advocate's discovery requests production as outlined below:

In Request No. 5, the Consumer Advocate seeks a copy of any related registration statement filed with the Securities and Exchange Commission (5(a)); information regarding the identity and selection of attorneys, underwriters and accounting firm(s) handling the IPO (5(b),

⁵ *Consumer Advocate's Response to Tennessee American Water Company's Objections to First Discovery Request of the Consumer Advocate and Motion to Compel*, p. 20 (February 8, 2007) (quoting Petition of TAWC in Docket No. 06-00119 at p. 8 (April 21, 2006)).

5(c), and 5(d)); and a copy of those portions of the underwriting agreement which identify the underwriters' discounts and fees and which identify the underwriters' Over-Allotment option (5(e)).

In Request No. 6, the Consumer Advocate seeks copies of appraisals and reports in the possession of TWAUSHI or AWWC, or RWE, or the Thames Water Aqua Holdings, or the underwriters, containing estimates of the fair value of the merged company's stock at any point in time from the day of the offering through December 31, 2010. The Consumer Advocate also requests copies of the following: portions of proposed Charter or Bylaws addressing AWWC's capitalization (6(a)); written communications between the underwriters and TWAUSHI or AWWC, or RWE, or the Thames Water Aqua Holdings which request or discuss AWWC's future revenues or AWWC's future stock stockprices (6(b)); written communications between the underwriters and investors or potential investors in AWWC (6(c)); and written communications which discuss stock grants, bonuses, and option grants to AWW's employees or officers (6(d)).

Under Request No. 7, the Consumer Advocate asks for appraisals and reports or other written communication in the possession of TWAUSHI or AWWC, or RWE, or the Thames Water Aqua Holdings, or underwriters, accountants or legal firm containing estimates of expected gross proceeds from the IPO (7(a)); underwriter's portion of gross proceeds (7(b)); and portion of expected gross proceeds which will flow to AWWC (7(c)).

Request No. 8 seeks production of appraisals and reports or other written communication in the possession of TWAUSHI or AWWC, or RWE, or the Thames Water Aqua Holdings, or underwriters, accountants or legal firm containing estimates of the book value of equity which

AWWC will hold 31 days after the IPO is completed (8(a)); and the book value of debt which AWWC will bear 31 days after the IPO is completed (8(b)).

TAWC objects to these requests on the grounds that they are overbroad, unduly burdensome, seek work product, are protected by the attorney-client privilege and are not relevant to this proceeding nor reasonably calculated to lead to the discovery of admissible evidence. TAWC asserts that the requests seek documents and information of a highly sensitive and confidential nature, the production of which may implicate potential violation of federal securities laws. Further, such documentation is not adequately protected by the Protective Order entered in this docket. The arguments of TAWC relating to the relevance of the IPO in this docket are the same as those asserted in opposition to Chattanooga's Motion to Compel.

The Consumer Advocate's counter-arguments incorporate the arguments put forth by Chattanooga, focusing on the assertion that the information it seeks is relevant to the subject matter of this proceeding and that its requests are reasonably calculated to lead to the discovery of admissible evidence. The Consumer Advocate specifically argues that such information is relevant to a rate case proceeding under Tennessee law and relies on the Tennessee Supreme Court case of *Tennessee Public Service Commission v. Nashville Gas Company*,⁶ stating,

the Tennessee Supreme Court held that it was proper for the PSC to look into the transactions between a parent and its subsidiary in a rate case because these transactions were necessary in determining "the proper rate base and rate structure of the [regulated] subsidiary."⁷

In addition to the arguments regarding the production of specific information and documentation relating to the IPO, it is the position of the Intervenors, particularly CMA, that if such information is not produced then perhaps TAWC's petition in this docket should be withdrawn and refiled after the IPO is completed.

⁶ 551 S.W.2d 315, 321 (Tenn. 1977).

⁷ *Id.*

FINDINGS AND CONCLUSIONS

Pursuant to Authority Rule 1220-1-2-.11, when informal discovery is not practicable, discovery shall be effectuated in accordance with the Tennessee Rules of Civil Procedure. The Rules of Civil Procedure permit discovery through oral or written depositions, written interrogatories, production of documents or things, and requests for admission.⁸ Through these instruments, a party “may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter involved in the pending action, whether it relates to the claim or defense of the party seeking discovery or to the claim or defense of any other party.”⁹ The information sought need not be admissible if it is reasonably calculated to lead to admissible evidence.¹⁰ The Tennessee Court of Appeals has commented on relevancy as follows:

Relevancy is extremely important at the discovery stage. However, it is more loosely construed during discovery than it is at trial. The phrase “relevant to the subject matter involved in the pending action” has been construed “broadly to encompass any matter that bears on or that reasonably could lead to other matter that could bear on, any issue that is or may be in the case.”¹¹

Further, parties may seek to learn of information related to books, documents or other tangible items as well as the identity and location of individuals with knowledge of a discoverable matter.¹² Nevertheless, Tennessee’s rules governing discovery do provide some limitations and protections. Rule 26.02 of the Rules of Civil Procedure permits a court to limit discovery under certain circumstances, such as undue burden. Rule 26.03 permits a court to issue protective orders as justice requires.¹³ In *Duncan v. Duncan*, the Tennessee Court of Appeals held that:

⁸ Tenn. R. Civ. P. 26.01.

⁹ *Id.* at 26.02(1).

¹⁰ *Id.*

¹¹ *Boyd v. Comdata Network, Inc.*, 88 S.W.3d 203, 220 n.25 (Tenn. Ct. App. 2002) (citations omitted) (quoting *Oppenheimer Fund, Inc. v. Sanders*, 437 U.S. 340, 351, 98 S.Ct. 2380, 2389, 57 L.Ed.2d 253 (1978)).

¹² Tenn. R. Civ. P. 26.02(1).

¹³ *Id.* at 26.02 & .03.

A trial court should balance the competing interests and hardships involved when asked to limit discovery and should consider whether less burdensome means for acquiring the requested information are available. If the court decides to limit discovery, the reasonableness of its order will depend on the character of the information being sought, the issues involved, and the procedural posture of the case (citations omitted).¹⁴

While Rule 37.01(2) permits a party to file a motion to compel if a party fails to answer an interrogatory, including providing an evasive or incomplete answer, “[d]ecisions to grant a motion to compel rest in the trial court’s reasonable discretion.”¹⁵

The Authority’s approval of the change of control in Docket No. 06-00119, which is expected to occur with the IPO, was based, in part, on the following representations of TAWC in that docket:

The Proposed Transaction will not adversely impact the Petitioner’s rates or its policies with respect to service to customers, employees, operations, financing, or other matters affecting the public interest or utility operations. The Petitioners will continue to operate under its existing tariffs and rates. The transition to a publicly-traded company will similarly not adversely impact current investment and capital programs.¹⁶

The Company is completely within its rights to petition this Authority for an increase in rates notwithstanding other financial transactions it or its parent may be contemplating. Nevertheless, information concerning transactions occurring at the parent level or between a parent and its subsidiary may be relevant to the subject matter of a rate case proceeding. This is particularly true when a subsidiary’s capital structure is potentially impacted by decisions of the parent.¹⁷ For these reasons, the Hearing Officer finds, as relevant and reasonable, discovery of information and documentation relating to whether and to what extent the anticipated IPO of TAWC’s parent

¹⁴ *Duncan v. Duncan*, 789 S.W.2d 557, 561 (Tenn. Ct. App. 1990).

¹⁵ *Kuehne & Nagel, Inc. v. Preston, Skahan & Smith International, Inc.*, 2002 WL 1389615, *5 n.4 (Tenn. Ct. App. June 27, 2002).

¹⁶ *Petition of TAWC for Approval of Change of Control*, Docket No. 06-00119, p. 14, ¶45.

¹⁷ See, *Tennessee Public Serv. Comm. v. Nashville Gas Co.*, 551 S.W.2d 315 (Tenn. 1977) (operations and revenues of parent corporation were a proper and relevant consideration for Commission in fixing reasonable rates for subsidiary).

company may impact or affect the Company's rates, policies, service, operations, financing, and other matters affecting the public interest.

Additionally, as TAWC agreed at the regularly scheduled Authority Conference held February 5, 2007, in Docket No. 06-00305,¹⁸ the issues raised in that docket may be related to the subject matter of the rate case in this docket.¹⁹ Likewise, information and materials related to the anticipated IPO of the parent company of TAWC, which may also be related to the subject matter of this docket, should be discoverable. As provided in Rule 26.02(1) of the Rules of Civil Procedure,

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.²⁰

Discovery seeking information regarding matters, not privileged, which is relevant to the subject matter involved in the pending action, and which is reasonably calculated to lead to admissible evidence, must be permitted.

Nevertheless, the Hearing Officer finds that the requests for information pertaining to the IPO must not be overly broad or unduly burdensome, and therefore, such requests should be tailored narrowly to elicit specific discoverable information, as set forth herein. Additionally, in providing responses or making the requested information available for inspection, any assertions of attorney-client privilege or work product privilege should be raised with specificity as to the particular information which is claimed to fall within those privileges. The production of confidential information will be in accordance with the Protective Order entered on January 19,

¹⁸ *In re Petition of TAWC for Approval of and Authority to Borrow up to \$44,900,000*, Docket No. 06-00305.

¹⁹ See, Transcript of Authority Conference, February 5, 2007, pp. 58-61.

²⁰ *Consumer Advocate's Response to Tennessee American Water Company's Objections to First Discovery Request of the Consumer Advocate and Motion to Compel*, p. 2 (February 8, 2007).

2007 and/or the Supplemental Protective Order to be issued contemporaneously with this Order by the Hearing Officer.

THEREFORE IT IS ORDERED THAT:

1. As to the City of Chattanooga's discovery Request Nos. 3, 5, 7, 8, and 9, Tennessee American Water Company shall provide information and/or documents responsive to these requests; however, such responses shall be limited to documents reflecting, recording, referring to, reporting, or relating to TAWC and any parent of TAWC. In addition to the above, as to Request No. 9 specifically, such responsive documents shall be limited to that which is in the possession of TAWC and any parent of TAWC. To the extent that the Company asserts attorney-client privilege or work product privilege as to this information, such assertions must be made with specificity.

2. As to the City of Chattanooga's discovery Request Nos. 26, 27, and 28, Tennessee American Water Company shall provide unredacted copies of the transcripts referenced in these requests, and if available, shall make available for inspection or copying any audio or video recordings of same. To the extent that the Company asserts attorney-client privilege or work product privilege as to this information, such assertions must be made with specificity.

3. As to the City of Chattanooga's discovery Request No. 34, Tennessee American Water Company shall make available for inspection and copying the documents responsive to this request. To the extent that the Company asserts attorney-client privilege or work product privilege as to this information, such assertions must be made with specificity.

4. As to the City of Chattanooga's discovery Request No. 36, Tennessee American Water Company is not required to respond to this request as it does not involve TAWC or any of its parent companies.

5. As to the Consumer Advocate's discovery Request No. 5, including subparts thereof, Tennessee American Water Company shall respond and provide supplemental information that may be or become available as requested in 5(a) and 5(e), but is not required to respond to questions 5(b), 5(c), or 5(d). To the extent that the Company asserts attorney-client privilege or work product privilege as to this information, such assertions must be made with specificity.


6. As to the Consumer Advocate's discovery Request No. 6, including subparts thereof, Tennessee American Water Company shall respond and provide supplemental information that may be or become available as requested in 6, 6(a) and 6(b), limited to that which is in the possession of TAWC and any parent of TAWC, but is not required to respond to questions 6(c) or 6(d). To the extent that the Company asserts attorney-client privilege or work product privilege as to this information, such assertions must be made with specificity.

7. As to the Consumer Advocate's discovery Request No. 7, including subparts thereof, Tennessee American Water Company shall respond and provide supplemental information that is or may become available as requested in 7(a) and 7(c), limited to that which is in the possession of TAWC and any parent of TAWC, but is not required to respond to question 7(b) as it is repetitive and such information may be obtained from the responses of Tennessee American Water Company as directed in this Order. To the extent that the Company asserts attorney-client privilege or work product privilege as to this information, such assertions must be made with specificity.

8. As to the Consumer Advocate's discovery Request No. 8, including subparts thereof, Tennessee American Water Company has agreed to provide a pro forma capital structure of AWWC at the time of the IPO, under the safeguard of a protective order, and production of

such information shall constitute a response to questions 8(a) and 8(b). To the extent that the Company asserts attorney-client privilege or work product privilege as to this information, such assertions must be made with specificity.

9. Tennessee American Water Company shall provide the information or documentation as set forth herein within seven days of the date of this Order.


J. Richard Collier, Hearing Officer