

IN THE TENNESSEE REGULATORY AUTHORITY  
NASHVILLE, TENNESSEE

RECEIVED  
2007 MAR 23 11:11:06

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 )

T.R.A. DOCKET ROOM

DOCKET NO. 06-00290

**CONSUMER ADVOCATE AND PROTECTION DIVISION'S OBJECTIONS  
AND RESPONSES TO TENNESSEE AMERICAN WATER COMPANY'S  
DISCOVERY REQUESTS TO CONSUMER ADVOCATE AND PROTECTION  
DIVISION OF THE ATTORNEY GENERAL FOR THE STATE OF  
TENNESSEE**

The Office of the Tennessee Attorney General, by and through the Consumer Advocate and Protection Division, hereby submits its responses to Tennessee American Water Company's Discovery Requests to Consumer Advocate and Protection Division of the Attorney General for the State of Tennessee.

**I. GENERAL OBJECTIONS**

A. The Consumer Advocate objects to the definitions and instructions contained in the data requests to the extent that the definitions and instructions attempt to impose on the Consumer Advocate a burden or obligation greater than that required by the *Tennessee Rules of Civil Procedure* and applicable statutes and regulations governing contested case hearings.

B. The Consumer Advocate objects to the data requests to the extent they call for information and the production of documents which are protected from disclosure by the attorney-client privilege, the common interest privilege, the work product doctrine or any other applicable privilege or protection. In particular, the Consumer Advocate objects to requests

seeking its legal research related to pertinent statutes, rules, orders and case law. The Consumer Advocate objects to the data requests to the extent that the Company is attempting to impose on the Consumer Advocate obligations with regard to identification of privileged documents beyond those required by the *Tennessee Rules of Civil Procedure* and applicable statutes and regulations governing contested case hearings.

C. The Consumer Advocate objects to the Company's data requests to the extent they seek information relating to matters not at issue in this litigation or to the extent they are not reasonably calculated to lead to the discovery of admissible evidence. By providing information in response to these requests, the Consumer Advocate does not concede that such information is relevant, material or admissible in evidence. The Consumer Advocate reserves all rights to object to the use of such information as evidence.

D. The Consumer Advocate objects to the Company's data requests to the extent that the Company is attempting to require the Consumer Advocate to provide information and produce documents beyond those in its possession, custody or control as that phrase is used in the *Tennessee Rules of Civil Procedure* and applicable statutes and regulations governing contested case hearings.

E. The Consumer Advocate objects to the Company's data requests to the extent they seek information and documents that are readily available through public sources or are in the Company's own possession, custody or control. It is unduly burdensome and oppressive to require the Consumer Advocate to respond or produce documents that are equally available to the Company.

F. The Consumer Advocate's objections and responses to these requests are based on information now known to it. The Consumer Advocate reserves the right to amend, modify or supplement its objections and responses if it learns of new information.

G. The Consumer Advocate's objections and responses to these requests are made without waiving or intending to waive the right to object to the use of any information provided in this response in any subsequent proceeding or trial of this or any other action. The Consumer Advocate's responses to these requests are also not a waiver of any of the foregoing objections or any objections it has made or may make with respect to any similar, related, or future data request, and the Consumer Advocate specifically reserves the right to interpose any objection to further requests notwithstanding any response or lack of objection made in this response.

H. The Consumer Advocate objects to any request seeking all documents reviewed by its witnesses over an undefined time period. Such a request is ambiguous, overly broad, burdensome and is not likely to lead to the discovery of admissible evidence.

I. The Consumer Advocate expressly incorporates these general objections into its objections and responses to discovery in this matter.

## **II. RESPONSES BY REQUEST NUMBER**

### **DISCOVERY REQUEST NO. 1:**

State each fact that you rely on to support your contention(s), position(s) or belief(s) that any of the request(s) for relief, including any increase in rates, made by TAWC in TRA Docket No. 06-00290 should not be approved by the Tennessee Regulatory Authority ("TRA").

### **OBJECTION AND RESPONSE NO. 1:**

The Consumer Advocate objects to this request on the grounds that it is overly broad,

unduly burdensome, and unlikely to lead to the discovery of admissible evidence. Furthermore, this request may seek the production of documents that are protected by the Work Product Doctrine.

The overall breadth of the request constitutes an undue burden upon the Consumer Advocate. The Consumer Advocate does not track or maintain copies of all documents that its witnesses create or review in connection with this matter. Additionally, this request may encompass documents created or assembled by or on behalf of the Consumer Advocate's attorneys in anticipation of litigation, which are protected from disclosure under the Work Product Doctrine. Tenn. R. Civ. P. 26.02(3).

Consistent with these objections and the General Objections, and without waiving them, the Consumer Advocate responds to this request as follows:

The facts relied upon by the Consumer Advocate in opposing the rate increase proposed by Tennessee American are set forth in the testimony (and attachments and exhibits) of Consumer Advocate witnesses Mike Chrysler, Terry Buckner, and Dr. Steve Brown; the Consumer Advocate is also including in this response additional materials reviewed or considered by its witnesses in preparing their testimony but not necessarily referred to in it. In addition, the Consumer Advocate relies on the testimony, discovery responses and filings of the other parties in this case.

Due to the procedural schedule in this case, the Consumer Advocate anticipates receiving additional information when Tennessee American responds to the discovery requests of the Consumer Advocate on March 30, 2007. This information will be used and relied upon by the Consumer Advocate in its case and may lead to additional testimony by the Consumer Advocate

witnesses, either oral or written.

**DISCOVERY REQUEST NO. 2:**

Identify all persons known to you, your attorney, or other agent who have knowledge, information or possess any document(s) or claim to have knowledge, information or possess any document(s) which support your answer to Interrogatory number one (1) above.

**OBJECTION AND RESPONSE NO. 2:**

The Consumer Advocate objects to this request on the grounds that it is overly broad, unduly burdensome, and unlikely to lead to the discovery of admissible evidence. Furthermore, this request may seek the production of documents that are protected by the Work Product Doctrine.

The overall breadth of the request constitutes an undue burden upon the Consumer Advocate. The Consumer Advocate does not track or maintain copies of all documents that its witnesses create or review in connection with this matter. Additionally, this request may encompass documents created or assembled by or on behalf of the Consumer Advocate's attorneys in anticipation of litigation, which are protected from disclosure under the Work Product Doctrine. Tenn. R. Civ. P. 26.02(3).

Consistent with these objections and the General Objections, and without waiving them, the Consumer Advocate responds as follows to this request:

See Response to Request No. 1.

**DISCOVERY REQUEST NO. 3:**

Identify each document, photograph, or any other article or thing whatsoever, which you rely on to corroborate any part of your contention(s), position(s) or belief(s) that any of the

request(s) for relief, including any increase in rates, made by TAWC in TRA Docket No. 06-00290 should not be approved, whether as to the issues of credibility or any other issue, or which is adverse to these same contention(s), position(s) or belief(s).

**OBJECTION AND RESPONSE NO. 3:**

The Consumer Advocate objects to this request on the grounds that it is overly broad, unduly burdensome, and unlikely to lead to the discovery of admissible evidence. Furthermore, this request may seek the production of documents that are protected by the Work Product Doctrine.

The overall breadth of the request constitutes an undue burden upon the Consumer Advocate. The Consumer Advocate does not track or maintain copies of all documents that its witnesses create or review in connection with this matter. Additionally, this request may encompass documents created or assembled by or on behalf of the Consumer Advocate's attorneys in anticipation of litigation, which are protected from disclosure under the Work Product Doctrine. Tenn. R. Civ. P. 26.02(3).

Consistent with these objections and the General Objections, and without waiving them, the Consumer Advocate responds as follows to this request:

See Response to Request No. 1. In addition, CAPD will provide a disc which contains additional material they reviewed or created; hard copies are also being provided.

**DISCOVERY REQUEST NO. 4:**

With respect to each person you expect to call as a witness, including any expert witness, regarding this matter, state or provide:

- a. the witness's full name and work address;

**RESPONSE NO. 4(a):**

The Consumer Advocate's witnesses are: Mike Chrysler; Terry Buckner; and Dr. Steve Brown. The work address for all three witnesses is: Tennessee Attorney General's Office, 425 Fifth Avenue, North, Nashville, Tennessee 37243-0491.

- b. each subject matter about which such witness is expected to testify;

**OBJECTION AND RESPONSE NO. 4(b):**

See Objection and Response to Request No. 1. The requested material is included in the testimony.

- c. the substance of the facts and opinions to which any expert is expected to testify;

**OBJECTION AND RESPONSE NO. 4(c):**

See Objection and Response to Request No. 1. The requested material is included in the testimony.

- d. a summary of the grounds or basis of each opinion to which any such expert witness is expected to testify;

**OBJECTION AND RESPONSE NO. 4(d):**

See Objection and Response to Request No. 1. The requested material is included in the testimony.

- e. whether or not the expert has prepared a report, letter or memorandum of his findings, conclusions, or opinions;

**OBJECTION AND RESPONSE NO. 4(e):**

See Objection and Response to Request No. 1. The requested material is included in the testimony.

- f. the witness's complete background information, including current employer, educational, professional and employment history, and qualifications within the field in which the witness is expected to testify, and identify all publications written or presentations made in whole or in part by the witness;

**OBJECTION AND RESPONSE NO. 4(f):**

See Objection and Response to Request No. 1. The requested material is included in the testimony.

- g. an identification of any matter in which the expert has testified (through deposition or otherwise) by specifying the name, docket number and forum of each case, the dates of the prior testimony and the subject of the prior testimony, and identify the transcripts of any such testimony;

**OBJECTION AND RESPONSE NO. 4(g):**

The witnesses have testified in the following recent cases at the TRA: 1) Mike Chrysler: see testimony and the attached Revised Appendix A; 2) Terry Buckner: Docket No. 06-00175 Chattanooga Gas Company; Docket No.05-00258 Atmos Energy Corporation; Docket No.04-00288 Tennessee American Water Company; Docket No.03-00391 BellSouth, Citizens, and United Southeast and Docket No.02-00383 Chattanooga Gas Company; and 3) Dr. Steve Brown, see attached Response Attachment to 4(g).

- h. the identity of any person with whom the witness consulted or otherwise communicated in connection with his expected testimony;

**OBJECTION AND RESPONSE NO. 4(h):**

See Objection and Response to Request No. 1. The witnesses have communicated with the attorneys and staff of the Attorney General and certain employees of Tennessee American, including Mike Miller.

- i. the terms of the retention or engagement of each expert including but not limited to the terms of any retention or engagement letters or agreements relating to his/her engagement, testimony, and opinions as well as the compensation to be paid for the testimony and opinions;

**OBJECTION AND RESPONSE NO. 4(i):**

The witnesses are employees of the Attorney General.

- j. the identity of all documents or things shown to, delivered to, received from, relied upon, or prepared by any expert witness, which are related to the witness' expected testimony in this case, whether or not such documents are supportive of such testimony, including without limitation all documents or things provided to that expert for review in connection with testimony and opinions; and

**OBJECTION AND RESPONSE NO. 4(j):**

See Objection and Response to Request No. 1.

- k. the identity of any exhibits to be used as a summary of or support for the testimony or opinions provided by the expert.

**OBJECTION AND RESPONSE NO. 4(k):**

See Objection and Response to Request No. 1. In addition, exhibits for use at trial may be prepared by the witnesses at some point in the future but no decision has been made about this.

**DISCOVERY REQUEST NO. 5:**

Provide any and all documents identified or specified in your answers or responses to discovery requests served upon you in this matter.

**OBJECTION AND RESPONSE NO. 5:**

The Consumer Advocate objects to this request on the grounds that it is overly broad,

unduly burdensome, and unlikely to lead to the discovery of admissible evidence. Furthermore, this request may seek the production of documents that are protected by the Work Product Doctrine.

The overall breadth of the request constitutes an undue burden upon the Consumer Advocate. The Consumer Advocate does not track or maintain copies of all documents that its witnesses create or review in connection with this matter. Additionally, this request may encompass documents created or assembled by or on behalf of the Consumer Advocate's attorneys in anticipation of litigation, which are protected from disclosure under the Work Product Doctrine. Tenn. R. Civ. P. 26.02(3).

Consistent with these objections and the General Objections, and without waiving them, the Consumer Advocate responds as follows to this request:

See Response to Request No. 1.

**DISCOVERY REQUEST NO. 6:**

Provide any and all documents and things relied upon by any CAPD witness in providing testimony in this matter.

**OBJECTION AND RESPONSE NO. 6:**

The Consumer Advocate objects to this request on the grounds that it is overly broad, unduly burdensome, and unlikely to lead to the discovery of admissible evidence. Furthermore, this request may seek the production of documents that are protected by the Work Product Doctrine.

The overall breadth of the request constitutes an undue burden upon the Consumer Advocate. The Consumer Advocate does not track or maintain copies of all documents that its

witnesses create or review in connection with this matter. Additionally, this request may encompass documents created or assembled by or on behalf of the Consumer Advocate's attorneys in anticipation of litigation, which are protected from disclosure under the Work Product Doctrine. Tenn. R. Civ. P. 26.02(3).

Consistent with these objections and the General Objections, and without waiving them, the Consumer Advocate responds as follows to this request:

See Response to Request No. 1.

**DISCOVERY REQUEST NO. 7:**

Provide any and all expert reports which have been obtained from any expert.

**OBJECTION AND RESPONSE NO. 7:**

The Consumer Advocate objects to this request on the grounds that it is overly broad, unduly burdensome, and unlikely to lead to the discovery of admissible evidence. Furthermore, this request may seek the production of documents that are protected by the Work Product Doctrine.

The overall breadth of the request constitutes an undue burden upon the Consumer Advocate. The Consumer Advocate does not track or maintain copies of all documents that its witnesses create or review in connection with this matter. Additionally, this request may encompass documents created or assembled by or on behalf of the Consumer Advocate's attorneys in anticipation of litigation, which are protected from disclosure under the Work Product Doctrine. Tenn. R. Civ. P. 26.02(3).

Consistent with these objections and the General Objections, and without waiving them, the Consumer Advocate has received no expert reports but has set forth its positions in

opposition to the proposed rate increase in the testimony of its witnesses.

**DISCOVERY REQUEST NO. 8:**

Provide each document, photograph, or any other article or thing whatsoever, upon which you rely in support of your contention(s), position(s) or belief(s) that any of the request(s) for relief, including any increase in rates, made by TAWC in TRA Docket No. 06-00290 should not be approved.

**OBJECTION AND RESPONSE NO. 8:**

The Consumer Advocate objects to this request on the grounds that it is overly broad, unduly burdensome, and unlikely to lead to the discovery of admissible evidence. Furthermore, this request may seek the production of documents that are protected by the Work Product Doctrine.

The overall breadth of the request constitutes an undue burden upon the Consumer Advocate. The Consumer Advocate does not track or maintain copies of all documents that its witnesses create or review in connection with this matter. Additionally, this request may encompass documents created or assembled by or on behalf of the Consumer Advocate's attorneys in anticipation of litigation, which are protected from disclosure under the Work Product Doctrine. Tenn. R. Civ. P. 26.02(3).

Consistent with these objections and the General Objections, and without waiving them, the Consumer Advocate responds to this request as follows:

See Response to Request No. 1.

**DISCOVERY REQUEST NO. 9:**

Provide in electronic media (Word, Excel, or other Microsoft Office compatible format)

and in hard copy all workpapers and other documents, generated by or relied upon by all CAPD witnesses.

**RESPONSE NO. 9:**

The Consumer Advocate objects to this request on the grounds that it is overly broad, unduly burdensome, and unlikely to lead to the discovery of admissible evidence. Furthermore, this request may seek the production of documents that are protected by the Work Product Doctrine.

The overall breadth of the request constitutes an undue burden upon the Consumer Advocate. The Consumer Advocate does not track or maintain copies of all documents that its witnesses create or review in connection with this matter. Additionally, this request may encompass documents created or assembled by or on behalf of the Consumer Advocate's attorneys in anticipation of litigation, which are protected from disclosure under the Work Product Doctrine. Tenn. R. Civ. P. 26.02(3).

Consistent with these objections and the General Objections, and without waiving them, the Consumer Advocate will provide (or has already provided) in electronic media (Word, Excel, PDF, or other Microsoft Office compatible format) and/or in hard copy all workpapers and other documents, generated by or relied upon by all CAPD witnesses.

**DISCOVERY REQUEST NO. 10:**

Please produce a copy of all trade articles, journals, treatises and publications of any kind in any way utilized or relied upon by any of CAPD's proposed expert witnesses in evaluating, reaching conclusions or formulating an opinion in the captioned matter.

**OBJECTION AND RESPONSE NO. 10:**

The Consumer Advocate objects to this request on the grounds that it is overly broad, unduly burdensome, and unlikely to lead to the discovery of admissible evidence. Furthermore, this request may seek the production of documents that are protected by the Work Product Doctrine.

The overall breadth of the request constitutes an undue burden upon the Consumer Advocate. The Consumer Advocate does not track or maintain copies of all documents that its witnesses create or review in connection with this matter. Additionally, this request may encompass documents created or assembled by or on behalf of the Consumer Advocate's attorneys in anticipation of litigation, which are protected from disclosure under the Work Product Doctrine. Tenn. R. Civ. P. 26.02(3).

Consistent with these objections and the General Objections, and without waiving them, all trade articles, journals, treatises and publications of any kind in any way utilized or relied upon by any of CAPD's proposed expert witnesses in evaluating, reaching conclusions or formulating an opinion in the captioned matter have been cited in the witnesses' testimony in such a way that all relevant material is already available or can be obtained by Tennessee American from the references cited.

**DISCOVERY REQUEST NO. 11:**

Please produce a copy of all articles, journals, books or speeches written by or co-written by any of CAPD's expert witnesses, whether published or not.

**OBJECTION AND RESPONSE NO. 11:**

The Consumer Advocate objects to this request on the grounds that it is overly broad,

unduly burdensome, and unlikely to lead to the discovery of admissible evidence. Furthermore, this request may seek the production of documents that are protected by the Work Product Doctrine.

The overall breadth of the request constitutes an undue burden upon the Consumer Advocate. The Consumer Advocate does not track or maintain copies of all documents that its witnesses create or review in connection with this matter. Additionally, this request may encompass documents created or assembled by or on behalf of the Consumer Advocate's attorneys in anticipation of litigation, which are protected from disclosure under the Work Product Doctrine. Tenn. R. Civ. P. 26.02(3).

Consistent with these objections and the General Objections, and without waiving them, the Consumer Advocate will make available for inspection at its office a copy of all articles, journals, books or speeches written by or co-written by any of CAPD's expert witnesses, whether published or not.

**DISCOVERY REQUEST NO. 12:**

Please produce any and all documentation, items, reports, data, communications, and evidence of any kind that CAPD intends to offer as evidence at the hearing or to refer to in any way at the hearing.

**OBJECTION AND RESPONSE NO. 12:**

The Consumer Advocate objects to this request on the grounds that it is overly broad, unduly burdensome, and unlikely to lead to the discovery of admissible evidence. Furthermore, this request may seek the production of documents that are protected by the Work Product Doctrine.

The overall breadth of the request constitutes an undue burden upon the Consumer Advocate. The Consumer Advocate does not track or maintain copies of all documents that its witnesses create or review in connection with this matter. Additionally, this request may encompass documents created or assembled by or on behalf of the Consumer Advocate's attorneys in anticipation of litigation, which are protected from disclosure under the Work Product Doctrine. Tenn. R. Civ. P. 26.02(3).

Furthermore, disclosure of material to be used in cross-examination of witnesses would reveal attorney work product and, therefore, is objectionable.

Consistent with these objections and the General Objections, and without waiving them, the Consumer Advocate may use all the material referred to in the Response to Request No. 1 and explicitly reserves the right to use any other permissible material for cross-examination or rebuttal.

**DISCOVERY REQUEST NO. 13:**

Please produce copies of any and all documents referred to or relied upon in responding to these discovery requests.

**OBJECTION AND RESPONSE NO. 13:**

The Consumer Advocate objects to this request on the grounds that it is overly broad, unduly burdensome, and unlikely to lead to the discovery of admissible evidence. Furthermore, this request may seek the production of documents that are protected by the Work Product Doctrine.

The overall breadth of the request constitutes an undue burden upon the Consumer Advocate. The Consumer Advocate does not track or maintain copies of all documents that its

witnesses create or review in connection with this matter. Additionally, this request may encompass documents created or assembled by or on behalf of the Consumer Advocate's attorneys in anticipation of litigation, which are protected from disclosure under the Work Product Doctrine. Tenn. R. Civ. P. 26.02(3).

Consistent with these objections and the General Objections, and without waiving them, the Consumer Advocate responds to this request as follows:

See Response to Request No. 1.

**DISCOVERY REQUEST NO. 14:**

Please identify each person who provided information or participated in the preparation of the responses to each of these discovery requests, and for each such person specify the responses to which he or she provided information or participated in preparing, and describe the information provided or the participation in preparation.

**OBJECTION AND RESPONSE NO. 14:**

The Consumer Advocate objects to this request on the grounds that it is overly broad, unduly burdensome, and unlikely to lead to the discovery of admissible evidence. Furthermore, this request may seek the production of documents that are protected by the Work Product Doctrine.

The overall breadth of the request constitutes an undue burden upon the Consumer Advocate. The Consumer Advocate does not track or maintain copies of all documents that its witnesses create or review in connection with this matter. Additionally, this request may encompass documents created or assembled by or on behalf of the Consumer Advocate's attorneys in anticipation of litigation, which are protected from disclosure under the Work

Product Doctrine. Tenn. R. Civ. P. 26.02(3).

Consistent with these objections and the General Objections, and without waiving them, the Consumer Advocate states that these responses were prepared by the Consumer Advocate attorneys and staff.

**DISCOVERY REQUEST NO. 15:** Reference p.10, lines 10-12.

“Mr. Miller warned all parties that if AWW became a public company, it would, at its discretion, deplete TAWC’s equity.”

**Questions:**

- a. In what way does Dr. Brown believe that AWW would “deplete TAWC’s equity?”
- b. What does Dr. Brown believe would be AWW’s incentive to deplete TAWC’s equity?

**RESPONSE NO. 15(a):**

For the record, this issue began with Mr. Miller’s sworn testimony in 2003.

---

DIRECT EXAMINATION: BY MR. GRIMES:

- Q. Mr. Miller, I believe it’s in the testimony that you provided, I don’t think you stated this in your summary yesterday, so could you please tell us what your position is with the company.”
- A. I’m the vice president and treasurer of Tennessee American Water Company, its chief financial officer. [TRA Docket 03-0018, Trans. Vol. II, Tuesday, July 1, Page 173, lines 16-24].
- Q. Is Tennessee American guaranteed additional parent equity or debt through American Water Company?
- A. Absolutely not. There is always a possibility that the company would have to retract that capital as a stand-alone entity in the public market... [TRA Docket

AWW, at its discretion, would retract or deplete its subsidiary's capital via increases in management fees and billings from the services group to the subsidiary, via increases in dividend payments from the subsidiary, via directed sourcing of equipment purchases, via forms of non-arms length pricing for services provided to the subsidiary, via increases in overhead expenses, via reductions in maintenance expenses to maintain service quality, via increased prices without an improvement in service.

**RESPONSE NO. 15(b):**

The incentives for depletion are acute in the near-term, which is the time between now and the end of 2010, the end date for the current tax rates on dividends and capital gains. The incentives are a product of RWE's decision to divest itself of AWW, a company for which RWE paid 35% above market price at the end of 2002. It is clear from the 2004 rate case that RWE was disappointed in the return created by the investment in AWW. RWE's decision to divest itself of AWW via an IPO is surely a way for RWE to extricate itself from an asset which has not met the expectations that caused RWE to pay a 35% premium for AWW. In other words RWE is betting that the value of AWW to the buying public is higher than the value that RWE places on AWW.

However, any buyer of the IPO will face the following well documented post-IPO behavior.

1. There will be an annual decline in post-IPO profitability where the decline ranges from 2% to 10% from the first year after the IPO to the 5th year after the IPO. These findings are

based on a sample of 7,183 IPOs in the United States between 1975 and 2004. The results appear in “Entrepreneurial Learning, the IPO Decision, and the Post-IPO Drop in Firm Profitability”, a working paper dated December 15, 2006 and authored by Lubos Pastor, Lucian Taylor, and Pietro Veronesi of the Graduate School of Business of the University Of Chicago. A copy of that paper is provided as attachment A to this response. At page 2 the authors say:

profitability, measured as return on equity (ROE), declines significantly after the IPO. The average decline in quarterly ROE is 2.7% after one year and 4.3% after three years.

Refer to Table 2 at page 39 and Table 3 at page 40 for detailed results. The authors also say:

It is optimal for the entrepreneur to take his firm public when the market value of the firm (value to investors) exceeds the private value of the firm (value to the entrepreneur)...The model also predicts that firm profitability increases before the IPO. We do not test this prediction due to the lack of pre-IPO data, but supporting evidence is provided by Degeorge and Zeckhauser (1993) who study 62 reverse LBOs that went public between 1983 and 1987. They find that profitability increases sharply before LBOs return to public ownership ....

This finding is consistent with the apparent strategy to raise AWW’s perceived profitability to potential investors. In addition to the proposed 20% rate increase in Tennessee, other information in the public domain confirms an on-going effort to raise AWW’s perceived profitability prior to the IPO:

April 17, 2006:

Ohio American Water filed a rate request with the Public Utility Commission of Ohio (PUCO) that would change rates for water service in the company's operating districts... In its filing, the water company requested an overall rate increase that averages 17.4%. [Source: Company Press Release At Company’s web site]

July 28, 2006: Arizona-American Water Company, Inc. (“Arizona-American” or “Company”), a wholly owned subsidiary of RWE AG, filed an application with the Arizona Corporation Commission (“ACC” or “Commission”) requesting approval of a determination of the current fair value of the Company's utility plant and property; and for increases in rates and charges based thereon for utility service provided by Arizona-American's Sun City & Sun City West Wastewater Districts. Arizona-American is seeking revenue increases of \$1,606,495, or 35.84 percent in Sun City and \$2,337,050, or 51.49 percent for Sun City West [Source: Arizona Residential Consumer Utility Office

[www.azruco.com/PC\\_AZ-AM\\_Sun\\_City\\_Wastewater\\_2006.htm](http://www.azruco.com/PC_AZ-AM_Sun_City_Wastewater_2006.htm)

December 05, 2006:

Indiana American Water today filed a rate request with the Indiana Utility Regulatory Commission (IURC) that would change rates for water service in all of the company's operating districts. In its filing, the water company requested an overall rate increase that averages 17.4%, across all of the company's operating districts. [Source: Company Press Release At Company's web site]

December 15, 2006:

Missouri American Water today filed a rate request with the Missouri Public Service Commission (PSC) that would change rates for water service in all of the company's operating districts. In its filing, the water company requested an across the board rate increase that averages 24.85% across all the company's operating districts.” [Source: Company Press Release At Company's web site]

January 22, 2007:

Application of California-American Water Company (U 210 W) to Increase Revenues for Water Service in its Sacramento District by \$8,966,900 or 33.89% in 2008, \$1,905,700 or 5.36% in 2009, and \$1,860,700 or 4.97% in 2010 Under the Current Rate Design.”

[Source:www.rosemontca.org/calam/exhibit-e-SLW\_DOCS\_SF-6553940.pdf]

May 2007: New Mexico-American Water 20%.

[Source:www.newschannel10.com/Global/story.asp?S=6267602]

2. The capital structure will tilt towards more debt and less equity once the company acquires the equity infusion from the IPO. These findings are based on a sample of 5300 Seasoned Equity Offerings (equity issued by a company already public) and 2400 IPOs in the United States between 1975 and 2004. The results appear in “Public Equity Issues and The Scope for Market Timing the Scope for Market Timing”, a working paper dated January 20, 2007 authored by Hannes F. Wagner of London Business School. A copy of that paper is provided as attachment B to this response. In the abstract the author concludes: “I also do not find high persistence of changes in capital structure as firms instead actively releverage through increased debt issuance following equity issues.”

Anyone performing due diligence on the IPO is likely to be aware of these documents, and would probably wonder whether the IPO has any profit potential above and beyond what might be gained from investments in bonds or other alternatives. Thus, there is a third consideration which neither study has or could address: the potential that current federal tax rates on dividends and capital gains will terminate at the end of 2010 and revert to higher levels.

3. Lets say that the IPO occurs in July 2007. Anyone buying into the IPO and wanting a quick capital-gains profit has to wait until July 2008, a mere 30 months away from the potential change in tax rates. A problem is likely to be encountered at this point: in the face of the tax rate uncertainty a potential buyer is likely to bid down the price as of July 2008. However,

the IPO buyer will probably factor this into the price paid at the time of the IPO, which in turn takes us back to offering price - it has to be low enough for IPO buyer to resell it in July 2008, and the buyer in July 2008 has to have some sense that the purchases can again be resold profitably in July 2009, with the tax rates potentially going up in just another 18 months. Add this chain of events to declines in the post-IPO profitability and a debt-heavy capital structure pointed out to you, and the likely result is the creation of the incentives to “retract” or “deplete” capital via the methods described, once the IPO is complete.

Of course if RWE had not paid a 35% premium above AWW’s 2002 market price, then the IPO would not be an issue in this case.

**DISCOVERY REQUEST NO. 16:** Reference p.11, lines 27-36

Also, AWW’s equity ratios were well below the equity ratios of most other publicly-traded water companies. These facts are presented in my Schedules 1, 2 and 3. Furthermore, I provided direct testimony in TRA Dockets Nos. 03-00118 and 04-00288 regarding the equity ratio of TAWC’s ultimate owner, RWE. At the time, RWE’s equity ratios were about 11% and 27%.

**Questions:**

- a. The testimony claims that “RWE’s equity ratios were about 11% and 27%.” Are those book value or market value capital structure ratios?

**RESPONSE NO. 16(a):**

Book Value

- b. If book value ratios, please confirm that the accounting books are not based upon U.S. Generally Accepted Accounting Procedures (GAAP).

**RESPONSE NO. 16(b):**

The values are not GAAP.

- c. Please specify the accounting standards relied upon.

**RESPONSE NO. 16(c):**

International Financial Reporting Standards (IFRS).

- d. If the answer to part b) is confirmed, how does the difference in accounting procedures affect the reported equity percentages in the capital structure?

**RESPONSE NO. 16(d):**

Dr. Brown does not know because in the prior two dockets Dr. Brown made no effort to reconcile equity ratios derived from IFRS to equity ratios derived from GAAP.

**DISCOVERY REQUEST NO. 17:** Reference p. 12, lines 11-17.

In addition, my opinion is that AWW's post-IPO capital structure, whatever level it may be initially, will not be sustainable without additional rounds of rate cases for the subsidiary, despite TAWC having filed rate cases 2003, 2004, and November 2006.

**Questions:**

- a) In what way is the capital structure of TAWC "not sustainable without additional rounds of rate cases?"

**RESPONSE NO. 17(a):**

Page 12 lines 12-17 of Dr. Brown's testimony refers to AWW's post-IPO capital structure not TAWC's. To the extent that TAWC's rates are determined via double-leverage of AWW's capital structure, TAWC's capital structure is derived from AWW's. Also, refer to Dr. Brown's reply to TAWC's discovery request 15.

- b) Please explain fully why the capital structure percentages of debt and equity in TAWC capital structure would necessarily change because of a future rate case.

**RESPONSE NO. 17(b):**

Page 12 lines 12-17 of Dr. Brown's testimony refers to AWW's post-IPO capital structure not TAWC's. To the extent that TAWC's rates are determined via double-leverage of AWW's TAWC's capital structure is derived from AWW's. Refer to Dr. Brown's reply to TAWC's discovery request 15.

**DISCOVERY REQUEST NO. 18:** Reference p. 12, lines 25-28.

At page 18 he notes that AWW will have to provide \$1.75 billion to redeem AWW's preferred stock held by an RWE affiliate.

**Questions:**

- a) If investors know that AWW will have "to redeem \$1.75 billion of AWW's preferred stock held by an RWE affiliate", why wouldn't investors in AWW's IPO pay RWE \$1.75 *less* for the IPO than if the preferred were redeemed prior to the IPO? Please explain fully
- b) Does Dr. Brown agree that the book value of AWW's common stock after the IPO will equal the book value of AWW's assets minus the book value of debt and preferred allocated to AWW? If not, please explain fully.

**RESPONSE NO. 18(a):**

Refer to the response to 18(b) below.

**RESPONSE NO. 18(b):**

No, Dr. Brown does not agree. The post issue book value equity equals A) - the book value of equity from the most recent pre-IPO financial statement, PLUS, B) - the sum of the offering proceeds, which is equal to number of newly issued shares times the offer price. As of the date of this reply to the Company's discovery request, the Company has not placed into the record items A and B.

For the record, CAPD expects item A to be the equity from TWAUSHI's 2006 audited statements. In CAPD Discovery Request Part III 5(f), CAPD requested the company to provide "copies of annual audited financial statements for AWW and TWAUSHI for each fiscal year from 2004 through 2006." In its latest supplemental response received by the CAPD on March 9, 2007, the Company responded "The requested audited financial statements for 2006 are not yet available."

Item B (the IPO's offer price and the IPO's number of shares) raises questions regarding your offer in your supplemental response 8(a)(b), where you say "Attached is the Pro-forma capital structure for the consolidated AWWC at the time of the IPO." However, in this discovery request, 18(b) directed to CAPD, you ask about "common stock after the IPO". Clearly, the phrases you employ, "at the time of the IPO" and "after the IPO" are different from each other. By the phrase, "at the time of the IPO" in your supplemental response 8(a)(b), do you mean that you are willing to provide only item A - the book value of equity from the most recent pre-IPO financial statement? If you do, there is no need for that to be confidential. You did not file the 2005 and 2004 audit statements under a protective order. But those audits, 2004 and 2005, are unusual in the sense they lag the fiscal year's end by 12 to 24 months. This raises questions about the forthcoming audit of 2006: how far will it lag behind the fiscal year's end, and will it show changes that make debt and equity ratios substantially different from those reported in 2004 and 2005?

The long lag between the end of TWAUSHI's fiscal year and the auditor's consent date (January 31, 2007) is unusual, as shown by the data in the table attached to this reply. The table displays 12 columns from left to right. Column (1) displays the fiscal years 1998-2006. Columns

(5) - (12) display a history of dates showing when each of the comparables companies filed its fiscal year 10-K form with the SEC . The 10-K provides audited financial statements. Column (3) displays a history of dates showing when AWW filed its 10-K with the SEC from 1998 through 2002, 2002 being the last year before AWW was acquired by RWE. Column (4) displays the dates when the independent auditor gave its consent to AWW's financial statements. A comparison of Columns (3) and (4) prove that the normal practice is for audits to be complete within three months of the fiscal year's end. Column (2) shows what TWAUSHI has done.

The lag may bear on your question of 18(a), "why wouldn't investors in AWW's IPO pay RWE \$1.75 Billion less for the IPO than if the preferred were redeemed prior to the IPO?" Here is the answer:

Potential investors in an IPO may be wary of an offering, once complete, that calls for an immediate disbursement of \$1.75 billion in cash or other obligations that require near-term pay-offs.

On the other hand if the preferred is redeemed prior to the IPO, the company's pre-IPO cash-reserves may shrink or the future ability to borrow may be hampered. In either case the looming redemption of preferred stock may hurt the IPO itself. If RWE is both the holder of preferred and the recipient of substantial funds that flow from the IPO, and if the preferred amount is substantially outweighed by the funds RWE expects to garner via the underwriter and the IPO, then RWE's interest is served by removing the preferred stock from the picture, and by converting it to debt repaid over a long-term period in a level manner, such as equal semi-annual payments over a 20-year term. Of course, those debt terms may be set by RWE and then embedded in the new company, AWW, whose subsidiaries may then have to pay for the debt on those terms, assuming no interveners question this aspect of the new company's debt structure.

This ties back to the 2006 audit, or lack thereof. Will it show changes that reflect a positioning for the IPO? As of this date, CAPD does not have the 2006 audit and its potential effect on Tennessee's ratepayers has not been analyzed.

Getting back to the link between TAWC's question 18(b) and the Pro-forma capital structure TAWC is offering in return for signing on to a supplemental protective order, does the Pro-forma include Item B (the sum of the newly issued shares times the offer price)? If it does, then an immediate question arises: how did TAWC arrive at its choice of an offering price and the shares issued? Furthermore, in TAWC's supplemental response 5(e), received by the CAPD on March 9, TAWC said "there is no underwriting agreement related to the IPO at this time." Does this phrasing, for example, imply that TAWC have an underwriting agreement that is not related to the IPO? Nonetheless, if the Company does not yet have an agreement with an underwriter that will handle the IPO, the Pro-forma capital structure is baseless.

In sum, several questions arise when viewing the "book value of AWW's common stock after the IPO" as A) - the book value of equity from the most recent pre-IPO financial statement, PLUS, B) - the sum of the offering proceeds, which is equal to number of newly issued shares times the offer price.

**DISCOVERY REQUEST NO. 19:** Reference p. 21, lines 16-18.

"...but in 2007 Dr. Vilbert's respective estimates are 6.5% and 13%"

**Questions:**

- a) Please confirm that the 6.5% referenced in the citation is Dr. Vilbert's estimate of the long-term market risk premium? If not confirmed, please explain fully why not.

- b) Please confirm that the 13% referenced in the citation is the expected return on the market.
- c) Please confirm that Dr. Vilbert used an estimate of 5.0% for the long-term risk-free rate. If not confirmed, please explain fully why not.
- d) Please confirm that using the 5.0% risk-free rate with a 6.5% MRP results in an estimate of 11.5% for the market, not the 13% in the citation. If not confirmed, please explain fully why not.

**RESPONSE NO. 19(a):**

Refer to Dr. Vilbert's testimony, page B-10, lines 6-10:

One of their results is an estimate of the market risk premium over the long-term Treasury bond yield that is based on careful analysis of actual major investment decisions, not realized market returns. Their median estimate is 7.78 percent and their mean estimate is 7.97 percent. This is considerably higher than my estimate of 6.5 percent. (Also, refer to page B-37, line 5.)

**RESPONSE NO. 19(b):**

Refer to Dr. Vilbert's testimony, page 4 of 35, lines 3-6:

The cost of capital estimates for the water sample are higher than for the gas LDC sample. The midpoint of the range of the overall cost of capital estimates for the water sample is 7 1/2% percent with a range of 7 1/4% to 7 3/4% percent. The corresponding cost of equity is 12 1/2 % percent with a range of 12 to 13 percent.

**RESPONSE NO. 19(c):**

Dr. Brown cannot confirm that Dr. Vilbert used 5% solely, as the discovery request suggests, as the long-term risk free rate to reach his opinion on the cost of equity. Refer to Dr. Vilbert's testimony page 28 of 35, the data in the far-left panel under the heading "RISK POSITIONING MODEL (Long-Term Risk-Free Rate) Water Sample," where the cost of equity ranges as high as 12.8%, with an implied risk premium of 7.8% [ 12.8 -5], an amount that would

contradict Dr. Vilbert's estimate of 6.5% as the premium. With a 12.8% return and a 6.5% premium the implied risk free rate is 6.3%, not 5%. Nowhere in his testimony does Dr. Vilbert repudiate the equity cost estimates in that table. He relies on all those numbers to arrive at his opinion, and he uses all those numbers to arrive at his opinion.

**RESPONSE NO. 19(d):**

Dr. Brown cannot confirm the statement in 19(d) due to the reason stated in 19(c) above.

**DISCOVERY REQUEST NO. 20:** Reference p. 27, lines 16-18.

In addition, for seven out of eight companies, price growth from 2003 to 2007 was much larger than the price growth from 2000 to 2003.

**Questions:**

- a) What was the return on the S&P 500 during 2000 to May 2003 compared to May 2003 to December 2006?
- b) Given the return differences on the market, wouldn't Dr. Brown expect the prices of the water companies to grow more rapidly in the latter period? If not, please explain fully why not.

**RESPONSE NO. 20(a):**

On January 3, 2000 the S&P 500 index was 1455.22. On May 1, 2003 the S&P 500 index was 916.3. The index declined of 37% from January 3, 2000 to May 1, 2003. On December 29, 2006 the S&P 500 index was 1418.3, a rise of 55%.

**RESPONSE NO. 20(b):**

Yes, the prices for the water companies grew more rapidly in the second period, May 2003 to December 2006.

**DISCOVERY REQUEST NO. 21:** Reference p. 30 lines 25-27.

I use historical growth rates, and I shed light on the effect of the tax cut.

**Questions:**

Please provide all references on which Dr. Brown relies that documents the superiority of using historical dividend growth rates over use of analysts' forecasts of growth rates in the DCF model.

**RESPONSE NO. 21.:**

Refer to *The Equity Premium* by Eugene Fama and Kenneth French in *The Journal of Finance*, Vol. 67, No. 2, April 2002, p. 651: “

We are interested in post-2000 dividend growth...our evidence that dividend growth is essentially unpredictable confirms the results in Campbell (1991), Cochrane (1991,1994), and Campbell and Shiller (1998). If dividend growth is unpredictable, the historical average growth rate is the best forecast of future growth.  
(The article is attached.)

**DISCOVERY REQUEST NO. 22:** Reference p. 33, lines 29-33.

The former Chairman of the Federal Reserve Board singled out I/B/E/S as a data source of exaggeration. The NYSE NAD joint report says that conflicts of-interest still exist.

**Questions:**

- a) Please provide a citation to the publication quoting the Chairman of the Federal Reserve Board.
- b) Please confirm that I/B/E/S serves as a collection and distribution source for stock analysts' forecasts. If Dr. Brown cannot confirm, please explain fully why not.
- c) Given that I/B/E/S merely collects the forecasts of analysts, please specify how I/B/E/S is a “source of exaggeration”?

**RESPONSE NO. 22(a):**

A copy of the Chairman's remarks are provided. For your own copy go to the internet:  
[www.federalreserve.gov/BoardDocs/Speeches/2002/200203262/default.htm](http://www.federalreserve.gov/BoardDocs/Speeches/2002/200203262/default.htm).

**RESPONSE NO. 22(b):**

Confirm.

**RESPONSE NO. 22(c):**

I/B/E/S has a history of being a source of exaggeration as the Federal Reserve Chairman's remarks prove. Even today I/B/E/S does no vetting of its sources nor claim responsibility for them. Thus I/B/E/S is a conduit for and inseparable from the content it carries and the content's sources.

**DISCOVERY REQUEST NO. 23:** Reference p. 35, lines 14-16.

In a FERC docket where he testified as a witness Dr. Vilbert relied on the DCF model.

**Questions:**

- a) Has Dr. Brown ever testified before the FERC on the cost of capital?
- b) If so, please provide citations to all such proceedings.
- c) Please provide a copy of Dr. Brown's testimony in the three most recent proceedings before the FERC.

**RESPONSE NO. 23(a):**

No.

**RESPONSE NO. 23(b):**

None.

**RESPONSE NO. 23(c):**

None.

**DISCOVERY REQUEST NO. 24:** Reference p. 17.

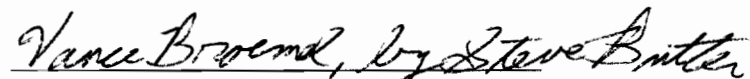
**Questions:** Please provide any and all the back-up material referenced including the sources for

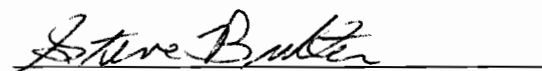
- a) Bank of America's ROE of 8.5% in October of 2006.
- b) Roger Ibbotson's ROE of 9.0% in October of 2006.
- c) Vanguard Group's ROE of 8.0% in May of 2006.

**RESPONSE NO. 24(a)(b) and (c):**

Items 24(a), 24(b), and 24(c) were provided in the filing and on the CD sent to you in the folder named "Brown's cost of capital attachments". They are also at the TRA's web site.

Respectfully submitted,

  
Vance L. Broemel, B.P.R. No. 11421  
Assistant Attorney General

  
Stephen R. Butler, B.P.R. No. 14772  
Assistant Attorney General  
Office of the Attorney General  
Consumer Advocate and Protection Division  
P.O. Box 20207  
Nashville, TN 37202  
(615) 741-8733

## CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing is being forwarded via U.S. mail, to:

R. Dale Grimes, Esq.  
Bass, Berry & Sims PLC  
AmSouth Center  
315 Deaderick Street, Suite 2700  
Nashville, TN 37238


David C. Higney  
Grant, Konvalinka & Harrison, P.C.  
Ninth Floor, Republic Centre  
633 Chestnutt Street  
Chattanooga, TN 37450-0900

Henry Walker  
1600 Division Street, Suite 700  
P.O. Box 340025  
Nashville, Tennessee 37203

Michael A. McMahan  
Special Counsel - City of Chattanooga  
801 Broad Street, Suite 400  
Chattanooga, TN 37450-0900

Richard Collier  
General Counsel  
Tennessee Regulatory Authority  
460 James Robertson Pkwy.  
Nashville, TN 37243-0505

on this the 30 day of March, 2007.

  
Stephen R. Butler

105608