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April 9, 2007

**VIA HAND-DELIVERY**

Chairman Sara Kyle  
c/o Sharla Dillon  
Tennessee Regulatory Authority  
460 James Robertson Parkway  
Nashville, Tennessee 37243-0505

***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***

Dear Chairman Kyle:

Enclosed please find an original and sixteen (16) copies of each Rebuttal Testimony of Michael A. Miller.

Please return three copies of each Rebuttal, which I would appreciate your stamping as "filed," and returning to me by way of our courier.

Should you have any questions concerning any of the enclosed, please do not hesitate to contact me.

With kindest regards, I remain

Yours very truly,



R. Dale Grimes

RDG/ms  
Enclosures

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Chairman Sara Kyle

April 9, 2007

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cc: Hon. Pat Miller (*w/o enclosure*)  
Hon. Ron Jones (*w/o enclosure*)  
Hon. Eddie Roberson (*w/o enclosure*)  
Ms. Darlene Standley, Chief of Utilities Division (*w/o enclosure*)  
Richard Collier, Esq. (*w/o enclosure*)  
Mr. Jerry Kettles, Chief of Economic Analysis & Policy Division (*w/o enclosure*)  
Ms. Pat Murphy (*w/o enclosure*)  
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Henry Walker, Esq. (*w/enclosure*)  
David Higney, Esq. (*w/enclosure*)  
Mr. John Watson (*w/enclosure*)  
Mr. Michael A. Miller (*w/enclosure*)



**TENNESSEE-AMERICAN WATER COMPANY**  
**PSC CASE NO. 06-00290**  
**REBUTTAL TESTIMONY OF MICHAEL A. MILLER**

1.  
2.  
3.  
4.  
5.  
6.  
7. 1. Q. WHAT IS YOUR NAME AND BUSINESS ADDRESS?

8. A. Michael A. Miller, 1600 Pennsylvania Avenue, Charleston, West Virginia.  
9.

10. 2. Q. DID YOU FILE DIRECT TESTIMONY IN THIS CASE?

11. A. Yes.  
12.

13. 3. Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

14. A. I will address the obvious attempt of the CAPD to inappropriately and artificially  
15. deflate any reasonable cost of service of the Company in this case. They provide  
16. significant banter about the Company's filing, but during this rebuttal testimony  
17. the Directors should easily discern that the CAPD's testimony is short on facts,  
18. substance, support and use of established rate making principles. The CAPD  
19. witnesses use terms, such as, affordability, rate shock, enormous increase, and  
20. unjust, but they provide little, if any, support or justification for their positions.  
21. They use supposition and speculation in an attempt to create a "smoke screen" to  
22. mask the absence of reasonable conclusions based on the facts in this case.  
23. What you won't find in the testimony of Dr. Brown or Terry Buckner is even one  
24. supportable rebuttal point to (i) TAWC's filing in this case, (ii) the historical test-  
25. year numbers, or (iii) the attrition year adjustments. There is not one item of  
26. rebuttal, other than the capital structure and ROE proposed by Dr. Brown that  
27. disputes the facts concerning the drivers of this rate increase as outlined on  
28. Exhibit MAM-2 of my direct testimony. The CAPD, nor any party to this case,  
29. does not provide one thread of rebuttal to the facts that TAWC has invested over  
30. \$26.0 million in capital improvements since the last rate case, or that there has  
31. been an increase in the various T-bills and T-bonds, and Corporate Bond rates  
32. since the last rate case which would support an increase in ROE. Upon

1 examination of the CAPD's witnesses testimony the Directors will not find any  
2 discussion of the Company's historical test-year filing, the adjustments to arrive at  
3 the Attrition Year O&M expenses or general taxes which the Company identified  
4 as drivers of the need to increase rates. Their comments are limited to simply  
5 saying that they don't agree or that the increases are unreasonable, but they  
6 provide no comment or support for how they determine those assertions. They  
7 then proceed to create their own expenses by selectively choosing multiple base  
8 periods as far back as 2005 on which to make their calculations. I will cover  
9 these gaping holes in their testimony later in my rebuttal. In addition, I will  
10 address the testimonies of AG witness Mr. Chrysler. I will also have limited  
11 comments about the testimony of CMA witness Mr. Gorman; and the testimonies  
12 of the City's witnesses. The general topics of my testimony are as follows:

- 13 1. Capital Structure
- 14 2. Capital Cost Other Than Cost of Equity
- 15 3. Return on Equity
- 16 4. Rate Base
- 17 5. Revenues at Present Rates
- 18 6. Salaries and Wages
- 19 7. Benefit Costs-Pensions and Group Insurance
- 20 8. Incentive Plan Costs
- 21 9. Deferred Income Taxes
- 22 10. Property Taxes
- 23 11. Insurance Other

1    **GENERAL**

2  
3    4.    Q.    DO YOU HAVE GENERAL COMMENTS ABOUT THE TESTIMONY OF  
4           DR. BROWN?

5  
6           A.    Dr. Brown in his direct testimony goes so far as to retrieve the word (“retract”)  
7                from the transcript in my testimony in case 03-00118 to support his woefully  
8                inadequate capital structure and WCC of 6.5% proposed in this case. Dr. Brown  
9                is a man of many theories, but in my review of his testimony in this case and  
10              TAWC’s previous case, he has never provided one thread of proof to support his  
11              theories and unfounded allegations. In TAWC case number 04-00103 his theory  
12              was that RWE had coerced TAWC, me and Dr. Vanderweide to manufacture a  
13              WCC to meet RWE’s desires and to inappropriately recover the premium RWE  
14              paid for American Water Works Company (“AWWC”). In this case he attempts  
15              to claim the only reason for TAWC’s rate increase filing is to impact the price  
16              RWE receives for the AWWC stock in the IPO. It appears not to matter to him  
17              that TAWC achieved an ROE of 5.1% in 2006, has invested \$26.0 million in  
18              capital improvements since the last rate case, or that the expected ROE for 2007 is  
19              2% without rate relief. He then uses a typographical error from of my testimony  
20              in case number 03-00118 in an attempt to support his parent company capital  
21              structure used to arrive at his “Double Leverage” capital structure proposed for  
22              setting the rates of TAWC. I take exception with his use of my testimony in case  
23              03-00118 and will cover this in more detail later in this testimony. As in the past  
24              case, missing from his testimony is support for his theory and allegations. The  
25              conclusions he reaches on capital structure and WCC from his unsupported theory  
26              are misplaced at best.

27  
28    5.    Q.    DO YOU HAVE GENERAL COMMENTS ABOUT THE TESTIMONY OF  
29           MR. BUCKNER?

30           A.    Yes. Mr. Buckner does not use the historical test-year (the historical test-year in  
31                this case is the year ended June 30, 2006) as the base period for even one O&M

1 expense in his analysis nor does he make one comment about the Company's  
2 filing or attrition year adjustments. Amazingly Mr. Buckner used at least 5  
3 different test-year periods for his base period numbers for the various  
4 classifications of expenses. While Mr. Buckner provides only limited explanation  
5 and support for his reasoning for the use of the various base periods, the result is  
6 that in each case use of those different base periods serves to artificially deflate  
7 TAWC's requested and supported cost of service in this case. This type of  
8 approach is generally described as "cherry picking." Standard cost of service rate  
9 making dictates that Mr. Buckner should start with a uniform test-year base  
10 period and make his adjustments based on a reasonable estimation of those  
11 "known and measurable" adjustments to be present in the attrition year in this  
12 case. This is the approach the Company used. Mr. Buckner could have provided  
13 at least some comment as to why TAWC's historical test-year adjusted for non-  
14 recurring expenses or attrition year adjustments were faulty, but he didn't.  
15 Instead Mr. Buckner selectively chooses different base periods for various  
16 classifications of O&M expenses and applies inflation factors based on historical  
17 data.

18  
19 Mr. Buckner does not address the Company's adjustments for such items as 2007  
20 ERISA contributions as provided by TAWC in its work papers, or the support for  
21 the shift from Company labor approved in previous rate cases to management fees  
22 in this case, other than to say they are unreasonable. Mr. Buckner in some  
23 instances claims the Company has not supported its positions in spite of the  
24 information provided by the Company in its work papers, and in the volumes of  
25 data responses that have addressed each area of the case. He instead sets the  
26 employee level as of January, 2007 without any consideration for the filling of  
27 those vacancies (Mr. Watson will address this issue in his rebuttal), used the  
28 pension actuarial data from 2004 to establish pensions expense (ignoring much  
29 more recent data supplied by TAWC from the CFO of AWWC based on Towers  
30 Perrin projections for 2007 contributions), and uses the management fees from the  
31 prior rate case (04-00288) and inflation to establish the expense level in this case..

1  
2 Although hindsight is 20/20, Mr. Buckner's attempt to use that approach to  
3 predict the future is not supported by him in this case. This is troubling because  
4 Mr. Buckner's expense levels in many cases are below the levels experienced in  
5 the historical test-period adjusted for non-recurring expenses, and in the case of  
6 the combination of fully loaded TAWC labor and management fees, significantly  
7 less than the levels approved by the TRA in case number 03-00118. The impact  
8 of Mr. Buckner's recommendation would be extremely harmful to TAWC and  
9 would result in (i) no opportunity to achieve the ROE authorized in this case,  
10 unless TAWC drastically reduced expenses and employee levels, (ii) reduced  
11 service which TAWC absolutely does not want to do, or (iii) curtailed investment  
12 in needed capital improvements. TAWC certainly does not believe that is the  
13 appropriate way to regulate a utility with a proven track record of outstanding  
14 service and investment, and does not believe that would be the outcome desired  
15 by the TRA or the TAWC customers.

16  
17 Later in this testimony I will address each of these issues and others to show how  
18 out of touch Mr. Buckner is with the Company's operations and how  
19 unreasonable many of his expense level recommendations are.

20  
21 6. Q. DO YOU HAVE GENERAL COMMENTS ABOUT CAPD WITNESS, MR.  
22 CHRYSLER'S TESTIMONY?

23  
24 A. Yes. On pages 7 and 8 of Mr. Chrysler's testimony he compliments TAWC  
25 concerning the service metric data that it has been supplying the TRA and CAPD  
26 as a condition of the Settlement Agreement reached in case number 04-00288. He  
27 indicates TAWC's reports are being used as a model for other utilities in  
28 Tennessee to provide similar information about their service levels. TAWC is  
29 appreciative of Mr. Chrysler's comments.  
30

1 7. Q. DOES MR. CHRYSLER DISCUSS THE LEVEL OF SERVICE PROVIDED  
2 BY TAWC AS INDICATED ON THOSE METRIC REPORTS?

3  
4 A. No. But I believe it is important to recap some of the critical metrics contained in  
5 those reports. I have attached Rebuttal Exhibits MAM-1 to 4 which are graphs of  
6 those key service level metrics for both the AWWC National Call Center and  
7 TAWC local operations. Rebuttal Exhibit MAM-1 relates to key National Call  
8 Center Metrics for the percentage (%) of calls answered within 30 seconds, calls  
9 abandoned after 30 seconds, and first call effectiveness. Each of the metrics  
10 shows significant improvement from the time the metric reports were first  
11 submitted compared to the current day. The first call effectiveness has been  
12 above 90% for some time, 95% of the calls are answered within 30 seconds and  
13 the abandoned call rate has averaged approximately 0.5% over the last year.  
14 Rebuttal Exhibit MAM-2 indicates significant improvement in speed to answer  
15 and average handling times. Rebuttal Exhibit MAM-3 indicates continual  
16 improvement in the number of customer service orders worked by TAWC  
17 operation employees. The improvements are driven by additional employees to  
18 address service orders and improved efficiencies gained by such investment as  
19 on-line, real time access to customer records by field personnel. Rebuttal Exhibit  
20 MAM-4 indicates that TAWC field service employees achieve over 99% success  
21 in making service order appointment orders on time, and actual meter readings are  
22 obtained for over 98% of the customers.

23  
24 8. Q. DID THE SETTLEMENT IN CASE NUMBER 04-00288 REQUIRE  
25 CUSTOMER SURVEYS BE PERFORMED AND FILED WITH THE TRA  
26 AND CAPD?

27  
28 A. Yes. TAWC completed a customer survey and filed it with the TRA and CAPD  
29 on September 8, 2006. In that survey 88.9% of the respondents indicated they are  
30 very satisfied or satisfied with the overall level and quality of service provided by  
31 TAWC.

1  
2 9. Q. HOW WOULD YOU CHARACTERIZE THE SERVICE METRIC AND  
3 CUSTOMER SURVEY INFORMATION?  
4

5 A. In my opinion, the information described above and shown on the graphs  
6 identified in Rebuttal Exhibits MAM-1 to 4 clearly indicate that TAWC is  
7 providing service to its customers at a very high level. TAWC, its employees,  
8 and AWWC have always taken pride in the level of service provided to our  
9 customers and believe this is not an area for compromise. While some of the  
10 witnesses for the City and CMA take exception with service levels and the Call  
11 Center performance, it is simply not supported by the facts.  
12

13 10. Q. DOES THE REVENUE REQUIREMENT RECOMMENDED BY CAD TO  
14 REDUCE REVENUES AT PRESENT RATES BY \$2,062,924 (AS AMENDED  
15 BY THE SUPPLEMENTAL TESTIMONY OF MR. BUCKNER AND MR.  
16 CHRYSLER ON APRIL 3, 2007) CAUSE YOU CONCERN?

17 A. Yes, very much so. In fact, the testimony of Mr. Chrysler and the testimony of  
18 Dr. Brown and Terry Buckner appear to conflict. On the one hand Mr. Chrysler  
19 appears to recognize and appreciate the emphasis TAWC places on service and  
20 the results of those efforts as shown on the graphs mentioned above. While Dr.  
21 Brown and Mr. Buckner come to the conclusion that current rates need to be  
22 reduced by not recognizing a level of employees and FTE's provided through  
23 management fees that are critical to maintaining those service levels, providing no  
24 additional revenue to cover the capital cost for over \$26.0 million of capital  
25 investment since the Company's previous rate case, or recognizing the known and  
26 measurable level for pension expense currently being expended by TAWC in  
27 2007. In the supplemental testimony Mr. Buckner filed on April 3, 2007, he adds  
28 to the CAPD's attempt to eviscerate the Company's financial condition by  
29 recommending denial of the ECIS investment (customer service software) which  
30 the CAPD included in their recommended rate base in case number 04-00288.  
31 What is amazing about this development is that is was filed in supplemental

1 testimony on April 3, 2007, less than 2 weeks before the hearing, even though Mr.  
2 Buckner referenced the Indiana Order in case number 42520 in TAWC's case  
3 number 04-00288. If the CAPD wanted to take this stance they could have taken  
4 that position in the previous TAWC rate case. Moreover, there is no reason that  
5 he could not have done so in his Direct Testimony as filed per the procedural  
6 schedule in this case. There is no basis for Mr. Buckner to withhold this  
7 testimony until just before the hearing. While I feel confident that the CAPD  
8 would **cry out loud and long** if they were to see a decline in those service metrics  
9 (which TAWC has no intention to let happen), while at the same time their  
10 recommendation in this case does not provide any reasonable opportunity for  
11 TAWC to achieve a fair and reasonable return on its investments. It is  
12 unfathomable to me how the CAPD could make such a potentially damaging  
13 recommendation in this case based on what I perceive to be speculative  
14 conclusions with little if any support for those positions and recommendations.  
15

16 11. Q. WOULD YOU QUANTIFY THE IMPACT ON TAWC'S FINANCIAL  
17 POSITION IF THE CAPD'S RECOMMENDATION WERE ADOPTED BY  
18 THE TRA?  
19

20 A. Yes. I have attached to this testimony Rebuttal Exhibit MAM-5 which is a  
21 summation of a response to data request CMA-01-Q007. The information is from  
22 the budget for 2007-2011 for TAWC approved by the Board of Directors. The  
23 schedule is an income statement for the five-year period adjusted to show no rate  
24 increase from the current case. Near the bottom of the schedule is an ROE  
25 calculation (highlighted in yellow) based on that approved budget. I have also  
26 added to the bottom of the schedule the impact of the CAPD's recommendation to  
27 reduce TAWC's present tariffs in this case. The following is a summary of the  
28 ROE's shown on Rebuttal Exhibit MAM-5.  
29

30 **Table 1: Pro-forma ROE Achieved**

31 **2007 2008 2009 2010 2011**



<b>ROE per Approved Budget</b>	<b>2.32%</b>	<b>1.65%</b>	<b>(.42%)</b>	<b>(1.51%)</b>	<b>(2.92%)</b>
<b>ROE per CAPD Recommendation</b>	<b>0.75%</b>	<b>(1.08%)</b>	<b>(2.89%)</b>	<b>(3.89%)</b>	<b>(5.30%)</b>

Obviously, the dismal financial projections shown above can not be considered a reasonable result in this case. Even at the CAPD's woefully inadequate ROE recommendation of 7.5%, the information shown above clearly indicates the CAPD's adjustments to revenues, O&M Expenses, taxes and rate base provide no opportunity for TAWC to achieve the return authorized in this case. As stated in the Rebuttal Testimony of Dr. Vilbert, I agree with him that the recommendations of the CAPD (the devastating impact of those recommendations, for capital structure, ROE, and expense levels are shown in the table above) can not meet the opportunity to earn a rate of return commensurate with that earned on comparable risk investments, or that the return would be sufficient to attract capital and maintain TAWC's financial integrity as specified in the "Bluefield Water Works" and "Hope Natural Gas" decisions. The Company respectfully requests that the TRA directors look carefully at the CAPD's testimony and recommendations in this case and see them for what they are, an attack on established regulatory policies and practices that are speculative and without support, and if implemented would be devastating to TAWC and harmful to service levels and our customers.

## **CAPITAL STRUCTURE**

12. Q. HAVE YOU REVIEWED THE TESTIMONY CONCERNING CAPITAL STRUCTURE FILED BY DR. BROWN?

A. Yes.

13. Q. WHAT CAPITAL STRUCTURE AND WEIGHTED COST OF CAPITAL DID THE COMPANY USE IN ITS PETITION IN THIS CASE?

A. The Company determined the capital structure used in its filing from the books and records of the Company, along with known and measurable changes to that Capital Structure that will occur in the Attrition Year in this case, to determine its

1 “stand alone” capital structure. The Company to my knowledge has never filed a  
2 rate case that included the imputation of double leverage from its parent. The  
3 reason for this is simple; the Company does not believe the use of a double  
4 leverage capital structure is appropriate for determining the cost of capital for the  
5 Company in a rate setting proceeding. The Company’s proposed capital structure  
6 in this case was attached to my direct testimony as Exhibit MAM-3.

7  
8  
9  
10 14. Q. DO YOU HAVE ANY CHANGES TO THE CAPITAL STRUCTURE YOU  
11 INCLUDED IN YOUR DIRECT TESTIMONY.

12 A. Yes. I am attaching the revised capital structure as Rebuttal Exhibit MAM-6.  
13

14 15. Q. PLEASE DESCRIBE THE CHANGES TO YOUR CAPITAL STRUCTURE?

15 A. At the time the Company’s filing in this case was prepared, I knew that TAWC  
16 was going to issue new debt in either late 2006 or early 2007 to replace short-term  
17 debt, and that in 2007 TAWC would refinance its \$19.0 million, 4.75% debt issue  
18 that would be subject to call prior to the IPO. In the capital structure proposed for  
19 this case I included \$36.5 million of new LT debt to provide the capital necessary  
20 to accomplish this. As stated in my direct testimony I indicated that I believed the  
21 interest rate would be 6.15% for the new LT Debt issue as shown on page 2 of 3  
22 of Exhibit MAM-3. I determined the interest rate by using the 2007 Value Line  
23 forecast for 10-year T-bonds adjusted for the latest 2 and 4 quarter average  
24 spreads of “A” –rated utility bonds from Value Line to arrive at my estimate as  
25 indicated on Exhibit MAM-4 of my direct testimony.  
26

27 After approval of the Company’s financing plan by the TRA, TAWC issued \$15.0  
28 million of new LT debt on February 15, 2007 at 5.39% for a term of seven years.  
29 In addition, as part of the on-going RWE divestiture cases around the country,  
30 RWE agreed to “make whole” the AWWC subsidiaries for any increase in interest  
31 rates related to the call of those bonds by RWE as a result of the IPO. I have

1 reflected on Rebuttal Exhibit MAM-6 the \$15.0 million LT debt issue at 5.39%,  
2 and reflected the current \$19.0 million, 4.75% issue in the capital structure so that  
3 there will be no impact on the rates charged to TAWC customers related to the  
4 IPO.

5  
6 I had indicated to the parties and the hearing officer at one of the status  
7 conferences regarding discovery disputes that the changes included in Rebuttal  
8 Exhibit MAM-6 would occur. I am simply following through with my  
9 representations given at that conference. I made those representations based on  
10 the commitment of RWE to make TAWC whole on any increase in interest rate  
11 related to the early call of the \$19.0 million LT Debt issue; and indicated I would  
12 amend TAWC's capital structure and make the TRA Directors and all parties  
13 aware of these developments.

14  
15 16. Q. WHAT IMPACT DOES THE ADJUSTMENTS JUST MENTIONED HAVE ON  
16 THE WEIGHTED COST OF CAPITAL?

17 A. As reflected on Rebuttal Exhibit MAM-6 these adjustments lower our requested  
18 weighted LT debt cost to **3.232%** (from the 3.593% included in the Petition and  
19 my direct testimony), and lowers the Overall Weighted Cost of Capital ("WCC")  
20 to **8.100%** from the requested amount of 8.466%.

21  
22 17. Q. WHAT CAPITAL STRUCTURE METHODOLOGY HAS BEEN UTILIZED  
23 BY DR. BROWN IN ARRIVING AT HIS RECOMMENDATION FOR THE  
24 COST OF CAPITAL?

25 A. Dr. Brown determines his recommended capital structure by starting with the  
26 Company's capital structure as filed and adjusting that capital structure for the  
27 impact of double leverage. He then goes through an analysis to determine in his  
28 terms the level of capital structure that comes from external sources (non parent  
29 company related) and the portion of the capital that in his opinion is derived from  
30 internal sources (the parent company relationship). He then applies his  
31 interpretation of the AWWC capital structure ratio's to the portion of TAWC's

capital structure that he says are obtained through AWCC or AWWC (internal capital). He then applies his estimated cost rates for Debt and Common Equity to arrive at a Weighted Cost of Capital ("WCC") that he applies to his parent company derived portion of the capital structure. He then applies the actual cost rates for what he considers external debt to arrive at an average cost of capital for that portion of the capital structure. He then sums the total of the external cost of capital and the parent company supplied capital to arrive at his overall recommendation for WCC.

18. Q. OBVIOUSLY THERE IS A HUGE DIFFERENCE IN THE CAPITAL STRUCTURE AND WCC PROPOSED BY THE COMPANY AND THE CAPD IN THIS CASE. WOULD YOU DEMONSTRATE THOSE DIFFERENCES AND THEIR IMPACT ON THIS CASE?

A. Yes. Table 2 below provides a comparison of the capital structures and WCC of the Company and the CAPD.

**Table 2: Comparison of Capital Structure and WCC**

	<u>TAWC</u>				<u>CAPD</u>		
	<u>%</u>	<u>Rate</u>	<u>WCC</u>		<u>%</u>	<u>Rate</u>	<u>WCC</u>
<b>LT Debt</b>	53.07%	6.08%	<b>3.227%</b>		14.70%	9.30%	<b>1.37%</b>
<b>LT Debt Parent</b>					59.70%	5.30%	<b>3.16%</b>
<b>ST Debt</b>	3.76%	5.40%	<b>0.203%</b>				
<b>Pref.Stock</b>	1.32%	5.00%	<b>0.066%</b>				
<b>Com.Equity</b>	41.86%	11.00%	<b>4.604%</b>		25.60%	7.50%	<b>1.92%</b>
<b>Total</b>	100.00%		<b>8.100%</b>		100.00%		<b>6.45%</b>

The difference in capital structures and WCC has a major impact on the difference in the proposed revenue requirements in this case. The difference in revenue requirement related to capital structure and WCC as filed by the Company and the CAPD in this case is \$4.041 million. The difference is reduced

1 to \$3.637 million when the amended TAWC capital structure included in Rebuttal  
2 Exhibit MAM-6 is used. Dr. Brown's recommendation of a WCC of 6.4% is a  
3 major driver of the reduction of revenues for TAWC proposed by the CAPD in  
4 this case and a major driver of the disastrous financial results (ROE) described in  
5 Table 1 provided earlier in this testimony. As stated earlier in this testimony and  
6 in Dr. Vilbert's rebuttal, Dr. Brown's recommendations when combined with the  
7 CAPD's proposal to reduce current rates by \$2.062 million, if accepted, would  
8 result in financial ratios consistent with BB Bond Ratings ("junk bonds") or lower  
9 and could not meet the financial integrity and capital attractions tests in the  
10 landmark "Bluefield" and "Hope" U. S. Supreme Court decisions.

11  
12 19. Q. IN YOUR OPINION HOW WOULD DR.BROWN'S RECOMMENDATION BE  
13 VIEWED BY THE COMPANY AND ITS INVESTORS?

14 A. Very critically. Dr. Brown's recommendation of 7.5% ROE at a 25.6% equity  
15 ratio as Dr. Vilbert points out places TAWC at best at a BB S&P rating. His  
16 WCC of 6.4% implies that there is essentially no more risk associated with an  
17 equity investment in TAWC than a debt investment. There is no financial theory  
18 documentation anywhere that supports the unreasonable results recommended by  
19 Dr. Brown.

20  
21 I am providing Rebuttal Exhibit MAM-7 to demonstrate how an investor would  
22 view the impact of Dr. Brown's recommendation on TAWC's capital structure.  
23 The first two sections are the TAWC capital structure as included in the Petition  
24 in this case and as amended by Rebuttal Exhibit MAM-6. The last three columns  
25 of the exhibit show the impact of Dr. Brown's recommendation at the TAWC  
26 level. In order to reach his recommendation for WCC of 6.5% it implies an  
27 equity cost at the subsidiary level of 7.18% as indicated in the highlighted box. I  
28 question why any investor would willingly provide additional equity to a  
29 company under this scenario. If it were your or my 401(k) or IRA fund  
30 considering an equity investment, I doubt that we would knowingly take on the

1 additional risk associated with that equity investment at an expected return of  
2 7.18%.

3  
4 It is my opinion that the investors in TAWC would view the impact of Dr.  
5 Brown's recommendation as described on Rebuttal Exhibit MAM-7 and the  
6 attraction of capital under that scenario would be compromised significantly.  
7

8 20. Q. WHAT IS THE COMPANY'S POSITION ON THE "DOUBLE LEVERAGE"  
9 CAPITAL STRUCTURE PROPOSED BY DR. BROWN?

10 A. The Company does not believe that the use of a "double leverage" capital  
11 structure in setting rates for TAWC is appropriate. The Company believes one of  
12 the major components of regulation is to determine what the cost of capital for a  
13 regulated business is. Where the regulated business obtains that capital should  
14 have no bearing on the determination of a fair and reasonable cost of capital used  
15 to determine just and reasonable rates for that entity. Whether it be an individual,  
16 an institutional investor, or a utility holding company that makes the equity  
17 investment, should have no bearing on establishing the true cost of the capital for  
18 a regulated entity. Just because the equity investor happens to be a utility holding  
19 company does not and should not have a bearing on determining the true cost of  
20 capital for setting just and reasonable rates. The individual investing in a mutual  
21 fund or an institutional investor can just as easily use their borrowing power to  
22 obtain the funds to invest in equity capital as could a utility holding company, but  
23 in the case of rate making they are handled quite differently. The cost of equity is  
24 what the market determines it to be and should not be influenced by where the  
25 equity investor obtains the funds to purchase that equity interest. The Company  
26 believes the capital structure of TAWC as included in the Company's filing (as  
27 amended in Rebuttal Exhibit MAM-6) should be used in determining the cost of  
28 capital in this proceeding.  
29

30 21. Q. HAS THE TRA HISTORICALLY USED A "DOUBLE LEVERAGE" CAPITAL  
31 STRUCTURE IN SETTING THE RATES OF THE COMPANY?

1 A. Yes.

2  
3 22. Q. IF THE TRA DECIDES TO USE A DOUBLE LEVERAGE CAPITAL  
4 STRUCTURE IN THIS CASE WHAT IS THE COMPANY'S POSITION ON  
5 DR. BROWN'S CAPITAL STRUCTURE?

6 A. If the TRA elects to continue to determine just and reasonable rates using the a  
7 capital structure impacted by parent company capital, Dr. Brown's use of a 70%  
8 debt, 30% equity parent company capital structure is unreasonable and not  
9 supported by the capital structure of AWWC prior to RWE ownership, currently,  
10 or at the time of the IPO.  
11

12 23. Q. WHERE DID DR. BROWN OBTAIN THE INFORMATION TO SUPPORT HIS  
13 RECOMMENDATION OF THE PARENT COMPANY CAPITAL  
14 STRUCTURE?

15 A. It appears from annual reports somewhere in the timeframe of 1997 to 2005 for  
16 either AWWC or TWAUSHI, but it is not clear. On page 2 of his testimony he  
17 claims he is providing his recommendation without knowing the capital structure  
18 and capital costs of TAWC's soon-to-be parent, AWW. I would just like to  
19 clarify that AWW has been TAWC's parent for at least 50 years and that  
20 relationship did not change with the purchase of the AWW stock by RWE. On  
21 page 11 of Dr. Brown's testimony at lines 20-36 and continuing on pages 12 and  
22 13 he refers to the AWWC capital structure prior to RWE, RWE's capital  
23 structure at the time of case number 03-00118, AWWC's capital structure in early  
24 2002, and recent audits of AWWC. While he mentions all of this information  
25 there is no clear indication of what period or on which entity he is basing his  
26 recommendation.  
27  
28

29 24. Q. DO YOU HAVE CONCERNS ABOUT DR. BROWN'S USE OF THIS DATA?

30 A. Yes, I have two primary concerns. I believe all of the AWWC and TWAUSHI  
31 capital structures mentioned by Dr. Brown come from consolidated audited



1 financial statements. Those consolidated audited statements include the roll-up  
2 of the subsidiary debt at the consolidated level. Even though I don't agree with  
3 the so-called "double leverage" capital structure approach, it is my belief that the  
4 concept attempts to capture the source of the funds utilized to invest in the equity  
5 of a subsidiary. Dr. Brown's numbers include the debt issued at the AWWC  
6 subsidiary level (including the debt of TAWC) which would dilute the equity ratio  
7 of the parent company on the consolidated basis. If double leverage is applied,  
8 only the debt/equity ratios of the parent as a stand-alone entity should be utilized.  
9 Certainly the subsidiary debt issued by the subsidiaries, including TAWC, are not  
10 a source of funds for AWWC to invest in the equity of those same subsidiaries  
11 because they were utilized to fund the subsidiary operations, including funding  
12 on-going capital improvements. In addition, if double leverage is applied the  
13 retained earnings at the subsidiary level should not be subject to the parent  
14 company stand-alone capital structure. The retained earnings at TAWC were  
15 generated through TAWC's dividend policy of retaining 25% of earnings for re-  
16 investment. The retained earnings are a function of capital that could have been  
17 paid to the stockholders as dividends. Retained earnings should not be subject to  
18 double leverage, because they are not funded by the parent company capital  
19 structure.

20  
21 The second area of concern relates to the equity ratio of AWWC in the  
22 consolidated capital structure which has not only been impacted by subsidiary  
23 debt, but also impacted by the premium paid by RWE for the common stock of  
24 AWWC. The capital raised to purchase the stock of AWWC was certainly not a  
25 source of funds for AWWC to invest in equity at the subsidiary level. Dr.  
26 Brown's approach incorrectly and inappropriately imputes the impact of double  
27 leverage for both the subsidiary debt and the additional capital utilized to fund the  
28 purchase of AWWC's common stock to artificially deflate the equity ratio for  
29 AWWC in his proposed capital structure.  
30



1 25. Q. WHAT PARENT CAPITAL STRUCTURE DID DR. BROWN RECOMMEND  
2 IN CASE NUMBER 04-00288?

3 A. On schedule 9 of his testimony in case number 04-00288 he used a parent  
4 company equity ratio of 51.1%.

5  
6 26. Q. HOW DID HE COME TO THAT RECOMMENDATION?

7 A. Dr. Brown utilized an average of the capital structures of the sample of water  
8 companies used for his cost of equity calculations to arrive at his parent company  
9 capital structure utilized to apply double leverage to the TAWC capital structure.  
10 Based on discovery in that case and his testimony he used that approach because  
11 the equity ratio's determined from RWE's annual report generated under  
12 "International Accounting Standards" were so low as to not appear reasonable and  
13 "not representative of private water-supply companies in the United States" (See  
14 page 5 – line 6-8 of Dr. Brown's testimony in case number 04-00288).

15  
16 27. Q. DID CASE NUMBER 04-00288 END IN SETTLEMENT?

17 A. Yes. TAWC came to settlement on all issues in that case as approved by the TRA  
18 in its order of July 21, 2005.

19  
20 28. Q. WHAT CAPITAL STRUCTURE WAS INCLUDED IN THAT SETTLEMENT  
21 AGREEMENT AND TRA ORDER?

22 A. The capital structure used in the settlement is shown on schedule 9 of the  
23 settlement agreement. As indicated on that schedule the capital structure  
24 proposed by Dr. Brown was used with an ROE of 9.9%.

25  
26 29. Q. DOES DR. BROWN MENTION OTHER SUPPORT FOR THE PARENT  
27 COMPANY CAPITAL STRUCTURE HE USED IN THIS CASE?

28 A. Yes. On page 11, lines 20-22 of his testimony he says that "in his opinion  
29 consumers can only be protected by a capital structure based on AWWC's past  
30 behavior." On page 1, lines 24-30 he indicates "there is good reason to base any  
31 change of rates for Tennessee-American Water Company's customers on a capital

1 structure and a capital cost that reflects the utmost caution towards the financial  
2 behavior of TAWC's parent, American Water Works."

3  
4 He utilizes these terms to set the stage for his basis (an unfounded theory) for  
5 using the 70% debt-30% equity parent capital structure. On page 2, beginning on  
6 line 1 he says, "I have the opinion because in the discovery process TAWC has  
7 made representations that differ significantly from the Company's statement made  
8 under oath in 2003 regarding AWW's potential transformation to a publicly-  
9 traded stock and the possible effects on TAWC's capital structure and costs."

10  
11 30. Q. WHAT REPRESENTATIONS BY TAWC IS DR. BROWN REFERRING TO?

12 A On page 8 he refers to the statement I made before the hearing officer and the  
13 parties indicating that I expected the IPO to have limited impact on the rate payers  
14 and relaying to them that the debt issued in February was at an interest rate lower  
15 than the 6.15% I used for the new LT debt issue included in our filing and my  
16 direct testimony. I also indicated that RWE had committed to Commissions in a  
17 number of states that RWE would make the AWWC subsidiaries whole for any  
18 increase in interest rates on the call of bonds due to the IPO. I told the parties at  
19 that meeting that I would make those changes known to the TRA and parties to  
20 this case which I have now done in Rebuttal Exhibit MAM-6. In addition, he  
21 correctly indicates that I represented there had been no change in TAWC's  
22 dividend policy since RWE purchased AWWC and that I did not expect any  
23 change in that policy going forward.

24  
25 He then refers to a portion of the transcript in case number 03-00118 concerning  
26 my testimony and claims these representations conflict, and formulates his theory  
27 that any AWWC capital structure at the IPO or post IPO could not be trusted or  
28 sustained.

29  
30 31 Q. WHY DOES DR. BROWN INDICATE YOUR REPRESENTATIONS ARE IN  
31 CONFLICT?

1           A.    On page 10, line 1-8 he provides a question and my answer in case number 03-  
2               00118. In that answer the recorder (or stenographer) typed the word "retract."  
3               This is a typographical error, I am certain that I used the word attract. This  
4               testimony was related to the public fire service issue in that case, which was the  
5               one issue not settled and which went to full hearing before the Directors. I was  
6               addressing in that case the positions of the CAPD, the City and CMA that TAWC  
7               should have the rate recovery of its cost of service permanently lowered by \$1.1  
8               million. This particular testimony was given as rebuttal to CMA witness  
9               Gorman's position that TAWC could just make all this go away by writing off  
10              \$8.0 to \$10.0 million of rate base that was going to remain used and useful. Mr.  
11              Gorman also suggested that TAWC could fix the capital structure ratio problems  
12              by having the stockholders infuse more equity in a company (TAWC) to correct  
13              the write-off rate base that would still be providing service. I believe Dr. Brown  
14              was an active participant in that case and present for this testimony. I believe any  
15              financial person reading that transcript beginning on page 173 through 183 in the  
16              context of the entire testimony would know that I said attract and not retract as the  
17              recorder typed. I don't know if there is an audio of that transcript, but if you  
18              listened to that I am sure I said attract. On page 176 of that same transcript,  
19              beginning on line 10 I said, "To cure this financial harm and restore our credit  
20              quality, the company can forgo an additional \$5 to \$6 million of dividends over  
21              the next three-to four-year period. Or he suggests the Company cheerfully invest  
22              an additional equity of between 5 or 6 million to cure this situation." On page  
23              177 of the same transcript beginning on line 4 the question was ask, "Given that  
24              scenario (the one just described above), would you want to invest in Tennessee-  
25              American Water Company?" and my answer was given beginning on line 6, "I  
26              think not. The stockholders, I believe would not look favorably on a situation  
27              where they invested in good faith in plant to provide service and be deprived of a  
28              revenue stream to cover that investment, and be deprived of an opportunity to  
29              achieve a fair and reasonable return on that investment." The question leading to  
30              Dr. Brown's inaccurate assertion began on line 13, Q. "Is Tennessee American  
31              guaranteed additional parent company equity or debt through American Water?"

1 and my answer was given in the context of if TAWC could not get capital from  
2 AWWC, "There is always a possibility that the company would have to *attract*  
3 (retract) that capital as a stand-alone entity in the public market. In the context of  
4 the exchange the work retract makes no sense, how could TAWC retract capital  
5 in the public market?  
6

7 32. Q. IS THERE OTHER EVIDENCE THAT SUPPORTS YOUR CONTENTION  
8 THAT THE WORD RETRACT IS A TYPOGRAPHICAL ERROR?

9 A. Yes. In the same transcript described above on pages 60 through 69 is the  
10 summary of my testimony at that hearing. On page 68 lines 8 through 18, I say,  
11 "If the Company's demonstrated revenue requirement is permanently reduced by  
12 the fire protection reduction, it will permanently be precluded from having an  
13 opportunity to achieve a fair and reasonable return on its investment in  
14 Chattanooga. That would effectively place the company on a path of financial  
15 hardship that could lead to a situation where it has trouble meeting its public  
16 service obligation and place the company in a position where it could not **attract**  
17 debt at reasonable rates, if at all, and certainly would have trouble **attracting**  
18 outside equity."  
19

20 In addition, I refer you to the transcript of the TRA conference held on August 4,  
21 2003 in docket 03-00118 where on page 6, beginning on line 25 and continuing  
22 on to page 7, Chairman Kyle said, "Denying such may impede the water company  
23 from attracting sufficient capital to properly maintain the existing plant and  
24 restrict future improvements."  
25

26 33. Q. WHAT CONCLUSION CAN YOU REACH ABOUT DR. BROWN'S  
27 CONTENTION THAT YOU HAVE PROVIDED CONFLICTING  
28 REPRESENTATIONS?

29 A. I believe that is a serious accusation about my truthfulness. Based on his  
30 misrepresentation of the record in case 03-00118 Dr. Brown says on page 9,  
31 beginning on line 9, "TAWC's statements refer to future events. In this situation

1 it is not possible to declare that one scenario is accurate and the other is wrong, or  
2 that one scenario is the truth while the other is not.” I take that to mean I have not  
3 been truthful. I take my credibility very seriously and that credibility is critical in  
4 my position of representing several AWWC subsidiaries before regulatory  
5 commissions. I take strong exception to Dr. Brown’s baseless assertion about my  
6 truthfulness, particularly given that he should certainly have attempted to verify  
7 his assertion in the context of the entire testimony before making such a serious  
8 accusation. I believe that with the least bit of effort (e.g. through a discovery  
9 request) he could have determined his accusation was not based on reasonable  
10 facts. I believe the more complete record and history described above clearly  
11 indicates that Mr. Brown has based his proposed 70/30 parent capital structure on  
12 a **typographical** error. This portion of his testimony should be given no credence  
13 by the Directors in that it is not based on any fact or reasonable conclusion.  
14 Contrary to Dr. Brown’s claim that pro-forma data supplied by TAWC is not  
15 reliable (his assertions were based on a typographical error), TAWC has and will  
16 continue to provide only information that can be supported by fact and that can be  
17 relied upon in this case.

18  
19 34. Q. HAS THE COMPANY PROVIDED THE PRO-FORMA CAPITAL  
20 STRUCTURE OF AWWC AFTER COMPLETION OF THE IPO?

21 A. Yes. The pro-forma capital structure of TWAUSHI/AWWC after the IPO was  
22 provided in the response to discovery request CAPD-01-Part III-Q008. This is  
23 the same capital structure provided in the Divestiture cases in Illinois, West  
24 Virginia, Pennsylvania, and New Jersey where settlements have been reached on  
25 approving the IPO. The West Virginia Order in case number 06-0597-W-PC  
26 issued on January 26, 2007 is being provided as Rebuttal Exhibit MAM-9 and its  
27 relevance to this testimony and rebuttal of Dr. Brown’s proposed capital structure  
28 will be discussed in the following paragraphs. This information has been  
29 provided protection under the supplemental protective order issued by the hearing  
30 officer. I am providing that same document attached to this testimony as Rebuttal  
31 Exhibit MAM-8 in both redacted version for the public record and unredacted

1 version under seal to maintain the confidentiality of the information as permitted  
2 in the Supplemental Protection Order.

3  
4 35. Q. WHAT INFORMATION IS INCLUDED IN EXHIBIT MAM-8?

5 A. (Begin redaction)  
6  
7  
8  
9  
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29  
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31

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(End redaction)

36. Q. WERE YOU A WITNESS IN WV CASE NO. 06-00597-W-PC MENTIONED ABOVE?

A. Yes. I was the witness that sponsored the settlement reached in that proceeding before the Commissioners.

37. Q. PLEASE DESCRIBE THE WEST VIRGINIA ORDER IDENTIFIED AS REBUTTAL EXHIBIT MAM-9 AND WHY IT IS RELEVANT TO YOUR DISCUSSION OF DR. BROWN'S CAPITAL STRUCTURE?

A. The WV PSC was the first regulatory commission to approve the IPO in a contested state. Scott Rubin was also a witness in the WV proceeding and his testimony in WV was very similar, if not the same, in WV as the Scott Rubin testimony Dr. Brown attached to his testimony in this case from the Pennsylvania case. While there are many conditions included in the settlement agreement in WV approved by the Commission in their order of January 26, 2007, settlement agreement condition 22-AA was the central condition to the settlement by the parties.

That condition incorporates the commitment by RWE to infuse cash equity into AWWC prior to the IPO. Rebuttal Exhibit MAM-9, page 17 includes the WV Commission discussion of the importance of that commitment in the second paragraph on that page. "Other conditions, though, such as Condition 22-AA, set forth new responsibilities. The Commission agrees with WVAWC, Staff and the CAD that the equity infusion into American Water's capital structure prior to the IPO is the heart of the settlement. Going forward, American Water's equity capital structure directly affects the cost of capital available to WVAWC, one of American Water's operating subsidiaries. Without an infusion to American

1 Water's equity capital structure, WVAWC's capital costs likely would increase.  
2 Under the settlement, sufficient capital will be added to put American Water in an  
3 equity position comparable to other similar companies. This is essential to protect  
4 West Virginia rate payers and the Commission applauds the parties for achieving  
5 this result."

6  
7 The third paragraph says, "While the Commission's statutory responsibility is to  
8 balance the interests of West Virginia ratepayers, the utility and the state's  
9 economy, the Commission recognizes that the capital infusion obligation, which  
10 was wrought in this West Virginia proceeding, will benefit the rate payers in the  
11 17 other operating subsidiaries of American Water." This includes TAWC.

12  
13 Finally in the fourth paragraph the WV PSC said, "The Commission also believes  
14 that the conditions relating to reporting requirements and IPO transactions costs  
15 are important to the settlement. The Commission should be promptly told when  
16 bond ratings deteriorate, and the settlement requires this to be done. Similarly,  
17 the Commission should be promptly told if American Water's capital structure  
18 deviates from what was promised in the settlement. And, the Commission should  
19 be informed if WVAWC plans to pay common dividends in excess of its historic  
20 level of 75 percent of net income."

21  
22 38. Q. DO THE COMMITMENTS MADE BY AWWC IN WEST VIRGINIA  
23 SUPPORT DR. BROWN'S CONTENTION THAT AWWC'S PROJECTED  
24 INFORMATION IS NOT RELIABLE OR SUSTAINABLE?

25 A. No, quite the opposite in fact.

26  
27 39. Q. WERE SIMILAR COMMITMENTS MADE IN THE PENNSYLVANIA, NEW  
28 JERSEY, ILLINOIS AND NEW JERSEY SETTLEMENTS REFERENCED  
29 PREVIOUSLY?

30 A. Yes. After RWE made the equity infusion commitments in WV and the  
31 settlement was reached, similar commitments were made in the other divestiture



1 proceedings and settlements were completed. All of those settlements include  
2 conditions similar to those in WV. I believe the condition contained in the Illinois  
3 settlement with the AG in case number 06-0336 bears mentioning. Condition P  
4 on page 5 of the settlement says, "RWE has made the commitment that AWW's  
5 common equity ratio will be at least 45% at the time of the IPO. As of December  
6 15, 2006, RWE infused \$1.194 billion of common equity capital into AWW. If  
7 any additionally equity capital is needed to achieve a common equity of at least  
8 45% at the time of the IPO, the required infusion by AWW will be provided prior  
9 to the IPO. The calculation of common equity ratio will not include equity-like  
10 financial instruments. AWW will file a balance sheet as of the quarter ended  
11 immediately preceding the IPO." The settlement agreements for the other states  
12 can be found on the commission websites under cases numbers New Jersey-  
13 #WM06050388, and Pennsylvania-#A212285F0136.

14  
15 40. Q. DO YOU HAVE ANY CONCERN THAT AWWC WILL NOT MAINTAIN  
16 THE CAPITAL STRUCTURE AT OR ABOVE THE EQUITY LEVELS TO  
17 WHICH IT HAS NOW COMMITTED BEFORE AT LEAST FIVE STATE  
18 REGULATORY COMMISSIONS?

19 A. I have no concerns that AWWC will not honor their commitments. AWWC is  
20 required to report to each of those Commissions a reduction in Common Equity if  
21 it falls below 45% of pure equity (excluding any equity-like components of the  
22 capital structure like convertible debt and preferred stock which the bond rating  
23 agencies do give equity credit) immediately and report any decline in the bond  
24 rating of AWWC after the IPO. I have no doubt AWWC would be called before  
25 those Commission in short order to explain any shortfall and face possible  
26 sanctions for those actions if they occurred. I also believe any increase in interest  
27 rates for such actions would be eliminated from rate recovery. AWWC's  
28 credibility before the Commission's would be damaged significantly and I know  
29 AWWC would make every effort to not let that happen.

1 41. Q. WHAT IS YOUR RECOMMENDATION REGARDING CAPITAL  
2 STRUCTURE?

3 A. My recommendation is that the TRA set rates in this case on the stand-alone  
4 capital structure of TAWC as filed in this case as amended by Rebuttal Exhibit  
5 MAM-6, because that capital structure reflects the capital invested in the rate base  
6 of TAWC on which a fair and reasonable return should be established in this case.  
7 If the TRA elects to continue its imputation of double leverage, it should amend  
8 Dr. Brown's proposed capital structure to reflect the (begin redaction) (end  
9 redaction) equity capital of AWWC post IPO and which is essentially in place as  
10 of March 31, 2007.  
11

12 **COST OF CAPITAL OTHER THAN COST OF EQUITY**  
13

14 42. Q. HAVE YOU REVIEWED UPDATED INFORMATION ON CURRENT BOND  
15 MARKET CONDITIONS SINCE YOU FILED YOUR DIRECT TESTIMONY?

16 A. Yes. In my direct testimony I included Exhibit MAM-4 which recapped bond  
17 market information from October 2005 through September 2006. From this  
18 information I obtained average quarterly spreads between A-rated utility bonds  
19 and 30-year T-bonds according to the Value Line Publications. From this  
20 information I determined the latest two and four quarter spreads and applied those  
21 spreads to the 2007 Value Line forecast for 30-year T-bonds to arrive at a  
22 reasonable forecast of the coupon rate for the Company's bond refinancing that  
23 will occur in 2007, the attrition year in this case. I have updated direct testimony  
24 Exhibit MAM-4 to reflect the Value Line recap of bond rates through the latest  
25 publication date of March 14, 2007. This updated information is being provided  
26 as Rebuttal Exhibit MAM-10 attached to this testimony. I have also included the  
27 updated forecast of bond rates into the amended capital structure provided in  
28 Rebuttal Exhibit MAM-6.  
29

30 43. Q. DO YOU HAVE FURTHER COMMENTS REGARDING REBUTTAL  
31 EXHIBIT MAM-10?

1 A. Yes. I will use the forecasted interest rate of for 30-year A rate utility bonds in  
2 my rebuttal concerning Dr. Brown's recommendation of an ROE of 7.5% in the  
3 following section of this testimony.  
4

5 **RETURN ON EQUITY**  
6

7 44. Q. HAVE YOUR REVIEWED THE TESTIMONY OF DR. BROWN  
8 REGARDING RETURN ON EQUITY?

9 A. Yes.  
10

11 45. Q. DO YOU HAVE ANY GENERAL COMMENTS ABOUT THAT  
12 TESTIMONY?

13 A. Yes. As I read Dr. Brown's testimony, it is his opinion and belief that his analysis  
14 fully captures investor expectations and produces an ROE of 7.50%. He relies  
15 primarily on his DCF calculation. His DCF actually produces 7.6%. He performs  
16 a CAPM analysis, but he mercifully did not rely on his calculation under that  
17 method which produced 6.3%. The 6.3% ROE result in Dr. Brown's CAPM is  
18 less than 50 basis points higher than the 30-year, A-rated bond rates I determined  
19 on Rebuttal Exhibit MAM-10. His recommendation for ROE of 7.5% is only  
20 146 basis points above those bond rates. The Company does not believe the risk  
21 premiums just described are in line with the risk premium between 30-year A-  
22 rated utility bonds and the ROE's granted other water companies of similar risk in  
23 regulatory jurisdictions where American Water subsidiaries have received orders.  
24 The 7.5% ROE is manifestly inadequate. The end result of the Dr. Brown's  
25 calculations produce a result that is significantly below ROE's in all other U.S.  
26 regulatory jurisdictions included in my analysis for water companies of similar  
27 risk. I will address the ROE's awarded in other states and Dr. Vilbert will address  
28 the shortcomings of the determination of a 7.5% ROE using the DCF and CAPM  
29 calculations.  
30

1 46. Q. HAS DR. BROWN MISSED AN IMPORTANT CONSIDERATION IN HIS  
2 RECOMMENDATION OF A 7.5% ROE?

3 A. I believe he has. An ROE authorized by a regulatory commission must pass the  
4 constitutional tests established in the landmark cases Bluefield Waterworks and  
5 Hope Gas. Those cases as decided by the U. S. Supreme Court provide the basic  
6 tests for regulatory commissions in establishing a fair and reasonable return on  
7 equity. Those orders establish that the cost of equity established for a regulated  
8 entity must provide the opportunity to achieve an ROE that 1) permits the  
9 Company to attract capital, 2) maintains the financial integrity of the Company,  
10 and 3) the cost of equity capital should be authorized at a rate comparable to that  
11 of companies of similar risk. The Company believes Dr. Brown's  
12 recommendation if approved by the TRA would fail these basic tests. My rebuttal  
13 testimony will focus on the comparable earnings test by comparing the authorized  
14 equity returns of TAWC's sister companies and three Aqua American companies  
15 as approved in other regulatory jurisdictions.  
16

17 47. Q. WHY SHOULD THE TRA CONSIDER THE A-RATED UTILITY BONDS TO  
18 BENCHMARK THE BASIS POINTS SPREAD (RISK PREMIUM) FOR THE  
19 COMPANY'S ROE IN THIS CASE?

20 A. The utility business is a long-term business. Utility plant investments are  
21 recovered over many years, with useful depreciation lives for water mains, for  
22 instance, of upwards of 70 years. Many water lines and treatment plants remain  
23 in service for over 100 years. It is also a ratemaking and financial community  
24 axiom that there is greater risk associated with the ownership of the equity in a  
25 company than with the ownership of the debt of a company, based on the simple  
26 fact that the shareholders stand "last in line" in the event of dissolution.  
27 Consequently, a comparison of current rates for long-term bonds in relation to  
28 authorized ROEs provides a viable and meaningful benchmark of the extent of  
29 that additional risk as authorized by regulatory commissions for companies with  
30 the most similar risk to that of the Company. A-rated utility bonds provide the  
31 best reflection of the risk associated with equity because the interest rates on those

1 bonds reflect the cost at which the utility could obtain that long-term debt in the  
2 market at any given time.

3  
4 48. Q. YOU INDICATED EARLIER THAT YOU DISAGREE WITH THE ROE  
5 RECOMMENDATIONS OF DR. BROWN. WHY?

6 A. The recently authorized ROEs for other American Water operating subsidiaries  
7 and the Aqua American subsidiaries for which I could obtain information, when  
8 compared to the Value Line interest rate for A-rated utility bonds at the time of  
9 the Order, demonstrates just how unreasonable Dr. Brown's ROE  
10 recommendation is. This comparison is a simple method the Commission can use  
11 to benchmark the risk between A-rated utility bonds and equity recognized by  
12 Commissions in other jurisdictions in determining a fair and reasonable rate of  
13 return on equity, and to benchmark the fairness and reasonableness of the  
14 recommended ranges of ROE in this case.

15  
16  
17 49. Q. WHAT ARE THE ROE's CALCULATED USING THIS APPROACH?

18 A. On Rebuttal Exhibit MAM-11, I applied the projected 2007 30-year A-rated  
19 utility bond rates of 6.04% (latest 4 qtr. Spread) and 6.02% (latest 2 qtr. Spread),  
20 and then added the average spread (risk premium) of the American Water  
21 subsidiaries and Aqua American subsidiaries authorized return on equity to  
22 produce ROE's of 10.48% and 10.45%, respectively. These calculations produce  
23 results very close to the range provided by Dr. Vilbert.

24  
25 50. Q. WHY SHOULD THE TRA REVIEW THE LEVEL OF ROE AUTHORIZED BY  
26 OTHER REGULATORY JURISDICTIONS?

27 A. The Company does not obtain its equity capital in the open market, but obtains  
28 that equity from American Water. Each of the rate of return witnesses recognizes  
29 this fact and utilizes a proxy group of publicly-traded water companies to  
30 determine a market expectation of ROE. There is an incredibly wide range of  
31 recommendations from the cost of capital witnesses for the Company and the

1 CAPD in this case. If the Company (or any company) is to be able to attract  
2 capital when needed to maintain facilities and improve service it must have the  
3 opportunity to achieve an ROE that is comparable to companies with similar risk.  
4 I believe it is appropriate, if not essential, that the TRA review all available data  
5 on ROE, including the level of ROE that other regulatory commissions are  
6 recognizing as fair and reasonable based on the most current data. All of the  
7 AWWC subsidiaries obtain their equity capital from the same parent, as do the  
8 Aqua American subsidiaries. The AWWC subsidiaries obtain their debt from  
9 AWCC, all have similar capital structures, and all face similar financial and  
10 business risks. These returns can, at the very least, provide a frame of reference  
11 and comparison for the TRA to benchmark its determination of a fair and  
12 reasonable return on equity in this case.  
13

14 51. Q. YOU INCLUDED THE RECOMMENDED ROE OF DR. BROWN IN THIS  
15 CASE ON THIS SCHEDULE. HOW DO THOSE RECOMMENDATIONS  
16 COMPARE?

17 A. I included those ROEs to show how low and unreasonable they are. The  
18 recommended 7.5% ROE of Dr. Brown compared to the calculated 2007 A-rated  
19 utility bonds on Rebuttal Exhibit MAM-11 produces a spread of only 146 and 149  
20 basis points respectively, far below that recognized in any other jurisdiction in  
21 which American Water operates. It is worthy of note that the average ROE  
22 authorized between 2004 and 2007 is **10.14%**. Dr. Brown's recommendation is  
23 256 basis points below the average spread produced from the latest authorized  
24 ROE for all American Water Subsidiaries and the three Aqua American  
25 subsidiaries receiving Commission orders since 2004. The Company believes an  
26 ROE spread to current A-rated utility bond projections this far below other  
27 regulatory jurisdictions is unreasonable and out of touch with market  
28 expectations.  
29

30 52. Q. IS THE COMPANY ASKING THE TRA TO USE THE METHOD JUST  
31 DESCRIBED TO DETERMINE THE ROE?

1 A. No. The Company is only asking that the TRA consider the information as a  
2 benchmark in determining the reasonableness of the ROE it establishes in this  
3 case and to point out the unreasonableness of Dr. Brown's recommended ROE.  
4 The Company believes that a comparison of other Commission established risk  
5 premiums between ROE and the A-rated utility bonds at the time the ROE was  
6 established, when compared to the current bond market expectations, provides a  
7 valuable point of reference for the TRA. This is particularly true when the  
8 comparative companies compete for the same equity capital, obtain their capital  
9 from the same source, and have very similar business and financial risk.

10  
11 53. Q. HOW DOES DR. BROWN'S RECOMMENDATION ON ROE IN THIS CASE  
12 COMPARE TO THE ROE APPROVED BY THE TRA IN THE COMPANY'S  
13 LAST RATE CASE, CASE NO. 04-00288?

14 A. The Company was authorized an ROE of 9.9% in its last rate case which was the  
15 ROE included in the settlement between TAWC and the CAPD, and approved by  
16 the TRA in its order dated July 21, 2005. I have looked at the bond market  
17 conditions at the time the settlement in that case was reached and compared the  
18 current bond market conditions to the bond market conditions in February 2005  
19 and find no justification for a reduction from the currently authorized ROE of  
20 9.9%. In fact the numbers support an increase in authorized ROE.

21  
22  
23  
24  
25 54. Q. WOULD YOU DEMONSTRATE THE FACTORS THAT CONTRIBUTE TO  
26 YOUR BELIEF THAT AN INCREASE IN ROE IS WARRANTED WHEN THE  
27 CURRENT BOND MARKETS ARE COMPARED TO THOSE AT THE TIME  
28 OF THE ORDER IN THE PRIOR RATE CASE?

29 A. Yes. I have prepared a schedule to demonstrate this fact and attached that  
30 schedule to this testimony titled Rebuttal Exhibit MAM-12.

1 55. Q. PLEASE EXPLAIN REBUTTAL EXHIBIT MAM-12?

2 A. The first section compares the interest rates as published by Value Line for 30-  
3 year A-rate utility bonds, 10-year A-rated corporate bonds, 30-year T-bonds and  
4 10-year T-bonds at the time the settlement was reached in the Company's  
5 previous rate case to the 9.9% ROE approved by the TRA. In the second section I  
6 then applied those equity to bond spreads from the previous rate case to the most  
7 current Value Line (April 6, 2007) rates for those same bonds. The results  
8 produced ROE's ranging from 10.58% to 10.03% and an average of the four ROE  
9 results of 10.32%. The last section uses the current Value Line forecast (February  
10 23, 2007) for 30-year T-bonds (5.0%) and applies the spread of (5.22%) present a  
11 the time of the settlement in case 04-00288 to arrive at a projection of ROE of  
12 10.22%.

13  
14 56. Q. YOU HAVE PROVIDED SEVERAL CALCULATIONS THAT IN THE  
15 COMPANY'S OPINION SHOULD BE USED TO BENCHMARK THE ROE  
16 THE TRA ULTIMATELY DECIDES IN THIS CASE. WOULD YOU RECAP  
17 THOSE CALCULATIONS?

18 A. Yes. The following schedule will recap the ROE results from Rebuttal Exhibits  
19 MAM-11 and MAM-12.

20  
21 **Table MAM-3**

22 **Rebuttal Exhibit MAM-11:**

23 Average of AWWC& Aqua subs. Auth. ROE	10.14%
24 ROE using current bond information and AW avg. spread	10.45%

25 **Rebuttal Exhibit MAM-12:**

26 Avg. ROE based on current bond market	10.32%
27 ROE based on current 2007 bond forecast	<u>10.22%</u>
28 Average of four calculations	<b>10.28%</b>

29  
30 57. Q. WHAT DO YOU BELIEVE THE TABLE ABOVE INDICATES?



1           A.     I believe the above table if viewed by any prudent investor would indicate that the  
2                   cost of equity based on a reasonable risk premium applied to the current bond  
3                   market conditions and forecasts for the 2007-2008 attrition year in this case would  
4                   indicate an ROE of at least 10.28% as reasonable. I believe this table also  
5                   indicates that when current bond market conditions are compared to those present  
6                   at the time of the Company's previous case, an increase in the currently  
7                   authorized ROE of 9.9% is warranted. I believe that this table also indicates that  
8                   Dr. Brown's recommendation of a 7.5% ROE is unreasonable and could not pass  
9                   any of the basic tests for a fair and reasonable ROE established in the **Bluefield**  
10                  and **Hope** cases, particularly the test of comparable earnings to companies of  
11                  similar risk.

12  
13     **RATE BASE & DEPRECIATION EXPENSE**  
14

15     58.     Q.     HOW DID TAWC ARRIVE AT ITS RATE BASE REQUESTED IN THIS  
16                   CASE?

17            A.     TAWC started with the rate base (Utility Plant Balances, CWIP, Capital Leases,  
18                   Accum. Depr., Accum. Def. Income Taxes, ITC and CIAC's) as of the historical  
19                   test-year June 30, 2006, and adjusted for known and measurable changes that will  
20                   occur through the mid-point of the attrition year for such items as, additional plant  
21                   in service, additional depreciation, additional deferred income taxes, and  
22                   amortization of ITC. This method is consistent with the approach used by TAWC  
23                   in past cases.

24  
25  
26     59.     Q.     HOW DID THE CAPD ARRIVE AT RATE BASE?

27            A.     The CAPD used the same beginning point, but elected to use a thirteen month  
28                   average of the attrition year. In so doing they included plant additions,  
29                   depreciation expense, deferred taxes, CIAC and ITC on a monthly basis through  
30                   February, 2008. They calculated a 13-month average of the rate base for the 13  
31                   month period ending February, 2008, the Attrition Year in this case. They

1 determined the rate base under this method was \$104,169,393. I agree with the  
2 CAPD methodology because that proposed method using the 13-month average is  
3 the correct method to calculate rate base. To their credit, the CAPD moved to this  
4 method in this case and this method is consistent with regulation in most states  
5 that use forecasted test-years. I am involved with the rate process in Kentucky  
6 and they use the 13-month average rate base method for the forecasted test-year  
7 period. The CAPD rate base results in a better match of the capital invested by  
8 TAWC (as shown on Rebuttal Exhibit MAM-6) which should be the target for  
9 setting rates in this case if those rates are to provide an opportunity to achieve the  
10 authorized ROE. I commend the CAPD for recognizing this improved method of  
11 determining rate base.

12  
13 60. Q. WERE THERE ANY ERRORS IN THE CAPD'S RATE BASE  
14 CALCULATIONS?

15 A. I hesitate to even mention them but I believe there are two errors that basically  
16 offset one another. The CAPD used accumulated depreciation at 12-31-06 but  
17 should have included additional depreciation through the attrition year. I believe  
18 this adjustment would have decreased their recommended rate base by  
19 approximately \$1.5 million. The second area involves Unamortized ITC. The  
20 CAPD deducted the Unamortized 4% and 10% ITC which would be in violation  
21 of normalization rules based on AWWC's election of Option 2 of the IRS rules.  
22 In his supplemental testimony submitted on April 3, 2007, Mr. Buckner  
23 acknowledged this error and made the adjustment. This adjustment increases the  
24 CAPD rate base by \$1,102,935. The net result of these adjustments would make  
25 the CAPD's rate base recommendation in this case \$103,815,196.

26  
27 61. Q. YOU MENTIONED THAT MR. BUCKNER HAD FILED SUPPLEMENTAL  
28 TESTIMONY ON APRIL 3, 2007. WHAT WAS YOUR REACTION TO THE  
29 SUPPLEMENTAL TESTIMONY?

30 A. Other than Mr. Buckner's adjustment to reflect the proper rate base reduction for  
31 Unamortized ITC, I find his supplemental testimony and recommendations

1 regarding rate base and depreciation expense troublesome, disturbing and  
2 disappointing.

3  
4 62. Q. EXPLAIN WHY YOU HAD THIS REACTION?

5 A. First let me say that TAWC has moved that Mr. Buckner's supplemental  
6 testimony regarding the E-CIS be stricken from the record because it was not filed  
7 timely within the procedural schedule issued in this case, was based on  
8 information clearly available to the CAPD in case number 04-00288 when the rate  
9 base was first approved for rate recovery, and **does not relate** to any discovery  
10 disputes which could be construed to have precluded Mr. Buckner from raising  
11 this issue in his direct testimony filed in accordance with the Procedural Schedule  
12 approved by the Hearing Officer in this case. Due to the very untimely filing of  
13 the supplemental testimony, it does not appear that the Hearing Officer will have  
14 time to rule on TAWC's motion to strike prior to the submittal of the rebuttal  
15 testimony on April 9, 2007; therefore, I will address this unsupported and  
16 unnecessary issue in this testimony.

17  
18 63. Q. WHAT IS CAPD WITNESS MR. BUCKNER PROPOSING REGARDING THE  
19 E-CIS INVESTMENT AND RELATED DEPRECIATION EXPENSE?

20 A. The E-CIS investment relates to the ORCOM software used by AWWC and  
21 TAWC to perform all customer contact, customer service, and billing, and  
22 collections activities. Mr. Buckner recommends that **\$1,343,298** of rate base be  
23 eliminated, including a reduction in associated depreciation expense of  
24 **\$1,056,344.**

25  
26 64. Q. DO THE CUSTOMER SERVICE AND FIELD SERVICE PERSONNEL AT  
27 TAWC RELY AND USE THIS SOFTWARE DAILY TO PROVIDE SERVICE  
28 TO ITS CUSTOMERS?

29 A. Yes. The E-CIS software and related devices are integral to providing service to  
30 the customers, issuing and tracking service requests, scheduling customer  
31 contacts, obtaining information for billing adjustments setting up customer

1 records, obtaining meter readings, issuing customer bills, and registering  
2 collections of customer bills. TAWC could not effectively provide service to its  
3 customers without the E-CIS system or in the absence of the E-CIS applications  
4 replacement software.

5  
6 65. Q. COULD TAWC REPLACE THE E-CIS SYSTEM FOR THE \$147,682 MR.  
7 BUCKNER LEFT IN RATE BASE FOR THIS ORIGINAL INVESTMENT OF  
8 \$3.271 MILLION?

9 A. That is not possible. If TAWC were to undertake such a ludicrous plan, they  
10 would have to purchase mainframe hardware and a customer service and billing  
11 software package capable of providing the existing service standards (I doubt that  
12 such a software package could be purchased without major modifications  
13 necessary to match the current capabilities), replace the entire networking  
14 capabilities, modify interfaces with many auxiliary devices (such as mobile  
15 computing), and develop data conversion files to populate the customer records,  
16 including sufficient historical data. I do not believe such an undertaking is  
17 possible for TAWC as a stand alone entity for an investment of less than the ECIS  
18 investment of \$3.3 million. I believe it would cost significantly more. There  
19 would also be a significant loss of economies of scale to TAWC under this  
20 scenario compared to the shared information systems and functions provided by  
21 AWWSC, including obtaining ITS experience locally to manage a stand-alone  
22 system. In my opinion this is not a workable solution.

23  
24 66. Q. WHAT JUSTIFICATION DOES MR. BUCKNER GIVE TO SUPPORT SUCH  
25 AN EXTRAORDINARY RECOMMENDATION?

26 A. His sole support for this recommendation is a reference to an Order of the Indiana  
27 URC dated November 18, 2004, page 146. He provides no evidence of an  
28 independent review or study he made on the prudence of the TAWC investment,  
29 or any other support for his recommendation other than reference to the Indiana  
30 Order. Mr. Buckner's claim regarding the E-CIS investment is baseless and his  
31 motives for providing this recommendation in supplemental testimony filed less

1 than two weeks prior to the hearing in this case are questionable. He obviously  
2 had the Indiana Order in sufficient time to take this position in his direct  
3 testimony by the date provided in the procedural schedule. Mr. Buckner's  
4 supplemental testimony regarding the E-CIS investment is not supported by any  
5 evidence of fact in this case and should be disregarded.  
6

7 67. Q. YOU SAID EARLIER THAT MR. BUCKNER HAD THE INDIANA ORDER  
8 DURING TAWC CASE 04-00288, WOULD YOU PLEASE EXPLAIN THAT  
9 STATEMENT?

10 A. Yes. In Mr. Buckner's testimony in case 04-00288 on page 7, beginning on line  
11 12 he says, "Similar circumstances were found in Indiana-American Water  
12 Company's petition to increase rates before the Indiana Utility Regulatory  
13 Commission ("IURC") in Cause No. 42520 dated November 18, 2004." His  
14 footnote 6 references Case No. 42520, Page 82. This confirms that Mr. Buckner  
15 relied on the same Indiana Order in TAWC case number 04-00288 which is the  
16 same Indiana Order he relies on to support his position regarding E-CIS in this  
17 case. If Mr. Buckner believed that the E-CIS was an imprudent investment he  
18 could have certainly performed his own study to confirm his opinion in TAWC  
19 case 04-00288 based on the finding in Indiana, but he didn't. It is also obvious he  
20 could have performed his own due diligence through discovery requests in this  
21 case and provided direct testimony in this case in accordance with the procedural  
22 schedule, but he did not issue one discovery request seeking information about  
23 this issue nor apparently did he make any effort whatsoever to formulate his own  
24 due diligence or confirmation to support his position at all. Instead he makes this  
25 untimely and unsupported recommendation without any independent information  
26 of his own at the last possible minute in this case.  
27

28 68. Q. DO YOU KNOW OF ANY OTHER REGULATORY JURISDICTIONS  
29 WHERE AWWC SUBSIDIARIES OPERATE THAT HAVE DENIED RATE  
30 RECOVERY OF THE E-CIS INVESTMENT?

1 A. No. I spoke to each of the managers of rates across AWWC and the corporate  
2 rate team, and determined that of the 18 regulated subsidiaries, the only instance  
3 where E-CIS investment has been reduced is Indiana. Further, I have looked at  
4 the Indiana Order and it appears the Indiana decision was based on the Staff's  
5 belief that Indiana-American had not supplied information and evidence to  
6 support the increase in the original E-CIS cost estimate from 1996 to the cost  
7 included in the 2004 rate case. Indiana-American has a current case pending that  
8 addresses the cost increase, and provides support for that increase. In 1996 it was  
9 contemplated that the ORCOM software would simply replace the functionality of  
10 the EDIS system which was an in-house customer service and billing system that  
11 was non-Y2K compliant. The end result of the E-CIS project included a fully  
12 integrated customer service, billing, and collections software package, including  
13 mobile computing for field service personnel. To compare the cost estimate for  
14 the simple replacement software project developed in 1996 to the final E-CIS  
15 project is an "apples to oranges" comparison. If Mr. Buckner had desired to  
16 explore and support his position on E-CIS in this case he could and should have  
17 issued discovery requests or independently supported his position. Instead he  
18 elected to use a less open and transparent approach.

19  
20 68. Q. DID THE COMPANY INCLUDE THE \$3.271 MILLION INVESTMENT IN E-  
21 CIS IN ITS PREVIOUS RATE CASE?

22 A. Yes

23  
24 69. Q. DID THE CAPD AGREE TO THAT RATE BASE ADDITION IN CASE NO.  
25 04-00288?

26 A. Yes. Schedule 1 attached to the settlement agreement indicates that the rate base  
27 included in the settlement agreement was \$87,611,390. TAWC included the E-  
28 CIS in its proposed rate base for that case. The CAPD agreed to TAWC's rate  
29 base in the settlement agreement.  
30

1 70. Q. HAS THE CAPD PROVIDED ANY EVIDENCE OR SUPPORT THAT WAS  
2 NOT AVAILABLE TO THEM WHEN THEY AGREED TO THE RATE BASE  
3 IN CASE NO. 04-00288?

4 A. No, and it is not appropriate for the CAPD to attempt to do that in this case  
5 without asking one data request or providing evidence that supports their  
6 inappropriate claim that the E-CIS was not a prudent investment or that the E-CIS  
7 system is not an integral part of the excellent service provided by TAWC. Mr.  
8 Buckner's recommendation to reduce the rate base for the E-CIS project and  
9 reduce depreciation expense by \$1.056 million is baseless and should be  
10 disregarded in this proceeding.  
11

12 71. Q. WHAT IS YOUR CONCLUSION AND RECOMMENDATION CONCERNING  
13 THE CAPD'S SUPPLEMENTAL TESTIMONY?

14 A. The reductions of rate base and related depreciation expense recommended by  
15 Mr. Buckner regarding the E-CIS investment, in addition to not being filed  
16 timely, are without merit or support. Mr. Buckner provides no analysis or  
17 independent support for this extraordinary recommendation. The CAPD can not  
18 deny that they had sufficient information to make this inappropriate claim in case  
19 number 04-00288, or in the direct testimony filed in this case, or that they agreed  
20 to the addition to rate base for the E-CIS investment in case number 04-00288.  
21 The TRA should place no reliance on this unsupported supplemental testimony of  
22 Mr. Buckner.  
23  
24  
25  
26

27 **REVENUES**  
28

29 72. Q. IS THERE AN ISSUE WITH THE REVENUES AT PRESENT RATES USED  
30 BY THE COMPANY IN ITS FILING?



1           A.     Yes, but the CAPD did not provide comments about going-level revenues in their  
2                 direct testimony, However Mr. Chrysler provided a recommendation in his  
3                 untimely supplemental testimony that TAWC's going-level revenue as filed  
4                 should be increased by \$279,668 effectively reducing the revenue requirement  
5                 requested by the Company and increasing the reduction in present rates proposed  
6                 by the CAPD in their direct testimony. Again, Mr. Chrysler had ample  
7                 opportunity to address this issue in his direct testimony, but elected not to do so.  
8                 In fact, TAWC provided data in an informal data request that was sufficient for  
9                 Mr. Chrysler to perform the same analysis that he used to support his  
10                recommendation in the supplemental testimony. The data previously provided  
11                informally was again provided with bill analysis back-up in response to the  
12                second round of formal discovery requests submitted by the CAPD. I don't  
13                believe the procedural schedule included a process where the parties were to  
14                supply supplemental testimony, particularly when the CAPD had sufficient  
15                opportunity to obtain that data (and in this instance was provided data) in time to  
16                include the information in their direct testimony. In addition, Mr. Chrysler's  
17                recommendation fails to meet any form of acceptable rate making standards.

18  
19       73.     Q.     WHY IS MR. CHRYSLER'S RECOMMENDATION UNFOUNDED AND  
20                 DEFICIENT REGARDING ACCEPTABLE RATE MAKING STANDARDS?

21           A     It does not meet the known and measurable test.

22  
23                 TAWC was informally requested by the CAPD to provide an attrition year  
24                 calculation of present rate revenues with bill analysis support using both 2005 and  
25                 2006 calendar years as the base year, even though TAWC had provided the same  
26                 information in its filing based on the historical test-year for this case, the 12-  
27                 months ended June 2006. Obviously the generation of an annual bill analysis is a  
28                 major undertaking, and I agreed to provide the calculations based on total billing  
29                 units based on both 2005 and 2006 calendar year data without generating the  
30                 detailed bill analysis by meter class and tariff block in response to the informal  
31                 CAPD discovery request. The CAPD indicated they wanted this data to verify the



1           reasonableness of the calculations from the historical test-year data in this case,  
2           and I thought we had agreed that this method would sufficiently meet that  
3           purpose. After spending significant time to generate the data in reply to the  
4           informal request, the CAPD issued a formal discovery request insisting that the  
5           Company provide the information along with a complete bill analysis for both the  
6           2005 and 2006 calendar years. The Company at great expense in time and effort  
7           provided this data in response to discovery request CAPD-02-Q001. It is of note  
8           that the data provided in the formal data request was within \$50,000 of the  
9           information provided in the informal data request for both the 2005 and 2006 base  
10          years. It is also important to note that I cautioned the CAPD that the weather  
11          normalization factors provided by Dr. Spitznagel for use in this case were  
12          determined specifically for the historical test-year ended June 2006. I told the  
13          CAPD that I had not asked Dr. Spitznagel to generate those factors (which would  
14          be different for the 2005 and 2006 calendar year base periods) because that would  
15          be very expensive, and the result of the process of using the 2005 and 2006  
16          calendar year base period should not produce significantly different results than  
17          the historical test-period in this case if those normalization factors had been  
18          generated.

19  
20          Despite those cautionary statements included in the discovery response mentioned  
21          above, Mr. Chrysler then used this data in his supplemental testimony not to  
22          confirm the reasonableness of the historical test-year information provided by  
23          TAWC in its filing, but used the data to inappropriately create an inflation factor  
24          for the difference between the revenue generated for 2006 calendar year base  
25          period compared to the 2005 calendar year base period. He then used those  
26          inflation factors to increase the calendar year 2006 revenue results to generate the  
27          going-level revenues for the attrition year for this case included in his  
28          supplemental testimony. The assumption embedded in Mr. Chrysler's calculation  
29          is that the changes in revenue that occurred in 2006 would repeat themselves in  
30          2007. It is inappropriate in rate making to make such assumptions without any  
31          consideration to non-recurring events and other factors that would be different in

1 the attrition year than in the base period, particularly when those base years are  
2 not properly adjusted for weather normalization specifically identified as an issue  
3 in the discovery response.  
4

5 Mr. Chrysler's method of determining going-level revenue is unreasonable and  
6 unsupportable because there are numerous significant events that drive the  
7 difference in going level revenue when using the 2006 and 2005 calendar year  
8 base periods that will not reoccur in the attrition year, and Mr. Chrysler's  
9 information does not reflect any change in the weather normalization factors from  
10 those produced specifically for use in properly adjusting the June 2006 historical  
11 test-year to the attrition year. The TRA should not rely on such questionable  
12 methods and unsupportable conclusions.  
13

14 74. Q. CAN YOU PROVIDE EXAMPLES OF WHY MR. CHRYSLER'S  
15 ASSUMPTIONS USED TO SUPPORT HIS SUPPLEMENTAL TESTIMONY  
16 ARE FAULTY AND INAPPROPRIATE?

17 A. Yes. Mr. Chrysler applies his revenue inflation factor to each class of customers,  
18 but embedded in the industrial class of customers is Southern Cellulose, a  
19 significant industrial customer whose usage history clearly demonstrates the  
20 problems with Mr. Chrysler's method. I have attached to this testimony Rebuttal  
21 Exhibit MAM-13 that demonstrates just how unsupportable Mr. Chrysler's  
22 method and assumptions are based on actual data for Southern Cellulose.  
23

24 75. Q. PLEASE DESCRIBE THE INFORMATION REGARDING SOUTHERN  
25 CELLULOSE?

26 A. The top section of the schedule includes the actual usage data for Southern  
27 Cellulose from July 2003 through March 2007. The yellow shaded areas  
28 represent the historical test-year and attrition year sales used by TAWC in its  
29 filing. The actual data demonstrates that in December 2005 Southern Cellulose  
30 significantly increased their usage from TAWC and the increased usage pattern  
31 continued through November 2006. TAWC contacted Southern Cellulose and

1 determined that they were experiencing trouble with their on-site wells which  
2 they use to supplement water purchased from TAWC in their production process.  
3 This pattern of increased usage from the TAWC system continued during 2006  
4 due to hot, dry conditions and until they put their wells back in operation. As  
5 indicated in the data, the usage taken from the TAWC system declined  
6 dramatically in December 2006 and that reduced usage pattern has continued  
7 through March 2007. The data clearly indicates that Southern Cellulose returned  
8 to their normal usage patterns in December 2006 once their wells were placed in  
9 service in November 2006 and they continue to use the well supply through  
10 March 2007. This data also supports the fact that the sales to Southern Cellulose  
11 during 2006 were extraordinary in nature and are highly unlikely to reoccur in  
12 2007 or the attrition year in this case.

13  
14 TAWC prepared its filing in this case with the actual usage for Southern Cellulose  
15 embedded in the historical test-year with no adjustments to arrive at the attrition  
16 year usage and revenue included in its filing. Based on the latest data it would  
17 appear that TAWC overstated the attrition year revenue for Southern Cellulose, if  
18 in fact, they continue as expected to keep the wells in service during 2007.

19  
20 76. Q. WHAT LEVEL OF USAGE DID MR. CHRYSLER INCLUDE IN THE  
21 ATTRITION YEAR FOR SOUTHERN CELLULOSE AND WHY DO YOU  
22 BELIEVE THAT IS INCORRECT?

23 A. In the second outlined area of Rebuttal Exhibit MAM-13, I have demonstrated the  
24 impact of Mr. Chrysler's faulty assumptions and unreasonable conclusions for  
25 Southern Cellulose that are embedded in his recommendation for attrition year  
26 revenues at present rates as supplied in his Supplemental Testimony.

27  
28 Mr. Chrysler's Supplemental Testimony and working papers not only assume that  
29 the extraordinary usage for Southern Cellulose experienced in 2006 due to  
30 problems with their wells will continue in 2007 and the attrition year, but he also  
31 assumes that the extraordinary usage increase for 2006 will repeat itself at the

1 same growth ratio from 2006 to 2007 as it did from 2005 to 2006. **This is an**  
2 **unsupportable assumption** and it certainly does not comply with any recognized  
3 rate making principles, including the known and measurable test. Mr. Chrysler  
4 has determined that Southern Cellulose will use 998.697 million gallons from  
5 TAWC's system in the attrition year. This compares to the 151,639 100 CCF  
6 they used in 2004, 230.226 100 CCF in 2005, 479.506 100 CCF for 2006, and  
7 395.819 100CCF for the 12-months ended June 2006, the historical test-year in  
8 this case.  
9

10 77. Q. WHAT IS THE IMPACT ON ATTRITION YEAR REVENUES AT PRESENT  
11 RATES INCLUDED IN MR. CHRYSLER'S SUPPLEMENTAL TESTIMONY?

12 A. Southern Cellulose is a significant customer of TAWC and conservatively the  
13 "phantom" usage recommended by Mr. Chrysler would fall into the tail block rate  
14 of \$.0582 per 100 CCF. As shown at the conclusion of the second section of  
15 Rebuttal Exhibit MAM-13, Mr. Chrysler has overstated attrition year revenues by  
16 at least \$350,875 for Southern Cellulose. In fact, Mr. Chrysler's impact is greater  
17 than \$350,875 because his method assumes average revenue per 100 CCF for the  
18 industrial customer classification which would be higher than the tail-block rate.  
19

20 78. Q. CAN YOU PROVIDE OTHER EXAMPLES OF PROBLEMS WITH MR.  
21 CHRYSLER'S APPROACH?

22 A. Yes. In 2005 the Chattanooga Housing Authority vacated many of their public  
23 housing units for replacement or renovation. The 2005 OPA revenue was  
24 depressed because of this development. As those new or renovated public  
25 housing units were returned to service in 2006 the OPA revenues increased over  
26 the 2005 levels by 3.593% as shown on the work papers of Mr. Chrysler. For this  
27 classification of customers Mr. Chrysler's method again assumes that the level of  
28 growth will increase at the same ratio in the attrition year as it did from 2005 to  
29 2006. Mr. Chrysler provides no rational explanation for this increase and the  
30 assumption can not be known and measurable. The fact is that OPA revenues will

1            **not** increase at the same level in the attrition year for the reasons described above.  
2            This is another example of the problem with Mr. Chrysler's approach.

3  
4        79.     Q.     WHAT IS YOUR CONCLUSION AND RECOMMENDATION REGARDING  
5                   THE ADJUSTMENTS TO ATTRITION YEAR REVENUES AT PRESENT  
6                   RATES PROPOSED BY MR. CHRYSLER IN HIS SUPPLEMENTAL  
7                   TESTIMONY?

8            A.     Mr. Chrysler's method and assumptions do not comply with established rate  
9                   making principles, including the known and measurable test. His  
10                  recommendation is based on extremely faulty assumptions which can not be  
11                  supported by the facts described in this rebuttal. It is my recommendation based  
12                  on the analysis provided in this rebuttal that Mr. Chrysler's supplemental  
13                  testimony should be disregarded entirely. TAWC has provided reliable  
14                  calculations of going level revenues at present rates for the historical test-year in  
15                  this case properly adjusted for known and measurable adjustments, including  
16                  proper recognition for non-reoccurring events and TAWC's going-level revenues  
17                  provide the only reasonable determination of the attrition year revenue at present  
18                  rates on which to base the revenue deficiency in this case.

19  
20  
21    **OPERATING EXPENSES – GENERAL OBSERVATIONS**

22  
23        80.     Q.     DO YOU HAVE A GENERAL OBSERVATION ABOUT MR. BUCKNER'S  
24                   APPROACH TO DETERMINING THE APPROPRIATE LEVEL OF  
25                   OPERATING EXPENSES FOR SETTING RATES IN THIS CASE?

26            A.     Yes. Mr. Buckner appears to ignore the fact that Tennessee regulatory rules and  
27                   regulations permit the use of a forecasted test-year through the use of an attrition  
28                   year that would coincide with the time the rates from this case would be effective.  
29                   In this case the attrition year is the 12 months ending February 2008. The CAPD  
30                   provides little, if any, justification or proof that the Company's forecasted  
31                   operation expenses for the attrition year are not reflective of the costs that will be

1 present during that period. The CAPD's position on numerous operating  
2 expenses in this case do not reflect a reasonable adherence to the regulatory  
3 principle of matching revenue and expenses, nor do they meet the known and  
4 measurable test. As stated earlier in this testimony, Mr. Buckner instead uses  
5 multiple base periods for different categories of expenses, calculates inflation  
6 factors which he then applies to those multiple base periods to arrive at the  
7 attrition year expense levels. Mr. Buckner's approach does not appear to  
8 recognize that TAWC, like any other responsible utility, must continually search  
9 for improved methods to provide service, or that the test-year or in his case  
10 multiple base periods, include non-reoccurring expenses, or that those base  
11 periods may only include a portion of a justified increase which should be  
12 annualized to properly reflect the attrition year expenses. His method instead  
13 implies that regardless of the drivers of increased costs, the only acceptable  
14 attrition year level of expenses is one that meets his generated inflation factors.  
15 Mr. Buckner's method of arriving at a number of operating and maintenance  
16 expenses included in his recommendation falls significantly short of the  
17 established rate making principles of matching revenue and expense, and  
18 adjustments to test-year expenses must be known and measurable. In TAWC case  
19 04-00288 the CAPD expressed concern about TAWC's service levels and we  
20 addressed that by agreeing to perform customer surveys and provide monthly data  
21 on key service metrics. It is disappointing to me that the CAPD now fails to  
22 recognize the employee levels and other expenses necessary to maintain the high  
23 service levels provided by TAWC. The positions of the CAPD regarding service  
24 levels must be supported by recovery in rates of reasonable expense levels. The  
25 CAPD appears to want it both ways, and I believe that to be unfair and unrealistic  
26 regarding TAWC's filing in this case.

27  
28  
29 81. Q. ON WHAT DO YOU BASE THIS BELIEF?

30 A. CAPD witness Buckner readily admits on page 3 of his testimony that he has  
31 based his salary & wages recommendation on actual employee levels at January

1 31, 2007. He does not mention the level of employees in the historical test-year  
2 or the fact that TAWC had 109 employees in November 2006, or the fact that he  
3 eliminated over 600 hours of overtime included in TAWC historical test-year.  
4 Mr. Watson will provide rebuttal to Mr. Buckner indicating the level of  
5 employees required to meet the service levels expected of TAWC and the status  
6 of the employee level as of today. Mr. Buckner on page 4 of his testimony  
7 indicates Pension and Management Fee expenses are forecasted on the history of  
8 Operations and Maintenance Expenses of TAWC and those forecasted expenses  
9 are based on TRA precedent, although Mr. Buckner fails to cite or reference any  
10 precedent. Mr. Buckner based his pension expense on the 2005 actuarial report  
11 prepared by AWWC's actuary Towers & Perrin and disregarded the actuarially  
12 determined projections for 2007 ERISA pension payments. His forecast of  
13 management fees is based on the level included in the Settlement Agreement  
14 approved by the TRA in case 04-00288 adjusted for an inflation factor that in his  
15 opinion is appropriate. As we all know settlement agreements are reached by give  
16 and take by both parties and do not reflect any position of the parties or do they  
17 represent precedent. In my opinion, Mr. Buckner can not reasonably claim  
18 precedent support for his specific methods in arriving at pension and management  
19 fee expenses because they do not come close to meeting the known and  
20 measurable test. I provide evidence in the following sections of this rebuttal that  
21 demonstrate Mr. Buckner's approach for these two expenses produces drastically  
22 understated attrition year expense levels. In addition, on page 4 of his testimony  
23 he indicates that for 12 categories of expenses the CAPD adopted the amounts for  
24 the twelve months ended October 31, 2006 adjusted for inflation and customer  
25 growth.

26  
27 In each case mentioned above, Mr. Buckner's testimony demonstrates that he  
28 made no effort to determine if any known and measurable adjustments were  
29 warranted or supported by TAWC's filing, that any partial base period expense  
30 should be normalized, or that any expense was non-reoccurring. Instead Mr.  
31 Buckner calculates the attrition year expenses with his implied belief that



1 expenses should be limited to historical inflation with disregard for any other  
2 factor. Mr. Buckner's approach is not consistent with established rate making  
3 principles and does not comply with the known and measurable principle.  
4  
5

6 **SALARIES AND WAGES**  
7

8 82. Q. MR. BUCKNER ELIMINATES SIX POSITIONS WHICH WERE INCLUDED  
9 IN THE COMPANY'S FILING. WHAT IS THE COMPANY'S POSITION ON  
10 THIS ADJUSTMENT?

11 A. We disagree with the position. Mr. Buckner limits his salary and wage  
12 recommendation to that generated by the level of employees which the Company  
13 had as of January 31, 2007. This does not reflect the number of employees that  
14 will be required to continue adequate service levels during the attrition year. Mr.  
15 Watson, V.P and General Network Manager for TAWC, the person responsible  
16 for the day to day operations, will address the need and specific service issues  
17 related to those six positions.  
18

19 83. Q. WHAT REASONING DOES MR. BUCKNER USE TO JUSTIFY HIS  
20 ADJUSTMENT?

21 A. Mr. Buckner concludes that there is a pattern of petitioning for funding by TAWC  
22 for vacant positions in their cost of service. Mr. Watson explains in his rebuttal,  
23 as I have in this rebuttal that TAWC has gone through significant change during  
24 the period Mr. Buckner references on page 7 of his direct testimony. Mr. Buckner  
25 then attempts to use the data during the period January 2003 to the present to  
26 support his position. Again, Mr. Buckner fails to recognize or refuses to  
27 recognize that utility service and costs are not static and looking at the past is not  
28 an acceptable or appropriate method of determining future customer service levels  
29 or costs. Mr. Buckner made the same type of claims in TAWC case 04-0288 and  
30 in fact he used the 2004 Indiana Order referenced earlier in support of this  
31 position



1  
2 84. Q. WOULD YOU ADDRESS THE ASSERTION ABOUT A PATTERN BEING  
3 ESTABLISHED BY TAWC?

4 A. Yes. Mr. Buckner has reached conclusions without any consideration of what  
5 transpired between 2003 and January 2007, or any reasonable support for his  
6 position. Looking at the graph attached as page P7 to his direct testimony he fails  
7 to mention that TAWC has been operating at or above the level of employees  
8 authorized in TAWC case 04-00288 since May 2006. He gives no support nor  
9 does he appear to provide any analysis regarding the overtime that occurred in  
10 those periods that TAWC operated at less than 106 employees. In fact, in this  
11 case Mr. Buckner reduced the historical test-year overtime hours by 680. TAWC,  
12 like other companies and utilities, experiences employee turn-over due to  
13 retirements, deaths, and employees leaving the business for various other reasons.  
14 It is not possible to always anticipate those occurrences in advance, and it takes  
15 time to place ads, interview candidates and place new employees on the payroll.  
16 It is also true that you can not measure the employee hours required to provide the  
17 service during these transition periods by looking at strictly employee levels.  
18 TAWC, like other companies, has available to it the ability to supplement  
19 employee vacancies with overtime. The more accurate approach to view the  
20 required employee levels is on an FTE basis. Mr. Buckner does not appear to  
21 provide any consideration for these facts. Instead he again wants it both ways.  
22 He wants to limit salary and wages based on a "snapshot" in time with no other  
23 factors considered, and he gives no consideration to the overtime (or FTE's)  
24 required to provide the service. Mr. Watson will provide evidence and support  
25 for the employee levels he believes are required to appropriately maintain service,  
26 and support for employees that have been added to the payroll after Mr.  
27 Buckner's cut-off date of January, 2007. It is not appropriate to exclude the  
28 proper level of employees in this case and also not recognize the additional  
29 overtime that would be required to supplement the absence of those employees.  
30 Mr. Buckner's approach does not comply with the matching principle or the  
31 known and measurable test.

1  
2 **ANNUAL INCENTIVE PLAN COSTS**  
3

4 85. Q. WHAT ADJUSTMENTS TO THE COMPANY'S FILING DID THE CAPD  
5 MAKE RELATED TO INCENTIVE PLAN COSTS?

6 A. Mr. Buckner removed 30% of the Annual Incentive Plan ("AIP") costs from both  
7 TAWC's salary and wages expense and the management fee expense. Those  
8 adjustments reduced the two expenses by \$29,390 and \$260,268, respectively.  
9 He incorrectly supports these adjustments by indicating that the financial targets  
10 of the AIP are in place to increase regulated earnings, and incorrectly indicates  
11 there is no mechanism for the rate payers to share in the benefits that inure from  
12 the AIP. He also incorrectly asserts that the AIP is circular in that it only rewards  
13 the TAWC employees for merely increasing the rates charged to rate payers.  
14

15 86. Q. DOES THE COMPANY AGREE WITH MR. BUCKNER'S  
16 RECOMMENDATION TO ELIMINATE THE FINANCIAL PORTION OF  
17 THE AIP COST?

18 A. No. Mr. Buckner's reasoning does not comport to the basic principles of rate  
19 making. He is incorrect when he indicates only the shareholders benefit from the  
20 strong financial performance of the Company. The AIP is structured to  
21 incorporate a culture in management to continually strive to seek out efficiencies  
22 and cost saving measures whenever possible. It is not true in the regulated  
23 environment that only the shareholders benefit when strong financial performance  
24 is obtained. As the Company continues to operate more productively and  
25 efficiently, the savings from those efforts offset other cost increases until other  
26 factors (such as, capital investment, inflation, etc.) drive the need to increase  
27 rates. Once new rates are approved those savings then are flowed directly to the  
28 customers. Efficiency and productivity gains, and associated cost savings  
29 promoted by the AIP, will directly benefit the customers in that they help offset  
30 increased costs in other areas of the business and prolong the need to raise rates.  
31 Once a rate increase is necessary it will be less than what the need to increase

1 rates would have been if the efficiency and productivity gains, and associated cost  
2 savings, had not been made. The customers are the ultimate beneficiaries of the  
3 financial benefits that accrue from the strong financial performance of the  
4 Company.

5  
6 It would be inappropriate to pass the savings generated to the rate payers from  
7 cost savings initiatives but deny the Company recovery of the costs that contribute  
8 to generation of those savings. If this theory of regulation were routinely  
9 imposed on Companies it would be a disincentive for any regulated company to  
10 pursue efficiency and productivity gains if the cost to generate those savings were  
11 not recovered by the Company. The Company does not believe that is the  
12 message that the TRA wishes to send to the utility companies operating in  
13 Tennessee.

14  
15 87. Q. ARE THERE OTHER JUSTIFICATIONS FOR THE RATE RECOVERY OF  
16 AIP COMPENSATION?

17 A. Yes. Incentive pay plans should not be viewed as a form of entitlement in utility  
18 operations; they should be viewed as an integral part of the overall compensation  
19 package. It is the norm in most utility compensation packages. One of the goals  
20 of the AIP is to provide a competitive overall compensation package in order to  
21 attract and retain employees possessing the high qualifications and technical skills  
22 required to manage and operate a major utility. The customers benefit in the form  
23 of enhanced service and lower cost when the Company is able to attract, motivate  
24 and retain employees with high qualifications and management skills.

25  
26 88. Q. YOU SAY THAT THE PRESENCE OF INCENTIVE PAY PLANS IS  
27 PREVALENT IN THE UTILITY INDUSTRY. WHAT SUPPORT DO YOU  
28 HAVE FOR THIS?

29 A. I am attaching a report issued by the firm of Towers/Perrin, the Company's  
30 actuary, as Rebuttal Exhibit MAM-14. I must note that copies of incentive plans  
31 of other utilities are not easily accessible to the Company, and many companies

1 do not share those plans for public knowledge. The Company was able to obtain  
2 from one of its consultants, Towers Perrin, a copy of a recap of the information  
3 they had obtained in a survey they performed of various regulated entities.  
4 Exhibit MAM-14 is a letter issued to the Company recapping the survey results  
5 regarding the prevalence of incentive plans in the utilities responding to the  
6 survey. The letter indicates that 99% of the utilities responding had incentive pay  
7 plans for their executives and 95% of the utilities had incentive pay plans for their  
8 middle management and professional employees. The Company believes this  
9 data strongly supports the Company's position that if it is to attract and retain  
10 highly qualified and capable employees, the AIP is an important aspect of its  
11 overall compensation plan.

12  
13 89. Q. WHAT IS THE COMPANY'S POSITION ON MR. BUCKNER'S ASSERTION  
14 THAT IN SOME YEARS THERE IS NO PAYMENT OF THE AIP?

15 A. The AIP is not intended to be, nor is it, an employee give away. There are  
16 aggressive goals concerning financial and operational results, including  
17 challenging individual goals for each employee to assure their contribution to  
18 service goals. What Mr. Buckner fails to recognize is that for both the TAWC  
19 AIP and AIP included in management fees for the attrition year started with the  
20 historical test year cost for the AIP. The AIP payments for both 2005 and 2006  
21 did not include an award for the financial category of the AIP, because AWWC  
22 did not meet the threshold financial target. Therefore, TAWC's attrition year  
23 expenses did not reflect any AIP related to the financial portion of the AIP.

24  
25 If Mr. Buckner's adjustments to AIP cost included in both his salary and wage,  
26 and management fee recommendations were accepted, it would eliminate an  
27 expense from the attrition year that was not in the attrition year of TAWC's filing.  
28 Mr. Buckner's recommendation regarding eliminating the financial portion of the  
29 AIP should be disregarded.

30  
31 **MANAGEMENT FEES**

1  
2 90. Q. DOES MR. BUCKNER ADDRESS THE LEVEL OF MANAGEMENT FEE  
3 EXPENSES?

4 A. Yes. He addresses management fees beginning on page 9 of his direct testimony.  
5 I have previously taken exception with many of the positions of the CAPD  
6 witnesses' positions, and pointed out that they do not comply with established  
7 regulatory practices, but Mr. Buckner's approach to determining the level of  
8 management fees in his recommendation sets a new standard for variance from  
9 any reasonable effort to work within those established regulatory principles. In  
10 Mr. Buckner's direct testimony and exhibits he provides little, if any, support for  
11 this extraordinary position other than to inappropriately claim "The level of  
12 Management Fees is simply not reasonable for the rate payers of TAWC," (at  
13 page 9-beginning line 17), and claims on page 10-beginning line 1," no offset  
14 anywhere in TAWC's forecast to account for the dramatic rise in Management  
15 Fees." Mr. Buckner made no attempt to determine if there were reasons for the  
16 increase, or there was a shift in cost between TAWC labor and management fees,  
17 or to back-up these inaccurate claims with facts although he had every  
18 opportunity to do so in discovery. Instead he proceeds to inappropriately reduce  
19 management fees requested by the Company by \$1,043,310. He bases his  
20 calculation of management fees included in the Settlement Agreement between  
21 TAWC and the CAPD in case number 00-00288 and a calculated inflation factor.  
22 He pays no attention, nor makes any mention of his basis for contesting, the  
23 historical test-year number supplied by TAWC in its filing which was normalized  
24 for non-reoccurring items. Mr. Buckner's recommendation for management fees  
25 strays as far from the known and measurable test as I have ever witnessed.

26  
27 91. Q. IS THERE AN OFFSET TO THE INCREASE IN MANAGEMENT FEES?

28 A. Yes. As addressed previously in this testimony and the rebuttal testimony of Mr.  
29 Watson, TAWC has been undergoing reorganization. There have been FTE's  
30 shifted to the Regional Service Company as part of that reorganization, and Mr.  
31 Buckner is attempting to have it both ways by taking advantage of the lower fully

1 loaded labor cost in TAWC's filing in this case and to artificially understate  
2 management fees by ignoring the shift of FTE's to management fees. Mr.  
3 Buckner's claim of no offset is without basis and he provides no support for this  
4 claim.

5  
6 92. Q. PLEASE EXPLAIN HOW MR. BUCKNER HAS IGNORED THAT SHIFT?

7 A. It is not appropriate for Mr. Buckner to start his recommendation of management  
8 fees with the level included in the Settlement Agreement in case 04-00288 and I  
9 believe the CAPD knows settlements do not constitute TRA precedent as it  
10 appears Mr. Buckner is claiming. At the time of the previous rate case, TAWC  
11 was in the midst of the reorganization and history tells us TAWC understated the  
12 impact of the reorganization in the attrition year management fees in case 04-  
13 00288. I will provide evidence to this fact later in this testimony. Mr. Buckner  
14 by inappropriately starting his management fee analysis with the Settlement  
15 Agreement level reached in case 04-00288 understates management fee expense  
16 in this case, and either misses or ignores the shift in cost from TAWC's fully  
17 loaded labor to management fees..

18  
19 93. Q. WOULD YOU DEMONSTRATE THE OFFSET YOU ARE REFERRING TO?

20 A. Yes. I have attached to this testimony schedules that I believe clearly demonstrate  
21 the shift between fully loaded TAWC labor and management fees, and  
22 demonstrate how unreasonable the recommendation of the CAPD is. The  
23 schedules are identified as Rebuttal Exhibit MAM-15.

24  
25 In order to properly determine a shift in FTE's between TAWC and management  
26 fees the analysis must compare fully loaded costs at TAWC to management fees  
27 because as prescribed in the "1989 Service Company Agreement" between  
28 TAWC and AWWSC, management fees include labor and all overheads. I have  
29 captured this comparison on Rebuttal Exhibit MAM-15. I started my analysis  
30 with the level of fully loaded labor costs included in TAWC case 03-00118,  
31 because that period reflects the costs TAWC experienced prior to the

1 reorganization that transpired from 2003 to 2006. The costs for TAWC's fully  
2 loaded labor plus management fees from case number 03-00118 are shown on  
3 page one of Rebuttal Exhibit MAM-15, Page 1 of 2 under the column identified  
4 as (1). To determine a reasonable expectation of what the total of fully loaded  
5 TAWC labor plus management fees would be in 2007 if no reorganization had  
6 occurred (the attrition year in this case), I determined actual cost increase ratios  
7 for TAWC in each of the categories of expense. The calculations of these cost  
8 increase ratios are provided on page 2 of 2 of the Exhibit.

9  
10 The next step in my analysis was to inflate (or deflate as the case may be) the  
11 costs shown on page 1 of 2, column (1) (the costs included case number 03-  
12 00118) for those cost increase ratios shown at the bottom of page 2 of 2 of the  
13 Exhibit. The result of this analysis produces \$10,912,896 for the combination of  
14 TAWC fully loaded labor cost plus management fees as shown in column (5) on  
15 page 1 of 2 of the Exhibit.

16  
17 In column (6) I show the various categories of expenses that TAWC included in  
18 the attrition year of its filing. Those expenses total \$10,953,912 and are within  
19 \$41,016 of the total in column (5), a variance of less than 0.4%. Column (7) of  
20 page 1 of 2 on the Exhibit demonstrates the shift (or offset) to management fees  
21 as a result of the reorganization. The 2007 TAWC fully loaded labor costs as  
22 determined using the costs included in TAWC case 03-00118 (the period prior to  
23 reorganization) is \$1,252,154 less than the fully loaded costs included for those  
24 expense categories included in the attrition year of TAWC's filing in this case and  
25 offset the increase in management fees of \$1,293,170.

26  
27 94. Q. DOES THIS INFORMATION CONTRADICT THE CLAIM OF MR.  
28 BUCKNER THAT NO OFFSET TO THE INCREASE IN MANAGEMENT  
29 FEES?

30 A. Yes. It clearly demonstrates that Mr. Buckner's claims that no offset to the  
31 increased management fees exists and that the management fees requested in this



1 case by TAWC “are not just and reasonable”, “there is no offset anywhere”, and  
2 that “TAWC’s stated justification for its Management Fees is simply without  
3 support”, as indicated in his response to his answer on pages 9 and 10 of his direct  
4 testimony.

5  
6 It is Mr. Buckner’s recommendation for management fees in this case that is  
7 without support, and Mr. Buckner’s recommendation clearly does not comply  
8 with any reasonable interpretation of established regulatory principles, especially  
9 the known and measurable test. As demonstrated in column (8) of Rebuttal  
10 Exhibit MAM-15, Mr. Buckner’s recommendation in this case for fully loaded  
11 TAWC labor costs plus management fees is \$8,817,318, or \$2,136,594 below  
12 TAWC’s filing. I believe the facts as demonstrated on Rebuttal Exhibit MAM-15  
13 clearly demonstrate that there has been an offset to increased management fees as  
14 demonstrated by the reduction of \$1,252,154 in fully loaded labor costs at  
15 TAWC. I find it amazing that Mr. Buckner’s recommendation of \$8,817,318 for  
16 this entire category of cost is over \$600,000 less than the unadjusted actual cost  
17 levels approved in Case 03-00118 over four years ago. Mr. Buckner’s  
18 recommendation for management fees and his claims are unsupported and out of  
19 touch with any acceptable level of reasonableness. Mr. Buckner’s claims and  
20 unsupported recommendations should be disregarded in determining the revenue  
21 requirement in this case.

22  
23 95. Q. DO YOU HAVE ANY FURTHER COMMENTS REGARDING  
24 MANAGEMENT FEES?

25 A. Only to point out that my rebuttal concerning AIP costs also relates to an  
26 adjustment Mr. Buckner made to management fees for the AIP costs. I will not  
27 repeat my rebuttal of Mr. Buckner’s position on AIP which he inappropriately  
28 eliminated from management fee expense.

29  
30 **PENSIONS**



1 96. Q. WOULD YOU ADDRESS THE ADJUSTMENTS TO THE PENSION  
2 EXPENSE INCLUDED IN TAWC'S FILING PROPOSED BY MR.  
3 BUCKNER?

4 A. Yes. This is another major example where Mr. Buckner violates the TRA policy  
5 of permitting rate filings using a forecasted attrition years by refusing to recognize  
6 known and measurable levels of ERISA pensions contributions for the attrition  
7 year. He recommends pension expense of only \$12,662 for this case, a reduction  
8 of \$583,136 from TAWC's attrition year level of \$595,798.  
9

10 97. Q. HOW DID MR. BUCKNER ARRIVE AT SUCH A DIFFERENT PENSION  
11 EXPENSE?

12 A. As indicated on page 11 of Mr. Buckner's testimony he relied on the 2005  
13 actuarial report for AWWC's pension plan prepared by Towers Perrin. He also  
14 indicates that this is the latest known contribution level, and claims that TRA  
15 policy is to recognize only actual pension contributions. Mr. Buckner indicates  
16 that the 2005 actuarial study is the latest known evidence of TAWC's pension  
17 contribution.  
18

19 98. Q. IS MR. BUCKNER CORRECT THAT THE 2005 ACTUARIAL REPORT  
20 BASED ON 2004 DATA IS THE LATEST KNOWN PENSION  
21 CONTRIBUTION BY TAWC?

22 A. No. Mr. Buckner fails to mention the actual pension expense recorded on the  
23 books of TAWC for the calendar year 2006 which was provided in response to  
24 several data requests. For the calendar year 2006, TAWC recorded pension  
25 expense based on ERISA contributions (net of capitalized amount) of \$1,080,083  
26 and that certainly is in excess of the Company's request in the attrition year in this  
27 case, but that evidently did not satisfy Mr. Buckner's definition of "known and  
28 measurable." Mr. Buckner could have pursued this subject in discovery, but he  
29 didn't, he only requested the latest actuarial report. At the time of the discovery  
30 request, the 2005 Towers Perrin report was the latest actuarial report that I had.  
31 However, the Company did provide the ERISA pension contributions to be made

1 in 2007 as part of the work papers supporting its filing in this case, and in his  
2 testimony he claims that is not sufficient support. What Mr. Buckner didn't  
3 request in discovery was if there were any documents from Towers Perrin to  
4 support the 2007 ERISA contribution provided by TAWC in its work papers.  
5

6 99. Q. DO YOU HAVE FURTHER SUPPORT FOR TAWC'S REQUESTED ERISA  
7 PENSION EXPENSE LEVELS FOR THE ATTRITION YEAR?

8 A. Yes. I have attached that evidence to this testimony identified as Rebuttal Exhibit  
9 MAM-16 which consists of thirteen pages.  
10

11 100. Q. PLEASE DESCRIBE THE INFORMATION BEING PROVIDED IN  
12 REBUTTAL EXHIBIT MAM-16?

13 A. Pages 1 and 2 of Rebuttal Exhibit MAM-16 consist of a letter approved by Ellen  
14 Wolf, CFO of AWWC and James Kalinovich, Treasurer of AWWC authorizing  
15 the ERISA contributions of AWWC to its pension fund for the calendar year  
16 2007. Page 3 of the Exhibit provides the quarterly payments for 2007, including  
17 the portion of the ERISA contributions for TAWC. Pages 4 and 5 of the Exhibit  
18 consist of an e-mail from Mahaveer P. Jain with an attachment of the wire transfer  
19 of the \$19.2 million ERISA contribution to the AWWC pension plan made on  
20 March 9, 2007. Pages 6-12 consist of a letter from Towers Perrin dated August  
21 18, 2006 outlining their projections for pension and other post-employment  
22 benefit costs for 2007, including their estimates of the required ERISA pension  
23 contributions. Page 13 provides Towers Perrin's projection of ERISA Minimum  
24 Required Contributions for the years 2006-2011. The Towers Perrin letter and  
25 estimates of August 16, 2006 are the support for the actual 2007 ERISA pension  
26 contributions authorized by Ms. Wolf and Mr. Kalinovich on pages 1 and 2 of the  
27 Exhibit.  
28

29 101. Q. DO YOU BELIEVE THE EVIDENCE PROVIDED IN REBUTTAL EXHIBIT  
30 MAM-16 SUPPORTS TAWC'S ERISA PENSION EXPENSE INCLUDED IN  
31 THE ATTRITION YEAR IN THIS CASE?

1 A. Yes. Not only are the estimates provided by the independent actuarial firm but  
2 those ERISA contributions are supported by the actual transfer of the funds as  
3 provided on pages 4 and 5 of the Exhibit. In my opinion, this clearly meets the  
4 known and measurable test and is evidence of the ERISA contribution far superior  
5 to the 2005 actuarial report relied on by Mr. Buckner.

6  
7 102. Q. HOW DOES THE LEVEL OF ERISA CONTRIBUTION SHOWN ON PAGE 3  
8 OF 13 OF REBUTTAL EXHIBIT MAM-16 COMPARE TO THE LEVEL  
9 INCLUDED FOR THE ATTRITION YEAR IN TAWC'S FILING?

10 A. The following table compares TAWC's estimated level of ERISA pension  
11 expense requested in the attrition year to the actual 2007 ERISA contribution  
12 being made in 2007 as shown on page 3 of 13 of Rebuttal Exhibit MAM-16

13  
14 **Table 4: Comparison of ERISA Contribution for 2007**

	Attrition	Actual 2007
	<u>Year</u>	<u>Contributions</u>
2007 ERISA contributions	\$756,208	\$885,492
Percentage to O&M Expense	<u>78.79%</u>	<u>78.79%</u>
2007 ERISA Expense for		
Attrition Year	<b>\$595,798</b>	<b>\$697,679</b>

22  
23 Table 4 clearly indicates that TAWC under estimated the ERISA pension  
24 contribution for 2007 at the time of its filing based on the latest actual data for the  
25 2007 ERISA contribution.

26  
27 103. Q. WHAT IS YOUR RECOMMENDATION FOR ERISA PENSION EXPENSE?

28 A. The recommendation of Mr. Buckner to establish the pension expense in this case  
29 at \$12,662 is woefully short and is not supported by the facts presented by TAWC  
30 in its filing or this rebuttal. I agree with Mr. Buckner that the TRA should  
31 establish rates on the latest actual pension contributions. The information

1           recapped in Table 4 above and supported by the actual 2007 ERISA pension  
2           contribution information supplied in Rebuttal Exhibit MAM-16 provides known  
3           and measurable support that \$697,679 is the actual pension expense for the  
4           attrition year in this case and that number should be used to establish the approved  
5           revenue requirement in this case.

6  
7    **Group Insurance**  
8

9    104.   Q.     PLEASE DESCRIBE MR. BUCKNER'S RECOMMENDATION FOR GROUP  
10           INSURANCE EXPENSE?

11           A.     Mr. Buckner recommends group insurance expense of \$1,386,168 or a reduction  
12           of \$127,499 from the level requested by TAWC. Mr. Buckner doesn't mention  
13           his basis for this significant change other than to indicate on page 4-beginning on  
14           line 14 of his testimony that for 12 categories of expense he uses the base period  
15           of October 31, 2006 and a 4.4% inflation factor. Since he didn't mention Group  
16           Insurance anywhere else in his testimony he apparently included Group Insurance  
17           expense in this category of expenses. As would be true for each of the 12 O&M  
18           expenses he includes in this category, his absence of any attempt to recognize or  
19           acknowledge any adjustments to the historical test-year in this case or supported  
20           adjustments made by TAWC in arriving at the attrition year expenses in this case  
21           does not meet established regulatory practices, including the known and  
22           measurable test. I know I have made this claim numerous times, but only because  
23           Mr. Buckner's recommendations are consistently unsupported or are based on  
24           extremely faulty practices.

25  
26           Mr. Buckner provides no support for his recommendation on group insurance  
27           expense other than to say the attrition year expense can only be set in this case  
28           based on historical trends. He ignores the Towers Perrin determined forecast for  
29           2007 OPEB expense included in TAWC's filing and supported in the work  
30           papers, and does not appear to make any effort whatsoever to determine if there  
31           are elements of the expense that need to be annualized in his base period. I am

1           sorry, but Mr. Buckner's approach does not even pass the smell test for known  
2           and measurable attrition year adjustments.

3  
4           Although he doesn't address group insurance in his testimony or make it clear in  
5           the schedules attached to his testimony, I believe one major difference between  
6           the CAPD and TAWC's numbers are driven by his elimination of 6 employees.  
7           Both Mr. Watson and I address those employee levels in our rebuttal and Mr.  
8           Buckner's group insurance expense recommendation should be adjusted to  
9           include the appropriate level of group insurance expense for those six employees  
10          if the Directors agree with TAWC on the level of employee issue.

11  
12  
13    **INSURANCE OTHER**

14  
15    105. Q.   DO YOU HAVE ANY COMMENTS ON MR. BUCKNER'S  
16           RECOMMENDATION FOR INSURANCE OTHER?

17          A.   Yes. Mr. Buckner limits his recommendation for the insurance other expense to  
18           the level for the 12 months ended October 2006 adjusted. The result of his  
19           recommendation is to lower the insurance level requested and supported by  
20           TAWC for the attrition year by \$60,972. As described in my discussion of group  
21           insurance expense Mr. Buckner's conclusion is not correct and it is unsupported.  
22           His recommendation for this expense is extremely deficient in meeting the known  
23           and measurable test.

24  
25           I have attached to this testimony Rebuttal Exhibit MAM-17 which is a screen  
26           print from TAWC's accounting records for November 2006 insurance other  
27           transactions. I believe this information illustrates how deficient Mr. Buckner's  
28           methods of basing expense levels on a point in time with only inflation factor  
29           adjustments are. The Company used expected 2007 insurance other costs (which  
30           were very close the historical test-year expense levels) in arriving at a reasonable  
31           attrition year expense level. TAWC's method normalized the impact for what is

1 referred to as retro or audit adjustments. Mr. Buckner contends that his more  
2 recent base period of October 2006 is superior. I don't disagree that using more  
3 current information is better, but only if you consider all the facts. For instance, if  
4 Mr. Buckner had used November 2006, a more recent period than the October  
5 2006 data used by Mr. Buckner he would have gotten a very different result.  
6 Rebuttal Exhibit MAM-17 indicates in the debit column that in November 2006  
7 an audit adjustment was recorded that increased insurance expense of \$50,801.75.  
8 Mr. Buckner's method of limiting the expense to the October 2006 level includes  
9 an audit adjustment refund of \$86,000 recorded in October 2006 that reduces  
10 expense but fails to normalize the insurance audit adjustments by ignoring the  
11 additional insurance cost from the November audit adjustment.

12  
13 I believe this rebuttal and Rebuttal Exhibit MAM-17 demonstrate the significant  
14 deficiencies in Mr. Buckner's approach, and clearly demonstrate his lack of  
15 adherence to the attrition year based on known and measurable adjustments to the  
16 historical base period permitted by the regulations and policies of the TRA, and is  
17 in contradiction to established rate making principles to normalize expenses to the  
18 attrition year, and violates the known and measurable test.

19  
20 **OTHER OPERATION AND MAINTENANCE EXPENSES**

21  
22 106. Q. DO YOU HAVE CONCERNS ABOUT MR. BUCKNER'S APPROACH TO  
23 THE REMAINING OPERATION AND MAINTENANCE EXPENSES ITEMS?

24 A. Yes. I have the same concerns about the remaining O&M expense  
25 recommendations of Mr. Buckner. Those expenses are comprised of the  
26 following categories: customer accounting expense, uncollectible expense, rents,  
27 general office expense, miscellaneous expense and maintenance expense. The  
28 impact of Mr. Buckner's recommendations for these categories of expenses is to  
29 reduce TAWC's fully supported attrition year expense levels by \$4,182. I don't  
30 agree with Mr. Buckner's methods and lack of adherence to known and

1 measurable principles, but I am not going to bore the Directors and parties with a  
2 discussion of each of those expenses when the net difference is only \$4,182.

3  
4 **DEFERRED INCOME TAXES**

5  
6 107. Q. WHAT ARE THE ISSUES WITH DEFERRED INCOME TAXES?

7 A. The CAPD recommends a reduction of \$142,695 to the deferred state income tax  
8 expense and a reduction of \$497,011 to the deferred federal income tax expense  
9 included in TAWC's attrition year, respectively. I am sorry for the situation, but I  
10 must inform the TRA that TAWC made an error in its filing for deferred income  
11 tax expense. TAWC based its calculations for both federal and state deferred  
12 income tax expense on the historical test-year ended June 2006 and adjusted those  
13 numbers to reflect adjustments to deferred income tax expense for additional  
14 accelerated depreciation that will occur through the attrition year. In preparing  
15 the response to CAPD discovery request CAPD-02-Q010 and CAPD-02-Q12, I  
16 discovered that we had mistakenly included adjustments to both federal and state  
17 deferred tax expense that applied to periods outside the historical test-year.  
18 Immediately upon discovering this problem TAWC acknowledged the error in  
19 response to the two CAPD discovery mentioned above.

20  
21 108. Q. WHAT IS YOUR RECOMMENDATION FOR DEFERRED INCOME TAXES?

22 A. The CAPD accepted TAWC's accumulated deferred income tax reduction to rate  
23 base. The Company calculated its accumulated deferred income tax based on  
24 FAS 109. FAS 109 deferred income taxes are a function of all the timing  
25 differences (both temporary and permanent differences) between the taxable  
26 income and book income, including timing differences that fall under the  
27 normalization requirements of IRS rules.

28  
29 The CAPD calculation of deferred income tax expense properly accounts for the  
30 current timing differences, but does not properly reflect the FAS 109 adjustments  
31 required to record the reversal of timing differences from prior years as they occur

in the current period. The CAPD calculations of deferred income tax expense must reflect the FAS 109 adjustments that apply to the attrition year expense to be in compliance with FAS 109 and in compliance with IRS normalization rules. The CAPD's acceptance of the FAS 109 rate base reduction requires recognition of the FAS 109 amortizations to be included in the current deferred tax expense or the normalization rules would be violated. This would place TAWC (and AWWC who files the consolidated tax return) in jeopardy of losing its ability to utilize accelerated depreciation. That is not an outcome that TAWC desires and one that the TRA should avoid because it would not be in the best interest to TAWC or its customers to lose that tax benefit.

109. Q. WHAT ADJUSTMENTS SHOULD BE MADE TO THE CAPD'S RECOMMENDATION FOR CURRENT DEFERRED INCOME TAX EXPENSE?

A. The CAPD state deferred income tax expense should be reduced by \$4,871 and the federal deferred income tax expense should be increased by \$228,138. The required adjustments are shown in the following table and are derived from the responses to CAPD discovery requests CAPD-02-Q010-ATTACHMENT and CAPD-02-Q012-ATTACHMENT.

**Table 5: FAS 109 adjustments required to meet normalization rules**

	<b>Deferred FIT</b>	<b>Deferred SIT</b>
	<b><u>Expense</u></b>	<b><u>Expense</u></b>
Flow thru of FAS 109 Reg. Assets	(\$120,222)	(\$23,879)
Amtz. Of FAS 109 Reg. Assets	<u>\$348,360</u>	<u>\$19,008</u>
Net increase to def. inc. tax		
Expense	\$228,138	(\$ 4,871)

**GENERAL TAXES**

110. Q. IS THERE AN ISSUE WITH GENERAL TAXES?



1           A.    Yes. The CAPD in my opinion inappropriately recommends a reduction of  
2               \$82,522 to property taxes included in TAWC's attrition year. The Company  
3               calculated its property taxes by calculating an effective property tax rate based on  
4               historical test-year property taxes and rate base. TAWC then applied this  
5               effective property tax rate to the attrition year rate base to arrive at the proper  
6               property tax expense for the attrition year. As shown on P133 of the schedules  
7               attached to Mr. Buckner's testimony, he uses the 2005 property tax assessment  
8               rates applied to the 2005 gross assessment adjusted by an inflation factor he  
9               determines from a very short-period of history. I believe that the rate base  
10              included in the attrition year based on known and measurable plant additions is  
11              far more reliable and accurate for the property tax base than Mr. Buckner's  
12              property tax base determined by use of an historical inflation factor. As  
13              mentioned many times in this testimony, Mr. Buckner appears to believe that the  
14              only way to determine attrition year expenses is by looking to the past to  
15              determine the future. In this instance he ignores the known and measurable rate  
16              base recommended in this case which provides a more accurate method to  
17              calculate attrition year property taxes.

18  
19              In TAWC case 03-00118, TAWC calculated its property taxes in a manner very  
20              similar to the method used by the CAPD in this case. However, in that case the  
21              CAPD witness Mr. Crocker on page 3 beginning on line 38 of his direct testimony  
22              says, "The Consumer Advocate bases its computation of Property Tax Expense on  
23              a ratio of the expense to the rate base, which is historical in perspective." Mr.  
24              Crocker goes on to say beginning on line 43, "CAPD proposes to use the same  
25              2.8% as paid in the Test-Year applied to the Rate Base as established by the  
26              CAPD."

27  
28              In the settlement agreement in case 03-00118 TAWC accepted CAPD's  
29              methodology and has utilized the method proposed by the CAPD in both case 04-  
30              00288 and this case to determine attrition year property taxes. TAWC agreed to  
31              that method in the 2003 case because we believe the effective property tax rate

1 applied to attrition year rate base is a more accurate method and more accurately  
2 matches attrition year revenues and expenses. TAWC continues to believe that  
3 the most recent historical effective property tax rate applied to the attrition year  
4 rate base provides the more accurate level of property taxes for the attrition year.  
5 The CAPD does not appear to be able to make up its mind on the topic. Based on  
6 these facts, TAWC believes the TRA should not rely on the CAPD's ever  
7 changing approaches and use the consistent approach recommended by the  
8 Company because that approach is based on the known and measurable rate base  
9 levels for the attrition year, not the unreliable and unsupported inflation factors  
10 calculated by the CAPD.

11  
12 **COMMENTS BY DR. BROWN AND MR. BUCKNER**

13  
14 111. Q. DO YOU HAVE ANYTHING FURTHER COMMENT ON THE TESTIMONY  
15 OF DR. BROWN OR MR. BUCKNER?

16 A. Just one area. On page 16 of his testimony Dr. Brown makes the assertion that  
17 the requested level of increased revenues by TAWC constitutes rate shock, and on  
18 page 17 of Mr. Buckner's direct testimony he says, "TAWC is asking for a  
19 staggering 20% increase."

20  
21 Both Dr. Brown and Mr. Buckner appear to put more emphasis on the level of the  
22 increase than they do in supporting their speculative and unsupported  
23 recommendations in this case. It should not be the position of the CAPD  
24 witnesses to attempt to deprive TAWC of recovery in rates of its demonstrated  
25 and prudent investments for rate base through unsupported assertions, nor by  
26 sensationalized comments. As in the majority of their positions they provide no  
27 support or evidence for the claim regarding rate shock.

28  
29 112. Q. WOULD YOU GIVE US YOUR PERSPECTIVE ABOUT THE INCREASE IN  
30 RATES REQUESTED BY TAWC IN THIS CASE?

1           A.     Yes. If the entire rate increase requested in this case by TAWC were granted by  
2           the TRA, the average residential customer's bill would increase approximately \$3  
3           per month or \$0.10 per day, and the average residential customer bill would be  
4           \$18.38 per month. In my opinion that hardly could be considered rate shock. It  
5           certainly provides no basis to deprive TAWC of a return on the \$26.0 million of  
6           capital improvements made since the last rate case, or to artificially deflate  
7           reasonable, known and measurable expenses levels as recommended by the  
8           CAPD in this case. Neither is it a basis for placing TAWC in a financial position  
9           where it can not attract additional capital for needed capital improvements. I  
10          believe the recommendation of the CAPD to reduce the rates of TAWC by \$2.062  
11          million is without merit and unsupportable.

12  
13          According to the Chattanooga Times article written by David Flessner published  
14          on March 29, 2007, "A water rate survey last year by the Memphis consulting  
15          firm of Allen & Hoshall found that water charges for the biggest water providers  
16          in Southeast Tennessee - - Tennessee-American; the cities of Cleveland, Athens,  
17          and South Pittsburg; and the Hixon and Eastside Utility Districts - - were all  
18          below the statewide average of \$22.84 per month per residential customer. Later  
19          in the article Mr. Flessner quotes Dr. Jan Beecher, director of the Institute of  
20          Public Utilities at Michigan State University, "Many water and waste-water  
21          systems are in need of a lot of investment to meet water-quality standards and  
22          maintain and repair networks that were built decades ago. Water rates and water  
23          issues in many communities are going to continue to be a challenge." In the next  
24          sentence Mr. Flessner says, "Dr. Beecher's studies indicate water rates nationwide  
25          have risen faster than inflation in the past five years." TAWC's requested  
26          increase in this case produces an average monthly residential bill of \$18.38, well  
27          below the average quoted in the article based on the independent study, and this  
28          too contradicts Mr. Brown's claim of rate shock.

29  
30          In my direct testimony filed in this case I included a recap of TAWC's rate  
31          increase history from 1995 through the rate increase requested by TAWC in this

1 filing identified as Exhibit MAM-1. That schedule demonstrates that if the TRA  
2 were to approve the entire request of TAWC in this case, TAWC's rates would  
3 have increased on average only 3.4% per year during that 12 year period.

4  
5 Contrary to the claims by Dr. Brown that the increase in rates requested by  
6 TAWC constitutes rate shock, the facts simply do not support his claim which has  
7 been a common occurrence regarding the CAPD's recommendations in this case.

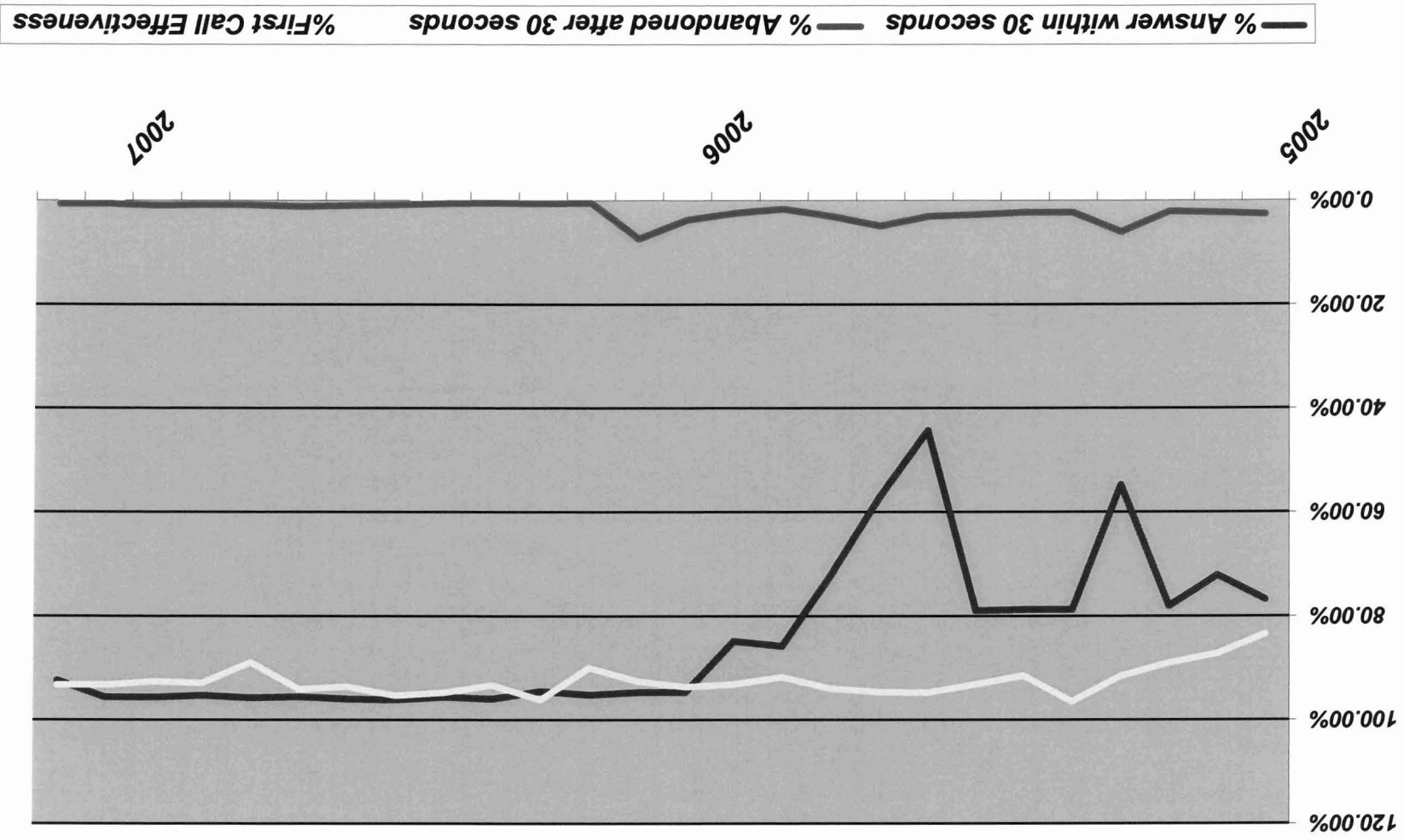
8  
9 113. Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

10 A. Yes.  
11  
12  
13

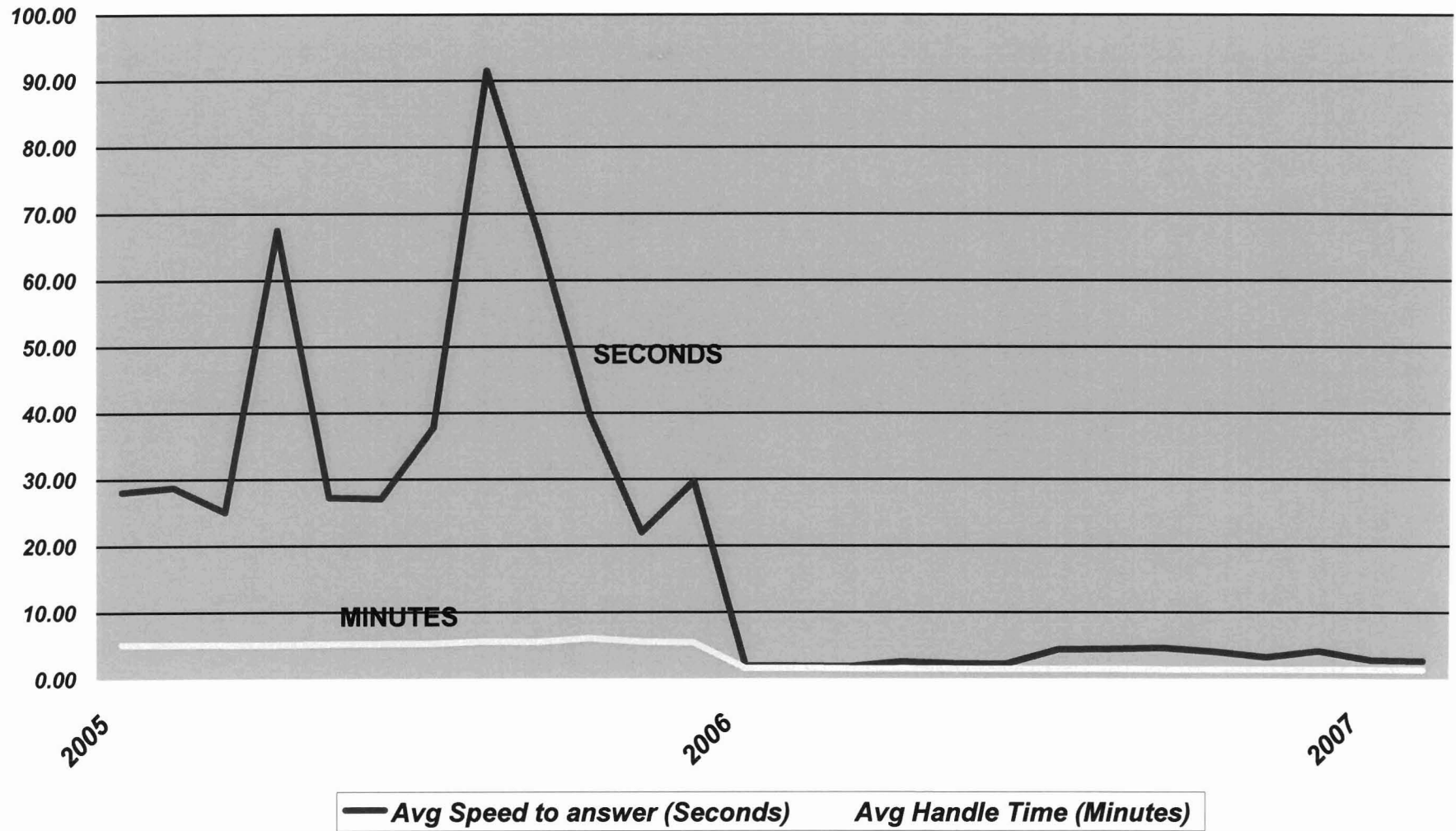
Tennessee-American Water Company

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb
<b>Call Center Stats</b>	<b>2005</b>												<b>2006</b>												<b>2007</b>	
Avg. % Answered with 30 Seconds	76.75%	72.05%	78.03%	54.66%	78.69%	78.69%	78.90%	44.18%	57.07%	72.03%	85.76%	84.79%	94.65%	94.66%	95.14%	94.44%	95.93%	95.52%	96.05%	95.89%	95.48%	95.67%	95.20%	95.59%	95.59%	92.33%
Avg. % Abandoned After 30 Seconds	2.52%	2.20%	1.98%	5.94%	2.21%	2.19%	2.62%	2.92%	4.81%	2.92%	1.50%	2.29%	3.64%	7.20%	0.36%	0.48%	0.36%	0.46%	0.71%	0.86%	1.07%	0.74%	0.69%	0.85%	0.52%	0.59%
% First Call Effectiveness	83.39%	87.19%	88.96%	91.52%	96.45%	91.45%	93.13%	94.67%	94.60%	93.89%	91.70%	93.14%	93.61%	92.49%	89.92%	96.07%	93.26%	94.67%	95.25%	93.54%	94.01%	88.83%	92.87%	92.52%	93.21%	93.22%
Avg. Speed to Answer (seconds)	28.04	28.69	25.02	67.43	27.22	27.00	37.74	91.46	66.81	39.52	21.96	29.66	1.96	1.92	1.82	2.53	2.25	2.20	4.37	4.43	4.61	4.04	3.20	4.13	2.77	2.64
Avg. Handle Time (Minutes)	5.14	5.15	5.13	5.12	5.18	5.25	5.26	5.59	5.53	6.06	5.56	5.42	1.54	1.59	1.52	1.52	1.45	1.46	1.47	1.46	1.37	1.37	1.39	1.40	1.37	1.36
<b>Operational Service Metrics</b>																										
Service Orders Worked	4,971	4,326	5,162	4,556	4,680	5,113	4,506	4,698	5,051	6,356	6,022	5,726	6,053	6,838	7,540	6,667	7,900	7,419	7,235	7,391	6,786	6,783	6,652	7,064	7,909	6,378
% Of Appointment Order On-time	99.13%	99.40%	99.40%	99.78%	99.72%	99.73%	99.71%	99.49%	99.49%	99.56%	99.55%	99.60%	99.77%	99.65%	99.83%	99.82%	99.84%	99.69%	99.82%	99.86%	99.60%	99.82%	99.68%	99.89%	99.76%	99.78%
% Of Meters Estimated	10.64%	14.53%	10.36%	8.33%	4.77%	5.12%	4.85%	4.45%	10.27%	11.93%	5.42%	12.77%	6.18%	2.71%	1.27%	1.22%	1.30%	1.08%	1.08%	0.97%	0.97%	3.35%	3.69%	1.59%	1.32%	1.01%

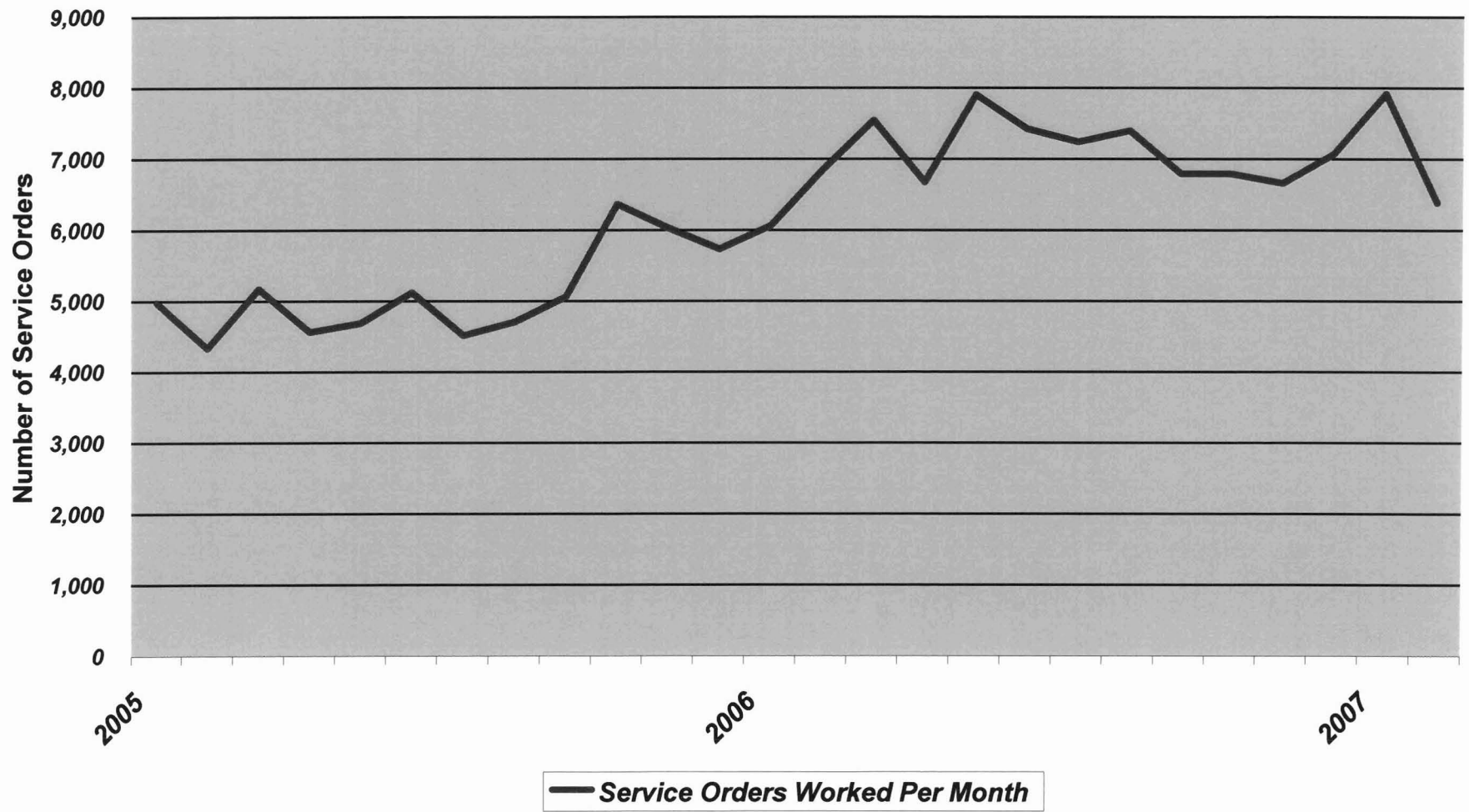
**TENNESSEE AMERICAN WATER COMPANY  
CALL CENTER STATISTICS  
Rebuttal Exhibit MAM-1**



**TENNESSEE AMERICAN WATER COMPANY  
CALL CENTER STATISTICS  
Rebuttal Exhibit MAM-2**

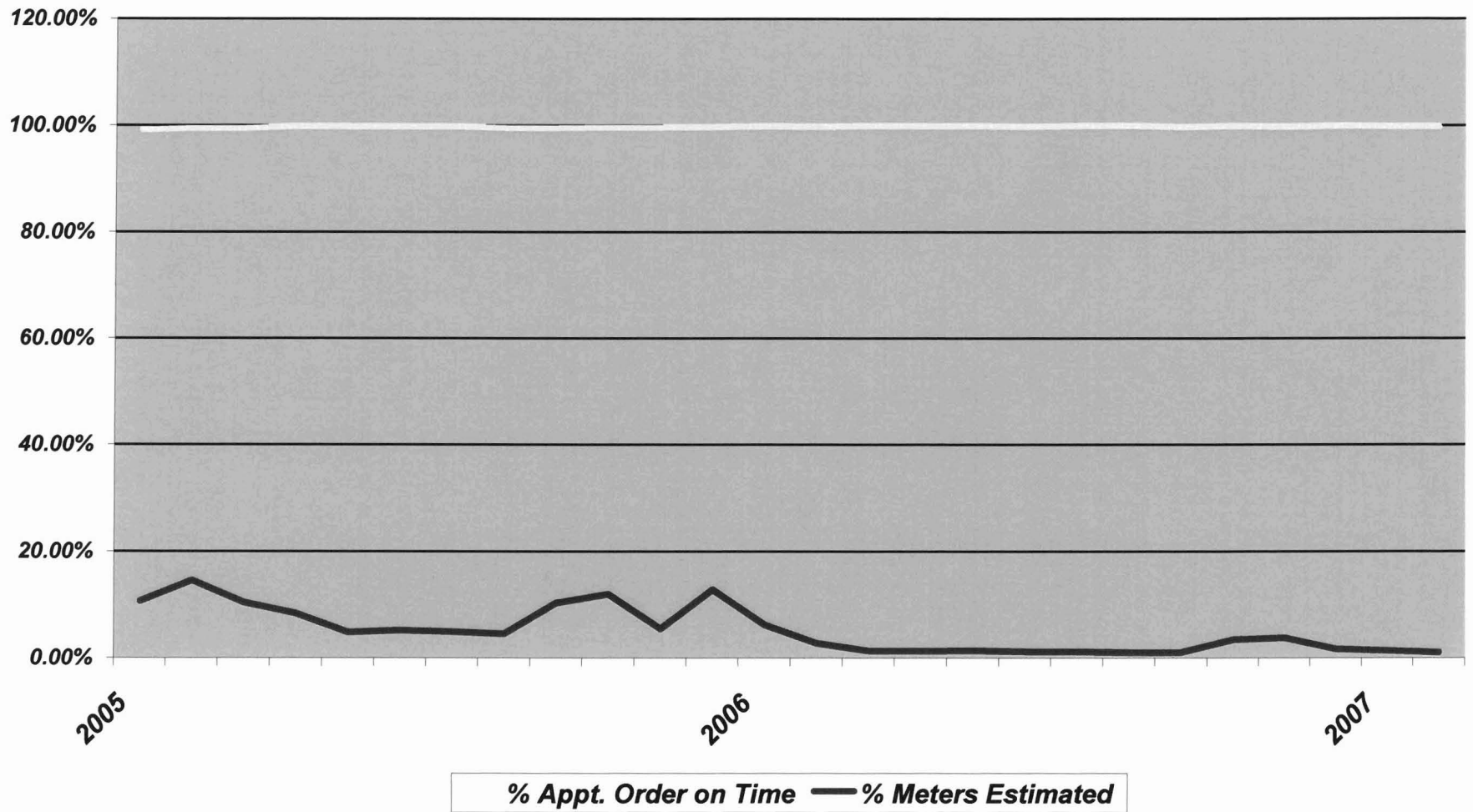


**TENNESSEE AMERICAN WATER COMPANY**  
**OPERATIONAL SERVICE METRICS**  
**Rebuttal Exhibit MAM-3**





**TENNESSEE AMERICAN WATER COMPANY  
OPERATIONAL SERVICE METRICS  
Rebuttal Exhibit MAM-4**



## Tennessee American Water Co.

Budget Income Statement without any rate increase from this Case  
Response to CAPD Data Request CMA-1-Question 7

## Rebuttal Exhibit MAM-5

		2007				
DESCRIPTION		TOTAL	2008	2009	2010	2011
1	OPERATING REVENUES		1			
2	WATER (L9,SC5)	32,144,484	2	32,368,484	32,499,791	32,677,445
3	SEWER	0	3	0	0	0
4	OTHER	1,377,072	4	1,377,072	1,377,072	1,377,072
5	MANAGEMENT	0	5	0	0	0
6	TOTAL	33,521,556	6	33,745,556	33,876,863	34,054,517
7	OPERATING EXPENSE		7	0	0	0
8	LABOR (L14,SC5)	4,695,759	8	4,836,632	4,981,731	5,131,183
9	PURCHASED WATER	51,050	9	52,582	54,159	55,784
10	FUEL & POWER	1,936,389	10	2,023,382	2,114,290	2,209,287
11	CHEMICALS	1,002,921	11	1,013,075	1,023,337	1,033,708
12	WASTE DISPOSAL	174,265	12	178,629	183,103	187,688
13	MANAGEMENT FEES	4,483,328	13	4,154,660	4,174,582	4,201,379
14	GROUP INSURANCE	1,505,372	14	1,564,821	1,632,418	1,708,895
15	PENSIONS	652,678	15	722,947	679,018	642,619
16	REG. EXPENSE (L18,SC5)	241,458	16	173,479	149,331	49,332
17	INSURANCE NOT GROUP	523,940	17	554,776	590,405	643,737
18	CUSTOMER ACCTG (L22,SC5)	1,217,192	18	1,253,696	1,291,295	1,330,022
19	RENTS	41,925	19	41,925	41,925	41,925
20	GENERAL OFFICE	242,264	20	248,206	254,461	260,899
21	MISCELLANEOUS	1,804,660	21	1,839,107	1,878,732	1,916,548
25	OTHER MAINT. EXPENSE	862,167	25	887,672	913,942	941,000
22	TOTAL	19,435,370	22	19,545,589	19,962,728	20,354,007
	OTHER OPERATING EXPENSES			0	0	0
27	DEPRECIATION	5,012,115	27	5,346,913	5,897,403	6,202,868
28	AMORTIZATION	121,776	28	121,776	121,776	121,776
29	GENERAL TAXES (L41,SC5)	3,414,732	29	3,430,227	3,470,828	3,773,929
30	SIT (L48,SC5)	116,464	30	120,576	-7,684	-66,016
31	FIT (L53,SC5)	586,124	31	446,890	-38,920	-332,603
32			32	0	0	0
33	TOTAL OPERATING EXP	28,686,580	33	29,011,971	29,406,130	30,053,961
34	UTILITY OPER INCOME	4,834,976	34	4,733,585	4,470,733	4,000,556
35	OTHER INCOME & DED		35	0	0	0
36	NONOPERATING RENTAL INCOME	0	36	0	0	0
37	DIVIDEND INCOME - COMMON	0	37	0	0	0
38	- PREFERRED	0	38	0	0	0
39	INTEREST INCOME (L62,SC3)	0	39	0	0	0
40	AFUDC (AFUDC WORKSHEET)	49,626	40	252,386	68,276	182,661
41		0	41	0	0	0
42	M&J MISC INC	0	42	0	0	0
43	GAIN (LOSS) ON DISPOSITION	0	43	0	0	0
44		0	44	0	0	0
45	TOTAL OTHER INCOME	49,626	45	252,386	68,276	182,661
46	MISC AMORTIZATION (L69,SC5)	0	46	0	0	0
47		0	47	0	0	0
48	MISC OTHER DEDUCTIONS	74,000	48	76,220	78,507	80,862
49	GENERAL TAXES	0	49	0	0	0
50	SIT (SCH 4)	-4,654	50	-4,798	-4,947	-5,100
51	FIT (SCH 4)	-23,431	51	-24,158	-24,906	-25,677
52	TOTAL OTHER DEDUCTIONS	45,915	52	47,264	48,654	50,085
53	TOTAL OTHER INCOME NET	3,711	53	205,122	19,623	132,576
54	INCOME BEFORE INTEREST	4,838,687	54	4,938,708	4,490,356	4,133,132
55	INTEREST CHARGES:	0	55	0	0	0
56	LONG TERM DEBT	3,658,231	56	3,648,462	4,422,386	4,478,312
57	AMORTIZATION	69,156	57	72,165	93,570	96,570
58	SHORT TERM DEBT (L56,SC3)	103,233	58	588,143	142,940	341,516
59	OTHER	0	59	0	0	0
60	AFUDC DEBT	-27,613	60	-145,698	-40,446	-108,206
61	TOTAL INTEREST	3,803,006	61	4,163,072	4,618,449	4,808,191
62	NET INCOME	1,035,681	62	775,636	-128,093	-675,059
		41,619,162		42,685,545	47,228,817	49,189,756
	Return on Equity per Budget	2.3224%		1.6552%	-0.4175%	-1.5128%
						-2.9176%
Adjust for CAPD Recommendation		(722,023)				
			(1,237,754)	(1,237,754)	(1,237,754)	(1,237,754)
Revised Net Income to Common						
Per CAPD recommendation		313,657	(462,118)	(1,365,848)	(1,912,813)	(2,600,647)
ROE per CAPD recommendation		0.7536%	-1.0826%	-2.8920%	-3.8886%	-5.2986%

**Rate of Return Summary  
At the Mid-Point of the Attrition Year**

**Rebuttal Exhibit MAM-6**

**Page 1 of 2**

**Updated Schedule from those included in Direct Testimony**

**Tennessee Regulatory Authority  
Company: Tennessee-American Water Company  
Case No:**

**Test Year: Twelve Months Ended: June 30, 2006**

**Exhibit No. 3, Schedule 1**

**Page 1 of 1**

<u>Line No.</u>	<u>Class of Capital</u>	<u>Reference</u>	<u>Amount</u>	<u>Percent of Total</u>	<u>Cost Rate</u>	<u>Weighted Cost of Capital</u>
1						
2						
3	Long-term Debt	Schedule 2	\$55,759,080	53.07%	6.08%	3.227%
4						
5	Short-term Debt		3,948,000	3.76%	5.40%	0.203%
6						
7	Preferred Equity	Schedule 3	1,382,100	1.32%	5.00%	0.066%
8						
9	Common Equity					
10	Common Stock		25,043,003	23.84%	11.00%	2.622%
11	Retained Earnings		18,925,643	18.02%	11.00%	1.982%
12						
13	Total Capitalization		105,057,826	100.00%		8.100%
14						
15						
16						
17						
18	Total Common Equity Return Proposed		11.00%			
19						
20						
21						

**Embedded Cost of Long-Term Debt  
At the Mid-Point of the Attrition Year**

Rebuttal Exhibit MAM-6  
Page 2 of 2  
Updated Schedule from those included in Direct Testimony

Tennessee Regulatory Authority  
Company: Tennessee-American Water Company  
Case No:

Test Year: Twelve Months Ended: June 30, 2006  
Exhibit No. 3, Schedule 2  
Page 1 of 1

Line No.	Debt Issue Type, Coupon Rate	Interest Rate	Issue Date	Maturity Date	Principal Amount	Face Amount Outstanding	Unamortized (Issuance) Debt Exp.	Carrying Value	Annual Interest Expense	Annual Amortization of Issue Expense	Total Cost
1											
2											
3											
4											
5	General Mortgage Bonds										
6											
7	9.25% Series	9.25%	01/12/90	12/01/19	2,500,000	2,500,000	18,685	2,481,315	231,250	1,525	232,775
8	7.84% Series	7.84%	09/04/96	09/01/26	5,700,000	5,700,000	43,269	5,656,731	446,880	2,278	449,158
9	6.50% Series	6.50%	05/31/98	06/01/08	6,500,000	6,500,000	5,569	6,494,431	422,500	7,434	429,934
10	6.87% Series	6.87%	03/31/01	03/29/11	5,100,000	4,080,000	17,936	4,062,064	280,296	5,004	285,300
11	5.39% Series (proposed)	5.39%	02/15/07	02/15/14	15,000,000	15,000,000	138,749	14,861,251	808,500	19,821	828,321
12	4.75% Series (proposed)	4.75%	03/28/07	03/28/17	19,000,000	19,000,000	175,748	18,824,252	902,500	17,575	920,075
13	5.81% Series (proposed)	5.81%	10/15/07	10/15/17	2,500,000	2,500,000	23,125	2,476,875	145,250	2,313	147,563
14											
15	Capital Lease 9.489%	9.489%	06/01/98	05/31/13	1,590,500	902,161		902,161	97,432	0	97,432
16											
17											
18	Total				\$57,890,500	\$56,182,161	\$423,081	\$55,759,080	\$3,334,608	\$55,950	\$3,390,558
19											

Embedded Cost of Long-Term Debt

6.08%

Tennessee American Water Co.  
CAPD EFFECTIVE COST OF EQUITY CAPITAL PER:  
TAWC Capital Structure

Rebuttal Exhibit MAM-7

	AMOUNT	As Filed			As Amended in Rebuttal Exhibit MAM-6			Effect Of CAPD Cap. Str. @ TAWC		
		RATIO	COST RATE	WEIGHTED	RATIO	COST RATE	WEIGHTED	RATIO	COST RATE	WEIGHTED
LONG-TERM DEBT	\$55,759,080	53.075%	6.77%	3.59%	53.075%	6.08%	3.23%	53.075%	6.08%	3.23%
SHORT-TERM DEBT	3,948,000	3.758%	5.40%	0.20%	3.758%	5.40%	0.20%	3.758%	5.40%	0.20%
PREFERRED STOCK	1,382,100	1.316%	5.00%	0.07%	1.316%	5.00%	0.07%	1.316%	5.00%	0.07%
COMMON EQUITY	43,968,646	41.852%	11.00%	4.60%	41.852%	11.00%	4.60%	41.852%	7.18%	3.01%
Retained Earnings										
DEFERRED TAXES	0	0.000%	0.00%	0.00%	0.000%	0.00%	0.00%	0.000%	0.00%	0.00%
JDITC	0	0.000%	0.00%	0.00%	0.000%	0.00%	0.00%	0.000%	0.00%	0.00%
OTHER CAPITAL ELEMENTS	0	0.000%	0.00%	0.00%	0.000%	0.00%	0.00%	0.000%	0.00%	0.00%
TOTALS	105,057,826	100.00%		8.47%	100.00%		8.10%	100.00%		6.50%





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**PUBLIC SERVICE COMMISSION  
OF WEST VIRGINIA  
CHARLESTON**

At a session of the Public Service Commission of West Virginia, in the City of Charleston, on the 26<sup>th</sup> day of January, 2007.

CASE NO. 06-0597-W-PC

WEST VIRGINIA-AMERICAN WATER COMPANY and  
THAMES WATER AQUA HOLDINGS GmbH

Joint Petition for Consent and Approval of the sale by  
Thames Water Aqua Holdings GmbH of the outstanding  
common stock of American Water Works Company, Inc.

**COMMISSION ORDER**

The Commission approves the settlement of this matter.

**BACKGROUND**

*WVAWC and Thames' petition for consent*

On May 8, 2006, West Virginia-American Water Company ("WVAWC") and Thames Water Aqua Holdings GmbH ("Thames," and Thames and WVAWC collectively as "Petitioners"), requested the Commission's consent and approval of the following:

- i. Thames' sale of up to 100% of the common stock of American Water Works Company, Inc. (American Water), WVAWC's immediate corporate parent, in one or more public offerings; and
- ii. The merger of American Water's immediate corporate parent, Thames Water Aqua US Holdings, Inc. (Thames US Holdings), with and into American Water, with American Water being the surviving corporation (to occur prior to the closing of the initial public offering).

Joint Petition pp. 1-18 & Exs. A-D. The proposed transaction will not adversely affect the public, and will result in continuous and seamless provision of reliable water service by WVAWC at just and reasonable rates, they said.



The offerings would be conducted in compliance with the U.S. Securities Act of 1933, and American Water's common stock will be listed on the New York Stock Exchange, WVAWC and Thames said.

American Water, a Delaware corporation, owns utilities operating in 18 states, including WVAWC. American Water itself is not authorized to conduct business in West Virginia.

Thames GmbH, the holding company for most of RWE's water operations, owns American Water's stock. RWE is a foreign corporation, existing under the laws of the Federal Republic of Germany.

Under the proposed transaction, American Water will become the largest publicly-traded water company in the United States. American Water will be subject to the extensive disclosure and governance requirements of the Securities and Exchange Commission (SEC), including the federal Sarbanes-Oxley legislation, and to the requirements of the New York Stock Exchange. WVAWC will continue to be operated on a day-to-day basis by its local management under WVAWC's board of directors.

While Thames intends to sell 100% of the shares in the initial public offering, under certain market conditions Thames may sell less than that. If this occurs, then the remaining shares would be sold in a subsequent offering(s) as soon as is practical after the initial public offering, pursuant to SEC rules for underwritten public offerings.

The key participants in an underwritten public offering are: (1) the issuer (company in which the shares are being sold-in this case, American Water); (2) the underwriters (in this case a group of investment banks who prepare the necessary SEC filings and participate in marketing the offering to investors); and (3) the seller of the shares (in this case, Thames GmbH). They do not expect the initial filing to be made with the SEC sooner than late 2006.

Thames and WVAWC are not requesting approval for any individual or group to acquire a majority ownership interest in American Water in either the initial public offering or subsequent public offerings. The prospectus will clearly state that no investor will be permitted to acquire control of American Water unless the investor obtains any necessary state regulatory approvals.

WVAWC and Thames asserted that the proposed transaction should not impair WVAWC's ability to maintain a reasonable capital structure, which is representative of other utilities, nor should it impair WVAWC's ability to raise needed capital on reasonable terms. As of December 31, 2005, WVAWC's debt consists of: (1) \$121,000,000 in third-party debt issued by WVAWC in capital markets and (2) \$122,501,291 in inter-company debt owed by WVAWC to American Water Capital Corp., a subsidiary of American Water. WVAWC used American Water Capital Corp. as a financing vehicle prior to RWE's acquisition of American Water, they said.

American Water Capital Corp's debt, as of December 31, 2005, consists of \$2,438,586,000 in corporate loans from RWE and a \$226,860,000 in debt issued in the capital markets. Standard

& Poor's rates American Water Capital Corp. as "A-" (on negative credit watch) and Moody's Investors Service, Inc. rates the company as "Baa1" (on negative outlook), they wrote.

American Water owes \$150,000,000 in inter-company debt to RWE, as of December 31, 2005. Additionally, RWE indirectly holds \$1.75 billion of preferred shares of American Water. Under the proposed transaction, all RWE inter-company financial relationships will be terminated. The timing and composition of any replacement financing depends largely on market conditions, they wrote. American Water's capital structure is intended to be comparable to that of other publicly-traded utilities following the proposed transaction. If the refinancing of American Water Capital Corp.'s debt with RWE requires changes in the terms of the inter-company debt between American Water Capital Corp. and WVAWC, then WVAWC will, if required, seek approval from the Commission in a separate petition for any changes that may be needed, WVAWC and Thames wrote.

Once the proposed transaction is completed, American Water and its subsidiaries will report all financial information in accordance with generally accepted accounting principles (GAAP) and SEC regulations.

American Water Works Service Company, Inc. will continue to provide customer service, accounting, administration, engineering, financial, human resources, information systems, operations, risk management, water quality and other services to WVAWC under the Service Company Agreement. Additionally, American Water Capital Corp. will continue to provide services to WVAWC under the Financial Services agreement, after the proposed transaction is consummated.

WVAWC customers may invest in their water utility by buying American Water stock, and American Water may create an employee stock purchase program following the proposed transaction, they said.

WVAWC will honor all of its existing agreements, including its collective bargaining agreements. Day-to-day operations of WVAWC are not expected to change as a result of the proposed transaction. Nor will the existing book value of any of WVAWC's assets be adjusted due to the proposed transaction.

WVAWC and Thames also asserted that they will not seek recovery of the transaction costs.

They attached the financial information required of WVAWC and Thames GmbH pursuant to Rule 21 of the Commission's *Rules of Practice and Procedure*.

They asked that, upon closing of the proposed transaction, the Commission release RWE, Thames US Holdings, American Water, Thames and WVAWC from any further obligations under the conditions that the PSC imposed in its orders approving of RWE's acquisition of American Water's common stock. If the Commission wishes to continue any of those conditions, Thames and WVAWC asked that any such conditions be handled in this proceeding. Petition pp. 17- 18.

*Early procedural filings*

On June 9, 2006, Staff wrote that several questions needed to be addressed and that Staff would obtain additional information from the Joint Petitioners. See Initial Joint Staff Memorandum.

On July 17, 2006, the Commission granted the Consumer Advocate Division's petition to intervene and required WVAWC and Thames to publish notice of the application one time in each county in which WVAWC provides service.

On August 2, 2006, WVAWC and Thames pre-filed the direct testimony of Michael A. Miller, vice president and treasurer of West Virginia-American Water Company, and Ellen C. Wolf, senior vice president and chief financial officer of American Water Works.

On August 11, 2006, affidavits of publication<sup>1</sup> regarding notice of the application were filed as follows:

July 21, 2006	<i>Point Pleasant Register</i> (Mason County), <i>The Logan Banner</i> , <i>The Exponent Telegram</i> (Harrison County)
July 22, 2006	<i>Bluefield Daily Telegraph</i> (Mercer County)
July 24, 2006	<i>Wayne County News</i> , <i>The Fayette Tribune</i> , <i>The Saturday Gazette Mail</i> (Kanawha County), <i>Register-Herald</i> (Raleigh County)
July 25, 2006	<i>Hinton News</i> (Summers County), <i>Braxton Citizens' News</i> , <i>The Jackson Herald</i>
July 26, 2006	<i>Lincoln Journal</i> , <i>Webster Echo</i> , <i>Coal Valley News</i> (Boone County), <i>Clay County Free Press</i> , <i>The Weston Democrat</i> (Lewis County)
July 27, 2006	<i>Roane County Reporter</i> , <i>The Putnam Democrat</i> and <i>The Hurricane Breeze</i> (Putnam County)

*Motions for protected treatment & in camera hearing*

In response to CAD's first data request, WVAWC and Thames provided certain materials to Staff and the CAD under an interim protective agreement. Thereafter, they asked the

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<sup>1</sup> The Commission ordered WVAWC and Thames to publish notice in each county where WVAWC provides service, there being 19 such counties. WVAWC and Thames provided affidavits for all of the counties except Cabell. Moreover, WVAWC and Thames published notice in two papers in neighboring Putnam County, and they published in both Charleston papers, which have a considerable statewide readership. Under these circumstances, the Commission concludes that WVAWC and Thames have substantially complied with the publication requirement.

Commission to accord the information permanent protected treatment. See Joint Motion for Protective Order pp. 1-2 (Aug. 24, 2006).<sup>2</sup>

WVAWC and Thames noted that the Public Service Commission of Kentucky, following an *in camera* review,<sup>3</sup> protected the same information from disclosure, because it was not related to the issues of the change of control of American Water. They asked the West Virginia PSC to do the same.

American Water's initial public stock offering (IPO) is subject to extensive federal SEC disclosure and governance requirements, including Sarbanes-Oxley, they wrote. The IPO's structure and timing will depend on American Water's present and projected post-IPO financial condition, the IPO's impact on Thames and RWE (Thames's parent), and current and foreseeable market conditions. Joint Motion p. 3. Extensive due diligence has been conducted, which includes analyses and reports containing highly sensitive, confidential, or privileged information, which has enormous commercial value to competitors because it describes American Water's current financial condition; reflects expectations for American Water's post-IPO future, including projections of business performance, identification of risks, assessments of market and industry conditions, and the relative characteristics of certain industry competitors; shows each party's independent review of how the transaction would affect its shareholders and operations; and includes advice from legal counsel, they argued. Id. p. 3. The information was generated at great cost and effort, and no outside party would be able to reproduce the information without access to the confidential information, they wrote. Id. p. 4.

Release of some of the information could result in a "gun-jumping" violation under federal securities law, they argued, because it is unlawful to sell securities before filing a registration statement with the SEC. Courts and the SEC have broadly construed an "offer to sell," and the publication of this information could constitute an offer to sell, they argued. If gun-jumping occurs, the SEC could delay the stock offering and a court might allow a buyer to rescind its purchase. Id. p. 4.

They also argued that the information is known to a very limited number of people, is comprised of trade secrets and privileged communications and should be protected from public disclosure. Id. p. 5.

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<sup>2</sup> This motion was revised several times, and for clarity the Commission summarizes the total request as follows:

Aug. 24, 2006, Joint Motion	materials responding to the CAD's first data request
Sept. 14, 2006	correcting Exhibit 3 to Aug. 24, 2006, motion
Sept. 15, 2006, 1st Am.	materials responding to the CAD's second data request
Oct. 18, 2006, 2d Am.	materials responding to the Staff's first data request
Nov. 14, 2006, 3d Am.	materials ordered to be produced by the PSC at the <i>in camera</i> hearing (responding to CAD's first data request)

<sup>3</sup> Kentucky PSC Case No. 2006-00197.

Generally, PSC documents are available for public inspection, unless a Freedom of Information Act exemption applies, WVAWC and Thames wrote. Id. p. 7. To obtain protected treatment, the information must be a trade secret and more than a mere assertion of privilege must be made, they said. The party seeking protection must make a “credible showing of likely harm.” W. Va. Code § 29B-1-4(1) defines trade secret to include any “compilation of information which is not patented which is known only to certain individuals within a commercial concern” and which “gives its users an opportunity to obtain business advantage over its competitors.” Id. p. 7.

To evaluate a trade secret claim, they wrote, the PSC must, pursuant to State ex rel. Johnson v. Tsapis, 187 W. Va. Code 337, 419 S.E.2d 1 (1992), analyze these factors:

1. The extent the information is known by persons outside the requesting business,
2. The extent the information is known by employees and others involved in the party’s business,
3. The measures taken to guard the information’s secrecy,
4. The information’s value to competitors and the requesting party,
5. The cost and effort expended to develop the information, and
6. The ease or difficulty that others could duplicate or obtain the information.

Id. pp. 8-9. Further, several items are subject to the attorney-client privilege, they said.

In the Kentucky proceeding, the Kentucky Attorney General retained the same expert witness as West Virginia’s CAD did. Thus, many of the CAD’s data requests were the same as requests made in Kentucky. Kentucky’s process for confidential treatment is similar to West Virginia’s process, they said. Id. p. 10. The Kentucky PSC concluded that none of the withheld information was relevant to the takeover case and ordered that such material be redacted from responses to discovery requests. Id. p. 12 (Kentucky PSC order attached as Ex. 2).

WVAWC and Thames advised that less than 20 of the 155,000 employees have had access to the data, and everyone involved in due diligence signed a confidentiality agreement. Joint motion pp. 15-17. They asked the West Virginia Commission to accord deference to the Kentucky ruling. Id. pp. 19-20.

On September 15, 2006, in the motion’s first amendment, they sought protection of 1) documents relating to American Water’s issuance of 1,750 shares of 5.9% preferred stock, and the related repurchase transaction, and 2) a line drawing of the pro forma capital structure of the preferred stock transaction, including affiliated parties and their respective corporate relationships. First Amendment to Joint Motion pp. 2-3. The preferred stock transaction was designed to secure tax efficiencies, and was developed with the assistance of expert securities counsel, tax counsel, and financial and tax advisors, they said. Id. The documents include assurances that the preferred stock transaction is legal and effective for its intended purposes, which results in a strategic advantage over actual and potential competitors that could not be replicated by those competitors without



investing considerable resources. Id. p. 3. Thus, the transaction constitutes a trade secret under West Virginia law, they said. Id.

On October 2, 2006, the CAD asked the Commission to require WVAWC and Thames to provide 1) Board of Director minutes that discussed the proposed separation of American Water from RWE and 2) presentations made to directors concerning the proposed separation of American Water from RWE, which had been omitted from the data responses.

CAD's counsel was permitted to review, but not copy, the information which had been redacted, CAD wrote. Motion to compel & for *in camera* review p. 3. Additionally, counsel's ability to take notes on the content of the disputed materials was restricted. Id. The CAD argued that the materials are relevant to the issues in this proceeding, "or at the very least, could be the basis for additional questions that are reasonably calculated to lead to the discovery of admissible evidence." Id. These materials bear on the managerial, financial and technical abilities of WVAWC and Thames and are relevant to this case due to representations made, and conditions imposed by the Commission in Case Number 01-1691-W-PC, relating to Thames' acquisition of WVAWC. Id. pp. 3-4. Since the documents have been refused to the CAD, the only alternative is for the Commission to conduct an *in camera* review, the CAD argued. The CAD also asked the Commission to require the materials to be provided to the CAD, subject to the protective agreement. Id. p. 5.

WVAWC and Thames provided no legal support for the proposition that another state's decision should resolve an issue pending before the West Virginia PSC, the CAD wrote. Id. p. 5. Moreover, the Kentucky decision contains two sentences, which do not explain how the materials are not relevant to the change-in-control issue. Id.

On October 12, 2006, the Commission set an *in camera* hearing, because the Commission was not willing to accord permanent protected treatment before reviewing the contested materials. WVAWC and Thames were required to provide the unredacted materials to the Commission by October 23, 2006. The Commission did not require the materials to be provided to Staff or the CAD.

On October 23, 2006, the unredacted materials were filed with the Commission, under seal.

At the October 31, 2006, *in camera* hearing, counsel for CAD and WVAWC and Thames argued their respective positions, and the essential elements of those arguments appear in the public pleadings. In addition, Staff counsel argued that,<sup>4</sup> like CAD, Staff would not challenge the

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<sup>4</sup> Staff did not file a written response to the motions, but made legal arguments at the *in camera* hearing, which the Commission found to be very persuasive. Since Staff's position does not appear in any of the public documents, the Commission summarized Staff's legal position in this order, to provide background for the Commission's decision to require that the underlying documents be provided.

assertions of attorney-client privilege. Staff also argued that, under traditional PSC practice as authorized by W. Va. Code § 24-1-7, information is sometimes provided to the PSC that circuit courts might not receive under the Rules of Evidence. If so, the Commission allows the parties to argue about the weight to be accorded such information. Staff also agreed with the CAD that information may be discoverable if it is reasonably calculated to lead to the discovery of admissible evidence. Id. Staff noted that different arguments might apply, should the information be offered at a hearing. Staff suggested then, that the materials be made available to the parties pursuant to the interim protective agreements and that the Commission need not separately review each excerpt. Staff also agreed that the West Virginia PSC is not bound by the decisions of another state's utility commission.

At the conclusion of the *in camera* hearing, the Commission ordered the unredacted documents to be provided to Staff and the CAD, pursuant to the existing interim protective agreements. The Commission also advised that it was not addressing whether the information could be offered at hearing and that the Commission would rule on permanent protected treatment should any of the information be used at trial.

*CAD & Staff direct testimony, WVAWC & Thames rebuttal testimony*

On November 8, 2006, the CAD pre-filed, in public and proprietary versions, the direct testimony of Scott J. Rubin. He is an independent consultant and attorney, and his practice is limited to matters affecting the public utility industry. Also on November 8, 2006, Staff pre-filed the direct testimony of Charles "Chuck" Knurek, utilities analyst III in the Commission's Water and Wastewater Division. On November 29, 2006, Staff filed corrections to Mr. Knurek's pre-filed direct testimony.

On November 21, 2006, WVAWC and Thames pre-filed Mr. Miller's rebuttal testimony. They also pre-filed Ms. Wolf's rebuttal testimony, in public and proprietary versions.

*Proposed settlement*

On December 1, 2006, WVAWC, Thames, Staff and the CAD jointly filed a proposed settlement of this proceeding. See Joint Ex. No. 1 (Tr. Dec. 4, 2006). They asked the Commission to grant its prior consent, under W. Va. Code § 24-2-12, for Thames' sale of up to 100% of American Water's common stock; and for the merger of Thames Water Aqua Holdings, Inc., American Water's immediate corporate parent, into American Water, with American Water being the surviving corporation, prior to the closing of the IPO. Joint Ex. 1 p. 2 (Tr. Dec. 4, 2006).

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The Commission's decision to summarize Staff's legal position in this order shall not be extended to justify the public release of the transcript. The October 31, 2006, hearing was conducted *in camera* and, statements made at the hearing are replete with references to the underlying materials. Thus, it is appropriate to accord permanent protected treatment to the transcript of the *in camera* hearing. No part of the transcript may be made public, except for the brief summary of Staff's legal arguments which is set forth above.

Staff and CAD conducted extensive discovery, they wrote. The CAD served five sets of data requests and Staff served two sets of data requests and undertook extensive informal discovery. Id. p. 5. In addition, the parties met for prehearing conferences on November 13 and November 29, 2006, to narrow the issues and finalize numerous conditions. Id. pp. 5-6.

The parties negotiated the following conditions, all appearing in Paragraph 22, which they asked the Commission to impose:

A. WVAWC will pass through to WVAWC's customers, in future rate cases, any actual savings from efficiencies resulting from the IPO/Proposed Transaction for the Common Stock of AWW and the continued ownership of WVAWC by AWW.

B. For a period of three (3) years from the date of the Commission Order ("Order") in this case (and after it has first notified its WVAWC employees), WVAWC will notify the Commission in writing of a planned reduction of 5% or more in WVAWC's work force.

C. WVAWC will continue to use its best efforts to meet or improve upon WVAWC's water service standards, including but not limited to standards for water service interruptions, employee response time, customer complaints and complaint response time.

D. WVAWC will continue to make its best efforts, at all times, to meet applicable water quality standards and will commit to make no changes in the basic operations of WVAWC as a result of the IPO/Proposed Transaction that would be detrimental to this commitment.

E. WVAWC will maintain its corporate offices in West Virginia. Furthermore, there will be no reduction in the overall levels and responsibilities of West Virginia local management located in West Virginia as a result of the IPO/Proposed Transaction.

F. WVAWC will maintain a substantial "local interest" representation on its Board of Directors, and the Board of Directors of WVAWC will continue to provide guidance and oversight of the business and affairs of WVAWC.

G. WVAWC will continue its current level of support for and involvement in local and community projects, including continued funding for WVAWC's Helping Hand Program to assist low income residential customers with their water bills.

H. AWW will make no attempt to recover through WVAWC's rates any costs of the IPO/Proposed Transaction, purchase price, goodwill, early termination payment, change in control payment, incentive or retention bonus payment in connection with the IPO/Proposed Transaction, either directly or indirectly through American Water



Works Service Company, Inc., or any other affiliate, or by any other means. AWW will supply a report to the Commission summarizing such costs, including the amount of such costs allocated to WVAWC, within one year from the date of the Order or, if the sale by Thames Holdings of the Common Stock occurs in more than one year after the date of the Order, within 60 days of the date of the sale.

I. AWW will not recover from WVAWC's customers or have WVAWC's customers fund any portion of the costs of the IPO/Proposed Transaction, including but not limited to financial, legal, severance payments, regulatory fees, investment services or the installation of the initial procedures for compliance with The Sarbanes - Oxley Act of 2002 (Pub. L. No. 107-204, 116 Stat. 745, also known as the Public Company Accounting Reform and Investor Protection Act of 2002 ("Sarbanes-Oxley").

J. For a period of three years from the date of the Order, AWW will not be permitted to charge WVAWC more than its allocated share of \$1 million per year (adjusted annually for inflation) for additional audit costs for Sarbanes Oxley compliance as calculated under the existing agreement between AWWSC and WVAWC.

K. For three years following the date of the Order, WVAWC will maintain its equity-to-capital ratio between 35% and 45%. If the equity-to-capital ratio falls outside of this range, WVAWC will notify the Commission in writing within 30 days.

L. WVAWC will flow through to the benefit of its customers any lower cost of debt applicable to WVAWC, to the extent known and measurable, as a result of its relationship with AWW in future general rate cases.

M. WVAWC will report to the Commission within 30 days any downgrading of the bonds of AWW, AWCC, WVAWC or any subsidiary of AWW and will provide a full copy of the report issued by the bond rating agency.

N. When implementing "best practices", AWW and WVAWC will consider any related effects on customer service and customer satisfaction levels.

O. WVAWC will honor all of its existing contracts, easements and other agreements in accordance with their respective terms.

P. WVAWC will not allow the use of any of its personnel, assets or equipment by any affiliated entity without the Commission's prior consent and approval pursuant to W. Va. Code § 24-2-12. Further, to the extent that WVAWC allows the use of such personnel, assets or equipment by any unaffiliated entity, other than a government body or non-profit entity, WVAWC will file a report with the Commission within thirty days after the use of such personnel, assets or equipment on the identity of the

personnel, assets or equipment involved and the estimated fully-allocated cost of such personnel, assets or equipment.

Q. AWW will not issue any debt that pledges as security or otherwise encumbers the assets of WVAWC.

R. AWW agrees that (I) it will not sell a majority of the common stock of WVAWC to any person or corporation, whether or not organized under the laws of this state, until that person or corporation has obtained the prior consent and approval of the Commission under the provisions of W. Va. Code 24-2-12; and (ii) until Thames Holdings has disposed of its interests in AWW, AWW will advise the Parties of any person or corporation that, to the knowledge of AWW or WVAWC, attempts to acquire, either directly or indirectly, a majority of the common stock of WVAWC under the provisions of W. Va. Code § 24-2-12.

S. WVAWC will file reports annually that detail how it proposes to bring WVAWC into compliance with the Commission's Water Rules regarding unaccounted for water.

T. The payment for AWW stock will not be recorded on WVAWC's books.

U. RWE and Thames Holdings' divestiture of AWW will not affect the accounting and rate making treatments of WVAWC's excess deferred income taxes.

V. WVAWC will not bear any costs incurred to comply with any law, regulation, standard, or practice of the United Kingdom, Federal Republic of Germany, or European Community necessary to complete the IPO/Proposed Transaction.

W. WVAWC will notify the Commission before making a dividend that is more than 75% of net income.

X. AWW or WVAWC will file the following reports with the Commission or provide the relevant Securities and Exchange Commission website where such reports are available: AWW's quarterly interim reports to its shareholders; AWW's annual reports to its shareholders; and AWW's and WVAWC's annual audit reports.

Y. WVAWC customers will experience no material adverse change in utility service due to the IPO/Proposed Transaction.

Z. AWW and WVAWC will adequately fund and maintain WVAWC's treatment, transmission, and distribution systems; supply the service needs of WVAWC customers; comply with all applicable West Virginia statutes; and make best efforts to remain in compliance with all administrative regulations of the Commission.

AA. RWE and Thames Holdings will infuse equity capital into AWW prior to the IPO/Proposed Transaction sufficient to establish a capital structure for AWW at the time of the IPO that includes an equity/capitalization ratio no lower than 45% common equity. AWW will file a balance sheet as of the quarter ended immediately preceding the IPO.

Id. pp. 7-10. AWW, through Ms. Wolf's signature on the settlement, agreed to be bound by the conditions. Further, RWE, through Jens Gemmecke's signature on the settlement, agreed to be bound by Condition 22-AA. See also Tr. p. 35 (Dec. 4, 2006).

WVAWC, Thames, Staff and the CAD asked the Commission to issue findings of fact and conclusions of law to the effect that 1) the terms and conditions of the IPO/Proposed Transaction and the settlement are reasonable, 2) no party to the IPO/Proposed Transaction is given an undue advantage over another, and 3) that the completion of the IPO/Proposed Transaction, and related transactions, will not adversely affect the public. Id. p. 11. In the settlement, they also asked the Commission to grant the motion for confidential treatment, as amended.

Finally, they advised that the settlement was the result of extensive negotiations, reflected substantial compromises, and was proposed to expedite and simplify the resolution of this case. Id. pp. 11-12. They acknowledged the Commission's ability to accept, reject or modify the settlement. Id. p. 12.

#### *Final hearing*

At the December 4, 2006, hearing, counsel for WVAWC and Thames advised that the affidavits of publication<sup>5</sup> regarding the required notice of the hearing (see Commission's August 10, 2006, order) were filed on December 1, 2006. The case file reflects the following:

November 6, 2006	<i>The Charleston Gazette &amp; The Daily Mail</i> (both Kanawha County), <i>The Logan Banner</i> , <i>Bluefield Daily Telegraph</i> (Mercer County)
November 7, 2006	<i>Braxton Citizens' News</i> , <i>Register-Herald</i> (Raleigh County), <i>Hinton News</i> (Summers County), <i>The Jackson Herald</i> , <i>Point Pleasant Register</i> (Mason County)
November 8, 2006	<i>Wayne County News</i> , <i>Lincoln Journal</i> , <i>Coal Valley News</i> (Boone County), <i>Clay County Free Press</i> , <i>Webster Echo</i> , <i>The Weston Democrat</i> (Lewis County)
November 9, 2006	<i>Roane County Reporter</i> , <i>The Hurricane Breeze &amp; The Putnam Democrat</i> (both Putnam County), <i>The Fayette Tribune</i>
November 11, 2006	<i>The Exponent Telegram</i> (Harrison County)

Tr. p. 7 (Dec. 4, 2006).

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<sup>5</sup> For the same reasons as appear in footnote 1, the Commission concludes that WVAWC and Thames have substantially complied with the requirement to publish in 19 counties.

WVAWC and Thames' counsel also summarized the transaction as returning American Water to a stand-alone publicly traded company. Tr. p. 8. (Dec. 4, 2006). WVAWC would continue to be an operating subsidiary of American Water. Id. "While we believe that the RWE transaction has worked, as indicated in the testimony, the circumstances have changed. And it is our belief that it is in the best interest of the water company, West Virginia-American and AWW, to consummate the IPO," said counsel. Id.

At the hearing, Mr. Miller and Ms. Wolf took the stand to speak to the settlement.<sup>6</sup> Tr. pp. 9-47 (Mr. Miller), 54-68 (Ms. Wolf).

Mr. Miller said that the negotiated conditions are "the very heart of the stipulation." Id. p. 15. These conditions provide assurance that West Virginia-American will have a strong capital base, going forward; will continue to be a part of a strong corporate structure; will continue to provide quality water service at reasonable rates; will continue to have its headquarters in Charleston; and will continue its history of investment and providing or extending water service in West Virginia, he testified. Tr. pp. 15-16.

Condition 22-A means that if there are any savings or efficiencies due to the IPO, WVAWC will flow those through to the benefit of its rate payers, he said. Id. p. 16. Condition 22-B is an assurance that WVAWC does not intend any major personnel reductions. Id. pp. 16-17. WVAWC will advise the Commission if it plans a reduction of five percent or more. Id. p. 17.

Several conditions are assurances that WVAWC's service will not be compromised by the IPO, and Mr. Miller noted that such assurances had also been made in the petition. Id. pp. 17, 19-20 (i.e., Conditions 22-C, 22-D, 22-N, 22-Y & 22-Z). Conditions 22-E and 22-F address continued local operations. Id. pp. 20-21.

Conditions 22-H and 22-I, as well as assurances in the petition, state that IPO-related costs will not be passed to WVAWC rate payers. Id. pp. 21-22. The reporting requirement in Condition 22-H was a key component of the settlement, Mr. Miller testified. Id. p. 22. WVAWC will report

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<sup>6</sup> Throughout the hearing, care was taken to refrain from addressing the discovery information which is subject to the interim protective agreements. The hearing was closed, due to discussion of the sensitive information, for only a few minutes. Since the underlying sensitive information was not presented to the Commission as evidence, the Commission will not grant permanent protective treatment to the information exchanged in discovery. Instead, the Commission will order the parties to return the contested discovery information or destroy it.

The Commission wishes to make clear that a limited portion of the transcript from the December 4, 2006, hearing is granted permanent protective treatment and shall not be made available, without prior Commission order. See WVAWC's motion for protected treatment of hearing transcript, Tr. pp. 51-52 (Dec. 4, 2006). Similarly, permanent protective treatment is granted to the proprietary versions of the pre-filed testimonies of Mr. Rubin and Ms. Wolf. These proprietary testimonies, likewise, may not be made available, without prior Commission order.

to the Commission all of the transaction costs “so that we’re very clear about what those costs are, what was charged in West Virginia, and that there will be no recovery of those in the rates of West Virginia-American.” Id. Condition 22-V goes a little further to state that WVAWC will not recover any of the IPO costs incurred by RWE or other foreign parties. Id. p. 31. In response to a question by Commissioner Staats, Mr. Miller testified that these particular conditions do not require any of the compliance reports with Sarbanes-Oxley to be filed with the PSC. Id. pp. 40-41.

Condition 22-O reflects WVAWC’s intent to honor all existing contracts, which was also stated in the petition. Id. pp. 22-23. Mr. Miller advised that WVAWC’s bargaining units support the IPO. Id. p. 23.

Condition 22-G relates to local support that WVAWC provides, he said. Id. pp. 23-24. “West Virginia-American believes that it is a very important company player in all of the local communities where we operate,” he said. “West Virginia-American does supply the more significant metropolitan areas in the state, Charleston and Huntington and areas in between. But we also serve over 100 smaller communities around the state. In our below-the-line contributions, the company has continued to provide its employees, its donations to support many, many efforts around these communities.”

In response to a question from Chairman McKinney, Mr. Miller said that WVAWC would continue to provide local support, including the Helping Hand program, and the current level of such dollars could be determined from WVAWC’s income statement, in the below-the-line contributions. Id. p. 45.

Sarbanes-Oxley compliance and costs are addressed in Condition 22-J. Id. p. 24. Although in Conditions 22-H and 22-I WVAWC and Thames agreed not to pass through any of the IPO costs, including Sarbanes-Oxley costs, Condition 22-J goes further and limits WVAWC’s rate recovery for three years to \$1 million, adjusted for inflation, of additional audit costs of American Water. Id. pp. 24-25.

WVAWC’s capital structure is addressed in Condition 22-K. Id. p. 25. “I think it was important to the Staff and CAD, and it is for the company that we maintain a good capital equity ratio at West Virginia-American Water Company, in line with what we can see with other regulated water utilities,” Mr. Miller testified. “We formalized that into that it will be a 35 to 45 percent range. And if there would be any reason, which I don’t foresee that reason at this time, but if there would be a need to go outside that range, we will notify this Commission.” Id. This is within the historic range of 39 to 42 percent, he said.

Mr. Miller agreed with Commissioner Staats that the common equity ratio relates to the components of the balance sheet’s capital structure, and not to the balance sheet’s debt structure. Id. p. 41.

If the equity capital ratio drops below 35 percent, Mr. Miller said that WVAWC likely would borrow short-term debt, then roll that amount into long-term debt. In response to Commissioner



Staats' questions, Mr. Miller said he could not visualize circumstances under which the equity capital ratio would so fall, but if so, in the unlikely event that funds could not be borrowed or that capital could not be raised through additional equity methods, he said that rate relief could be considered. Id. pp. 42-43.

Mr. Miller said the 35 to 45 percent range would be measured quarterly. Id. p. 43. PSC rules require WVAWC to file quarterly reports, which include a complete balance sheet. Id. p. 44.

Conditions 22-M and 22-X require WVAWC and American Water to report to the Commission if bond ratings are downgraded and to provide the Commission with annual reports and audits. Id. pp. 26-27. Sarbanes-Oxley compliance will be addressed in these reports. Id. p. 41.

Condition 22-P, relating to transactions with affiliates, is a holdover condition from the 2001 case when RWE took control of American Water. Id. p. 27. "Basically what it provides is that we will continue not to permit any affiliate of American Water or West Virginia-American, or any non-governmental entity to utilize the assets of West Virginia-American Water Company, without first notifying this Commission, or in some cases regarding an affiliate transaction, come before this Commission for its authorization to do so," he said. Id. pp. 27-28. The condition allows WVAWC to continue to use its resources continue to assist state agencies in times of crisis, such as floods.

Encumbering of assets is addressed by Condition 22-Q, in response to Staff and CAD concerns that WVAWC assets would not be encumbered by American Water. Id. pp. 28-29. WVAWC's assets are now encumbered by a general mortgage indenture, which does not permit American Water to place a lien on WVAWC's assets, or encumber WVAWC's assets, in a way superior or equal to the general mortgage indenture. Id. p. 29. "This commitment goes one step further, and it provides that American Water Works will not encumber the assets of West Virginia-American and any debt they issue in the future," he said. Id.

Under Condition 22-R, until the IPO is complete and Thames is entirely divested of American Water, American Water will advise the Commission of any attempt to acquire the majority of WVAWC's stock, Mr. Miller testified.

Unaccounted-for water was discussed extensively in the pre-filed testimony, and Condition 22-S memorializes Water Rule 5.6's requirement that WVAWC annually report to the Commission on activities taken to reduce its unaccounted-for water to a 15% level, as well as plans for the upcoming year. Id. p. 30.

Condition 22-T does not allow the payment for American Water's stock to be reflected on WVAWC's books. Id. p. 30. This is a furtherance of the commitment that IPO-related accounting treatment will not be pushed down to West Virginia-American's ratepayers, Mr. Miller testified. Id. pp. 30-31. Similarly, Condition 22-U is a commitment that the IPO will not affect the accounting or rate making treatment for WVAWC's excess deferred income taxes; the deferred income taxes will remain with WVAWC. Id. p. 31.

WVAWC has historically paid common dividends at 75 percent of net income, and Condition 22-W provides that WVAWC will notify the Commission if it plans to exceed that historic percentage, he said. Id. p. 32.

Mr. Miller said that Condition 22-AA was the stipulation's central condition, and it assures that prior to the IPO, RWE will infuse equity capital into American Water so that American Water's common equity will not be lower than 45 percent of the capital ratio. Id. p. 32. "This capital structure should facilitate American Water Works' continued investment-grade rating, from the bond agencies," he said. "Obviously, those conditions had a significant amount of discussion among the parties, but we believe this commitment by RWE should leave American Water Works with a very strong balance sheet, and it will enhance its ability to continue to attract capital at the cost-effective rates." Id. pp. 32-33.

In response to a question from Commissioner Staats, Mr. Miller reiterated that RWE's equity infusion would occur prior to the IPO, saying, "So at the time of the IPO, with the sale of the stock, American's balance sheet would be in the form that this condition describes." Id. p. 44. He further agreed with Commissioner Staats that, at the time of the IPO, there will be no lower than a 45 percent common equity relationship, at the American Water level, between Thames stock and the remainder of the capital section of the balance. Id. (CLW Note: Have I summarized correctly?)

In Mr. Rubin's pre-filed testimony, to have adequate capital available to American Water, he suggested that 20% of the IPO proceeds be returned to American Water. Tr. pp. 36-37 (Dec. 4, 2006). However, at the conclusion of the hearing, CAD's counsel advised that it preferred RWE's equity infusion over the recommendation in Mr. Rubin's pre-filed testimony. CAD's counsel advised that IPO transaction costs were a major concern and that the settlement resolved those concerns. Tr. pp. 71-72.

The future financial health of the company, the most important concern, was addressed by Condition 22-AA, the CAD said. "The only way to take care of [those concerns] was to make sure that West Virginia-American and its parent, AWW, going forward, were in reasonably good financial health to address the challenges that Mr. Rubin identified for us in his testimony. And, we're relatively confident that the infusion of common equity capital into this company, in the amount identified, will do that, will allow them the flexibility to start to address the challenge that we've identified, the issues that need to be dealt with and the rather substantial capital requirements that this company is going to go ahead and face going forward," he said. Id. pp. 72-73.

The CAD also was concerned with quality of service issues and advised that the settlement's requirements were a sufficient first-step to address those concerns. Id. p. 73.

Staff and the CAD both advised that the settlement reasonably resolved their concerns and they asked the Commission to adopt it. Id. p. 73. Like the CAD, Staff said that Condition 22-AA was essential to the agreement.

## DISCUSSION

### *Settlement*

Some of the settlement's many conditions memorialize existing obligations. To the extent such conditions are included, the Commission recognizes that they do not represent new duties. Such conditions acknowledge matters that are vital to the provision of water utility service and are a public renewal of WVAWC's covenant to meet such existing obligations.

Other conditions, though, such as Condition 22-AA, set forth new responsibilities. The Commission agrees with WVAWC, Staff and the CAD that the equity infusion into American Water's capital structure prior to the IPO is the heart of the settlement. Going forward, American Water's equity capital structure directly affects the cost of capital available to WVAWC, one of American Water's operating utility subsidiaries. Without an infusion to American Water's equity capital structure, WVAWC's future capital costs likely would increase. Under the settlement, sufficient capital will be added to put American Water in an equity position comparable to other similar companies. This is essential to protect West Virginia rate payers and the Commission applauds the parties for achieving this result.

While the Commission's statutory responsibility is to balance the interests of West Virginia ratepayers, the utility and the state's economy, the Commission recognizes that the capital infusion obligation, which was wrought in this West Virginia proceeding, will benefit rate payers in the 17 other utility operating subsidiaries of American Water.

The Commission also believes that the conditions relating to reporting requirements and IPO transaction costs are important to the settlement. The Commission should be promptly told when bond ratings deteriorate, and the settlement requires this to be done. Similarly, the Commission should be promptly told if American Water's capital structure deviates from what was promised in the settlement. And, the Commission should be informed if WVAWC plans to pay common dividends in excess of its historic level of 75 percent of net income.

By way of several different conditions, West Virginia rate payers are excluded from the responsibility of the IPO transaction costs. The Commission concludes that the costs of the corporate decision to return ownership of American Water to the public sector should be borne by the corporation, not by West Virginia rate payers, and these conditions in the settlement place such costs on the corporation.

In the petition, Thames and WVAWC stated that, if the refinancing of American Water Capital Corp.'s debt with RWE requires changes in the terms of the inter-company debt between American Water Capital Corp. and WVAWC, then WVAWC will, if required, seek approval from the Commission in a separate petition for any changes that may be needed. The Commission wishes to make clear that such approval must be requested.



Based upon our review of these proceedings then, we agree with WVAWC, Thames, Staff and CAD that 1) the terms and conditions of the IPO/Proposed Transaction and the settlement are reasonable, 2) no party to the IPO/Proposed Transaction is given an undue advantage over another, and 3) that the completion of the IPO/Proposed Transaction, and related transactions, will not adversely affect the public. Accordingly, it is reasonable for the Commission to accept the settlement.

*Confidential treatment*

Discovery materials

In preparation for the litigation of this matter, WVAWC and Thames provided confidential information to Staff and the CAD, pursuant to interim protective agreements. None of the confidential discovery materials were entered into evidence in this case. Accordingly, we conclude that there is simply no need to retain the proprietary files at the Public Service Commission. The proprietary filings shall be returned to the Joint Petitioners. Therefore, it is not necessary for the Commission to consider granting them permanent protective treatment. Instead, in accordance with the terms of the interim protective agreement,<sup>7</sup> Staff and the CAD shall return or destroy all such confidential information and certify to WVAWC and Thames that they have done so.

In a very unusual circumstance, the Commission received some confidential discovery materials prior to the October 31, 2006, *in camera* hearing. The Commission shall likewise return or destroy all of those confidential discovery materials, and the Commission's Executive Secretary shall certify to WVAWC and Thames that the Commission has done so.

Pre-filed testimony

The CAD pre-filed testimony from Mr. Rubin, which contained testimony relating to the confidential information. Similarly, WVAWC and Thames pre-filed testimony from Ms. Wolf,

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<sup>7</sup> The interim protective agreement provides, in pertinent part, as follows:

G. The Parties agree and shall inform the Executive Secretary of the Commission that no copies of the Confidential Information or testimony including the Confidential Information shall be made and such information shall not be included in unexpurgated form in the Commission's files except upon the consent of the Disclosing Parties or upon an order of the Commission

H. Upon the conclusion of the Proceeding, any testimony which references or contains any of the Confidential Information shall not be made available to the public or made available to anyone not a party to a protective agreement with the Disclosing Parties, unless this Protective Agreement is lifted by an order of the Commission. Upon the Receiving Party's destruction of or return of all of the Confidential Information to the Disclosing Parties, this Agreement shall terminate.

which related to the confidential information. Both of those testimonies were admitted into evidence at the December 4, 2006, final hearing. Therefore, the Commission must consider whether it is appropriate to accord permanent protected treatment to those pre-filed testimonies.

We agree with WVAWC and Thames that PSC documents generally are available for public inspection, and that to obtain protected treatment, the information must be a trade secret and the party seeking protection must make a “credible showing of likely harm.” Under W. Va. Code § 29B-1-4(1), a trade secret includes any “compilation of information which is not patented which is known only to certain individuals within a commercial concern” and which “gives its users an opportunity to obtain business advantage over its competitors.”

We find that WVAWC and Thames have borne the burden to establish that the confidential information should be accorded permanent protected treatment. Early release of some of the information may constitute a “gun-jumping” violation under federal securities law. The contested information contains analyses and reports containing highly sensitive, confidential, or privileged information, which has enormous commercial value to competitors because it describes American Water’s current financial condition; reflects expectations for American Water’s post-IPO future, including projections of business performance, identification of risks, assessments of market and industry conditions, and the relative characteristics of certain industry competitors; shows each party’s independent review of how the transaction would affect its shareholders and operations; and includes advice from legal counsel. Substantial care has been taken to keep the contested information private. Less than 20 of the 155,000 employees have had access to the data, and everyone involved in due diligence signed a confidentiality agreement. Some of the materials are protected by the attorney-client privilege. The contested documents were developed with the assistance of expert securities counsel, tax counsel, and financial and tax advisors, and contain confidential information relating to competitive positions. These documents could not be replicated by those competitors without investing considerable resources and having access to the underlying private data. Thus, we agree that the information constitutes a trade secret under West Virginia law. Therefore, we shall grant permanent protected treatment to the proprietary versions of the pre-filed testimony.

### *Transcripts*

The proprietary transcripts from the October 31 and December 4, 2006, PSC hearings contain references to the permanently protected information. Therefore, the proprietary versions of those transcripts shall not be made available, without further Commission order.

## **FINDINGS OF FACT**

### *WVAWC and Thames’ petition for consent*

1. On May 8, 2006, WVAWC and Thames requested the Commission’s consent and approval of the following:

- i. Thames' sale of up to 100% of the common stock of American Water Works Company, Inc. (American Water), WVAWC's immediate corporate parent, in one or more public offerings; and
- ii. The merger of American Water's immediate corporate parent, Thames Water Aqua US Holdings, Inc. (Thames US Holdings), with and into American Water, with American Water being the surviving corporation (to occur prior to the closing of the initial public offering).

Joint Petition pp. 1-18 & Exs. A-D. The proposed transaction will not adversely affect the public, and will result in continuous and seamless provision of reliable water service by WVAWC at just and reasonable rates, they said.

2. American Water's common stock will be offered for sale on the New York Stock Exchange. Under the proposed transaction, American Water will become the largest publicly-traded water company in the United States.

3. WVAWC will continue to be operated on a day-to-day basis by its local management under WVAWC's board of directors.

4. While Thames intends to sell 100% of the shares in the initial public offering, under certain market conditions Thames may sell less than that. If this occurs, then the remaining shares would be sold in a subsequent offering(s) as soon as is practical after the initial public offering, pursuant to SEC rules for underwritten public offerings.

5. Thames and WVAWC are not requesting approval for any individual or group to acquire a majority ownership interest in American Water in either the initial public offering or subsequent public offerings. The prospectus will clearly state that no investor will be permitted to acquire control of American Water unless the investor obtains any necessary state regulatory approvals.

6. If the refinancing of American Water Capital Corp.'s debt with RWE requires changes in the terms of the inter-company debt between American Water Capital Corp. and WVAWC, then WVAWC will seek approval from the Commission in a separate petition for any changes that may be needed.

7. WVAWC customers may invest in their water utility by buying American Water stock, and American Water may create an employee stock purchase program following the proposed transaction.

8. WVAWC will honor all of its existing agreements, including its collective bargaining agreements.

9. The book value of WVAWC's assets will not be adjusted due to the proposed transaction.

10. WVAWC and Thames will not seek recovery of the transaction costs from West Virginia rate payers.

*Notice of the application*

11. On August 11, 2006, affidavits of publication regarding notice of the application were filed as follows:

July 21, 2006	<i>Point Pleasant Register</i> (Mason County), <i>The Logan Banner</i> , <i>The Exponent Telegram</i> (Harrison County)
July 22, 2006	<i>Bluefield Daily Telegraph</i> (Mercer County)
July 24, 2006	<i>Wayne County News</i> , <i>The Fayette Tribune</i> , <i>The Saturday Gazette Mail</i> (Kanawha County), <i>Register-Herald</i> (Raleigh County)
July 25, 2006	<i>Hinton News</i> (Summers County), <i>Braxton Citizens' News</i> , <i>The Jackson Herald</i>
July 26, 2006	<i>Lincoln Journal</i> , <i>Webster Echo</i> , <i>Coal Valley News</i> (Boone County), <i>Clay County Free Press</i> , <i>The Weston Democrat</i> (Lewis County)
July 27, 2006	<i>Roane County Reporter</i> , <i>The Putnam Democrat</i> and <i>The Hurricane Breeze</i> (Putnam County)

*Motions for protected treatment & in camera hearing*

12. In response to CAD's first data request, WVAWC and Thames provided certain materials to Staff and the CAD under an interim protective agreement. Thereafter, they asked the Commission to accord the information permanent protected treatment. See Joint Motion for Protective Order pp. 1-2 (Aug. 24, 2006) (materials responding to the CAD's first data request), as amended Sept. 14, 2006 (correcting Exhibit 3 to Aug. 24, 2006, motion), Sept. 15, 2006 (materials responding to the CAD's second data request), Oct. 18, 2006 (materials responding to the Staff's first data request), & Nov. 14, 2006 (materials ordered to be produced by the PSC at the *in camera* hearing, responding to CAD's first data request.)

13. Thames and WVAWC conducted extensive due diligence, which includes analyses and reports containing highly sensitive, confidential, or privileged information, which has enormous commercial value to competitors because it describes American Water's current financial condition; reflects expectations for American Water's post-IPO future, including projections of business performance, identification of risks, assessments of market and industry conditions, and the relative characteristics of certain industry competitors; shows each party's independent review of how the transaction would affect its shareholders and operations; and includes advice from legal counsel, they argued. The information was generated at substantial cost and effort, and no outside party would be able to reproduce the information without access to the confidential information.

14. The proposed transaction was designed to secure tax efficiencies, and was developed with the assistance of expert securities counsel, tax counsel, and financial and tax advisors. The documents include assurances that the preferred stock transaction is legal and effective for its intended purposes, which results in a strategic advantage over actual and potential competitors that could not be replicated by those competitors without investing considerable resources. Id. p. 3. Thus, the transaction constitutes a trade secret under West Virginia law, they said. Id.

15. Release of some of the information could result in a “gun-jumping” violation under federal securities law.

16. Less than 20 of 155,000 employees have had access to the confidential data, and everyone involved in due diligence signed a confidentiality agreement.

17. On October 2, 2006, the CAD asked the Commission to require WVAWC and Thames to provide 1) Board of Director minutes that discussed the proposed separation of American Water from RWE and 2) presentations made to directors concerning the proposed separation of American Water from RWE, which had been omitted from the data responses. See CAD’s Motion to compel & for *in camera* hearing.

18. CAD’s counsel was permitted to review, but not copy, the information which had been redacted. Additionally, counsel’s ability to take notes on the content of the disputed materials was restricted.

19. The CAD argued that the materials are relevant to the issues in this proceeding, “or at the very least, could be the basis for additional questions that are reasonably calculated to lead to the discovery of admissible evidence.” These materials also are relevant due to representations made, and conditions imposed by the Commission in Case Number 01-1691-W-PC, relating to Thames’ acquisition of WVAWC.

20. On October 12, 2006, the Commission set an *in camera* hearing, because the Commission was not willing to accord permanent protected treatment before reviewing the contested materials. WVAWC and Thames were required to provide the unredacted materials to the Commission.

21. On October 23, 2006, the unredacted materials were filed with the Commission, under seal.

22. At the October 31, 2006, *in camera* hearing, counsel for CAD and WVAWC and Thames argued their respective positions, and the essential elements of those arguments appear in the public pleadings. In addition, Staff counsel argued that, like CAD, Staff would not challenge the assertions of attorney-client privilege. Staff also argued that, under traditional PSC practice as authorized by W. Va. Code § 24-1-7, information is sometimes provided to the PSC that circuit courts might not receive under the Rules of Evidence. If so, the Commission allows the parties to argue about the weight to be accorded such information. Staff also agreed with the CAD that



information may be discoverable if it is reasonably calculated to lead to the discovery of admissible evidence. *Id.* Staff noted that different arguments might apply, should the information be offered at a hearing. Staff suggested then, that the materials be made available to the parties pursuant to the interim protective agreements and that the Commission need not separately review each excerpt. *Id.* pp. 30-31. Staff also agreed that the West Virginia PSC is not bound by the decisions of another state's utility commission.

23. At the conclusion of the *in camera* hearing, the Commission ordered the unredacted documents to be provided to Staff and the CAD, pursuant to the existing interim protective agreements. The Commission also advised that it was not addressing whether the information could be offered at hearing and that the Commission would rule on permanent protected treatment should any of the information be used at trial.

*CAD & Staff direct testimony, WVAWC & Thames rebuttal testimony*

24. On November 8, 2006, the CAD pre-filed, in public and proprietary versions, Mr. Rubin's direct testimony and Staff pre-filed the Mr. Knurek's direct testimony. On November 29, 2006, Staff filed corrections to Mr. Knurek's pre-filed direct testimony.

25. On November 21, 2006, WVAWC and Thames pre-filed Mr. Miller's rebuttal testimony. They also pre-filed Ms. Wolf's rebuttal testimony, in public and proprietary versions.

*Proposed settlement*

26. On December 1, 2006, WVAWC, Thames, Staff and the CAD jointly filed a proposed settlement of this proceeding. See Joint Ex. No. 1 (Tr. Dec. 4, 2006). The parties negotiated 27 following conditions, all appearing in Paragraph 22, which they asked the Commission to impose.

27. AWW, through Ms. Wolf's signature on the settlement, agreed to be bound by the conditions of the settlement.

28. RWE, through Jens Gemmecke's signature on the settlement, agreed to be bound by Condition 22-AA. See also Tr. p. 35 (Dec. 4, 2006).

*Final hearing*

29. Notice of the final hearing was published as follows:

November 6, 2006	<i>The Charleston Gazette &amp; The Daily Mail</i> (both Kanawha County), <i>The Logan Banner</i> , <i>Bluefield Daily Telegraph</i> (Mercer County)
November 7, 2006	<i>Braxton Citizens' News</i> , <i>Register-Herald</i> (Raleigh County), <i>Hinton News</i> (Summers County), <i>The Jackson Herald</i> , <i>Point Pleasant Register</i> (Mason County)

November 8, 2006 *Wayne County News, Lincoln Journal, Coal Valley News* (Boone County), *Clay County Free Press, Webster Echo, The Weston Democrat* (Lewis County)  
November 9, 2006 *Roane County Reporter, The Hurricane Breeze & The Putnam Democrat* (both Putnam County), *The Fayette Tribune*  
November 11, 2006 *The Exponent Telegram* (Harrison County)

Tr. p. 7 (Dec. 4, 2006).

30. Mr. Miller and Ms. Wolf testified about the settlement. Tr. pp. 9-47 (Mr. Miller), 54-68 (Ms. Wolf).

31. Mr. Miller said that the negotiated conditions are “the very heart of the stipulation.” Id. p. 15.

32. Conditions 22-H and 22-I, as well as assurances in the petition, state that IPO-related costs will not be passed to WVAWC rate payers. Id. pp. 21-22. The reporting requirement in Condition 22-H was a key component of the settlement, Mr. Miller testified. Id. p. 22. WVAWC will report to the Commission all of the transaction costs “so that we’re very clear about what those costs are, what was charged in West Virginia, and that there will be no recovery of those in the rates of West Virginia-American.” Id. Condition 22-V goes a little further to state that WVAWC will not recover any of the IPO costs incurred by RWE or other foreign parties. Id. p. 31. Mr. Miller testified that these particular conditions do not require any of the compliance reports with Sarbanes-Oxley to be filed with the PSC. Id. pp. 40-41.

33. Sarbanes-Oxley compliance and costs are addressed in Condition 22-J. Id. p. 24. Although in Conditions 22-H and 22-I WVAWC and Thames agreed not to pass through any of the IPO costs, including Sarbanes-Oxley costs, Condition 22-J goes further and limits WVAWC’s rate recovery for three years to \$1 million, adjusted for inflation, of additional audit costs of American Water. Id. pp. 24-25.

34. WVAWC’s capital structure is addressed in Condition 22-K. Id. p. 25. For three years, WVAWC’s equity-to-capital ratio will be in the 35 to 45 percent range, and if it goes beyond that range WVAWC will notify the Commission. WVAWC’s capital equity ratio has historically been 39 to 42 percent. This ratio relates to the components of the balance sheet’s capital structure, and not to the balance sheet’s debt structure. The 35 to 45 percent range will be measured quarterly, and PSC rules require WVAWC to file quarterly reports, which include a complete balance sheet. Id. pp. 43-44.

35. Conditions 22-M and 22-X require WVAWC and American Water to report to the Commission if bond ratings are downgraded and to provide the Commission with annual reports and audits. Id. pp. 26-27. Sarbanes-Oxley compliance will be addressed in these reports. Id. p. 41.

36. Encumbering of assets is addressed by Condition 22-Q. Id. pp. 28-29. WVAWC's assets are now encumbered by a general mortgage indenture, which does not permit American Water to place a lien on WVAWC's assets, or encumber WVAWC's assets, in a way superior or equal to the general mortgage indenture. Id. p. 29. "This commitment goes one step further, and it provides that American Water Works will not encumber the assets of West Virginia-American and any debt they issue in the future," Mr. Miller said. Id.

37. Condition 22-T does not allow the payment for American Water's stock to be reflected on WVAWC's books. Id. p. 30. This is a furtherance of the commitment that IPO-related accounting treatment will not be pushed down to West Virginia-American's ratepayers, Mr. Miller testified. Id. pp. 30-31. Similarly, Condition 22-U is a commitment that the IPO will not affect the accounting or rate making treatment for WVAWC's excess deferred income taxes; the deferred income taxes will remain with WVAWC. Id. p. 31.

38. WVAWC has historically paid common dividends at 75 percent of net income, and Condition 22-W provides that WVAWC will notify the Commission if it plans to exceed that historic percentage, Mr. Miller said. Id. p. 32.

39. Mr. Miller said that Condition 22-AA was the stipulation's central condition, and it assures that prior to the IPO, RWE will infuse equity capital into American Water so that American Water's common equity will not be lower than 45 percent of the capital ratio. Id. p. 32. "This capital structure should facilitate American Water Works' continued investment-grade rating, from the bond agencies," he said. Id. pp. 32-33.

40. Although Mr. Rubin suggested in pre-filed testimony that 20% of the IPO proceeds be returned to American Water, at the conclusion of the final hearing CAD's counsel advised that CAD preferred RWE's equity infusion over Mr. Rubin's pre-filed recommendation. Tr. pp. 36-37 (Dec. 4, 2006).

41. The CAD also was concerned with quality of service issues and advised that the settlement's requirements were a sufficient first-step to address those concerns. Id. p. 73.

42. Staff and the CAD both advised that the settlement reasonably resolved their concerns and they asked the Commission to adopt it. Id. p. 73. Like the CAD, Staff said that Condition 22-AA was essential to the agreement.

## **CONCLUSIONS OF LAW**

### *Settlement*

1. The Commission's policy is to encourage settlement, and all parties have urged the Commission to accept the settlement. We have reviewed the settlement and find it reasonable and in the public interest.



2. Some of the settlement's many conditions memorialize existing obligations. To the extent such conditions are included, the Commission recognizes that they do not represent new duties. Such conditions acknowledge matters that are vital to the provision of water utility service and are a public renewal of WVAWC's covenant to meet such existing obligations.

3. The Commission agrees with WVAWC, Staff and the CAD that Condition 22-AA's requirement of an equity infusion into American Water's capital structure prior to the IPO is the heart of the settlement. Going forward, American Water's equity capital structure directly affects the cost of capital available to WVAWC, one of American Water's operating utility subsidiaries. Without an infusion to American Water's equity capital structure, WVAWC's future capital costs likely would increase. Under the settlement, sufficient capital will be added to put American Water in an equity position comparable to other similar companies. This is essential to protect West Virginia rate payers and the Commission applauds the parties for achieving this result.

4. In addition to benefitting the interests of West Virginia ratepayers, the utility and the state's economy, the capital infusion obligation, which was wrought in this West Virginia proceeding, will benefit rate payers in the 17 other utility operating subsidiaries of American Water.

5. The conditions relating to reporting requirements and IPO transaction costs are important to the settlement. The Commission should be promptly told when bond ratings deteriorate, and the settlement requires this to be done. Similarly, the Commission should be promptly told if American Water's capital structure deviates from what was promised in the settlement. And, the Commission should be informed if WVAWC plans to pay common dividends in excess of its historic level of 75 percent of net income.

6. By way of several different conditions, West Virginia rate payers are excluded from the responsibility of the IPO transaction costs. The Commission concludes that the costs of the corporate decision to return ownership of American Water to the public sector should be borne by the corporation, not by West Virginia rate payers, and these conditions in the settlement place such costs on the corporation.

7. If the refinancing of American Water Capital Corp.'s debt with RWE requires changes in the terms of the inter-company debt between American Water Capital Corp. and WVAWC, then WVAWC must seek approval from the Commission in a separate petition for any changes that may be needed.

8. Based upon our review of these proceedings then, we agree with WVAWC, Thames, Staff and CAD that 1) the terms and conditions of the IPO/Proposed Transaction and the settlement are reasonable, 2) no party to the IPO/Proposed Transaction is given an undue advantage over another, and 3) that the completion of the IPO/Proposed Transaction, and related transactions, will not adversely affect the public. Accordingly, it is reasonable for the Commission to accept the settlement.

*Confidential treatment*

Discovery materials

9. In preparation for the litigation of this matter, WVAWC and Thames provided confidential information to Staff and the CAD, pursuant to interim protective agreements. None of the confidential discovery materials were entered into evidence in this case. Accordingly, we conclude that there is simply no need to retain the proprietary files at the Public Service Commission. The proprietary filings shall be returned to the Joint Petitioners. Therefore, it is not necessary for the Commission to consider granting them permanent protective treatment.

10. In accordance with the terms of the interim protective agreement, Staff and the CAD should return or destroy all such confidential information exchanged during discovery and certify to WVAWC and Thames that they have done so.

11. The Commission should likewise return or destroy all of those confidential discovery materials it received prior to the October 31, 2006, *in camera* hearing, and the Commission's Executive Secretary should certify to WVAWC and Thames that the Commission has done so.

Pre-filed testimony

12. The pre-filed testimonies of Mr. Rubin and Ms. Wolf contained references to the confidential information, and both of these testimonies were admitted into evidence at the December 4, 2006, final hearing. Therefore, the Commission should consider whether to accord permanent protected treatment to the pre-filed testimonies.

13. We agree with WVAWC and Thames that PSC documents generally are available for public inspection, and that to obtain protected treatment, the information must be a trade secret and the party seeking protection must make a "credible showing of likely harm." Under W. Va. Code § 29B-1-4(1), a trade secret includes any "compilation of information which is not patented which is known only to certain individuals within a commercial concern" and which "gives its users an opportunity to obtain business advantage over its competitors."

14. We conclude that WVAWC and Thames have borne the burden to establish that the confidential information should be accorded permanent protected treatment. Early release of some of the information may constitute a "gun-jumping" violation under federal securities law. The contested information contains analyses and reports containing highly sensitive, confidential, or privileged information, which has substantial commercial value to competitors because it describes American Water's current financial condition; reflects expectations for American Water's post-IPO future, including projections of business performance, identification of risks, assessments of market and industry conditions, and the relative characteristics of certain industry competitors; shows each party's independent review of how the transaction would affect its shareholders and operations; and includes advice from legal counsel. Substantial care has been taken to keep the contested information private. Less than 20 of the 155,000 employees have had access to the data, and everyone involved in due diligence signed a confidentiality agreement. Some of the materials are protected by the attorney-client privilege. The contested documents were developed with the

assistance of expert securities counsel, tax counsel, and financial and tax advisors, and contain confidential information relating to competitive positions. These documents could not be replicated by competitors without investing considerable resources and having access to the underlying private data. Thus, we agree that the information constitutes a trade secret under West Virginia law. Therefore, we shall grant permanent protected treatment to the proprietary versions of the pre-filed testimony.

### *Transcripts*

15. The confidential transcripts from the October 31 and December 4, 2006, PSC hearings contain references to the permanently protected information. Therefore, the proprietary versions of those transcripts should not be made available, without further Commission order.

### **ORDER**

IT IS THEREFORE ORDERED that the settlement filed on December 1, 2006, which is attached as Exhibit A, is accepted as a reasonable resolution of the issues in this proceeding.

IT IS FURTHER ORDERED that the Commission accords permanent protected treatment of the transcript of the October 31, 2006, *in camera* hearing. The Commission also accords permanent protected treatment to the confidential portion of the transcript of the December 4, 2006, final hearing.

IT IS FURTHER ORDERED that the materials which are subject to the interim protective agreements which were not admitted into evidence shall be destroyed or returned to WVAWC and Thames, with no copy being retained by this Commission or its Staff.

IT IS FURTHER ORDERED that the Commission's Executive Secretary shall destroy or return all copies possessed by the Commissioners, the Commissioners' staff and the Executive Secretary's staff of the unredacted information which the Commission ordered WVAWC and Thames to provide prior to the October 31, 2006, *in camera* hearing. The Commission's Executive Secretary shall certify to WVAWC and Thames the completion of this task.

IT IS FURTHER ORDERED that the Commission Staff and the CAD shall destroy or return all copies they possess of the materials which are subject to the interim protective agreements and which were not admitted into evidence in this proceeding. Commission Staff and the CAD shall certify to WVAWC and Thames the completion of this task.

IT IS FURTHER ORDERED that this case shall be removed from the Commission's docket of active cases.

IT IS FURTHER ORDERED that the Commission's Executive Secretary serve a copy of this order upon all parties of record by United States First Class Mail and upon Commission Staff by hand delivery.

A True Copy, Teste:

  
Sandra Squire  
Executive Secretary

CLW/sek  
060597ce.wpd



EXHIBIT A

PUBLIC SERVICE COMMISSION  
OF WEST VIRGINIA  
CHARLESTON

CASE NO. 06-0597-W-PC

WEST VIRGINIA-AMERICAN WATER COMPANY,  
a West Virginia corporation, and  
THAMES WATER AQUA HOLDINGS GmbH,  
a corporation organized under the laws of  
the Federal Republic of Germany,

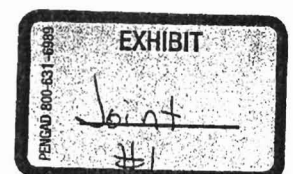
Petitioners.

Joint Petition for the Consent and Approval of the  
Sale by Thames Water Aqua Holdings GmbH of  
the Outstanding Common Stock of American Water  
Works Company, Inc., the Controlling Shareholder  
of West Virginia-American Water Company

JOINT STIPULATION  
AND AGREEMENT FOR SETTLEMENT

Pursuant to West Virginia Code § 24-1-9(f) and Rule 13(d) of the Public  
Service Commission's Rules of Practice and Procedure, West Virginia-American Water  
Company ("WVAWC") and Thames Water Aqua Holdings GmbH ("Thames Holdings")  
the Staff of the Public Service Commission of West Virginia ("Staff"), and the Consumer  
Advocate Division of the Public Service Commission ("CAD") (collectively referred to  
herein as the ("Parties")) join in this Joint Stipulation and Agreement for Settlement  
("Joint Stipulation").

(C1150821 1)



## INTRODUCTION

This Joint Stipulation proposes and recommends a settlement ("Settlement") among the Parties by which they have agreed and recommend that the Public Service Commission ("Commission") enter a Commission Order granting its prior consent and approval under West Virginia Code § 24-2-12 to the Joint Petition for the Consent and Approval ("Joint Petition") (i) for the sale by Thames Holdings of up to 100% of the shares of common stock of WVAWC's immediate corporate parent, American Water Works Company, Inc. ("AWW"), in one or more public offerings and (ii) prior to the closing of the initial public offering ("IPO"), the merger of AWW's immediate corporate parent, Thames Water Aqua US Holdings, Inc. ("TWAUSHI"), with and into AWW, with AWW being the surviving corporation (the transactions set forth in (i) and (ii) are hereinafter collectively referred to as the ("IPO/Proposed Transaction")).

In this Joint Stipulation, the Parties recommend that the Commission approve the Joint Petition, but have also agreed and recommend that the Commission condition consent and approval of the IPO/Proposed Transaction to certain commitments and undertakings contemplated in the Joint Stipulation (the "Conditions").

In support of this Joint Stipulation and the Settlement embodied herein, the Parties state that:

## PROCEDURAL MATTERS AND THE PARTIES

1. On May 8, 2006, WVAWC and Thames Holdings ("Joint Petitioners") filed a Joint Petition for Commission consent and approval of (i) the sale by Thames

Holdings of up to 100% of the shares of common stock of AWW ("Common Stock"), WVAWC's immediate corporate parent, in one or more public offerings; and (ii) the merger of American Water's immediate corporate parent, TWAUSHI, with and into American Water, with American Water being the surviving corporation (this is to occur prior to the IPO).

2. On May 22, 2006, the Consumer Advocate Division of the Public Service Commission (CAD) filed a petition to intervene in this proceeding.

3. Staff filed its Initial Joint Staff Memorandum on June 9, 2006. Staff indicated that its initial review of the Joint Petition raised certain issues that needed to be addressed and that would require Staff to obtain additional information from the Joint Petitioners. Staff recommended that, given the significance of the transaction, that the Commission order the Joint Petitioners to publish notice of this case and provide an opportunity for the filing of comments and petitions to intervene.

4. On July 17, 2006, the Commission entered an Order granting the CAD's intervention and requiring the Joint Petitioners to publish notice of this proceeding. Notice was given as required by the Commission's Order.

5. On July 26, 2006, the Joint Petitioners filed a Joint Motion to Establish Procedural Schedule.

6. On August 10, 2006, the Commission entered an Order adopting the procedural schedule proposed by the Parties in the Motion to Establish Procedural Schedule.



7. On August 24, 2006, WVAWC and Thames Holdings filed a Joint Petition for a Protective Order for certain documents they produced in discovery.

8. On August 31, 2006, the CAD requested an extension of time to respond to the Joint Motion for Protective Order.

9. On September 11, 2006, the Commission entered an Order granting the CAD's request for extension of time to respond to the Joint Motion for Protective Order.

10. On August 2, 2006, the Joint Petitioners filed their Direct Testimony with the Commission. The pre-filed testimony consisted of the Direct Testimony and related exhibits of Ellen C. Wolf and Michael A. Miller.

11. On November 8, 2006, Staff filed the Direct Testimony of Charles (Chuck) Knurek and the CAD filed the Direct Testimony of Scott J. Rubin.

12. On November 21, 2006, the Joint Petitioners filed the Rebuttal Testimony of Ellen Wolf and Michael A. Miller.

NATURE OF THE TRANSACTION  
AND THE IPO

13. As set forth in the Joint Petition, the offering of the Common Stock will be conducted in compliance with the U. S. Securities Act of 1933. The shares of Common Stock are intended to be listed on the New York Stock Exchange. The Joint Petitioners asserted that the IPO/Proposed Transaction will not adversely affect the public

and will result in the continuous and seamless provision of water service by WVAWC at just and reasonable rates.

14. AWW is a corporation organized and existing under the laws of the State of Delaware and owns the common stock of WVAWC. AWW's principal offices are located at 1025 Laurel Oak Road, Voorhees, New Jersey.

15. While Thames Holdings intends to sell 100% of the Common Stock in the IPO, under certain market conditions 100% of the Common Stock may not be sold in the IPO. If this occurs, then the remainder of the shares of Common Stock would be sold in a subsequent offering or offerings pursuant to the Commission's order in this case as soon as is practical after the IPO. Any subsequent public offerings will be conducted in accordance with the SEC rules for underwritten public offerings.

16. The Joint Petitioners have asserted that the IPO/Proposed Transaction should not impair WVAWC's ability to maintain a reasonable capital structure, which is representative of other utilities, nor should the IPO/Proposed Transaction impair WVAWC's ability to raise needed capital on reasonable terms.

17. The Staff and CAD have undertaken extensive discovery, both of a formal and informal character, with respect to the IPO/Proposed Transaction and the relief requested in the Joint Petition. The CAD served five sets of Data Requests with numerous questions and the Staff served two sets of Data Requests and undertook extensive informal discovery.

18. In addition to the formal and informal discovery by the CAD and Staff, the Parties, in the weeks prior to the hearing conducted two separate prehearing

conferences held on November 13, 2006 and November 29, 2006, at which they discussed various aspects of the IPO/Proposed Transaction, attempted to narrow or eliminate certain of the issues and concerns raised by the Staff and CAD with respect to the IPO/Proposed Transaction, and discussed and finalized the numerous conditions set forth in paragraph 22 below.

19. Under the IPO/Proposed Transaction, the Joint Petitioners noted that American Water Works Service Company, Inc. ("AWWSC") will continue to provide customer service, accounting, administration, engineering, financial, human resources, information systems, operations, risk management, water quality and other services to WVAWC under the Service Company Agreement with WVAWC. Additionally, American Water Capital Corp. will continue to provide services under the Financial Services agreement between it and WVAWC after the IPO/Proposed Transaction is consummated.

20. WVAWC will continue to honor all existing agreements, including its collective bargaining agreements and the day-to-day operations of WVAWC are not expected to change as a result of the IPO/Proposed Transaction. WVAWC does not expect any adjustment to the existing book value of any of WVAWC's assets to result from the IPO/Proposed Transaction.

21. The Parties jointly recommend that the Commission enter an Order approving the Joint Petition and granting the consent and approval of the Commission to the Joint Petition and the transactions contemplated therein pursuant to the provisions of W. Va. Code § 24-2-12.

22. In furtherance and support by the Parties for the relief sought in the Joint Petition and this Settlement, the Parties have negotiated various conditions that WVAWC and AWW support for purposes of this Joint Stipulation. Specifically, AWW and WVAWC undertake in this Joint Stipulation the following conditions:

- A. WVAWC will pass through to WVAWC's customers, in future rate cases, any actual savings from efficiencies resulting from the IPO/Proposed Transaction for the Common Stock of AWW and the continued ownership of WVAWC by AWW.
- B. For a period of three (3) years from the date of the Commission Order ("Order") in this case (and after it has first notified its WVAWC employees), WVAWC will notify the Commission in writing of a planned reduction of 5% or more in WVAWC's work force.
- C. WVAWC will continue to use its best efforts to meet or improve upon WVAWC's water service standards, including but not limited to standards for water service interruptions, employee response time, customer complaints and complaint response time.
- D. WVAWC will continue to make its best efforts, at all times, to meet applicable water quality standards and will commit to make no changes in the basic operations of WVAWC as a result of the IPO/Proposed Transaction that would be detrimental to this commitment.
- E. WVAWC will maintain its corporate offices in West Virginia. Furthermore, there will be no reduction in the overall levels and responsibilities of West Virginia local management located in West Virginia as a result of the IPO/Proposed Transaction.
- F. WVAWC will maintain a substantial "local interest" representation on its Board of Directors, and the Board of Directors of WVAWC will continue to provide guidance and oversight of the business and affairs of WVAWC.
- G. WVAWC will continue its current level of support for and involvement in local and community projects, including continued

funding for WVAWC's Helping Hand Program to assist low income residential customers with their water bills.

H. AWW will make no attempt to recover through WVAWC's rates any costs of the IPO/Proposed Transaction, purchase price, goodwill, early termination payment, change in control payment, incentive or retention bonus payment in connection with the IPO/Proposed Transaction, either directly or indirectly through American Water Works Service Company, Inc., or any other affiliate, or by any other means. AWW will supply a report to the Commission summarizing such costs, including the amount of such costs allocated to WVAWC, within one year from the date of the Order or, if the sale by Thames Holdings of the Common Stock occurs more than one year after the date of the Order, within 60 days of the date of the sale.

I. AWW will not recover from WVAWC's customers or have WVAWC's customers fund any portion of the costs of the IPO/Proposed Transaction, including but not limited to financial, legal, severance payments, regulatory fees, investment services or the installation of the initial procedures for compliance with The Sarbanes – Oxley Act of 2002 (Pub. L. No. 107-204, 116 Stat. 745, also known as the Public Company Accounting Reform and Investor Protection Act of 2002 ("Sarbanes-Oxley").

J. For a period of three years from the date of the Order, AWW will not be permitted to charge WVAWC more than its allocated share of \$1 million per year (adjusted annually for inflation) for additional audit costs for Sarbanes Oxley compliance as calculated under the existing agreement between AWWSC and WVAWC.

K. For three years following the date of the Order, WVAWC will maintain its equity-to-capital ratio between 35% and 45%. If the equity-to-capital ratio falls outside of this range, WVAWC will notify the Commission in writing within 30 days.

L. WVAWC will flow through to the benefit of its customers any lower cost of debt applicable to WVAWC, to the extent known and measurable, as a result of its relationship with AWW in future general rate cases.

M. WVAWC will report to the Commission within 30 days any downgrading of the bonds of AWW, AWCC, WVAWC or any

subsidiary of AWW and will provide a full copy of the report issued by the bond rating agency.

N. When implementing "best practices", AWW and WVAWC will consider any related effects on customer service and customer satisfaction levels.

O. WVAWC will honor all of its existing contracts, easements and other agreements in accordance with their respective terms.

P. WVAWC will not allow the use of any of its personnel, assets or equipment by any affiliated entity without the Commission's prior consent and approval pursuant to W. Va. Code § 24-2-12. Further, to the extent that WVAWC allows the use of such personnel, assets or equipment by any unaffiliated entity, other than a government body or non-profit entity, WVAWC will file a report with the Commission within thirty days after the use of such personnel, assets or equipment on the identity of the personnel, assets or equipment involved and the estimated fully-allocated cost of such personnel, assets or equipment.

Q. AWW will not issue any debt that pledges as security or otherwise encumbers the assets of WVAWC.

R. AWW agrees that (i) it will not sell a majority of the common stock of WVAWC to any person or corporation, whether or not organized under the laws of this state, until that person or corporation has obtained the prior consent and approval of the Commission under the provisions of W. Va. Code § 24-2-12; and (ii) until Thames Holdings has disposed of its interests in AWW, AWW will advise the Parties of any person or corporation that, to the knowledge of AWW or WVAWC, attempts to acquire, either directly or indirectly, a majority of the common stock of WVAWC under the provisions of W. Va. Code § 24-2-12.

S. WVAWC will file reports annually that detail how it proposes to bring WVAWC into compliance with the Commission's Water Rules regarding unaccounted for water.

T. The payment for AWW stock will not be recorded on WVAWC's books.

U. RWE and Thames Holdings divestiture of AWW will not affect the accounting and ratemaking treatments of WVAWC excess deferred income taxes.

V. WVAWC will not bear any costs incurred to comply with any law, regulation, standard, or practice of the United Kingdom, Federal Republic of Germany, or European Community necessary to complete the IPO/Proposed Transaction.

W. WVAWC will notify the Commission before making a dividend that is more than 75% of net income.

X. AWW or WVAWC will file the following reports with the Commission or provide the relevant Securities and Exchange Commission website where such reports are available: AWW's quarterly interim reports to its shareholders; AWW's annual reports to its share holders; and AWW's and WVAWC's annual audit reports.

Y. WVAWC customers will experience no material adverse change in utility service due to the IPO/Proposed Transaction.

Z. AWW and WVAWC will adequately fund and maintain WVAWC's treatment, transmission, and distribution systems; supply the service needs of WVAWC customers; comply with all applicable West Virginia statutes; and make best efforts to remain in compliance with all administrative regulations of the Commission.

AA. RWE and Thames Holdings will infuse equity capital into AWW prior to the IPO/Proposed Transaction sufficient to establish a capital structure for AWW at the time of the IPO that includes an equity/capitalization ratio no lower than 45% common equity. AWW will file a balance sheet as of the quarter ended immediately preceding the IPO.

23. By the execution of this Joint Stipulation by their counsel, the Joint Petitioners affirmatively commit to be bound by the conditions set forth in Paragraph 22 above.



24. Petitioner Thames Holdings is a wholly-owned subsidiary of RWE AG ("RWE"), a corporation organized under the laws of the Federal Republic of Germany. RWE, through the acknowledgement of this Joint Stipulation by Jens Gemmecke, a representative of RWE duly authorized pursuant to power of attorney of RWE, commits to the provisions of Condition AA of Paragraph 22 above and AWW, through the written acknowledgement of Ellen C. Wolf, Senior Vice President and Chief Financial Officer of AWW, commits AWW to be bound by the conditions of Paragraph 22 above.

25. Based on the affirmative representations of the Joint Petitioners, RWE, and AWW as set forth in Paragraphs 23 and 24 above, the Parties agree to recommend that the Commission issue appropriate findings of fact and conclusions of law to the effect (i) the terms and conditions of the IPO/Proposed Transaction and the Joint Stipulation are reasonable, (ii) that no party to the IPO/Proposed Transaction is given an undue advantage over another and (iii) that the IPO/Proposed Transaction and the other transactions contemplated by the Joint Petition and this Settlement do not and, upon the completion of the IPO/Proposed Transaction, will not adversely affect the public in this State.

26. The Parties further request that the Commission grant the Motion for Confidential Treatment, as amended, filed by the Joint Petitioners in this case.

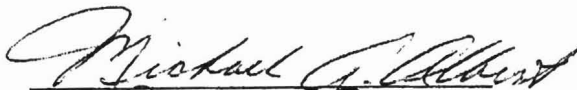
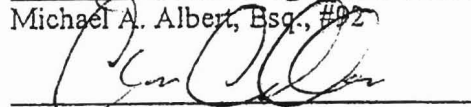
27. The Joint Stipulation is entered into subject to the acceptance and approval of the Commission. It results from a review of all filings in this proceeding and extensive negotiation. It reflects substantial compromises by the Parties and the

modification of their respective positions asserted in this case, and is being proposed to expedite and simplify the resolution of these proceedings and other matters. It is made without any admission or prejudice to any positions which any Party might adopt during subsequent litigation.

28. The Parties adopt the Joint Stipulation as being in the public interest, without adopting any of the compromise positions set forth herein as principles applicable to future regulatory proceedings, except as may otherwise be provided herein. The Parties acknowledge that it is the Commission's prerogative to accept, reject, or modify any stipulation. However, in the event that the Joint Stipulation is modified or rejected by the Commission, it is expressly understood by the Parties that they are not bound to accept the Joint Stipulation as modified or rejected, and may avail themselves of whatever rights are available to them under law and the Commission's Rules of Practice and Procedure.

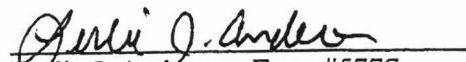
WHEREFORE, the Parties, on the basis of all of the foregoing, respectfully request that the Commission make appropriate findings of fact and conclusions of law adopting and approving the Joint Stipulation in its entirety.

WEST VIRGINIA-AMERICAN WATER  
COMPANY  
and  
THAMES WATER AQUA HOLDINGS  
GmbH,  
By Counsel

  
\_\_\_\_\_  
Michael A. Albert, Esq., #92  
\_\_\_\_\_  
Christopher L. Callas, Esq., #5991  
Jackson Kelly PLLC  
P.O. Box 553  
Charleston, WV 25322-0553  
Phone (304) 340-1287  
Fax (304) 340-1080

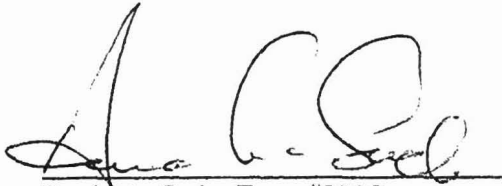
THE STAFF OF THE PUBLIC SERVICE  
COMMISSION OF WEST VIRGINIA

By Counsel

  
\_\_\_\_\_  
Leslie J. Anderson, Esq., #5777  
201 Brooks Street  
P. O. Box 812  
Charleston, WV 25323

CONSUMER ADVOCATE DIVISION OF  
THE PUBLIC SERVICE COMMISSION OF  
WEST VIRGINIA

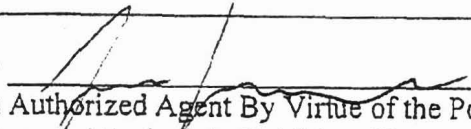
By Counsel



David A. Sade, Esq., #3229  
Consumer Advocate Division  
7<sup>th</sup> Floor, Union Building  
723 Kanawha Boulevard, East  
Charleston, West Virginia 25301

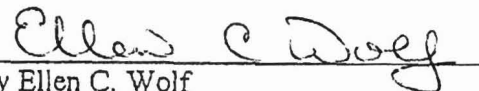
Acknowledged and agreed to by:

RWE AKTIENGESELLSCHAFT

By   
An Authorized Agent By Virtue of the Power of  
Attorney Attached As Exhibit A Hereto

Acknowledged and agreed to by:

AMERICAN WATER WORKS COMPANY,  
INC.

  
By Ellen C. Wolf  
Senior Vice-President and Chief Financial  
Officer

## Power of Attorney

Made this 30<sup>th</sup> day of November, 2006.

### WHEREAS

- (A) We, **RWE Aktiengesellschaft**, are a corporation incorporated in accordance with the laws of the Federal Republic of Germany and with its registered office at Opernplatz 1, 45128 Essen, Federal Republic of Germany ("**RWE AG**").
- (B) It is intended that RWE AG enters into a transaction involving, among other things, the negotiation of and entering into settlement agreements by which the regulatory procedures for the approval of the sale of the shares of American Water Works Company, Inc. are settled with the respective authorities (all of the foregoing the "**Transaction**").

**NOW, THEREFORE**, we, RWE AG, hereby appoint each of the following:

1. **Andreas Zetzsche**
2. **Jens Gemmecke**
3. **Dr. Manfred Döss**
4. **Christian Ring**
5. **Gunnar Helberg**

- each having his business address at Opernplatz 1, 45128 Essen, Germany -

6. **Dietrich Firnhaber**
7. **Dr. Volker Heischkamp**
8. **Christoph Quick**

- each having his business address at 1025 Laurel Oak Rd., Voorhees, NJ 08054, USA -

(each an "**Attorney**")

- each of them authorized to solely represent RWE AG -

to be our attorney, each of whom shall be vested with full power and authority in our name and on our behalf to do all such acts and things as follows:

- 1) to agree, sign, seal, execute, amend and deliver on behalf and in the name of RWE AG any agreement, contract, memorandum, notice, communication, deed, declaration, instrument, letter or other document and to do all such acts and things that the Attorney considers to be required or expedient in relation to the Transaction;

RWE Aktiengesellschaft  
Opernplatz 1  
45128 Essen  
T +49 (0)201/12-00  
F +49 (0)201/12-1 51 99  
I www.rwe.com  
Vorsitzender des  
Aufsichtsrates:  
Dr. Thomas R. Fischer  
Vorstand:  
Harry Roels  
(Vorsitzender)  
Berthold A. Bonekamp  
Alwin Fitting  
Dr. Klaus Sturany  
Jan Zilius

Sitz der Gesellschaft: Essen  
Eingetragen beim  
Amtsgericht Essen

Handelsregister-Nr. HRB 14 525

USt.-IdNr. DE 2130 23 534

Exhibit A

- 2 -

- 2) to do all such acts and things as the Attorney considers may be required or desirable in connection with the Transaction;
- 3) to sub-delegate the power of attorney granted hereunder on the same terms and conditions as set forth herein, except that a person to whom the power of attorney is sub-delegated may not further sub-delegate such power.

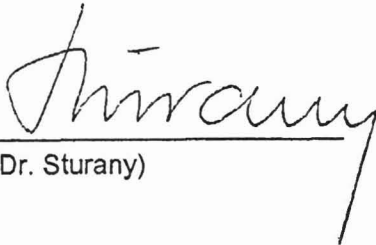
This Power of Attorney is governed by and shall be construed in accordance with the laws of the Federal Republic of Germany without its conflict of law principles.

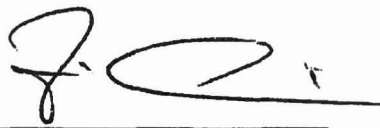
This Power of Attorney shall expire on the 30<sup>th</sup> day of September, 2007.

IN WITNESS WHEREOF this Power of Attorney has been executed for and on behalf of RWE Aktiengesellschaft on the date and year first above written.

*gr*

RWE Aktiengesellschaft

  
(Dr. Sturany)

  
(Zilius)

CERTIFICATE OF SERVICE

I, Michael A. Albert, counsel for West Virginia-American Water Company, hereby affirm that the **Joint Stipulation and Agreement for Settlement** was served on the parties of record by hand delivering true and correct copies thereof addressed as follows:

David A. Sade, Esq.  
Consumer Advocate Division  
7<sup>th</sup> Floor, Union Building  
723 Kanawha Boulevard, East  
Charleston, West Virginia 25301

Caryn Watson Short, Esq.  
Public Service Commission  
P. O. Box 812  
Charleston, West Virginia 25323

Leslie J. Anderson, Esq.  
Public Service Commission  
P. O. Box 812  
Charleston, West Virginia 25323

  
\_\_\_\_\_  
Michael A. Albert

Dated: December 4, 2006



**Tennessee American Water**  
**Analysis of Interest Rates of Past Year**

**Exhibit MAM-10**

**Page 1 of 2**

Value Line Publication Date	As of Market Date	"A" Rated Utility Bonds	30-year Treasury Bonds	Spread	10-year Corporate Bonds	10-year Treasury Bonds	Spread	13-Week Treasury Bills	Federal Reserve Rate
10/13/2006	10/5/2006	5.810%	4.760%	1.050%	5.540%	4.600%	0.940%	4.930%	5.250%
10/20/2006	10/11/2006	5.950%	4.910%	1.040%	5.670%	4.780%	0.890%	5.010%	5.250%
10/27/2006	10/18/2006	5.960%	4.880%	1.080%	5.680%	4.750%	0.930%	5.080%	5.250%
11/3/2006	10/25/2006	5.940%	4.880%	1.060%	5.700%	4.760%	0.940%	5.110%	5.250%
11/10/2006	11/1/2006	5.700%	4.680%	1.020%	5.500%	4.560%	0.940%	5.050%	5.250%
11/17/2006	11/8/2006	5.750%	4.670%	1.080%	5.520%	4.640%	0.880%	5.090%	5.250%
11/24/2006	11/15/2006	5.720%	4.700%	1.020%	5.540%	4.620%	0.920%	5.080%	5.250%
12/1/2006	11/21/2006	5.670%	4.660%	1.010%	5.480%	4.570%	0.910%	5.030%	5.250%
12/8/2006	11/29/2006	5.630%	4.610%	1.020%	5.450%	4.520%	0.930%	5.030%	5.250%
12/15/2006	12/6/2006	5.620%	4.600%	1.020%	5.350%	4.490%	0.860%	4.980%	5.250%
12/22/2006	12/13/2006	5.730%	4.700%	1.030%	5.440%	4.580%	0.860%	4.930%	5.250%
12/29/2006	12/20/2006	5.750%	4.730%	1.020%	5.450%	4.600%	0.850%	4.960%	5.250%
1/5/2007	12/27/2006	5.790%	4.780%	1.010%	5.500%	4.650%	0.850%	4.970%	5.250%
<b>Quarterly Average</b>		<b>5.771%</b>	<b>4.735%</b>	<b>1.035%</b>	<b>5.525%</b>	<b>4.625%</b>	<b>0.900%</b>	<b>5.019%</b>	<b>5.250%</b>
1/12/2007	1/3/2007	5.790%	4.760%	1.030%	5.500%	4.650%	0.850%	5.040%	5.250%
1/19/2007	1/10/2007	5.760%	4.780%	0.980%	5.530%	4.680%	0.850%	5.080%	5.250%
1/26/2007	1/17/2007	5.860%	4.870%	0.990%	5.620%	4.780%	0.840%	5.100%	5.250%
2/2/2007	1/24/2007	5.870%	4.910%	0.960%	5.620%	4.810%	0.810%	5.120%	5.250%
2/9/2007	1/31/2007	5.880%	4.910%	0.970%	5.630%	4.810%	0.820%	5.100%	5.250%
2/16/2007	2/7/2007	5.810%	4.850%	0.960%	5.560%	4.740%	0.820%	5.150%	5.250%
2/23/2007	2/14/2007	5.770%	4.830%	0.940%	5.520%	4.740%	0.780%	5.150%	5.250%
3/2/2007	2/21/2007	5.740%	4.790%	0.950%	5.510%	4.690%	0.820%	5.170%	5.250%
3/9/2007	2/28/2007	5.650%	4.680%	0.970%	5.380%	4.570%	0.810%	5.120%	5.250%
3/16/2007	3/7/2007	5.590%	4.630%	0.960%	5.310%	4.490%	0.820%	5.080%	5.250%
3/23/2007	3/14/2007	5.850%	4.700%	1.150%	5.400%	4.530%	0.870%	5.040%	5.250%
				0.000%			0.000%		
				0.000%			0.000%		
<b>Quarterly Average</b>		<b>5.779%</b>	<b>4.792%</b>	<b>0.987%</b>	<b>5.507%</b>	<b>4.681%</b>	<b>0.826%</b>	<b>5.105%</b>	<b>5.250%</b>
4/14/2006	4/6/2006	6.060%	4.970%	1.090%	5.820%	4.900%	0.920%	4.670%	4.750%
4/21/2006	4/12/2006	6.160%	5.060%	1.100%	5.900%	4.980%	0.920%	4.700%	4.750%
4/28/2006	4/20/2006	6.240%	5.140%	1.100%	5.960%	5.040%	0.920%	4.720%	4.750%
5/5/2006	4/27/2006	6.250%	5.170%	1.080%	6.000%	5.070%	0.930%	4.770%	4.750%
5/12/2006	5/4/2006	6.340%	5.240%	1.100%	6.090%	5.150%	0.940%	4.790%	4.750%
5/19/2006	5/11/2006	6.330%	5.230%	1.100%	6.080%	5.150%	0.930%	4.810%	5.000%
5/28/2006	5/18/2006	6.280%	5.170%	1.110%	6.010%	5.060%	0.950%	4.820%	5.000%
6/2/2006	5/25/2006	6.260%	5.170%	1.090%	6.020%	5.070%	0.950%	4.810%	5.000%
6/9/2006	6/1/2006	6.250%	5.190%	1.060%	6.040%	5.100%	0.940%	4.820%	5.000%
6/16/2006	6/8/2006	6.150%	5.060%	1.090%	5.960%	4.990%	0.970%	4.850%	5.000%
6/23/2006	6/15/2006	6.200%	5.140%	1.060%	6.060%	5.090%	0.970%	4.820%	5.000%
6/30/2006	6/22/2006	6.330%	5.240%	1.090%	6.180%	5.210%	0.970%	4.900%	5.000%
7/7/2006	6/29/2006	6.330%	5.250%	1.080%	6.180%	5.190%	0.990%	4.990%	5.250%
<b>Quarterly Average</b>		<b>6.245%</b>	<b>5.156%</b>	<b>1.088%</b>	<b>6.023%</b>	<b>5.077%</b>	<b>0.946%</b>	<b>4.805%</b>	<b>4.923%</b>
7/14/2006	7/6/2006	6.260%	5.220%	1.040%	6.140%	5.180%	0.960%	4.990%	5.250%
7/21/2006	7/13/2006	6.190%	5.110%	1.080%	6.020%	5.060%	0.960%	5.040%	5.250%
7/28/2006	7/20/2006	6.120%	5.080%	1.040%	6.010%	5.030%	0.980%	5.080%	5.250%
8/4/2006	7/27/2006	6.180%	5.100%	1.080%	6.030%	5.030%	1.000%	5.090%	5.250%
8/11/2006	8/3/2006	6.090%	5.040%	1.050%	5.950%	4.960%	0.990%	5.100%	5.250%
8/18/2006	8/10/2006	6.140%	5.070%	1.070%	5.890%	4.930%	0.960%	5.040%	5.250%
8/25/2006	8/17/2006	6.070%	5.000%	1.070%	5.820%	4.860%	0.960%	5.080%	5.250%
9/1/2006	8/25/2006	5.980%	4.940%	1.040%	5.760%	4.800%	0.960%	5.080%	5.250%
9/8/2006	8/31/2006	5.920%	4.880%	1.040%	5.680%	4.730%	0.950%	5.030%	5.250%
9/15/2006	9/7/2006	5.980%	4.930%	1.050%	5.730%	4.790%	0.940%	4.960%	5.250%
9/22/2006	9/14/2006	5.980%	4.920%	1.060%	5.720%	4.790%	0.930%	4.930%	5.250%
9/29/2006	9/21/2006	5.790%	4.770%	1.020%	5.540%	4.640%	0.900%	4.910%	5.250%
10/6/2006	9/28/2006	5.740%	4.760%	0.980%	5.540%	4.610%	0.930%	4.860%	5.250%

Quarterly Average

6.034% 4.986% 1.048%

5.833% 4.878% 0.955%

5.015% 5.250%

**Exhibit MAM-?**  
**Page 2 of 2**

	2007 Projected 30-Yr. "A" Rated Util. <u>Bond Rate</u>			2007 Projected 10-Yr. "A" Rated Util. <u>Bond Rate</u>		
	Value Line <u>Forecast</u>	Average <u>Spread</u>	Value Line <u>Forecast</u>	Average <u>Spread</u>		
<b>2007 Value Line Projection (8-25-06):</b>						
"A" Rated Utility Bonds 30-Yr. & 10-Yr. Corp. Bonds based on:						
Latest 2 Qtr. Avg. Spread	6.01%	5.00%	1.011%	5.76%	4.90%	0.863%
Latest 4 Qtr. Avg. Spread	6.04%	5.00%	1.040%	5.81%	4.90%	0.907%

**Tennessee American Water**  
**Comparison of Authorized ROE's - American Water Subsidiaries**

<u>Company:</u>	<u>Order</u> <u>Date</u>	<u>Authorized</u> <u>ROE</u>	<u>Value Line</u> <u>"A" Utility</u> <u>Bonds</u>	<u>Date</u>	<u>Spread</u> <u>over "A"</u> <u>Util. Bonds</u>
Arizona-Am.	3/13/2007	10.40%	5.74%	FEB. 07	4.66%
California-Am. - Felton	11/30/2006	9.95%	5.74%	SEP. 07	4.21%
California-Am. - Coronado	11/30/2006	10.10%	5.74%	SEP. 07	4.36%
California-Am. - Larkfield	11/30/2006	9.85%	5.74%	SEP. 07	4.11%
California-Am. - Monterey	11/30/2007	10.10%	5.74%	SEP. 07	4.36%
California-Am. - Los Angeles	11/30/2007	10.04%	5.74%	SEP. 07	4.30%
California-Am. - Sacramento	11/30/2006	9.85%	5.74%	SEP. 07	4.11%
California-Am. - Village	11/30/2006	10.10%	5.74%	SEP. 07	4.36%
Illinois-Am.	8/12/2003	10.27%	5.95%	Jul. 03	4.32%
New Mexico - Am.	2/2/2005	10.00%	5.57%	DEC. 04	4.43%
New York - Am.	3/15/2005	10.10%	5.31%	JAN. 05	4.79%
Kentucky-Am.	5/28/2005	10.00%	5.57%	DEC. 04	4.43%
Missouri-Am.	4/6/2004	10.00%	5.62%	FEB. 04	4.38%
Pennsylvania-Am.	1/16/2004	10.60%	5.77%	DEC. 03	4.83%
New Jersey-Am.	2/18/2004	9.75%	5.50%	JAN. 04	4.25%
Hawaii-Am.	5/6/2004	10.60%	5.49%	MAR. 04	5.11%
Virginia-Am.	6/15/2004	10.10%	6.18%	JUN. 04	3.92%
Indiana-Am.	11/18/2004	9.25%	5.60%	SEP. 04	3.65%
Ohio-Am.	3/7/2007	10.00%	5.79%	DEC. 06	4.21%
West Virginia-Am.	1/7/2005	9.85%	5.59%	NOV. 04	4.26%
Tennessee-Am.	3/9/2005	9.90%	5.31%	JAN. 05	4.59%
SW Utilities, Inc. (AWWC)	2/1/2004	12.00%	5.77%	DEC. 04	6.23%
Aqua Pennsylvania	6/22/2006	10.60%	6.25%	APR. 06	4.35%
Aqua Illinois	4/20/2005	10.37%	5.26%	FEB. 05	5.11%
Aqua New Jersey	6/10/2004	<u>9.75%</u>	<u>6.06%</u>	APR. 04	<u>3.69%</u>
Averages		10.14%	5.70%		4.44%
CAD witness opinion of proper ROE		7.50%	5.62%	FEB. 07	1.88%
<b>CAD variance from average</b>		<b><u>2.64%</u></b>			<b><u>2.56%</u></b>

<u>Conclusion:</u>	<u>4 Quarter</u> <u>Spread</u>	<u>2 Quarter</u> <u>Spread</u>
Value Line "A" Utility Bonds projection based on		
<b>2007</b> Projected 30 Yr. T-Bond plus 1.040% (4 Qtr. Avg.)	6.04%	
<b>2007</b> Projected 30 Yr. T-Bond plus 1.011% (2 Qtr. Avg.)		6.01%
Average Spread of AWW Companies	<u>4.44%</u>	<u>4.44%</u>
<b>ROE Calculated on Average Spread</b>	<b>10.48%</b>	<b>10.45%</b>

**Tennessee American  
Analysis of Interest Rates in Relation to ROE**

**Rebuttal Exhibit MAM-12**

**Per Value Line Publications:**

**Publication 1-27-05:**

		<b>ROE Awarded in Case 04-00288</b>	<b>Spread</b>
30-yr, A-rated Utility Bonds	5.31%	9.90%	4.59%
10-yr. A-rated Corp. Bonds	5.08%	9.90%	4.82%
30-yr T-Bonds	4.68%	9.90%	5.22%
10-yr. T-Bonds	4.22%	9.90%	5.68%
13-week T-Bills	2.43%		
Fed Funds	2.25%		

**Publication 4-6-07:**

		<b>Spread Last Case</b>	<b>ROE</b>
30-yr, A-rated Utility Bonds	5.99%	4.59%	10.58%
10-yr. A-rated Corp. Bonds	5.51%	4.82%	10.33%
30-yr T-Bonds	4.83%	5.22%	10.05%
10-yr. T-Bonds	4.62%	5.68%	10.30%
13-week T-Bills	5.04%		
Fed Funds	5.25%		

Average

**10.32%**

**FORECAST INFORMATION:**

**Publication 2-23-07:**

		<b>ROE Spread Case 04-00288</b>	<b>ROE</b>
2007 Forecast for 30-yr. T-Bonds	5.00%	5.22%	<b>10.22%</b>

**Tennessee American Water  
Southern Celulose (TAWC Industrial Customer  
Usage History**

**Rebuttal Exhibit MAM-13**

(in 100 CCF:)	<u>Actual Usage</u>					<u>Actual</u>
	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>Test Year</u> <u>Ended 6-30-06</u>
Jan		9,545	21,565	65,596	29,036	65,596
Feb		12,239	14,422	27,491	13,645	27,491
Mar		11,037	12,575	11,355	22,467	11,355
Apr		13,209	10,496	12,242		12,242
May		11,923	11,997	36,088		36,088
Jun		13,040	13,912	76,223		76,223
Jul	15,855	14,177	14,254	57,250		14,254
Aug	15,754	15,368	13,805	75,355		13,805
Sep	14,514	12,088	11,947	67,160		11,947
Oct	12,854	22,859	17,474	48,357		17,474
Nov	16,279	13,412	15,570	46,360		15,570
Dec	<u>12,213</u>	<u>12,287</u>	<u>93,774</u>	<u>21,625</u>		<u>93,774</u>
	87,469	151,639	230,226	479,506		395,819

**Mr. Chrysler's Method  
and Assumption:**

Variance actual usage 2005 to 2006	249,280
% increase 2005 to 2006	<b>108.28%</b>
Actual 2006 Usage	479,506
Assumption that Attrition Year Usage Will increase @ same level as 2006	519,191
<b>Attrition Year Usage for Southern Cellulose Embedded in Mr. Chrysler's Supplemental Testimony</b>	<b>998,697</b>
Attrition Year Usage included in TAWC filing	<u>395,819</u>
Difference in Usage	602,878
Tariff at Industrial tail-block rate	<u>\$0.582</u>
Mr. Chryslers overstatement of revenue for Southern Cellulose	<b>\$350,875</b>

**Note1:** Yellow shading represents Historical test-year and attrition year included in TAWC's filing.

**Note 2:** As can be clearly determined from actual usage above, Southern Cellulose began having trouble with their wells in December 2005 and due to dry conditions in 2006 they continued to use TAWC service at a much higher level in 2006 thru November than at any other time in recent history.

**Note 3:** As can clearly determined from the actual usage above, Southern Cellulose's usage returned to Pre-2006 levels in December 2006 and has remained there thru March 2007. The usage experienced in 2006 is obviously non-reoccurring and **should not be embedded in the ATTRITION YEAR.**

**Note 4:** Mr. Chrysler's Supplemental Testimony not only assumes that the extraordinary usage experienced in 2006 due to problems with their wells will continue in 2007, he assumes that it will increase at the same ratio from 2006 to 2007 as it did from 2005 to 2006. **This is an unsupportable assumption.**

**TOWERS  
PERRIN**

## Memorandum

DATE: August 3, 2004

TO: Debbie Krauss-Kelleher — American Water  
Timothy McKittrick — American Water

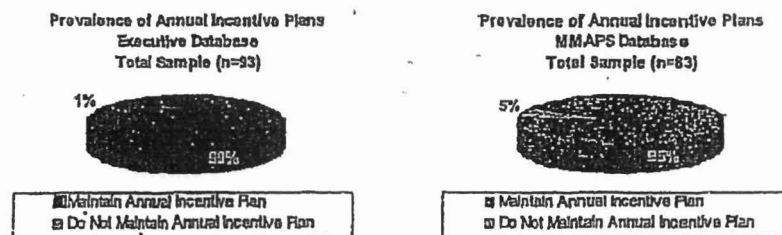
FROM: James Dickinson — Towers Perrin  
Amani Macaulay — Towers Perrin

RE: ANNUAL INCENTIVE PLAN PREVALENCE

American Water requested that Towers Perrin provide information regarding the prevalence of annual incentive plans in the utility industry. In response, we collected prevalence information based on the total sample of companies that provided data to our energy/utility compensation databases. Specifically, data were collected from the following sources:

- Towers Perrin's 2003 Energy Services Industry Executive Compensation Database
- Towers Perrin's 2003 Energy Services Industry Middle Management & Professional (MMAPS) Database

The following charts provide prevalence information for the companies in each database.



The charts show that annual incentive plans are very prevalent in the energy/utility industry, with 99 percent and 95 percent of energy/utility companies in our executive and middle management & professional compensation databases, respectively, maintaining a formal annual incentive plan.

A listing of the companies included in both samples is provided on the following pages.

Ms. Debbie Krauss-Kelleher  
August 3, 2004  
Page 3.

2003 Energy Services Industry Middle Management & Professional Database  
Participants

AES	FirstEnergy	PPL
AGL Resources	Great Plains Energy	Progress Energy
Allegheny Energy	Hawaiian Electric	Public Service Enterprise Group
Alliant Energy	IDACORP	Puget Energy
Ameren	KeySpan	Reliant Resources
American Electric Power	LG&E Energy	Salt River Project
American Transmission	Lower Colorado River Authority	SCANA
Alamos Energy	MGE Energy	SEMCO Energy
Avista	MidAmerican Energy	Sempra Energy
Black Hills	Mirant	Southern Company
Calpine	New York Power Authority	STP Nuclear Operating
CenterPoint Energy	Nicor	TECO Energy
Central Vermont Public Service	Northeast Utilities	Tennessee Valley Authority
CH Energy Group	NorthWestern Energy	TNP Enterprises
Cinergy	NRG Energy	Tractebel
Cleco	NSTAR	TransCanada
CMS Energy	Nuclear Management	TXU
Consolidated Edison	NW Natural	UHL Holdings
Constellation Energy Group	OGE Energy	Unisource Energy
Dominion Resources	Oglethorpe Power	United States Enrichment
Duke Energy	Omaha Public Power	Unifi
Dynegy	Otter Tail	Washington Gas
Edison International	Pacific Gas & Electric	Westar Energy
El Paso Corporation	PacifiCorp	Williams Companies
Energy East	Pepco Holdings	Wisconsin Energy
Enron	Plimack West	WPS Resources
Entergy	PNM Resources	Xcel Energy
Exelon	Portland General Electric	

\* \* \* \* \*

Debbie, we hope this information satisfies your request. Please feel free to call if you have any questions or should you require further information.

cc: Larry Parks — Towers Perrin

Direct Dials: 215-246-3920  
215-246-6538



Ms. Debbie Krauss-Kalleher  
August 3, 2004  
Page 2.

2003 Energy Services Industry Executive Compensation Database Participants

AES	Equitable Resources	Pinnacle West
AGL Resources	Exelon	PNM Resources
Allegheny Energy	FirstEnergy	Portland General Electric
Allele	FPL Group	PPL
Alliant Energy	Great Plains Energy	Progress Energy
Ameren	Hawaiian Electric	Public Service Enterprise Group
American Electric Power	IDACORP	Puget Energy
American Transmission	KeySpan	Reliant Resources
Atmos Energy	LG&E Energy	Salt River Project
Avista	Lower Colorado River Authority	SCANA
Black Hills	MDU Resources	SEMCO Energy
Calpine	MGE Energy	Sempra Energy
CenterPoint Energy	MidAmerican Energy	Southern Company
Central Vermont Public Service	Mirant	STP Nuclear Operating
CH Energy Group	National Grid USA	TECO Energy
Cinergy	New York Power Authority	Tennessee Valley Authority
Cleco	Nicor	TNP Enterprises
CMS Energy	Northeast Utilities	Tractebel
Consolidated Edison	NorthWestern Energy	TransCanada
Constellation Energy Group	NRG Energy	TXU
Dominion Resources	NSTAR	UIL Holdings
DTE Energy Services	Nuclear Management	UniSource Energy
Duke Energy	NUI	United States Enrichment
Dynegy	NW Natural	Unifi
Edison International	OGE Energy	Vectren
El Paso Corporation	Oglethorpe Power	Washington Gas
Energex	Omaha Public Power	Westar Energy
Energy East	Otter Tail	Williams Companies
Energy Northwest	Pacific Gas & Electric	Wisconsin Energy
Enron	PacifiCorp	WPS Resources
Entergy	Pepco Holdings	Xcel Energy

**Labor & Management Fee Analysis That Demonstrates the Shift From  
Fully Loaded Company Labor to Management Fees**

**Rebuttal Exhibit MAM-15  
Page 1 of 2**

**In Rebuttal to Testimony of Mr. Terry Buckner - From the CAPD**

	<u>(1)</u>	<u>(2)</u>	<u>(3)</u>	<u>(4)</u>	<u>(5)</u>	<u>(6)</u>	<u>(7)</u>	<u>(8)</u>
	As Approved in TAWC Case No. 03-00118 Attrition Yr. <u>3/31/2004</u>	2004 Labor Cost <u>Inflated</u>	2005 Labor Cost <u>Inflated</u>	2006 Labor Cost <u>Inflated</u>	2007 Labor Cost <u>Inflated</u>	Current Case Attrition Year Request by <u>Company</u>	Variance Column 5 to <u>Column 6</u>	Current Case Recommended <u>by CAPD</u>
Labor (Used normal % pay increase of 3.2%)	5,066,666	5,228,799	5,396,121	5,568,797	5,746,998	4,702,966		4,397,377
Group Insurance	1,463,924	1,725,805	2,060,248	1,912,718	1,729,041	1,520,667		1,386,168
Pensions	<u>387,985</u>	<u>141,820</u>	<u>344,846</u>	<u>1,151,099</u>	<u>665,606</u>	<u>665,858</u>		<u>12,662</u>
Fully Loaded Labor Cost	6,918,575	7,096,424	7,801,215	8,632,614	8,141,645	6,889,491	(1,252,154)	5,796,207
Management Fees	<u>2,507,276</u>	<u>2,535,587</u>	<u>2,607,538</u>	<u>3,010,950</u>	<u>2,771,251</u>	<u>4,064,421</u>	<u>1,293,170</u>	<u>3,021,111</u>
Total Labor & Management Fees	9,425,851	9,632,011	10,408,753	11,643,564	10,912,896	10,953,912	41,016	8,817,318

**Footnotes:**

**Note 1:** The calculation of inflation factors used to determine the pro-forma 2007 costs shown in column 5 above are included on page 2 of this Exhibit.

**Note 2:** The CAPD costs recommended in this case do not reflect the shift in labor from the local operation to management fees as a result of the reorganization that began in 2004 and was completed in 2006.

**Note 3:** The CAPD recommendation starts with the management fee level included in the Settlement Agreement of TAWC case 04-00288 and does not capture the full impact of the reorganization and causes the CAPD to significantly understate the appropriate management fee expense for the attrition year.

**Note 4:** This schedule clearly shows that there is an offset to the increased management fees in direct contradiction to the claim of Mr. Buckner on page 10 of his testimony.

**Note 5:** The CAPD total for fully loaded TAWC labor costs + management fees is over \$600,000 less than approved by the TRA in case 03-00118.

**Note 6:** The CAPD does not mention or recognize the increased service being provided by a 24/7 call center, improvements in meter reading, or the increased service related to real-time access through mobile computing to just name a few of the service improvements.

	2003	2004	2005	2006	2007 Budget
<b><u>TAWC Actual Loaded Labor Costs</u></b>					
AVG. # Employees	118.17	100.17	96.33	102.33	111.00
Labor	4,858,845	4,212,010	3,765,383	4,256,528	4,695,801
Group Insurance	1,363,154	1,362,217	1,563,967	1,542,409	1,512,376
Pensions	<u>439,268</u>	<u>136,107</u>	<u>318,289</u>	<u>1,128,624</u>	<u>707,880</u>
Fully Loaded Cost	6,661,267	5,710,334	5,647,639	6,927,561	6,916,057

Management Fees	2,324,942	4,012,316	3,752,617	4,312,528	4,483,328
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Note: management fee level included in case 04-00288 3,062,940

<b><u>Cost per Employee</u></b>					
Labor	41,119	42,050	39,087	41,595	42,305
Group Insurance	11,536	13,600	16,235	15,072	13,625
Pensions	<u>3,717</u>	<u>1,359</u>	<u>3,304</u>	<u>11,029</u>	<u>6,377</u>
Fully Loaded Cost per employee	56,372	57,008	58,626	67,696	62,307

	<u>% Increase</u>	<u>% Increase</u>	<u>% Increase</u>	<u>% Increase</u>
Labor	1.023	0.930	1.064	1.017
Group Insurance	1.179	1.194	0.928	0.904
Pensions	<u>0.366</u>	<u>2.432</u>	<u>3.338</u>	<u>0.578</u>
Fully Loaded Cost per customer	1.011	1.028	1.155	0.920

# Memo

Rebuttal Exhibit MAM-16

Page 1 of 13

To: Ellen Wolf

From: Mahaveer Jain

Cc: James Kalinovich  
Robert Sievers  
Ed Keiffer

Date: February 16, 2007

**RE: American Water Pension Plan Quarterly Contributions**

## Proposal:

That Ellen Wolf approves \$ 49.6 Million in contributions to the American Water Pension Plan

## Discussion:

Attached is a detailed analysis of the contribution scenarios for the AW Pension Plan. The following summarizes the proposed contributions, by quarter, for the year.

	3/9/2007	2 Q	8/10/2007	11/9/2007	Total
Qualified Pension Plan	19,200,000	0	15,200,000	15,200,000	49,600,000

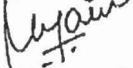
The AWW Pension contributions are based on ERISA minimums. However, the first quarter payment includes a \$ 7.5 Million additional contribution, which increases the funded liability ratio to 80% as of 1/7/2006 and will avoid the need to send notices informing participants of the plan's funded status.

We are also analyzing the possibility of the making higher contributions in 2008 to avoid the PGBC premium of \$ 1.5 Million, which is paid from the Trust. Historically AWW has been paying the PGBC premium but this payment can be avoided if contributions are higher than the ERISA minimums. If this objective is to be achieved for 2007, a total contribution of \$ 38.3 Million is required in the first quarter 2007 saving AWW Pension Plan \$ 1.5 Million. However it is not feasible to get regulatory approval in such a short span of time. Hence we are exploring this possibility for 2008.

By signing this document, you will be approving the quarterly contributions for 2007. According to the Delegations of Authority, you have unlimited approval authority for this activity.

Please contact me or James Kalinovich if you have any questions.

Thanks

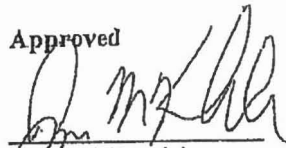


Mahaveer Jain

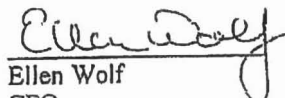
American Water  
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T +1 856 346 8247  
F +1 856 566 4004  
I [www.amwater.com](http://www.amwater.com)  
[Mahaveer.jain@amwater.com](mailto:Mahaveer.jain@amwater.com)

**RE: American Water Pension Plan Quarterly Contributions**

Approved

  
James Kalinovich  
Treasurer

2-16-07  
Date

  
Ellen Wolf  
CFO

2/16/07  
Date

AMERICAN WATER SYSTEM  
QUALIFIED PENSION PLAN  
2007 FUNDING SCHEDULE

<u>COMPANY</u>	<u>A</u> ALLOCATION OF 2007 PENSION FUNDING	<u>B</u> ESTIMATED FUNDING ON MARCH 9	<u>C</u> ESTIMATED FUNDING ON AUGUST 10	<u>D</u> ESTIMATED FUNDING ON NOVEMBER 9
AMERICAN WATER WORKS COMPANY	\$ 45,374	\$ 17,564	\$ 13,905	\$ 13,905
AMERICAN WATER RESOURCES	-	-	-	-
AMERICAN WATER SERVICES	307,575	119,061	94,257	94,257
AMERICAN WATER WORKS SERVICE COMPANY	12,062,315	4,669,285	3,696,517	3,696,513
ARIZONA-AMERICAN	1,013,709	392,403	310,653	310,653
CALIFORNIA-AMERICAN	1,809,568	700,478	554,545	554,545
ELIZABETHTOWN	4,055,385	1,569,826	1,242,779	1,242,780
HAWAII-AMERICAN	185,861	71,946	56,957	56,958
ILLINOIS-AMERICAN	3,280,298	1,269,793	1,005,253	1,005,252
INDIANA-AMERICAN	2,494,948	965,786	764,581	764,581
IOWA-AMERICAN	514,271	199,073	157,599	157,599
KENTUCKY-AMERICAN	928,556	359,441	284,557	284,558
LONG ISLAND	948,608	367,203	290,702	290,703
MARYLAND-AMERICAN	73,936	28,620	22,658	22,658
MICHIGAN-AMERICAN	56,590	21,906	17,342	17,342
MISSOURI-AMERICAN	4,910,537	1,900,853	1,504,842	1,504,842
NEW JERSEY-AMERICAN	4,194,209	1,623,565	1,285,322	1,285,322
NEW MEXICO-AMERICAN	196,033	75,884	60,075	60,074
OHIO-AMERICAN	696,940	269,783	213,578	213,579
PENNSYLVANIA-AMERICAN	7,668,641	2,968,507	2,350,067	2,350,067
TENNESSEE-AMERICAN	855,492	331,158	262,167	262,167
TEXAS-AMERICAN	77,320	29,930	23,695	23,695
VIRGINIA-AMERICAN	577,076	223,384	176,846	176,846
VIRGINIA EASTERN	58,335	22,581	17,877	17,877
WEST VIRGINIA-AMERICAN	2,588,423	1,001,970	793,226	793,227
	<u>\$ 49,600,000</u>	<u>\$ 19,200,000</u>	<u>\$ 15,200,000</u>	<u>\$ 15,200,000</u>

Mahaveer P Jain  
03/29/2007 09:03 AM

To: Sheila Miller/WVAWC/AWWSC@AWW  
cc: Trisha Etadali/SHARVCS/AWWSC@AWW  
Subject: Fw: \$19.2M AWW 1st Pension Contribution Fedwire Confirmation

Sheila,

Attached is a screen shot of the Pension Payment made in First Quarter. Also Attached is the Subsidiary wise Allocation of the Pension expense and the going forward allocation for the rest of 2007



2007 AWW pension funding schedule.xls

Please let me know if you have any questions or if I can be of any help.

Regards,

Mahaveer Jain  
Manager - Financial Evaluation & Analysis  
American Water Works  
1025 Laurel Oak Road  
Voorhees NJ 08043  
Phone: (856) 346-8247  
Fax : (856) 566-4004  
email : mahaveer.jain@amwater.com

— Forwarded by Mahaveer P Jain/ADMIN/CORP/AWWSC on 03/29/2007 09:00 AM —

Glisson F Inguito/SHARVCS/AWWSC

03/09/2007 05:38 PM

To Mahaveer P Jain/ADMIN/CORP/AWWSC@AWW  
cc

Subject \$19.2M AWW 1st Pension Contribution Fedwire Confirmation



https://www.treasury.pncbank.com/wire/WireServlet - Microsoft Internet Explorer provided by American Water ITS - 6/12



## Quick Search by Trace ID Report

03/09/2007 5:34:09 PM

Initiation Date: 03/09/2007

### Account Summary

8013583379 - American Water Capital C

	<u>Amount</u>	<u>Count</u>
Debits :	\$19,200,000.00 USD	1

### Debits

Status: confirmed Trace ID: 200703427306			
Debit Amount	\$19,200,000.00 USD	Bene Bank Addr	CHARLOTTE, NC
Wire Type	Repetitive Domestic Wire	Bene Account	D5000000016439
Repeat ID	AWCC4PEN	Bene Name	TRUST OPS INCOMING WIRES
Repeat Name	AWCC4PEN	OBI	FFC:1540000905 AWW
Value Date	03/09/2007	Company	PENSION;ATTN:EB843
Wire TRN	070309025929	Initiated By	911300
Fed Reference Number	001093	Initiator Phone	Brian Perhacs 03/09/2007
Bene Bank ID	053000219	Approved By	08:48 AM
Bene Bank Name	WACHOVIA BANK, NA	Approver Phone	856-310-5851
			Jeffery R Colkers 03/09/2007
			04:51 PM
			856-309-4899

**DRAFT**

**TOWERS  
PERRIN**

HR SERVICES

PRIVATE AND CONFIDENTIAL

August 18, 2006

Mr. Ed Keiffer  
Director Accounting  
American Water  
1025 Laurel Oak Road  
Voorhees, NJ 08043-7770

Dear Ed.

**American Water – Pension and Postretirement Welfare Projections**

As requested, attached are five-year projections for the current American Water and Elizabethtown Water sponsored qualified and postretirement welfare (PRW) plans. The projections are as follows:

- For the qualified pension plans
  - the IRS minimum required contributions for the plan years beginning in 2006 through 2010, (e.g., for the AW pension plan this is the plan year beginning July 1, 2006 through the plan year beginning July 1, 2010)
  - the accounting costs under FAS 87 before purchase accounting, FAS 87 after purchase accounting, and IAS 19 for fiscal years 2006 through 2011
- For the PRW plans, the accounting costs under FAS 106 before purchase accounting, FAS 106 after purchase accounting and IAS 19 and the cash costs for fiscal years 2006 through 2011. All projections reflect the subsidy provided under Medicare Part D.

**Qualified Pension Plan Projections**

The projected FAS 87 accounting costs (before and after purchase accounting) and IAS 19 accounting costs (split by OR cost and IC cost) are summarized in Exhibit 1, and the projected minimum required contributions are summarized in Exhibit 2. The results are shown on a plan by plan basis for each qualified plan.

Mr. Ed Keiffer  
August 18, 2006  
Page 2

**TOWERS  
PERRIN**

HR SERVICES

The projections are based on the data and results of the:

- July 1, 2005 funding and January 1, 2006 accounting actuarial valuations for the AW pension plan
  - Assets as of June 30, 2006
  - Census data as of June 30, 2005
- January 1, 2006 actuarial valuation for the Elizabethtown pension plan
  - Assets as of June 30, 2006
  - Obligations as of December 31, 2005 reflecting assumption changes and plan changes but based on the census data as of January 1, 2006
- We reflected the plan merger of the E'town plan into AW plan as of December 31, 2006. This will cause a mid-year remeasurement for funding purposes.
- We reflected the E'town curtailment for 2006.
- For funding purposes, we captured the plan changes for both the AW pension plan and E'town pension plan effective January 1, 2006 (see Exhibit A for details).
  - This includes changes for AW union and nonunion, E'town union and nonunion and Long Island union.
  - These changes were already reflected for 2006 accounting costs and are now reflected for 2006 plan year contributions.
- We did not anticipate any plan changes (e.g., changes that may be attributable to future union negotiations for any union employees) after January 1, 2006 (except known LI union changes as of January 1, 2008 and January 1, 2010) for the projection period.
- Since the AW plan is closed to new hires (for most of the population), we reflected 5% turnover per year (terminations and retirements) for current employees.
  - Based on a historical demographic analysis that we recently conducted, the valuation assumptions indicate that a 5% turnover rate is reasonable for the projection period.
  - As was assumed in the projections produced in February, we assumed that AW does not expect significant reductions or increases in headcount over the projection period.
- We assumed that AW contributes the minimum required contribution on a quarterly basis – consistent with current practice.

- Recently, the Senate has passed the Pension Protection Act (PPA) of 2006.
  - The new funding rules will be effective for plan years beginning in 2008.
  - The interest rate relief of 2004 and 2005 is extended to the 2006 and 2007 plan years. Below are the assumed Current Liability (CL) rates. For the July 1, 2006 and July 1, 2007 plan years, the CL rates assume that the composite corporate bond yield for July 2006 of 6.15% remains constant over the projection period. We also reflected an update to the CL mortality table as of July 1, 2007 from the 1983 GAM table to the expected mortality table, the RP 2000 table with adjustments.
  - Under the new rules, the funding target will be 100% of the accrued liability with a potential three-year transition.
  - The interest rate used to determine the funding target will be determined using three "segment" interest rates based on a high-quality corporate bond yield curve, averaged over 24 months. There is a three-year phase-in from current corporate bond rates to new segment rates from 2008-2010. However, the employer can opt out of the transition. American Water may elect to use the full yield curve of interest without any averaging. Based on our discussions, AW has chosen to allow the interest rate be transitioned to the full yield curve over 3-years for purposes of these projections.

Plan year	As of July 1 <sup>st</sup>
	3-year transition
2006*	5.77%
2007**	5.90%
2008***	6.10%
2009***	6.20%
2010***	6.23%

\* The CL interest rate for the E'town plan as of January 1, 2006 is 5.77%.

\*\* The CL interest rates for 2006 and 2007 are based on the corporate bond yields over 4 years.

\*\*\* For the years 2008, 2009 and 2010, the interest rates are estimated based on the new funding rules.

- The mortality table to determine the liabilities was updated to meet the new expected requirements in 2007, i.e., the RP2000 table with adjustments.
- Assets are smoothed over three years instead of the current five-year period, using the new 90%-110% corridor.
- The new rules provide an increased funding target if the plan is deemed to be "at-risk". We have projected AW pension plan's "at-risk" status. The "at-risk" test requires that the plan is below 80% without reflecting at-risk provisions and less than 70% after reflecting the "at-risk" assumptions. We have only completed the 80% test and have determined that the plan is not "at-risk" during the projection period, based on the assumptions used.

- The projections reflect all of the assumptions discussed at the December assumption setting meeting – retirement rates, termination rates, mortality table (where not prescribed), EROA, salary increase rate, etc.
- We did not reflect:
  - Any potential changes to the accounting rules for either FAS or IAS
  - Future plan changes that have not yet been negotiated or determined, other than Long Island
  - The impact of the IPO, if any, that will be issued by AW
  - Potential partial plan termination for E'town

### **Postretirement Welfare Plan Projections**

The projected FAS 106 accounting costs (before and after purchase accounting), the IAS 19 accounting costs and the Estimated Cash Contributions are reflected in Exhibit 3. The accounting costs are shown after reflecting Medicare Part D. The results are shown separately for each plan.

### **Basis of Projections**

The projections are based on the data and results of the:

- The January 1, 2006 accounting valuation for the AW plan, St. Louis plan and Northern Illinois plan
- The January 1, 2005 actuarial valuations for the E'town plan rolled forward to December 31, 2005 and adjusted for assumption changes and curtailment as of January 1, 2006
- We reflected the E'town curtailment for 2006.
- We reflected the plan mergers of St. Louis and E'town into AW plan as of December 31, 2006
- Since the AW plan and E'town plan are closed to new hires (for most of the population), we assumed a 5% per year turnover assumption for current employees.
- We reflected the impact of the federal subsidy due to Medicare Part D in the current AW, E'town and St. Louis postretirement welfare costs.
- We assumed the RWE promise remains in effect for the entire projection period

- We assumed pre-65 retiree contributions for both union and non-union legacy AW (not covered by RWE promise) are based on the active union contributions set forth in the union contract. After 2010, we assume the 2010 contributions are increased with assumed health care trend.
- For E'town VEBA assets, we adjusted the assets by \$1.7M to reflect the reimbursement of benefit payments from the VEBA to the company, as discussed.
- We did not reflect:
  - Any potential changes to the accounting rules for either FAS or IAS
  - Future plan changes not yet determined, including any plan changes that may be attributable to future union negotiations for any union employees
  - Divestiture of AW and the potential impact on the accounting costs
  - The cost of the \$500/year VEBA benefit

#### **Assumptions and Methods**

The key assumptions and methods that have been used in the projections are summarized below:

##### Baseline Accounting Assumptions

- 5.65% discount rate for all plans for fiscal year 2006 and 6.15% discount rate for all plans for fiscal years 2007 and thereafter, as discussed. The Moody's Aa bond yield as of August 10, 2006 was 6.00%.
- 4.25% compensation increase rate per year
- 8.25% expected return on asset rate (pre-tax); 7.95% expected return on asset rate for the AW PRW plan (this represents a blended rate for the combination of taxable and nontaxable VEBAs). For the Elizabethtown Water PRW plan, 8.25% for Bargaining VEBA and 5.15% for the nonbargaining VEBA (this is about 6.7% for the entire plan).
- The RP 2000 table projected to 2015 with phase-out reflecting white/blue collar mortality for FAS 87/106, IAS 19 and going-concern funding for AW pension plan (for 2006 and 2007 plan years)

■ Medical Trend Rate:

<u>Year</u>	<u>Rate</u>
2006	10%
2007	9%
2008	8%
2009	7%
2010	6%
2011+	5%

- For the AW pension plan, the accounting cost estimates assume AW will make the minimum required contribution for the respective plan year on a quarterly basis for the AW pension plan (consistent with current practice)
- For the AW PRW plan, St. Louis PRW plan and Elizabethtown PRW plan, contributions equal to the FAS 106 cost (before reflecting purchase accounting) were assumed to be made on a quarterly basis and were assumed to be fully deductible. This scope does not include an analysis of the tax-deductible limits for the projection period.

Baseline Pension Funding Assumptions

- Interest rate for determining the funding target for the AW pension plan were described earlier and based on a yield curve and the estimated benefit payments of the plan.
- 4 25% compensation increase rate per year for funding purposes
- Current liability interest rates as described earlier which represent estimates of the highest allowable rates that American can use. The interest rate relief of 2004 and 2005 continues for the 2006 and 2007 plan years. The projected current liability interest rate assumes that the Composite Corporate Bond Yield of 6.15%, in effect as of July 2006, remains constant until June 2007.
- The target liability interest rates for years on and after July 1, 2008 were projected assuming the yield curve as of July 31, 2006 stays constant. The interest rates are calculated based on AW plan's expected benefit payments.
- The mortality assumption was updated from 1983 GAM to RP2000 table that we expect to be prescribed by the IRS on and after July 1, 2007 (for Current Liability purposes). The RP2000 table is adjusted to provide mortality improvements to the current valuation year plus an additional fixed period of improvements.



Mr. Ed Keiffer  
August 18, 2006  
Page 7

**TOWERS  
PERRIN**  
HR SERVICES

General Assumptions Applicable to Accounting and Funding

- We used actual assets as of June 30, 2006. For the remainder of 2006 and all periods after 2006, we assumed an 8.25% investment return (annualized).
- We assumed that actual experience (asset returns, medical trend, mortality rates, etc.) matched the assumptions throughout the projection period. To the extent that actual experience differs from assumed experience these projections will change.
- Turnover rate was assumed to be 5% per year for calculating the service cost for plans that are closed to new hires.

**Next Steps**

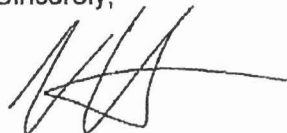
In this projection, we have calculated minimum required contributions for plan years 2006 and later for the qualified pension plan. We understand that AW has made a decision on strategic contributions to be made through 2006.

The Pension Protection Act is the largest pension bill enacted in 30 years. It fundamentally changes contribution amounts and funding strategies. We recommend a meeting with AW to discuss the provisions of the Pension Protection Act and its implications for AW.

\* \* \* \*

Please let us know when would be a convenient time to meet to discuss the new law.

Sincerely,



Roy Costa, FSA  
Senior Consultant

Direct Dial: 215-246-6675



Sheri X. DeCristofaro, FSA  
Consultant

215-246-6297

cc. Bob Sievers — American Water  
Cynthia C. King, FSA — Towers Perrin/Philadelphia

**Attachments**

S:\00270\06RETWP\TEAM\AW 5YEAR PROJECTION\_JAN.DOC

## Exhibit 2

DRAFT

## American Water

**Five-Year Projection of Qualified Pension Funding Requirements\***  
(\$ in Millions)

**Estimated ERISA Minimum Required Contribution**

Plan Year	2006	2007	2008	2009	2010	2011
American Water	\$6.4	\$59.0	\$56.2	\$52.0	\$50.4	\$47.4
Elizabethtown	\$1.7	N/A	N/A	N/A	N/A	N/A

**Assumptions**

- Interest Rate: 8.25% for AW plan and Elizabethtown plan
- Current Liability Interest Rate (Target Liability Interest Rate after 2007)

Plan Year	AW Plan as of July 1
2006	5.77%
2007	5.90%
2008	6.10%
2009	6.20%
2010	6.23%

- Mortality: AAL: RP2000 projected to 2015 with phase-out reflecting a 50% white collar and 50% blue collar blend  
CL/Target Liability: 1983 GAM for 2006, RP2000 with adjustments thereafter
- Salary Increase Rate: 4.25% per year

Note: The 2006 contribution for the AW plan reflected the strategic contributions that AW plans to make for the 2006 plan year.

\* Please see the letter dated August 18, 2006 for additional details.

**[092001] - Account Ledger Inquiry**

Functions Options Tools Help

Account: 2502054557000515 From Date/Period: 12/10/05  
 Ins Gen Liab Oper AG Thru Date/Period: 12/31/06  
 Skip to Doc/Type: \_\_\_\_\_ Ledger Type: RA  
 Y-T-D Period End: 10,740.18- Subledger: \_\_\_\_\_  
 Cumul Period End: 10,740.18-

Additional Selections Exist

DT	Document	Date	Explanation	Debit	Credit	P
JE	30257008	04/04/06	Record 1992-2005 R	50,545 32		P
JE	30301225	06/19/06	Adj Deferred Liabi		25,858 59-	P
JE	2607	09/25/06	Retclass Ins Premiu		38 57-	P
JE	30656049	09/29/06	3rd Qtr 2006 Retro		86,190 09-	P
JE	30757948	12/22/06	4TH QTR RETRO INS	50,801 75		P
				101,347 07	112,087 25-	
			Ledger Total		10,740 18-	
			Unposted Total			

Opt: 1/2=Orig Entry 5=Details F17=Top F10=Totals F21=Prn Ledg F24=More MW

Rebuttal Exhibit MAM-17

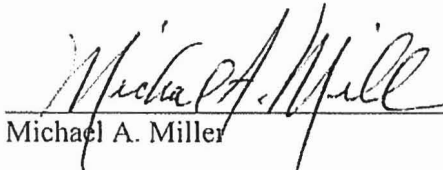
**TENNESSEE REGULATORY AUTHORITY**

**STATE OF WEST VIRGINIA**


**COUNTY OF KANAWHA**

BEFORE ME, the undersigned authority, duly commissioned and qualified in and for the State and County aforesaid, personally came and appeared Michael A. Miller, being by me first duly sworn deposed and said that:

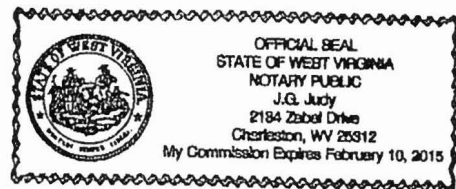
He is appearing as a witness on behalf of Tennessee-American Water Company before the Tennessee Regulatory Authority, and if present before the Authority and duly sworn, his rebuttal testimony would set forth in the annexed transcript consisting 68 of pages.

  
Michael A. Miller

Sworn to and subscribed before me  
this 9th day of April 2007.

  
Notary Public

My commission expires February 10, 2015



### CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing has been served via the method(s) indicated, on this the 9th day of April, 2007, upon the following:

<input type="checkbox"/> Hand	Michael A. McMahan
<input type="checkbox"/> Mail	Special Counsel
<input type="checkbox"/> Facsimile	City of Chattanooga (Hamilton County)
<input checked="" type="checkbox"/> Overnight	Office of the City Attorney
<input checked="" type="checkbox"/> Email	Suite 400
	801 Broad Street
	Chattanooga, TN 37402
<input type="checkbox"/> Hand	Timothy C. Phillips, Esq.
<input type="checkbox"/> Mail	Vance L. Broemel, Esq.
<input type="checkbox"/> Facsimile	Stephen Butler
<input checked="" type="checkbox"/> Overnight	Office of the Attorney General
<input checked="" type="checkbox"/> Email	Consumer Advocate and Protection Division
	2nd Floor
	425 5th Avenue North
	Nashville, TN 37243-0491
<input type="checkbox"/> Hand	Henry M. Walker, Esq.
<input type="checkbox"/> Mail	Boult, Cummings, Conners & Berry, PLC
<input type="checkbox"/> Facsimile	Suite 700
<input checked="" type="checkbox"/> Overnight	1600 Division Street
<input checked="" type="checkbox"/> Email	P.O. Box 340025
	Nashville, TN 37203
<input type="checkbox"/> Hand	David C. Higney, Esq.
<input type="checkbox"/> Mail	Grant, Konvalinka & Harrison, P.C.
<input type="checkbox"/> Facsimile	633 Chestnut Street, 9 <sup>th</sup> Floor
<input checked="" type="checkbox"/> Overnight	Chattanooga, TN 37450
<input checked="" type="checkbox"/> Email	
<input type="checkbox"/> Hand	Frederick L. Hitchcock, Esq.
<input type="checkbox"/> Mail	Chambliss, Bahner & Stophel, P.C.
<input type="checkbox"/> Facsimile	1000 Tallan Building
<input checked="" type="checkbox"/> Overnight	Two Union Square
<input checked="" type="checkbox"/> Email	Chattanooga, TN 37402

