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April 12, 2007

VIA HAND-DELIVERY

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

filed electronically in docket office on 04/12/07

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 Tennessee American Water Company's First Supplemental Response to the Consumer Advocate and Protection Division's Discovery Request Number Two, Part I, Questions 10 and 12. The documents referenced in the Response were filed under seal in a separate, contemporaneous, filing.

Please return three copies of the Response, 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
R. Dale Grimes

RDG/ms
Enclosures

w/ permission

Chairman Sara Kyle

April 12, 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*)
Michael A. McMahon, Esq. (*w/enclosure*)
Frederick L. Hitchcock, Esq. (*w/enclosure*)
Vance Broemel, Esq. (*w/enclosure*)
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
Docket No. 06-00290
Supplemental Response to CAPD Discovery Request No. 10

Responsible Witness: Michael Miller/or others

Question:

10. Provide a detailed reconciliation book to taxable income of Deferred Federal Income Tax Expense for the test year ended June 30, 2006 amount of \$894,154 per Exhibit No. 2, Schedule 6. Include in your response detailed work papers of all temporary differences generating the Deferred Federal Income Tax Expense. Also, show any prior year adjustments for book to tax reconciliation, for example \$209,202 per the response to TRA Discovery Request # 49, page 1 of 2.

Supplemental Response:

Attached you will find the reconciliation and source documents for the \$348,360 and \$19,008 of amortization of FAS 109 regulatory assets-deferred tax expense previously provided on the tax reconciliation for the base period ended June 2006 as provided in response to CAPD-02-Q010 and Q012. While TAWC reconciled to the per books number we found that the amortization of the account 186045 (column 2 on the supporting documents) had been incorrectly recorded using the 2002 amortization year for the base period ending June 2006 and the correcting entry for that was recorded in July 2006. TAWC in fact understated the FAS 109 amortizations in the historical test-year by \$98,814 as shown at the bottom section of the excel file.

FAS 109 is a balance sheet approach to deferred income taxes where the deferred income tax expense must conform to an effective tax rate (ETR) determined from the impact of both permanent and temporary differences. It is required under FAS 109 that the ETR properly reflect the impact as those difference reverse themselves over the life of the assets driving those book to tax differences.

The basis for the FAS 109 amortizations is: In the early years of assets when the tax depreciation, amortized, exceeded book depreciation, amortized, the build up of the reg asset created timing difference that served to drive the ETR below the statutory income tax rates. During this period the ratepayers received the benefit of those timing differences under FAS109. Once those assets reach the break over point where the book depreciation, amortized, exceeded tax those reversals drive the effective tax rate above the statutory income tax rates. FAS 109 properly applies and matches the impact of those book/tax differences to the customers properly over the life of the assets.

As for the flow-thru credit of \$120,222 for deferred FIT expense and \$23,879 for deferred SIT expense. The amortizations (mentioned above) as they are recorded on the books impact taxable income and that must also be accounted for properly. Under FAS 109 that impact is captured in the ETR calculation itself and the flow-thru credit to expense is captured in the FAS 109 deferred income tax expenses recorded to obtain the proper ETR for per books pre-tax income.

TAWC is providing the 2006 EFT calculations which incorporate all of the differences and FAS 109 entries necessary to determine the EFT. On a monthly basis there is no distinct calculation of the flow through piece. A distinct calculation can be made and TAWC has asked its tax department to make the calculation for the historical test-year and will provide that later information this as it becomes available.

TENNESSEE AMERICAN WATER COMPANY
Docket No. 06-00290
Supplemental Response to CAPD Discovery Request No. 12

Responsible Witness: Michael Miller/or others

Question:

12. Provide a detailed reconciliation book to taxable income of Deferred State Income Tax Expense for the test year ended June 30, 2006 amount of \$231,004 per Exhibit No. 2, Schedule 6. Include in your response detailed work papers of all temporary differences generating the Deferred Federal Income Tax Expense. Also, show any prior year adjustments for book to tax reconciliation.

Supplemental Response:

Attached you will find the reconciliation and source documents for the \$348,360 and \$19,008 of amortization of FAS 109 regulatory assets-deferred tax expense previously provided on the tax reconciliation for the base period ended June 2006 as provided in response to CAPD-02-Q010 and Q012. While TAWC reconciled to the per books number we found that the amortization of the account 186045 (column 2 on the supporting documents) had been incorrectly recorded using the 2002 amortization year for the base period ending June 2006 and the correcting entry for that was recorded in July 2006. TAWC in fact understated the FAS 109 amortizations in the historical test-year by \$98,814 as shown at the bottom section of the excel file.

FAS 109 is a balance sheet approach to deferred income taxes where the deferred income tax expense must conform to an effective tax rate (ETR) determined from the impact of both permanent and temporary differences. It is required under FAS 109 that the ETR properly reflect the impact as those difference reverse themselves over the life of the assets driving those book to tax differences.

The basis for the FAS 109 amortizations is: In the early years of assets when the tax depreciation, amortized, exceeded book depreciation, amortized, the build up of the reg asset created timing difference that served to drive the ETR below the statutory income tax rates. During this period the ratepayers received the benefit of those timing differences under FAS109. Once those assets reach the break over point where the book depreciation, amortized, exceeded tax those reversals drive the effective tax rate above the statutory income tax rates. FAS 109 properly applies and matches the impact of those book/tax differences to the customers properly over the life of the assets.

As for the flow-thru credit of \$120,222 for deferred FIT expense and \$23,879 for deferred SIT expense. The amortizations (mentioned above) as they are recorded on the books impact taxable income and that must also be accounted for properly. Under FAS 109 that impact is captured in the ETR calculation itself and the flow-thru credit to expense is captured in the FAS 109 deferred income tax expenses recorded to obtain the proper ETR for per books pre-tax income.

TAWC is providing the 2006 EFT calculations which incorporate all of the differences and FAS 109 entries necessary to determine the EFT. On a monthly basis there is no distinct calculation of the flow through piece. A distinct calculation can be made and TAWC has asked its tax department to make the calculation for the historical test-year and will provide that information later as it becomes available.

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 12th 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 checked="" type="checkbox"/> Hand	Timothy C. Phillips, Esq.
<input type="checkbox"/> Mail	Vance L. Broemel, Esq.
<input type="checkbox"/> Facsimile	Office of the Attorney General
<input type="checkbox"/> Overnight	Consumer Advocate and Protection Division
<input checked="" type="checkbox"/> Email	425 5th Avenue North, 2 nd Floor
	Nashville, TN 37243
<input checked="" type="checkbox"/> Hand	Henry M. Walker, Esq.
<input type="checkbox"/> Mail	Boult, Cummings, Conners & Berry, PLC
<input type="checkbox"/> Facsimile	Suite 700
<input type="checkbox"/> Overnight	1600 Division Street
<input checked="" type="checkbox"/> Email	Nashville, TN 37203
<input type="checkbox"/> Hand	David C. Higney, Esq.
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<input type="checkbox"/> Facsimile	633 Chestnut Street, 9 th Floor
<input checked="" type="checkbox"/> Overnight	Chattanooga, TN 37450
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