

**TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE**

IN RE:)	
)	
PETITION OF TENNESSEE)	DOCKET NO. 06-00290
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)	
)	

**CONSUMER ADVOCATE’S RESPONSE TO TENNESSEE AMERICAN WATER
COMPANY’S MOTION IN LIMINE TO EXCLUDE AS INADMISSIBLE EVIDENCE
RELATED TO THE INITIAL PUBLIC OFFERING OF AMERICAN WATER WORKS**

Tennessee American Water Company (“TAWC”, “Company”) seeks to exclude practically all materials related to the Initial Public Offering (“IPO”) of American Water Works (“AWW”). In the *Motion in Limine*, TAWC relies on broad arguments under the Tennessee Rules of Evidence without expressing any degree of specificity as to how the evidence in question is irrelevant or how the Company will suffer from an “unfair prejudice” if such evidence is used at the hearing in this matter. To this end, TAWC relies strictly on legal authority which has no bearing before the Tennessee Regulatory Authority (“Authority”, “TRA”).¹

In response to TAWC’s motion, the Consumer Advocate would submit that such evidence

¹ See Section IV of this Response for the appropriate standard in determining the admissibility of evidence for administrative agencies and the TRA.

is relevant to the cost of capital and capital structure that will be determined by the Authority in this matter. Furthermore, for evidentiary and impeachment purposes, the intervenors in this docket would be unfairly prejudiced without the inclusion of the IPO related information as evidence in this proceeding. Finally, the Consumer Advocate would note that the Authority is not strictly bound in anyway by the Tennessee Rules of Evidence during the course of a contested case. Tenn.Code Ann. § 65-2-109 (1).

I. The Relevance of the IPO Related Information

Rate-making is a complex undertaking. This proceeding is made all the more complex with the unknown variables inherent in the IPO and the resulting impact on the Cost of Capital and Capital Structure. In essence, capital structure consists of ratios of debt and equity. Any potential change in debt or flow of equity that results directly or indirectly from the IPO will affect the capital structure of TAWC, thus affecting the rates paid by consumers. The proposed IPO will alter the capital structure that was set in place in the Company's prior rate case. Until the IPO is complete, some aspects of the capital structure will be unknown. The proposed IPO looms large over this rate case as the outcome of the public offering will produce an unknown stream of equity that will impact the capital structure of subsidiaries such as TAWC. In setting rates, the Authority should be unfettered in hearing all IPO related evidence presented by the parties.

TAWC has publicly acknowledged that the IPO will affect the ability of AWW to invest in TAWC.² Furthermore, TAWC has acknowledged that market conditions during the IPO may dictate as to whether Thames Water Aqua Holdings GmbH ("Thames GmbH") sells all or only a

² See TRA Docket 06-00119, *Petition of TAWC for Approval of Change in Control*, p. 5, 13 Filed 4/21/06. See Section II of this Response for more discussion.

portion of the authorized common stock.³ In the face of this uncertainty in regards to the resulting unknown affects on capital structure and cost of capital, the Consumer Advocate would submit that the IPO related materials are relevant in this matter and that the Authority must be allowed to consider such materials in setting just and reasonable rates.

The Company will likely propose a capital structure based on speculative information contained in the IPO related materials.⁴ However, the setting of “just and reasonable” rates requires more than a mathematical point, but rather an appropriate zone of reasonableness. *Southern Bell Telephone v. Tennessee Public Service Commission*, 305 S.W. 2d 640, 648 (Tenn.1957). Without the benefit of IPO related materials, the Intervenors and the Authority will have little ability to test the veracity of TAWC’s pro-forma figures and, thus, their reasonableness. Rather than limiting the review of the impact of the IPO on this matter to the two documents suggested by TAWC, the parties should be allowed to properly employ the IPO related documents in presenting and rebutting such speculative evidence before the Hearing Panel. As a basic element of rate-making, any and all evidence relating to cost of capital and capital structure should be examined by the parties and considered by the Authority.

Tennessee law has consistently approved of the examination and consideration of a wide spectrum of evidence when the Authority is conducting a rate-making proceeding. *Consumer Advocate v. TRA*, 1997 WL 92079, *3 (Tenn.Ct.App.1997) - (copy attached, Exhibit #1). This wide scope has extended from subsidiary to parent. In *Tennessee Public Service Commission v. Nashville Gas Company*, 515 S.W.2d 315, 321 (Tenn. 1977), the Tennessee Supreme Court held

³ *Id.*, p. 6, See Section II of this Response for more discussion.

⁴ See TAWC’s *Motion in Limine*, p. 1. Filed 4/11/07.

that it was proper for the Authority to look into the transactions between a parent and its subsidiary in a rate case because these transactions were necessary in determining “the proper rate base and rate structure of the [regulated] subsidiary.” Such evidentiary discretion extends to evidence that impacts rates and service. The TRA has the authority to consider all “relevant circumstances” during the course of a rate-making proceeding. *CF Industries v. Tennessee Public Service Commission*, 599 S.W. 2d 536, 543 (Tenn.1980). Thus, the Consumer Advocate would submit that the IPO related material is relevant and that the Authority is well within the realm of established law in admitting such relevant evidence under the “reasonably prudent person in the course of their affairs” standard that guides the Authority in evidentiary matters.⁵ Tenn.Code Ann. § 65-2-109(1).

II. Prior Statements of TAWC Indicate the Relevance and Probative Value of the IPO Related Documents

The relevance of the IPO in this matter and, by extension, of the IPO related documents, were in effect conceded in TAWC’s *Petition for Approval of Change in Control* in Docket 06-00119. In that docket, TAWC sought permission from the Authority for an indirect change in control that will result once the IPO is completed. In seeking approval, TAWC stated that the “proposed transaction will provide American Water with access to the public equity and debt markets in the United States, maintaining American Water’s ability to finance necessary and vital investments in the infrastructure of its subsidiaries, *including the Petitioner*”.⁶ (emphasis added).

⁵ See Section IV of this Response for the appropriate standard in determining the admissibility of evidence for administrative agencies and the TRA.

⁶ See Docket 06-00119, *Petition of TAWC for Approval of Change in Control*, p. 5, Filed 4/21/06.

TAWC has admitted in its petition in Docket 06-00119, that the IPO itself will provide TAWC's parent with the ability to finance "necessary and vital investments" for TAWC to provide water services in Tennessee. *Id.* The "necessary and vital investments" referred to by TAWC in its petition is the Company's rate base. Because, as TAWC admitted, the IPO will provide the capital resources TAWC needs to invest in rate base, the IPO is highly probative in setting rates in this proceeding. As TAWC stated in its petition in Docket 06-00119, the financing provided by the IPO comes through the "capital markets in the United States." Indeed, the new influx of financing that is generated by the IPO will have a direct impact on the capital structure, cost of capital, and, ultimately, the fair rate of return that the Authority is asked to establish in this case.

TAWC has further indicated in Docket 06-00119 that the results of the IPO are based on unknown variables. While providing a description of the proposed IPO, TAWC stated that it was the desire of Thames GmbH to sell 100% of the offered shares. The petition further stated that Thames GmbH "may not decide to sell 100% of the shares in the IPO" depending upon market conditions.⁷ This admission illustrates the unknown variables entailed in the IPO and subsequent impact on the stream of equity and on the capital structure of TAWC. Given that uncertainty, it would appear imprudent to throw out all available information related to the IPO.

By its own admissions and representations in a prior docket before the Authority, TAWC has stated that the IPO will affect the ability of the AWW to invest in TAWC and further that the extent of equity flowing from the IPO is an unknown variable based on market conditions. The IPO, therefore, is relevant to these proceedings, and the TRA should consider all of the IPO-related information in making its decision on these issues.

⁷ *Id.*, p. 6.

In granting the petition in Docket 06-00119, the Authority itself has further recognized that the IPO would alter the access of AWW to equity and debt markets and the ability of AWW to invest in the infrastructure in TAWC.⁸ As such, TAWC should be estopped from claims that the IPO related documents are irrelevant.

III. Intervenors Would be Unfairly Prejudiced if Denied the Right to Use IPO Related Evidence for Impeachment Purposes

Intervening parties taking part in contested cases before the Authority are entitled to the cross-examination of witnesses who testify and to submit rebuttal evidence. Tenn.Code Ann. § 65-2-109 (3). The exclusion of IPO related information from the course of the hearing would prevent the intervenors from attempting to impeach witnesses if their representations are contrary to those statements and data contained within the IPO related documents. Without waiving the Work Product Doctrine, including any protections concerning mental impressions, the Consumer Advocate would submit that the IPO related information contains substantive material facts that may contradict the positions of TAWC witnesses. To exclude all such documents would result in a material and unfairly prejudicial disadvantage upon the Intervenors in this contested case. Without such materials, the intervening parties would have little recourse in attempting to raise questions and issues concerning TAWC's proposed capital structure. The end all result would leave the Intervenors operating in a near vacuum in regards to the pro-forma capital structure proposed by TAWC. While TAWC has not described with specificity as to what "unfair" prejudice would be visited upon the Company if the IPO documents are not excluded from the hearing, the Consumer Advocate would state that the admission of said documents is in the public

⁸ See Docket 06-00119, *TRA Order*, p. 3, Filed 1/30/07.

interest.

In addition, there are less complex considerations for denying TAWC's *Motion in Limine*. As a practical matter at the hearing, excluding IPO related documents could place the expert witnesses of the Consumer Advocate in an awkward position during cross-examination. Being sworn under oath, if a Consumer Advocate witness is asked a question which truthfully requires an answer that references and includes information from excluded IPO materials, then the witness must answer truthfully and honestly. As the Consumer Advocate does not now know what questions will be asked of its expert witnesses during cross-examination, it is unknown whether references to IPO related documents would be required by oath in response. The same scenario can equally be applied to the expert witnesses of TAWC during the course of cross-examination by the Intervenor. Put simply, the IPO related documents have presumably been examined and relied upon by all sides in their formation of each respective party's position in this case. Due to the complexity of the capital structure issue in this matter, the genie can not so easily be put back in the bottle.

IV. Statutory Law Expressly States That The TRA is Not Strictly Bound by the Tennessee Rules of Evidence

By statute, the Authority is not strictly bound by the Tennessee Rules of Evidence. Tenn.Code Ann. § 65-2-109 (1); Tenn.Code Ann. § 4-5-313(1); TRA Rules & Regulations 1220-1-2-.16(1).⁹ The Uniform Administrative Procedures Act (UAPA) as adopted by the State of Tennessee further reflects that administrative agencies are not strictly bound by the Tennessee

⁹ The Consumer Advocate would note that Tennessee case law provides that the Tennessee Rules of Evidence may govern administrative agencies in regards to the qualifications of expert witnesses to testify (Tenn.R.Evid. 702.). *Martin v. Sizemore*, 78 S.W. 3d 249, 273 (Tenn.Ct.App.2001).

Rules of Evidence. Tenn.Code Ann. § 4-5-313(1). The proper standard for determining the admissibility of evidence during a contested case before the Authority is laid out in Tenn.Code Ann. § 65-2-109 (1);

The authority shall not be bound by the rules of evidence applicable in a court, ***but it may admit and give probative effect to any evidence which possesses such probative value as would entitle it to be accepted by reasonably prudent persons in the conduct of their affairs***; provided, that the authority shall give effect to the rules of privilege recognized by law; and provided further, that the authority may exclude incompetent, irrelevant, immaterial or unduly repetitious evidence; (emphasis added).

In determining the admissibility of evidence and in applying a reasonably prudent person standard, administrative agencies are permitted to consider evidence under the liberal practice of administrative agencies that may be excluded in a chancery or circuit court. *Consumer Advocate v. TRA*, 1997 WL 92079, *3 (Tenn.Ct.App.1997) - (copy attached, Exhibit #1). Tennessee law states that in regards to the admission of evidence before an administrative agency, almost “any matter relevant to the pending issue may be considered, provided interested parties are given adequate notice of the matter to be considered and full opportunity to interrogate, cross-examine and impeach the source of information and to contradict the information”. *Id.*

In an analysis for the admissibility of evidence under a “reasonably prudent person in the conduct of their affairs” standard, the Consumer Advocate would submit that the IPO related information is highly relevant to this proceeding. Specifically regarding the issue of capital structure and, if diligence requires, use of the IPO related materials in good faith for the impeachment of a TAWC expert witness. As such, the admission of said documents is reasonably prudent in the course of setting just and reasonable rates.

V. Response to TAWC's Arguments that Admission Would be Unfairly Prejudicial

TAWC has sought and been granted many additional protections in this matter due to the IPO information not normally granted during the course of a rate case.¹⁰ TAWC has continued to maintain that the IPO related documents are not relevant and that the company would suffer from an “unfair prejudice”. While TAWC has not articulated with specificity as to why the IPO materials are not relevant, the Consumer Advocate has clearly expressed their relevance in the setting of just and reasonable rates due to the impact on the calculation of the capital structure and for impeachment purposes.

Furthermore, the Consumer Advocate would disagree that consideration of the IPO related materials is a waste of the Authority's time. The probative value of the IPO information concerning the calculation of the capital structure illustrates the necessity of the evidence in this matter. In addition to the calculation of the capital structure, the IPO documents are all the more probative in impeaching the expert witnesses of TAWC. It should be noted that TAWC plans to offer two documents of the IPO related materials. If the veracity of the pro forma calculations are to be tested, diligence may require the Intervenors to employ IPO related materials for impeachment.

In any event, the alleged unfair prejudice that TAWC would suffer if the IPO information is admitted into evidence would be mitigated by the fact that the Directors of the Hearing Panel in this matter are endowed with experience, technical expertise and supported by an advisory staff. *CF Industries v. Tennessee Public Service Commission*, 599 S.W. 2d 536, 543 (Tenn.1980). The panel is more than qualified as the trier of both fact and law in this matter and can determine for

¹⁰ See Amended Supplemental Protective Order, Filed 3/30/2007

itself during the course of presiding over the hearing whether specific IPO documents raised by the Intervenors or TAWC are relevant to the proceeding and how much probative value to assign such documents.

While the Consumer Advocate would submit that the “reasonably prudent person in the course of their affairs” standard is the proper mechanism for the admission of evidence before the Authority, in the event the Hearing Officer employs the balancing test inherent in Tennessee Rule of Evidence 403, the IPO materials would still be admissible for issues of capital structure and impeachment. Tennessee law provides that a trial court should not exclude evidence under Rule 403 when the balance between the probative value of the evidence and the countervailing factors are fairly debatable. *White v. Vanderbilt*, 21 S.W. 3d 215, 227 (Tenn.Ct.App.1999) (cert.denied). The compelling necessity of the Intervenors far outweighs the desires and wishes of TAWC in regards to the IPO materials.

In response to TAWC’s allegation that the Consumer Advocate has attempted to undermine the *Amended Supplemental Protective Order* (“*A.S.P.Order*”), TAWC has neglected to point out that the Company was still serving the Consumer Advocate with “Highly Confidential” materials up until April 12, 2007, one day before the Final Status Conference.¹¹ The *A.S.P. Order* was issued on March 30. Since that time, the Consumer Advocate has in good faith reviewed such materials as they were served while still preparing other aspects of the rate case. In addition, the Consumer Advocate has identified in a *Notice of Intent* to use highly confidential information and furthermore supplemented the notice in a good faith effort to comply with the

¹¹ See copies of most recent cover-letters and envelopes dated 4/12/07 submitted with “Highly Confidential Materials” attached as Exhibit #2.

Hearing Officer's instructions under the *A.S.P. Order*. The Consumer Advocate's request of the Hearing Officer to allow use of additional "Highly Confidential Information" not formally noticed is grounded in the fact that diligence may require additional documents for purposes of impeachment of TAWC witnesses. The Consumer Advocate has no knowledge as to how any TAWC witness will answer any and all questions on cross-examination. Lacking in clairvoyance, the Consumer Advocate can not predict as to how an expert witness will answer every question and how such an answer may contradict any specific IPO related document.

However, the Consumer Advocate would note respectfully that the additional protections entailed in the *A.S.P. Order* are designed and employed for purposes outside the hearing room. In fact, the *A.S.P. Order* was designed to protect TAWC and AWW from improper disclosure of "Highly Confidential" documents to entities and individuals that are not approved by the Hearing Officer, have not signed a non-disclosure form and have not complied with the notice requirements for identification of individuals to TAWC.¹² The instrument does not appear in any way to extend to protecting the credibility of the expert witnesses of TAWC from impeachment. In essence, the *A.S.P. Order* serves its purpose by forbidding improper disclosure to all others not a party to it. It is designed and intended to prevent disclosure to the outside world. This purpose differs considerably from use of the "Highly Confidential" materials within the hearing in this matter among all parties and individuals that are party to the *A.S.P. Order*.¹³


¹² The *Amended Supplemental Protective Order* makes it clear that it's existence is based on the concerns of the Company in relation to federal law and the regulations of the Securities & Exchange Commission. See p.1, Footnote 1 of the *A.S.P. Order*.

¹³ The Consumer Advocate does not in any way suggest that the general provisions of *A.S.P. Order* will prematurely lapse after the hearing in this matter.

CONCLUSION

For then reasons stated herein, the Consumer Advocate respectfully requests that TAWC's *Motion in Limine* in regards to the IPO related material be denied.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read "Ryan McGehee", is written over a horizontal line.

Ryan L. McGehee, B.P.R. # 025559
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CERTIFICATE OF SERVICE

I hereby certify that on April 16, 2007, a copy of the foregoing is being forwarded via electronic mail and U.S. mail, to:

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on this the __ day of April, 2007.



Ryan L. McGehee

106198

Exhibit 1

Westlaw.

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Tennessee Consumer Advocate v. Tennessee
 Regulatory Authority
 Tenn.App., 1997.

Only the Westlaw citation is currently available.
 SEE COURT OF APPEALS RULES 11 AND 12

Court of Appeals of Tennessee, Middle Section, at
 Nashville.

TENNESSEE CONSUMER ADVOCATE,
 Plaintiff/Appellant,
 v.

TENNESSEE REGULATORY AUTHORITY
 AND UNITED CITIES GAS COMPANY,
 Defendant/Appellee.
 March 5, 1997.

Appeal from the Davidson County Tennessee
 Public Service Commission, at Nashville,
 Tennessee.

Charles W. Burson, Attorney General & Reporter,
 L. Vincent Williams, Consumer Advocate Division,
 Nashville, for Plaintiff/Appellant.
 H. Edward Phillips, III, Tennessee Regulatory
 Authority, Nashville, for Defendant/Appellee.

OPINION

TODD, Presiding Judge.

*1 The petitioner, Tennessee Consumer Advocate, has petitioned this Court for review of administrative decisions of the Tennessee Public Services Commission pursuant to T.R.A.P. Rule 12. By order entered by this Court on October 3, 1996, the review is limited to an order entered by the Commission on May 3, 1996. However, the circumstances stated hereafter require reference to an order previously entered by the Tennessee Public Service Commission on May 12, 1995.

The Parties.

Prior to June 30, 1996, the Public Service

Commission controlled the charges of public utilities in Tennessee. On June 30, 1996, the Public Service Commission was discontinued by enactment of the Legislature which created the Tennessee Regulatory Commission which has been substituted for the Public Service Commission in proceedings before this Court.

By T.C.A. § 65-4-118, the Consumer Advocate Division of the Office of Attorney General and Reporter may with the approval of the Attorney General and Reporter appear before any administrative body in the interests of Tennessee consumers of public utility services.

United Cities Gas Company is a public utility which purchases and distributes natural gas through its pipelines to patrons in parts of Tennessee.

The Administrative Proceedings.

On January 20, 1995, United filed with the Public Utilities Commission (hereafter P.S.C.), an application for approval of a scheme of variable rates based upon the wholesale price of gas purchased from suppliers.

P.S.C. granted leave to the Consumer Advocate to intervene.

On May 12, 1995, the P.S.C. entered an order approving the proposed scheme on condition that an independent consultant be engaged to review the "mechanism" and report to the commission annually.

On October 31, 1995, United Gas submitted to the Commission for approval, a contract with Consulting & Systems Integration, providing that the work was to be performed by a Mr. Frank Creamer. Subsequently, United Gas requested that Anderson Consulting be substituted for Consulting Systems because Mr. Creamer had severed his connection with Consulting Systems and affiliated

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with Anderson.

The May 3, 1996, order of the Commission, which is the subject of this appeal, approved the contract with Anderson Consulting and thereby satisfied all of the conditions for activation of the rate plan conditionally approved in the May 12, 1995 order.

On appeal, the Consumer Advocate presents ten issues for review. Only those which relate to the May 3, 1996, order will be considered.

The appellant's fourth, fifth, sixth and seventh issues are:

IV. The commission's action violated statutory provisions, was asked upon unlawful procedure, was arbitrary and capricious, or was clear error when it took judicial notice of a report prepared by a consultant of UCG.

V. The Consumer Advocate was denied an opportunity to be heard as to the propriety of taking judicial notice of the report.

VI. The Consumer Advocate division was not notified of the material noticed and afforded an opportunity to contest and rebut the facts or material so noticed.

*2 VII. A decision of the Tennessee Public Service Commission is void or voidable when agency members receive aid from staff assistants, and such persons received ex parte communications of a type that the administrative judge hearing officer or agency members would be prohibited from receiving, and which furnish, augment, diminish or modify the evidence in the record in violation of Tenn.Code Ann. § 4-5-304(b).

At a hearing before the Commission on February 3, 1996, the following occurred:

Mr. Irion: We have the independent consultant here. Does the Commission wish to hear from him?

Chairman: I think what we have agreed to is just summarize his testimony.

Mr. Williams: He has not made any testimony, and-

Mr. Irion: He has only filed a report, and he is not technically our witness or-

Mr. Williams: I think he is their witness. They chose him and paid for him. We did not have any

choice. The Consumer Advocate was not given any choice in the matter who was going to be the witness.

Chairman: The Commission can take judicial notice of that, that record. That's our record.

Com. Hewlett: This is our consultant.

Mr. Hal Novak: That's correct, sir. The Commission staff chose this consultant.

Chairman: We can take judicial notice of that and it can referred to in your argument here.

Mr. Williams: I would say that the Commission staff approved the consultant after the company selected the consultant.

Mr. Novak: That's not true, sir.

Chairman: Well, now wait a minute now, fellows.

We can take judicial notice, and will take judicial notice of all our records and reports like that to the Commission and you can refer to that in your argument.

Mr. Williams: What I would also like to do, Commissioner, maybe we need to have a longer period of time. I would like to know what the staff's position-it was indicated that the staff had a position that the rule operated effectively, that the Commissioners had obviously heard and were considering. I would like disclosure under the statute of the staff's position on why they think that it operates correctly.

Com. Hewlett: Well, that would be in my way of thinking not impossible to get into the record, but very difficult it is most appropriate, as I understand the law, for us to discuss without technical staff.

That's the reason that the Consumer Advocate Division was created because of the ex parte concerns of when our staff were parties to the case and when they are not. Our staff, as I understand it, it not a party to this case, and they are a resource for us for analyzing anything that is before this Commission. In this case this situation. So, I think you are trying to make a party to the case somebody that is not.

Mr. Williams: No, sir, what we are trying to do is get all the salient information on the record. The statute explicitly, the UAPA explicitly requires that the Commission disclose when it has any of the position papers that are presented by the staff, and the Public Records Act does not prevent the disclosure of those items either.

*3 Chairman: We will rule on that at the beginning

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of the meeting at 1:30.

Mr. Williams: Okay.

Chairman: Well, we will evaluate that with our legal counsel, and rule on it before issuing an order or in the order in this manner.

The record of proceedings clearly indicates that the Commission considered a report of an expert despite the objections of the Consumer Advocate and his efforts to impeach the report by cross-examination of the expert. T.C.A. § 65-2-109(1) and (2), authorize the consideration of a broad spectrum of evidence. However, no authority is cited to empower the Commission to deny a protesting party access to all evidence considered by the Commission and opportunity to impeach it by cross-examination of the origin of such evidence.

The issue of consideration of documents and/or communications is not an issue of "judicial notice" or "administrative notice," but an issue of admissibility of evidence and procedural fairness in respect to notice of the matter to be considered and opportunity to cross-examine, or impeach the source or contradict the evidence to be considered.

It is elementary that administrative agencies are permitted to consider evidence which, in a court of law, would be excluded under the liberal practice of administrative agencies. Almost any matter relevant to the pending issue may be considered, provided interested parties are given adequate notice of the matter to be considered and full opportunity to interrogate, cross-examine and impeach the source of information and to contradict the information.

No error is found in the consideration of informal forms of communication. However, error is found in the failure to give timely notice of the communication with opportunity to question, cross-examine and impeach the source and contradict the information.

As illustrated by the above quotation from the record, the Commission was unfamiliar with basic rules of fairness in an administrative hearing.

Tenn.Code Ann. § 4-5-312(b)

Procedure of hearing. To the extent necessary for full disclosure of all relevant facts and issues, the administrative judge or hearing officer shall afford to all parties the opportunity to respond, present evidence and argument, conduct cross-examination, and submit rebuttal evidence, as restricted by a limited grant of intervention or by the pre-hearing order. (Emphasis added.)

Tenn.Code Ann. § 4-5-313(6)

Parties must be notified before or during the hearing, or before the issuance of any initial or final order that is based in whole or in part on facts or material noticed, of the specific facts or material noticed and the source thereof, including any staff memoranda and data, and be afforded an opportunity to contest and rebut the facts or material so noticed.

Tenn.Code Ann. § 4-5-304(a)(b)

Ex parte communications.

(a) Unless required for the disposition of ex parte matters specifically authorized by statute, an administrative judge, hearing officer or agency member serving in a contested case proceeding may not communicate, directly or indirectly, regarding any issue in the proceeding, while the proceeding is pending, with any person without notice and opportunity for all parties to participate in the communication.

*4 (b) Notwithstanding subsection (a), an administrative judge, hearing officer or agency member may communicate with agency members regarding a matter pending before the agency or may receive aid from staff assistants, members of the staff of the attorney general and reporter, or a licensed attorney, if such persons do not receive ex parte communications of a type that the administrative judge, hearing officer or agency members would be prohibited from receiving, and do not furnish, augment, diminish or modify the evidence in the record. (Emphasis added.)

This Court concludes that the Commission committed a violation of basic principles of fairness in failing to afford the Consumer Advocate reasonable access to the materials to be considered

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and reasonable opportunity to cross-examine or otherwise impeach the origin of such materials..

For the foregoing reasons, the order entered by the Public Service Commission on May 3, 1996, is reversed, vacated, and the cause is remanded to the Tennessee Regulatory Authority for such further proceedings and actions as it may deem appropriate including a reconsideration of the subject of the May 3, 1996, order of the Public Service Commission.

Should the Regulatory Authority reach a conclusion different from that expressed in the May 3, 1996, order of the Commission, the way may be opened for a further consideration of the subject matter of the May 26, 1995, order, in which event the authority will be free to examine the merits of the order and the proposal dealt with therein.

Of particular interest and concern are the propriety of omitting certain income from considering "fair return," of "rewarding" utility for keeping its expenses at the minimum, and of utilizing the services of an expert employed by the utility. These issues have not been discussed in this opinion because of the limitation of the scope of the appeal granted by this Court.

Costs of this appeal are assessed against the Tennessee Regulatory Authority.

REVERSED AND REMANDED.

CANTRELL and KOCH, JJ., concur.

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Tennessee Consumer Advocate v. Tennessee
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 (Tenn.Ct.App.)

END OF DOCUMENT

Exhibit 2

BASS, BERRY & SIMS PLC

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MEMPHIS

April 11, 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 copy of Tennessee American Water Company's Third Supplemental Response to the Consumer Advocate and Protection Division's Discovery Request Number One, Part III, Question 8. The documents attached to this Response are marked "HIGHLY CONFIDENTIAL." Please file these documents under seal pursuant to the Amended Supplemental Protective Order.

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

BASS, BERRY & SIMS PLC
A PROFESSIONAL LIMITED LIABILITY COMPANY
ATTORNEYS AT LAW

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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:

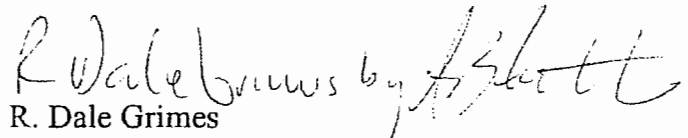
Enclosed please find an original copy of Tennessee American Water Company's First Supplemental Response to the Consumer Advocate and Protection Division's Discovery Request Number Two, Part I, Question 10 and 12. The documents attached to this Response (TAWC-HC-02000-02001) are marked "HIGHLY CONFIDENTIAL." Please file these documents under seal pursuant to the Amended Supplemental Protective Order.

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

W/permission

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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
with permission

RDG/ms
Enclosures

BASS, BERRY & SIMS PLC
Attorneys at Law

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Tennessee American Water Company's First
Supplemental Response to the Consumer Advocate
and Protection Division's Discovery Request
Number Two, Part 1, Questions 10 and 12

Highly Confidential
Docket 06-00290
April 12, 2007

HANDLED BY

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Docket 06-00290
April 12, 2007