TENNESSEE REGULATORY AUTHORITY

460 James Robertson Parkway
Nashville, Tennessee 37243-0505

May 14, 2007

Chairman Sara Kyle
Tennessee Regulatory Authority
460 James Robertson Pkwy.
Nashville, TN 37243

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 Services To Its Customers, TRA Docket 06-00290***

Dear Chairman Kyle:

Please find the attached motion that I plan to make in our scheduled hearing tomorrow in the above referenced docket. For your convenience, I am filing this today in order that you have sufficient time to review before we deliberate tomorrow.

With kindest regards, I am

Yours truly,

Pat Miller

Pat Miller

Smb
Attachment
Cc: Director Ron Jones
Docket File 06-00290

Director Miller's Motion
Docket #06-00290

Test Period and Attrition Period

I move that the Authority reject the multiple test periods utilized by the CAPD to forecast Revenues and Expenses and accept the Company's uniform test period of the twelve months ended June 30, 2006 for Revenues and Expenses, except in the instance of Insurance Other Than Group where abnormal monthly bookings were noted by the Authority.

I move that the Authority accept the test period of the twelve months ended June 30, 2006 for Rate Base components to which Tennessee American Water Company ("TAWC" or the "Company") and the CAPD agree in their projections. For Rate Base components to which there is dispute among the Parties, I move that the Authority adopt actual average thirteen month ending balances at December 31, 2006.

I move that the Authority adopt the forward looking attrition period of the twelve months ending February 29, 2008.

Revenues

I move that the Authority accept the Company's attrition period Revenue forecast at current rates of $33,432,287 as it properly takes into account normalizing adjustments for nonrecurring usage and properly matches the test period utilized by the Company.

Expenses

I move that the Authority find that an appropriately normalized test period of the twelve months ended June 30, 2006 should be used as a base to grow expenses that are forecasted to the attrition period by the application of a factor, excluding Insurance Other Than Group, since the test year contained abnormal monthly activity. Further, I move that the Authority find that the annual growth and inflation factor of 3.745% as projected by the CAPD be used to develop a proper compounded growth rate of 6.2417%.[1]

I move that the Authority find that the Salaries and Wages Expense for the attrition period is $4,673,576. This determination is based upon the Company forecast of $4,702,966. This amount reflects the Company's projected employee level and overtime reduced by the CAPD's $29,390 adjustment to incentive payroll solely attributed to the meeting of financial goals, and is consistent with the Authority's decisions in recent cases.

[1] (.0309+.00655)/12*20.

I move that the Authority adopt the Company attrition period forecast of $52,331 for Purchased Water Expense since it is based on the June 30, 2006 test period.

I move that the Authority accept the agreed upon attrition period forecast for Fuel and Power Expense of $1,734,958.
I move that the Authority accept the agreed upon attrition period forecast for Chemicals Expense of $952,795.

I move that the Authority adopt Waste Disposal Expenses for the attrition period of $174,265 to reflect the 16.5% increase in rates from the City of Chattanooga.

I move that the Authority determine that the Management Fee for the attrition period is $3,979,825. This amount is based upon the actual Management Fee booked for the twelve months ended June 30, 2006, as adjusted for: (1) non-recurring items, and (2) the annual growth/inflation factor proposed by the CAPD of 3.745% compounded for 20 months. Additionally, I move that the Authority direct TAWC to have a management audit performed in compliance with Sarbanes-Oxley requirements and to submit the audit results concurrent with any future rate case filing. This audit should determine whether all costs allocated to TAWC were incurred as a result of prudent or imprudent management decisions by TAWC's parent and should address the reasonableness of the methodology used to allocate costs to TAWC.

I move that the Authority adopt the Company's projection for Group Insurance Expense of $1,513,667 based upon the Company's projected employee level.

I move that the Authority adopt Pension Expense for the attrition period of $0 based upon the latest Actuarial Report from Towers Perrin dated August 2006[2] showing that the minimum required employer contribution is $0. This decision is consistent with the Authority's past treatment of Pension Expense.

I move that the Authority adopt the actual price out of Regulatory Expense of $269,298 as proposed by the Company.

I move that the Authority reject both the Company and CAPD projections for Insurance Other Than Group Expense due to the abnormal bookings to account # 557000 in both Parties' test periods and the failure by both Parties to normalize expenses in this account.

I move that the Authority determine that Insurance Other Than Group Expense for the attrition period is $517,911[3] based upon current monthly expense levels at October 31, 2006 and application of the CAPD growth/inflation factor properly compounded to 16 months.

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[2] Hearing Exhibit 25.
[3] The sum of current monthly expense levels at October 31, 2006 for account #557000 and #559000 of $22,880 and $5,326 respectively and the 12 month average expense at October 31, 2006 for account #558000 of $12,902 per month multiplied by 12 multiplied by the CAPD annual growth/inflation factor of 3.745% properly compounded to 16 months which equates to 1.0499.

I move that the Authority adopt Customer Accounting Expense for the attrition period of $631,581. This amount is based upon acceptance of the actual twelve months ended June 30, 2006 expense of $585,288; acceptance of the Wireless Service First normalizing adjustment of $1,361; rejection of the Company proposed postage normalization adjustment of $13,036; inclusion of a proper postage normalization adjustment of $7,826; and adoption of the annual growth/inflation factor developed by the CAPD compounded to 20 months which equates to 1.062417.

I move that the Authority adopt an Uncollectible Expense at current rates of $618,452 which is based upon the Company booked amount for the twelve months ended June 30, 2006 and a normalizing adjustment. Any incremental increase in Uncollectible Expense will be accounted for by the application of the Revenue Conversion Factor.

I move that the Authority adopt the Company forecast of Rent Expense of $38,011 since it is based upon actual results which have been properly normalized.

I move that the Authority determine that the General Office Expense for the attrition period is $201,342. This amount is based upon the Company methodology using the actual General Office Expense booked for the twelve months ended June 30, 2006 adjusted for non-recurring items and application of the annual growth/inflation factor proposed by the CAPD of 3.745% compounded for 20 months.

I move that the Authority determine that the Miscellaneous Expense for the attrition period is $1,853,556. This amount is based upon the Company methodology using the actual Miscellaneous Expense booked for the twelve months ended June 30, 2006 adjusted in the manner proposed by the Company and application of the annual growth/inflation factor proposed by the CAPD of 3.745% compounded for 20 months.

I move that the Authority determine that the Maintenance Expense for the attrition period is $778,265. This amount is based upon the Company methodology using the actual Maintenance Expense booked for the twelve months ended June 30, 2006 adjusted for the one normalizing item proposed by the Company and application of the annual growth/inflation factor proposed by the CAPD of 3.745% compounded for 20 months.

I move that the Authority adopt the CAPD forecast for Depreciation Expense of $4,936,937 originally filed in CAPD's Direct Testimony and filed by the Company in Hearing Exhibit 38. This amount is based upon more recent actual balances at December 31, 2006, includes forecasted additions and retirements provided by the Company through the attrition period, and includes depreciation associated with the Customer Information System ("E-CIS") investment.

I move that the Authority determine that the Gross Receipts Tax associated with the attrition period Revenue at current rates is $396,741. This amount is based upon gross revenues and uncollectible revenues for the attrition period at current rates, the Tennessee percentage of Entire Company Revenue of 95% and the effective Gross Receipts tax rate for the 2005 reporting period. Additionally, I move that the Authority determine that an additional Gross Receipts Tax of $51,464 be allowed on the difference between the

jurisdictional attrition period Revenue at new rates and the attrition period Revenue at current rates.

I move that the Authority determine that the TRA Inspection Fee associated with the attrition period Revenue at current rates is $63,336. This amount is based upon gross revenues and uncollectible revenues for the attrition period at current rates, the Tennessee percentage of Entire Company Revenue of 95% and the current exemption and tax rates. Additionally, I move that the Authority determine that an additional TRA Inspection Fee of $8,087 be allowed on the difference between the jurisdictional attrition period Revenue at new rates and the attrition period Revenue at current rates.

I move that the Authority determine that Property Taxes for the attrition period are $2,732,213 based on an attrition period average Rate Base of $104,282,949 and application of the effective tax rate calculated by the Company of 2.62%.[4]

I move that the Authority determine that Franchise Taxes for the attrition period are $341,840. This amount is based on the attrition period average Rate Base of $104,282,949 and application of the ratio of 2005 actual Franchise Taxes paid to the average 2005 Rate Base.

I move that the Authority find that FICA Tax for the attrition period is $350,242. This amount is based on the Company forecasted FICA Tax of $352,445 adjusted for the .625%[5] reduction for incentive payroll solely attributed to the meeting of financial goals as proposed by the CAPD.[6]

I move that the Authority find that Unemployment Tax for the attrition period is $7,300. This amount is based on the Company forecasted Unemployment Tax of $7,346 adjusted for the .625%[7] reduction for incentive payroll solely attributed to the meeting of financial goals as proposed by the CAPD.[8]

I move that the Authority find that Excise Tax for the attrition period is $172,194. This amount is based upon forecasted results from operations at current rates for the attrition period determined in this case, adjusted for interest expense and permanent differences and application of the statutory tax rate of 6.5%.

I move that the Authority find that Federal Income Tax for the attrition period is $790,562. This amount is based upon forecasted results from operations at current rates for the attrition period determined in this case, adjusted for interest expense, permanent differences, excise tax and ITC amortization and application of the statutory tax rate of 35%.

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[4] Company response to TRA Minimum Filing Guidelines, Item 13, TN-TRA-01-Q013-GENERAL TAXES, p. 30 of 130.

[5] 29,390 / 4,702,966.

[6] 352,445 – ((352,445 * (29,390 / 4,702,966)) = 350,242.

[7] 29,390 / 4,702,966.

[8] 7,346 – ((7,346 * (29,390 / 4,702,966)) = 7,300.

I move that the Authority determine that the proper Allowance for Funds Used During Construction (AFUDC) is $123,261 based upon the actual 12 month-to-date amount reported on the December 2006 TRA Monthly 3.06 Surveillance Report.

Net Operating Income

I move that the Authority find that based upon the preceding determinations Net Operating Income is $5,774,350 for the attrition period based upon current rates.

Rate Base

I move that the Authority reject the CAPD exclusion of the E-CIS investment from Rate Base on the grounds that E-CIS provides benefit to TAWC customers. As a customer service tool, E-CIS was implemented at a reasonable cost. Inclusion of E-CIS costs is reasonable and consistent with costs incurred for such customer information systems. I move that the Authority adopt the CAPD's attrition period forecast for average Utility Plant in Service of $189,828,780 as originally filed in Direct Testimony since it is based on the most current information available. For comparative purposes, the Utility Plant Capital Lease of $1,590,500, which the CAPD included in Utility Plant in Service rather than as a separate Rate Base line item, has been removed from the Utility Plant in Service and shown as a separate Rate Base addition.

I move that the Authority accept the CAPD's use of the December 31, 2006 Construction Work in Progress ("CWIP") of $1,580,421 balance since it mirrors the starting point used by the CAPD to project Plant in Service.

I move that the Authority adopt the Company attrition period forecast for Utility Plant Capital Lease of $1,590,500 which the CAPD included in Utility Plant in Service rather than as a separate Rate Base line item.

I move that the Authority accept the agreed upon attrition period forecast for Net Limited-Term Utility Plant of $(20,953).

I move that the Authority accept the original agreed upon attrition period forecast for Working Capital of $962,583 since the Company's late filed revisions were unsupported.

I move that the Authority adopt the CAPD's attrition period forecast for average Accumulated Depreciation of $54,713,939 as originally filed in CAPD's Direct Testimony since it is based on the most current information available and it includes the Accumulated Depreciation associated with the E-CIS investment.

I move that the Authority accept the agreed upon attrition period forecast for Accumulated Amortization of Utility Capital Lease of $980,808.

I move that the Authority accept the agreed upon attrition period forecast for Accumulated Deferred Income Taxes of $18,833,369.

I move that the Authority accept the agreed upon attrition period forecast for Customer Advances for Construction of $5,593,604.

I move that the Authority accept the agreed upon attrition period forecast for Contributions in Aid of Construction ("CIAC") of $7,946,162.

I move that the Authority adopt the CAPD's average attrition period balance of $0 for Unamortized Investment Tax Credit ("ITC") since the Company reduces its Federal Income Tax Expense by the total amount of the ITC amortization.

<u>Revenue Conversion Factor</u>

I move that the Authority adopt the methodology used by the CAPD to calculate the Revenue Conversion Factor, as well as the Forfeited Discount Factor of 0.0113, a State Excise Tax Factor of 0.065, and a Federal Income Tax Factor of 0.35 as proposed by the CAPD. I move that the Authority adopt the Uncollectible Factor proposed by the Company of 0.01277.[9] I move that the Authority find that the appropriate Revenue Conversion Factor for use in this case is 1.648074. Additionally, I move that the Authority adopt the Company position regarding the application of the Gross Receipts Tax Factor, State Excise Tax rate and FIT rate to the amount of the calculated Revenue Deficiency based on Revenues at current rates. I also move that the Authority include the TRA Inspection Fee incremental rate of .2% in its calculation of the Revenue Increase since this fee would also be paid on the amount of the Revenue Increase.

<u>Rate of Return</u>

I move that Tennessee American's rate of return be set using a double leveraged capital structure. To implement the double leverage methodology, I move setting the portion of Tennessee American's capitalization held by parties outside the American Water Works system to be 14.787% and costing 7.6%. For Tennessee American's parent, I move a capital structure comprised of 45% equity and 55% debt with debt costing 6.1% and an equity return of 10.2% resulting in an overall rate of return of 7.89% for Tennessee American.

The pending Initial Public Offering of American Water has been extensively discussed in this case. To monitor compliance with the representations made concerning the parent's capital structure, I move that, consistent with agreements made in other states, Tennessee American shall promptly notify the TRA if its parent's equity ratio falls below 45%.

<u>Revenue Deficiency</u>

I move that the Authority find that based upon the preceding determinations the Revenue Deficiency is $4,079,865 for the attrition period.

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[9] Company Data Response TN-TRA-01-Q013-Uncollectibles, p. 1 of 9.

Rate Design

I move that the Authority adopt a rate design based upon across-the-board uniform increases to base rates and volumetric rates for all customer classes to address the revenue deficiency stated above. The Company's proposed tariff should be denied. The Company should file a new tariff within thirty (30) days with new rates sufficient to produce the incremental revenues in the amount of the revenue deficiency cited above. The tariff filing must be accompanied by a detailed price out demonstrating that the new rates, based upon attrition year billing determinates, produce incremental revenues in the amount of the revenue deficiency determined above when compared to attrition year billing determinates at current rates. Uncollectible revenues, forfeited discounts and taxes have been accounted for in the Authority's determined revenue deficiency.