

BEFORE THE

In the Matter of the Application of)
TENNESSEE-AMERICAN WATER CO.) Docket 08-00039
Petition to Change and Increase Certain)
Rates for Water Service)

DIRECT TESTIMONY OF

ON BEHALF OF THE

July 14, 2008

Table of Contents

Introduction	1
Prior Experience	2
Subject and Purpose of Testimony	2
Background	4
Sarbanes-Oxley	5
BAH Report	6
Booz Allen Audit Does Not Comply With SOX	8
Baryenbruch Report	10
BAH Report Did Not Test for Prudence or Reasonableness	10
Other Report Failings	11
Management Audits	11
Summary	12

1 **Introduction**

2 **Q. State your name, position, and business address.**

3 A. My name is Michael J. Majoros, Jr. I am Vice President of Snavelly King Majoros
4 O'Connor & Bedell, Inc. ("Snavelly King"), located at 1111 14th Street, N.W., Suite
5 300, Washington, D.C. 20005.

6 **Q. Describe Snavelly King.**

7 A. Snavelly King is an economic consulting firm founded in 1970 to conduct
8 research on a consulting basis into the rates, revenues, costs and economic
9 performance of regulated firms and industries. We have a professional staff of
10 12 economists, accountants, engineers and cost analysts. Most of our work
11 involves the development, preparation and presentation of expert witness
12 testimony before Federal and state regulatory agencies. Over the course of our
13 37-year history, members of the firm have participated in more than 1,000
14 proceedings before almost all of the state commissions and all Federal
15 commissions that regulate utilities or transportation industries.

16 **Q. Have you prepared a summary of your qualifications and experience?**

17 A. Yes, Appendix A is a summary of my qualifications and experience. Appendix B
18 contains a tabulation of my appearances as an expert witness before state and
19 Federal regulatory agencies.

20 **Q. For whom are you appearing in this proceeding?**

21 A. I am appearing on behalf of the City of Chattanooga.

22

1 **Prior Experience**

2 **Q. Do you have any specific experience in the public utility field?**

3 A. Yes, I have been in the field of public utility regulation since the late 1970's. My
4 testimony has encompassed numerous complex issues – including mergers,
5 transfers, affiliate transactions and inter-company allocations.

6 **Q. Does your experience specifically include water utilities?**

7 A. Yes, I have appeared as an expert in several water utility proceedings.

8 **Subject and Purpose of Testimony**

9 **Q. What is the subject of your testimony?**

10 A. I am addressing the level of administrative charges and fees imposed on TAWC
11 by its parent, American Water Works Company ("AWC"). In particular, this
12 testimony addresses Joe Van den Berg's Audit Report relating to the American
13 Water Works Service Company ("AWWSC"). I will address whether the audit
14 complies with the Tennessee's Regulatory Authority's ("TRA" or "Commission")
15 mandate for a management audit performed in compliance with Sarbanes-Oxley
16 requirements to determine whether all costs allocated to TAWC were incurred as
17 a result of prudent or imprudent management decisions by TAWC's parent, and
18 the reasonableness of the methodology used to allocate costs to TAWC.¹ I will
19 also address the usefulness of this report for ratemaking purposes.

20 **Q. What do you conclude?**

21 A. My testimony presents the results of my review and analysis of Mr. Van den
22 Berg's report (the "BAH Report"). I conclude that Mr. Van den Berg did not

¹ Docket No. 06-00290 Order, June 10, 2008 ("Order"), pages 26-27.

1 conduct an audit in compliance with Sarbanes-Oxley requirements. I conclude
2 that Mr. Van den Berg did not address whether all costs allocated to TAWC were
3 incurred as a result of prudent or imprudent management decisions by the parent
4 of the Petitioner, Tennessee American Water Company ("TAWC") as the TRA
5 ordered. I also conclude that the Authority should not rely on the BAH Report as
6 a basis to determine the necessity or the reasonableness of AWWSC's costs
7 allocated and assigned to TAWC. Finally, I recommend disallowance of all costs
8 related to the BAH Report and all AWWSC management fees and allocated
9 costs until the originally specified audit is conducted and examined in a later
10 proceeding.

11 **Q. What did you do to prepare yourself to submit this testimony?**

12 A. I read Mr. Van den Berg's testimony and studied his Exhibit. I reviewed
13 responses to various data requests. I reviewed Public Law 107-204 - the
14 "Sarbanes-Oxley Act of 2002" which is attached as Exhibit____ (MJM-1) to my
15 testimony. I reviewed Patrick L. Baryenbruch's prefilled testimony, exhibits and
16 transcripts in Docket No. 06-00290. I reviewed Director Miller's May 14, 2007
17 letter to Chairman Kyle setting-forth the Motion he intended to introduce at the
18 next day's hearing. I also reviewed the transcript of the May 15, 2007 hearing in
19 which Director Miller introduced his Motion. Finally, I reviewed the Authority's
20 June 10, 2008 Order in Docket No. 06-00290. Director Miller's letter, the May 15,
21 2007 transcript, and the June 10, 2008 Order are attached as collective
22 Exhibit____ (MJM-2).

1 **Background**

2 **Q. What is the background of your testimony?**

3 A. TAWC includes \$4.3 million in its revenue requirement for management fees and
4 service company charges. This has long been an area of concern for ratepayers.
5 For example, in 1996 the management fees and service company charges were
6 only \$1.3 million.² In Docket No. 06-00290 TAWC was granted \$3.9 million, and
7 has requested rates in this proceeding based on a further 10 percent increase.
8 In Docket No. 06-00290, TAWC submitted Mr. Baryenbruch's testimony and
9 exhibits, which purported to demonstrate the necessity and reasonableness of
10 the charges submitted in that proceeding. Mr. Baryenbruch conceded that his
11 study was not an audit and that he did not bore into the numbers and the process
12 to collect the numbers, he merely accepted numbers provided to him and then
13 compared those numbers to other benchmarks he had accumulated.³ The
14 benchmarks were not water industry benchmarks, rather they related to other
15 industries. The TRA Order accepted a certain amount of TAWC's requested
16 charges but ordered TAWC to complete a management audit performed in
17 compliance with Sarbanes-Oxley requirements.

18 **Q. Why do you conclude that TRA desired a Sarbanes-Oxley audit to**
19 **determine the prudence, necessity and reasonableness of these charges?**

20 A. Director Miller's May 15, 2007 Motion clearly spelled-out the requirement for an
21 audit conducted in conformance with Sarbanes-Oxley requirements. The Motion
22 was incorporated into the June 10, 2008 Order. Clearly, the TRA desired a

² Docket No. 06-00290, April 18, 2007 Transcript, page 18.

³ Id., page 52.

comprehensive audit in conformity with rigid standards. TRA did not order completion of a comparison of AWWSC's costs to electric utility costs. Rather, it ordered a management audit performed in compliance with Sarbanes-Oxley requirements and ordered that the audit was to determine whether all costs allocated to TAWC were incurred as a result of prudent or imprudent management decisions by TAWC's parent. The audit was also to address the reasonableness of the methodology used to allocate costs to TAWC.⁴

Q. What are the benefits of adherence to Sarbanes-Oxley?

A. Compliance with Sarbanes-Oxley requirements determines whether the Company has internal controls in place designed to ensure that the reported costs are accurate, and accurately classified and meet the required attributes, i.e. prudence and reasonableness. That is because Sarbanes-Oxley places a heavy emphasis on audit testing, internal controls and accountability. It also requires management attestation to the propriety of the costs at issue.

Sarbanes-Oxley

Q. What is Sarbanes-Oxley?

A. Sarbanes-Oxley ("SOX") is an Act co-authored by Senator's Sarbanes and Oxley and signed into law by President George W. Bush. It emanates from the ENRON and other corporate scandals in early part of President Bush's first term. SOX requires detailed audits by independent certified public accountants. The purpose of this law is "To protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws and for

⁴ June 10, 2008 Order.

1 other purposes.”⁵

2 **Q. What is the primary thrust of SOX?**

3 A. Independent tests of internal controls in place in accordance with a set of
4 professional standards in order to express an independent opinion on
5 management’s financial statements.

6 **Q. How does SOX define an audit?**

7 A. SOX defines an audit as:

8 An examination of the financial statements of any issuer by
9 an independent public accounting firm in accordance with
10 the rules of the Board or the Commission (or, for the period
11 preceding the adoption of applicable rules of the Board
12 under section 103, in accordance with then-applicable
13 generally accepted auditing and related standards for such
14 purposes), for the purpose of expressing an opinion on such
15 statements.⁶
16

17 **BAH Report**

18 **Q. Please describe and summarize Mr. Van den Berg’s report and the process**
19 **BAH used to arrive at its conclusions.**

20 A. Even though the TRA specified an audit performed in compliance with Sarbanes-
21 Oxley requirements, and Mr. Van den Berg recognizes that requirement on page
22 2 of his testimony, he states at the beginning of the same paragraph that TAWC
23 “retained Booz Allen to provide an independent assessment of the costs incurred
24 by AWWSC that are subject to potential allocation to TAWC.”⁷ Mr. Van den Berg

⁵ Exhibit___(MJM-1), Preamble

⁶ SOX Section 2(a) (2).

⁷ Van den Berg Testimony, page 2.

1 does not identify his assignment as an audit, let alone an audit performed in
2 compliance with Sarbanes-Oxley requirements.

3 **Q. Did Mr. Van den Berg conduct an audit?**

4 A. No, Mr. Van den Berg did not conduct an audit; he conducted an assessment
5 described in Figure 1-1 of his report. The figure, titled "Approach to Analysis",
6 clearly demonstrates that Mr. Van den Berg did not complete a management
7 audit in compliance with Sarbanes-Oxley requirements. Mr. Van den Berg does
8 not mention Sarbanes-Oxley in his Approach to Analysis. While Mr. Van den
9 Berg discusses his review of AWWSC's budget process, he does not state that
10 the system in place as described to him by Company managers is functioning
11 properly, nor does he describe the controls in place to insure compliance, nor
12 does he provide any objective basis, such as audit test work, for his opinions.
13 Mr. Van den Berg's report discusses how AWWSC described its process, but
14 provides no indication of whether it is working properly.

15 Mr. Van den Berg also describes his benchmark comparison of AWWSC
16 fees and charges against certain electric utilities. The BAH Report does not use
17 readily available benchmarking data for water utilities. The TRA is no better off
18 than it was in Docket No. 06-00290, when it reviewed the Baryenbruch report,
19 which used a similarly flawed methodology, and found it necessary to order a
20 management audit conducted in conformity with SOX requirements.

21 **Q. Should the cost of the BAH Report be disallowed?**

22 A. In my opinion, AWWSC should not have paid for this report, none of its cost
23 should be assigned to ratepayers, TAWC should not have submitted this report

1 to the TRA, and TAWC should be required to have a real Sarbanes-Oxley audit
2 completed before management fees or allocations are charged to TAWC's
3 ratepayers.

4 **Booz Allen Audit Does Not Comply With SOX**

5 **Q. Why do you conclude the Booz Allen Report does not comply with SOX**
6 **requirements?**

7 A. I will summarize the BAH failings based on what I believe are the more salient
8 requirements.

- 9 • BAH is not an independent public accounting firm.⁸
- 10 • BAH did not conduct an "audit" as specified by SOX.⁹
- 11 • BAH did not conduct an audit in conformity with or even cite to the rules of the
12 Public Company Accounting Oversight Board.¹⁰
- 13 • BAH did not cite to professional standards and did not comply with stringent
14 standards SOX requires.¹¹
- 15 • BAH report did not include a concurring or second partner review and
16 approval of such report.¹²
- 17 • BAH Report did not contain any management attestations.¹³
- 18 • BAH Report is not independent, it was reviewed and edited by
19 management.¹⁴

⁸ SOX 2.(a)(2).

⁹ Id.

¹⁰ Id.

¹¹ Id., and 2.(a)(10), and Section 103.

¹² SOX Section 103.

¹³ SOX Title 3.

¹⁴ SOX 2.(a)(2).

- 1 • BAH report did not describe the scope of the auditor's testing of the internal
2 control structure and procedures required by section 404(b) Internal Control
3 Evaluation and Reporting.¹⁵
- 4 • BAH Report did not present the findings of the auditor from such testing.¹⁶
- 5 • BAH Report did not provide an evaluation of whether AWWSC's internal
6 control structure and procedures include maintenance of records that in
7 reasonable detail accurately and fairly reflect the transactions reported to
8 BAH by AWWSC.¹⁷
- 9 • BAH Report did not provide an evaluation of whether such internal control
10 structure and procedures provide reasonable assurance that transactions are
11 recorded as necessary to permit calculation of costs conforming to TRA
12 requirements, and that receipts and expenditures underlying those costs are
13 being made only in accordance with authorizations of management and
14 directors in conformance with TRA rules.¹⁸
- 15 • BAH Report did not contain a description, at a minimum, of material
16 weaknesses in such internal controls, and of any material noncompliance
17 found on the basis of such testing.¹⁹

¹⁵ SOX 103(a)(2)(A)(iii)

¹⁶ SOX 103(a)(2)(A)(iii)(I)

¹⁷ SOX 103(a)(2)(A)(iii)(II)(aa)

¹⁸ SOX 103(a)(2)(A)(iii)(II)(bb) with modifications

¹⁹ SOX 103(a)(2)(A)(iii)(III)

1 **Baryenbruch Report**

2 **Q. Please compare Mr. Van den Berg's study with Mr. Baryenbruch's findings**
3 **in Docket 06-00290.**

4 A. In my opinion, Mr. Van den Berg's study is merely an expansion of the type of
5 study Mr. Baryenbruch submitted in Docket No. 06-00290. In both cases, the
6 authors seek to justify costs for a water utility by comparing them to costs
7 reported by electric utilities. That type of study lead to the TRA's directive to
8 have an "audit performed in compliance with Sarbanes-Oxley requirements."

9 **BAH Report Did Not Test for Prudence or Reasonableness**

10 **Q. How did the BAH report address prudence and reasonableness?**

11 A. Mr. Van den Berg states that he "used both quantitative and qualitative
12 assessments to establish a comprehensive framework within which the
13 'prudency' of activities and related costs could be determined."²⁰

14 **Q. Did the BAH Report establish whether all costs allocated to TAWC were**
15 **incurred as a result of prudent or imprudent management decisions?**

16 A. No. BAH conducted an assessment based on a framework he developed using
17 information provided by the Company and electric utility statistics. Based on my
18 review of Mr. Van den Berg's testimony and Exhibit, I conclude he did not
19 specifically determine and apply definitions of prudence, imprudence or
20 reasonableness, and he did not determine or verify that AWWSC's internal
21 controls were designed to catch imprudent costs. Hence, Mr. Van den Berg's
22 conclusions are subjective. I did not see any reference to actual testing of

²⁰ Van den Berg Testimony, page 3.

1 whether all costs were incurred as a result of prudent or imprudent management
2 decisions. Nor did I find any evidence of an analysis to determine whether
3 AWWSC's internal control system would catch excessive and imprudent costs
4 resulting from imprudent management decisions.

5 **Other Report Failings**

6 **Q. Why do you conclude the TRA should not use the Booz Allen report as a**
7 **basis to judge the reasonableness of AWWSC's allocated and assigned**
8 **costs to TAWC?**

9 A. In addition to its other failings, Mr. Van den Berg compared benchmarks to
10 electric industry statistics when he could have used water industry statistics.

11 **Management Audits**

12 **Q. Although BAH did not conduct an audit in compliance with SOX**
13 **requirements, does Mr. Van den Berg's report resemble other management**
14 **audits with which you are familiar?**

15 A. No, I have reviewed several management audit reports in the past, and in fact, I
16 participated in a management audit conducted by the Kentucky Public Service
17 Commission. I have reviewed management audits conducted by other
18 jurisdictional agencies, the Pennsylvania Public Service Commission for
19 example. Mr. Van den Berg's report does not resemble any of those other
20 management audits in either scope or findings.

21 **Q. Can you provide an example of a management audit?**

22 A. Yes, the Pennsylvania Public Service Commission conducted a management
23 audit of TAWC's sister company, the Pennsylvania American Water Company

1 ("PAWC"). I have attached a copy of the audit report as Exhibit___ (MJM-3).²¹

2 All one must do is examine and contrast that report with the BAH report to realize
3 that BAH did not conduct a management audit.

4 **Q. Did the Pennsylvania Public Service Commission conduct the PAWC audit**
5 **in compliance with SOX?**

6 A. No, SOX was not a law, or even in the works at the time.

7 **Q. Do you believe that a requirement to conduct an audit complying with SOX**
8 **to determine whether all costs allocated to PAWC were incurred as a result**
9 **of prudent or imprudent management decisions by PAWC's parent and the**
10 **reasonableness of the methodology used to allocate those costs would**
11 **have had a measurable impact on the PAWC management audit report?**

12 A. Absolutely, the report would have been more detailed, focusing on the controls in
13 place and whether they were working in such a way as to have confidence in the
14 results. The report would also include management's sworn attestations as to
15 the propriety, prudence and reasonableness of those allocated costs.

16 **Summary**

17 **Q. Please summarize your testimony.**

18 A. BAH did not conduct a management audit in compliance with Sarbanes-Oxley
19 requirements to determine whether all costs allocated to TAWC were incurred as
20 a result of prudent or imprudent management decisions by TAWC's parent and
21 the reasonableness of the methodology used to allocate costs to TAWC, as TRA
22 specified in Docket No. 06-00290. The BAH Report is merely an expansion of

²¹ Although TAWC classifies this report as "Confidential," I am using the unconfidential version I obtained in discovery in the current Pennsylvania Docket No. R-2008-232689.

1 the type of study Mr. Baryenbruch submitted in Docket No. 06-00290 which led to
2 the TRA's Sarbanes-Oxley requirement. BAH did not conduct audit test work of
3 specific transaction to determine if they were the result of prudent or imprudent
4 management decisions. Nor did he determine or verify if AWWSC's internal
5 controls were designed to catch imprudent and unreasonable costs. The BAH
6 Report is not useful for ratemaking purposes. None of the costs of the BAH
7 Report should be charged to ratepayers in anyway. Furthermore, I recommend
8 disallowance of all AWWSC management fees and allocated costs until the
9 originally specified audit is conducted and examined in a later proceeding.

10 **Q. Does this conclude your testimony?**

11 **A.** Yes, it does.

**.IN THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE**

IN RE:)
)
PETITION OF TENNESSEE AMERICAN)
WATER COMPANY TO CHANGE AND)
INCREASE CERTAIN RATES AND)
CHARGES SO AS TO PERMIT IT TO EARN)
A FAIR AND ADEQUATE RATE OF)
RETURN ON ITS PROPERTY USED AND)
USEFUL IN FURNISHING WATER)
SERVICE TO ITS CUSTOMERS)

Docket No. 08-00039

**AFFIDAVIT OF
MICHAEL J. MAJOROS, JR.**

Washington, :
District of Columbia :

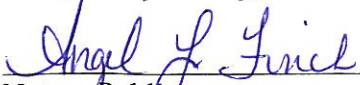
BEFORE ME, the undersigned authority, duly commissioned and qualified in the State and County aforesaid, personally came and appeared Michael J. Majoros, Jr., being by me first duly sworn, who deposed and said as follows:

He is appearing as a witness on behalf of the City of Chattanooga before the Tennessee Regulatory Authority in the matter captioned above, and, if present before the Authority and duly sworn, his testimony would be as set forth in the transcript attached hereto, consisting of [13] pages.



Michael J. Majoros, Jr.

Sworn to and subscribed before me
this 17th day of July, 2008.



Notary Public

My Commission Expires: March 14th 2011

Experience

Snively King Majoros O'Connor & Lee, Inc.

Vice President and Treasurer (1988 to Present)
Senior Consultant (1981-1987)

Mr. Majoros provides consultation specializing in accounting, financial, and management issues. He has testified as an expert witness or negotiated on behalf of clients in more than one hundred thirty regulatory federal and state regulatory proceedings involving telephone, electric, gas, water, and sewerage companies. His testimony has encompassed a wide array of complex issues including taxation, divestiture accounting, revenue requirements, rate base, nuclear decommissioning, plant lives, and capital recovery. Mr. Majoros has also provided consultation to the U.S. Department of Justice and appeared before the U.S. EPA and the Maryland State Legislature on matters regarding the accounting and plant life effects of electric plant modifications and the financial capacity of public utilities to finance environmental controls. He has estimated economic damages suffered by black farmers in discrimination suits.

Van Scoyoc & Wiskup, Inc., Consultant (1978-1981)

Mr. Majoros conducted and assisted in various management and regulatory consulting projects in the public utility field, including preparation of electric system load projections for a group of municipally and cooperatively owned electric systems; preparation of a system of accounts and reporting of gas and oil pipelines to be used by a state regulatory commission; accounting system analysis and design for rate proceedings involving electric, gas, and telephone utilities. Mr. Majoros provided onsite management accounting and controllership assistance to a municipal electric and water utility. Mr. Majoros also assisted in an antitrust proceeding involving a major electric utility. He submitted expert testimony in FERC Docket No. RP79-12 (El Paso Natural Gas Company), and he co-authored a study entitled Analysis of Staff Study on Comprehensive Tax Normalization that was submitted to FERC in Docket No. RM 80-42.

Handling Equipment Sales Company, Inc. ***Controller/Treasurer (1976-1978)***

Mr. Majoros' responsibilities included financial management, general accounting and reporting, and income taxes.

Ernst & Ernst, Auditor (1973-1976)

Mr. Majoros was a member of the audit staff where his responsibilities included auditing, supervision, business systems analysis, report preparation, and corporate income taxes.

University of Baltimore - (1971-1973)

Mr. Majoros was a full-time student in the School of Business.

During this period Mr. Majoros worked consistently on a part-time basis in the following positions: Assistant Legislative Auditor – State of Maryland, Staff Accountant – Robert M. Carney & Co., CPA's, Staff Accountant – Naron & Wegad, CPA's, Credit Clerk – Montgomery Wards.

Central Savings Bank, (1969-1971)

Mr. Majoros was an Assistant Branch Manager at the time he left the bank to attend college as a full-time student. During his tenure at the bank, Mr. Majoros gained experience in each department of the bank. In addition, he attended night school at the University of Baltimore.

Education

University of Baltimore, School of Business, B.S. –
Concentration in Accounting

Professional Affiliations

American Institute of Certified Public Accountants
Maryland Association of C.P.A.s
Society of Depreciation Professionals

Publications, Papers, and Panels

"Analysis of Staff Study on Comprehensive Tax Normalization," FERC Docket No. RM 80-42, 1980.

"Telephone Company Deferred Taxes and Investment Tax Credits – A Capital Loss for Ratepayers," Public Utility Fortnightly, September 27, 1984.

"The Use of Customer Discount Rates in Revenue Requirement Comparisons," Proceedings of the 25th Annual Iowa State Regulatory Conference, 1986

"The Regulatory Dilemma Created By Emerging Revenue Streams of Independent Telephone Companies," Proceedings of NARUC 101st Annual Convention and Regulatory Symposium, 1989.

"BOC Depreciation Issues in the States," National Association of State Utility Consumer Advocates, 1990 Mid-Year Meeting, 1990.

"Current Issues in Capital Recovery" 30th Annual Iowa State Regulatory Conference, 1991.

"Impaired Assets Under SFAS No. 121," National Association of State Utility consumer Advocates, 1996 Mid-Year Meeting, 1996.

"What's 'Sunk' Ain't Stranded: Why Excessive Utility Depreciation is Avoidable," with James Campbell, Public Utilities Fortnightly, April 1, 1999.

"Local Exchange Carrier Depreciation Reserve Percents," with Richard B. Lee, Journal of the Society of Depreciation Professionals, Volume 10, Number 1, 2000-2001

"Rolling Over Ratepayers," Public Utilities Fortnightly, Volume 143, Number 11, November, 2005.

Michael J. Majoros, Jr.

<u>Date</u>	<u>Jurisdiction / Agency</u>	<u>Docket</u>	<u>Utility</u>
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Federal Courts

2005	US District Court, Northern District of AL, Northwestern Division 55/56/57/	CV 01-B-403-NW	Tennessee Valley Authority
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State Legislatures

2006	Maryland General Assembly 61/	SB154	Maryland Healthy Air Act
2006	Maryland House of Delegates 62/	HB189	Maryland Healthy Air Act

Federal Regulatory Agencies

1979	FERC-US 19/	RP79-12	El Paso Natural Gas Co.
1980	FERC-US 19/	RM80-42	Generic Tax Normalization
1996	CRTC-Canada 30/	97-9	All Canadian Telecoms
1997	CRTC-Canada 31/	97-11	All Canadian Telecoms
1999	FCC 32/	98-137 (Ex Parte)	All LECs
1999	FCC 32/	98-91 (Ex Parte)	All LECs
1999	FCC 32/	98-177 (Ex Parte)	All LECs
1999	FCC 32/	98-45 (Ex Parte)	All LECs
2000	EPA 35/	CAA-00-6	Tennessee Valley Authority
2003	FERC 48/	RM02-7	All Utilities
2003	FCC 52/	03-173	All LECs
2003	FERC 53/	ER03-409-000, ER03-666-000	Pacific Gas and Electric Co.

State Regulatory Agencies

1982	Massachusetts 17/	DPU 557/558	Western Mass Elec. Co.
1982	Illinois 16/	ICC81-8115	Illinois Bell Telephone Co.
1983	Maryland 8/	7574-Direct	Baltimore Gas & Electric Co.
1983	Maryland 8/	7574-Surrebuttal	Baltimore Gas & Electric Co.
1983	Connecticut 15/	810911	Woodlake Water Co.
1983	New Jersey 1/	815-458	New Jersey Bell Tel. Co.
1983	New Jersey 14/	8011-827	Atlantic City Sewerage Co.
1984	Dist. Of Columbia 7/	785	Potomac Electric Power Co.
1984	Maryland 8/	7689	Washington Gas Light Co.
1984	Dist. Of Columbia 7/	798	C&P Tel. Co.
1984	Pennsylvania 13/	R-832316	Bell Telephone Co. of PA
1984	New Mexico 12/	1032	Mt. States Tel. & Telegraph
1984	Idaho 18/	U-1000-70	Mt. States Tel. & Telegraph
1984	Colorado 11/	1655	Mt. States Tel. & Telegraph

Michael J. Majoros, Jr.

1984	Dist. Of Columbia <u>7/</u>	813	Potomac Electric Power Co.
1984	Pennsylvania <u>3/</u>	R842621-R842625	Western Pa. Water Co.
1985	Maryland <u>8/</u>	7743	Potomac Edison Co.
1985	New Jersey <u>1/</u>	848-856	New Jersey Bell Tel. Co.
1985	Maryland <u>8/</u>	7851	C&P Tel. Co.
1985	California <u>10/</u>	I-85-03-78	Pacific Bell Telephone Co.
1985	Pennsylvania <u>3/</u>	R-850174	Phila. Suburban Water Co.
1985	Pennsylvania <u>3/</u>	R850178	Pennsylvania Gas & Water Co.
1985	Pennsylvania <u>3/</u>	R-850299	General Tel. Co. of PA
1986	Maryland <u>8/</u>	7899	Delmarva Power & Light Co.
1986	Maryland <u>8/</u>	7754	Chesapeake Utilities Corp.
1986	Pennsylvania <u>3/</u>	R-850268	York Water Co.
1986	Maryland <u>8/</u>	7953	Southern Md. Electric Corp.
1986	Idaho <u>9/</u>	U-1002-59	General Tel. Of the Northwest
1986	Maryland <u>8/</u>	7973	Baltimore Gas & Electric Co.
1987	Pennsylvania <u>3/</u>	R-860350	Dauphin Cons. Water Supply
1987	Pennsylvania <u>3/</u>	C-860923	Bell Telephone Co. of PA
1987	Iowa <u>6/</u>	DPU-86-2	Northwestern Bell Tel. Co.
1987	Dist. Of Columbia <u>7/</u>	842	Washington Gas Light Co.
1988	Florida <u>4/</u>	880069-TL	Southern Bell Telephone
1988	Iowa <u>6/</u>	RPU-87-3	Iowa Public Service Company
1988	Iowa <u>6/</u>	RPU-87-6	Northwestern Bell Tel. Co.
1988	Dist. Of Columbia <u>7/</u>	869	Potomac Electric Power Co.
1989	Iowa <u>6/</u>	RPU-88-6	Northwestern Bell Tel. Co.
1990	New Jersey <u>1/</u>	1487-88	Morris City Transfer Station
1990	New Jersey <u>5/</u>	WR 88-80967	Toms River Water Company
1990	Florida <u>4/</u>	890256-TL	Southern Bell Company
1990	New Jersey <u>1/</u>	ER89110912J	Jersey Central Power & Light
1990	New Jersey <u>1/</u>	WR90050497J	Elizabethtown Water Co.
1991	Pennsylvania <u>3/</u>	P900465	United Tel. Co. of Pa.
1991	West Virginia <u>2/</u>	90-564-T-D	C&P Telephone Co.
1991	New Jersey <u>1/</u>	90080792J	Hackensack Water Co.
1991	New Jersey <u>1/</u>	WR90080884J	Middlesex Water Co.
1991	Pennsylvania <u>3/</u>	R-911892	Phil. Suburban Water Co.
1991	Kansas <u>20/</u>	176, 716-U	Kansas Power & Light Co.
1991	Indiana <u>29/</u>	39017	Indiana Bell Telephone
1991	Nevada <u>21/</u>	91-5054	Central Tele. Co. – Nevada
1992	New Jersey <u>1/</u>	EE91081428	Public Service Electric & Gas
1992	Maryland <u>8/</u>	8462	C&P Telephone Co.
1992	West Virginia <u>2/</u>	91-1037-E-D	Appalachian Power Co.
1993	Maryland <u>8/</u>	8464	Potomac Electric Power Co.
1993	South Carolina <u>22/</u>	92-227-C	Southern Bell Telephone
1993	Maryland <u>8/</u>	8485	Baltimore Gas & Electric Co.
1993	Georgia <u>23/</u>	4451-U	Atlanta Gas Light Co.
1993	New Jersey <u>1/</u>	GR93040114	New Jersey Natural Gas. Co.

Michael J. Majoros, Jr.

1994	Iowa <u>6</u> /	RPU-93-9	U.S. West – Iowa
1994	Iowa <u>6</u> /	RPU-94-3	Midwest Gas
1995	Delaware <u>24</u> /	94-149	Wilm. Suburban Water Corp.
1995	Connecticut <u>25</u> /	94-10-03	So. New England Telephone
1995	Connecticut <u>25</u> /	95-03-01	So. New England Telephone
1995	Pennsylvania <u>3</u> /	R-00953300	Citizens Utilities Company
1995	Georgia <u>23</u> /	5503-0	Southern Bell
1996	Maryland <u>8</u> /	8715	Bell Atlantic
1996	Arizona <u>26</u> /	E-1032-95-417	Citizens Utilities Company
1996	New Hampshire <u>27</u> /	DE 96-252	New England Telephone
1997	Iowa <u>6</u> /	DPU-96-1	U S West – Iowa
1997	Ohio <u>28</u> /	96-922-TP-UNC	Ameritech – Ohio
1997	Michigan <u>28</u> /	U-11280	Ameritech – Michigan
1997	Michigan <u>28</u> /	U-112 81	GTE North
1997	Wyoming <u>27</u> /	7000-ztr-96-323	US West – Wyoming
1997	Iowa <u>6</u> /	RPU-96-9	US West – Iowa
1997	Illinois <u>28</u> /	96-0486-0569	Ameritech – Illinois
1997	Indiana <u>28</u> /	40611	Ameritech – Indiana
1997	Indiana <u>27</u> /	40734	GTE North
1997	Utah <u>27</u> /	97-049-08	US West – Utah
1997	Georgia <u>28</u> /	7061-U	BellSouth – Georgia
1997	Connecticut <u>25</u> /	96-04-07	So. New England Telephone
1998	Florida <u>28</u> /	960833-TP et. al.	BellSouth – Florida
1998	Illinois <u>27</u> /	97-0355	GTE North/South
1998	Michigan <u>33</u> /	U-11726	Detroit Edison
1999	Maryland <u>8</u> /	8794	Baltimore Gas & Electric Co.
1999	Maryland <u>8</u> /	8795	Delmarva Power & Light Co.
1999	Maryland <u>8</u> /	8797	Potomac Edison Company
1999	West Virginia <u>2</u> /	98-0452-E-GI	Electric Restructuring
1999	Delaware <u>24</u> /	98-98	United Water Company
1999	Pennsylvania <u>3</u> /	R-00994638	Pennsylvania American Water
1999	West Virginia <u>2</u> /	98-0985-W-D	West Virginia American Water
1999	Michigan <u>33</u> /	U-11495	Detroit Edison
2000	Delaware <u>24</u> /	99-466	Tidewater Utilities
2000	New Mexico <u>34</u> /	3008	US WEST Communications, Inc.
2000	Florida <u>28</u> /	990649-TP	BellSouth -Florida
2000	New Jersey <u>1</u> /	WR30174	Consumer New Jersey Water
2000	Pennsylvania <u>3</u> /	R-00994868	Philadelphia Suburban Water
2000	Pennsylvania <u>3</u> /	R-0005212	Pennsylvania American Sewerage
2000	Connecticut <u>25</u> /	00-07-17	Southern New England Telephone
2001	Kentucky <u>36</u> /	2000-373	Jackson Energy Cooperative
2001	Kansas <u>38/39/40</u> /	01-WSRE-436-RTS	Western Resources
2001	South Carolina <u>22</u> /	2001-93-E	Carolina Power & Light Co.
2001	North Dakota <u>37</u> /	PU-400-00-521	Northern States Power/Xcel Energy
2001	Indiana <u>29/41</u> /	41746	Northern Indiana Power Company

Michael J. Majoros, Jr.

2001	New Jersey 1/	GR01050328	Public Service Electric and Gas
2001	Pennsylvania 3/	R-00016236	York Water Company
2001	Pennsylvania 3/	R-00016339	Pennsylvania America Water
2001	Pennsylvania 3/	R-00016356	Wellsboro Electric Coop.
2001	Florida 4/	010949-EL	Gulf Power Company
2001	Hawaii 42/	00-309	The Gas Company
2002	Pennsylvania 3/	R-00016750	Philadelphia Suburban
2002	Nevada 43/	01-10001 & 10002	Nevada Power Company
2002	Kentucky 36/	2001-244	Fleming Mason Electric Coop.
2002	Nevada 43/	01-11031	Sierra Pacific Power Company
2002	Georgia 27/	14361-U	BellSouth-Georgia
2002	Alaska 44/	U-01-34,82-87,66	Alaska Communications Systems
2002	Wisconsin 45/	2055-TR-102	CenturyTel
2002	Wisconsin 45/	5846-TR-102	TelUSA
2002	Vermont 46/	6596	Citizen's Energy Services
2002	North Dakota 37/	PU-399-02-183	Montana Dakota Utilities
2002	Kansas 40/	02-MDWG-922-RTS	Midwest Energy
2002	Kentucky 36/	2002-00145	Columbia Gas
2002	Oklahoma 47/	200200166	Reliant Energy ARKLA
2002	New Jersey 1/	GR02040245	Elizabethtown Gas Company
2003	New Jersey 1/	ER02050303	Public Service Electric and Gas Co.
2003	Hawaii 42/	01-0255	Young Brothers Tug & Barge
2003	New Jersey 1/	ER02080506	Jersey Central Power & Light
2003	New Jersey 1/	ER02100724	Rockland Electric Co.
2003	Pennsylvania 3/	R-00027975	The York Water Co.
2003	Pennsylvania /3	R-00038304	Pennsylvania-American Water Co.
2003	Kansas 20/ 40/	03-KGSG-602-RTS	Kansas Gas Service
2003	Nova Scotia, CN 49/	EMO NSPI	Nova Scotia Power, Inc.
2003	Kentucky 36/	2003-00252	Union Light Heat & Power
2003	Alaska 44/	U-96-89	ACS Communications, Inc.
2003	Indiana 29/	42359	PSI Energy, Inc.
2003	Kansas 20/ 40/	03-ATMG-1036-RTS	Atmos Energy
2003	Florida 50/	030001-E1	Tampa Electric Company
2003	Maryland 51/	8960	Washington Gas Light
2003	Hawaii 42/	02-0391	Hawaiian Electric Company
2003	Illinois 28/	02-0864	SBC Illinois
2003	Indiana 28/	42393	SBC Indiana
2004	New Jersey 1/	ER03020110	Atlantic City Electric Co.
2004	Arizona 26/	E-01345A-03-0437	Arizona Public Service Company
2004	Michigan 27/	U-13531	SBC Michigan
2004	New Jersey 1/	GR03080683	South Jersey Gas Company
2004	Kentucky 36/	2003-00434,00433	Kentucky Utilities, Louisville Gas & Electric
2004	Florida 50/ 54/	031033-EI	Tampa Electric Company
2004	Kentucky 36/	2004-00067	Delta Natural Gas Company

Michael J. Majoros, Jr.

2004	Georgia 23/	18300, 15392, 15393	Georgia Power Company
2004	Vermont 46/	6946, 6988	Central Vermont Public Service Corporation
2004	Delaware 24/	04-288	Delaware Electric Cooperative
2004	Missouri 58/	ER-2004-0570	Empire District Electric Company
2005	Florida 50/	041272-EI	Progress Energy Florida, Inc.
2005	Florida 50/	041291-EI	Florida Power & Light Company
2005	California 59/	A.04-12-014	Southern California Edison Co.
2005	Kentucky 36/	2005-00042	Union Light Heat & Power
2005	Florida 50/	050045 & 050188-EI	Florida Power & Light Co.
2005	Kansas 38/ 40/	05-WSEE-981-RTS	Westar Energy, Inc.
2006	Delaware 24/	05-304	Delmarva Power & Light Company
2006	California 59/	A.05-12-002	Pacific Gas & Electric Co.
2006	New Jersey 1/	GR05100845	Public Service Electric and Gas Co.
2006	Colorado 60/	06S-234EG	Public Service Co. of Colorado
2006	Kentucky 36/	2006-00172	Union Light, Heat & Power
2006	Kansas 40/	06-KGSG-1209-RTS	Kansas Gas Service
2006	West Virginia 2/	06-0960-E-42T, 06-1426-E-D	Allegheny Power
2006	West Virginia 2/	05-1120-G-30C, 06-0441-G-PC, et al.	Hope Gas, Inc. and Equitable Resources, Inc.
2007	Delaware 24/	06-284	Delmarva Power & Light Company
2007	Kentucky 36/	2006-00464	Atmos Energy Corporation
2007	Colorado 60/	06S-656G	Public Service Co. of Colorado
2007	California 59/	A.06-12-009, A.06-12-010	San Diego Gas & Electric Co., and Southern California Gas Co.
2007	Kentucky 36/	2007-00143	Kentucky-American Water Co.
2007	Kentucky 36/	2007-00089	Delta Natural Gas Co.
2008	Kansas 40/	08-ATMG-280-RTS	Atmos Energy Corporation
2008	New Jersey 1/	GR07110889	New Jersey Natural Gas Co.
2008	North Dakota 37/	PU-07-776	Northern States Power/Xcel Energy

Michael J. Majoros, Jr.

**PARTICIPATION AS NEGOTIATOR IN FCC TELEPHONE DEPRECIATION
RATE REPRESRIPTION CONFERENCES**

<u>COMPANY</u>	<u>YEARS</u>	<u>CLIENT</u>
Diamond State Telephone Co. <u>24/</u>	1985 + 1988	Delaware Public Service Comm
Bell Telephone of Pennsylvania <u>3/</u>	1986 + 1989	PA Consumer Advocate
Chesapeake & Potomac Telephone Co. - Md. <u>8/</u>	1986	Maryland People's Counsel
Southwestern Bell Telephone – Kansas <u>20/</u>	1986	Kansas Corp. Commission
Southern Bell – Florida <u>4/</u>	1986	Florida Consumer Advocate
Chesapeake & Potomac Telephone Co.-W.Va. <u>2/</u>	1987 + 1990	West VA Consumer Advocate
New Jersey Bell Telephone Co. <u>1/</u>	1985 + 1988	New Jersey Rate Counsel
Southern Bell - South Carolina <u>22/</u>	1986 + 1989 + 1992	S. Carolina Consumer Advocate
GTE-North – Pennsylvania <u>3/</u>	1989	PA Consumer Advocate

Michael J. Majoros, Jr.

**PARTICIPATION IN PROCEEDINGS WHICH WERE
SETTLED BEFORE TESTIMONY WAS SUBMITTED**

<u>STATE</u>	<u>DOCKET NO.</u>	<u>UTILITY</u>
Maryland <u>8</u> /	7878	Potomac Edison
Nevada <u>21</u> /	88-728	Southwest Gas
New Jersey <u>1</u> /	WR90090950J	New Jersey American Water
New Jersey <u>1</u> /	WR900050497J	Elizabethtown Water
New Jersey <u>1</u> /	WR91091483	Garden State Water
West Virginia <u>2</u> /	91-1037-E	Appalachian Power Co.
Nevada <u>21</u> /	92-7002	Central Telephone - Nevada
Pennsylvania <u>3</u> /	R-00932873	Blue Mountain Water
West Virginia <u>2</u> /	93-1165-E-D	Potomac Edison
West Virginia <u>2</u> /	94-0013-E-D	Monongahela Power
New Jersey <u>1</u> /	WR94030059	New Jersey American Water
New Jersey <u>1</u> /	WR95080346	Elizabethtown Water
New Jersey <u>1</u> /	WR95050219	Toms River Water Co.
Maryland <u>8</u> /	8796	Potomac Electric Power Co.
South Carolina <u>22</u> /	1999-077-E	Carolina Power & Light Co.
South Carolina <u>22</u> /	1999-072-E	Carolina Power & Light Co.
Kentucky <u>36</u> /	2001-104 & 141	Kentucky Utilities, Louisville Gas and Electric
Kentucky <u>36</u> /	2002-485	Jackson Purchase Energy Corporation

Michael J. Majoros, Jr.

Clients

<u>1/</u> New Jersey Rate Counsel/Advocate	<u>33/</u> Michigan Attorney General
<u>2/</u> West Virginia Consumer Advocate	<u>34/</u> New Mexico Attorney General
<u>3/</u> Pennsylvania OCA	<u>35/</u> Environmental Protection Agency Enforcement Staff
<u>4/</u> Florida Office of Public Advocate	<u>36/</u> Kentucky Attorney General
<u>5/</u> Toms River Fire Commissioner's	<u>37/</u> North Dakota Public Service Commission
<u>6/</u> Iowa Office of Consumer Advocate	<u>38/</u> Kansas Industrial Group
<u>7/</u> D.C. People's Counsel	<u>39/</u> City of Wichita
<u>8/</u> Maryland's People's Counsel	<u>40/</u> Kansas Citizens' Utility Rate Board
<u>9/</u> Idaho Public Service Commission	<u>41/</u> NIPSCO Industrial Group
<u>10/</u> Western Burglar and Fire Alarm	<u>42/</u> Hawaii Division of Consumer Advocacy
<u>11/</u> U.S. Dept. of Defense	<u>43/</u> Nevada Bureau of Consumer Protection
<u>12/</u> N.M. State Corporation Comm.	<u>44/</u> GCI
<u>13/</u> City of Philadelphia	<u>45/</u> Wisc. Citizens' Utility Rate Board
<u>14/</u> Resorts International	<u>46/</u> Vermont Department of Public Service
<u>15/</u> Woodlake Condominium Association	<u>47/</u> Oklahoma Corporation Commission
<u>16/</u> Illinois Attorney General	<u>48/</u> National Assn. of State Utility Consumer Advocates
<u>17/</u> Mass Coalition of Municipalities	<u>49/</u> Nova Scotia Utility and Review Board
<u>18/</u> U.S. Department of Energy	<u>50/</u> Florida Office of Public Counsel
<u>19/</u> Arizona Electric Power Corp.	<u>51/</u> Maryland Public Service Commission
<u>20/</u> Kansas Corporation Commission	<u>52/</u> MCI
<u>21/</u> Public Service Comm. – Nevada	<u>53/</u> Transmission Agency of Northern California
<u>22/</u> SC Dept. of Consumer Affairs	<u>54/</u> Florida Industrial Power Users Group
<u>23/</u> Georgia Public Service Comm.	<u>55/</u> Sierra Club
<u>24/</u> Delaware Public Service Comm.	<u>56/</u> Our Children's Earth Foundation
<u>25/</u> Conn. Ofc. Of Consumer Counsel	<u>57/</u> National Parks Conservation Association, Inc.
<u>26/</u> Arizona Corp. Commission	<u>58/</u> Missouri Office of the Public Counsel
<u>27/</u> AT&T	<u>59/</u> The Utility Reform Network
<u>28/</u> AT&T/MCI	<u>60/</u> Colorado Office of Consumer Counsel
<u>29/</u> IN Office of Utility Consumer Counselor	<u>61/</u> MD State Senator Paul G. Pinsky
<u>30/</u> Unitel (AT&T – Canada)	<u>62/</u> MD Speaker of the House Michael Busch
<u>31/</u> Public Interest Advocacy Centre	
<u>32/</u> U.S. General Services Administration	

PUBLIC LAW 107–204—JULY 30, 2002

116 STAT. 745

Public Law 107–204
107th Congress

An Act

To protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes.

July 30, 2002
[H.R. 3763]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) **SHORT TITLE.**—This Act may be cited as the “Sarbanes-Oxley Act of 2002”.

(b) **TABLE OF CONTENTS.**—The table of contents for this Act is as follows:

- Sec. 1. Short title; table of contents.
- Sec. 2. Definitions.
- Sec. 3. Commission rules and enforcement.

TITLE I—PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

- Sec. 101. Establishment; administrative provisions.
- Sec. 102. Registration with the Board.
- Sec. 103. Auditing, quality control, and independence standards and rules.
- Sec. 104. Inspections of registered public accounting firms.
- Sec. 105. Investigations and disciplinary proceedings.
- Sec. 106. Foreign public accounting firms.
- Sec. 107. Commission oversight of the Board.
- Sec. 108. Accounting standards.
- Sec. 109. Funding.

TITLE II—AUDITOR INDEPENDENCE

- Sec. 201. Services outside the scope of practice of auditors.
- Sec. 202. Preapproval requirements.
- Sec. 203. Audit partner rotation.
- Sec. 204. Auditor reports to audit committees.
- Sec. 205. Conforming amendments.
- Sec. 206. Conflicts of interest.
- Sec. 207. Study of mandatory rotation of registered public accounting firms.
- Sec. 208. Commission authority.
- Sec. 209. Considerations by appropriate State regulatory authorities.

TITLE III—CORPORATE RESPONSIBILITY

- Sec. 301. Public company audit committees.
- Sec. 302. Corporate responsibility for financial reports.
- Sec. 303. Improper influence on conduct of audits.
- Sec. 304. Forfeiture of certain bonuses and profits.
- Sec. 305. Officer and director bars and penalties.
- Sec. 306. Insider trades during pension fund blackout periods.
- Sec. 307. Rules of professional responsibility for attorneys.
- Sec. 308. Fair funds for investors.

TITLE IV—ENHANCED FINANCIAL DISCLOSURES

- Sec. 401. Disclosures in periodic reports.
- Sec. 402. Enhanced conflict of interest provisions.
- Sec. 403. Disclosures of transactions involving management and principal stockholders.

Sarbanes-Oxley
Act of 2002.
Corporate
responsibility.
15 USC 7201
note.

116 STAT. 746

PUBLIC LAW 107-204—JULY 30, 2002

- Sec. 404. Management assessment of internal controls.
- Sec. 405. Exemption.
- Sec. 406. Code of ethics for senior financial officers.
- Sec. 407. Disclosure of audit committee financial expert.
- Sec. 408. Enhanced review of periodic disclosures by issuers.
- Sec. 409. Real time issuer disclosures.

TITLE V—ANALYST CONFLICTS OF INTEREST

- Sec. 501. Treatment of securities analysts by registered securities associations and national securities exchanges.

TITLE VI—COMMISSION RESOURCES AND AUTHORITY

- Sec. 601. Authorization of appropriations.
- Sec. 602. Appearance and practice before the Commission.
- Sec. 603. Federal court authority to impose penny stock bars.
- Sec. 604. Qualifications of associated persons of brokers and dealers.

TITLE VII—STUDIES AND REPORTS

- Sec. 701. GAO study and report regarding consolidation of public accounting firms.
- Sec. 702. Commission study and report regarding credit rating agencies.
- Sec. 703. Study and report on violators and violations
- Sec. 704. Study of enforcement actions.
- Sec. 705. Study of investment banks.

TITLE VIII—CORPORATE AND CRIMINAL FRAUD ACCOUNTABILITY

- Sec. 801. Short title.
- Sec. 802. Criminal penalties for altering documents.
- Sec. 803. Debts nondischargeable if incurred in violation of securities fraud laws.
- Sec. 804. Statute of limitations for securities fraud.
- Sec. 805. Review of Federal Sentencing Guidelines for obstruction of justice and extensive criminal fraud.
- Sec. 806. Protection for employees of publicly traded companies who provide evidence of fraud.
- Sec. 807. Criminal penalties for defrauding shareholders of publicly traded companies.

TITLE IX—WHITE-COLLAR CRIME PENALTY ENHANCEMENTS

- Sec. 901. Short title.
- Sec. 902. Attempts and conspiracies to commit criminal fraud offenses.
- Sec. 903. Criminal penalties for mail and wire fraud.
- Sec. 904. Criminal penalties for violations of the Employee Retirement Income Security Act of 1974.
- Sec. 905. Amendment to sentencing guidelines relating to certain white-collar offenses.
- Sec. 906. Corporate responsibility for financial reports.

TITLE X—CORPORATE TAX RETURNS

- Sec. 1001. Sense of the Senate regarding the signing of corporate tax returns by chief executive officers.

TITLE XI—CORPORATE FRAUD AND ACCOUNTABILITY

- Sec. 1101. Short title.
- Sec. 1102. Tampering with a record or otherwise impeding an official proceeding.
- Sec. 1103. Temporary freeze authority for the Securities and Exchange Commission.
- Sec. 1104. Amendment to the Federal Sentencing Guidelines.
- Sec. 1105. Authority of the Commission to prohibit persons from serving as officers or directors.
- Sec. 1106. Increased criminal penalties under Securities Exchange Act of 1934.
- Sec. 1107. Retaliation against informants.

15 USC 7201.

SEC. 2. DEFINITIONS.

(a) IN GENERAL.—In this Act, the following definitions shall apply:

(1) APPROPRIATE STATE REGULATORY AUTHORITY.—The term “appropriate State regulatory authority” means the State agency or other authority responsible for the licensure or other regulation of the practice of accounting in the State or States

having jurisdiction over a registered public accounting firm or associated person thereof, with respect to the matter in question.

(2) **AUDIT.**—The term “audit” means an examination of the financial statements of any issuer by an independent public accounting firm in accordance with the rules of the Board or the Commission (or, for the period preceding the adoption of applicable rules of the Board under section 103, in accordance with then-applicable generally accepted auditing and related standards for such purposes), for the purpose of expressing an opinion on such statements.

(3) **AUDIT COMMITTEE.**—The term “audit committee” means—

(A) a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer; and

(B) if no such committee exists with respect to an issuer, the entire board of directors of the issuer.

(4) **AUDIT REPORT.**—The term “audit report” means a document or other record—

(A) prepared following an audit performed for purposes of compliance by an issuer with the requirements of the securities laws; and

(B) in which a public accounting firm either—

(i) sets forth the opinion of that firm regarding a financial statement, report, or other document; or
(ii) asserts that no such opinion can be expressed.

(5) **BOARD.**—The term “Board” means the Public Company Accounting Oversight Board established under section 101.

(6) **COMMISSION.**—The term “Commission” means the Securities and Exchange Commission.

(7) **ISSUER.**—The term “issuer” means an issuer (as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c)), the securities of which are registered under section 12 of that Act (15 U.S.C. 78l), or that is required to file reports under section 15(d) (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn.

(8) **NON-AUDIT SERVICES.**—The term “non-audit services” means any professional services provided to an issuer by a registered public accounting firm, other than those provided to an issuer in connection with an audit or a review of the financial statements of an issuer.

(9) **PERSON ASSOCIATED WITH A PUBLIC ACCOUNTING FIRM.**—

(A) **IN GENERAL.**—The terms “person associated with a public accounting firm” (or with a “registered public accounting firm”) and “associated person of a public accounting firm” (or of a “registered public accounting firm”) mean any individual proprietor, partner, shareholder, principal, accountant, or other professional employee of a public accounting firm, or any other independent contractor or entity that, in connection with the preparation or issuance of any audit report—

(i) shares in the profits of, or receives compensation in any other form from, that firm; or

(ii) participates as agent or otherwise on behalf of such accounting firm in any activity of that firm.

(B) EXEMPTION AUTHORITY.—The Board may, by rule, exempt persons engaged only in ministerial tasks from the definition in subparagraph (A), to the extent that the Board determines that any such exemption is consistent with the purposes of this Act, the public interest, or the protection of investors.

(10) PROFESSIONAL STANDARDS.—The term “professional standards” means—

(A) accounting principles that are—

(i) established by the standard setting body described in section 19(b) of the Securities Act of 1933, as amended by this Act, or prescribed by the Commission under section 19(a) of that Act (15 U.S.C. 17a(s)) or section 13(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78a(m)); and

(ii) relevant to audit reports for particular issuers, or dealt with in the quality control system of a particular registered public accounting firm; and

(B) auditing standards, standards for attestation engagements, quality control policies and procedures, ethical and competency standards, and independence standards (including rules implementing title II) that the Board or the Commission determines—

(i) relate to the preparation or issuance of audit reports for issuers; and

(ii) are established or adopted by the Board under section 103(a), or are promulgated as rules of the Commission.

(11) PUBLIC ACCOUNTING FIRM.—The term “public accounting firm” means—

(A) a proprietorship, partnership, incorporated association, corporation, limited liability company, limited liability partnership, or other legal entity that is engaged in the practice of public accounting or preparing or issuing audit reports; and

(B) to the extent so designated by the rules of the Board, any associated person of any entity described in subparagraph (A).

(12) REGISTERED PUBLIC ACCOUNTING FIRM.—The term “registered public accounting firm” means a public accounting firm registered with the Board in accordance with this Act.

(13) RULES OF THE BOARD.—The term “rules of the Board” means the bylaws and rules of the Board (as submitted to, and approved, modified, or amended by the Commission, in accordance with section 107), and those stated policies, practices, and interpretations of the Board that the Commission, by rule, may deem to be rules of the Board, as necessary or appropriate in the public interest or for the protection of investors.

(14) SECURITY.—The term “security” has the same meaning as in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)).

PUBLIC LAW 107-204—JULY 30, 2002

116 STAT. 749

(15) SECURITIES LAWS.—The term “securities laws” means the provisions of law referred to in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), as amended by this Act, and includes the rules, regulations, and orders issued by the Commission thereunder.

(16) STATE.—The term “State” means any State of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other territory or possession of the United States.

(b) CONFORMING AMENDMENT.—Section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)) is amended by inserting “the Sarbanes-Oxley Act of 2002,” before “the Public”.

SEC. 3. COMMISSION RULES AND ENFORCEMENT.

15 USC 7202.

(a) REGULATORY ACTION.—The Commission shall promulgate such rules and regulations, as may be necessary or appropriate in the public interest or for the protection of investors, and in furtherance of this Act.

(b) ENFORCEMENT.—

(1) IN GENERAL.—A violation by any person of this Act, any rule or regulation of the Commission issued under this Act, or any rule of the Board shall be treated for all purposes in the same manner as a violation of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) or the rules and regulations issued thereunder, consistent with the provisions of this Act, and any such person shall be subject to the same penalties, and to the same extent, as for a violation of that Act or such rules or regulations.

(2) INVESTIGATIONS, INJUNCTIONS, AND PROSECUTION OF OFFENSES.—Section 21 of the Securities Exchange Act of 1934 (15 U.S.C. 78u) is amended—

(A) in subsection (a)(1), by inserting “the rules of the Public Company Accounting Oversight Board, of which such person is a registered public accounting firm or a person associated with such a firm,” after “is a participant,”;

(B) in subsection (d)(1), by inserting “the rules of the Public Company Accounting Oversight Board, of which such person is a registered public accounting firm or a person associated with such a firm,” after “is a participant,”;

(C) in subsection (e), by inserting “the rules of the Public Company Accounting Oversight Board, of which such person is a registered public accounting firm or a person associated with such a firm,” after “is a participant,”; and

(D) in subsection (f), by inserting “or the Public Company Accounting Oversight Board” after “self-regulatory organization” each place that term appears.

(3) CEASE-AND-DESIST PROCEEDINGS.—Section 21C(c)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78u-3(c)(2)) is amended by inserting “registered public accounting firm (as defined in section 2 of the Sarbanes-Oxley Act of 2002),” after “government securities dealer,”.

(4) ENFORCEMENT BY FEDERAL BANKING AGENCIES.—Section 12(i) of the Securities Exchange Act of 1934 (15 U.S.C. 78l(i)) is amended by—

(A) striking “sections 12,” each place it appears and inserting “sections 10A(m), 12,”; and

116 STAT. 750

PUBLIC LAW 107-204—JULY 30, 2002

(B) striking “and 16,” each place it appears and inserting “and 16 of this Act, and sections 302, 303, 304, 306, 401(b), 404, 406, and 407 of the Sarbanes-Oxley Act of 2002,”.

(c) EFFECT ON COMMISSION AUTHORITY.—Nothing in this Act or the rules of the Board shall be construed to impair or limit—

(1) the authority of the Commission to regulate the accounting profession, accounting firms, or persons associated with such firms for purposes of enforcement of the securities laws;

(2) the authority of the Commission to set standards for accounting or auditing practices or auditor independence, derived from other provisions of the securities laws or the rules or regulations thereunder, for purposes of the preparation and issuance of any audit report, or otherwise under applicable law; or

(3) the ability of the Commission to take, on the initiative of the Commission, legal, administrative, or disciplinary action against any registered public accounting firm or any associated person thereof.

TITLE I—PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

15 USC 7211.

SEC. 101. ESTABLISHMENT; ADMINISTRATIVE PROVISIONS.

(a) ESTABLISHMENT OF BOARD.—There is established the Public Company Accounting Oversight Board, to oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors. The Board shall be a body corporate, operate as a nonprofit corporation, and have succession until dissolved by an Act of Congress.

(b) STATUS.—The Board shall not be an agency or establishment of the United States Government, and, except as otherwise provided in this Act, shall be subject to, and have all the powers conferred upon a nonprofit corporation by, the District of Columbia Nonprofit Corporation Act. No member or person employed by, or agent for, the Board shall be deemed to be an officer or employee of or agent for the Federal Government by reason of such service.

(c) DUTIES OF THE BOARD.—The Board shall, subject to action by the Commission under section 107, and once a determination is made by the Commission under subsection (d) of this section—

(1) register public accounting firms that prepare audit reports for issuers, in accordance with section 102;

(2) establish or adopt, or both, by rule, auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports for issuers, in accordance with section 103;

(3) conduct inspections of registered public accounting firms, in accordance with section 104 and the rules of the Board;

(4) conduct investigations and disciplinary proceedings concerning, and impose appropriate sanctions where justified upon,

registered public accounting firms and associated persons of such firms, in accordance with section 105;

(5) perform such other duties or functions as the Board (or the Commission, by rule or order) determines are necessary or appropriate to promote high professional standards among, and improve the quality of audit services offered by, registered public accounting firms and associated persons thereof, or otherwise to carry out this Act, in order to protect investors, or to further the public interest;

(6) enforce compliance with this Act, the rules of the Board, professional standards, and the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, by registered public accounting firms and associated persons thereof; and

(7) set the budget and manage the operations of the Board and the staff of the Board.

(d) COMMISSION DETERMINATION.—The members of the Board shall take such action (including hiring of staff, proposal of rules, and adoption of initial and transitional auditing and other professional standards) as may be necessary or appropriate to enable the Commission to determine, not later than 270 days after the date of enactment of this Act, that the Board is so organized and has the capacity to carry out the requirements of this title, and to enforce compliance with this title by registered public accounting firms and associated persons thereof. The Commission shall be responsible, prior to the appointment of the Board, for the planning for the establishment and administrative transition to the Board's operation.

(e) BOARD MEMBERSHIP.—

(1) COMPOSITION.—The Board shall have 5 members, appointed from among prominent individuals of integrity and reputation who have a demonstrated commitment to the interests of investors and the public, and an understanding of the responsibilities for and nature of the financial disclosures required of issuers under the securities laws and the obligations of accountants with respect to the preparation and issuance of audit reports with respect to such disclosures.

(2) LIMITATION.—Two members, and only 2 members, of the Board shall be or have been certified public accountants pursuant to the laws of 1 or more States, provided that, if 1 of those 2 members is the chairperson, he or she may not have been a practicing certified public accountant for at least 5 years prior to his or her appointment to the Board.

(3) FULL-TIME INDEPENDENT SERVICE.—Each member of the Board shall serve on a full-time basis, and may not, concurrent with service on the Board, be employed by any other person or engage in any other professional or business activity. No member of the Board may share in any of the profits of, or receive payments from, a public accounting firm (or any other person, as determined by rule of the Commission), other than fixed continuing payments, subject to such conditions as the Commission may impose, under standard arrangements for the retirement of members of public accounting firms.

(4) APPOINTMENT OF BOARD MEMBERS.—

(A) INITIAL BOARD.—Not later than 90 days after the date of enactment of this Act, the Commission, after consultation with the Chairman of the Board of Governors

Deadline.

of the Federal Reserve System and the Secretary of the Treasury, shall appoint the chairperson and other initial members of the Board, and shall designate a term of service for each.

(B) VACANCIES.—A vacancy on the Board shall not affect the powers of the Board, but shall be filled in the same manner as provided for appointments under this section.

(5) TERM OF SERVICE.—

(A) IN GENERAL.—The term of service of each Board member shall be 5 years, and until a successor is appointed, except that—

(i) the terms of office of the initial Board members (other than the chairperson) shall expire in annual increments, 1 on each of the first 4 anniversaries of the initial date of appointment; and

(ii) any Board member appointed to fill a vacancy occurring before the expiration of the term for which the predecessor was appointed shall be appointed only for the remainder of that term.

(B) TERM LIMITATION.—No person may serve as a member of the Board, or as chairperson of the Board, for more than 2 terms, whether or not such terms of service are consecutive.

(6) REMOVAL FROM OFFICE.—A member of the Board may be removed by the Commission from office, in accordance with section 107(d)(3), for good cause shown before the expiration of the term of that member.

(f) POWERS OF THE BOARD.—In addition to any authority granted to the Board otherwise in this Act, the Board shall have the power, subject to section 107—

(1) to sue and be sued, complain and defend, in its corporate name and through its own counsel, with the approval of the Commission, in any Federal, State, or other court;

(2) to conduct its operations and maintain offices, and to exercise all other rights and powers authorized by this Act, in any State, without regard to any qualification, licensing, or other provision of law in effect in such State (or a political subdivision thereof);

(3) to lease, purchase, accept gifts or donations of or otherwise acquire, improve, use, sell, exchange, or convey, all of or an interest in any property, wherever situated;

(4) to appoint such employees, accountants, attorneys, and other agents as may be necessary or appropriate, and to determine their qualifications, define their duties, and fix their salaries or other compensation (at a level that is comparable to private sector self-regulatory, accounting, technical, supervisory, or other staff or management positions);

(5) to allocate, assess, and collect accounting support fees established pursuant to section 109, for the Board, and other fees and charges imposed under this title; and

(6) to enter into contracts, execute instruments, incur liabilities, and do any and all other acts and things necessary, appropriate, or incidental to the conduct of its operations and the exercise of its obligations, rights, and powers imposed or granted by this title.

Contracts.

PUBLIC LAW 107-204—JULY 30, 2002

116 STAT. 753

(g) **RULES OF THE BOARD.**—The rules of the Board shall, subject to the approval of the Commission—

(1) provide for the operation and administration of the Board, the exercise of its authority, and the performance of its responsibilities under this Act;

(2) permit, as the Board determines necessary or appropriate, delegation by the Board of any of its functions to an individual member or employee of the Board, or to a division of the Board, including functions with respect to hearing, determining, ordering, certifying, reporting, or otherwise acting as to any matter, except that—

(A) the Board shall retain a discretionary right to review any action pursuant to any such delegated function, upon its own motion;

(B) a person shall be entitled to a review by the Board with respect to any matter so delegated, and the decision of the Board upon such review shall be deemed to be the action of the Board for all purposes (including appeal or review thereof); and

(C) if the right to exercise a review described in subparagraph (A) is declined, or if no such review is sought within the time stated in the rules of the Board, then the action taken by the holder of such delegation shall for all purposes, including appeal or review thereof, be deemed to be the action of the Board;

(3) establish ethics rules and standards of conduct for Board members and staff, including a bar on practice before the Board (and the Commission, with respect to Board-related matters) of 1 year for former members of the Board, and appropriate periods (not to exceed 1 year) for former staff of the Board; and

(4) provide as otherwise required by this Act.

(h) **ANNUAL REPORT TO THE COMMISSION.**—The Board shall submit an annual report (including its audited financial statements) to the Commission, and the Commission shall transmit a copy of that report to the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives, not later than 30 days after the date of receipt of that report by the Commission.

Deadline.

SEC. 102. REGISTRATION WITH THE BOARD.

15 USC 7212.

(a) **MANDATORY REGISTRATION.**—Beginning 180 days after the date of the determination of the Commission under section 101(d), it shall be unlawful for any person that is not a registered public accounting firm to prepare or issue, or to participate in the preparation or issuance of, any audit report with respect to any issuer.

(b) **APPLICATIONS FOR REGISTRATION.**—

(1) **FORM OF APPLICATION.**—A public accounting firm shall use such form as the Board may prescribe, by rule, to apply for registration under this section.

(2) **CONTENTS OF APPLICATIONS.**—Each public accounting firm shall submit, as part of its application for registration, in such detail as the Board shall specify—

(A) the names of all issuers for which the firm prepared or issued audit reports during the immediately preceding calendar year, and for which the firm expects to prepare or issue audit reports during the current calendar year;

(B) the annual fees received by the firm from each such issuer for audit services, other accounting services, and non-audit services, respectively;

(C) such other current financial information for the most recently completed fiscal year of the firm as the Board may reasonably request;

(D) a statement of the quality control policies of the firm for its accounting and auditing practices;

(E) a list of all accountants associated with the firm who participate in or contribute to the preparation of audit reports, stating the license or certification number of each such person, as well as the State license numbers of the firm itself;

(F) information relating to criminal, civil, or administrative actions or disciplinary proceedings pending against the firm or any associated person of the firm in connection with any audit report;

(G) copies of any periodic or annual disclosure filed by an issuer with the Commission during the immediately preceding calendar year which discloses accounting disagreements between such issuer and the firm in connection with an audit report furnished or prepared by the firm for such issuer; and

(H) such other information as the rules of the Board or the Commission shall specify as necessary or appropriate in the public interest or for the protection of investors.

(3) CONSENTS.—Each application for registration under this subsection shall include—

(A) a consent executed by the public accounting firm to cooperation in and compliance with any request for testimony or the production of documents made by the Board in the furtherance of its authority and responsibilities under this title (and an agreement to secure and enforce similar consents from each of the associated persons of the public accounting firm as a condition of their continued employment by or other association with such firm); and

(B) a statement that such firm understands and agrees that cooperation and compliance, as described in the consent required by subparagraph (A), and the securing and enforcement of such consents from its associated persons, in accordance with the rules of the Board, shall be a condition to the continuing effectiveness of the registration of the firm with the Board.

(c) ACTION ON APPLICATIONS.—

Deadline.

(1) TIMING.—The Board shall approve a completed application for registration not later than 45 days after the date of receipt of the application, in accordance with the rules of the Board, unless the Board, prior to such date, issues a written notice of disapproval to, or requests more information from, the prospective registrant.

(2) TREATMENT.—A written notice of disapproval of a completed application under paragraph (1) for registration shall be treated as a disciplinary sanction for purposes of sections 105(d) and 107(c).

(d) PERIODIC REPORTS.—Each registered public accounting firm shall submit an annual report to the Board, and may be required

to report more frequently, as necessary to update the information contained in its application for registration under this section, and to provide to the Board such additional information as the Board or the Commission may specify, in accordance with subsection (b)(2).

(e) **PUBLIC AVAILABILITY.**—Registration applications and annual reports required by this subsection, or such portions of such applications or reports as may be designated under rules of the Board, shall be made available for public inspection, subject to rules of the Board or the Commission, and to applicable laws relating to the confidentiality of proprietary, personal, or other information contained in such applications or reports, provided that, in all events, the Board shall protect from public disclosure information reasonably identified by the subject accounting firm as proprietary information.

(f) **REGISTRATION AND ANNUAL FEES.**—The Board shall assess and collect a registration fee and an annual fee from each registered public accounting firm, in amounts that are sufficient to recover the costs of processing and reviewing applications and annual reports.

SEC. 103. AUDITING, QUALITY CONTROL, AND INDEPENDENCE STANDARDS AND RULES. 15 USC 7213.

(a) **AUDITING, QUALITY CONTROL, AND ETHICS STANDARDS.**—

(1) **IN GENERAL.**—The Board shall, by rule, establish, including, to the extent it determines appropriate, through adoption of standards proposed by 1 or more professional groups of accountants designated pursuant to paragraph (3)(A) or advisory groups convened pursuant to paragraph (4), and amend or otherwise modify or alter, such auditing and related attestation standards, such quality control standards, and such ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports, as required by this Act or the rules of the Commission, or as may be necessary or appropriate in the public interest or for the protection of investors.

(2) **RULE REQUIREMENTS.**—In carrying out paragraph (1), the Board—

(A) shall include in the auditing standards that it adopts, requirements that each registered public accounting firm shall—

(i) prepare, and maintain for a period of not less than 7 years, audit work papers, and other information related to any audit report, in sufficient detail to support the conclusions reached in such report;

(ii) provide a concurring or second partner review and approval of such audit report (and other related information), and concurring approval in its issuance, by a qualified person (as prescribed by the Board) associated with the public accounting firm, other than the person in charge of the audit, or by an independent reviewer (as prescribed by the Board); and

(iii) describe in each audit report the scope of the auditor's testing of the internal control structure and procedures of the issuer, required by section 404(b), and present (in such report or in a separate report)—

- (I) the findings of the auditor from such testing;
- (II) an evaluation of whether such internal control structure and procedures—
 - (aa) include maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer;
 - (bb) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the issuer; and
 - (III) a description, at a minimum, of material weaknesses in such internal controls, and of any material noncompliance found on the basis of such testing.
- (B) shall include, in the quality control standards that it adopts with respect to the issuance of audit reports, requirements for every registered public accounting firm relating to—
 - (i) monitoring of professional ethics and independence from issuers on behalf of which the firm issues audit reports;
 - (ii) consultation within such firm on accounting and auditing questions;
 - (iii) supervision of audit work;
 - (iv) hiring, professional development, and advancement of personnel;
 - (v) the acceptance and continuation of engagements;
 - (vi) internal inspection; and
 - (vii) such other requirements as the Board may prescribe, subject to subsection (a)(1).
- (3) AUTHORITY TO ADOPT OTHER STANDARDS.—
 - (A) IN GENERAL.—In carrying out this subsection, the Board—
 - (i) may adopt as its rules, subject to the terms of section 107, any portion of any statement of auditing standards or other professional standards that the Board determines satisfy the requirements of paragraph (1), and that were proposed by 1 or more professional groups of accountants that shall be designated or recognized by the Board, by rule, for such purpose, pursuant to this paragraph or 1 or more advisory groups convened pursuant to paragraph (4); and
 - (ii) notwithstanding clause (i), shall retain full authority to modify, supplement, revise, or subsequently amend, modify, or repeal, in whole or in part, any portion of any statement described in clause (i).
 - (B) INITIAL AND TRANSITIONAL STANDARDS.—The Board shall adopt standards described in subparagraph (A)(i) as initial or transitional standards, to the extent the Board determines necessary, prior to a determination of the

Commission under section 101(d), and such standards shall be separately approved by the Commission at the time of that determination, without regard to the procedures required by section 107 that otherwise would apply to the approval of rules of the Board.

(4) **ADVISORY GROUPS.**—The Board shall convene, or authorize its staff to convene, such expert advisory groups as may be appropriate, which may include practicing accountants and other experts, as well as representatives of other interested groups, subject to such rules as the Board may prescribe to prevent conflicts of interest, to make recommendations concerning the content (including proposed drafts) of auditing, quality control, ethics, independence, or other standards required to be established under this section.

(b) **INDEPENDENCE STANDARDS AND RULES.**—The Board shall establish such rules as may be necessary or appropriate in the public interest or for the protection of investors, to implement, or as authorized under, title II of this Act.

(c) **COOPERATION WITH DESIGNATED PROFESSIONAL GROUPS OF ACCOUNTANTS AND ADVISORY GROUPS.**—

(1) **IN GENERAL.**—The Board shall cooperate on an ongoing basis with professional groups of accountants designated under subsection (a)(3)(A) and advisory groups convened under subsection (a)(4) in the examination of the need for changes in any standards subject to its authority under subsection (a), recommend issues for inclusion on the agendas of such designated professional groups of accountants or advisory groups, and take such other steps as it deems appropriate to increase the effectiveness of the standard setting process.

(2) **BOARD RESPONSES.**—The Board shall respond in a timely fashion to requests from designated professional groups of accountants and advisory groups referred to in paragraph (1) for any changes in standards over which the Board has authority.

(d) **EVALUATION OF STANDARD SETTING PROCESS.**—The Board shall include in the annual report required by section 101(h) the results of its standard setting responsibilities during the period to which the report relates, including a discussion of the work of the Board with any designated professional groups of accountants and advisory groups described in paragraphs (3)(A) and (4) of subsection (a), and its pending issues agenda for future standard setting projects.

SEC. 104. INSPECTIONS OF REGISTERED PUBLIC ACCOUNTING FIRMS. 15 USC 7214.

(a) **IN GENERAL.**—The Board shall conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with this Act, the rules of the Board, the rules of the Commission, or professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers.

(b) **INSPECTION FREQUENCY.**—

(1) **IN GENERAL.**—Subject to paragraph (2), inspections required by this section shall be conducted—

(A) annually with respect to each registered public accounting firm that regularly provides audit reports for more than 100 issuers; and

(B) not less frequently than once every 3 years with respect to each registered public accounting firm that regularly provides audit reports for 100 or fewer issuers.

(2) ADJUSTMENTS TO SCHEDULES.—The Board may, by rule, adjust the inspection schedules set under paragraph (1) if the Board finds that different inspection schedules are consistent with the purposes of this Act, the public interest, and the protection of investors. The Board may conduct special inspections at the request of the Commission or upon its own motion.

(c) PROCEDURES.—The Board shall, in each inspection under this section, and in accordance with its rules for such inspections—

(1) identify any act or practice or omission to act by the registered public accounting firm, or by any associated person thereof, revealed by such inspection that may be in violation of this Act, the rules of the Board, the rules of the Commission, the firm's own quality control policies, or professional standards;

(2) report any such act, practice, or omission, if appropriate, to the Commission and each appropriate State regulatory authority; and

(3) begin a formal investigation or take disciplinary action, if appropriate, with respect to any such violation, in accordance with this Act and the rules of the Board.

(d) CONDUCT OF INSPECTIONS.—In conducting an inspection of a registered public accounting firm under this section, the Board shall—

(1) inspect and review selected audit and review engagements of the firm (which may include audit engagements that are the subject of ongoing litigation or other controversy between the firm and 1 or more third parties), performed at various offices and by various associated persons of the firm, as selected by the Board;

(2) evaluate the sufficiency of the quality control system of the firm, and the manner of the documentation and communication of that system by the firm; and

(3) perform such other testing of the audit, supervisory, and quality control procedures of the firm as are necessary or appropriate in light of the purpose of the inspection and the responsibilities of the Board.

(e) RECORD RETENTION.—The rules of the Board may require the retention by registered public accounting firms for inspection purposes of records whose retention is not otherwise required by section 103 or the rules issued thereunder.

(f) PROCEDURES FOR REVIEW.—The rules of the Board shall provide a procedure for the review of and response to a draft inspection report by the registered public accounting firm under inspection. The Board shall take such action with respect to such response as it considers appropriate (including revising the draft report or continuing or supplementing its inspection activities before issuing a final report), but the text of any such response, appropriately redacted to protect information reasonably identified by the accounting firm as confidential, shall be attached to and made part of the inspection report.

(g) REPORT.—A written report of the findings of the Board for each inspection under this section, subject to subsection (h), shall be—

(1) transmitted, in appropriate detail, to the Commission and each appropriate State regulatory authority, accompanied by any letter or comments by the Board or the inspector, and any letter of response from the registered public accounting firm; and

(2) made available in appropriate detail to the public (subject to section 105(b)(5)(A), and to the protection of such confidential and proprietary information as the Board may determine to be appropriate, or as may be required by law), except that no portions of the inspection report that deal with criticisms of or potential defects in the quality control systems of the firm under inspection shall be made public if those criticisms or defects are addressed by the firm, to the satisfaction of the Board, not later than 12 months after the date of the inspection report.

(h) INTERIM COMMISSION REVIEW.—

(1) REVIEWABLE MATTERS.—A registered public accounting firm may seek review by the Commission, pursuant to such rules as the Commission shall promulgate, if the firm—

(A) has provided the Board with a response, pursuant to rules issued by the Board under subsection (f), to the substance of particular items in a draft inspection report, and disagrees with the assessments contained in any final report prepared by the Board following such response; or

(B) disagrees with the determination of the Board that criticisms or defects identified in an inspection report have not been addressed to the satisfaction of the Board within 12 months of the date of the inspection report, for purposes of subsection (g)(2).

(2) TREATMENT OF REVIEW.—Any decision of the Commission with respect to a review under paragraph (1) shall not be reviewable under section 25 of the Securities Exchange Act of 1934 (15 U.S.C. 78y), or deemed to be “final agency action” for purposes of section 704 of title 5, United States Code.

(3) TIMING.—Review under paragraph (1) may be sought during the 30-day period following the date of the event giving rise to the review under subparagraph (A) or (B) of paragraph (1).

SEC. 105. INVESTIGATIONS AND DISCIPLINARY PROCEEDINGS.

15 USC 7215.

(a) IN GENERAL.—The Board shall establish, by rule, subject to the requirements of this section, fair procedures for the investigation and disciplining of registered public accounting firms and associated persons of such firms.

Establishment.

(b) INVESTIGATIONS.—

(1) AUTHORITY.—In accordance with the rules of the Board, the Board may conduct an investigation of any act or practice, or omission to act, by a registered public accounting firm, any associated person of such firm, or both, that may violate any provision of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under this Act, or professional standards, regardless of how the act, practice, or omission is brought to the attention of the Board.

(2) TESTIMONY AND DOCUMENT PRODUCTION.—In addition to such other actions as the Board determines to be necessary or appropriate, the rules of the Board may—

(A) require the testimony of the firm or of any person associated with a registered public accounting firm, with respect to any matter that the Board considers relevant or material to an investigation;

(B) require the production of audit work papers and any other document or information in the possession of a registered public accounting firm or any associated person thereof, wherever domiciled, that the Board considers relevant or material to the investigation, and may inspect the books and records of such firm or associated person to verify the accuracy of any documents or information supplied;

(C) request the testimony of, and production of any document in the possession of, any other person, including any client of a registered public accounting firm that the Board considers relevant or material to an investigation under this section, with appropriate notice, subject to the needs of the investigation, as permitted under the rules of the Board; and

(D) provide for procedures to seek issuance by the Commission, in a manner established by the Commission, of a subpoena to require the testimony of, and production of any document in the possession of, any person, including any client of a registered public accounting firm, that the Board considers relevant or material to an investigation under this section.

(3) NONCOOPERATION WITH INVESTIGATIONS.—

(A) IN GENERAL.—If a registered public accounting firm or any associated person thereof refuses to testify, produce documents, or otherwise cooperate with the Board in connection with an investigation under this section, the Board may—

(i) suspend or bar such person from being associated with a registered public accounting firm, or require the registered public accounting firm to end such association;

(ii) suspend or revoke the registration of the public accounting firm; and

(iii) invoke such other lesser sanctions as the Board considers appropriate, and as specified by rule of the Board.

(B) PROCEDURE.—Any action taken by the Board under this paragraph shall be subject to the terms of section 107(c).

(4) COORDINATION AND REFERRAL OF INVESTIGATIONS.—

(A) COORDINATION.—The Board shall notify the Commission of any pending Board investigation involving a potential violation of the securities laws, and thereafter coordinate its work with the work of the Commission's Division of Enforcement, as necessary to protect an ongoing Commission investigation.

(B) REFERRAL.—The Board may refer an investigation under this section—

(i) to the Commission;

Notification.

(ii) to any other Federal functional regulator (as defined in section 509 of the Gramm-Leach-Bliley Act (15 U.S.C. 6809)), in the case of an investigation that concerns an audit report for an institution that is subject to the jurisdiction of such regulator; and

(iii) at the direction of the Commission, to—

(I) the Attorney General of the United States;

(II) the attorney general of 1 or more States;

and

(III) the appropriate State regulatory authority.

(5) USE OF DOCUMENTS.—

(A) CONFIDENTIALITY.—Except as provided in subparagraph (B), all documents and information prepared or received by or specifically for the Board, and deliberations of the Board and its employees and agents, in connection with an inspection under section 104 or with an investigation under this section, shall be confidential and privileged as an evidentiary matter (and shall not be subject to civil discovery or other legal process) in any proceeding in any Federal or State court or administrative agency, and shall be exempt from disclosure, in the hands of an agency or establishment of the Federal Government, under the Freedom of Information Act (5 U.S.C. 552a), or otherwise, unless and until presented in connection with a public proceeding or released in accordance with subsection (c).

(B) AVAILABILITY TO GOVERNMENT AGENCIES.—Without the loss of its status as confidential and privileged in the hands of the Board, all information referred to in subparagraph (A) may—

(i) be made available to the Commission; and

(ii) in the discretion of the Board, when determined by the Board to be necessary to accomplish the purposes of this Act or to protect investors, be made available to—

(I) the Attorney General of the United States;

(II) the appropriate Federal functional regulator (as defined in section 509 of the Gramm-Leach-Bliley Act (15 U.S.C. 6809)), other than the Commission, with respect to an audit report for an institution subject to the jurisdiction of such regulator;

(III) State attorneys general in connection with any criminal investigation; and

(IV) any appropriate State regulatory authority,

each of which shall maintain such information as confidential and privileged.

(6) IMMUNITY.—Any employee of the Board engaged in carrying out an investigation under this Act shall be immune from any civil liability arising out of such investigation in the same manner and to the same extent as an employee of the Federal Government in similar circumstances.

(c) DISCIPLINARY PROCEDURES.—

(1) NOTIFICATION; RECORDKEEPING.—The rules of the Board shall provide that in any proceeding by the Board to determine

whether a registered public accounting firm, or an associated person thereof, should be disciplined, the Board shall—

(A) bring specific charges with respect to the firm or associated person;

(B) notify such firm or associated person of, and provide to the firm or associated person an opportunity to defend against, such charges; and

(C) keep a record of the proceedings.

(2) PUBLIC HEARINGS.—Hearings under this section shall not be public, unless otherwise ordered by the Board for good cause shown, with the consent of the parties to such hearing.

(3) SUPPORTING STATEMENT.—A determination by the Board to impose a sanction under this subsection shall be supported by a statement setting forth—

(A) each act or practice in which the registered public accounting firm, or associated person, has engaged (or omitted to engage), or that forms a basis for all or a part of such sanction;

(B) the specific provision of this Act, the securities laws, the rules of the Board, or professional standards which the Board determines has been violated; and

(C) the sanction imposed, including a justification for that sanction.

(4) SANCTIONS.—If the Board finds, based on all of the facts and circumstances, that a registered public accounting firm or associated person thereof has engaged in any act or practice, or omitted to act, in violation of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under this Act, or professional standards, the Board may impose such disciplinary or remedial sanctions as it determines appropriate, subject to applicable limitations under paragraph (5), including—

(A) temporary suspension or permanent revocation of registration under this title;

(B) temporary or permanent suspension or bar of a person from further association with any registered public accounting firm;

(C) temporary or permanent limitation on the activities, functions, or operations of such firm or person (other than in connection with required additional professional education or training);

(D) a civil money penalty for each such violation, in an amount equal to—

(i) not more than \$100,000 for a natural person or \$2,000,000 for any other person; and

(ii) in any case to which paragraph (5) applies, not more than \$750,000 for a natural person or \$15,000,000 for any other person;

(E) censure;

(F) required additional professional education or training; or

(G) any other appropriate sanction provided for in the rules of the Board.

(5) INTENTIONAL OR OTHER KNOWING CONDUCT.—The sanctions and penalties described in subparagraphs (A) through (C) and (D)(ii) of paragraph (4) shall only apply to—

(A) intentional or knowing conduct, including reckless conduct, that results in violation of the applicable statutory, regulatory, or professional standard; or

(B) repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard.

(6) FAILURE TO SUPERVISE.—

(A) IN GENERAL.—The Board may impose sanctions under this section on a registered accounting firm or upon the supervisory personnel of such firm, if the Board finds that—

(i) the firm has failed reasonably to supervise an associated person, either as required by the rules of the Board relating to auditing or quality control standards, or otherwise, with a view to preventing violations of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission under this Act, or professional standards; and

(ii) such associated person commits a violation of this Act, or any of such rules, laws, or standards.

(B) RULE OF CONSTRUCTION.—No associated person of a registered public accounting firm shall be deemed to have failed reasonably to supervise any other person for purposes of subparagraph (A), if—

(i) there have been established in and for that firm procedures, and a system for applying such procedures, that comply with applicable rules of the Board and that would reasonably be expected to prevent and detect any such violation by such associated person; and

(ii) such person has reasonably discharged the duties and obligations incumbent upon that person by reason of such procedures and system, and had no reasonable cause to believe that such procedures and system were not being complied with.

(7) EFFECT OF SUSPENSION.—

(A) ASSOCIATION WITH A PUBLIC ACCOUNTING FIRM.—It shall be unlawful for any person that is suspended or barred from being associated with a registered public accounting firm under this subsection willfully to become or remain associated with any registered public accounting firm, or for any registered public accounting firm that knew, or, in the exercise of reasonable care should have known, of the suspension or bar, to permit such an association, without the consent of the Board or the Commission.

(B) ASSOCIATION WITH AN ISSUER.—It shall be unlawful for any person that is suspended or barred from being associated with an issuer under this subsection willfully to become or remain associated with any issuer in an accountancy or a financial management capacity, and for any issuer that knew, or in the exercise of reasonable

116 STAT. 764

PUBLIC LAW 107-204—JULY 30, 2002

care should have known, of such suspension or bar, to permit such an association, without the consent of the Board or the Commission.

(d) REPORTING OF SANCTIONS.—

(1) RECIPIENTS.—If the Board imposes a disciplinary sanction, in accordance with this section, the Board shall report the sanction to—

(A) the Commission;

(B) any appropriate State regulatory authority or any foreign accountancy licensing board with which such firm or person is licensed or certified; and

(C) the public (once any stay on the imposition of such sanction has been lifted).

(2) CONTENTS.—The information reported under paragraph (1) shall include—

(A) the name of the sanctioned person;

(B) a description of the sanction and the basis for its imposition; and

(C) such other information as the Board deems appropriate.

(e) STAY OF SANCTIONS.—

(1) IN GENERAL.—Application to the Commission for review, or the institution by the Commission of review, of any disciplinary action of the Board shall operate as a stay of any such disciplinary action, unless and until the Commission orders (summarily or after notice and opportunity for hearing on the question of a stay, which hearing may consist solely of the submission of affidavits or presentation of oral arguments) that no such stay shall continue to operate.

(2) EXPEDITED PROCEDURES.—The Commission shall establish for appropriate cases an expedited procedure for consideration and determination of the question of the duration of a stay pending review of any disciplinary action of the Board under this subsection.

15 USC 7216.

SEC. 106. FOREIGN PUBLIC ACCOUNTING FIRMS.

(a) APPLICABILITY TO CERTAIN FOREIGN FIRMS.—

(1) IN GENERAL.—Any foreign public accounting firm that prepares or furnishes an audit report with respect to any issuer, shall be subject to this Act and the rules of the Board and the Commission issued under this Act, in the same manner and to the same extent as a public accounting firm that is organized and operates under the laws of the United States or any State, except that registration pursuant to section 102 shall not by itself provide a basis for subjecting such a foreign public accounting firm to the jurisdiction of the Federal or State courts, other than with respect to controversies between such firms and the Board.

(2) BOARD AUTHORITY.—The Board may, by rule, determine that a foreign public accounting firm (or a class of such firms) that does not issue audit reports nonetheless plays such a substantial role in the preparation and furnishing of such reports for particular issuers, that it is necessary or appropriate, in light of the purposes of this Act and in the public interest or for the protection of investors, that such firm (or class of firms) should be treated as a public accounting firm

(or firms) for purposes of registration under, and oversight by the Board in accordance with, this title.

(b) PRODUCTION OF AUDIT WORKPAPERS.—

(1) CONSENT BY FOREIGN FIRMS.—If a foreign public accounting firm issues an opinion or otherwise performs material services upon which a registered public accounting firm relies in issuing all or part of any audit report or any opinion contained in an audit report, that foreign public accounting firm shall be deemed to have consented—

(A) to produce its audit workpapers for the Board or the Commission in connection with any investigation by either body with respect to that audit report; and

(B) to be subject to the jurisdiction of the courts of the United States for purposes of enforcement of any request for production of such workpapers.

(2) CONSENT BY DOMESTIC FIRMS.—A registered public accounting firm that relies upon the opinion of a foreign public accounting firm, as described in paragraph (1), shall be deemed—

(A) to have consented to supplying the audit workpapers of that foreign public accounting firm in response to a request for production by the Board or the Commission; and

(B) to have secured the agreement of that foreign public accounting firm to such production, as a condition of its reliance on the opinion of that foreign public accounting firm.

(c) EXEMPTION AUTHORITY.—The Commission, and the Board, subject to the approval of the Commission, may, by rule, regulation, or order, and as the Commission (or Board) determines necessary or appropriate in the public interest or for the protection of investors, either unconditionally or upon specified terms and conditions exempt any foreign public accounting firm, or any class of such firms, from any provision of this Act or the rules of the Board or the Commission issued under this Act.

(d) DEFINITION.—In this section, the term “foreign public accounting firm” means a public accounting firm that is organized and operates under the laws of a foreign government or political subdivision thereof.

SEC. 107. COMMISSION OVERSIGHT OF THE BOARD.

15 USC 7217.

(a) GENERAL OVERSIGHT RESPONSIBILITY.—The Commission shall have oversight and enforcement authority over the Board, as provided in this Act. The provisions of section 17(a)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78q(a)(1)), and of section 17(b)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78q(b)(1)) shall apply to the Board as fully as if the Board were a “registered securities association” for purposes of those sections 17(a)(1) and 17(b)(1).

(b) RULES OF THE BOARD.—

(1) DEFINITION.—In this section, the term “proposed rule” means any proposed rule of the Board, and any modification of any such rule.

(2) PRIOR APPROVAL REQUIRED.—No rule of the Board shall become effective without prior approval of the Commission in accordance with this section, other than as provided in section 103(a)(3)(B) with respect to initial or transitional standards.

(3) APPROVAL CRITERIA.—The Commission shall approve a proposed rule, if it finds that the rule is consistent with the requirements of this Act and the securities laws, or is necessary or appropriate in the public interest or for the protection of investors.

(4) PROPOSED RULE PROCEDURES.—The provisions of paragraphs (1) through (3) of section 19(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(b)) shall govern the proposed rules of the Board, as fully as if the Board were a “registered securities association” for purposes of that section 19(b), except that, for purposes of this paragraph—

(A) the phrase “consistent with the requirements of this title and the rules and regulations thereunder applicable to such organization” in section 19(b)(2) of that Act shall be deemed to read “consistent with the requirements of title I of the Sarbanes-Oxley Act of 2002, and the rules and regulations issued thereunder applicable to such organization, or as necessary or appropriate in the public interest or for the protection of investors”; and

(B) the phrase “otherwise in furtherance of the purposes of this title” in section 19(b)(3)(C) of that Act shall be deemed to read “otherwise in furtherance of the purposes of title I of the Sarbanes-Oxley Act of 2002”.

(5) COMMISSION AUTHORITY TO AMEND RULES OF THE BOARD.—The provisions of section 19(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(c)) shall govern the abrogation, deletion, or addition to portions of the rules of the Board by the Commission as fully as if the Board were a “registered securities association” for purposes of that section 19(c), except that the phrase “to conform its rules to the requirements of this title and the rules and regulations thereunder applicable to such organization, or otherwise in furtherance of the purposes of this title” in section 19(c) of that Act shall, for purposes of this paragraph, be deemed to read “to assure the fair administration of the Public Company Accounting Oversight Board, conform the rules promulgated by that Board to the requirements of title I of the Sarbanes-Oxley Act of 2002, or otherwise further the purposes of that Act, the securities laws, and the rules and regulations thereunder applicable to that Board”.

(c) COMMISSION REVIEW OF DISCIPLINARY ACTION TAKEN BY THE BOARD.—

(1) NOTICE OF SANCTION.—The Board shall promptly file notice with the Commission of any final sanction on any registered public accounting firm or on any associated person thereof, in such form and containing such information as the Commission, by rule, may prescribe.

(2) REVIEW OF SANCTIONS.—The provisions of sections 19(d)(2) and 19(e)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78s (d)(2) and (e)(1)) shall govern the review by the Commission of final disciplinary sanctions imposed by the Board (including sanctions imposed under section 105(b)(3) of this Act for noncooperation in an investigation of the Board), as fully as if the Board were a self-regulatory organization and the Commission were the appropriate regulatory agency for such organization for purposes of those sections 19(d)(2) and 19(e)(1), except that, for purposes of this paragraph—

PUBLIC LAW 107-204—JULY 30, 2002

116 STAT. 767

(A) section 105(e) of this Act (rather than that section 19(d)(2)) shall govern the extent to which application for, or institution by the Commission on its own motion of, review of any disciplinary action of the Board operates as a stay of such action;

(B) references in that section 19(e)(1) to “members” of such an organization shall be deemed to be references to registered public accounting firms;

(C) the phrase “consistent with the purposes of this title” in that section 19(e)(1) shall be deemed to read “consistent with the purposes of this title and title I of the Sarbanes-Oxley Act of 2002”;

(D) references to rules of the Municipal Securities Rule-making Board in that section 19(e)(1) shall not apply; and

(E) the reference to section 19(e)(2) of the Securities Exchange Act of 1934 shall refer instead to section 107(c)(3) of this Act.

(3) COMMISSION MODIFICATION AUTHORITY.—The Commission may enhance, modify, cancel, reduce, or require the remission of a sanction imposed by the Board upon a registered public accounting firm or associated person thereof, if the Commission, having due regard for the public interest and the protection of investors, finds, after a proceeding in accordance with this subsection, that the sanction—

(A) is not necessary or appropriate in furtherance of this Act or the securities laws; or

(B) is excessive, oppressive, inadequate, or otherwise not appropriate to the finding or the basis on which the sanction was imposed.

(d) CENSURE OF THE BOARD; OTHER SANCTIONS.—

(1) RESCISSION OF BOARD AUTHORITY.—The Commission, by rule, consistent with the public interest, the protection of investors, and the other purposes of this Act and the securities laws, may relieve the Board of any responsibility to enforce compliance with any provision of this Act, the securities laws, the rules of the Board, or professional standards.

(2) CENSURE OF THE BOARD; LIMITATIONS.—The Commission may, by order, as it determines necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act or the securities laws, censure or impose limitations upon the activities, functions, and operations of the Board, if the Commission finds, on the record, after notice and opportunity for a hearing, that the Board—

(A) has violated or is unable to comply with any provision of this Act, the rules of the Board, or the securities laws; or

(B) without reasonable justification or excuse, has failed to enforce compliance with any such provision or rule, or any professional standard by a registered public accounting firm or an associated person thereof.

(3) CENSURE OF BOARD MEMBERS; REMOVAL FROM OFFICE.—The Commission may, as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act or the securities laws, remove

116 STAT. 768

PUBLIC LAW 107-204—JULY 30, 2002

from office or censure any member of the Board, if the Commission finds, on the record, after notice and opportunity for a hearing, that such member—

(A) has willfully violated any provision of this Act, the rules of the Board, or the securities laws;

(B) has willfully abused the authority of that member;

or

(C) without reasonable justification or excuse, has failed to enforce compliance with any such provision or rule, or any professional standard by any registered public accounting firm or any associated person thereof.

15 USC 7218.

SEC. 108. ACCOUNTING STANDARDS.

(a) AMENDMENT TO SECURITIES ACT OF 1933.—Section 19 of the Securities Act of 1933 (15 U.S.C. 77s) is amended—

(1) by redesignating subsections (b) and (c) as subsections (c) and (d), respectively; and

(2) by inserting after subsection (a) the following:

“(b) RECOGNITION OF ACCOUNTING STANDARDS.—

“(1) IN GENERAL.—In carrying out its authority under subsection (a) and under section 13(b) of the Securities Exchange Act of 1934, the Commission may recognize, as ‘generally accepted’ for purposes of the securities laws, any accounting principles established by a standard setting body—

“(A) that—

“(i) is organized as a private entity;

“(ii) has, for administrative and operational purposes, a board of trustees (or equivalent body) serving in the public interest, the majority of whom are not, concurrent with their service on such board, and have not been during the 2-year period preceding such service, associated persons of any registered public accounting firm;

“(iii) is funded as provided in section 109 of the Sarbanes-Oxley Act of 2002;

“(iv) has adopted procedures to ensure prompt consideration, by majority vote of its members, of changes to accounting principles necessary to reflect emerging accounting issues and changing business practices; and

“(v) considers, in adopting accounting principles, the need to keep standards current in order to reflect changes in the business environment, the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors; and

“(B) that the Commission determines has the capacity to assist the Commission in fulfilling the requirements of subsection (a) and section 13(b) of the Securities Exchange Act of 1934, because, at a minimum, the standard setting body is capable of improving the accuracy and effectiveness of financial reporting and the protection of investors under the securities laws.

PUBLIC LAW 107-204—JULY 30, 2002

116 STAT. 769

“(2) ANNUAL REPORT.—A standard setting body described in paragraph (1) shall submit an annual report to the Commission and the public, containing audited financial statements of that standard setting body.”.

(b) COMMISSION AUTHORITY.—The Commission shall promulgate such rules and regulations to carry out section 19(b) of the Securities Act of 1933, as added by this section, as it deems necessary or appropriate in the public interest or for the protection of investors.

Regulations.

(c) NO EFFECT ON COMMISSION POWERS.—Nothing in this Act, including this section and the amendment made by this section, shall be construed to impair or limit the authority of the Commission to establish accounting principles or standards for purposes of enforcement of the securities laws.

(d) STUDY AND REPORT ON ADOPTING PRINCIPLES-BASED ACCOUNTING.—

(1) STUDY.—

(A) IN GENERAL.—The Commission shall conduct a study on the adoption by the United States financial reporting system of a principles-based accounting system.

(B) STUDY TOPICS.—The study required by subparagraph (A) shall include an examination of—

(i) the extent to which principles-based accounting and financial reporting exists in the United States;

(ii) the length of time required for change from a rules-based to a principles-based financial reporting system;

(iii) the feasibility of and proposed methods by which a principles-based system may be implemented; and

(iv) a thorough economic analysis of the implementation of a principles-based system.

(2) REPORT.—Not later than 1 year after the date of enactment of this Act, the Commission shall submit a report on the results of the study required by paragraph (1) to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

SEC. 109. FUNDING.

15 USC 7219.

(a) IN GENERAL.—The Board, and the standard setting body designated pursuant to section 19(b) of the Securities Act of 1933, as amended by section 108, shall be funded as provided in this section.

(b) ANNUAL BUDGETS.—The Board and the standard setting body referred to in subsection (a) shall each establish a budget for each fiscal year, which shall be reviewed and approved according to their respective internal procedures not less than 1 month prior to the commencement of the fiscal year to which the budget pertains (or at the beginning of the Board’s first fiscal year, which may be a short fiscal year). The budget of the Board shall be subject to approval by the Commission. The budget for the first fiscal year of the Board shall be prepared and approved promptly following the appointment of the initial five Board members, to permit action by the Board of the organizational tasks contemplated by section 101(d).

(c) SOURCES AND USES OF FUNDS.—

(1) RECOVERABLE BUDGET EXPENSES.—The budget of the Board (reduced by any registration or annual fees received under section 102(e) for the year preceding the year for which the budget is being computed), and all of the budget of the standard setting body referred to in subsection (a), for each fiscal year of each of those 2 entities, shall be payable from annual accounting support fees, in accordance with subsections (d) and (e). Accounting support fees and other receipts of the Board and of such standard-setting body shall not be considered public monies of the United States.

(2) FUNDS GENERATED FROM THE COLLECTION OF MONETARY PENALTIES.—Subject to the availability in advance in an appropriations Act, and notwithstanding subsection (i), all funds collected by the Board as a result of the assessment of monetary penalties shall be used to fund a merit scholarship program for undergraduate and graduate students enrolled in accredited accounting degree programs, which program is to be administered by the Board or by an entity or agent identified by the Board.

(d) ANNUAL ACCOUNTING SUPPORT FEE FOR THE BOARD.—

(1) ESTABLISHMENT OF FEE.—The Board shall establish, with the approval of the Commission, a reasonable annual accounting support fee (or a formula for the computation thereof), as may be necessary or appropriate to establish and maintain the Board. Such fee may also cover costs incurred in the Board's first fiscal year (which may be a short fiscal year), or may be levied separately with respect to such short fiscal year.

(2) ASSESSMENTS.—The rules of the Board under paragraph (1) shall provide for the equitable allocation, assessment, and collection by the Board (or an agent appointed by the Board) of the fee established under paragraph (1), among issuers, in accordance with subsection (g), allowing for differentiation among classes of issuers, as appropriate.

(e) ANNUAL ACCOUNTING SUPPORT FEE FOR STANDARD SETTING BODY.—The annual accounting support fee for the standard setting body referred to in subsection (a)—

(1) shall be allocated in accordance with subsection (g), and assessed and collected against each issuer, on behalf of the standard setting body, by 1 or more appropriate designated collection agents, as may be necessary or appropriate to pay for the budget and provide for the expenses of that standard setting body, and to provide for an independent, stable source of funding for such body, subject to review by the Commission; and

(2) may differentiate among different classes of issuers.

(f) LIMITATION ON FEE.—The amount of fees collected under this section for a fiscal year on behalf of the Board or the standards setting body, as the case may be, shall not exceed the recoverable budget expenses of the Board or body, respectively (which may include operating, capital, and accrued items), referred to in subsection (c)(1).

(g) ALLOCATION OF ACCOUNTING SUPPORT FEES AMONG ISSUERS.—Any amount due from issuers (or a particular class of issuers) under this section to fund the budget of the Board or the standard setting body referred to in subsection (a) shall be allocated among and payable by each issuer (or each issuer in

a particular class, as applicable) in an amount equal to the total of such amount, multiplied by a fraction—

(1) the numerator of which is the average monthly equity market capitalization of the issuer for the 12-month period immediately preceding the beginning of the fiscal year to which such budget relates; and

(2) the denominator of which is the average monthly equity market capitalization of all such issuers for such 12-month period.

(h) CONFORMING AMENDMENTS.—Section 13(b)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(b)(2)) is amended—

(1) in subparagraph (A), by striking “and” at the end; and

(2) in subparagraph (B), by striking the period at the end and inserting the following: “; and

“(C) notwithstanding any other provision of law, pay the allocable share of such issuer of a reasonable annual accounting support fee or fees, determined in accordance with section 109 of the Sarbanes-Oxley Act of 2002.”.

(i) RULE OF CONSTRUCTION.—Nothing in this section shall be construed to render either the Board, the standard setting body referred to in subsection (a), or both, subject to procedures in Congress to authorize or appropriate public funds, or to prevent such organization from utilizing additional sources of revenue for its activities, such as earnings from publication sales, provided that each additional source of revenue shall not jeopardize, in the judgment of the Commission, the actual and perceived independence of such organization.

(j) START-UP EXPENSES OF THE BOARD.—From the unexpended balances of the appropriations to the Commission for fiscal year 2003, the Secretary of the Treasury is authorized to advance to the Board not to exceed the amount necessary to cover the expenses of the Board during its first fiscal year (which may be a short fiscal year).

TITLE II—AUDITOR INDEPENDENCE

SEC. 201. SERVICES OUTSIDE THE SCOPE OF PRACTICE OF AUDITORS.

(a) PROHIBITED ACTIVITIES.—Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j-1) is amended by adding at the end the following:

“(g) PROHIBITED ACTIVITIES.—Except as provided in subsection (h), it shall be unlawful for a registered public accounting firm (and any associated person of that firm, to the extent determined appropriate by the Commission) that performs for any issuer any audit required by this title or the rules of the Commission under this title or, beginning 180 days after the date of commencement of the operations of the Public Company Accounting Oversight Board established under section 101 of the Sarbanes-Oxley Act of 2002 (in this section referred to as the ‘Board’), the rules of the Board, to provide to that issuer, contemporaneously with the audit, any non-audit service, including—

“(1) bookkeeping or other services related to the accounting records or financial statements of the audit client;

“(2) financial information systems design and implementation;

“(3) appraisal or valuation services, fairness opinions, or contribution-in-kind reports;

“(4) actuarial services;

“(5) internal audit outsourcing services;

“(6) management functions or human resources;

“(7) broker or dealer, investment adviser, or investment banking services;

“(8) legal services and expert services unrelated to the audit; and

“(9) any other service that the Board determines, by regulation, is impermissible.

“(h) **PREAPPROVAL REQUIRED FOR NON-AUDIT SERVICES.**—A registered public accounting firm may engage in any non-audit service, including tax services, that is not described in any of paragraphs (1) through (9) of subsection (g) for an audit client, only if the activity is approved in advance by the audit committee of the issuer, in accordance with subsection (i).”.

15 USC 7231.

(b) **EXEMPTION AUTHORITY.**—The Board may, on a case by case basis, exempt any person, issuer, public accounting firm, or transaction from the prohibition on the provision of services under section 10A(g) of the Securities Exchange Act of 1934 (as added by this section), to the extent that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors, and subject to review by the Commission in the same manner as for rules of the Board under section 107.

SEC. 202. PREAPPROVAL REQUIREMENTS.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j-1), as amended by this Act, is amended by adding at the end the following:

“(i) **PREAPPROVAL REQUIREMENTS.**—

“(1) **IN GENERAL.**—

“(A) **AUDIT COMMITTEE ACTION.**—All auditing services (which may entail providing comfort letters in connection with securities underwritings or statutory audits required for insurance companies for purposes of State law) and non-audit services, other than as provided in subparagraph (B), provided to an issuer by the auditor of the issuer shall be preapproved by the audit committee of the issuer.

“(B) **DE MINIMUS EXCEPTION.**—The preapproval requirement under subparagraph (A) is waived with respect to the provision of non-audit services for an issuer, if—

“(i) the aggregate amount of all such non-audit services provided to the issuer constitutes not more than 5 percent of the total amount of revenues paid by the issuer to its auditor during the fiscal year in which the nonaudit services are provided;

“(ii) such services were not recognized by the issuer at the time of the engagement to be non-audit services; and

“(iii) such services are promptly brought to the attention of the audit committee of the issuer and approved prior to the completion of the audit by the audit committee or by 1 or more members of the audit committee who are members of the board of directors to whom authority to grant such approvals has been delegated by the audit committee.

“(2) DISCLOSURE TO INVESTORS.—Approval by an audit committee of an issuer under this subsection of a non-audit service to be performed by the auditor of the issuer shall be disclosed to investors in periodic reports required by section 13(a).

“(3) DELEGATION AUTHORITY.—The audit committee of an issuer may delegate to 1 or more designated members of the audit committee who are independent directors of the board of directors, the authority to grant preapprovals required by this subsection. The decisions of any member to whom authority is delegated under this paragraph to preapprove an activity under this subsection shall be presented to the full audit committee at each of its scheduled meetings.

“(4) APPROVAL OF AUDIT SERVICES FOR OTHER PURPOSES.—In carrying out its duties under subsection (m)(2), if the audit committee of an issuer approves an audit service within the scope of the engagement of the auditor, such audit service shall be deemed to have been preapproved for purposes of this subsection.”.

SEC. 203. AUDIT PARTNER ROTATION.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j-1), as amended by this Act, is amended by adding at the end the following:

“(j) AUDIT PARTNER ROTATION.—It shall be unlawful for a registered public accounting firm to provide audit services to an issuer if the lead (or coordinating) audit partner (having primary responsibility for the audit), or the audit partner responsible for reviewing the audit, has performed audit services for that issuer in each of the 5 previous fiscal years of that issuer.”.

SEC. 204. AUDITOR REPORTS TO AUDIT COMMITTEES.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j-1), as amended by this Act, is amended by adding at the end the following:

“(k) REPORTS TO AUDIT COMMITTEES.—Each registered public accounting firm that performs for any issuer any audit required by this title shall timely report to the audit committee of the issuer—

“(1) all critical accounting policies and practices to be used;

“(2) all alternative treatments of financial information within generally accepted accounting principles that have been discussed with management officials of the issuer, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the registered public accounting firm; and

“(3) other material written communications between the registered public accounting firm and the management of the issuer, such as any management letter or schedule of unadjusted differences.”.

SEC. 205. CONFORMING AMENDMENTS.

(a) DEFINITIONS.—Section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) is amended by adding at the end the following:

“(58) AUDIT COMMITTEE.—The term ‘audit committee’ means—

“(A) a committee (or equivalent body) established by and amongst the board of directors of an issuer for the

purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer; and

“(B) if no such committee exists with respect to an issuer, the entire board of directors of the issuer.

“(59) REGISTERED PUBLIC ACCOUNTING FIRM.—The term ‘registered public accounting firm’ has the same meaning as in section 2 of the Sarbanes-Oxley Act of 2002.”.

(b) AUDITOR REQUIREMENTS.—Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j-1) is amended—

(1) by striking “an independent public accountant” each place that term appears and inserting “a registered public accounting firm”;

(2) by striking “the independent public accountant” each place that term appears and inserting “the registered public accounting firm”;

(3) in subsection (c), by striking “No independent public accountant” and inserting “No registered public accounting firm”; and

(4) in subsection (b)—

(A) by striking “the accountant” each place that term appears and inserting “the firm”;

(B) by striking “such accountant” each place that term appears and inserting “such firm”; and

(C) in paragraph (4), by striking “the accountant’s report” and inserting “the report of the firm”.

(c) OTHER REFERENCES.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended—

(1) in section 12(b)(1) (15 U.S.C. 78l(b)(1)), by striking “independent public accountants” each place that term appears and inserting “a registered public accounting firm”; and

(2) in subsections (e) and (i) of section 17 (15 U.S.C. 78q), by striking “an independent public accountant” each place that term appears and inserting “a registered public accounting firm”.

(d) CONFORMING AMENDMENT.—Section 10A(f) of the Securities Exchange Act of 1934 (15 U.S.C. 78k(f)) is amended—

15 USC 78j-1.

(1) by striking “DEFINITION” and inserting “DEFINITIONS”; and

(2) by adding at the end the following: “As used in this section, the term ‘issuer’ means an issuer (as defined in section 3), the securities of which are registered under section 12, or that is required to file reports pursuant to section 15(d), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn.”.

SEC. 206. CONFLICTS OF INTEREST.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78j-1), as amended by this Act, is amended by adding at the end the following:

“(1) CONFLICTS OF INTEREST.—It shall be unlawful for a registered public accounting firm to perform for an issuer any audit service required by this title, if a chief executive officer, controller, chief financial officer, chief accounting officer, or any person serving in an equivalent position for the issuer, was employed by that registered independent public accounting firm and participated in

PUBLIC LAW 107-204—JULY 30, 2002

116 STAT. 775

any capacity in the audit of that issuer during the 1-year period preceding the date of the initiation of the audit.”.

SEC. 207. STUDY OF MANDATORY ROTATION OF REGISTERED PUBLIC ACCOUNTING FIRMS. 15 USC 7232.

(a) **STUDY AND REVIEW REQUIRED.**—The Comptroller General of the United States shall conduct a study and review of the potential effects of requiring the mandatory rotation of registered public accounting firms.

(b) **REPORT REQUIRED.**—Not later than 1 year after the date of enactment of this Act, the Comptroller General shall submit a report to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives on the results of the study and review required by this section. Deadline.

(c) **DEFINITION.**—For purposes of this section, the term “mandatory rotation” refers to the imposition of a limit on the period of years in which a particular registered public accounting firm may be the auditor of record for a particular issuer.

SEC. 208. COMMISSION AUTHORITY.

15 USC 7233.

(a) **COMMISSION REGULATIONS.**—Not later than 180 days after the date of enactment of this Act, the Commission shall issue final regulations to carry out each of subsections (g) through (l) of section 10A of the Securities Exchange Act of 1934, as added by this title. Deadline.

(b) **AUDITOR INDEPENDENCE.**—It shall be unlawful for any registered public accounting firm (or an associated person thereof, as applicable) to prepare or issue any audit report with respect to any issuer, if the firm or associated person engages in any activity with respect to that issuer prohibited by any of subsections (g) through (l) of section 10A of the Securities Exchange Act of 1934, as added by this title, or any rule or regulation of the Commission or of the Board issued thereunder.

SEC. 209. CONSIDERATIONS BY APPROPRIATE STATE REGULATORY AUTHORITIES. 15 USC 7234.

In supervising nonregistered public accounting firms and their associated persons, appropriate State regulatory authorities should make an independent determination of the proper standards applicable, particularly taking into consideration the size and nature of the business of the accounting firms they supervise and the size and nature of the business of the clients of those firms. The standards applied by the Board under this Act should not be presumed to be applicable for purposes of this section for small and medium sized nonregistered public accounting firms.

TITLE III—CORPORATE RESPONSIBILITY

SEC. 301. PUBLIC COMPANY AUDIT COMMITTEES.

Section 10A of the Securities Exchange Act of 1934 (15 U.S.C. 78f) is amended by adding at the end the following:

15 USC 78j-1.

“(m) **STANDARDS RELATING TO AUDIT COMMITTEES.**—

“(1) **COMMISSION RULES.**—

116 STAT. 776

PUBLIC LAW 107-204—JULY 30, 2002

Deadline.

“(A) IN GENERAL.—Effective not later than 270 days after the date of enactment of this subsection, the Commission shall, by rule, direct the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that is not in compliance with the requirements of any portion of paragraphs (2) through (6).

“(B) OPPORTUNITY TO CURE DEFECTS.—The rules of the Commission under subparagraph (A) shall provide for appropriate procedures for an issuer to have an opportunity to cure any defects that would be the basis for a prohibition under subparagraph (A), before the imposition of such prohibition.

“(2) RESPONSIBILITIES RELATING TO REGISTERED PUBLIC ACCOUNTING FIRMS.—The audit committee of each issuer, in its capacity as a committee of the board of directors, shall be directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm employed by that issuer (including resolution of disagreements between management and the auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or related work, and each such registered public accounting firm shall report directly to the audit committee.

“(3) INDEPENDENCE.—

“(A) IN GENERAL.—Each member of the audit committee of the issuer shall be a member of the board of directors of the issuer, and shall otherwise be independent.

“(B) CRITERIA.—In order to be considered to be independent for purposes of this paragraph, a member of an audit committee of an issuer may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee—

“(i) accept any consulting, advisory, or other compensatory fee from the issuer; or

“(ii) be an affiliated person of the issuer or any subsidiary thereof.

“(C) EXEMPTION AUTHORITY.—The Commission may exempt from the requirements of subparagraph (B) a particular relationship with respect to audit committee members, as the Commission determines appropriate in light of the circumstances.

“(4) COMPLAINTS.—Each audit committee shall establish procedures for—

“(A) the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and

“(B) the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.

“(5) AUTHORITY TO ENGAGE ADVISERS.—Each audit committee shall have the authority to engage independent counsel and other advisers, as it determines necessary to carry out its duties.

“(6) FUNDING.—Each issuer shall provide for appropriate funding, as determined by the audit committee, in its capacity as a committee of the board of directors, for payment of compensation—

PUBLIC LAW 107-204—JULY 30, 2002

116 STAT. 777

“(A) to the registered public accounting firm employed by the issuer for the purpose of rendering or issuing an audit report; and

“(B) to any advisers employed by the audit committee under paragraph (5).”.

SEC. 302. CORPORATE RESPONSIBILITY FOR FINANCIAL REPORTS.

15 USC 7241.

(a) **REGULATIONS REQUIRED.**—The Commission shall, by rule, require, for each company filing periodic reports under section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)), that the principal executive officer or officers and the principal financial officer or officers, or persons performing similar functions, certify in each annual or quarterly report filed or submitted under either such section of such Act that—

(1) the signing officer has reviewed the report;

(2) based on the officer’s knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading;

(3) based on such officer’s knowledge, the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition and results of operations of the issuer as of, and for, the periods presented in the report;

(4) the signing officers—

(A) are responsible for establishing and maintaining internal controls;

(B) have designed such internal controls to ensure that material information relating to the issuer and its consolidated subsidiaries is made known to such officers by others within those entities, particularly during the period in which the periodic reports are being prepared;

(C) have evaluated the effectiveness of the issuer’s internal controls as of a date within 90 days prior to the report; and

(D) have presented in the report their conclusions about the effectiveness of their internal controls based on their evaluation as of that date;

(5) the signing officers have disclosed to the issuer’s auditors and the audit committee of the board of directors (or persons fulfilling the equivalent function)—

(A) all significant deficiencies in the design or operation of internal controls which could adversely affect the issuer’s ability to record, process, summarize, and report financial data and have identified for the issuer’s auditors any material weaknesses in internal controls; and

(B) any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer’s internal controls; and

(6) the signing officers have indicated in the report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

116 STAT. 778

PUBLIC LAW 107-204—JULY 30, 2002

(b) **FOREIGN REINCORPORATIONS HAVE NO EFFECT.**—Nothing in this section 302 shall be interpreted or applied in any way to allow any issuer to lessen the legal force of the statement required under this section 302, by an issuer having reincorporated or having engaged in any other transaction that resulted in the transfer of the corporate domicile or offices of the issuer from inside the United States to outside of the United States.

(c) **DEADLINE.**—The rules required by subsection (a) shall be effective not later than 30 days after the date of enactment of this Act.

15 USC 7242.

SEC. 303. IMPROPER INFLUENCE ON CONDUCT OF AUDITS.

(a) **RULES TO PROHIBIT.**—It shall be unlawful, in contravention of such rules or regulations as the Commission shall prescribe as necessary and appropriate in the public interest or for the protection of investors, for any officer or director of an issuer, or any other person acting under the direction thereof, to take any action to fraudulently influence, coerce, manipulate, or mislead any independent public or certified accountant engaged in the performance of an audit of the financial statements of that issuer for the purpose of rendering such financial statements materially misleading.

(b) **ENFORCEMENT.**—In any civil proceeding, the Commission shall have exclusive authority to enforce this section and any rule or regulation issued under this section.

(c) **NO PREEMPTION OF OTHER LAW.**—The provisions of subsection (a) shall be in addition to, and shall not supersede or preempt, any other provision of law or any rule or regulation issued thereunder.

(d) **DEADLINE FOR RULEMAKING.**—The Commission shall—

(1) propose the rules or regulations required by this section, not later than 90 days after the date of enactment of this Act; and

(2) issue final rules or regulations required by this section, not later than 270 days after that date of enactment.

15 USC 7243.

SEC. 304. FORFEITURE OF CERTAIN BONUSES AND PROFITS.

(a) **ADDITIONAL COMPENSATION PRIOR TO NONCOMPLIANCE WITH COMMISSION FINANCIAL REPORTING REQUIREMENTS.**—If an issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer, as a result of misconduct, with any financial reporting requirement under the securities laws, the chief executive officer and chief financial officer of the issuer shall reimburse the issuer for—

(1) any bonus or other incentive-based or equity-based compensation received by that person from the issuer during the 12-month period following the first public issuance or filing with the Commission (whichever first occurs) of the financial document embodying such financial reporting requirement; and

(2) any profits realized from the sale of securities of the issuer during that 12-month period.

(b) **COMMISSION EXEMPTION AUTHORITY.**—The Commission may exempt any person from the application of subsection (a), as it deems necessary and appropriate.

SEC. 305. OFFICER AND DIRECTOR BARS AND PENALTIES.

(a) **UNFITNESS STANDARD.**—

PUBLIC LAW 107-204—JULY 30, 2002

116 STAT. 779

(1) SECURITIES EXCHANGE ACT OF 1934.—Section 21(d)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)(2)) is amended by striking “substantial unfitness” and inserting “unfitness”.

(2) SECURITIES ACT OF 1933.—Section 20(e) of the Securities Act of 1933 (15 U.S.C. 77t(e)) is amended by striking “substantial unfitness” and inserting “unfitness”.

(b) EQUITABLE RELIEF.—Section 21(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)) is amended by adding at the end the following:

“(5) EQUITABLE RELIEF.—In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, the Commission may seek, and any Federal court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors.”.

SEC. 306. INSIDER TRADES DURING PENSION FUND BLACKOUT PERIODS. 15 USC 7244.

(a) PROHIBITION OF INSIDER TRADING DURING PENSION FUND BLACKOUT PERIODS.—

(1) IN GENERAL.—Except to the extent otherwise provided by rule of the Commission pursuant to paragraph (3), it shall be unlawful for any director or executive officer of an issuer of any equity security (other than an exempted security), directly or indirectly, to purchase, sell, or otherwise acquire or transfer any equity security of the issuer (other than an exempted security) during any blackout period with respect to such equity security if such director or officer acquires such equity security in connection with his or her service or employment as a director or executive officer.

(2) REMEDY.—

(A) IN GENERAL.—Any profit realized by a director or executive officer referred to in paragraph (1) from any purchase, sale, or other acquisition or transfer in violation of this subsection shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such director or executive officer in entering into the transaction.

(B) ACTIONS TO RECOVER PROFITS.—An action to recover profits in accordance with this subsection may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer fails or refuses to bring such action within 60 days after the date of request, or fails diligently to prosecute the action thereafter, except that no such suit shall be brought more than 2 years after the date on which such profit was realized.

(3) RULEMAKING AUTHORIZED.—The Commission shall, in consultation with the Secretary of Labor, issue rules to clarify the application of this subsection and to prevent evasion thereof. Such rules shall provide for the application of the requirements of paragraph (1) with respect to entities treated as a single employer with respect to an issuer under section 414(b), (c), (m), or (o) of the Internal Revenue Code of 1986 to the extent necessary to clarify the application of such requirements and to prevent evasion thereof. Such rules may also provide for

appropriate exceptions from the requirements of this subsection, including exceptions for purchases pursuant to an automatic dividend reinvestment program or purchases or sales made pursuant to an advance election.

(4) **BLACKOUT PERIOD.**—For purposes of this subsection, the term “blackout period”, with respect to the equity securities of any issuer—

(A) means any period of more than 3 consecutive business days during which the ability of not fewer than 50 percent of the participants or beneficiaries under all individual account plans maintained by the issuer to purchase, sell, or otherwise acquire or transfer an interest in any equity of such issuer held in such an individual account plan is temporarily suspended by the issuer or by a fiduciary of the plan; and

(B) does not include, under regulations which shall be prescribed by the Commission—

(i) a regularly scheduled period in which the participants and beneficiaries may not purchase, sell, or otherwise acquire or transfer an interest in any equity of such issuer, if such period is—

(I) incorporated into the individual account plan; and

(II) timely disclosed to employees before becoming participants under the individual account plan or as a subsequent amendment to the plan; or

(ii) any suspension described in subparagraph (A) that is imposed solely in connection with persons becoming participants or beneficiaries, or ceasing to be participants or beneficiaries, in an individual account plan by reason of a corporate merger, acquisition, divestiture, or similar transaction involving the plan or plan sponsor.

(5) **INDIVIDUAL ACCOUNT PLAN.**—For purposes of this subsection, the term “individual account plan” has the meaning provided in section 3(34) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(34), except that such term shall not include a one-participant retirement plan (within the meaning of section 101(i)(8)(B) of such Act (29 U.S.C. 1021(i)(8)(B))).

(6) **NOTICE TO DIRECTORS, EXECUTIVE OFFICERS, AND THE COMMISSION.**—In any case in which a director or executive officer is subject to the requirements of this subsection in connection with a blackout period (as defined in paragraph (4)) with respect to any equity securities, the issuer of such equity securities shall timely notify such director or officer and the Securities and Exchange Commission of such blackout period.

(b) **NOTICE REQUIREMENTS TO PARTICIPANTS AND BENEFICIARIES UNDER ERISA.**—

(1) **IN GENERAL.**—Section 101 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1021) is amended by redesignating the second subsection (h) as subsection (j), and by inserting after the first subsection (h) the following new subsection:

“(i) NOTICE OF BLACKOUT PERIODS TO PARTICIPANT OR BENEFICIARY UNDER INDIVIDUAL ACCOUNT PLAN.—

“(1) DUTIES OF PLAN ADMINISTRATOR.—In advance of the commencement of any blackout period with respect to an individual account plan, the plan administrator shall notify the plan participants and beneficiaries who are affected by such action in accordance with this subsection.

“(2) NOTICE REQUIREMENTS.—

“(A) IN GENERAL.—The notices described in paragraph (1) shall be written in a manner calculated to be understood by the average plan participant and shall include—

“(i) the reasons for the blackout period,

“(ii) an identification of the investments and other rights affected,

“(iii) the expected beginning date and length of the blackout period,

“(iv) in the case of investments affected, a statement that the participant or beneficiary should evaluate the appropriateness of their current investment decisions in light of their inability to direct or diversify assets credited to their accounts during the blackout period, and

“(v) such other matters as the Secretary may require by regulation.

“(B) NOTICE TO PARTICIPANTS AND BENEFICIARIES.—Except as otherwise provided in this subsection, notices described in paragraph (1) shall be furnished to all participants and beneficiaries under the plan to whom the blackout period applies at least 30 days in advance of the blackout period.

“(C) EXCEPTION TO 30-DAY NOTICE REQUIREMENT.—In any case in which—

“(i) a deferral of the blackout period would violate the requirements of subparagraph (A) or (B) of section 404(a)(1), and a fiduciary of the plan reasonably so determines in writing, or

“(ii) the inability to provide the 30-day advance notice is due to events that were unforeseeable or circumstances beyond the reasonable control of the plan administrator, and a fiduciary of the plan reasonably so determines in writing,

subparagraph (B) shall not apply, and the notice shall be furnished to all participants and beneficiaries under the plan to whom the blackout period applies as soon as reasonably possible under the circumstances unless such a notice in advance of the termination of the blackout period is impracticable.

“(D) WRITTEN NOTICE.—The notice required to be provided under this subsection shall be in writing, except that such notice may be in electronic or other form to the extent that such form is reasonably accessible to the recipient.

“(E) NOTICE TO ISSUERS OF EMPLOYER SECURITIES SUBJECT TO BLACKOUT PERIOD.—In the case of any blackout period in connection with an individual account plan, the plan administrator shall provide timely notice of such

blackout period to the issuer of any employer securities subject to such blackout period.

“(3) EXCEPTION FOR BLACKOUT PERIODS WITH LIMITED APPLICABILITY.—In any case in which the blackout period applies only to 1 or more participants or beneficiaries in connection with a merger, acquisition, divestiture, or similar transaction involving the plan or plan sponsor and occurs solely in connection with becoming or ceasing to be a participant or beneficiary under the plan by reason of such merger, acquisition, divestiture, or transaction, the requirement of this subsection that the notice be provided to all participants and beneficiaries shall be treated as met if the notice required under paragraph (1) is provided to such participants or beneficiaries to whom the blackout period applies as soon as reasonably practicable.

“(4) CHANGES IN LENGTH OF BLACKOUT PERIOD.—If, following the furnishing of the notice pursuant to this subsection, there is a change in the beginning date or length of the blackout period (specified in such notice pursuant to paragraph (2)(A)(iii)), the administrator shall provide affected participants and beneficiaries notice of the change as soon as reasonably practicable. In relation to the extended blackout period, such notice shall meet the requirements of paragraph (2)(D) and shall specify any material change in the matters referred to in clauses (i) through (v) of paragraph (2)(A).

“(5) REGULATORY EXCEPTIONS.—The Secretary may provide by regulation for additional exceptions to the requirements of this subsection which the Secretary determines are in the interests of participants and beneficiaries.

“(6) GUIDANCE AND MODEL NOTICES.—The Secretary shall issue guidance and model notices which meet the requirements of this subsection.

“(7) BLACKOUT PERIOD.—For purposes of this subsection—

“(A) IN GENERAL.—The term ‘blackout period’ means, in connection with an individual account plan, any period for which any ability of participants or beneficiaries under the plan, which is otherwise available under the terms of such plan, to direct or diversify assets credited to their accounts, to obtain loans from the plan, or to obtain distributions from the plan is temporarily suspended, limited, or restricted, if such suspension, limitation, or restriction is for any period of more than 3 consecutive business days.

“(B) EXCLUSIONS.—The term ‘blackout period’ does not include a suspension, limitation, or restriction—

“(i) which occurs by reason of the application of the securities laws (as defined in section 3(a)(47) of the Securities Exchange Act of 1934),

“(ii) which is a change to the plan which provides for a regularly scheduled suspension, limitation, or restriction which is disclosed to participants or beneficiaries through any summary of material modifications, any materials describing specific investment alternatives under the plan, or any changes thereto, or

“(iii) which applies only to 1 or more individuals, each of whom is the participant, an alternate payee

(as defined in section 206(d)(3)(K)), or any other beneficiary pursuant to a qualified domestic relations order (as defined in section 206(d)(3)(B)(i)).

“(8) INDIVIDUAL ACCOUNT PLAN.—

“(A) IN GENERAL.—For purposes of this subsection, the term ‘individual account plan’ shall have the meaning provided such term in section 3(34), except that such term shall not include a one-participant retirement plan.

“(B) ONE-PARTICIPANT RETIREMENT PLAN.—For purposes of subparagraph (A), the term ‘one-participant retirement plan’ means a retirement plan that—

“(i) on the first day of the plan year—

“(I) covered only the employer (and the employer’s spouse) and the employer owned the entire business (whether or not incorporated), or

“(II) covered only one or more partners (and their spouses) in a business partnership (including partners in an S or C corporation (as defined in section 1361(a) of the Internal Revenue Code of 1986)),

“(ii) meets the minimum coverage requirements of section 410(b) of the Internal Revenue Code of 1986 (as in effect on the date of the enactment of this paragraph) without being combined with any other plan of the business that covers the employees of the business,

“(iii) does not provide benefits to anyone except the employer (and the employer’s spouse) or the partners (and their spouses),

“(iv) does not cover a business that is a member of an affiliated service group, a controlled group of corporations, or a group of businesses under common control, and

“(v) does not cover a business that leases employees.”.

(2) ISSUANCE OF INITIAL GUIDANCE AND MODEL NOTICE.—

The Secretary of Labor shall issue initial guidance and a model notice pursuant to section 101(i)(6) of the Employee Retirement Income Security Act of 1974 (as added by this subsection) not later than January 1, 2003. Not later than 75 days after the date of the enactment of this Act, the Secretary shall promulgate interim final rules necessary to carry out the amendments made by this subsection.

Deadlines.

Regulations.

(3) CIVIL PENALTIES FOR FAILURE TO PROVIDE NOTICE.—Section 502 of such Act (29 U.S.C. 1132) is amended—

(A) in subsection (a)(6), by striking “(5), or (6)” and inserting “(5), (6), or (7)”;

(B) by redesignating paragraph (7) of subsection (c) as paragraph (8); and

(C) by inserting after paragraph (6) of subsection (c) the following new paragraph:

“(7) The Secretary may assess a civil penalty against a plan administrator of up to \$100 a day from the date of the plan administrator’s failure or refusal to provide notice to participants and beneficiaries in accordance with section 101(i). For purposes of this paragraph, each violation with respect to any single participant or beneficiary shall be treated as a separate violation.”.

116 STAT. 784

PUBLIC LAW 107-204—JULY 30, 2002

(3) PLAN AMENDMENTS.—If any amendment made by this subsection requires an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after the effective date of this section, if—

(A) during the period after such amendment made by this subsection takes effect and before such first plan year, the plan is operated in good faith compliance with the requirements of such amendment made by this subsection, and

(B) such plan amendment applies retroactively to the period after such amendment made by this subsection takes effect and before such first plan year.

(c) EFFECTIVE DATE.—The provisions of this section (including the amendments made thereby) shall take effect 180 days after the date of the enactment of this Act. Good faith compliance with the requirements of such provisions in advance of the issuance of applicable regulations thereunder shall be treated as compliance with such provisions.

15 USC 7245.

Deadline.

SEC. 307. RULES OF PROFESSIONAL RESPONSIBILITY FOR ATTORNEYS.

Not later than 180 days after the date of enactment of this Act, the Commission shall issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers, including a rule—

(1) requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof); and

(2) if the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.

15 USC 7246.

SEC. 308. FAIR FUNDS FOR INVESTORS.

(a) CIVIL PENALTIES ADDED TO DISGORGEMENT FUNDS FOR THE RELIEF OF VICTIMS.—If in any judicial or administrative action brought by the Commission under the securities laws (as such term is defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)) the Commission obtains an order requiring disgorgement against any person for a violation of such laws or the rules or regulations thereunder, or such person agrees in settlement of any such action to such disgorgement, and the Commission also obtains pursuant to such laws a civil penalty against such person, the amount of such civil penalty shall, on the motion or at the direction of the Commission, be added to and become part of the disgorgement fund for the benefit of the victims of such violation.

(b) ACCEPTANCE OF ADDITIONAL DONATIONS.—The Commission is authorized to accept, hold, administer, and utilize gifts, bequests and devises of property, both real and personal, to the United

States for a disgorgement fund described in subsection (a). Such gifts, bequests, and devises of money and proceeds from sales of other property received as gifts, bequests, or devises shall be deposited in the disgorgement fund and shall be available for allocation in accordance with subsection (a).

(c) STUDY REQUIRED.—

(1) SUBJECT OF STUDY.—The Commission shall review and analyze—

(A) enforcement actions by the Commission over the five years preceding the date of the enactment of this Act that have included proceedings to obtain civil penalties or disgorgements to identify areas where such proceedings may be utilized to efficiently, effectively, and fairly provide restitution for injured investors; and

(B) other methods to more efficiently, effectively, and fairly provide restitution to injured investors, including methods to improve the collection rates for civil penalties and disgorgements.

(2) REPORT REQUIRED.—The Commission shall report its findings to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate within 180 days after of the date of the enactment of this Act, and shall use such findings to revise its rules and regulations as necessary. The report shall include a discussion of regulatory or legislative actions that are recommended or that may be necessary to address concerns identified in the study.

Deadline.

(d) CONFORMING AMENDMENTS.—Each of the following provisions is amended by inserting “, except as otherwise provided in section 308 of the Sarbanes-Oxley Act of 2002” after “Treasury of the United States”:

(1) Section 21(d)(3)(C)(i) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)(3)(C)(i)).

(2) Section 21A(d)(1) of such Act (15 U.S.C. 78u-1(d)(1)).

(3) Section 20(d)(3)(A) of the Securities Act of 1933 (15 U.S.C. 77t(d)(3)(A)).

(4) Section 42(e)(3)(A) of the Investment Company Act of 1940 (15 U.S.C. 80a-41(e)(3)(A)).

(5) Section 209(e)(3)(A) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-9(e)(3)(A)).

(e) DEFINITION.—As used in this section, the term “disgorgement fund” means a fund established in any administrative or judicial proceeding described in subsection (a).

TITLE IV—ENHANCED FINANCIAL DISCLOSURES

SEC. 401. DISCLOSURES IN PERIODIC REPORTS.

15 USC 7261.

(a) DISCLOSURES REQUIRED.—Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m) is amended by adding at the end the following:

“(i) ACCURACY OF FINANCIAL REPORTS.—Each financial report that contains financial statements, and that is required to be prepared in accordance with (or reconciled to) generally accepted accounting principles under this title and filed with the Commission shall reflect all material correcting adjustments that have been

116 STAT. 786

PUBLIC LAW 107-204—JULY 30, 2002

identified by a registered public accounting firm in accordance with generally accepted accounting principles and the rules and regulations of the Commission.

Deadline.
Regulations. “(j) OFF-BALANCE SHEET TRANSACTIONS.—Not later than 180 days after the date of enactment of the Sarbanes-Oxley Act of 2002, the Commission shall issue final rules providing that each annual and quarterly financial report required to be filed with the Commission shall disclose all material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the issuer with unconsolidated entities or other persons, that may have a material current or future effect on financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues or expenses.”.

Deadline. (b) COMMISSION RULES ON PRO FORMA FIGURES.—Not later than 180 days after the date of enactment of the Sarbanes-Oxley Act of 2002, the Commission shall issue final rules providing that pro forma financial information included in any periodic or other report filed with the Commission pursuant to the securities laws, or in any public disclosure or press or other release, shall be presented in a manner that—

(1) does not contain an untrue statement of a material fact or omit to state a material fact necessary in order to make the pro forma financial information, in light of the circumstances under which it is presented, not misleading; and

(2) reconciles it with the financial condition and results of operations of the issuer under generally accepted accounting principles.

Deadline. (c) STUDY AND REPORT ON SPECIAL PURPOSE ENTITIES.—

(1) STUDY REQUIRED.—The Commission shall, not later than 1 year after the effective date of adoption of off-balance sheet disclosure rules required by section 13(j) of the Securities Exchange Act of 1934, as added by this section, complete a study of filings by issuers and their disclosures to determine—

(A) the extent of off-balance sheet transactions, including assets, liabilities, leases, losses, and the use of special purpose entities; and

(B) whether generally accepted accounting rules result in financial statements of issuers reflecting the economics of such off-balance sheet transactions to investors in a transparent fashion.

Deadline. (2) REPORT AND RECOMMENDATIONS.—Not later than 6 months after the date of completion of the study required by paragraph (1), the Commission shall submit a report to the President, the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives, setting forth—

(A) the amount or an estimate of the amount of off-balance sheet transactions, including assets, liabilities, leases, and losses of, and the use of special purpose entities by, issuers filing periodic reports pursuant to section 13 or 15 of the Securities Exchange Act of 1934;

(B) the extent to which special purpose entities are used to facilitate off-balance sheet transactions;

(C) whether generally accepted accounting principles or the rules of the Commission result in financial statements of issuers reflecting the economics of such transactions to investors in a transparent fashion;

(D) whether generally accepted accounting principles specifically result in the consolidation of special purpose entities sponsored by an issuer in cases in which the issuer has the majority of the risks and rewards of the special purpose entity; and

(E) any recommendations of the Commission for improving the transparency and quality of reporting off-balance sheet transactions in the financial statements and disclosures required to be filed by an issuer with the Commission.

SEC. 402. ENHANCED CONFLICT OF INTEREST PROVISIONS.

(a) PROHIBITION ON PERSONAL LOANS TO EXECUTIVES.—Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m), as amended by this Act, is amended by adding at the end the following:

“(k) PROHIBITION ON PERSONAL LOANS TO EXECUTIVES.—

“(1) IN GENERAL.—It shall be unlawful for any issuer (as defined in section 2 of the Sarbanes-Oxley Act of 2002), directly or indirectly, including through any subsidiary, to extend or maintain credit, to arrange for the extension of credit, or to renew an extension of credit, in the form of a personal loan to or for any director or executive officer (or equivalent thereof) of that issuer. An extension of credit maintained by the issuer on the date of enactment of this subsection shall not be subject to the provisions of this subsection, provided that there is no material modification to any term of any such extension of credit or any renewal of any such extension of credit on or after that date of enactment.

“(2) LIMITATION.—Paragraph (1) does not preclude any home improvement and manufactured home loans (as that term is defined in section 5 of the Home Owners’ Loan Act (12 U.S.C. 1464)), consumer credit (as defined in section 103 of the Truth in Lending Act (15 U.S.C. 1602)), or any extension of credit under an open end credit plan (as defined in section 103 of the Truth in Lending Act (15 U.S.C. 1602)), or a charge card (as defined in section 127(c)(4)(e) of the Truth in Lending Act (15 U.S.C. 1637(c)(4)(e))), or any extension of credit by a broker or dealer registered under section 15 of this title to an employee of that broker or dealer to buy, trade, or carry securities, that is permitted under rules or regulations of the Board of Governors of the Federal Reserve System pursuant to section 7 of this title (other than an extension of credit that would be used to purchase the stock of that issuer), that is—

“(A) made or provided in the ordinary course of the consumer credit business of such issuer;

“(B) of a type that is generally made available by such issuer to the public; and

“(C) made by such issuer on market terms, or terms that are no more favorable than those offered by the issuer to the general public for such extensions of credit.

“(3) RULE OF CONSTRUCTION FOR CERTAIN LOANS.—Paragraph (1) does not apply to any loan made or maintained

116 STAT. 788

PUBLIC LAW 107-204—JULY 30, 2002

by an insured depository institution (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)), if the loan is subject to the insider lending restrictions of section 22(h) of the Federal Reserve Act (12 U.S.C. 375b).”.

SEC. 403. DISCLOSURES OF TRANSACTIONS INVOLVING MANAGEMENT AND PRINCIPAL STOCKHOLDERS.

(a) AMENDMENT.—Section 16 of the Securities Exchange Act of 1934 (15 U.S.C. 78p) is amended by striking the heading of such section and subsection (a) and inserting the following:

“SEC. 16. DIRECTORS, OFFICERS, AND PRINCIPAL STOCKHOLDERS.

“(a) DISCLOSURES REQUIRED.—

“(1) DIRECTORS, OFFICERS, AND PRINCIPAL STOCKHOLDERS REQUIRED TO FILE.—Every person who is directly or indirectly the beneficial owner of more than 10 percent of any class of any equity security (other than an exempted security) which is registered pursuant to section 12, or who is a director or an officer of the issuer of such security, shall file the statements required by this subsection with the Commission (and, if such security is registered on a national securities exchange, also with the exchange).

“(2) TIME OF FILING.—The statements required by this subsection shall be filed—

“(A) at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 12(g);

“(B) within 10 days after he or she becomes such beneficial owner, director, or officer;

“(C) if there has been a change in such ownership, or if such person shall have purchased or sold a security-based swap agreement (as defined in section 206(b) of the Gramm-Leach-Bliley Act (15 U.S.C. 78c note)) involving such equity security, before the end of the second business day following the day on which the subject transaction has been executed, or at such other time as the Commission shall establish, by rule, in any case in which the Commission determines that such 2-day period is not feasible.

“(3) CONTENTS OF STATEMENTS.—A statement filed—

“(A) under subparagraph (A) or (B) of paragraph (2) shall contain a statement of the amount of all equity securities of such issuer of which the filing person is the beneficial owner; and

“(B) under subparagraph (C) of such paragraph shall indicate ownership by the filing person at the date of filing, any such changes in such ownership, and such purchases and sales of the security-based swap agreements as have occurred since the most recent such filing under such subparagraph.

“(4) ELECTRONIC FILING AND AVAILABILITY.—Beginning not later than 1 year after the date of enactment of the Sarbanes-Oxley Act of 2002—

“(A) a statement filed under subparagraph (C) of paragraph (2) shall be filed electronically;

“(B) the Commission shall provide each such statement on a publicly accessible Internet site not later than the end of the business day following that filing; and

Deadline.

Deadline.

PUBLIC LAW 107-204—JULY 30, 2002

116 STAT. 789

“(C) the issuer (if the issuer maintains a corporate website) shall provide that statement on that corporate website, not later than the end of the business day following that filing.”

Deadline.

(b) **EFFECTIVE DATE.**—The amendment made by this section shall be effective 30 days after the date of the enactment of this Act.

15 USC 78p note.

SEC. 404. MANAGEMENT ASSESSMENT OF INTERNAL CONTROLS.

15 USC 7262.

(a) **RULES REQUIRED.**—The Commission shall prescribe rules requiring each annual report required by section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) to contain an internal control report, which shall—

(1) state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and

(2) contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.

(b) **INTERNAL CONTROL EVALUATION AND REPORTING.**—With respect to the internal control assessment required by subsection (a), each registered public accounting firm that prepares or issues the audit report for the issuer shall attest to, and report on, the assessment made by the management of the issuer. An attestation made under this subsection shall be made in accordance with standards for attestation engagements issued or adopted by the Board. Any such attestation shall not be the subject of a separate engagement.

SEC. 405. EXEMPTION.

15 USC 7263.

Nothing in section 401, 402, or 404, the amendments made by those sections, or the rules of the Commission under those sections shall apply to any investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8).

SEC. 406. CODE OF ETHICS FOR SENIOR FINANCIAL OFFICERS.

15 USC 7264.

(a) **CODE OF ETHICS DISCLOSURE.**—The Commission shall issue rules to require each issuer, together with periodic reports required pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934, to disclose whether or not, and if not, the reason therefor, such issuer has adopted a code of ethics for senior financial officers, applicable to its principal financial officer and comptroller or principal accounting officer, or persons performing similar functions.

Regulations.

(b) **CHANGES IN CODES OF ETHICS.**—The Commission shall revise its regulations concerning matters requiring prompt disclosure on Form 8-K (or any successor thereto) to require the immediate disclosure, by means of the filing of such form, dissemination by the Internet or by other electronic means, by any issuer of any change in or waiver of the code of ethics for senior financial officers.

Regulations.

(c) **DEFINITION.**—In this section, the term “code of ethics” means such standards as are reasonably necessary to promote—

(1) honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;

116 STAT. 790

PUBLIC LAW 107-204—JULY 30, 2002

(2) full, fair, accurate, timely, and understandable disclosure in the periodic reports required to be filed by the issuer; and

(3) compliance with applicable governmental rules and regulations.

(d) DEADLINE FOR RULEMAKING.—The Commission shall—

(1) propose rules to implement this section, not later than 90 days after the date of enactment of this Act; and

(2) issue final rules to implement this section, not later than 180 days after that date of enactment.

15 USC 7265.

SEC. 407. DISCLOSURE OF AUDIT COMMITTEE FINANCIAL EXPERT.

(a) RULES DEFINING “FINANCIAL EXPERT”.—The Commission shall issue rules, as necessary or appropriate in the public interest and consistent with the protection of investors, to require each issuer, together with periodic reports required pursuant to sections 13(a) and 15(d) of the Securities Exchange Act of 1934, to disclose whether or not, and if not, the reasons therefor, the audit committee of that issuer is comprised of at least 1 member who is a financial expert, as such term is defined by the Commission.

(b) CONSIDERATIONS.—In defining the term “financial expert” for purposes of subsection (a), the Commission shall consider whether a person has, through education and experience as a public accountant or auditor or a principal financial officer, comptroller, or principal accounting officer of an issuer, or from a position involving the performance of similar functions—

(1) an understanding of generally accepted accounting principles and financial statements;

(2) experience in—

(A) the preparation or auditing of financial statements of generally comparable issuers; and

(B) the application of such principles in connection with the accounting for estimates, accruals, and reserves;

(3) experience with internal accounting controls; and

(4) an understanding of audit committee functions.

(c) DEADLINE FOR RULEMAKING.—The Commission shall—

(1) propose rules to implement this section, not later than 90 days after the date of enactment of this Act; and

(2) issue final rules to implement this section, not later than 180 days after that date of enactment.

15 USC 7266.

SEC. 408. ENHANCED REVIEW OF PERIODIC DISCLOSURES BY ISSUERS.

(a) REGULAR AND SYSTEMATIC REVIEW.—The Commission shall review disclosures made by issuers reporting under section 13(a) of the Securities Exchange Act of 1934 (including reports filed on Form 10-K), and which have a class of securities listed on a national securities exchange or traded on an automated quotation facility of a national securities association, on a regular and systematic basis for the protection of investors. Such review shall include a review of an issuer’s financial statement.

(b) REVIEW CRITERIA.—For purposes of scheduling the reviews required by subsection (a), the Commission shall consider, among other factors—

(1) issuers that have issued material restatements of financial results;

(2) issuers that experience significant volatility in their stock price as compared to other issuers;

(3) issuers with the largest market capitalization;

(4) emerging companies with disparities in price to earning ratios;

(5) issuers whose operations significantly affect any material sector of the economy; and

(6) any other factors that the Commission may consider relevant.

(c) **MINIMUM REVIEW PERIOD.**—In no event shall an issuer required to file reports under section 13(a) or 15(d) of the Securities Exchange Act of 1934 be reviewed under this section less frequently than once every 3 years.

SEC. 409. REAL TIME ISSUER DISCLOSURES.

Section 13 of the Securities Exchange Act of 1934 (15 U.S.C. 78m), as amended by this Act, is amended by adding at the end the following:

“(1) **REAL TIME ISSUER DISCLOSURES.**—Each issuer reporting under section 13(a) or 15(d) shall disclose to the public on a rapid and current basis such additional information concerning material changes in the financial condition or operations of the issuer, in plain English, which may include trend and qualitative information and graphic presentations, as the Commission determines, by rule, is necessary or useful for the protection of investors and in the public interest.”.

TITLE V—ANALYST CONFLICTS OF INTEREST

SEC. 501. TREATMENT OF SECURITIES ANALYSTS BY REGISTERED SECURITIES ASSOCIATIONS AND NATIONAL SECURITIES EXCHANGES.

(a) **RULES REGARDING SECURITIES ANALYSTS.**—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 15C the following new section:

“SEC. 15D. SECURITIES ANALYSTS AND RESEARCH REPORTS.

15 USC 78o–6.

“(a) **ANALYST PROTECTIONS.**—The Commission, or upon the authorization and direction of the Commission, a registered securities association or national securities exchange, shall have adopted, not later than 1 year after the date of enactment of this section, rules reasonably designed to address conflicts of interest that can arise when securities analysts recommend equity securities in research reports and public appearances, in order to improve the objectivity of research and provide investors with more useful and reliable information, including rules designed—

Deadline.

“(1) to foster greater public confidence in securities research, and to protect the objectivity and independence of securities analysts, by—

“(A) restricting the prepublication clearance or approval of research reports by persons employed by the broker or dealer who are engaged in investment banking activities, or persons not directly responsible for investment research, other than legal or compliance staff;

“(B) limiting the supervision and compensatory evaluation of securities analysts to officials employed by the broker or dealer who are not engaged in investment banking activities; and

“(C) requiring that a broker or dealer and persons employed by a broker or dealer who are involved with investment banking activities may not, directly or indirectly, retaliate against or threaten to retaliate against any securities analyst employed by that broker or dealer or its affiliates as a result of an adverse, negative, or otherwise unfavorable research report that may adversely affect the present or prospective investment banking relationship of the broker or dealer with the issuer that is the subject of the research report, except that such rules may not limit the authority of a broker or dealer to discipline a securities analyst for causes other than such research report in accordance with the policies and procedures of the firm;

“(2) to define periods during which brokers or dealers who have participated, or are to participate, in a public offering of securities as underwriters or dealers should not publish or otherwise distribute research reports relating to such securities or to the issuer of such securities;

“(3) to establish structural and institutional safeguards within registered brokers or dealers to assure that securities analysts are separated by appropriate informational partitions within the firm from the review, pressure, or oversight of those whose involvement in investment banking activities might potentially bias their judgment or supervision; and

“(4) to address such other issues as the Commission, or such association or exchange, determines appropriate.

“(b) DISCLOSURE.—The Commission, or upon the authorization and direction of the Commission, a registered securities association or national securities exchange, shall have adopted, not later than 1 year after the date of enactment of this section, rules reasonably designed to require each securities analyst to disclose in public appearances, and each registered broker or dealer to disclose in each research report, as applicable, conflicts of interest that are known or should have been known by the securities analyst or the broker or dealer, to exist at the time of the appearance or the date of distribution of the report, including—

“(1) the extent to which the securities analyst has debt or equity investments in the issuer that is the subject of the appearance or research report;

“(2) whether any compensation has been received by the registered broker or dealer, or any affiliate thereof, including the securities analyst, from the issuer that is the subject of the appearance or research report, subject to such exemptions as the Commission may determine appropriate and necessary to prevent disclosure by virtue of this paragraph of material non-public information regarding specific potential future investment banking transactions of such issuer, as is appropriate in the public interest and consistent with the protection of investors;

“(3) whether an issuer, the securities of which are recommended in the appearance or research report, currently is, or during the 1-year period preceding the date of the appearance or date of distribution of the report has been, a client of the registered broker or dealer, and if so, stating the types of services provided to the issuer;

“(4) whether the securities analyst received compensation with respect to a research report, based upon (among any other factors) the investment banking revenues (either generally or specifically earned from the issuer being analyzed) of the registered broker or dealer; and

“(5) such other disclosures of conflicts of interest that are material to investors, research analysts, or the broker or dealer as the Commission, or such association or exchange, determines appropriate.

“(c) DEFINITIONS.—In this section—

“(1) the term ‘securities analyst’ means any associated person of a registered broker or dealer that is principally responsible for, and any associated person who reports directly or indirectly to a securities analyst in connection with, the preparation of the substance of a research report, whether or not any such person has the job title of ‘securities analyst’; and

“(2) the term ‘research report’ means a written or electronic communication that includes an analysis of equity securities of individual companies or industries, and that provides information reasonably sufficient upon which to base an investment decision.”.

(b) ENFORCEMENT.—Section 21B(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78u-2(a)) is amended by inserting “15D,” before “15B”.

(c) COMMISSION AUTHORITY.—The Commission may promulgate and amend its regulations, or direct a registered securities association or national securities exchange to promulgate and amend its rules, to carry out section 15D of the Securities Exchange Act of 1934, as added by this section, as is necessary for the protection of investors and in the public interest.

15 USC 78o-6
note.

TITLE VI—COMMISSION RESOURCES AND AUTHORITY

SEC. 601. AUTHORIZATION OF APPROPRIATIONS.

Section 35 of the Securities Exchange Act of 1934 (15 U.S.C. 78kk) is amended to read as follows:

“SEC. 35. AUTHORIZATION OF APPROPRIATIONS.

“In addition to any other funds authorized to be appropriated to the Commission, there are authorized to be appropriated to carry out the functions, powers, and duties of the Commission, \$776,000,000 for fiscal year 2003, of which—

“(1) \$102,700,000 shall be available to fund additional compensation, including salaries and benefits, as authorized in the Investor and Capital Markets Fee Relief Act (Public Law 107-123; 115 Stat. 2390 et seq.);

“(2) \$108,400,000 shall be available for information technology, security enhancements, and recovery and mitigation activities in light of the terrorist attacks of September 11, 2001; and

“(3) \$98,000,000 shall be available to add not fewer than an additional 200 qualified professionals to provide enhanced oversight of auditors and audit services required by the Federal securities laws, and to improve Commission investigative and

disciplinary efforts with respect to such auditors and services, as well as for additional professional support staff necessary to strengthen the programs of the Commission involving Full Disclosure and Prevention and Suppression of Fraud, risk management, industry technology review, compliance, inspections, examinations, market regulation, and investment management.”.

SEC. 602. APPEARANCE AND PRACTICE BEFORE THE COMMISSION.

The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 4B the following:

15 USC 78d-3.

“SEC. 4C. APPEARANCE AND PRACTICE BEFORE THE COMMISSION.

“(a) **AUTHORITY TO CENSURE.**—The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found by the Commission, after notice and opportunity for hearing in the matter—

“(1) not to possess the requisite qualifications to represent others;

“(2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or

“(3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations issued thereunder.

“(b) **DEFINITION.**—With respect to any registered public accounting firm or associated person, for purposes of this section, the term ‘improper professional conduct’ means—

“(1) intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards; and

“(2) negligent conduct in the form of—

“(A) a single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which the registered public accounting firm or associated person knows, or should know, that heightened scrutiny is warranted; or

“(B) repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.”.

SEC. 603. FEDERAL COURT AUTHORITY TO IMPOSE PENNY STOCK BARS.

(a) **SECURITIES EXCHANGE ACT OF 1934.**—Section 21(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)), as amended by this Act, is amended by adding at the end the following:

“(6) **AUTHORITY OF A COURT TO PROHIBIT PERSONS FROM PARTICIPATING IN AN OFFERING OF PENNY STOCK.**—

“(A) **IN GENERAL.**—In any proceeding under paragraph (1) against any person participating in, or, at the time of the alleged misconduct who was participating in, an offering of penny stock, the court may prohibit that person from participating in an offering of penny stock, conditionally or unconditionally, and permanently or for such period of time as the court shall determine.

“(B) **DEFINITION.**—For purposes of this paragraph, the term ‘person participating in an offering of penny stock’ includes

any person engaging in activities with a broker, dealer, or issuer for purposes of issuing, trading, or inducing or attempting to induce the purchase or sale of, any penny stock. The Commission may, by rule or regulation, define such term to include other activities, and may, by rule, regulation, or order, exempt any person or class of persons, in whole or in part, conditionally or unconditionally, from inclusion in such term.”.

(b) SECURITIES ACT OF 1933.—Section 20 of the Securities Act of 1933 (15 U.S.C. 77t) is amended by adding at the end the following:

“(g) AUTHORITY OF A COURT TO PROHIBIT PERSONS FROM PARTICIPATING IN AN OFFERING OF PENNY STOCK.—

“(1) IN GENERAL.—In any proceeding under subsection (a) against any person participating in, or, at the time of the alleged misconduct, who was participating in, an offering of penny stock, the court may prohibit that person from participating in an offering of penny stock, conditionally or unconditionally, and permanently or for such period of time as the court shall determine.

“(2) DEFINITION.—For purposes of this subsection, the term ‘person participating in an offering of penny stock’ includes any person engaging in activities with a broker, dealer, or issuer for purposes of issuing, trading, or inducing or attempting to induce the purchase or sale of, any penny stock. The Commission may, by rule or regulation, define such term to include other activities, and may, by rule, regulation, or order, exempt any person or class of persons, in whole or in part, conditionally or unconditionally, from inclusion in such term.”.

SEC. 604. QUALIFICATIONS OF ASSOCIATED PERSONS OF BROKERS AND DEALERS.

(a) BROKERS AND DEALERS.—Section 15(b)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78o) is amended—

(1) by striking subparagraph (F) and inserting the following:

“(F) is subject to any order of the Commission barring or suspending the right of the person to be associated with a broker or dealer;”; and

(2) in subparagraph (G), by striking the period at the end and inserting the following: “; or

“(H) is subject to any final order of a State securities commission (or any agency or officer performing like functions), State authority that supervises or examines banks, savings associations, or credit unions, State insurance commission (or any agency or office performing like functions), an appropriate Federal banking agency (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813(q))), or the National Credit Union Administration, that—

“(i) bars such person from association with an entity regulated by such commission, authority, agency, or officer, or from engaging in the business of securities, insurance, banking, savings association activities, or credit union activities; or

“(ii) constitutes a final order based on violations of any laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct.”.

(b) INVESTMENT ADVISERS.—Section 203(e) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3(e)) is amended—

(1) by striking paragraph (7) and inserting the following:

“(7) is subject to any order of the Commission barring or suspending the right of the person to be associated with an investment adviser;”;

(2) in paragraph (8), by striking the period at the end and inserting “; or”; and

(3) by adding at the end the following:

“(9) is subject to any final order of a State securities commission (or any agency or officer performing like functions), State authority that supervises or examines banks, savings associations, or credit unions, State insurance commission (or any agency or office performing like functions), an appropriate Federal banking agency (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813(q))), or the National Credit Union Administration, that—

“(A) bars such person from association with an entity regulated by such commission, authority, agency, or officer, or from engaging in the business of securities, insurance, banking, savings association activities, or credit union activities; or

“(B) constitutes a final order based on violations of any laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct.”.

(c) CONFORMING AMENDMENTS.—

(1) SECURITIES EXCHANGE ACT OF 1934.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended—

(A) in section 3(a)(39)(F) (15 U.S.C. 78c(a)(39)(F))—

(i) by striking “or (G)” and inserting “(H), or (G)”; and

(ii) by inserting “, or is subject to an order or finding,” before “enumerated”;

(B) in each of section 15(b)(6)(A)(i) (15 U.S.C. 78o(b)(6)(A)(i)), paragraphs (2) and (4) of section 15B(c) (15 U.S.C. 78o-4(c)), and subparagraphs (A) and (C) of section 15C(c)(1) (15 U.S.C. 78o-5(c)(1))—

(i) by striking “or (G)” each place that term appears and inserting “(H), or (G)”; and

(ii) by striking “or omission” each place that term appears, and inserting “, or is subject to an order or finding;”;

(C) in each of paragraphs (3)(A) and (4)(C) of section 17A(c) (15 U.S.C. 78q-1(c))—

(i) by striking “or (G)” each place that term appears and inserting “(H), or (G)”; and

(ii) by inserting “, or is subject to an order or finding,” before “enumerated” each place that term appears.

(2) INVESTMENT ADVISERS ACT OF 1940.—Section 203(f) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3(f)) is amended—

(A) by striking “or (8)” and inserting “(8), or (9)”; and

(B) by inserting “or (3)” after “paragraph (2)”.

PUBLIC LAW 107-204—JULY 30, 2002

116 STAT. 797

TITLE VII—STUDIES AND REPORTS**SEC. 701. GAO STUDY AND REPORT REGARDING CONSOLIDATION OF PUBLIC ACCOUNTING FIRMS.**15 USC 7201
note.

(a) **STUDY REQUIRED.**—The Comptroller General of the United States shall conduct a study—

(1) to identify—

(A) the factors that have led to the consolidation of public accounting firms since 1989 and the consequent reduction in the number of firms capable of providing audit services to large national and multi-national business organizations that are subject to the securities laws;

(B) the present and future impact of the condition described in subparagraph (A) on capital formation and securities markets, both domestic and international; and

(C) solutions to any problems identified under subparagraph (B), including ways to increase competition and the number of firms capable of providing audit services to large national and multinational business organizations that are subject to the securities laws;

(2) of the problems, if any, faced by business organizations that have resulted from limited competition among public accounting firms, including—

(A) higher costs;

(B) lower quality of services;

(C) impairment of auditor independence; or

(D) lack of choice; and

(3) whether and to what extent Federal or State regulations impede competition among public accounting firms.

(b) **CONSULTATION.**—In planning and conducting the study under this section, the Comptroller General shall consult with—

(1) the Commission;

(2) the regulatory agencies that perform functions similar to the Commission within the other member countries of the Group of Seven Industrialized Nations;

(3) the Department of Justice; and

(4) any other public or private sector organization that the Comptroller General considers appropriate.

(c) **REPORT REQUIRED.**—Not later than 1 year after the date of enactment of this Act, the Comptroller General shall submit a report on the results of the study required by this section to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.

Deadline.

SEC. 702. COMMISSION STUDY AND REPORT REGARDING CREDIT RATING AGENCIES.

(a) **STUDY REQUIRED.**—

(1) **IN GENERAL.**—The Commission shall conduct a study of the role and function of credit rating agencies in the operation of the securities market.

(2) **AREAS OF CONSIDERATION.**—The study required by this subsection shall examine—

(A) the role of credit rating agencies in the evaluation of issuers of securities;

116 STAT. 798

PUBLIC LAW 107-204—JULY 30, 2002

(B) the importance of that role to investors and the functioning of the securities markets;

(C) any impediments to the accurate appraisal by credit rating agencies of the financial resources and risks of issuers of securities;

(D) any barriers to entry into the business of acting as a credit rating agency, and any measures needed to remove such barriers;

(E) any measures which may be required to improve the dissemination of information concerning such resources and risks when credit rating agencies announce credit ratings; and

(F) any conflicts of interest in the operation of credit rating agencies and measures to prevent such conflicts or ameliorate the consequences of such conflicts.

Deadline.

(b) **REPORT REQUIRED.**—The Commission shall submit a report on the study required by subsection (a) to the President, the Committee on Financial Services of the House of Representatives, and the Committee on Banking, Housing, and Urban Affairs of the Senate not later than 180 days after the date of enactment of this Act.

SEC. 703. STUDY AND REPORT ON VIOLATORS AND VIOLATIONS.

(a) **STUDY.**—The Commission shall conduct a study to determine, based upon information for the period from January 1, 1998, to December 31, 2001—

(1) the number of securities professionals, defined as public accountants, public accounting firms, investment bankers, investment advisers, brokers, dealers, attorneys, and other securities professionals practicing before the Commission—

(A) who have been found to have aided and abetted a violation of the Federal securities laws, including rules or regulations promulgated thereunder (collectively referred to in this section as “Federal securities laws”), but who have not been sanctioned, disciplined, or otherwise penalized as a primary violator in any administrative action or civil proceeding, including in any settlement of such an action or proceeding (referred to in this section as “aiders and abettors”); and

(B) who have been found to have been primary violators of the Federal securities laws;

(2) a description of the Federal securities laws violations committed by aiders and abettors and by primary violators, including—

(A) the specific provision of the Federal securities laws violated;

(B) the specific sanctions and penalties imposed upon such aiders and abettors and primary violators, including the amount of any monetary penalties assessed upon and collected from such persons;

(C) the occurrence of multiple violations by the same person or persons, either as an aider or abettor or as a primary violator; and

(D) whether, as to each such violator, disciplinary sanctions have been imposed, including any censure, suspension, temporary bar, or permanent bar to practice before the Commission; and

(3) the amount of disgorgement, restitution, or any other fines or payments that the Commission has assessed upon and collected from, aiders and abettors and from primary violators.

(b) **REPORT.**—A report based upon the study conducted pursuant to subsection (a) shall be submitted to the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives not later than 6 months after the date of enactment of this Act.

SEC. 704. STUDY OF ENFORCEMENT ACTIONS.

(a) **STUDY REQUIRED.**—The Commission shall review and analyze all enforcement actions by the Commission involving violations of reporting requirements imposed under the securities laws, and restatements of financial statements, over the 5-year period preceding the date of enactment of this Act, to identify areas of reporting that are most susceptible to fraud, inappropriate manipulation, or inappropriate earnings management, such as revenue recognition and the accounting treatment of off-balance sheet special purpose entities.

(b) **REPORT REQUIRED.**—The Commission shall report its findings to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate, not later than 180 days after the date of enactment of this Act, and shall use such findings to revise its rules and regulations, as necessary. The report shall include a discussion of regulatory or legislative steps that are recommended or that may be necessary to address concerns identified in the study.

Deadline.

SEC. 705. STUDY OF INVESTMENT BANKS.

(a) **GAO STUDY.**—The Comptroller General of the United States shall conduct a study on whether investment banks and financial advisers assisted public companies in manipulating their earnings and obfuscating their true financial condition. The study should address the rule of investment banks and financial advisers—

(1) in the collapse of the Enron Corporation, including with respect to the design and implementation of derivatives transactions, transactions involving special purpose vehicles, and other financial arrangements that may have had the effect of altering the company's reported financial statements in ways that obscured the true financial picture of the company;

(2) in the failure of Global Crossing, including with respect to transactions involving swaps of fiberoptic cable capacity, in the designing transactions that may have had the effect of altering the company's reported financial statements in ways that obscured the true financial picture of the company; and

(3) generally, in creating and marketing transactions which may have been designed solely to enable companies to manipulate revenue streams, obtain loans, or move liabilities off balance sheets without altering the economic and business risks faced by the companies or any other mechanism to obscure a company's financial picture.

(b) **REPORT.**—The Comptroller General shall report to Congress not later than 180 days after the date of enactment of this Act on the results of the study required by this section. The report shall include a discussion of regulatory or legislative steps that

Deadline.

116 STAT. 800

PUBLIC LAW 107-204—JULY 30, 2002

are recommended or that may be necessary to address concerns identified in the study.

Corporate and
Criminal Fraud
Accountability
Act of 2002.

18 USC 1501
note.

TITLE VIII—CORPORATE AND CRIMINAL FRAUD ACCOUNTABILITY

SEC. 801. SHORT TITLE.

This title may be cited as the “Corporate and Criminal Fraud Accountability Act of 2002”.

SEC. 802. CRIMINAL PENALTIES FOR ALTERING DOCUMENTS.

(a) IN GENERAL.—Chapter 73 of title 18, United States Code, is amended by adding at the end the following:

“§ 1519. Destruction, alteration, or falsification of records in Federal investigations and bankruptcy

“Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 20 years, or both.

“§ 1520. Destruction of corporate audit records

“(a)(1) Any accountant who conducts an audit of an issuer of securities to which section 10A(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78j-1(a)) applies, shall maintain all audit or review workpapers for a period of 5 years from the end of the fiscal period in which the audit or review was concluded.

Regulations.

“(2) The Securities and Exchange Commission shall promulgate, within 180 days, after adequate notice and an opportunity for comment, such rules and regulations, as are reasonably necessary, relating to the retention of relevant records such as workpapers, documents that form the basis of an audit or review, memoranda, correspondence, communications, other documents, and records (including electronic records) which are created, sent, or received in connection with an audit or review and contain conclusions, opinions, analyses, or financial data relating to such an audit or review, which is conducted by any accountant who conducts an audit of an issuer of securities to which section 10A(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78j-1(a)) applies. The Commission may, from time to time, amend or supplement the rules and regulations that it is required to promulgate under this section, after adequate notice and an opportunity for comment, in order to ensure that such rules and regulations adequately comport with the purposes of this section.

“(b) Whoever knowingly and willfully violates subsection (a)(1), or any rule or regulation promulgated by the Securities and Exchange Commission under subsection (a)(2), shall be fined under this title, imprisoned not more than 10 years, or both.

“(c) Nothing in this section shall be deemed to diminish or relieve any person of any other duty or obligation imposed by Federal or State law or regulation to maintain, or refrain from destroying, any document.”.

PUBLIC LAW 107-204—JULY 30, 2002

116 STAT. 801

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 73 of title 18, United States Code, is amended by adding at the end the following new items:

“1519. Destruction, alteration, or falsification of records in Federal investigations and bankruptcy.

“1520. Destruction of corporate audit records.”.

SEC. 803. DEBTS NONDISCHARGEABLE IF INCURRED IN VIOLATION OF SECURITIES FRAUD LAWS.

Section 523(a) of title 11, United States Code, is amended—

- (1) in paragraph (17), by striking “or” after the semicolon;
- (2) in paragraph (18), by striking the period at the end and inserting “; or”; and
- (3) by adding at the end, the following:

“(19) that—

“(A) is for—

“(i) the violation of any of the Federal securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934), any of the State securities laws, or any regulation or order issued under such Federal or State securities laws; or

“(ii) common law fraud, deceit, or manipulation in connection with the purchase or sale of any security; and

“(B) results from—

“(i) any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding;

“(ii) any settlement agreement entered into by the debtor; or

“(iii) any court or administrative order for any damages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor.”.

SEC. 804. STATUTE OF LIMITATIONS FOR SECURITIES FRAUD.

(a) IN GENERAL.—Section 1658 of title 28, United States Code, is amended—

- (1) by inserting “(a)” before “Except”; and
- (2) by adding at the end the following:

“(b) Notwithstanding subsection (a), a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), may be brought not later than the earlier of—

“(1) 2 years after the discovery of the facts constituting the violation; or

“(2) 5 years after such violation.”.

(b) EFFECTIVE DATE.—The limitations period provided by section 1658(b) of title 28, United States Code, as added by this section, shall apply to all proceedings addressed by this section that are commenced on or after the date of enactment of this Act.

28 USC 1658
note.

(c) NO CREATION OF ACTIONS.—Nothing in this section shall create a new, private right of action.

28 USC 1658
note.

116 STAT. 802

PUBLIC LAW 107-204—JULY 30, 2002

28 USC 994 note. **SEC. 805. REVIEW OF FEDERAL SENTENCING GUIDELINES FOR OBSTRUCTION OF JUSTICE AND EXTENSIVE CRIMINAL FRAUD.**

(a) **ENHANCEMENT OF FRAUD AND OBSTRUCTION OF JUSTICE SENTENCES.**—Pursuant to section 994 of title 28, United States Code, and in accordance with this section, the United States Sentencing Commission shall review and amend, as appropriate, the Federal Sentencing Guidelines and related policy statements to ensure that—

(1) the base offense level and existing enhancements contained in United States Sentencing Guideline 2J1.2 relating to obstruction of justice are sufficient to deter and punish that activity;

(2) the enhancements and specific offense characteristics relating to obstruction of justice are adequate in cases where—

(A) the destruction, alteration, or fabrication of evidence involves—

(i) a large amount of evidence, a large number of participants, or is otherwise extensive;

(ii) the selection of evidence that is particularly probative or essential to the investigation; or

(iii) more than minimal planning; or

(B) the offense involved abuse of a special skill or a position of trust;

(3) the guideline offense levels and enhancements for violations of section 1519 or 1520 of title 18, United States Code, as added by this title, are sufficient to deter and punish that activity;

(4) a specific offense characteristic enhancing sentencing is provided under United States Sentencing Guideline 2B1.1 (as in effect on the date of enactment of this Act) for a fraud offense that endangers the solvency or financial security of a substantial number of victims; and

(5) the guidelines that apply to organizations in United States Sentencing Guidelines, chapter 8, are sufficient to deter and punish organizational criminal misconduct.

Deadline.

(b) **EMERGENCY AUTHORITY AND DEADLINE FOR COMMISSION ACTION.**—The United States Sentencing Commission is requested to promulgate the guidelines or amendments provided for under this section as soon as practicable, and in any event not later than 180 days after the date of enactment of this Act, in accordance with the procedures set forth in section 219(a) of the Sentencing Reform Act of 1987, as though the authority under that Act had not expired.

SEC. 806. PROTECTION FOR EMPLOYEES OF PUBLICLY TRADED COMPANIES WHO PROVIDE EVIDENCE OF FRAUD.

(a) **IN GENERAL.**—Chapter 73 of title 18, United States Code, is amended by inserting after section 1514 the following:

“§ 1514A. Civil action to protect against retaliation in fraud cases

“(a) **WHISTLEBLOWER PROTECTION FOR EMPLOYEES OF PUBLICLY TRADED COMPANIES.**—No company with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l), or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)),

PUBLIC LAW 107-204—JULY 30, 2002

116 STAT. 803

or any officer, employee, contractor, subcontractor, or agent of such company, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of any lawful act done by the employee—

“(1) to provide information, cause information to be provided, or otherwise assist in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of section 1341, 1343, 1344, or 1348, any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders, when the information or assistance is provided to or the investigation is conducted by—

“(A) a Federal regulatory or law enforcement agency;

“(B) any Member of Congress or any committee of Congress; or

“(C) a person with supervisory authority over the employee (or such other person working for the employer who has the authority to investigate, discover, or terminate misconduct); or

“(2) to file, cause to be filed, testify, participate in, or otherwise assist in a proceeding filed or about to be filed (with any knowledge of the employer) relating to an alleged violation of section 1341, 1343, 1344, or 1348, any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders.

“(b) ENFORCEMENT ACTION.—

“(1) IN GENERAL.—A person who alleges discharge or other discrimination by any person in violation of subsection (a) may seek relief under subsection (c), by—

“(A) filing a complaint with the Secretary of Labor;

or

“(B) if the Secretary has not issued a final decision within 180 days of the filing of the complaint and there is no showing that such delay is due to the bad faith of the claimant, bringing an action at law or equity for de novo review in the appropriate district court of the United States, which shall have jurisdiction over such an action without regard to the amount in controversy.

“(2) PROCEDURE.—

“(A) IN GENERAL.—An action under paragraph (1)(A) shall be governed under the rules and procedures set forth in section 42121(b) of title 49, United States Code.

“(B) EXCEPTION.—Notification made under section 42121(b)(1) of title 49, United States Code, shall be made to the person named in the complaint and to the employer.

“(C) BURDENS OF PROOF.—An action brought under paragraph (1)(B) shall be governed by the legal burdens of proof set forth in section 42121(b) of title 49, United States Code.

“(D) STATUTE OF LIMITATIONS.—An action under paragraph (1) shall be commenced not later than 90 days after the date on which the violation occurs.

Deadline.

“(c) REMEDIES.—

“(1) IN GENERAL.—An employee prevailing in any action under subsection (b)(1) shall be entitled to all relief necessary to make the employee whole.

116 STAT. 804

PUBLIC LAW 107-204—JULY 30, 2002

“(2) COMPENSATORY DAMAGES.—Relief for any action under paragraph (1) shall include—

“(A) reinstatement with the same seniority status that the employee would have had, but for the discrimination;

“(B) the amount of back pay, with interest; and

“(C) compensation for any special damages sustained as a result of the discrimination, including litigation costs, expert witness fees, and reasonable attorney fees.

“(d) RIGHTS RETAINED BY EMPLOYEE.—Nothing in this section shall be deemed to diminish the rights, privileges, or remedies of any employee under any Federal or State law, or under any collective bargaining agreement.”.

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 73 of title 18, United States Code, is amended by inserting after the item relating to section 1514 the following new item:

“1514A. Civil action to protect against retaliation in fraud cases.”.

SEC. 807. CRIMINAL PENALTIES FOR DEFRAUDING SHAREHOLDERS OF PUBLICLY TRADED COMPANIES.

(a) IN GENERAL.—Chapter 63 of title 18, United States Code, is amended by adding at the end the following:

“§ 1348. Securities fraud

“Whoever knowingly executes, or attempts to execute, a scheme or artifice—

“(1) to defraud any person in connection with any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)); or

“(2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale of any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d));

shall be fined under this title, or imprisoned not more than 25 years, or both.”.

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 63 of title 18, United States Code, is amended by adding at the end the following new item:

“1348. Securities fraud.”.

**TITLE IX—WHITE-COLLAR CRIME
PENALTY ENHANCEMENTS**

White-Collar
Crime Penalty
Enhancement
Act of 2002.

18 USC 1341
note.

SEC. 901. SHORT TITLE.

This title may be cited as the “White-Collar Crime Penalty Enhancement Act of 2002”.

SEC. 902. ATTEMPTS AND CONSPIRACIES TO COMMIT CRIMINAL FRAUD OFFENSES.

(a) IN GENERAL.—Chapter 63 of title 18, United States Code, is amended by inserting after section 1348 as added by this Act the following:

“§ 1349. Attempt and conspiracy

“Any person who attempts or conspires to commit any offense under this chapter shall be subject to the same penalties as those prescribed for the offense, the commission of which was the object of the attempt or conspiracy.

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 63 of title 18, United States Code, is amended by adding at the end the following new item:

“1349. Attempt and conspiracy.”.

SEC. 903. CRIMINAL PENALTIES FOR MAIL AND WIRE FRAUD.

(a) MAIL FRAUD.—Section 1341 of title 18, United States Code, is amended by striking “five” and inserting “20”.

(b) WIRE FRAUD.—Section 1343 of title 18, United States Code, is amended by striking “five” and inserting “20”.

SEC. 904. CRIMINAL PENALTIES FOR VIOLATIONS OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974.

Section 501 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1131) is amended—

- (1) by striking “\$5,000” and inserting “\$100,000”;
- (2) by striking “one year” and inserting “10 years”; and
- (3) by striking “\$100,000” and inserting “\$500,000”.

SEC. 905. AMENDMENT TO SENTENCING GUIDELINES RELATING TO CERTAIN WHITE-COLLAR OFFENSES. 28 USC 994 note.

(a) DIRECTIVE TO THE UNITED STATES SENTENCING COMMISSION.—Pursuant to its authority under section 994(p) of title 18, United States Code, and in accordance with this section, the United States Sentencing Commission shall review and, as appropriate, amend the Federal Sentencing Guidelines and related policy statements to implement the provisions of this Act.

(b) REQUIREMENTS.—In carrying out this section, the Sentencing Commission shall—

(1) ensure that the sentencing guidelines and policy statements reflect the serious nature of the offenses and the penalties set forth in this Act, the growing incidence of serious fraud offenses which are identified above, and the need to modify the sentencing guidelines and policy statements to deter, prevent, and punish such offenses;

(2) consider the extent to which the guidelines and policy statements adequately address whether the guideline offense levels and enhancements for violations of the sections amended by this Act are sufficient to deter and punish such offenses, and specifically, are adequate in view of the statutory increases in penalties contained in this Act;

(3) assure reasonable consistency with other relevant directives and sentencing guidelines;

(4) account for any additional aggravating or mitigating circumstances that might justify exceptions to the generally applicable sentencing ranges;

(5) make any necessary conforming changes to the sentencing guidelines; and

(6) assure that the guidelines adequately meet the purposes of sentencing, as set forth in section 3553(a)(2) of title 18, United States Code.

(c) EMERGENCY AUTHORITY AND DEADLINE FOR COMMISSION ACTION.—The United States Sentencing Commission is requested to promulgate the guidelines or amendments provided for under this section as soon as practicable, and in any event not later than 180 days after the date of enactment of this Act, in accordance with the procedures set forth in section 219(a) of the Sentencing Reform Act of 1987, as though the authority under that Act had not expired.

SEC. 906. CORPORATE RESPONSIBILITY FOR FINANCIAL REPORTS.

(a) IN GENERAL.—Chapter 63 of title 18, United States Code, is amended by inserting after section 1349, as created by this Act, the following:

“§ 1350. Failure of corporate officers to certify financial reports

(a) CERTIFICATION OF PERIODIC FINANCIAL REPORTS.—Each periodic report containing financial statements filed by an issuer with the Securities Exchange Commission pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)) shall be accompanied by a written statement by the chief executive officer and chief financial officer (or equivalent thereof) of the issuer.

“(b) CONTENT.—The statement required under subsection (a) shall certify that the periodic report containing the financial statements fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) and that information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of the issuer.

“(c) CRIMINAL PENALTIES.—Whoever—

“(1) certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than \$1,000,000 or imprisoned not more than 10 years, or both; or

“(2) willfully certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than \$5,000,000, or imprisoned not more than 20 years, or both.”.

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 63 of title 18, United States Code, is amended by adding at the end the following:

“1350. Failure of corporate officers to certify financial reports.”.

PUBLIC LAW 107-204—JULY 30, 2002

116 STAT. 807

TITLE X—CORPORATE TAX RETURNS

SEC. 1001. SENSE OF THE SENATE REGARDING THE SIGNING OF CORPORATE TAX RETURNS BY CHIEF EXECUTIVE OFFICERS.

It is the sense of the Senate that the Federal income tax return of a corporation should be signed by the chief executive officer of such corporation.

TITLE XI—CORPORATE FRAUD ACCOUNTABILITY

Corporate Fraud
Accountability
Act of 2002.

SEC. 1101. SHORT TITLE.

15 USC 78a note.

This title may be cited as the “Corporate Fraud Accountability Act of 2002”.

SEC. 1102. TAMPERING WITH A RECORD OR OTHERWISE IMPEDING AN OFFICIAL PROCEEDING.

Section 1512 of title 18, United States Code, is amended—

(1) by redesignating subsections (c) through (i) as subsections (d) through (j), respectively; and

(2) by inserting after subsection (b) the following new subsection:

“(c) Whoever corruptly—

“(1) alters, destroys, mutilates, or conceals a record, document, or other object, or attempts to do so, with the intent to impair the object’s integrity or availability for use in an official proceeding; or

“(2) otherwise obstructs, influences, or impedes any official proceeding, or attempts to do so,

shall be fined under this title or imprisoned not more than 20 years, or both.”.

SEC. 1103. TEMPORARY FREEZE AUTHORITY FOR THE SECURITIES AND EXCHANGE COMMISSION.

(a) IN GENERAL.—Section 21C(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78u-3(c)) is amended by adding at the end the following:

“(3) TEMPORARY FREEZE.—

“(A) IN GENERAL.—

“(i) ISSUANCE OF TEMPORARY ORDER.—Whenever, during the course of a lawful investigation involving possible violations of the Federal securities laws by an issuer of publicly traded securities or any of its directors, officers, partners, controlling persons, agents, or employees, it shall appear to the Commission that it is likely that the issuer will make extraordinary payments (whether compensation or otherwise) to any of the foregoing persons, the Commission may petition a Federal district court for a temporary order requiring the issuer to escrow, subject to court supervision, those payments in an interest-bearing account for 45 days.

“(ii) STANDARD.—A temporary order shall be entered under clause (i), only after notice and opportunity for a hearing, unless the court determines that

notice and hearing prior to entry of the order would be impracticable or contrary to the public interest.

“(iii) EFFECTIVE PERIOD.—A temporary order issued under clause (i) shall—

“(I) become effective immediately;

“(II) be served upon the parties subject to it;

and

“(III) unless set aside, limited or suspended by a court of competent jurisdiction, shall remain effective and enforceable for 45 days.

“(iv) EXTENSIONS AUTHORIZED.—The effective period of an order under this subparagraph may be extended by the court upon good cause shown for not longer than 45 additional days, provided that the combined period of the order shall not exceed 90 days.

“(B) PROCESS ON DETERMINATION OF VIOLATIONS.—

“(i) VIOLATIONS CHARGED.—If the issuer or other person described in subparagraph (A) is charged with any violation of the Federal securities laws before the expiration of the effective period of a temporary order under subparagraph (A) (including any applicable extension period), the order shall remain in effect, subject to court approval, until the conclusion of any legal proceedings related thereto, and the affected issuer or other person, shall have the right to petition the court for review of the order.

“(ii) VIOLATIONS NOT CHARGED.—If the issuer or other person described in subparagraph (A) is not charged with any violation of the Federal securities laws before the expiration of the effective period of a temporary order under subparagraph (A) (including any applicable extension period), the escrow shall terminate at the expiration of the 45-day effective period (or the expiration of any extension period, as applicable), and the disputed payments (with accrued interest) shall be returned to the issuer or other affected person.”.

(b) TECHNICAL AMENDMENT.—Section 21C(c)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78u-3(c)(2)) is amended by striking “This” and inserting “paragraph (1)”.

28 USC 994 note.

SEC. 1104. AMENDMENT TO THE FEDERAL SENTENCING GUIDELINES.

(a) REQUEST FOR IMMEDIATE CONSIDERATION BY THE UNITED STATES SENTENCING COMMISSION.—Pursuant to its authority under section 994(p) of title 28, United States Code, and in accordance with this section, the United States Sentencing Commission is requested to—

(1) promptly review the sentencing guidelines applicable to securities and accounting fraud and related offenses;

(2) expeditiously consider the promulgation of new sentencing guidelines or amendments to existing sentencing guidelines to provide an enhancement for officers or directors of publicly traded corporations who commit fraud and related offenses; and

(3) submit to Congress an explanation of actions taken by the Sentencing Commission pursuant to paragraph (2) and

any additional policy recommendations the Sentencing Commission may have for combating offenses described in paragraph (1).

(b) CONSIDERATIONS IN REVIEW.—In carrying out this section, the Sentencing Commission is requested to—

(1) ensure that the sentencing guidelines and policy statements reflect the serious nature of securities, pension, and accounting fraud and the need for aggressive and appropriate law enforcement action to prevent such offenses;

(2) assure reasonable consistency with other relevant directives and with other guidelines;

(3) account for any aggravating or mitigating circumstances that might justify exceptions, including circumstances for which the sentencing guidelines currently provide sentencing enhancements;

(4) ensure that guideline offense levels and enhancements for an obstruction of justice offense are adequate in cases where documents or other physical evidence are actually destroyed or fabricated;

(5) ensure that the guideline offense levels and enhancements under United States Sentencing Guideline 2B1.1 (as in effect on the date of enactment of this Act) are sufficient for a fraud offense when the number of victims adversely involved is significantly greater than 50;

(6) make any necessary conforming changes to the sentencing guidelines; and

(7) assure that the guidelines adequately meet the purposes of sentencing as set forth in section 3553 (a)(2) of title 18, United States Code.

(c) EMERGENCY AUTHORITY AND DEADLINE FOR COMMISSION ACTION.—The United States Sentencing Commission is requested to promulgate the guidelines or amendments provided for under this section as soon as practicable, and in any event not later than the 180 days after the date of enactment of this Act, in accordance with the procedures set forth in section 21(a) of the Sentencing Reform Act of 1987, as though the authority under that Act had not expired.

Deadline.

SEC. 1105. AUTHORITY OF THE COMMISSION TO PROHIBIT PERSONS FROM SERVING AS OFFICERS OR DIRECTORS.

(a) SECURITIES EXCHANGE ACT OF 1934.—Section 21C of the Securities Exchange Act of 1934 (15 U.S.C. 78u-3) is amended by adding at the end the following:

“(f) AUTHORITY OF THE COMMISSION TO PROHIBIT PERSONS FROM SERVING AS OFFICERS OR DIRECTORS.—In any cease-and-desist proceeding under subsection (a), the Commission may issue an order to prohibit, conditionally or unconditionally, and permanently or for such period of time as it shall determine, any person who has violated section 10(b) or the rules or regulations thereunder, from acting as an officer or director of any issuer that has a class of securities registered pursuant to section 12, or that is required to file reports pursuant to section 15(d), if the conduct of that person demonstrates unfitness to serve as an officer or director of any such issuer.”.

(b) SECURITIES ACT OF 1933.—Section 8A of the Securities Act of 1933 (15 U.S.C. 77h-1) is amended by adding at the end of the following:

116 STAT. 810

PUBLIC LAW 107-204—JULY 30, 2002

“(f) **AUTHORITY OF THE COMMISSION TO PROHIBIT PERSONS FROM SERVING AS OFFICERS OR DIRECTORS.**—In any cease-and-desist proceeding under subsection (a), the Commission may issue an order to prohibit, conditionally or unconditionally, and permanently or for such period of time as it shall determine, any person who has violated section 17(a)(1) or the rules or regulations thereunder, from acting as an officer or director of any issuer that has a class of securities registered pursuant to section 12 of the Securities Exchange Act of 1934, or that is required to file reports pursuant to section 15(d) of that Act, if the conduct of that person demonstrates unfitness to serve as an officer or director of any such issuer.”.

SEC. 1106. INCREASED CRIMINAL PENALTIES UNDER SECURITIES EXCHANGE ACT OF 1934.

Section 32(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78ff(a)) is amended—

(1) by striking “\$1,000,000, or imprisoned not more than 10 years” and inserting “\$5,000,000, or imprisoned not more than 20 years”; and

(2) by striking “\$2,500,000” and inserting “\$25,000,000”.

SEC. 1107. RETALIATION AGAINST INFORMANTS.

(a) **IN GENERAL.**—Section 1513 of title 18, United States Code, is amended by adding at the end the following:

Penalties.

“(e) Whoever knowingly, with the intent to retaliate, takes any action harmful to any person, including interference with the lawful employment or livelihood of any person, for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense, shall be fined under this title or imprisoned not more than 10 years, or both.”.

Approved July 30, 2002.

LEGISLATIVE HISTORY—H.R. 3763 (S. 2673):

HOUSE REPORTS: Nos. 107-414 (Comm. on Financial Services) and 107-610 (Comm. of Conference).

SENATE REPORTS: No. 107-205 accompanying S. 2673 (Comm. on Banking, Housing, and Urban Affairs).

CONGRESSIONAL RECORD, Vol. 148 (2002):

Apr. 24, considered and passed House.

July 15, considered and passed Senate, amended, in lieu of S. 2673.

July 25, House and Senate agreed to conference report.

WEEKLY COMPILATION OF PRESIDENTIAL DOCUMENTS, Vol. 38 (2002):

July 30, Presidential remarks and statement.



Exhibit____(MJM-2)

84 Pages

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,

A handwritten signature in black ink, appearing to read "PAT MILLER", is written over the typed name.

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 2006² 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 \$517,911³ based upon current monthly expense levels at October 31, 2006 and application of the CAPD growth/inflation factor properly compounded to 16 months.

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%.

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.

Revenue Conversion Factor

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.

Rate of Return

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%.

Revenue Deficiency

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

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.

BEFORE THE TENNESSEE REGULATORY AUTHORITY

**CERTIFIED
COPY**

TRANSCRIPT OF AUTHORITY CONFERENCE

Tuesday, May 15, 2007

APPEARANCES:

For TRA Staff:

Ms. Sharla Dillon
Mr. Gary Hotvedt
Ms. Rebecca Montgomery

For AT&T:

Mr. Guy Hicks

For Level 3:

Mr. Gregg Strumberger

For Atmos Energy:

Mr. Bill Ramsey

For Telelytics:

Mr. Scott Kaplan

Reported By:

Christina M. Rhodes, RPR, CCR

1 deferring this matter until the June 25th Authority
2 conference. We believe it's very possible that we will
3 have something concrete for your consideration and
4 potential approval in resolving these issues.

5 DIRECTOR MILLER: I don't have any
6 problem with that if -- Mr. Ramsey, if you want --

7 MR. RAMSEY: That was actually part of
8 my discussion. She has been very kind to meet with us
9 and we think we can work this one out.

10 DIRECTOR MILLER: That being the case,
11 I would ask we defer it per their request.

12 CHAIRMAN KYLE: No date, deadlines of
13 any type? We're not looking at any dates, deadlines,
14 times that have to be met that we need to consider at
15 this point?

16 MS. MONTGOMERY: There are no
17 deadlines. We have a meeting set May 30th, and we do
18 believe we will be ready for this to be back on for
19 your consideration for, hopefully, potential resolution
20 on June 25th.

21 CHAIRMAN KYLE: That's great. Thank
22 you. Good work.

23 MS. DILLON: Next we have Docket
24 No. 06-00290, Tennessee American Water Company,
25 petition of Tennessee American Water Company to change

1 and increase certain rates and charges so as to permit
2 it to earn a fair and adequate rate of return on it's
3 property used and useful in furnishing water service to
4 its customers; consider petition.

5 DIRECTOR MILLER: Madam Chair, I think
6 we have a preliminary matter before we get into this.
7 I filed a motion, so if I could --

8 CHAIRMAN KYLE: That's great. We can
9 move forward. We can move it to the heel or do you
10 want to hear this now? What's the pleasure?

11 DIRECTOR JONES: I'm indifferent.

12 DIRECTOR MILLER: I don't know that it
13 will take all that long. We can go ahead and proceed
14 now.

15 CHAIRMAN KYLE: Do you want the
16 parties up at the table or go ahead and begin?

17 DIRECTOR MILLER: I think we can go
18 ahead and begin.

19 CHAIRMAN KYLE: I will let you take
20 the lead. Will you?

21 DIRECTOR MILLER: Sure. Before we get
22 started with deliberation, I would like to address a
23 filing made on Friday, May 11th, by Tennessee American
24 Water objecting to the Consumer Advocate's post hearing
25 brief and asking the panel to strike or disregard. And

1 without going into a whole lot of detail, because I
2 don't think it requires it, I'm going to deny the
3 motion.

4 CHAIRMAN KYLE: All right.

5 DIRECTOR MILLER: And then I would
6 like to go ahead and proceed with my motion, if that's
7 okay.

8 CHAIRMAN KYLE: Yes, sir.

9 DIRECTOR MILLER: Tennessee American
10 Water Company filed a petition on November 22nd, 2006
11 for a 19.7 percent rate increase. The company alleged
12 that the existing rates and charges are not providing
13 sufficient revenues to cover all the costs incurred to
14 provide adequate water services in the city of
15 Chattanooga. The City of Chattanooga, the Chattanooga
16 Manufacturers Association, the Consumer Advocate all
17 intervened in this case.

18 Today I would like to express my
19 gratitude to the intervenors for their participation,
20 particularly the City of Chattanooga for its pointed
21 arguments.

22 I would like to take this opportunity
23 to thank Chairman Kyle for convening the hearing in
24 Chattanooga. I felt it was very important that the
25 hearing be held in the company's service area. That

1 minimizes the burden on consumers who want to appear in
2 person and have their voices heard before the full
3 panel.

4 I also want to thank the people who
5 took the time to appear in the hearing in Chattanooga
6 and voice their concerns. It was important for this
7 panel to hear.

8 Consistent with the Authority's
9 mission to promote the public interest by balancing the
10 interest of utility consumers and providers, my motion
11 today asks the Authority to reduce the proposed rate
12 increase by about 40 percent. My motion reduces the
13 company's requested rate increase from 6.4 million to
14 about \$4 million. This represents an increase of about
15 a dollar eighty-three to the average monthly bill of a
16 residential consumer in the city of Chattanooga.

17 Further, to address concerns related
18 to the management fees, my motion asks the Authority to
19 direct the company to have a management audit performed
20 encompassing the allocations to Tennessee American
21 Water prior to any further -- any future rate filing.
22 It is my belief that such an audit will give the
23 Authority valuable information to use in setting rates
24 in the future. My motion also directs the company to
25 notify this agency if the equity ratio of Tennessee

1 American Water's parent company, American Water Works,
2 drops below 45 percent.

3 With that, Madam Chair, I renew my
4 motion as filed in this docket yesterday.

5 CHAIRMAN KYLE: Thank you very much,
6 Commissioner Miller. We owe a lot to you. You've
7 guided this case. We appreciate all your effort and
8 hours after work that you've worked on this, and we
9 certainly appreciate, as you've stated, the City of
10 Chattanooga hosting us and providing a place for us in
11 their courthouse.

12 I respect all the attorneys and
13 witnesses that participated in this case. They
14 conducted themselves in the utmost manner and they did
15 a good job representing either their companies, the
16 citizens, and I'm proud that I worked on a case with
17 such fine professionals.

18 It's never easy when you're facing a
19 balancing act, but you always have guidelines that lead
20 you down the right road and I know that you have
21 followed these, Commissioner Miller. I have read your
22 motion. I think that our staff and those involved have
23 done a tremendous job in holding down the rates. I
24 know companies need moneys to provide services for the
25 citizens. On the other hand, we want to make sure that

1 our citizens don't pay more than what they receive.
2 You have done an excellent job in this case and, with
3 that, I second your motion.

4 DIRECTOR JONES: Director Miller, I
5 would like to thank you for filing that motion in
6 advance. It certainly streamlines our process when we
7 get up here to deliberate on this case.

8 I have stated in the past and I'm
9 going to state so again today that one of the
10 challenges in looking at rate cases and we have come to
11 some other agreement with two other people is you look
12 at the evidentiary record and one of the things -- one
13 of the standards at least that jumps out for me is one
14 of reasonableness of position. It's not to say that if
15 I were to look at the same issue, I would come out with
16 the exact same number but whether or not it's
17 reasonable on a continuum of certain numbers when
18 you're looking at revenues, expenses, rate base,
19 whatever the case may be.

20 So I've looked at and reviewed your
21 motion with that in mind in looking at reasonableness.
22 I would like to make it clear that while I may not have
23 come up with each of those numbers specifically myself,
24 the ones with which I do agree is based on my
25 determination and conclusion that they were, in fact,

1 reasonable. I will point out certain areas where I
2 have a specific comment or where I depart somewhat from
3 the motion that you did file in this docket.

4 First, I will start with the test
5 period and attrition period, and there I vote with you
6 on the motion but I specifically note that while I
7 agree that it is generally preferable and desirable to
8 ascertain a uniform and agreed to test period in
9 determining a company's overall return, there are
10 instances where the consideration of an alternative
11 test period may be appropriate such as with insurance
12 of the group in this docket.

13 Nevertheless, I do agree with your
14 prevailing motion, and by saying that what I'm saying
15 is I would not to be locked in in some kind of way in
16 suggesting that different test periods may not be
17 appropriate under certain circumstances on a
18 case-by-case basis.

19 With the expenses growth factor, I
20 vote yes on your motion, but note that the basis for my
21 decision to use the Consumer Advocate annual growth
22 factor to calculate a compounded growth rate is based
23 on, one, the fact that the Consumer Advocate's annual
24 growth factor takes into consideration customer growth,
25 a relative determinant in forecasting future expenses

1 that is not included in the company's annual factor;
2 and, two, the fact that the Authority adopted the same
3 approach as proposed by the Consumer Advocate in this
4 docket for other O&M expense in Docket No. 05-00258.

5 Also here I would like to note while
6 I'm agreeing with that, I was somewhat conflicted on
7 some of the growth factors. The Advocate had one
8 number. The company had a lower number, and in some
9 instances in your motion you devise a different growth
10 factor. But I certainly understand that and accept it
11 for the purposes of the motion that you did submit.

12 With respect to expenses, the expense,
13 salary, and wages, I do dissent from that -- from the
14 motion in regard to the reduction of the forecasted
15 incentive plan expense included in salary and wages.
16 I'm firmly in agreement with the disallowance of
17 recovery from ratepayers of the expensive incentive
18 plans that reward employees for meeting certain
19 financial goals. In this instance, however, the
20 evidence in this record, from what I can determine,
21 reveals that neither the test period nor the attrition
22 period expenses proposed by TAWC actually included any
23 of the expenses related to the financial portion of the
24 incentive plan.

25 Thus, in my opinion and as asserted by

1 the company, adoption of the Consumer Advocate's
2 position eliminates an expense from the attrition year
3 that was not in the attrition year to begin with.
4 Therefore, I would vote no with regard to that portion
5 of the motion.

6 Expenses with respect to the
7 management fees, I dissent from that motion in one
8 respect. The intervenors here have fully satisfied me
9 that further inquiry must be made into whether the
10 underlying functions performed by the services company
11 are necessary, efficiently executed, and a result of
12 prudent management decisions.

13 The record in this docket was void of
14 information upon which to answer these very, very
15 important questions. This conclusion, I believe, is
16 consistent with your motion. Contrary with the motion,
17 however, is my opinion that this issue is of such
18 critical importance that the results of a management
19 audit should not be put off until some unknown time in
20 the future when Tennessee American Water Company choses
21 to file a rate case. It is my position that Tennessee
22 American Water Company should file the results of the
23 management audit you identified in your motion as
24 described by no later than May 15th, 2008, and I would
25 certainly encourage the majority in voting on that part

1 to amend its motion to require that.

2 I would also say that in this
3 particular case that was one of the major difficulties
4 in looking at those expenses and making determinations
5 to start with as to the appropriateness of their full
6 inclusion. I think the management audit will certainly
7 reveal certain aspects of that.

8 The expenses on pensions. This was
9 another difficult area. I dissent from the motion on
10 this item. Generally I have adhered to a principle
11 that a company should only be permitted to recover its
12 minimum required pension payments. I maintain my
13 adherence to that principle today and reject Tennessee
14 American Water Company's contention that it should be
15 permitted to recover its actual contributions.

16 My dissent here, however, results
17 simply from a difference of opinion on the evidence. I
18 note that it is true that the August 2006 actuarial
19 report contains a minimum required contribution amount
20 of zero dollars. However, the period examined in that
21 report does not include the attrition period in this
22 case, the period over which these rates would be in
23 effect.

24 There is evidence in the record
25 supporting the conclusion that, in fact, the AWW

1 companies will be required to make payments in 2007 to
2 meet ERISA minimums. This evidence contains payment
3 amounts for calendar year 2007 and notes that with the
4 exception of the first quarter amounts which exceeds
5 the minimums by \$7.5 million, the numbers are based on
6 ERISA minimums.

7 There has been no sufficient criticism
8 of this evidence and I could find no reason to
9 disregard it. Thus, it is my position that TAWC should
10 be permitted to recover \$572,119 in pension expense.
11 This amount represents Tennessee American Water
12 Company's proportional share of the total listed on
13 hearing Exhibit 27 less Tennessee American Water
14 Company's proportional share of the \$7.5 million excess
15 described in the letter multiplied by the O&M expense
16 factor of 78.79 percent.

17 On a variety of the taxes, given my
18 position with respect to the salaries and wages and the
19 pension expenses that I just went through, my position
20 with regard to the appropriate level of taxes will be
21 different in many different places where taxes are
22 calculated based on the inclusion or adjustment of
23 those numbers. So with respect to the math involved,
24 the specific math that you have in your motion, I
25 obviously dissent from that; but with respect to all

1 other aspects of the methodology, other than the
2 figures, I would be in agreement with the motion with
3 respect to the methodology.

4 My position with respect to the
5 dissent on the math is equally applicable to the net
6 operating income. On the rate base utility plan
7 service I would like to vote yes in agreement with your
8 motion on that and offer the following comments.

9 First, in my opinion Tennessee
10 American Water Company provided sufficient proof at
11 this time of the reasonableness of the E/CIS-related
12 expenditures whereas the intervenors failed to
13 demonstrate that the expenditures were imprudent or
14 improperly allocated. In this instance there simply
15 was not enough proof in the record at this time to
16 support exclusion or adjustment of E/CIS-related
17 expenditures. There simply wasn't enough evidence to
18 suggest that the initial action of developing a system
19 was one that was imprudent, although the company
20 subsequently had to invest more dollars to make the
21 system work.

22 I have to be somewhat careful in
23 discouraging risks with respect to implementations that
24 have the potential of affording more efficiencies in
25 the future periods if we do not encourage that in the

1 current period, but with respect to that issue there
2 simply was just not enough evidence to make any
3 adjustments with respect to that.

4 But, secondly, I do not find it
5 extraordinary at all, as the company has suggested,
6 that the Consumer Advocate has challenged this item. I
7 believe the Consumer Advocate's inquiry into the
8 reasonableness of the E/CIS endeavor to be wholly
9 consistent with its urging of Tennessee American Water
10 Company to improve its service metrics. A company
11 should not be permitted to hide behind an imprudent
12 decision by asserting that the reasons for the
13 designation were to improve customer service. In fact,
14 I'm of the opinion that this is exactly the type of
15 issue that the Consumer Advocate should bring to the
16 Authority's attention.

17 With respect to the rate of return, I
18 concur in your position. I also note here that I gave
19 a great deal of consideration to the possible effects
20 of the anticipated IPO with American Water Works.
21 While I believe this future event must be given
22 considerable weight, I do not believe the event itself
23 should be permitted to foreclose this rate case. It is
24 the Authority's responsibility to investigate the
25 post-IPO capital structure of Tennessee American Water

1 Company and its parent to determine whether customers
2 should be provided rate relief as a result of changes
3 occurring after the IPO.

4 Based on these conclusions, it is my
5 request that the panel consider as a friendly amendment
6 to the motion, including a requirement in the order,
7 that regardless of American Water Works' equity ratio
8 Tennessee American Company file six months following
9 the close of the IPO the details of Tennessee American
10 Water Company's and American Water Works' existing
11 capital structure.

12 With the revenue deficiency -- because
13 the calculation of the revenue deficiency is based in
14 part on the calculation of the net operating income and
15 because I have dissented here today with regard to
16 certain components of the net operating income, I
17 obviously do not agree with the numerical result with
18 net operating income but do agree with the methodology.

19 Rate design, I do vote yes.

20 DIRECTOR MILLER: Could you back up?
21 What did you say with respect -- I apologize -- not
22 revenue deficiency but --

23 DIRECTOR JONES: That's the rate of
24 return.

25 DIRECTOR MILLER: What did you

1 suggest?

2 DIRECTOR JONES: Okay. I'm suggesting
3 that six months following the close of the IPO that
4 Tennessee American Water Company file with us the
5 details of the Tennessee American Water Company's and
6 American Water Works existing capital structure. I
7 believe in your motion you had if it dipped below a
8 certain threshold they were to file, and I think that
9 this item was so contentions in terms of what the
10 effect of the IPO would be on the rates that we have an
11 opportunity and perhaps an obligation here to see what
12 that capital structure is and perhaps revisit it after
13 the closing of the IPO.

14 And that position -- that amendment
15 would be appended -- I'm suggesting that be appended to
16 your motion with respect to the threshold that you
17 requested. So it wouldn't be exclusive of that; it
18 would be in addition to that.

19 (Off the record.)

20 DIRECTOR JONES: In addition to these
21 specific decisions, I have a couple of comments that I
22 wish to make for the record. Regarding this
23 procedure -- this proceeding generally, first, there
24 have been numerous references to the settlements that
25 this agency approved in the previous dockets involving

1 Tennessee American Water Company. I am somewhat
2 concerned by the parties attempts to bind the directors
3 to a number contained within an order that was arrived
4 at through settlement.

5 It is my generally held belief that
6 settlements result from compromise. When I review a
7 rate case settlement presented to me for approval, I
8 look at the overall outcome to make certain that the
9 result is a just and reasonable result. I do not adopt
10 particular numbers as if I had specifically considered
11 and approved them after a hearing. In the future,
12 however, I would review orders with more exacting
13 scrutiny to ensure that this approach is appropriately
14 reflected. However, I do understand based on language
15 in some of our orders how that misconception could be
16 had. That's why I think it's important -- the words
17 that we use in our orders are important so that they
18 are not waved at us later with an intent that was not
19 one that was intended when the order was issued.

20 Second, this rate case was highly
21 contentious involving numerous bitterly fought battles
22 between the parties. These battles strained the
23 procedural schedule -- and that was alluded to
24 earlier -- to the point where an administrative benefit
25 could have resulted from a slight modification of the

1 schedule. Nonetheless, the hearing went forward as
2 scheduled, and as a result, the Authority was
3 confronted with considerable procedural disputes as
4 well as evidentiary and due process issues.

5 Additionally, the panel was only able
6 to complete the hearing in time to deliberate the
7 merits at this conference by adopting abnormal
8 procedures such as hearing closing arguments in advance
9 of the completion of testimony and delegating the
10 hearing of cross-examination to a hearing officer to be
11 conducted in a deposition format.

12 I believe this happened based on an
13 admirable attempt on our part to hasten the completion
14 of this case in six months. I'm fully aware of the
15 provision of Section 65-4-103 that allows a company to
16 place rates into effect if the Authority -- if the
17 Authority is unable to issue a final order within six
18 months from the date the increase is filed. I'm also
19 fully aware that this same section affords the
20 Authority nine months to complete its review and to
21 require the company to post a bond for the full amount
22 of the proposed annual increase and to require refunds,
23 as necessary, if the company chooses to place the rates
24 into effect after six months.

25 Ironically, I cannot recall an

1 instance during a hearing in this proceeding where the
2 directors specifically inquired of Tennessee American
3 Water Company whether it would place its rates into
4 effect if a short amount of time beyond the six months
5 threshold was needed to complete this case. We simply
6 rushed through the process as if this were a certainty.

7 I do not believe that this is the best
8 manner in which to proceed for ratepayers, the parties,
9 or the Authority. It is my opinion that the
10 importance, one of conducting thorough and well
11 executed pretrial proceedings; and, two, of conducting
12 a hearing without question affords all parties adequate
13 due process; and, three, permitting the directors and
14 staff of the Authority a meaningful opportunity to
15 evaluate the evidence far outweigh the threat that the
16 company may put rates into effect sooner than nine
17 months. Thank you.

18 DIRECTOR MILLER: I will start with
19 your last comment first. I think the Tennessee general
20 assembly through the passage of that statute thinks
21 that we ought to be able to get through our job in six
22 months, and I agree with them. I don't think it's
23 unreasonable that we can get through the process.

24 Now, we had to -- we had to -- we had
25 to be innovative in order to accomplish that, but I

1 think it's extraordinary to allow a company to put
2 their rates in place under bond, and I think -- I think
3 some of those people on the hill would look down here
4 and wonder if we were doing our jobs if we couldn't
5 accomplish a rate case in six months. It's -- it's --
6 the company ought to be able to rely on that. The
7 consumers ought to be able to rely on that. So I
8 understand what you're saying, but I don't see it as an
9 option.

10 With respect to going ahead and asking
11 the company to conduct an audit, I -- my only concern
12 is -- I have a concern about -- I think it's reasonable
13 that we ask them to do an audit, and I think waiting
14 till the next rate case may -- may not be the best
15 circumstance. It was an idea I had that -- but I think
16 we could improve it certainly if we had a date certain
17 to do it. I don't know that one year is a reasonable
18 length of time. I just don't know how long it would
19 take to conduct that audit.

20 Could we set one year and ask them to
21 give us a status report if it hasn't been completed
22 within that time?

23 DIRECTOR JONES: Yeah, absolutely.

24 CHAIRMAN KYLE: I would agree with
25 that. And, again, Commissioner Miller, you did an

1 outstanding job running this case. If there had been
2 any concerns about the progress or procedure, they
3 could have been raised and the parties didn't. They
4 were very much in agreement with how you ran the case.
5 You followed the law, and I think that's why we all
6 agreed in a case going in as tough as this that it
7 would take somebody of your ability to guide us
8 through. You are just top in your field at this, and,
9 again, I want to thank you for how you handled this
10 case for us.

11 DIRECTOR JONES: And, Director Miller,
12 just so you're clear as to my comments, it was not in
13 any way suggesting that the -- each rate case take nine
14 months. I happen to agree if we start early we can,
15 but in those instances where we see that we have to
16 start truncating process in order to make six months,
17 the general assembly also put that provision in there
18 to extend it to the nine-month period in anticipation
19 that not all cases may be able to complete themselves
20 within that six months. That's why I believe that time
21 frame is in there to do that. It provides protections
22 for both the customers, the company, and the
23 ratepayers.

24 DIRECTOR MILLER: Yeah, but I would
25 hate to answer the phone after a 19.7 percent rate

1 increase went into effect, but -- under bond, but
2 that -- I understand what you're saying.

3 The other thing is -- well, first, I
4 would like to amend my motion to have the company go
5 ahead and conduct their audit of management fees and
6 report back to us within one year; and if it can't
7 reasonably be completed in one year, to give us a
8 status report on when it can reasonably be.

9 CHAIRMAN KYLE: Yes, I was with how
10 you said it in the first place. The status report, I
11 too don't think that such can be completed within a
12 year, but it may prove me wrong and that's great, but
13 at least every six months after or a year in this case
14 they can report to us.

15 DIRECTOR MILLER: And I would also
16 amend the -- that they notify us or report to us six
17 months after the IPO to let us know what their
18 structure is at that point. So I will move those two
19 amendments.

20 CHAIRMAN KYLE: I agree. Thank you.

21 DIRECTOR JONES: I vote yes.

22 DIRECTOR MILLER: Amendment and
23 addendum.

24 MS. DILLON: Next we have Docket
25 No. 07-00073, Ben Lomand Communications, Inc.;

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

June 10, 2008

IN RE:)	
)	
PETITION OF TENNESSEE AMERICAN WATER)	DOCKET NO.
COMPANY TO CHANGE AND INCREASE CERTAIN)	06-00290
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)	

ORDER

TABLE OF CONTENTS

I.	TRAVEL OF THE CASE.....	1
A.	DISCOVERY ISSUES.....	2
B.	PROTECTIVE ORDERS	4
C.	REQUEST TO HOLD HEARING ON MERITS IN CHATTANOOGA.....	9
D.	PRE-HEARING MOTIONS.....	11
	1. TAWC’S MOTION TO STRIKE SUPPLEMENTAL TESTIMONY OF TERRY BUCKNER	11
	2. TAWC’S <i>MOTION IN LIMINE</i> TO EXCLUDE AS EVIDENCE HIGHLY CONFIDENTIAL MATERIALS.....	13
II.	THE HEARING AND POST-HEARING FILINGS.....	14
A.	HEARING OFFICER’S RULINGS ON <i>MOTION TO STRIKE</i> AND <i>MOTIONS IN LIMINE</i>	15
B.	POST-HEARING TESTIMONY AND FILINGS	19
III.	CRITERIA FOR ESTABLISHING JUST AND REASONABLE RATES	20
IV.	TEST PERIOD AND ATTRITION PERIOD	20
V.	CONTESTED ISSUES	21
	V(A). <u>REVENUES</u>	21

V(B).	EXPENSES	22
V(B)1.	GROWTH FACTOR	22
V(B)2.	SALARIES AND WAGES	24
V(B)3.	PURCHASED WATER.....	24
V(B)4.	FUEL AND POWER.....	25
V(B)5.	CHEMICALS	25
V(B)6.	WASTE DISPOSAL	25
V(B)7.	MANAGEMENT FEES.....	26
V(B)8.	GROUP INSURANCE	27
V(B)9.	PENSION EXPENSE	28
V(B)10.	REGULATORY EXPENSE	28
V(B)11.	INSURANCE OTHER THAN GROUP.....	29
V(B)12.	CUSTOMER ACCOUNTING	29
V(B)13.	UNCOLLECTIBLE EXPENSE	30
V(B)14.	RENT.....	31
V(B)15.	GENERAL OFFICE EXPENSE	31
V(B)16.	MISCELLANEOUS.....	32
V(B)17.	MAINTENANCE EXPENSE.....	33
V(B)18.	DEPRECIATION EXPENSE	33
V(C).	<u>TAXES AND FEES</u>	34
V(C)1.	GROSS RECEIPTS TAX.....	34
V(C)2.	TRA INSPECTION FEES	35
V(C)3.	PROPERTY TAXES.....	35
V(C)4.	FRANCHISE TAXES	36
V(C)5.	FICA TAX	36
V(C)6.	UNEMPLOYMENT TAX.....	37
V(C)7.	STATE EXCISE TAX	38
V(C)8.	FEDERAL INCOME TAX	38
V(C)9.	ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION.....	38
V(D).	<u>NET OPERATING INCOME</u>	38
V(E).	<u>RATE BASE</u>	39
V(E)1.	UTILITY PLANT IN SERVICE.....	39
V(E)2.	CONSTRUCTION WORK IN PROGRESS.....	40
V(E)3.	UTILITY PLANT CAPITAL LEASE	40
V(E)4.	NET LIMITED-TERM UTILITY PLANT	41
V(E)5.	WORKING CAPITAL.....	41
V(E)6.	ACCUMULATED DEPRECIATION.....	41
V(E)7.	ACCUMULATED AMORTIZATION OF UTILITY CAPITAL LEASE.....	42

V(E)8.	ACCUMULATED DEFERRED INCOME TAXES.....	42
V(E)9.	CUSTOMER ADVANCES FOR CONSTRUCTION	42
V(E)10.	CONTRIBUTIONS IN AID OF CONSTRUCTION.....	42
V(E)11.	UNAMORTIZED INVESTMENT TAX CREDIT	42
V(F).	<u>REVENUE CONVERSION FACTOR</u>	43
V(G).	<u>RATE OF RETURN</u>	44
V(H).	<u>REVENUE DEFICIENCY</u>	47
V(I).	<u>RATE DESIGN</u>	48
ORDERING PARAGRAPHS		50

This matter came before Chairman Sara Kyle, Director Pat Miller and Director Ron Jones of the Tennessee Regulatory Authority (the “Authority” or “TRA”), the voting panel assigned to this docket, at a regularly scheduled Authority Conference held on May 15, 2007, for consideration of the *Petition* filed on November 22, 2006 by Tennessee American Water Company (“TAWC” or “the Company”) in which the Company seeks Authority approval to increase rates. Upon consideration of the entire record, including all exhibits and the testimony of the witnesses, a majority of the panel concluded that the Company had a Revenue Deficiency of \$4,079,865, which should be recovered through uniform increases to base rates and volumetric rates for all customer classes. These conclusions, as well as other decisions concerning the Revenues, Expenses, Taxes and Fees, Net Operating Income, Rate Base, Revenue Conversion Factor, and Rate of Return are fully discussed below.

I. TRAVEL OF THE CASE

On November 22, 2006, the Company filed its *Petition* in which it seeks approval by the Authority of proposed increased rates, alleging that “[t]he Company’s existing rates and charges will not provide, and cannot be made to provide, sufficient revenues to cover all the costs incurred in providing adequate quality water service including its cost of capital.”¹ The Company sought to put into effect “customer rates that will produce an overall rate of return of 8.466% on a rate base of \$100,583,193.”² According to TAWC, the additional gross revenues would be approximately \$6,379,887.³ At a regularly scheduled Authority Conference held on December 4, 2006, the panel voted unanimously to convene a contested case proceeding and to appoint General Counsel or his designee as Hearing Officer for the purpose of preparing this matter for hearing, including handling preliminary matters and establishing a procedural schedule to completion.

¹ *Petition* at 2 (November 22, 2006).

² *Id.* at 5.

³ *Id.*

On December 12, 2006, the Consumer Advocate and Protection Division of the Office of the Attorney General (“CAPD” or “Consumer Advocate”) filed a *Petition to Intervene*. No objection or opposition to the *Petition to Intervene* was filed. On December 21, 2006, the Hearing Officer entered an Order granting the Consumer Advocate’s *Petition to Intervene* and setting an initial Status Conference for January 8, 2007. The City of Chattanooga (“Chattanooga” or “the City”) and Chattanooga Manufacturers Association (“CMA”) filed petitions to intervene on December 28 and December 29, 2006, respectively. During the Status Conference held on January 8, 2007, the Hearing Officer granted the intervention petitions of Chattanooga and CMA, addressed the parameters of discovery and considered several procedural schedules proposed by the parties. Thereafter, the Hearing Officer established a Procedural Schedule which called for discovery to commence on January 22, 2007 and included a Hearing date of the week of April 16, 2007. On January 19, 2007, the Hearing Officer entered the Protective Order which had been agreed upon by the parties.

A. Discovery Issues

The parties commenced discovery in accordance with the Procedural Schedule. Objections to discovery were filed and motions to compel discovery followed. A second Status Conference was held on February 9, 2007 to resolve discovery disputes. The parties reached agreements during the Status Conference concerning most of the discovery requests in dispute. The Hearing Officer heard oral arguments from the parties regarding the motions to compel discovery seeking information and materials pertaining to an Initial Public Offering (“IPO”) which had come to light in the Company’s petition filed in another TRA matter, Docket No. 06-00119.⁴

In objecting to certain discovery requests regarding the IPO, TAWC argued that the action of the Authority in TRA Docket No. 06-00119 resolved all issues relating to the IPO, and therefore, the

⁴ See *In re: Petition of Tennessee-American Water Company for Approval of Change of Control*, Docket No. 06-00119, *Petition* (April 21, 2006).

IPO was not relevant to the rate case. Chattanooga responded to TAWC's objections by asserting that the discovery requests relating to the IPO were reasonably calculated to discover whether the cost of capital and cost of equity of TAWC would be adversely affected or impacted by the IPO. Chattanooga contended that, because RWE Aktiengesellschaft ("RWE") is the ultimate parent of TAWC and the opinions of RWE could affect its subsidiary, RWE's view of the value of TAWC, and other elements of the American Water Works Company's ("AWWC") system, as well as RWE's conclusions regarding rates of return, were relevant to the subject matter of this proceeding.

During the Status Conference, the Hearing Officer ruled on discovery not involving the IPO.⁵ After taking under advisement the discovery requests, objections and motions to compel pertaining to the IPO, the Hearing Officer issued a separate order regarding those discovery issues on March 1, 2007.⁶ Because of the sensitive nature of certain information to be produced by the Company related to the IPO, the Hearing Officer entered a *Supplemental Protective Order* in conjunction with the March 1, 2007 *Order Granting Motions to Compel Discovery Relating to Initial Public Offering (IPO) Information and Materials* ("Order Compelling Discovery").

In the *Order Compelling Discovery*, the Hearing Officer found that information concerning transactions occurring at the parent level or between a parent and its subsidiary may be relevant to the subject matter of a rate case proceeding and that this would be particularly true when a subsidiary's capital structure is potentially impacted by decisions of the parent. For these reasons, the Hearing Officer determined, as relevant and reasonable, discovery of information and documentation relating to whether and to what extent the anticipated IPO of TAWC's parent company may impact or affect the Company's rates, policies, service, operations, financing, and other matters impacting the public interest.

⁵ See *Order Resolving, in Part, Objections to Discovery Requests* (February 15, 2007).

⁶ *Order Granting Motions to Compel Discovery Relating to Initial Public Offering (IPO) Information and Materials* (March 1, 2007).

A *Second Modified Procedural Schedule* issued on March 1, 2007 provided for a second round of discovery to commence on March 14, 2007 and set another Status Conference to consider outstanding motions, objections to discovery and other pre-hearing matters. That Status Conference was convened on March 23, 2007, and was concluded on March 27, 2007 due to the considerable number of pending motions, objections and other matters to be considered. Additional discovery disputes were addressed at the Pre-Hearing Conference held on April 12, 2007.

B. Protective Orders

The *Supplemental Protective Order*, issued on March 1, 2007, provided an enhanced level of protection for certain information and documentation, including documents filed with the Securities and Exchange Commission, designated as “Highly Confidential Information,” which might be produced pursuant to the *Order Compelling Discovery*. The *Supplemental Protective Order* required a party receiving Highly Confidential Information to execute a Nondisclosure Statement in advance of obtaining copies of the production.

On March 8, 2007, TAWC filed certain documentation in compliance with the *Order Compelling Discovery*, pending execution of Nondisclosure Statements by the parties, in accordance with the *Supplemental Protective Order*. Nondisclosure Statements were signed and filed by counsel for CMA and counsel for the City on March 12 and March 14, 2007, respectively. The Consumer Advocate declined to execute the Nondisclosure Statement and instead, on March 9, 2007, filed *Consumer Advocate’s Motion to Reconsider Supplemental Protective Order, or in the Alternative, for Interlocutory Review by the Tennessee Regulatory Authority*. The City joined in that motion on March 14, 2007. In response to the attempts to modify the protections afforded certain information through the *Supplemental Protective Order*, TAWC filed *Tennessee American Water Company’s Emergency Motion for Stay of Order Granting Motions to Compel Discovery Relating to Initial Public Offering Information and Materials or, in the Alternative, for Emergency Interlocutory Review*

by the Tennessee Regulatory Authority on March 16, 2007. TAWC also filed, on March 22, 2007, *Tennessee American Water Company's Emergency Motion for Stay of Any Order Materially Altering the Supplemental Protective Order or, in the Alternative for Emergency Interlocutory Review by the Tennessee Regulatory Authority.*

At the March 23, 2007 Status Conference, the Consumer Advocate and the Company put forth their respective positions regarding whether the *Supplemental Protective Order* should remain in effect. Initially, the Consumer Advocate questioned the authority of the Hearing Officer to designate certain documentation as Highly Confidential Information. The Consumer Advocate argued that the original *Protective Order* was sufficient for the production of confidential or commercially sensitive information in this docket.

The Consumer Advocate argued further that the nondisclosure requirement in the *Supplemental Protective Order* should not apply to the Attorney General or certain members of that office because such a requirement would improperly restrict the Attorney General in the performance of the duties of that position. The Consumer Advocate also raised the question of whether executing the nondisclosure statement would in some way remove the immunity that is provided to state officers and employees for liability for acts or omissions within the scope of the officer's or employee's employment with the state of Tennessee as provided for in Tenn. Code Ann. § 9-8-307(h). The Company expressed concern that if the nondisclosure requirement was not applied to all persons in the Attorney General's Office, then the *Supplemental Protective Order* would not provide the enhanced protection that must be in place to allow the Company to produce the Highly Confidential Information.

The Hearing Officer initially found that because of the nature of Highly Confidential Information being produced through discovery in this case, a need existed for a supplemental

protective order that would provide enhanced protection.⁷ The Hearing Officer directed the parties, at the conclusion of the proceedings on March 23, 2007, to work together to propose specific language for the *Supplemental Protective Order* based upon the particular findings of the Hearing Officer.

Upon reconvening the Status Conference on March 27, 2007, the Consumer Advocate and the Company each provided to the Hearing Officer a separate proposed amended protective order and stated that they could not reach an agreement on certain language to be included therein. In the absence of an agreed amended order, the Hearing Officer proceeded to rule on the Consumer Advocate's specific objections to the *Supplemental Protective Order* raised in the reconsideration motion and on other pending motions filed by the parties relating to the production of Highly Confidential Information.

Addressing the Consumer Advocate's initial challenge, the Hearing Officer reaffirmed that the authority of a hearing officer to designate or rule upon a designation of Highly Confidential Information pursuant to the process set forth in the *Protective Order* and *Supplemental Protective Order* is established in the Tennessee Administrative Procedures Act⁸ and the procedural rules of the TRA.⁹ The Hearing Officer also reaffirmed the distinction that exists between the Highly Confidential Information requested in this matter, and the customary confidential information, such as trade secret or commercially sensitive information, which is generally filed with the TRA and adequately protected under standard protective orders.

The Consumer Advocate argued that, in issuing the *Supplemental Protective Order*, the TRA would be creating an exception to the Public Records Act. The Hearing Officer pointed out that the

⁷ The Hearing Officer noted that the Highly Confidential Information involves information, which if provided to the public or to persons not a part of this lawsuit, could result in violations of and perhaps prosecution under federal law.

⁸ Tenn. Code Ann. § 4-5-301 *et seq.*

⁹ Tenn. Comp. R. & Regs. 1120-1-2-.11

General Assembly expressly provided for exceptions to the requirement of producing records under the Public Records Act.¹⁰ Specifically, the Tennessee Rules of Civil Procedure qualify as a statutory exception to the Public Records Act, and protective orders, entered pursuant to the Tennessee Rules of Civil Procedure, are recognized as valid and proper exceptions to the Public Records Act. Inasmuch as the Tennessee Rules of Civil Procedure apply to the TRA through the Tennessee Administrative Procedures Act, and the proceedings in this docket are governed by the Tennessee Administrative Procedures Act, the protective orders entered in this docket pursuant to Tenn. Code Ann. § 4-5-311 constitute a valid exception to the Public Records Act.

The Consumer Advocate also expressed a concern that under the *Supplemental Protective Order* the Attorney General would be required to execute and be subject to the terms of a nondisclosure agreement. The parties discussed at length the role of the Attorney General when the Consumer Advocate appears as a party before the Tennessee Regulatory Authority. Counsel for the Consumer Advocate pointed out that the investigative role of the Attorney General, which exists apart from the Consumer Advocate and Protection Division, may be hampered if the Attorney General and certain members of that office are required to execute a nondisclosure agreement.

Based upon the statements made by the Consumer Advocate, the Hearing Officer determined that language would be inserted into the *Supplemental Protective Order* that would distinguish the roles of the Attorney General and would not require the Attorney General or persons in the Attorney General's Office, outside of the Consumer Advocate and Protection Division, to execute the Nondisclosure Statement. Nevertheless, any member of the Attorney General's Office would remain subject to the terms of the *Protective Order* that was entered initially on January 19, 2007. The Hearing Officer also modified the *Supplemental Protective Order* to include additional language addressing TAWC's concern regarding public records requests directed to the Attorney General's

¹⁰ Tenn. Code Ann. § 10-7-503(a).

Office. The Hearing Officer did not find merit in the Consumer Advocate's argument that the *Supplemental Protective Order* requires members of the Attorney General's Office to enter into a confidentiality agreement in contradiction to the Public Records Act. Tenn. Code Ann. § 65-4-118(d) specifically permits the Consumer Advocate to enter into agreements that would protect confidential information and trade secrets.¹¹

The Hearing Officer also determined that language should be inserted into the *Supplemental Protective Order* to address the issue regarding whether or not immunity for state officers and employees under Tenn. Code Ann. § 9-8-307(h) would be jeopardized. The revised language provided that common law and statutory defenses available to state officers and employees would remain intact and would not be affected by the *Supplemental Protective Order*.

Based on the foregoing determinations, the Hearing Officer denied the Consumer Advocate's request that the *Supplemental Protective Order* be vacated but modified certain portions of the *Supplemental Protective Order* to provide clarifying language and define the scope of the Nondisclosure Statement. Because of the modifications, the Hearing Officer also denied the Consumer Advocate's request for an interlocutory review of the *Supplemental Protective Order*.

Based on the denial of the Consumer Advocate's request to vacate the *Supplemental Protective Order* and finding no new grounds upon which to reconsider the decision that the IPO information was relevant to discovery, the Hearing Officer denied TAWC's *Motion to Reconsider Order Compelling Discovery*. The Hearing Officer also determined that because the protections under the *Supplemental Protective Order* would remain in place, TAWC's *Motion to Stay Order Compelling Discovery* also should be denied. Based upon the rulings regarding the Consumer Advocate's motions regarding the *Supplemental Protective Order*, TAWC agreed at the March 27, 2007 Status Conference that its motion asking the Hearing Officer to stay any order that might be

¹¹ Tenn. Code Ann. § 65-4-118(d) provides: "The consumer advocate division may enter into agreements regarding the nondisclosure of trade secrets or other confidential commercial information obtained by the division."

entered that would materially alter the terms of the *Supplemental Protective Order* had been rendered moot. On March 31, 2007, the Hearing Officer entered an *Amended Supplemental Protective Order* which acknowledged the need to afford enhanced protection to certain documentation and information and which incorporated the modifications determined by the Hearing Officer.

C. Request to Hold Hearing on Merits in Chattanooga

On December 29, 2006, CMA filed a Request to hold the hearing on the merits of this rate case in Chattanooga. CMA asserted in its Request that the Company's proposed rate increase would have an adverse effect on "citizens, residents and ratepayers throughout the Chattanooga area"¹² and that "[a] change of venue will enhance substantially any interested ratepayers' opportunity to be heard."¹³ TAWC issued a statement in opposition to CMA's request on January 5, 2007, arguing against the Request primarily on the basis of the inconvenience and cost of holding the hearing in a location other than Nashville. TAWC maintained that Nashville would be the best location for the hearing because,

(1) it is the location of the offices, staff, and resources of the TRA, (2) it is the location of the attorneys for the Petitioner, (3) it is the location of the majority of the attorneys for the Intervenors, (4) it is the most convenient location for the witnesses of the Petitioner, and (5) it best serves the interests of justice.¹⁴

CMA's Request was addressed during the Status Conference held on January 8, 2007, when the Hearing Officer heard oral arguments from the parties.

The Consumer Advocate stated during the January 8, 2007 Status Conference that it did not oppose the Request to hold the hearing in Chattanooga. The City supported CMA's Request, and on January 10, 2007, the City filed its own Request to hold the hearing in Chattanooga.¹⁵ In its Request, filed on behalf of the Mayor of the City of Chattanooga, the City stated:

¹² *Chattanooga Manufacturers Association's Request that Contested Case Hearing be Conducted in Chattanooga, Tennessee*, p. 1 (December 29, 2006).

¹³ *Id.* at 2.

¹⁴ *Id.* at 3.

¹⁵ *City of Chattanooga's Request that Contested Case Hearing be Conducted in Chattanooga, Tennessee* (January 10, 2007).

. . . holding a hearing in this matter in Chattanooga presents an educational opportunity for the TRA and the citizens of southeast Tennessee. . . . Although the activities of the TRA that have a peculiar local impact may be reported in the local paper, and, occasionally in other media outlets, it is reasonable to assume in that holding a hearing in Chattanooga will provide a vehicle for educating the public about the purpose and role of the TRA.¹⁶

TAWC filed its Supplemental Statement in opposition to the requests of the City and CMA on January 11, 2007.¹⁷ In its Supplemental Statement, the Company favored a public input meeting in Chattanooga as opposed to holding the entire hearing on the merits in Chattanooga which, according to the Company, would “. . . cause a costly, unnecessary, and unjustified burden on Chattanooga ratepayers and state taxpayers.”¹⁸

The Hearing Officer ruled on the Requests, finding that the TRA is not restricted by statute or rule in setting the location of meetings and hearings. Tenn. Code Ann. § 65-1-103(a) permits the Authority to hold sessions

. . . at such times and places as may be necessary for the proper discharge of their duties, or as the convenience of the parties, in the judgment of the Tennessee regulatory authority, may require.

TRA Rule 1220-1-1-.06 further expressly permits the Authority to conduct public hearings at locations other than Nashville, Tennessee, upon the Authority’s own motion or upon the motion of a party, as the Authority may deem appropriate.

In granting the Requests of CMA and the City, the Hearing Officer determined that

A Chattanooga location would afford ratepayers of the Company a ready opportunity to observe the hearing and become better educated concerning the ratemaking process. Ratepayers could actually participate in the process by offering public comments during the hearing. It is reasonable to assume that the costs associated with travel to and lodging, if necessary, in Nashville would prevent many ratepayers from attending and participating in a public hearing in Nashville.¹⁹

¹⁶ *Id.* at 1.

¹⁷ *Supplemental Statement of Tennessee American Water Company in Opposition to Chattanooga Manufacturers Association’s and City of Chattanooga’s Request that Contested Case Hearing be Conducted in Chattanooga, Tennessee* (January 11, 2007).

¹⁸ *Id.* at 1.

¹⁹ *Order Setting Hearing on the Merits in Chattanooga, Tennessee*, p. 6 (March 9, 2007).

The Hearing Officer concluded that conducting the hearing in Chattanooga would be in the public interest and that the costs involved “must be weighed against the benefits of holding the hearing in a location where interested members of the public, particularly ratepayers, have an opportunity to participate in the process.”²⁰ In addition, the Hearing Officer cited the City’s participation in this docket and its express request to hold the hearing in Chattanooga as significant factors in determining the location of the hearing.

D. Pre-Hearing Motions

1. TAWC’s Motion to Strike Supplemental Testimony of Terry Buckner

The Company filed its Direct Testimony with the *Petition* on November 22, 2006. The Intervenors filed Direct Testimony on March 5, 2007. On April 9, 2007, the Company filed its Rebuttal Testimony. After the close discovery, the Consumer Advocate filed *Supplemental Revised Direct Testimony of Michael D. Chrysler* and *Supplemental Direct Testimony of Terry Buckner* on April 3, 2007. The Consumer Advocate also filed *Supplemental Direct Testimony of Steve Brown* on April 9, 2007.

A portion of Mr. Buckner’s supplemental testimony raised for the first time in the proceeding an issue regarding TAWC’s Enterprise Customer Information System (“E-CIS”) asserting that it would be improper to include the E-CIS costs in the rate base. Mr. Buckner relied upon a 2004 decision by the Indiana Utility Regulatory Commission (“IURC”) in testifying that the Authority should remove the E-CIS costs from TAWC’s rate base.²¹ The Company filed a *Motion to Strike from the Record and/or to Exclude as Evidence the Supplemental Direct Testimony of Terry Buckner Related to the Tennessee American Water Company’s Customer Information System* (“*Motion to Strike*”) on April 5, 2007. The Consumer Advocate filed its response to the *Motion to Strike* on April 11, 2007.

²⁰ *Id.* at 6.

²¹ In his supplemental testimony, Mr. Buckner relied upon his own interpretation of decisions of the Indiana Utility Regulatory Commission and the Indiana Court of Appeals in testifying that TAWC’s rate base for E-CIS should be reduced by over one million dollars. Supplemental Direct Testimony of Terry Buckner, pp. 3-4 (April 3, 2007).

In its *Motion to Strike*, TAWC asserted that there was no justifiable reason for the Consumer Advocate to file Mr. Buckner's supplemental testimony one month after the pre-filed testimony of the Intervenors was required to be filed in accordance with the Procedural Schedule. According to TAWC, the Consumer Advocate was aware of the E-CIS costs and of the IURC decision regarding E-CIS for over two years and, in fact, had agreed with TAWC's rate base calculation in an earlier TAWC rate case, Docket No. 04-00288, which had included costs related to the E-CIS. TAWC argued that it had been prejudiced by the late insertion of the E-CIS issue in the proceeding and asked the Hearing Officer to strike and exclude as evidence only those portions of Mr. Buckner's supplemental testimony which raised the E-CIS cost issue and which provided changes to the Consumer Advocate's Rate Base and Depreciation Expense calculations.

The Consumer Advocate asserted in its response to the *Motion to Strike* that the significance of the IURC's E-CIS decision was not discovered by Mr. Buckner until after his direct testimony was filed on March 5, 2007. The Consumer Advocate asserted further that because the Company actually responded to the E-CIS issue in Michael Miller's rebuttal testimony filed on April 9, 2007, TAWC had sufficient time to present its position on the issue.

The Company and the Consumer Advocate presented oral argument on the *Motion to Strike* at the Pre-Hearing Conference held on April 12, 2007. There was no motion or request to strike or exclude the supplemental pre-filed testimony of Michael Chrysler or Dr. Steve Brown or those portions of Terry Buckner's supplemental testimony which did not relate to the E-CIS costs. The Hearing Officer took the *Motion to Strike* under advisement. Following the Pre-Hearing Conference, the *Consumer Advocate's Motion to Allow Supplemental Testimony* ("*Motion*") was filed on April 13, 2007. On April 16, 2007, the Company filed *Tennessee American Water Company's Response to Consumer Advocate's Motion to Allow Supplemental Testimony*. The Consumer Advocate's *Motion*, as well as the *Motion to Strike* were addressed by the Hearing Officer at the commencement of Hearing on April 17, 2007.

2. TAWC's *Motions in Limine* to Exclude as Evidence Highly Confidential Materials

On April 11, 2007, TAWC filed two motions *in limine* which sought to exclude or limit the introduction into evidence certain documentation classified as Highly Confidential Information. Those motions were: *Tennessee American Water Company's Motion in Limine to Exclude as Inadmissible Evidence Related to the Initial Public Offering of American Water Works Company* ("Motion to Exclude IPO Documents") and *Tennessee American Water Company's Motion in Limine to Exclude as Inadmissible All Highly Confidential RWE Presidium and Supervisory Board Minutes* ("Motion to Exclude RWE Minutes"), (collectively, "TAWC's *Motions in Limine*").

In its *Motion to Exclude IPO Documents*, TAWC argued that materials related to the IPO of AWWC were not relevant to the rate case and that admission of such materials would cause confusion and result in unfair prejudice to TAWC. The Company asserted in the *Motion to Exclude RWE Minutes* that the minutes were irrelevant to this rate case, highly confusing and prejudicial, and constituted inadmissible hearsay. In addition to these grounds, TAWC argued that the Intervenor should not be permitted to use Highly Confidential materials at the time of the Hearing because they had failed to designate such materials in accordance with the *Amended Supplemental Protective Order*.

Oral argument on TAWC's *Motions in Limine* was heard during the Pre-Hearing Conference on April 12, 2007. Nevertheless, because of the filing of those motions so close in time to the convening of the Pre-Hearing Conference, the Hearing Officer permitted the Intervenor to file written responses after the Pre-Hearing Conference. On April 16, 2007, the following filings were made in response to TAWC's *Motions in Limine*: *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*; *Chattanooga Manufacturers Association's Reply to Petitioner's Response Concerning Notice as to Materials Designated by Petitioner as Highly Confidential Information* and *CMA's Response to Petitioner's Motion in Limine Seeking to Exclude*

All But the Materials Designated as Highly Confidential That Petitioner Deems to be Relevant for This Hearing; and City of Chattanooga's Response to TAWC's Motions Relating to Identification and Use of Documents Designated by TAWC as "Highly Confidential Information."

In their filings, the Intervenor asserted that because the IPO would have an effect on the ability of AWWC to invest in TAWC and because the amount of equity that may flow from the IPO is a variable unknown and based on market conditions, the IPO would be relevant to this matter and information related to the IPO should be available to the TRA in considering the rate increase request of TAWC. In addition, the Intervenor argued that the IPO documents should be admitted for use in an analysis of the Company's capital structure and for the purpose of impeaching TAWC's expert witnesses.

The Intervenor also argued that the designation procedure in the *Amended Supplemental Protective Order* should not interfere with or violate the parties' due process rights in terms of impeding their ability to conduct effective cross-examination of TAWC's witnesses. The Intervenor asserted that requiring them to identify with specificity before the Hearing those Highly Confidential materials which they may use to cross-examine and impeach a witness would intrude upon their attorney work product privilege and impair the presentation of their cases by forcing them to reveal their case strategy. The Intervenor proposed that objections as to the admissibility of documents could be resolved during the Hearing at the time such documents are proffered without the necessity of disclosing the mental impressions or case strategy of the Intervenor's attorneys. In light of the written responses of the Intervenor being filed on April 16, 2007, additional oral argument on TAWC's *Motions in Limine* was held at the commencement of the Hearing on April 17, 2007.

II. THE HEARING AND POST-HEARING FILINGS

The Hearing in this matter was held in Chattanooga, Tennessee, before the voting panel on April 17 through 20, 2007. The Hearing concluded in Nashville on April 26, 2007. Participating in the Hearing were the following parties and their respective counsel:

Tennessee American Water Company – R. Dale Grimes, Esq. and Ross I. Booher, Esq., Bass, Berry & Sims, PLC, 315 Deaderick Street, Suite 2700, Nashville, TN 37238-3001.

Consumer Advocate and Protection Division - Vance Broemel, Esq. and Stephen R. Butler, Esq., Office of the Attorney General, 425 5th Ave. N, John Sevier Building, P.O. Box 20207, Nashville, TN 37202.

City of Chattanooga, Tennessee – Michael A. McMahan, Esq., Office of the City Attorney, 801 Broad Street, Suite 400, Chattanooga, TN 37402.; and **Frederick L. Hitchcock, Esq.,** Chambliss, Bahner & Stophel, P.C., 1000 Tallan Building, Two Union Square, Chattanooga, TN 37402.

Chattanooga Manufacturers Association (CMA) – Henry M. Walker, Esq., Boulton, Cummings, Conners & Berry, PLC, 1600 Division Street, Suite 700, P.O. Box 340025, Nashville, TN 37203; and **David C. Higney, Esq.,** Grant, Konvalinka & Harrison, P.C., 9th Floor, Republic Centre, 633 Chestnut Street, Chattanooga, TN 37450-0900.

The Hearing convened on April 17, 2007, at which time members of the public presented comments pertaining to the quality of water service provided by TAWC and TAWC's request for a rate increase.²²

A. Hearing Officer's Rulings on *Motion to Strike* and *Motions in Limine*

Following the presentation of public comments, the Hearing Officer heard from the parties additional oral argument regarding TAWC's *Motion to Strike* and *Motions in Limine* and the Intervenor's responses to those motions. The Hearing Officer also heard argument on the Consumer Advocate's motion to permit it to file the supplemental testimony of Terry Buckner. Thereafter, the Hearing Officer ruled on the pending motions in the following manner.

The Hearing Officer pointed out that the Consumer Advocate filed its *Motion to Allow Supplemental Testimony* on April 13, 2007, after the April 12 Pre-Hearing Conference during which the parties argued TAWC's *Motion to Strike*. Procedurally, the Hearing Officer found that the Consumer Advocate's *Motion*, was untimely filed because the supplemental testimony of Mr. Buckner had already been filed ten days earlier and argument on TAWC's *Motion to Strike* had already commenced.

²² Transcript of Public Hearing, pp. 8-30 (April 17, 2007).

As to TAWC's *Motion to Strike*, the Hearing Officer noted that the Company requested that the Hearing Officer strike only a portion of Mr. Buckner's supplemental testimony. The supplemental testimony of Mr. Buckner was filed significantly outside the time frame provided for in the procedural schedule, as was the supplemental testimony of Mike Chrysler and Dr. Steven Brown. Nevertheless, there was no motion to strike the supplemental testimony of either of those witnesses. Thus, it appeared that TAWC's claim of unfairness caused by the untimely filing of Mr. Buckner's supplemental testimony was linked to TAWC's argument of prejudice or harm resulting from the Consumer Advocate's delay in raising the E-CIS cost issue.

The Hearing Officer found that the Company's objections to Mr. Buckner's supplemental testimony boiled down to two major points. First, Mr. Buckner's testimony belatedly injected a new issue into the proceeding, thereby preventing TAWC from being able to adequately address the issue or rebut the testimony. Second, Mr. Buckner's interpretation of the IURC's decision was incorrect and misleading.

Mr. Buckner stated, at page 3 of his supplemental testimony, "In Cause Number 42520, the Indiana Utility Regulatory Commission, IURC, found the E-CIS to be 'an imprudent decision.'"²³ From a review of the IURC's decision, the Hearing Officer concluded that Mr. Buckner's interpretation and testimony regarding the IURC decision was incorrect.²⁴ Because it was clear to the Hearing Officer that the IURC did not find the inclusion of E-CIS to be "an imprudent decision," the Hearing Officer struck that portion of Mr. Buckner's testimony relating to the IURC decision. Mr. Buckner was permitted to testify regarding E-CIS, but he could not rely upon the IURC decision for his conclusions. The Hearing Officer determined that Mr. Buckner's conclusions regarding the E-CIS costs would have to be based on his own analysis and assessment, and if there was no

²³ Supplemental Direct Testimony of Terry Buckner, p. 3 (April 3, 2007).

²⁴ In addition, the Hearing Officer determined that the IURC decision should not have been raised in this proceeding through Mr. Buckner's testimony. Instead, it is the role of an attorney to argue the interpretation of the case law and its applicability to the facts of a particular case.

independent basis, such would go to the weight of his testimony. As to the remaining portions of Mr. Buckner's testimony, the Hearing Officer allowed that testimony to stand.

The Hearing Officer stated that the late discovery of the issue and failure to raise the issue earlier in the proceeding could be bases for discrediting the testimony of Mr. Buckner on cross examination. The Hearing Officer further determined that, because of the lateness of the Consumer Advocate's filing which raised the new issue, TAWC would be permitted to address the E-CIS issue either in its direct case or after cross examination of Mr. Buckner. TAWC was permitted to rebut Mr. Buckner's testimony through testimony of its own witnesses during the Hearing. Those portions of Mr. Buckner's testimony not related to the E-CIS issues were not stricken because they were not included in TAWC's *Motion to Strike*.

The Hearing Officer found two major issues were raised by TAWC's *Motions in Limine*. First, there was the substantive issue of the relevancy of the Highly Confidential documents sought to be used. Second, there was a procedural issue regarding whether the Intervenors should be prohibited from using certain documents because of a failure to identify with specificity in advance of the Hearing the documents the Intervenors intended to use during the Hearing.

TAWC's *Motions in Limine* were based in part on the Company's argument that the documentation and information in question were not relevant to the issues in this case. The Authority may exclude irrelevant and immaterial evidence. Nevertheless, Tenn. Code Ann. § 4-5-313 provides,

In contested cases: (1) the agency shall admit and give probative effect to evidence admissible in a court, and when necessary to ascertain facts not reasonably susceptible to proof under the rules of court, evidence not admissible thereunder may be admitted if it is of a type commonly relied upon by reasonably prudent men in the conduct of their affairs. The agency shall give effect to the rules of privilege recognized by law and to agency statutes protecting the confidentiality of certain records, and shall exclude evidence which in its judgment is irrelevant, immaterial or unduly repetitious[.]

The Hearing Officer concluded that the Tennessee Rules of Evidence can be applied to contested cases before the Authority and that under the Rules of Evidence, in order for evidence to be relevant, the evidence must satisfy two criteria. First, the evidence must have the “tendency to make the existence of any fact . . . more probable or less probable than it would be without the evidence,” and second, evidence must be material, that is, the fact sought to be proven must be “of consequence to the determination of the action.”²⁵ “Evidence offered in a cause, or a question propounded, is material when it is relevant and goes to the substantial matters in dispute, or has a legitimate and effective influence or bearing on the decision of the case.”²⁶ The Hearing Officer found that the Highly Confidential Information was relevant to the issues to be decided in this rate case and denied TAWC’s *Motions in Limine* on the grounds that it appeared that the subject matter of the certain documents was relevant to the issues in this case and would be admissible in the proceeding, in the least for use as impeachment materials during cross examination of witnesses.

The procedural issue raised by TAWC involved whether the Intervenors could be required to specify Highly Confidential Information or documents which they intended to rely upon during the Hearing. The Hearing Officer did not find that the parties were in error in failing to specify a particular document or particular documents that they intended to rely upon in their cross examination of the witnesses. To require the Intervenors to reveal, in advance of the cross examination of a witness, those specific documents that would be used in the cross-examination would be encroaching upon the mental impressions of the attorney in the preparation of the case.²⁷ The Hearing Officer proceeded to rule that the Intervenors could use Highly Confidential Information in their cross examination of the witnesses. Nevertheless, because of the situation

²⁵ Tennessee Rules of Evidence 401.

²⁶ Black’s Law Dictionary, Third Edition (1933), p. 1168, “Material” citing *Connecticut Fire Ins. Co. of Hartford, Conn. v. George*, S2 Okl. 432, 153 pp. 116, 119.

²⁷ Tenn. R. Civ. P. 26 provides that “. . . the court shall protect against disclosure the mental impressions, conclusions, opinions, or legal theories of any attorney or other representative of a party concerning the litigation.”

existing during the Hearing, where certain persons would be either attending or participating in some fashion in the Hearing who have not executed nondisclosure statements, the Hearing Officer determined that persons who had not executed nondisclosure statements must not be present during testimony involving the Highly Confidential Information.

B. Post-Hearing Testimony and Filings

During the Hearing, the panel heard further argument from the parties as to the extent, if any, that Mr. Buckner should be permitted to testify regarding the E-CIS costs. These arguments were raised in the course of objections to specific questions presented to witnesses and in the context of TAWC's appeal to the panel of the Hearing Officer's ruling striking a part of Mr. Buckner's supplemental testimony. The panel determined that the scope of the questions regarding the E-CIS costs would be determined as objections to specific questions were raised. In addition, in upholding the Hearing Officer's ruling and permitting Mr. Buckner to testify regarding any independent basis for his conclusions regarding E-CIS, the panel determined that the Company could submit additional testimony on the E-CIS. Because TAWC's additional testimony would be submitted after the conclusion of the Hearing, the Intervenor's were permitted to take the depositions of the Company's witnesses on the E-CIS issue. Thereafter, the parties would submit briefs to the panel on the question of whether TAWC's costs related to the E-CIS were recoverable in this rate case.

TAWC filed the testimony of A. Joseph Van Den Berg and John S. Watson on April 26, 2007 to present the Company's position on inclusion of the E-CIS costs. The Intervenor's took the depositions of Mr. Van Den Berg and Mr. Watson on May 4, 2007.

The parties filed briefs addressing the E-CIS cost issue on May 9, 2007. With the filing of additional testimony, the taking of depositions and the submission of post-hearing briefs, the panel proceeded to deliberate this case at a regularly scheduled Authority Conference held on May 15, 2007.

III. CRITERIA FOR ESTABLISHING JUST AND REASONABLE RATES

The Authority is obligated to balance the interests of the utilities subject to its jurisdiction with the interests of Tennessee consumers, i.e., it is obligated to fix just and reasonable rates.²⁸ The Authority must also approve rates that provide regulated utilities the opportunity to earn a just and reasonable return on their investments.²⁹

The Authority considers petitions for a rate increase, filed pursuant to Tenn. Code Ann. § 65-5-203, in light of the following criteria:

1. The investment or rate base upon which the utility should be permitted to earn a fair rate of return;
2. The proper level of revenues for the utility;
3. The proper level of expenses for the utility; and
4. The rate of return the utility should earn.

Applying these criteria, and upon consideration of the entire record, including all exhibits and the testimony of the witnesses, the panel made the following findings and conclusions.

IV. TEST PERIOD AND ATTRITION PERIOD

In a rate case the Authority must, as a preliminary determination, decide which test period is appropriate. The purpose in the selection of a test period is to provide an indication of the rate of return that is likely to be produced under the existing rate structure in the reasonably foreseeable future. The test period takes into consideration the estimated effect of reasonably expected revenues, expenses and investments.

The Company selected a historical test period of the twelve months ended June 30, 2006 and an attrition period of the twelve months ending February 29, 2008. The Company made normalizing adjustments to the test period as well as additional adjustments to forecast attrition period results.³⁰

²⁸ Tenn. Code Ann. § 65-5-201 (Supp. 2002).

²⁹ See *Bluefield Water Works and Improvement Company v. Public Service Commission of the State of West Virginia*, 262 U.S. 679, 43 S.Ct. 675 (1923).

³⁰ Sheila A. Miller, Pre-filed Direct Testimony, p. 4 (November 22, 2006).

The CAPD used a test period of the twelve months ended December 31, 2006 for Revenues.³¹ The CAPD used a test period of the twelve months ended October 31, 2006 for the majority of Operations and Maintenance Expenses.³² For labor related expenses, the CAPD adopted the Company's actual employee level as of January 31, 2007.³³ The CAPD forecast for Plant in Service and Accumulated Depreciation was based on actual balances at December 31, 2006 plus monthly additions and retirements as provided by the Company. The attendant depreciation expense was calculated upon the resulting balances.³⁴ Like the Company, the CAPD used an attrition period of the twelve months ending February 29, 2008.³⁵

The panel rejected the multiple test periods utilized by the CAPD to forecast Revenues and Expenses and accepted 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. Further, the panel voted to accept the test period of the twelve months ended June 30, 2006 for Rate Base components to which the Company and the CAPD agree in their projections. For Rate Base components to which there was dispute among the Parties, the panel adopted the actual average thirteen month ending balances at December 31, 2006. Finally, the panel voted to adopt the forward looking attrition period of the twelve months ending February 29, 2008.

V. CONTESTED ISSUES

The position of the parties and the determinations of the voting panel are set out below for each of the following contested issues: Section V(a) - Revenues, Section V(b) - Expenses, Section V(c) - Taxes and Fees, Section V(d) - Net Operating Income, Section V(e) - Rate Base, Section V(f) - Revenue Conversion Factor, Section V(g) - Rate of Return, Section V(h) - Revenue Deficiency, and Section V(i) - Rate Design.

³¹ Michael D. Chrysler, Pre-filed Supplemental Revised Direct Testimony, un-numbered p. 1 (April 3, 2007).

³² Terry Buckner, Pre-filed Direct Testimony, p. 12 (March 5, 2007).

³³ Terry Buckner, Pre-filed Direct Testimony, p. 6 (March 5, 2007).

³⁴ Terry Buckner, Pre-filed Direct Testimony, p. 15 (March 5, 2007).

³⁵ Terry Buckner, Pre-filed Direct Testimony, pp. 2-3 (March 5, 2007).

V(a). REVENUES

The Company projects attrition period Revenues at current rates of \$33,432,287. The Company used a bill analysis reflecting the actual billing determinants for the test year, twelve months ended June, 30, 2006, and made normalizing adjustments and added revenue for the estimated number of new customers to be added during the attrition year.³⁶

In its pre-filed Direct Testimony, the CAPD accepted the Company's attrition period revenue forecast at current rates of \$33,432,287.³⁷ In its Supplemental Revised Direct Testimony, the CAPD increased its projection of attrition period Revenues at current rates to \$33,711,956.³⁸ The CAPD calculated a growth factor for each class of customer and applied this to the test period to arrive at its attrition period Revenues.

The panel accepted the Company's attrition period Revenue forecast at current rates of \$33,432,287 as it determined that the Company had properly taken into account normalizing adjustments for nonrecurring usage and properly matched the test period utilized by the Company.

V(b). EXPENSES

V(b)1. GROWTH FACTOR

The Company used the Value Line Forecast for the US Economy Consumer Price Index to develop its Inflation Factor. The Company used 10/12th of the 2007 rate of 2.4% and 2/12th of the 2008 rate of 2.2% to arrive at the 2.367% annual Inflation Factor.³⁹ For expenses that the Company grows using its Inflation Factor, it first normalizes the twelve months ended June 30, 2006, then applies its annual Inflation Factor to compute projected amounts for the twelve months ending February 29, 2008.

³⁶ Sheila A. Miller, Pre-filed Direct Testimony, Exhibit 2, Schedule 1 (November 22, 2006).

³⁷ Sheila A. Miller, Pre-filed Direct Testimony, Exhibit 2, Schedule 1 (November 22, 2006); Terry Buckner, Pre-filed Direct Testimony, Exhibit CAPD-RTB, Schedule 3 (March 5, 2007).

³⁸ Michael D. Chrysler, Pre-filed Supplemental Direct Testimony, un-numbered p. 1 (April 3, 2007).

³⁹ Sheila A. Miller, Pre-filed Direct Testimony, p. 11 (November 22, 2006).

For twelve of the expense categories, the CAPD primarily adopted the Company's booked amounts for the twelve months ended October 31, 2006 and grew each amount for customer growth and inflation growth. The CAPD included in its Growth Factor $\frac{1}{2}$ of the annual growth in customer counts, which equates to .655%, and the average Gross Domestic Product Deflator for the twelve months ending September 2006, which is 3.09%, to compute its annual Growth Factor of 3.745%. Next, the CAPD compounded its Growth Factor to apply to actual twelve months ended October 31, 2006 booked expense amounts to produce projected amounts for the attrition period ending February 29, 2008. In performing the compounding computation, the CAPD divided its annual Growth Factor of 3.745% by 12 resulting in a monthly factor that was then compounded to reflect 14 months growth. The CAPD used a combined growth rate from October 31, 2006 through February 29, 2008 of approximately 4.4%.⁴⁰

The panel concluded 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. The panel excluded Insurance Other Than Group from this determination because the test year for that particular expense contained abnormal monthly activity. Further, based on its findings that the Consumer Advocate included customer growth in its projection and that the Authority had used a similar growth factor in Docket No. 05-00258,⁴¹ the panel adopted the annual growth and inflation factor of 3.745% as projected by the CAPD to be used to develop a proper compounded growth rate of 6.2417%.⁴²

⁴⁰ Terry Buckner, Pre-filed Direct Testimony, p. 4 (March 5, 2007).

⁴¹ *In re: Petition of the Consumer Advocate to Open an Investigation to Determine Whether Atmos Energy Corp. Should be Required by the Tennessee Regulatory Authority to Appear and Show Cause that Atmos Energy Corp. is not Overearning in Violation of Tennessee Law and that It is Charging Rates that are Just and Reasonable*, Docket No. 05-00258 (September 16, 2006).

⁴² $(.0309 + .00655) / 12 * 20$.

V(b)2. SALARIES AND WAGES

The Company projects Salaries and Wages Expense of \$4,702,966.⁴³ The Company's forecasted attrition period Salaries and Wages Expense is based on a projected employee count of 111 employees. The Company increased wages for all employees by 3% to arrive at wage rates for the attrition period.

The CAPD projects Salaries and Wages Expense of \$4,397,377.⁴⁴ The CAPD's forecasted attrition period Salaries and Wages Expense is based on the actual January 31, 2007 employee count of 105 employees. The CAPD increased wages for union employees by 3% in November and increased salaries and wages for all non-union employees by 3% in April. In his Supplemental Direct Testimony, CAPD made minor corrections that increased the CAPD Salaries and Wages projection from \$4,397,377 to \$4,405,253.⁴⁵

A majority of the panel found that the Company's forecast of \$4,702,966, which included the Company's projected employee level and overtime, should be reduced by the CAPD's \$29,390 adjustment to incentive payroll solely attributed to the meeting of financial goals. The majority found this to be consistent with the Authority's decisions in recent cases. Therefore, a majority of the panel concluded that the Salaries and Wages Expense for the attrition period is \$4,673,576.⁴⁶

V(b)3. PURCHASED WATER

The Company forecast for Purchased Water is \$52,331. This amount represents the actual twelve months ended June 30, 2006 expense without adjustment.⁴⁷ The CAPD forecasts \$49,660 for Purchased Water. This amount represents the actual twelve months ended October 31, 2006 expense grown by the CAPD growth/inflation factor.⁴⁸

⁴³ Sheila A. Miller, Pre-filed Direct Testimony, Exhibit 2, Schedule 3 (November 22, 2006).

⁴⁴ Terry Buckner, Pre-filed Direct Testimony, Exhibit CAPD-RTB, Schedule 5 (March 5, 2007).

⁴⁵ Terry Buckner, Pre-filed Supplemental Direct Testimony, p. 5 (April 3, 2007).

⁴⁶ Director Jones dissented from the majority decision and filed a separate opinion explaining his position.

⁴⁷ Sheila A. Miller, Pre-filed Direct Testimony, Exhibit 2, Schedule 3 (November 22, 2006).

⁴⁸ Terry Buckner, Pre-filed Direct Testimony, Exhibit CAPD-RTB, Schedule 5 (March 5, 2007).

After its review of the record, the panel adopted the Company's attrition period forecast of \$52,331 for Purchased Water Expense because it is based on the June 30, 2006 test period.

V(b)4. FUEL AND POWER

The CAPD accepted the Company's attrition period forecast for Fuel and Power Expense of \$1,734,958.⁴⁹ The panel accepted the agreed upon attrition period forecast for Fuel and Power Expense of \$1,734,958.

V(b)5. CHEMICALS

The CAPD accepted the Company's attrition period forecast for Chemicals Expense of \$952,795.⁵⁰ The panel accepted the agreed upon attrition period forecast for Chemicals Expense of \$952,795.

V(b)6. WASTE DISPOSAL

The Company forecast of \$174,265 for Waste Disposal is based upon the 2007 budget for the cost from the City of Chattanooga Sanitary Board to treat the water plant residuals⁵¹ and includes a 16.5% increase in sewer rates approved by the City of Chattanooga in September 2006.⁵² The CAPD forecast of \$153,521 for Waste Disposal is based upon the Company booked amounts for the twelve months ended October 31, 2006 grown by the CAPD annual growth/inflation factor compounded to 14 months to compute projected amounts for the twelve months ending February 29, 2008.⁵³ After review of the record, the panel adopted Waste Disposal Expenses of \$174,265 for the attrition period as that figure reflects the Company's 16.5% increase in rates from the City of Chattanooga.

⁴⁹ Sheila A. Miller, Pre-filed Direct Testimony, Exhibit 2, Schedule 3, (November 22, 2006); Terry Buckner, Pre-filed Direct Testimony, Exhibit CAPD-RTB, Schedule 5 (March 5, 2007).

⁵⁰ Terry Buckner, Pre-filed Direct Testimony, Exhibit CAPD-RTB, Schedule 5 (March 5, 2007).

⁵¹ Sheila A. Miller, Pre-filed Direct Testimony, p. 11 (November 22, 2006).

⁵² John S. Watson, Pre-filed Direct Testimony, p. 17 (November 22, 2006).

⁵³ Terry Buckner, Pre-filed Direct Testimony, Workpaper E-WD-1 (March 5, 2007).

V(b)7. MANAGEMENT FEES⁵⁴

The Company's filing includes management fees of \$4,064,421.⁵⁵ The Company started with the historical test-year expenses of \$4,006,278 and eliminated non-recurring expenses of \$260,268 for the STEP project, the STAR project, the Business Change project, the Divestiture, and implementation costs related to Sarbanes-Oxley compliance. AWWC has undertaken these initiatives to improve service and growth opportunities for its operating companies; however, there are expenses that will not be recurring during the attrition year for this case. To that adjusted historical test-year base period (twelve months ended June, 2006), the Company used an inflation factor of 5% per year to reflect the expected management fee cost for the attrition year.⁵⁶

The CAPD used the 2005 forecasted Management Fee in TRA Docket 04-00288 of \$3,062,940 as its base. The 2005 forecasted Management Fee was then grown at an annual inflation/growth rate of 3.75% and adjusted the result for non-recurring costs which the Company identified for the twelve months ended June 30, 2006 and 30% of allocated incentive pay, as discussed in the Salaries and Wages section above, to calculate its forecasted amount of \$3,021,111 for the attrition period.⁵⁷

After review of the record, the panel concluded that the Management Fee for the attrition period should be \$3,979,825. The 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, the panel concluded that TAWC should have a management audit performed in compliance with Sarbanes-Oxley requirements and submit the results to the Authority in one year or, if the audit is not

⁵⁴ Management fees are the charges from American Water Works Service Company for services provided under the 1989 Service Company contract. Those services consist of services related to accounting, administration, communication, corporate secretarial, engineering, finance, human resources, information systems, operations, rates and revenue, risk management, water quality and other services as agreed to by the Company. These services are billed at cost to Tennessee American.

⁵⁵ Data Response, Item 13, TN-TRA-01-Q013-Management Fees, p. 1 of 2 (December 28, 2006).

⁵⁶ Michael A. Miller, Pre-filed Direct Testimony, p. 11 (November 22, 2006).

⁵⁷ Terry Buckner, Pre-filed Direct Testimony, Workpaper E-MANAGEMENT FEES (March 5, 2007).

complete in one year, submit a status report on the audit in one year. 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.

V(b)8. GROUP INSURANCE

The Company projects Group Insurance Expense of \$1,513,667.⁵⁸ The Company's forecasted attrition period Group Insurance Expense is made up of two components, Group Insurance and Post Employee Benefits Other Than Pensions (OPEBs). The Company applied the group insurance rates in effect at June 30, 2006 to the pro-forma insurance coverages based upon its projected employee count and salary and wage information for the attrition period. The Company calculated attrition year Group Insurance to be \$1,006,020. The Company prorated the 2007 and 2008 costs to calculate an attrition year OPEB expense of \$507,647.

The CAPD projects Group Insurance Expense of \$1,386,168.⁵⁹ The CAPD's forecasted attrition period Group Insurance Expense is made up of two components, Group Insurance and OPEBs. The CAPD took the Company's actual expense for Group Insurance for the 12 months ended October 31, 2006 and applied its growth factor to calculate attrition year Group Insurance of \$804,744. The CAPD took the Company's actual OPEB expense for the 12 months ended October 31, 2006 and applied its growth factor and then reduced the amount by the Company's attrition period adjustment to calculate attrition year OPEB expense of \$581,424.

After review of the record, the panel adopted the Company's projection for Group Insurance Expense of \$1,513,667 based upon the Company's projected employee level.

⁵⁸ Sheila A. Miller, Pre-filed Direct Testimony, Exhibit 2, Schedule 3 (November 22, 2006).

⁵⁹ Terry Buckner, Pre-filed Direct Testimony, Exhibit CAPD-RTB, Schedule 5 (March 5, 2007).

V(b)9. PENSION EXPENSE

The Company is requesting pension cost of \$595,798 for the ERISA contribution related to the defined benefit portion of the American Water Pension Plan expected during the attrition year. The Company determined the attrition year expense by prorating the 2007 and 2008 cost to determine the attrition period amount.⁶⁰

The CAPD adopted the Pension funding amount as prescribed in the latest actuarial report filed by the Company.⁶¹ The CAPD further states that based on the latest level of contribution, the Company's portion of funded Pension Expense net of capitalization is \$12,662.

A majority of the panel concluded that the Pension Expense for the attrition period should be \$0 based upon the latest Actuarial Report from Towers Perrin dated August 2006⁶² showing that the minimum required employer contribution is \$0.⁶³ The majority noted that this determination is consistent with the Authority's past treatment of Pension Expense.

V(b)10. REGULATORY EXPENSE

The Company projects Regulatory Expense of \$269,298. The Company estimates the cost of the preparation and presentation of the current filing to be \$400,000. The Company proposes to amortize these costs over a three year period resulting in an annual cost of \$133,333. Also, included in the attrition year cost is the Cost of Service Study Expense in the amount of \$40,000 which the Company proposes to amortize over five years resulting in an annual cost of \$8,000. Total attrition year expense is \$141,333 plus the balance of \$127,965 resulting from the 2004 rate case that is currently being amortized.

The CAPD forecast of \$191,333 for Regulatory Expense is based upon the Company booked amounts for the twelve months ended October 31, 2006 grown by the CAPD annual growth/inflation

⁶⁰ Michael A. Miller, Pre-filed Direct Testimony, p. 13 (November 22, 2006).

⁶¹ Data Response, Item 36 (December 28, 2006).

⁶² Hearing Exhibit 25.

⁶³ Director Jones dissented from the majority decision and filed a separate opinion explaining his position.

factor compounded to 14 months to compute projected amounts for the twelve months ending February 29, 2008.⁶⁴ After review of the record, the panel adopted the actual price out of Regulatory Expense of \$269,298 as proposed by the Company.

V(b)11. INSURANCE OTHER THAN GROUP

The Company's proposed level for Insurance Other Than Group Expense⁶⁵ for the attrition year is \$523,940 and is based on the Company's 2007 budget.⁶⁶ The CAPD forecast of \$462,968 for Insurance Other Than Group Expense is based upon the Company booked amounts for the twelve months ended October 31, 2006 grown by the CAPD annual growth/inflation factor compounded to 14 months to compute projected amounts for the twelve months ending February 29, 2008.⁶⁷

After review of the record, the panel concluded that neither the Company nor CAPD projections were acceptable 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. The panel determined that the appropriate amount for Insurance Other Than Group Expense for the attrition period is \$517,911 based upon current monthly expense levels at October 31, 2006 and application of the CAPD growth/inflation factor properly compounded to 16 months.

V(b)12. CUSTOMER ACCOUNTING

The Company projects Customer Accounting Expense of \$606,702.⁶⁸ Customer Accounting Expense for the historical test year was \$585,288. The Company applied the inflation factor of 2.367% to these expenses, excluding uncollectibles and postage to arrive at an increase of \$7,017. The net effect of the Customer Accounting Expense for the attrition year is an increase of \$21,414.⁶⁹ The CAPD forecast of \$719,633 for Customer Accounting Expense is based upon the Company

⁶⁴ Terry Buckner, Pre-filed Direct Testimony, Workpaper E-REG1 (March 5, 2007).

⁶⁵ This expense category includes costs for general liability, workers compensation, and property insurance.

⁶⁶ Sheila A. Miller, Pre-filed Direct Testimony, p. 12 (November 22, 2006).

⁶⁷ Terry Buckner, Pre-filed Direct Testimony, Workpapers E-OI-0 – E-OI-4 (March 5, 2007).

⁶⁸ Sheila A. Miller, Pre-filed Direct Testimony, Exhibit 2, Schedule 3 (November 22, 2006).

⁶⁹ Sheila A. Miller, Pre-filed Direct Testimony, p. 12 (November 22, 2006).

booked amounts for the twelve months ended October 31, 2006 grown by the CAPD annual growth/inflation factor compounded to 14 months to compute projected amounts for the twelve months ending February 29, 2008.⁷⁰

After a review of the record, the panel concluded that the Customer Accounting Expense for the attrition period should be \$631,581. The panel based its conclusion 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 6.2417%.

V(b)13. UNCOLLECTIBLE EXPENSE

The Company uncollectible percentage of 1.277% was derived by taking a three year average of the net charge offs, less recoveries, as a percentage of total revenues. That percentage was applied to the proposed revenue increase of \$6,379,887 to arrive at the attrition year adjustment to Uncollectible Expense of \$81,478.⁷¹ The Company projects Uncollectible Expense of \$702,743 for the attrition period by adding the \$81,478 adjustment for proposed rates to the \$621,265 attrition period at current rates amount.⁷² The CAPD forecast of \$558,836 for Uncollectible Expense is based upon the Company booked amount of \$535,392 for the twelve months ended October 31, 2006 grown by the CAPD annual growth/inflation factor compounded to 14 months to compute projected amounts for the twelve months ending February 29, 2008.⁷³

After a review of the record, the panel adopted an Uncollectible Expense at current rates of \$618,452, which is based upon the Company booked amount for the twelve months ended June 30,

⁷⁰ Terry Buckner, Pre-filed Direct Testimony, Workpapers E-CA-0 – E-CA-13 (March 5, 2007).

⁷¹ Sheila A. Miller, Pre-filed Direct Testimony, p. 12 (November 22, 2006).

⁷² Sheila A. Miller, Pre-filed Direct Testimony, Exhibit 2, Schedule 3 (November 22, 2006).

⁷³ Terry Buckner, Pre-filed Direct Testimony, Workpapers E-UNC-1 (March 5, 2007).

2006 and a normalizing adjustment. The panel further noted that any incremental increase in Uncollectible Expense will be accounted for by the application of the Revenue Conversion Factor.

V(b)14. RENT

The Company projects attrition period Rent Expense⁷⁴ of \$38,011. The Company adjusts the actual twelve months ended June 30, 2006 Rent Expense of \$38,043 to eliminate the extra quarterly payment for the easement of the Brainard Road Tank and to include 12 months expense for wireless service.⁷⁵ The CAPD projects attrition period Rent Expense of \$39,896 based upon actual booked expense for the twelve months ended October 31, 2006 of \$38,222 grown by its annual inflation/growth factor of 3.745% compounded for 14 months.⁷⁶ The panel adopted the Company's forecast of Rent Expense of \$38,011 since it is based upon actual results which have been properly normalized.

V(b)15. GENERAL OFFICE EXPENSE

The Company projects General Office Expense⁷⁷ of \$194,066⁷⁸ for the attrition period. The Company projection was based upon the twelve months ended June 30, 2006 actual expense of \$575,179 adjusted for non-recurring items.⁷⁹ An inflation factor of 2.367% was applied to the remaining expenses (excluding postage) to arrive at an attrition year expense of \$194,066.

The CAPD projects attrition period General Office Expense of \$221,848. The CAPD projection is based upon actual booked expense for the twelve months ended October 31, 2006 of \$212,541 after removing non-recurring expenses for the STEP Project and Miscellaneous Charges

⁷⁴ Rent Expense includes the costs associated with the renting of mobile radios, postage equipment, copiers, and land.

⁷⁵ Sheila A. Miller, Pre-filed Direct Testimony, pp. 12 - 13 (November 22, 2006).

⁷⁶ Terry Buckner, Pre-filed Direct Testimony, Workpapers E-RENT0 – E-RENT3 (March 5, 2007).

⁷⁷ This expense category includes costs associated with the general expenses for the offices. These include report forms, office supplies, computer supplies, overnight mail expenses, janitorial services, telephone expense, electrical expense, employee expenses, credit line fees, bank service charges, and other miscellaneous general office expenses.

⁷⁸ Data Response, Item 13, TN-TRA-01-Q013-MISC EXPENSES, p.4 of 8 (December 28, 2006).

⁷⁹ Normalizing adjustments were made to eliminate relocation expenses, the write-off of the STEP Project, and severance pay.

that are included in the Company's test period. The adjusted test year expense was then grown by the CAPD annual inflation/growth factor of 3.745% compounded for 14 months.⁸⁰

After review of the record, the panel concluded that the General Office Expense for the attrition period is \$201,342. The panel based this amount on the Company's 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.

V(b)16. MISCELLANEOUS

The Company projects Miscellaneous Expense of \$1,792,405⁸¹ for the attrition period. The Company projection was based upon the twelve months ended June 30, 2006 actual expense of \$1,798,639 adjusted for normalizing items.⁸² The Company did not apply the inflation factor to the 401K expense, Defined Contribution expense, or the Retiree Medical Reimbursement Plan. Next, the Company applies its annual inflation factor adjustment of 2.367% resulting in an increase of \$37,357. The test period amounts for the 401K expense, Defined Contribution expense, and the Retiree Medical Reimbursement Plan are then added back followed by the projected attrition year increases totaling \$88,951 for these items resulting in the forecasted attrition period amount.⁸³

The CAPD projects attrition period Miscellaneous Expense of \$1,710,268. The CAPD projection is based upon actual booked expense for the twelve months ended October 31, 2006 of \$1,638,520. The test year expense was grown by the CAPD annual inflation/growth factor of 3.745% compounded for 14 months.⁸⁴

⁸⁰ Terry Buckner, Pre-filed Direct Testimony, Workpapers E-GO-0 – E-GO-23 (March 5, 2007).

⁸¹ Company response to TRA Minimum Filing Guidelines, Item 13, TN-TRA-01-Q013-MISC EXPENSES, p. 5 of 8.

⁸² The Company makes five normalizing adjustments: (1) adds an additional \$24,000 expense for airtime of cello units, (2) adjusts the negative \$8,375 account balance for EIP Contribution Expense, (3) adjust the negative \$182 account balance for Directors Expense, (4) eliminates the amortization of security costs of \$107,407 which ended July 2006, and (5) eliminates Penalties of \$57,693 which are not an expense includable for rate making purposes.

⁸³ Sheila A. Miller, Pre-filed Direct Testimony, pp. 13-14 (November 22, 2006); Company response to TRA Minimum Filing Guidelines, Item 13, TN-TRA-01-Q13-MISC EXPENSES, p. 5 of 8.

⁸⁴ Terry Buckner, Pre-filed Direct Testimony, Workpapers E-MISC0 – E-MISC48 (March 5, 2007).

After a review of the record, the panel concluded that the Miscellaneous Expense for the attrition period is \$1,853,556. The panel based its conclusion on the Company's 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.

V(b)17. MAINTENANCE EXPENSE

The Company projects Maintenance Expense⁸⁵ of \$749,879⁸⁶ for the attrition period. The Company projection was based upon the twelve months ended June 30, 2006 actual expense of \$1,110,461 adjusted for one normalizing item.⁸⁷ The annual inflation factor was applied to the remaining balance to arrive at the attrition period projection.

The CAPD projects attrition period Maintenance Expense of \$747,665. The CAPD projection is based upon actual booked expense for the twelve months ended October 31, 2006 of \$716,299. The test year expense was grown by the CAPD annual inflation/growth factor of 3.745% compounded for 14 months.⁸⁸

After review of the record, the panel determined that the Maintenance Expense for the attrition period is \$778,265. The panel based its determination upon the Company's 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.

V(b)18. DEPRECIATION EXPENSE

Although in initial testimony the parties held different positions regarding the correct amount for this expense, at the Hearing the Company provided revised financial exhibits that changed the

⁸⁵ This expense category includes costs associated with maintaining the property of the Company. This would include repair parts, tools, maintenance supplies, contracted services, paving, maintenance agreements, and other miscellaneous maintenance expenses.

⁸⁶ Data Response, Item 13, TN-TRA-01-Q013-MISC EXPENSES, p.8 of 8 (December 28, 2006).

⁸⁷ The Company makes one normalizing adjustment to eliminate the net negative salvage expense of \$377,919.

⁸⁸ Terry Buckner, Pre-filed Direct Testimony, Workpapers E-MAIN0- – E-MAIN2- (March 5, 2007).

Depreciation Expense to \$4,936,937,⁸⁹ which is in agreement with the Consumer Advocate's projection prior to the exclusion of the E-CIS Plant. The panel adopted the figure of \$4,936,937 for Depreciation Expense. 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 E-CIS investment.

V(c). TAXES AND FEES

V(c)1. GROSS RECEIPTS TAX

The Company projects Gross Receipts Tax for the attrition period of \$384,576.⁹⁰ The Company states that Gross Receipts Tax was based on projected jurisdictional revenues for TAWC including Other Operating revenues. The revenues for the 12 month period from September 2006 to August 2007, as adjusted for the Franchise Tax, Excise Tax and the \$5,000 exemption, were multiplied by the current 3% tax rate to arrive at the attrition year level.⁹¹

The CAPD projects Gross Receipts Tax for the attrition period of \$326,853.⁹² The CAPD forecasted amount is based on one-third of the actual Gross Receipts Tax return as filed with the Tennessee Department of Revenue for the tax period July 1, 2006 through June 30, 2007. The remaining two-thirds of the Gross Receipts Tax were based on twelve months to date revenue as of November 30, 2006.⁹³

After review of the record, a majority of the panel⁹⁴ concluded 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

⁸⁹ Hearing Exhibit 38, Exhibit 1, Schedule 2, p. 1 of 3.

⁹⁰ Data Response, Item 13, TN-TRA-01-Q013-GENERAL TAXES, p. 23 of 130 (December 28, 2006).

⁹¹ Sheila A. Miller, Pre-filed Direct Testimony, p. 14 (November 22, 2006).

⁹² Terry Buckner, Pre-filed Direct Testimony, Workpaper T-OTAX7 (March 5, 2007).

⁹³ Terry Buckner, Pre-filed Direct Testimony, p. 14 (March 5, 2007).

⁹⁴ Director Jones dissented from the majority's calculation of the dollar amount, but agrees with the methodology used to perform the calculation.

2005 reporting period. Additionally, a majority of the panel determined 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.

V(c)2. TRA INSPECTION FEES

The Company projects TRA Inspection Fees for the attrition period of \$64,957.⁹⁵ The TRA Inspection Fee was based on projected 2006 jurisdictional revenues. This was reduced by uncollectibles and a \$5,000 exemption to arrive at taxable revenues. The result was multiplied by the Tennessee statutory rates that were taken from the 2006 return.⁹⁶ The CAPD projects TRA Inspection Fees for the attrition period of \$64,706.⁹⁷

A majority of the panel⁹⁸ determined 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. The majority further determined that an additional TRA Inspection Fee of \$8,087 should be allowed on the difference between the jurisdictional attrition period Revenue at new rates and the attrition period Revenue at current rates.

V(c)3. PROPERTY TAXES

The Company projects Property Taxes for the attrition period of \$2,635,280.⁹⁹ Property Taxes for the test year were \$2,368,800. This amount was under-accrued during the historical test year necessitating a normalized adjustment of \$77,915. An effective Property Tax Rate based on the latest Property Tax returns was applied to the mid-point of the attrition year Rate Base to arrive at the attrition year adjustment of \$188,565.¹⁰⁰

⁹⁵ Data Response, Item 13, TN-TRA-01-Q013-GENERAL TAXES, p. 1 of 130 (December 28, 2006).

⁹⁶ Sheila A. Miller, Pre-filed Direct Testimony, p. 14 - 15 (November 22, 2006).

⁹⁷ Terry Buckner, Pre-filed Direct Testimony, Workpaper T-OTAX2 (March 5, 2007).

⁹⁸ Director Jones dissented from the majority's calculation of the dollar amount, but agrees with the methodology to perform the calculation.

⁹⁹ Sheila A. Miller, Pre-filed Direct Testimony, Exhibit 2, Schedule 5 (November 22, 2006)

¹⁰⁰ Sheila A. Miller, Pre-filed Direct Testimony, p. 14 (November 22, 2006).

The CAPD projects Property Taxes for 2007 of \$2,552,758.¹⁰¹ CAPD Exhibit T-OTAX-1 provides a historical summary of Property Taxes paid by the Company, gross assessment values, composite tax rate, and reported Rate Base amounts. The schedule reflects taxes due by TAWC for 2005 and 2006.

After review of the record, the panel concluded 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%.

V(c)4. FRANCHISE TAXES

The Company projects Franchise Taxes of \$303,980. The Company utilized the balances as of June 30, 2006 as a basis for the tax, applied the Schedule F ratio factor from the latest actual amended return, made an adjustment for Rentals from Schedule G from the latest actual amended return and multiplied the result by the statutory rate of \$.25 per \$100.¹⁰²

The CAPD projects Franchise Taxes for 2007 of \$352,833.¹⁰³ The CAPD calculated Franchise Tax using actual plant in service and accumulated depreciation net of forecasted plant additions and retirements.¹⁰⁴

After a review of the record, the panel determined 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.

V(c)5. FICA TAX

The Company projects FICA Tax of \$352,445.¹⁰⁵ The Company forecasted its attrition period FICA Tax by applying the current tax rates to its attrition period Salaries and Wages.

¹⁰¹ Terry Buckner, Pre-filed Direct Testimony, Workpaper T-OTAX1 (March 5, 2007).

¹⁰² Data Response, Item 13, TN-TRA-01-Q013-GENERAL TAXES, p. 4 of 130 (December 28, 2006).

¹⁰³ Terry Buckner, Pre-filed Direct Testimony, Workpaper T-OTAX8 (March 5, 2007).

¹⁰⁴ Terry Buckner, Pre-filed Direct Testimony, p. 14 (March 5, 2007).

¹⁰⁵ Sheila A. Miller, Pre-filed Direct Testimony, Exhibit 2, Schedule 5 (November 22, 2006).

The Consumer Advocate projects FICA Tax of \$342,649.¹⁰⁶ The CAPD forecasted its attrition period FICA Tax by applying the current tax rates to its attrition period Salaries and Wages. In its revised Exhibits provided at the Hearing, the CAPD revised its forecast to \$331,426.

After review of the record, a majority of the panel¹⁰⁷ determined that the 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% reduction for incentive payroll solely attributed to the meeting of financial goals as proposed by the CAPD.

V(c)6. UNEMPLOYMENT TAX

The Company projects Unemployment Tax of \$7,346.¹⁰⁸ The Company forecasted its attrition period Unemployment Tax by applying the current tax rates to its attrition period Salaries and Wages.

The CAPD projects Unemployment Tax of \$7,167.¹⁰⁹ The CAPD forecasted its attrition period Unemployment Tax by applying the current tax rates to its attrition period Salaries and Wages. In its revised Exhibits provided at the Hearing, the CAPD revised its forecast to \$6,968.

After a review of the record, a majority of the panel¹¹⁰ determined 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% reduction for incentive payroll solely attributed to the meeting of financial goals as proposed by the CAPD.

¹⁰⁶ Terry Buckner, Pre-filed Direct Testimony, Exhibit CAPD-RTB, Schedule 8 (March 5, 2007).

¹⁰⁷ Director Jones dissented from the majority's calculation of the dollar amount because it includes an adjustment for the financial portion of the AIP, an adjustment he rejected for salaries and wages.

¹⁰⁸ Sheila A. Miller, Pre-filed Direct Testimony, Exhibit 2, Schedule 5 (November 22, 2006).

¹⁰⁹ Terry Buckner, Pre-filed Direct Testimony, Exhibit CAPD-RTB, Schedule 8 (March 5, 2007).

¹¹⁰ Director Jones dissented from the majority's calculation of the dollar amount because it includes an adjustment for the financial portion of the AIP, an adjustment he rejected for salaries and wages.

V(c)7. STATE EXCISE TAX

A majority of the panel¹¹¹ concluded 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%.

V(c)8. FEDERAL INCOME TAX

A majority of the panel¹¹² concluded 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%.

V(c)9. ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION (AFUDC)

The Company projects AFUDC for the attrition period of \$83,747 based upon the 2007/2008 budget. The CAPD projects AFUDC for the attrition period of \$150,312 based upon the actual 12 months-to-date amount reported on the November 2006 Monthly Surveillance Report filed with the TRA.¹¹³ After review of the record, the panel concluded that the proper AFUDC is \$123,261 based upon the actual 12 months-to-date amount reported on the December 2006 TRA Monthly 3.06 Surveillance Report.

V(d). NET OPERATING INCOME

A majority of the panel¹¹⁴ found that based upon the preceding determinations Net Operating Income is \$5,774,350 for the attrition period based upon current rates.

¹¹¹ Director Jones dissented from the majority's calculation of the dollar amount, but agrees with the methodology used to perform the calculation.

¹¹² Director Jones dissented from the majority's calculation of the dollar amount, but agrees with the methodology used to perform the calculation.

¹¹³ Terry Buckner, Pre-filed Direct Testimony, Workpaper E-REC-1 (March 5, 2007).

¹¹⁴ Director Jones dissented from the majority's calculation of the dollar amount, but agrees with the methodology used to perform the calculation.

V(e). RATE BASE

V(e)1. UTILITY PLANT IN SERVICE

In Direct Testimony the Company projects an average attrition period balance for Utility Plant in Service of \$185,005,497.¹¹⁵ This projection is based upon the balance per books at June 30, 2006 and increased for the net effect of budgeted additions and retirements through August 31, 2007 to arrive at the Utility Plant in Service balance at the midpoint of the attrition period.

In Direct Testimony, the CAPD projects an average attrition period balance for Utility Plant in Service of \$189,828,780.¹¹⁶ This projection is based on the thirteen month average of the attrition period Utility Plant in Service. The CAPD began with the balance per books at December 31, 2006 and increased it for the net effect of budgeted additions and retirements through February 29, 2008. The CAPD forecast includes Capital Leases, which the Company shows as a separate line item.

In Supplemental Revised Direct Testimony, the CAPD argues for the exclusion of the Company's E-CIS actual cost in excess of its original estimated cost. The CAPD reduced its Rate Base projection relating to the E-CIS from \$1,490,980 to \$147,682, which is TAWC's share of the original E-CIS estimated cost.¹¹⁷

In Rebuttal Testimony, the Company states that it agrees with the CAPD methodology using the 13-month average because that method is the correct method to calculate Rate Base. The Company strongly disagrees with the E-CIS Rate Base deduction proposed by the CAPD.

At the Hearing the Company provided revised financial exhibits which changed the Utility Plant in Service to \$188,238,289.¹¹⁸ This amount is only \$9 more than the CAPD's original Utility Plant in Service projection.

¹¹⁵ Sheila A. Miller, Pre-filed Direct Testimony, Exhibit 1, Schedule 2 (November 22, 2006).

¹¹⁶ Terry Buckner, Pre-filed Direct Testimony, Exhibit CAPD-RTB, Schedule 2 (March 5, 2007).

¹¹⁷ Terry Buckner, Pre-filed Supplemental Revised Direct, pp. 3-4 (April 3, 2007).

¹¹⁸ Hearing Exhibit 38, Exhibit 1, Schedule 2, p. 1 of 3.

The panel rejected 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. The panel adopted 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.

V(e)2. CONSTRUCTION WORK IN PROGRESS ("CWIP")

The CAPD accepted the Company's attrition period forecast for CWIP of \$2,608,585 in its original Direct Testimony.¹¹⁹ In Supplemental Revised Direct Testimony the CAPD updated the CWIP to the December 31, 2006 amount of \$1,580,421 to mirror the starting point for the CAPD Plant in Service.¹²⁰ The Company agrees with the CAPD methodology using the 13-month average balance to calculate Plant in Service.¹²¹

The panel accepted 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.

V(e)3. UTILITY PLANT CAPITAL LEASE

The Company projects an average attrition period balance for Utility Plant Capital Lease of \$1,590,500. This projection is based upon the balance per books at June 30, 2006 held constant.¹²² The CAPD included Utility Plant Capital Lease of \$1,590,500, as projected by the Company in its Utility Plant in Service average attrition period balance.¹²³ The panel adopted the Company's 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.

¹¹⁹ Sheila A. Miller, Pre-filed Direct Testimony, Exhibit 1, Schedule 2 (November 22, 2006); Terry Buckner, Pre-filed Direct Testimony, Exhibit CAPD-RTB, Schedule 2 (March 5, 2007).

¹²⁰ Terry Buckner, Pre-filed Revised Supplemental Direct Testimony, p. 4 (April 3, 2007).

¹²¹ Michael A. Miller, Pre-filed Rebuttal Testimony, p. 34 (April 9, 2007).

¹²² Sheila A. Miller, Pre-filed Direct Testimony, Exhibit 1, Schedule 2 (November 22, 2006).

¹²³ Terry Buckner, Pre-filed Direct Testimony, Exhibit CAPD-RTB, Schedule 2 (March 5, 2007).

V(e)4. NET LIMITED-TERM UTILITY PLANT

The CAPD accepted the Company's attrition period forecast for Net Limited-Term Utility Plant of \$(20,953).¹²⁴ The panel accepted the agreed upon attrition period forecast for Net Limited-Term Utility Plant of \$(20,953).

V(e)5. WORKING CAPITAL

The CAPD accepted the Company's attrition period forecast for Working Capital of \$962,583.¹²⁵ At the Hearing, the Company provided revised financial exhibits that changed Working Capital to \$964,794.¹²⁶ This amount is \$2,211 more than the original projection. The Company provided no basis for the increase. The panel accepted the original agreed upon attrition period forecast for Working Capital of \$962,583 since the Company's late filed revisions were unsupported.

V(e)6. ACCUMULATED DEPRECIATION

The Company projects Accumulated Depreciation for the attrition period of \$56,170,309.¹²⁷ The Company began with the actual June 30, 2006 balance adjusted for negative salvage and added projected Deprecation Expense.¹²⁸

The CAPD projects Accumulated Depreciation for the attrition period of \$54,713,939.¹²⁹ The CAPD forecast of Accumulated Depreciation was calculated based on the actual balances as of December 31, 2006 plus the additions and retirements provided by the Company and calculated the Depreciation Expense through the attrition period.¹³⁰ In Supplemental Revised Direct Testimony, the CAPD reduces its projected Accumulated Depreciation for the attrition period from \$54,713,939 to \$52,502,858 due to the exclusion of the E-CIS investment.

¹²⁴ Sheila A. Miller, Pre-filed Direct Testimony, Exhibit 1, Schedule 2 (November 22, 2006); Terry Buckner, Pre-filed Direct Testimony, Exhibit CAPD-RTB, Schedule 2 (March 5, 2007).

¹²⁵ *Id.*

¹²⁶ Hearing Exhibit 38, Exhibit 1, Schedule 2, p. 1 of 3.

¹²⁷ Sheila A. Miller, Pre-filed Direct Testimony, Exhibit 1, Schedule 2 (November 22, 2006).

¹²⁸ Data Response, TN-TRA-01-Q013-RATE BASE BACK-UP, p. 1 of 14 (December 28, 2006).

¹²⁹ Terry Buckner, Pre-filed Direct Testimony, Exhibit CAPD-RTB, Schedule 2 (March 5, 2007).

¹³⁰ Terry Buckner, Pre-filed Direct Testimony, p. 15 (March 5, 2007).

The panel adopted 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.

V(e)7. ACCUMULATED AMORTIZATION OF UTILITY CAPITAL LEASE

The CAPD accepted the Company's attrition period forecast for Accumulated Amortization of Utility Capital Lease of \$980,808.¹³¹ The panel accepted the agreed upon attrition period forecast for Accumulated Amortization of Utility Capital Lease of \$980,808.

V(e)8. ACCUMULATED DEFERRED INCOME TAXES

The CAPD accepted the Company's attrition period forecast for Accumulated Deferred Income Taxes of \$18,833,369.¹³² The panel accepted the agreed upon attrition period forecast for Accumulated Deferred Income Taxes of \$18,833,369.

V(e)9. CUSTOMER ADVANCES FOR CONSTRUCTION

The CAPD accepted the Company's attrition period forecast for Customer Advances for Construction of \$5,593,604.¹³³ The panel accepted the agreed upon attrition period forecast for Customer Advances for Construction of \$5,593,604.

V(e)10. CONTRIBUTIONS IN AID OF CONSTRUCTION ("CIAC")

The CAPD accepted the Company's attrition period forecast for CIAC of \$7,946,162.¹³⁴ The panel accepted the agreed upon attrition period forecast for Contributions in Aid of Construction ("CIAC") of \$7,946,162.

¹³¹ Sheila A. Miller, Pre-filed Direct Testimony, Exhibit 1, Schedule 2 (November 22, 2006) and Terry Buckner, Pre-filed Direct Testimony, Exhibit CAPD-RTB, Schedule 2 (March 5, 2007).

¹³² *Id.*

¹³³ *Id.*

¹³⁴ *Id.*

V(e)11. UNAMORTIZED INVESTMENT TAX CREDIT (“UITC”)

The Company projects an average attrition period balance for UITC of \$38,767. The Company calculation is based upon the UITC balance in account 255101 at June 30, 2006, less monthly amortization through the mid-point of the attrition period.¹³⁵

The CAPD projects an average attrition period balance for UITC of \$1,141,720.¹³⁶ The CAPD notes that the Company only included the UITC balance in account 255101, yet the Company’s amortization of ITC for federal income tax purposes includes accounts 255101, 255102 and 255103.¹³⁷ The panel adopted an average attrition period balance of \$0 for UITC since the Company reduces its Federal Income Tax Expense by the total amount of the ITC amortization.

V(f). REVENUE CONVERSION FACTOR

The Company proposes a Gross Revenue Conversion Factor of 1.71513466.¹³⁸ The Company included the Uncollectible Factor, the effective tax rate for Gross Receipts Tax, State Excise Tax and FIT in its calculation of the Revenue Conversion Factor. Additionally, the Company applied factors for Forfeited Discounts, Uncollectibles, Gross Receipts Tax, State Excise Tax and FIT to the amount of the determined Revenue Deficiency based on Revenues at current rates.

The CAPD proposes a Revenue Conversion Factor of 1.642301.¹³⁹ This factor is based upon a Forfeited Discount Factor of 0.0113, an Uncollectible Ratio of 0.0093, which appears to be the factor used in Docket 04-00288, a State Excise Tax Factor of 0.065, and a Federal Income Tax Factor of 0.35.

The panel adopted 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. The panel adopted the Uncollectible

¹³⁵ Data Response, TN-TRA-01-Q013-RATE BASE BACK-UP, p. 9 of 14 (December 28, 2006).

¹³⁶ Terry Buckner, Pre-filed Direct Testimony, Workpaper RTB-ITC (March 5, 2007).

¹³⁷ Terry Buckner, Pre-filed Direct Testimony, pp. 16 and 17 (March 5, 2007).

¹³⁸ Sheila A. Miller, Pre-filed Direct Testimony, Exhibit 1, Schedule 1 (November 22, 2006).

¹³⁹ Terry Buckner, Pre-filed Direct Testimony, Exhibit CAPD-RTB, Schedule 8 (March 5, 2007).

Factor proposed by the Company of 0.01277. Based on these determinations, the panel concluded that the Revenue Conversion Factor is 1.648074.

The panel also adopted the Company's 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. The panel also included 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.

V(g). RATE OF RETURN

There are three steps to establishing the fair rate of return: (1) determine an appropriate capital structure; (2) determine the cost rates of each component of the capital structure: (i) short-term debt, (ii) long-term debt, (iii) preferred equity, and (iv) common equity; and (3) compute the overall cost of capital using a weighted average of the component rates to account for the proportion of each component.

There is no objective measure of the fair rate of return. Therefore, the TRA must exercise its judgment in making the appropriate determination. The Authority, however, is not without guidance in exercising its judgment. The principle factors that should be used in establishing a rate were set forth by the U.S. Supreme Court in *Bluefield Water Works & Improvement Company v. Public Service Commission*:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.¹⁴⁰

¹⁴⁰ *Bluefield*, 262 U.S. at 692-93; See also *Duquesne Light Company v. Barasch*, 488 U.S. 299, 310 (1989).

In *Federal Power Commission v. Hope Natural Gas Company*, the U.S. Supreme Court determined that regulated firms are entitled to a return that is “just and reasonable.”¹⁴¹ The rate a firm is permitted to charge should enable it “to operate successfully, to maintain its financial integrity, to attract capital, and to compensate investors for the risks assumed.”¹⁴²

According to the Court in *Hope*, the general standards to be considered in establishing the fair rate of return for a public utility are financial integrity, capital attraction and setting a return on equity that is commensurate with returns investors could achieve by investing in other enterprises of corresponding risk. The utility’s fair rate of return is the minimum return investors expect, or require, in order to make an investment in the utility. The proper level of return on the company’s capital, including equity capital, must be commensurate with returns on investment in other enterprises having corresponding risk.

Thus, pursuant to the *Hope* and *Bluefield* decisions, the general standards to be considered in establishing a fair rate of return for a public utility are financial integrity, capital attraction and setting a return on equity that is commensurate with returns investors could achieve by investing in other enterprises of corresponding risk. The utility’s fair rate of return is the minimum return investors expect, or require, in order to make an investment in the utility.

TAWC requests an overall rate of return of 8.1%.¹⁴³ The Company’s overall rate of return is based upon a capital structure derived from data for TAWC. The company proposes a capital structure for TAWC comprised of: 53.07% long-term debt; 3.76% short-term debt; 1.32% preferred equity; 23.84% common equity comprised of common stock; and 18.02% common equity in the form of retained earnings.¹⁴⁴ The Company states that, as part of settlement agreements in divestiture

¹⁴¹ *Hope*, 320 U.S. at 605.

¹⁴² *Id.*

¹⁴³ Michael Miller, Pre-filed Rebuttal Testimony, p. 11 (April 9, 2007).

¹⁴⁴ Michael Miller, Pre-filed Rebuttal Testimony, Rebuttal Exhibit MAM-6 (April 9, 2007).

proceedings in other states, its parent company, AWWC, is required to have at least 45% common equity at the time of the IPO.¹⁴⁵

TAWC proposes a short-term debt cost of 5.4% based upon market forecasts for 2007.¹⁴⁶ The Company proposes the cost of long-term debt at 6.08%.¹⁴⁷ In deriving its recommended cost of capital of 8.1%, TAWC claims that its return on equity should be set at 11%.¹⁴⁸ The Company's cost of capital methodology involves adjusting the required equity return to account for the influence of both taxation and capital structure.¹⁴⁹

The CAPD employs a double-leveraging methodology to determine the capital structure for TAWC. CAPD suggests a cautious approach to the capital structure of TAWC's parent, due to the pending IPO and the parent's history of operating at low equity ratio. As a result, CAPD proposes a capital structure for the parent comprised of 30% equity and 70% debt.¹⁵⁰ Based upon the posited parent company capital structure and TAWC's capital structure, the CAPD proposes a final capital structure for TAWC comprised of 59.7% long-term debt and 25.6% equity supplied by the parent, and 14.7% long-term debt held by TAWC.¹⁵¹ The CAPD asserts that the current long-term debt cost within the AWWC system is 5.3%¹⁵² and calculates the cost of TAWC's debt held outside the AWWC system as 7.6%¹⁵³

The CAPD states that the appropriate equity return is 7.5% based upon an implementation of the DCF model using historical dividend growth.¹⁵⁴ The CAPD projects an equity return estimate of 6.3% by implementing the CAPM. The CAPD uses a long-term debt cost of 5.0% for the risk free

¹⁴⁵ Michael Miller, Pre-filed Rebuttal Testimony, pp. 23-25 (April 9, 2007).

¹⁴⁶ Michael Miller, Pre-filed Direct Testimony, p. 5 and Exhibit MAM-3 (November 22, 2006).

¹⁴⁷ Michael Miller, Pre-filed Rebuttal Testimony, Rebuttal Exhibit MAM-6 (April 9, 2007).

¹⁴⁸ Michael Miller, Pre-filed Direct Testimony, pp. 8-9 (November 22, 2006).

¹⁴⁹ Dr. Michael Vilbert, Pre-filed Direct Testimony, pp. 2-3 (November 22, 2006).

¹⁵⁰ Dr. Steve Brown, Pre-filed Direct Testimony, p. 13 (March 2, 2007).

¹⁵¹ Dr. Steve Brown, Pre-filed Direct Testimony, Revised Schedule 8 (March 2, 2007).

¹⁵² Dr. Steve Brown, Pre-filed Direct Testimony, p. 16 (March 2, 2007).

¹⁵³ Dr. Steve Brown, Pre-filed Direct Testimony, Revised Schedule 8 (March 2, 2007).

¹⁵⁴ Dr. Steve Brown, Pre-filed Direct Testimony, pp. 29-30 (March 2, 2007).

return component of the CAPM.¹⁵⁵ Based on an estimated market return of 8.5% and a current yield on U.S. securities of 5%, the CAPD states that the market risk premium is 3.5%. The CAPD uses a BETA measure of 0.37 derived from data taken from the NASDAQ internet site to complete the CAPM calculation of a 6.3% equity return.¹⁵⁶ In sum, the CAPD recommends an overall cost of capital of 6.2%.¹⁵⁷ The 6.2% overall return is based upon a double leveraged capital structure, the debt costs described above and a 7.5% equity return.

After review of the record, the panel concluded that the Company's rate of return should be set using a double leveraged capital structure. To implement the double leverage methodology, the panel set the portion of the Company's capitalization held by parties outside the AWWC system at 14.787% and costing 7.6%. For AWWC, the panel adopted a capital structure comprised of 45% equity with a return of 10.2% and 55% debt with debt costing 6.1% resulting in an overall rate of return of 7.89% for the Company.

Due to the extensive discussion regarding the pending IPO of AWWC and to monitor compliance with the representations made concerning the AWWC's capital structure, the panel, consistent with agreements made in other states, requires the Company to promptly notify the TRA if AWWC's equity ratio falls below 45% and, in any event, to file a report six months after the IPO indicating the current Capital Structure.

V(h). REVENUE DEFICIENCY

A majority of the panel¹⁵⁸ determined that based upon the preceding determinations the Revenue Deficiency is \$4,079,865 for the attrition period.

¹⁵⁵ Dr. Steve Brown, Pre-filed Direct Testimony, p. 57 (March 2, 2007).

¹⁵⁶ Dr. Steve Brown, Pre-filed Direct Testimony, p. 57 (March 2, 2007).

¹⁵⁷ Dr. Steve Brown, Pre-filed Direct Testimony, Revised Schedule 8, (March 2, 2007).

¹⁵⁸ Director Jones dissented from the majority's calculation of the dollar amount, but agrees with the methodology used to perform the calculation.

V(i). RATE DESIGN

The Company filed a Cost of Service Allocation Study as of June 30, 2006.¹⁵⁹ The Study shows that under proposed rates Residential and Other Water Utilities (Wholesale Water Sales) are being subsidized by Commercial, Industrial, Other Public Authority and Private Fire Protection.¹⁶⁰ The Company supports a rate design based upon an across-the-board uniform increase.¹⁶¹

CMA states that each class of customers should pay its fair share for actual water usage, based upon what it costs to actually provide service to the customer. CMA also contends that any customer class should not subsidize another customer class.¹⁶²

Second, CMA asserts that the Company's own comparison of the allocated cost of service to each class and the revenues generated by the equal percent increase shows that the Commercial, Industrial, Public Authority and Private Fire Protection classes are providing significant subsidies to the Residential and Wholesale customers of TAWC. CMA recommends that TAWC begin to phase out these subsidies in this rate case stating that the elimination of inter-class subsidies will promote equity, efficiency (cost-minimization), conservation and stability.¹⁶³

For illustrative purposes only, CMA uses TAWC's revenue proposal to show the impacts on each customer class and CMA's proposed adjusted cost of service study results. Based upon the overall requested increase and in order to reach full cost of service in one step, the Residential increase would be 42.36% while Commercial revenues would be increased by only 2.46%. The Industrial and Public Authority classes would get percent increases less than the system average increase, while Wholesale water customers would get an increase of 27.69%. CMA recommends that interclass subsidies be phased out gradually, over the next three rate cases. Based upon a 19.61% overall increase in revenue and reduction of subsidies by 33%, Residential customers would

¹⁵⁹ Paul R. Herbert, Pre-filed Direct Testimony, Exhibit No. PRH-1 (November 22, 2006).

¹⁶⁰ Paul R. Herbert, Pre-filed Direct Testimony, Exhibit No. PRH-1, Schedule A (November 22, 2006).

¹⁶¹ Paul R. Herbert, Pre-filed Direct Testimony, p. 11 (November 22, 2006).

¹⁶² Dan Nuckolls, Pre-filed Direct Testimony, p. 6 (March 5, 2007).

¹⁶³ Michael Gorman, Pre-filed Direct Testimony, p. 2 (March 5, 2007).

receive a 27.13% increase; Commercial customers would receive a 12.33% increase; Industrial customers would receive a 16.39% increase; Other Public Authority customers would receive a 16.15% increase; Other Water Utility customers would receive a 21.69% increase; and Private Fire Protection customers would receive an 11.42% increase.¹⁶⁴

After review of the record, the panel adopted 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 panel denied the Company's proposed tariff and required the Company to 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. The panel further held that uncollectible revenues, forfeited discounts and taxes have been accounted for in its adopted revenue deficiency.

¹⁶⁴ Michael Gorman, Pre-filed Direct Testimony, pp. 8 - 9 (March 5, 2007).

IT IS THEREFORE ORDERED THAT:

1. The rates filed by Tennessee American Water Company on November 22, 2006 are denied.
2. For purposes of the rates herein, the test period shall be as follows:
 - (a) for Revenues and Expenses, except in the instance of Insurance Other Than Group, the test period shall be the uniform test period of the twelve months ended June 30, 2006;
 - (b) for Rate Base components to which the Company and the Consumer Advocate and Protection Division of the Office of the Attorney General agree in their projections, the test period shall be the twelve months ended June 30, 2006;
 - (c) for Rate Base components to which there was dispute among the parties, the test period shall be the actual average thirteen month ending balances at December 31, 2006; and
 - (d) the forward looking attrition period shall be the twelve months ending February 29, 2008.
3. For purposes of the rates herein, the rate base is \$104,282,949, and the net operating income is \$5,774,350 at current rates.
4. Capitalization held by parties outside the American Water Works Company system is set at 14.787% with a cost of 7.6%.
5. A capital structure comprised of 45% equity and 55% debt with debt costing 6.1% and an equity return of 10.2% is set for American Water Works Company, Tennessee American Water Company's parent.
6. For purposes of the rates herein, the capital structure and cost rates indicated above produce a fair rate of return of 7.89%.
7. For purposes of the rates herein, the Revenue Conversion Factor is 1.648074, resulting in a Revenue Deficiency of \$4,079,865, the amount needed for the Company to earn a fair return on its investment during the attrition year.

8. The Revenue Deficiency shall be addressed by uniform increases to base rates and volumetric rates for all customer classes.

9. The Company is directed to promptly notify the Authority if American Water Works Company's equity ratio falls below 45% and, in any event, to file a report six months after the IPO indicating the current Capital Structure.

10. Tennessee American Water Company shall have a management audit performed in compliance with Sarbanes-Oxley requirements and submit the results to the Authority in one year or, if the audit is not complete in one year, submit a status report on the audit in one year.

11. Tennessee American Water Company is directed to file tariffs with the Authority that are designed to produce an increase of \$4,079,865 in incremental revenues for service rendered and any tariffs necessary to be consistent with this Order.

12. The tariffs shall be filed within thirty days.

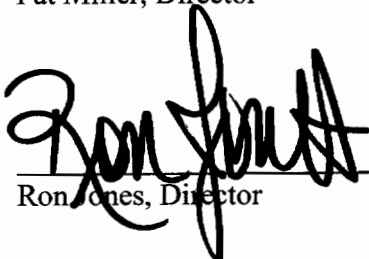
13. Any party aggrieved by the Authority's decision in this matter may file a Petition for Reconsideration with the Authority within fifteen days from the date of this Order.

14. Any party aggrieved by the Authority's decision in this matter has the right to judicial review by filing a Petition for Review in the Tennessee Court of Appeals, Middle Section, within sixty days from the date of this Order.


Sara Kyle, Chairman


Pat Miller, Director

11-30-07


Ron Jones, Director

**FOCUSED MANAGEMENT
AND
OPERATIONS AUDIT
OF
PENNSYLVANIA-
AMERICAN WATER
COMPANY**

**PREPARED BY THE
PENNSYLVANIA UTILITY COMMISSION
BUREAU OF AUDITS
MANAGEMENT AUDIT DIVISION**

Issued August 2000

**PENNSYLVANIA-AMERICAN WATER COMPANY
FOCUSED MANAGEMENT AND OPERATIONS AUDIT
TABLE OF CONTENTS**

<u>Chapter</u>	<u>Page</u>
I.	INTRODUCTION
	A. Objectives and Scope
	B. Audit Approach
	C. Diagnostic Assessments
	D. Functional Ratings
	E. Recommendation Summary
II.	BACKGROUND
III.	FLEET OPERATIONS
IV.	ENERGY PROCUREMENT
V.	UNACCOUNTED-FOR-WATER
VI.	DROUGHT CONTINGENCY PLANNING
VII.	CUSTOMER CALL CENTER CONSOLIDATION
VIII.	METER READING
IX.	COST ALLOCATIONS
X.	PG&W ACQUISITION
XI.	DIVERSITY
XII.	ACKNOWLEDGEMENTS
XIII.	APPENDIX

**PENNSYLVANIA-AMERICAN WATER COMPANY
FOCUSED MANAGEMENT AUDIT
EXHIBIT AND TABLE LIST**

LIST OF EXHIBITS		
<u>Exhibit No.</u>	<u>Exhibit Title</u>	<u>Follows Page</u>
ID-1	Summary of Functional Ratings	4
IE-1	Summary of Recommendations	4
II-1	Corporate Organization Chart	5
II-2	Company Organization Chart	5
VII-1	Customer Service Organization Chart	25
IX-1	Statement of Expenses and Billed Charges to and from PAWC, 1995-1998	35
X-1	Impact of the PG&W Acquisition	40
XI-1	Number of Employees by EEO Category, Gender, and Race (1995-1998)	41
XI-2	Comparison of 1998 Female and Minority Employment Percentages with the relevant PMSA Labor Force	42
XI-3	Total Utility Purchases for Minority, Women, and Disabled Person Businesses (1994-1998)	42

LIST OF TABLES		
<u>Table No.</u>	<u>Exhibit Title</u>	<u>Page</u>
III-1	Fleet Profile (1997-Sept 1999)	7
III-2	Fleet Comparative Benchmark Data (1997-1998)	9
V-1	UFW Percentages by Operating Region (1996-July 1999)	17
V-2	Main Replacement Statistics (1996 –1998)	18
V-3	Main Break Statistics (1996-July 1999)	19
VIII-1	Number of Full-time Meter Readers (1995-Sept 1999)	29
VIII-2	Number of Man-hours devoted to reading meters (1996-Sept 99)	30
VIII-3	Number of Meter Reading Routes (1995-Sept 1999)	30

I. INTRODUCTION

In accordance with the Pennsylvania Public Utility Commission's (PUC or Commission) program to identify improvements in the management and operations of fixed utilities under its jurisdiction, it was determined that a focused management and operations audit should be conducted of Pennsylvania-American Water Company (PAWC or Company). Management and operational reviews, which are required of certain utility companies pursuant to 66 PA C.S. § 516(a), come under the Commission's general administrative power and authority to supervise and regulate all public utilities in the Commonwealth, 66 PA C.S. § 501(b). More specifically, the Commission can investigate and examine the condition and management of any public utility, 66 PA C.S. § 331(a).

This report represents the written product of the focused management and operations audit and contains the resultant findings and recommendations for improvement in the management and operations of PAWC. The findings presented in the report identify certain areas and aspects where weaknesses or deficiencies exist. In all cases, recommendations have been offered to improve, correct, or eliminate these conditions. The final and most important step in the management audit process is to initiate actions toward implementation of the recommendations.

A. OBJECTIVES AND SCOPE

The objectives of this focused management and operations audit were threefold:

- To provide the Commission, PAWC, and the public with an assessment of the economy, efficiency, and effectiveness of the Company's operations, management methods, organization, practices, and procedures.
- To identify opportunities for improvement and develop recommendations to address those opportunities.
- To provide an information base for future regulatory and other inquiries into the management and operations of PAWC.

The scope of this audit was limited to certain areas of the Company as explained in Section B, the Audit Approach, below.

B. AUDIT APPROACH

The audit process began with a pre-field work analysis as outlined below:

- A five-year internal trend and ratio analysis was completed using financial and operational data obtained from the Company, Commission, and other available sources. This analysis, which focused on the period 1994-1998, was supplemented by comparisons to a panel of other water companies for the years 1995-1998.
- Input was solicited from Commission Bureaus and Offices, certain external parties, and the Company regarding any concerns or issues they would like to have addressed during the course of our review.

Information from the above steps was used to initially focus the Audit Staff's work efforts in the field. Some areas or functions of the Company were selected for in-depth analysis, other areas were selected for further diagnostic assessment during early stages of the field work, and still others were dropped from further consideration.

The actual field work began on August 18, 1999 and continued through November 9, 1999. The principal components of the fact gathering process included:

- Interviews with Company personnel.
- On-site analysis of records, documents, and reports of a financial and operational nature. This analysis focused primarily on the period 1994-1999, as available.

C. DIAGNOSTIC ASSESSMENTS

Based on our diagnostic assessment efforts, both before and during the field work, we excluded a number of Company functions or areas from this focused report. Our diagnostic assessment of these functions or areas revealed that minimum management controls were in place, critical operating factors appeared to be satisfactory, and/or performance of additional work could not be justified from a cost/benefit perspective. These excluded functions or areas are:

Executive Management and Organization
Finance
Budgeting
Management Information Systems
Human Resources
Compensation
Facilities Management
Purchasing
Materials Management

A diagnostic assessment should not be construed as a comprehensive evaluation of management or operations in the affected functional areas. Had we conducted a thorough review of these areas, other weaknesses or deficiencies may have come to our attention that were not identified in the limited review.

D. FUNCTIONAL RATINGS

In those functions or areas of the Company where a diagnostic assessment indicated that basic management controls and/or critical operating factors could be improved, the audit staff expanded the scope of the review and was able to rate each function or area's actual operating performance level relative to its expected performance level at the time of the audit. This expected performance level is the state at which each functional area should be operating given the resources, requirements, constraints, and general operating environment. Expected performance is not some "cutting edge" operating condition. Rather, it is the management of a function such that it produces reasonably expected operating results.

Presented below are the categories utilized to rate each function or area's actual operating performance level relative to its expected performance level:

- **MEETS EXPECTED PERFORMANCE LEVEL**
- **MINOR IMPROVEMENT NEEDED**
- **MODERATE IMPROVEMENT NEEDED**
- **SIGNIFICANT IMPROVEMENT NEEDED**
- **MAJOR IMPROVEMENT NEEDED**

Our functional ratings for the Company can be found in Exhibit I D-1.

E. RECOMMENDATION SUMMARY

Chapters III through XI provide findings, conclusions, and recommendations for each function or area reviewed in-depth during this focused audit. Exhibit I E-1 summarizes the recommendations with the following priority assessments for implementation:

- HIGH PRIORITY – implementation of the recommendation would result in significant cost savings, major service improvements, or substantial improvements in management practices and performance. These recommendations should be implemented as soon as practical.
- MEDIUM PRIORITY – implementation of the recommendation would result in important cost savings, service improvements, or meaningful improvements in management practices and performance. Implementation of these recommendations should begin within 12 months.
- LOW PRIORITY - implementation of the recommendation could potentially enhance cost controls, service improvements, or management practices and performances. Implementation of these recommendations should begin within 18 months.

These priorities were assigned based on the audit staff's assessment of the potential impact of the recommendations and the Company's available resources.

Exhibit I D-1

**PAWC
FOCUSED MANAGEMENT AUDIT
FUNCTIONAL RATING SUMMARY**

Functional Area	Meets Expected Performance Level	Minor Improvement Needed	Moderate Improvement Needed	Significant Improvement Needed	Major Improvement Needed
Fleet Operations			X		
Energy Procurement		X			
Unaccounted-For-Water		X			
Drought Contingency Planning		X			
Customer Call Center Consolidation			X		
Meter Reading		X			
Cost Allocations		X			
PG&W Acquisition	X				
Diversity			X		

PAWC

SUMMARY OF RECOMMENDATIONS

<u>Chapter/Section Title</u>	<u>Recommendation</u>	<u>Page Number</u>	<u>Priority</u>
III. Fleet Operations			
	1. Customize the vehicle exception parameters based on the Company's fleet profile. Management should periodically review and update the parameters on a timely basis to properly identify vehicles operating inefficiently and to enforce fleet operating standards.	11	High
	2. Conduct and document fleet cost activity and operating practice benchmarking studies on a periodic basis.	11	Medium
	3. Update the vehicle management operating policies and procedures manual and periodically review and revise as necessary.	11	Medium
IV. Energy Procurement			
	1. Conduct a current preliminary energy survey for its 29 demand metered accounts in order to identify potential energy audit candidate sites. Prioritize, schedule, and conduct energy audits for these sites in a timely manner based on the cost-effective energy conservation measures.	15	Medium

PAWC
SUMMARY OF RECOMMENDATIONS

<u>Chapter/Section Title</u>	<u>Recommendation</u>	<u>Page Number</u>	<u>Priority</u>
V. Unaccounted-for-Water			
	1. Develop an automated company-wide leak survey and repair database to be utilized with the recommended main replacement prioritization procedure.	21	Medium
	2. Develop a formalized main replacement procedure based on weighted factors in order to systematically prioritize main replacement candidates on a state-wide basis.	21	Medium
	3. Conduct a cost/benefit study on a periodic basis to determine the appropriate mix of contractors and in-house personnel to perform annual leak survey work.	21	Low
VI. Drought Contingency Planning			
	1. Develop internal management action plans to support the staged supply extension and demand reduction measures for those districts evaluated for drought vulnerability on a risk assessment basis.	24	Medium

PAWC

SUMMARY OF RECOMMENDATIONS

<u>Chapter/Section Title</u>	<u>Recommendation</u>	<u>Page Number</u>	<u>Priority</u>
VII. Customer Call Center Consolidation	<ol style="list-style-type: none"> Continue efforts to consolidate the existing customer service call centers. Management should complete and document detailed plans and cost benefit analyses in support of consolidation strategy chosen. Also, PAWC should formally track actual implementation costs and realized benefits from the consolidation, and retain these results for regulatory review. 	27	High
VIII. Meter Reading	<ol style="list-style-type: none"> Perform, and document, a cost/benefit analysis for full and/or partial deployment of an automatic fixed-network meter reading (AMR) system; include an analysis of operating and capital expenses which reflect productivity improvements and staffing reductions that could be realized. 	33	Medium
IX. Cost Allocations	<ol style="list-style-type: none"> Develop a more detailed internal audit report that clearly defines the audit scope and results, as well as the corrective actions recommended, for the periodic cost allocation and direct billing charge review. A copy of the audit report should be routinely provided to PAWC and the other AWC operating companies. 	37	Medium

PAWC

SUMMARY OF RECOMMENDATIONS

<u>Chapter/Section Title</u>	<u>Recommendation</u>	<u>Page Number</u>	<u>Priority</u>
X. PG&W Acquisition	None		
XI. Diversity			
	1. Set goals with timetables for increasing the Company's female and minority employment percentages, especially for the Pittsburgh, Wilkes-Barre/Scranton, and Hershey-Corporate geographic locations.	44	High
	2. Develop annual MWDBE procurement goals with accountability established at the Regional Operating Manager level.	44	High
	3. Update the Company's MWDBE vendor list and integrate it into the purchasing process, and establish a process to ensure that the MWDBE vendor list remains current in the future.	44	Medium

II. BACKGROUND

Pennsylvania-American Water Company (PAWC or Company), a wholly-owned subsidiary of American Water Works Company, Inc (AWWC), is one of the largest regulated public water utilities in the United States. As shown in Exhibit II-1, PAWC is one of 23 utility subsidiaries operating in 21 states. American Water Works Service Company (AWWSC), an affiliate, provides certain management services (i.e., administration, data processing, engineering, etc.) to PAWC and other operating companies in the American Water Works System on an at-cost basis in accordance with management and service agreements. PAWC also has agreements with another affiliate, American Commonwealth Management Service Company, Inc. (ACMS), for the lease of granular activated carbon at one of its purification plants, and for the purchase of carbon at several others. The lease and purchase agreements provide for ACMS to regenerate the spent carbon and return it to the plant where it originated.

PAWC provided water service to approximately 543,000 customers and wastewater service to approximately 4,800 customers as of December 31, 1999. These customers live in 291 municipalities in 31 of Pennsylvania's 67 counties. As of July 1999, the Company employed approximately 1,068 employees having expertise in all areas of water utility operations including engineering, water quality, treatment plant operation and maintenance, distribution system operation and maintenance, materials management, risk management, human resources, legal, finance, and accounting. The Company's organization chart is shown in Exhibit II-2.

The Company, headquartered in Hershey, is divided into four geographically diverse operating areas or regions (Eastern, Northeastern, Western, and Pittsburgh). The Eastern Operating Region, with its office located in Mechanicsburg, provides service to customers in central and eastern Pennsylvania with some of the larger customers including Hershey Foods, American Home Foods, and the Norristown State Hospital. The Northeastern Operating Region with its office located in Wilkes-Barre provides service to customers that include Harris Semiconductor and Quaker Oats Company. The Western Operating Region, with its office located in McMurray, provides service to customers in western Pennsylvania with its larger customers that include U.S. Steel, Washington Steel, United Refinery, Armco Steel, and Koppel Steel. The Pittsburgh Operating Region with its office located in Mt. Lebanon, a suburb of Pittsburgh, serves Allegheny County and is the second-largest contiguous distribution system in the American Water System.

Exhibit II-1

AWWC Corporate Organization Chart

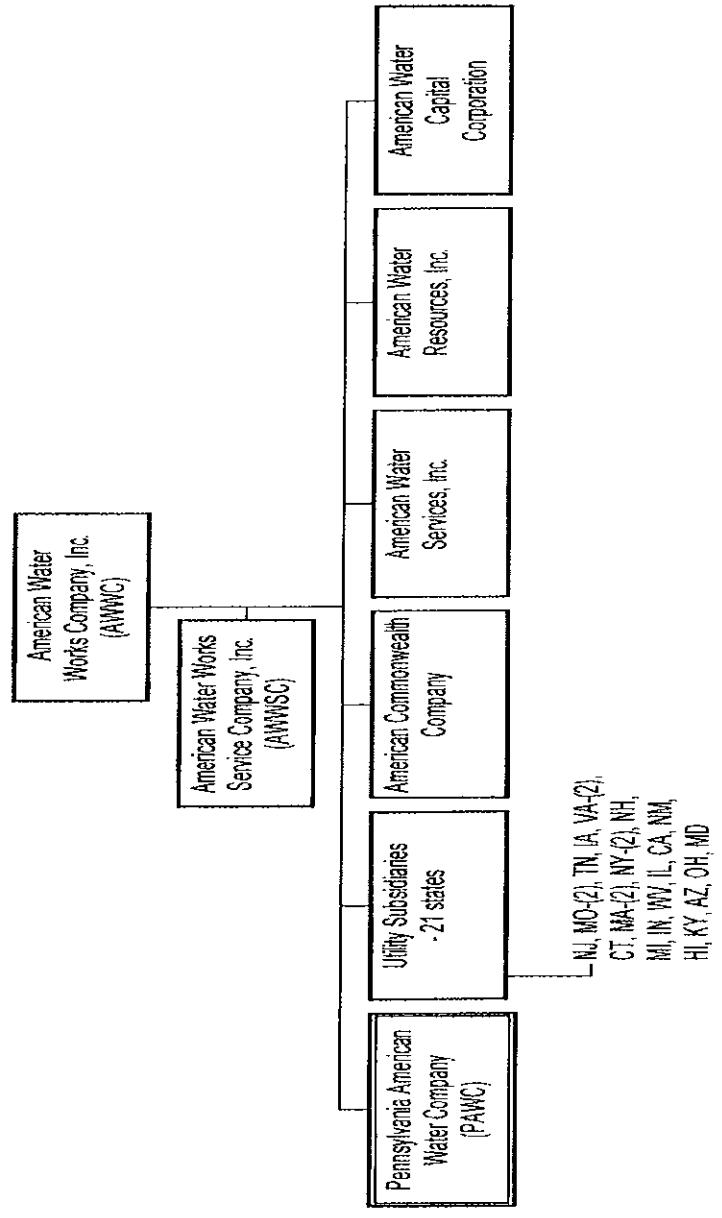
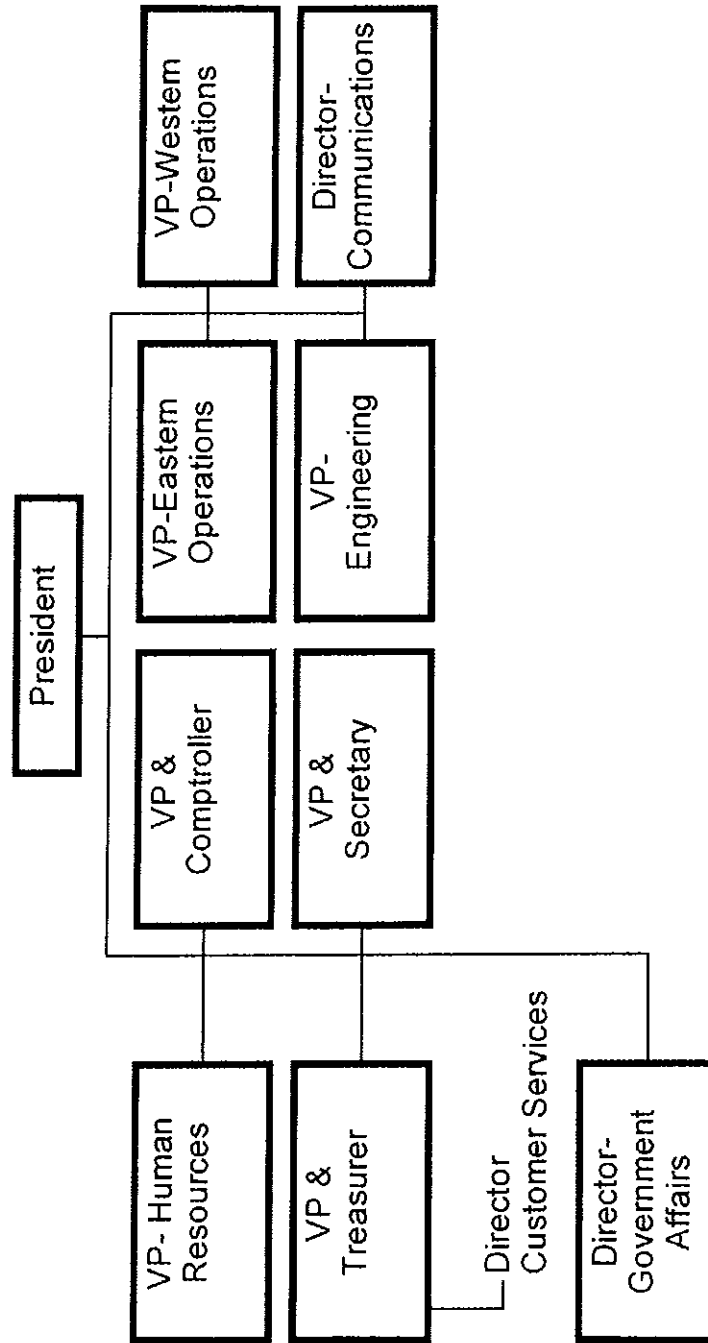


Exhibit II-2

PAWC ORGANIZATION CHART



The Company's water supply is provided principally from surface supplies such as rivers, streams, and reservoirs. Water is also supplied from wells and through purchase contracts via interconnections with other water suppliers. In 1998, the total amount of water delivered to the system averaged approximately 190 million gallons per day (MGD) of which surface water accounted for approximately 94%, wells approximately 4%, and purchased water approximately 2%.

Currently, the Company's strategic plan is growth through acquisition. During 1998, the Company acquired eight systems (Clarion Township General Authority, Green Valley Water Company, National Utilities, Inc. – Pocono Division, Franklin Manor Utilities Ltd., Evansburg Water Company, Taylor Township, Fairview Water Company, and Pocono Mountain Industrial Park Authority) serving populations in six counties. Through November 1999, the Company had acquired four additional systems including Applewood Borough (March 1999), Cedar Grove Water Association (July 1999), Independence Township Municipal Authority (July 1999), and Koppel Borough (November 1999). Additionally, in October 1999 AWWC announced the acquisition of Citizens Utilities Companies' water and wastewater assets. This increased the number of customers served in Pennsylvania by 38,000.

III. FLEET OPERATIONS

Background

As of September 1999, PAWC maintained a fleet of 609 vehicles, with all but three vehicles leased. By December of 1999, the Company projects its fleet size (as per its 1999 rate filing) to be 591 vehicles after salvaging its three remaining Company-owned vehicles and returning 12 vehicles with expiring lease terms to its lessor. As shown in Table III-1, the Company's employee to vehicle ratio has been maintained at a relatively stable range from 1997 to 1999 (using the projected 1999 year-end data).

**Table III-1
Fleet Profile**

Year	Leased Vehicles	Owned Vehicles	Total Vehicles	Employees per Vehicle
1997	517	83	600	1.82
1998	581	45	626	1.73
Sept-1999	606	3	609	1.75
Projected 1999 year-end	591	0	591	1.81
% change	14.3%	-100%	-1.5%	-0.5%

Source: VM-1, VM-9, auditor analysis

Prior to the 1997 expiration of its five-year lease contract, the Company reviewed its vehicle acquisition practices by performing a vehicle lease versus buy study. This study indicated that leasing was the most cost-effective method for acquiring vehicles. Additionally, the Company performed a life-cycle analysis, which compared different lease terms for passenger vehicles. The Company concluded that 36-month terms were more economically favorable than its previous practice of leasing for 50-month terms. As a result of the lease versus buy study and life-cycle analysis, competitive bids were obtained for providing vehicle leasing services on a 36-month term basis for cars, vans, four-wheel drive vehicles, and light/medium pick-up trucks while maintaining 50-month lease terms for heavy utility trucks. In January 1998 the Company entered into a five-year agreement with General Electric Capital Fleet Services (GECFS) for vehicle leasing services.

PAWC also renewed its maintenance management services agreement with GECFS for a five-year period in January 1998. This agreement includes preparation of monthly vehicle operating and expense reports grouped by district,

region, and Company-wide categories. Other maintenance management benefits include receipt of a 15% discount by utilizing the GE maintenance vendor network with additional GE year-end cash rebates provided upon attaining certain vendor utilization thresholds. Additionally, a fuel card purchasing program provides management with a tracking mechanism to monitor timely information regarding individual vehicle fuel consumption performance and expense trends.

Findings and Conclusions

Our examination of the fleet operations included a review of the assigned roles and responsibilities; vehicle maintenance and acquisition practices; policies and procedures; fleet size and utilization; and the vehicle management information system. We found these areas to be satisfactory except as follows:

1. The Company's vehicle management reporting system is not being fully utilized to monitor and control fleet operating expenses and to enforce compliance with fleet operating standards.

As previously mentioned, GECFS has been under contract since 1992 to provide vehicle maintenance management services to PAWC with the most recent contract renewal completed in 1998 for a five-year period. Management reports generated by GECFS include the electronic fuel program transaction report, executive vehicle expense summary report, fleet expense overview report, vehicle expense summary report, and the vehicle expense exception summary report. Apart from expense information, the vehicle management reports provide data regarding compliance with operating standards (e.g., fuel usage type, utilization of approved GE maintenance and fuel vendors, etc.)

Of particular importance is the exception summary report, which is generated on a quarterly basis and details four exception categories including cost per mile for unscheduled maintenance service, cost per mile for preventative maintenance, cost per mile for tires, and miles per gallon for fuel. Exception reporting is intended to readily identify vehicles operating outside of normal parameters including non-compliance with established policies and procedures, high operating costs or unusually low utilization. However, the existing exception reports are inadequate, outdated and rarely used. The Company's fleet manager feels that the exception reports are of limited value because the original exception parameters provided by GECFS in 1992 to serve as initial guidelines have never been modified, and are not tailored to the composition of the Company's existing fleet. For example, costs and utilization of heavy duty vehicles are not measured on a per hour basis. As a result, the original exception parameters (based primarily on passenger sedans) are being applied to all vehicle classes resulting in a high percentage of exceptions. For example, the June 1999 exception summary report showed a 75% exception rate.

The consequences of failing to monitor and modify the exception parameters continuously for all vehicle classes are: unnecessary expenses incurred by the Company as a result of an inability to identify underutilized and poor performing vehicles; low utilization of the GE approved maintenance vendor network as well as the loss of associated discounts for using approved vendors; additional invoice processing costs for using non-GE approved vendors; and potential lost rebate savings for not achieving vendor utilization thresholds.

While it is hard to quantify the savings from an improved vehicle management reporting system, there is one area where this is possible. Specifically, the Company could achieve annual savings of approximately \$44,400 (based on 1998 operating data) by increasing its vendor network utilization rate from 32% to 72%. This percentage represents utilization levels previously achieved in the Pittsburgh Service Area as well as a level achieved by a comparative fleet provided by GECFS' database.

2. The Company has not conducted extensive fleet cost activity and operating practice benchmarking studies.

Currently, GECFS provides PAWC with comparative fleet benchmark data on an annual basis. This benchmark data is limited, but does include a comparison between PAWC and two or three comparative fleets from GECFS' database. As shown in Table III-2, the expense and operating parameters compared include operating cost per mile, operating cost per unit per month, and average miles per month per vehicle.

**Table III-2
Fleet Comparative Benchmark Data**

Year	Category	PAWC	Fleet A	Fleet B	Fleet C
1998	Operating cost/mile	\$.0715	\$.0291	\$.0271	\$.0293
	Operating cost/unit/month	\$56.79	\$71.95	\$64.33	\$68.09
	Average miles/mo./vehicle	794	2,472	2,369	2,424
1997	Operating cost/mile	\$.0564	\$.0395	\$.0319	n/a
	Operating cost/unit/month	\$80.87	\$79.38	\$87.11	n/a
	Average miles/mo./vehicle	1,433	2,008	2,737	n/a

Source: 1999 & 1998 GECFS Annual Maintenance Management Review
n/a – not available

However, there are a couple of problems with this benchmark comparison. First, according to GECFS, the fleets of the comparative companies are not similar in size and composition. This appears to account for some of the wide differences

in operating cost per mile, etc. Secondly, there is no benchmark data for heavy duty vehicles such as operating costs per hour.

Apart from the benchmark data provided by GECFS, PAWC does not benchmark fleet operating practices regarding fleet maintenance (i.e., in-house vs. external), vehicle parts procurement (i.e., tires, etc.), maintenance management functions, etc. Moreover, although the Company contends that informal surveys have been conducted with other companies to help assess the Company's current fleet size, those efforts have not been documented. The Company's ratio of employees to vehicles decreased from 2.18 in 1983 to 1.73 in 1998, or by approximately 20%.

The Company currently feels that the vehicle acquisition bidding process and lease versus buy studies as well as the maintenance management services provided by GECFS have resulted in reasonable expense levels and adequate operating practices. Nevertheless, more extensive benchmarking would provide for a better comparison of the Company's fleet performance, processes, and activities with the best performers in the industry.

3. The Vehicle Management Operating Policies and Procedures Manual is outdated.

PAWC's current vehicle policy and procedure manual dates back to 1981 with partial revisions made in 1985 and 1986. The manual consists primarily of an AWWC corporate policy that outlines the vehicle assignment and administrative responsibilities for the American System Operating Companies in very general and broad terms. While the contents of the manual specify the minimum record-keeping requirements for fleet operations, these requirements are more relevant to a smaller fleet operation than PAWC's and one performed with manual record-keeping. Also, the vehicle manual includes references to vehicle operating reports no longer utilized by PAWC drivers, and lacks specific procedures relevant to PAWC's fleet operations.

An updated vehicle policies and procedures manual should be developed with detailed procedures specific to PAWC's operation. At a minimum, the manual should address vehicle assignment criteria, minimum annual vehicle utilization level goals, vehicle safety guidelines, vehicle operating practices, etc.

The Company acknowledges that the policies and procedures manual is outdated and that little priority has been given to updating the manual in a timely manner. Policies and procedures serve as administrative controls and provide guidance to operating personnel in support of Company and department

objectives. Without updated policies and procedures, operating practices may produce results that vary significantly from those objectives.

Recommendations

1. Customize the vehicle exception parameters based on the Company's fleet profile. Management should periodically review and update the parameters on a timely basis to properly identify vehicles operating inefficiently and to enforce fleet operating standards.

2. Conduct and document fleet cost activity and operating practice benchmarking studies on a periodic basis.

3. Update the vehicle management operating policies and procedures manual and periodically review and revise as necessary.

IV. ENERGY PROCUREMENT

Background

Subsequent to restructuring of the electric utility industry and the start of electric competition in Pennsylvania, the Company devised energy procurement strategies, which have yielded significant savings to date. Initiation of the Electric Choice Program resulted in the Company issuing a request for proposal (RFP) in November 1998 to six Pennsylvania-based Electric Generation Suppliers (EGSs) to provide electric service for approximately 66% of its system-wide load (387 of its 600 accounts). The low-cost provider selected from among the bidders enabled the Company to achieve first-year savings of approximately \$256,000. Additionally, prior to the open enrollment period for the Electric Choice Program, the Company negotiated a five-year contract with Allegheny Power for its Aldrich Water Treatment Plant (in the western part of the state) resulting in additional annual savings of \$84,000. Furthermore, as part of the electric industry restructuring agreement by the electric companies serving PAWC, the Company realized T&D rate reduction savings of approximately \$243,000. Overall, first-year savings from these initiatives totaled \$583,000, representing a reduction in energy costs of approximately 6%. Other efforts included installation of demand metering equipment at 29 of its largest electric consumption facilities in order to develop electric use profiles that will allow the Company to effectively negotiate future electric procurement contracts.

The Company has also indicated that, with the materialization of electric competition throughout different parts of the United States, American Water Works Company foresees future procurement of electricity on an aggregated basis for American Systems in six states (i.e., Pennsylvania, New Jersey, Illinois, California, New York, and Massachusetts) to achieve greater cost savings. In line with that vision, AWWC issued a RFP on October 28, 1999 to numerous EGSs on behalf of both PAWC and New Jersey-American Water Company to procure 100% of their aggregated load. It was anticipated that a contract would be executed by December 31, 1999.

Finding and Conclusion

Our examination of energy procurement included a review of the Company's procurement strategies, energy/electric consumption dollars by operating facility, electric choice program initiatives, internal energy management analyses, etc. We found these areas to be satisfactory except as follows:

1. The Company should conduct detailed energy audits for its 29 demand metered accounts as a follow-up to AWWSC's 1995 Energy Management Opportunities Study.

In 1995, American Water Works Service Company (AWWSC) issued a report entitled "Energy Management Opportunities in the American Water System" which evaluated a variety of strategies for reducing energy costs. Preliminary surveys were first conducted in order to collect information on annual water production, annual energy use, an inventory of equipment, and type of available monitoring and control systems to identify energy saving opportunities in the American Water Works System (AWWS). Based on the analysis of the survey results, detailed energy audits were then conducted at three AWWS (including the Pittsburgh and White Deer Systems in Pennsylvania) sites to identify applicable energy conservation measures (ECMs). The potential energy savings and implementation costs were estimated for each ECM. Based on the surveyed information and the results of the detailed energy audits, potential energy savings and implementation costs were extrapolated for the entire AWS.

The Pennsylvania sites selected for the study were at the Hays Mine Treatment Plant located in the Pittsburgh district and the Milton Water Treatment Plant located in the White Deer district. Cost-effective ECMs were defined as those meeting the financial feasibility criteria of a payback period of 5.9 years or less. The cost-effective ECMs identified for the Hays Mine audit consist of improving the efficiency of high service pumps, use of distributed control systems to control tank levels and installation of energy efficient lighting. These ECMs would result in a potential annual energy demand reduction of 743 kW and usage reduction of 1.9 million kWh were identified with an estimated annual cost savings of \$209,000. Based on an implementation cost of \$367,000, the estimated simple payback period would be 1.8 years. Additional ECMs requiring implementation costs of \$970,000 with annual savings of \$109,000 were identified but did not meet the minimum payback period criteria.

The Milton water treatment plant is one of two treatment plants that serve the White Deer district in Pennsylvania. The cost-effective ECMs identified include base loading the White Deer Creek treatment plant (i.e., designate the lower cost production facility as the primary supply to meet system demands while supplementing any additional demands with the higher cost production facility), installation of variable frequency drives and energy efficient motors for selected pumps, and operational changes to manage demand and installation of energy efficient lighting. These ECMs represent a potential annual energy demand reduction of 97 kW and usage reduction of 397,500 kWh with an estimated annual cost saving of \$38,200. Based on an implementation cost of \$17,600, the estimated simple payback period would be 0.46 years. Additional ECMs requiring

implementation costs of \$353,700 with annual savings of \$25,000 were identified but did not meet the minimum payback period criteria.

The detailed energy audits for these two Pennsylvania sites identified cost-effective ECMs for a combined savings of \$247,200, at a cost of \$384,600, representing a payback period of 1.5 years. Although estimated annual savings of \$801,650 and costs of \$3,257,400 have been extrapolated for the remaining Pennsylvania properties, which represents a payback period of 4.1 years, the Company has only performed a limited follow-up to the 1995 study. Specifically PAWC engineers have conducted energy cost saving analyses for its Montrose high service pumps and Brook Street pumps, and have partially completed an analysis for its North Abington and Wilson Street booster pumps.

As the majority of energy (typically 80%-90%) consumed in a water supply system is associated with the pumping of water, potential reductions in peak demand and total energy usage due to an efficient pumping program can result in significant energy savings. A common method of achieving an efficient pumping program is to conduct energy audits at pumping facilities in order to identify energy patterns and to evaluate strategies to reduce energy usage. A detailed energy audit consists of a complete inventory of equipment, an estimate of the distribution of demand and energy in the water system, and the identification of ECMs. The costs for the ECMs should be estimated and compared with the estimated energy savings to develop an implementation strategy. A follow-up program should then be conducted as an essential step of the audit in order to compare actual savings with the estimated savings.

The Company acknowledges that follow-up audits have not been conducted in a timely manner for its remaining facilities. However, as mentioned in the background section, continuous efforts (i.e., installation of demand meter equipment) are being made to monitor and analyze electric usage patterns that will enable the Company to alter operating procedures accordingly to achieve demand and usage rate reductions.

As a result of the detailed energy audits to date, the Company has already implemented some of the identified cost-effective ECMs for Hays Mine and the Milton Water Treatment plants, yielding annual savings of approximately \$122,000 of a possible \$247,000. Subsequent analyses conducted since the original study have identified additional annual savings of approximately \$27,000. Because energy charges (after employee expenses) represent the second highest operation and maintenance cost in the American Water Works System, management should aggressively pursue opportunities to further reduce energy expenses by completing the outstanding ECMs and conducting the detailed energy audits in a timely manner.

Recommendation

1. Conduct a current preliminary energy survey for its 29 demand metered accounts in order to identify potential energy audit candidate sites. Prioritize, schedule, and conduct energy audits for these sites in a timely manner based on the cost-effective energy conservation measures.

V. UNACCOUNTED-FOR-WATER

Background

The Company's unaccounted-for-water (UFW) program, formally developed in 1987, is modeled after the American Water Works Association's (AWWA) water audit loss program. This program is designed to identify, quantify, and verify water and revenue losses as well as prioritize the allocation of funds and manpower on an annual basis. As part of its UFW program, the Company maintains a group of eight employees dedicated full-time to leak detection efforts. These employees, referred to as leak detection specialists, survey approximately three miles of main on a daily basis as well as pinpoint known leaks. Over the past three years (1996-1998), the number of miles of main surveyed has gradually increased from 4,081 miles in 1996 to 4,783 miles in 1998. This 1998 survey level reflects approximately 63% of the total system mileage.

Supporting the Company's UFW program is an active main replacement program. Management personnel in their respective service districts review data continuously regarding the number of main breaks, the type pipe installed, age of the mains, water quality complaints, number of service disruptions, and liability claims in order to identify and prioritize main replacement candidates. Recent main replacement expenditures have ranged from \$14,951,000 in 1996 to \$20,400,000 in 1998 with budgeted expenditures of \$22,500,000 for the year 2000. These main replacement expenditures equate to approximately 36 to 47 miles of main replaced annually from 1996 through 1998, or an approximate 0.6% annual replacement of the miles of main in-service.

Table V-1 indicates that the Company reduced system-wide UFW percentages from a high of 27.1% in 1996 to a low of 20.7% in 1998. Through the twelve-month period ending July 1999, the Company further reduced unaccounted-for-water to 18.6%. Table V-1 shows that the greatest reduction occurred in the Northeast Region, or in the former Pennsylvania Gas and Water Company territory that PAWC acquired in 1996 (see Chapter X). The Company has established a future system-wide UFW goal of 15%, to be achieved by holding management employees accountable in their annual performance appraisals for achieving their respective Operating and District goals.

Table V-1
UFW percentages by Operation Region

Region	1996	1997	1998	1999*	% variance
Pittsburgh	26.5%	24.6%	23.4%	23.5%	-3.0%
West	17.3%	15.7%	12.7%	11.0%	-6.3%
East	13.5%	13.1%	13.6%	9.4%	-4.1%
Northeast	45.3%	36.1%	26.6%	22.5%	-22.8%
Total	27.4%	23.3%	20.7%	18.6%	-8.8%

*Twelve months ended July 31, 1999

Source: data request UFW-2

Findings and Conclusions

Our examination of unaccounted-for-water included a review of the Company's UFW trends, policies and procedures, water audit loss program, main replacement program, annual goals and objectives, etc. We found these areas to be satisfactory except as follows:

1. A system-wide leak survey and repair database has not been developed.

Currently, monthly leak detection summary reports are generated on a operating region basis detailing the number of leaks located and repaired on mains, hydrants, services, valves, and meters. Additionally, daily leak location reports are generated by district which provide more specific data including locations surveyed, municipality/distribution map coordinates, pipe size and type, type of service area, sounding access points, sound recorded, and location of leak detected as well as any associated leak repair data including size of leak (gallons per minute), date repaired, type of leak, and estimated repair cost. Daily leak sounding reports by district also provide data regarding the number of valves, hydrants, curb stops, and street location as well as noise and/or leaks detected. As mentioned previously, the district operating personnel review this data on an annual basis in order to identify and prioritize main replacement candidates. However, the reports being reviewed are generated manually with no systematic means available for compiling and analyzing system-wide leak survey and repair data.

An electronic leak survey and repair database should be developed on a common platform in order to compile and analyze data on a district and system-wide basis. Network terminals residing in the district offices could then be utilized to input weekly data on a real-time basis. The data fields (i.e., number of leaks, number of breaks, water quality complaints, main size, cost of repairs, etc.)

could then be quickly compiled and utilized as input into the recommended main replacement prioritization model (see Finding and Conclusion No. V-2) to effectively identify main replacement candidates.

Company Management believes that maintaining the leak survey and repair data on a decentralized basis only is the appropriate procedure as it allows the local district personnel to identify and prioritize their main replacement candidates. However, the Audit Staff believes that compiling a Company-wide electronic database will provide for more efficient and standardized reporting of data and allow more effective statewide main replacement decision-making to be performed.

2. A formal main replacement prioritization procedure needs to be developed.

Main replacement expenditures have increased from \$14.9 million in 1996 to a projected \$22.5 million by year-end 2000, or at an annual compound growth rate of 10.8%. As shown in Table V-2, this main replacement expenditure trend represents a 30% increase in the number of miles of main replaced from 1996 to 1998.

**Table V-2
Main Replacement Statistics**

	1996	1997	1998	% change
System Miles of Main	7,345	7,465	7,589	3.3%
Annual Miles Retired/Replaced	36	42	47	30.0%
% of System Miles Retired Annually	0.49%	0.56%	0.62%	0.13%

Source: data request UFW-9

Expressed as a percent of miles retired/replaced to total system miles in-service, the Company has increased its replacement efforts from 0.49% to 0.62%. PAWC's retired/replaced percentages compare favorably to a water utility industry 1995 regional average of 0.5%, and are in-line with a water utility industry 1995 national average of 0.6%.

Although local district personnel consider factors such as number of leaks, age of mains, type of main material, water quality complaints, number of service disruptions, liability claims, and the timing of municipality street repaving programs in order to identify main replacement candidates, PAWC lacks a uniform and standardized documented approach to incorporating these factors into the decision-making process. The Company should develop a formal state-wide

main replacement prioritization procedure that incorporates the evaluation of main replacement candidates based on a weighted factor formula. Each factor should be assigned a weighted point value and aggregated in order to identify and effectively prioritize main replacement candidates. The factors to be considered should include, but not be limited to, the following elements: water quality, repair history, number of leaks and breaks, number of customers affected, age of the main, type of main material, customer complaints, etc.

The Company's position is that its existing informal main replacement selection process adequately considers the necessary factors to identify main replacement candidates. Additionally, the Company is concerned that a formula-based approach may continually direct main replacement funds to specific districts, thereby creating a negative perception of the Company in its districts receiving reduced investment.

However, the Audit Staff believes that implementation of a formal state-wide main replacement prioritization procedure would enhance the Company's ability to systematically and effectively identify mains in the most need of repair/replacement. Additionally, the implementation of a more formal state-wide main replacement prioritization procedure may reverse the current negative main break trend as shown in Table V-3.

Table V-3
Main Break Statistics

	1996	1997	1998	July-1999	% Change
No. of Main Breaks	2,450	2,801	3,015	1,954 (3,349)*	37.0%
Miles of System Main	7,345	7,465	7,589	7,589**	3.3%
# Miles per Main Break	2.99	2.66	2.51	2.26	-24.4%

*annualized

**year-ending/mid-year 1999 data was not available

Source: data request UFW-10

The number of miles per main break performance ratio, as indicated in Table V-3, has decreased by 24.4% from 1996 to 1999 (as projected). This ratio compares unfavorably to the latest available (1995) regional average of 3.25 miles per main break as well as to the trend of another major Pennsylvania water utility that achieved improving ratios of 3.11, 3.08, and 4.54 during 1996, 1997, 1998, respectively.

3. The Company has not conducted a cost/benefit study to determine the appropriate mix of contractor and in-house crews to be used to perform annual leak surveys.

The Company currently conducts its annual leak survey program utilizing only in-house personnel. Eight Leak Detection Specialists are dedicated full-time to performing leak surveys covering 32 service districts and 7,589 miles of main system-wide. Each Leak Detection Specialist is assigned a specially equipped van that contains more than \$65,000 of equipment such as correlators, sonic equipment, and aqua log sensors (which are unmanned nighttime sensors deployed on valve boxes in the middle of the night in order to gather data in normally high traffic areas). Over the past three years (1996-1998), the number of miles of main surveyed has gradually increased resulting in approximately 63% of the total system being surveyed annually. Annual company-wide leak detection operating activity goals include sounding 100 percent of all hydrants, 20 percent of system valves, and 33 percent of all service line control valves. Additionally, meter readers and servicemen as part of normal operating duties supplement the leak detection specialists in their leak surveying work.

While current leak detection activities have resulted in lower UFW levels, management has not conducted a cost/benefit study to support its current operating practices. A study should be conducted periodically to compare the costs and benefits of using contractors versus Company personnel to perform this work throughout the year. The study should also examine the potential benefits of using contractors seasonally to supplement or reduce the existing internal staffing. Factors to consider in the cost/benefit study would include, but not be limited to, the following factors: labor costs, equipment and associated maintenance/repair costs, vehicle and associated maintenance/repair costs, supervision costs, training costs, overhead costs, insurance and liability costs, and fuel costs necessary to conduct annual leak surveys.

PAWC expressed a belief that the use of contractors to perform leak surveys would be more costly than the current use of Company personnel. However, as contractors have not been used by PAWC for many years, the Company was unable to provide any support for its contention. By performing periodic studies regarding the appropriate extent of the annual leak surveying and the costs and benefits of using contractors rather than Company personnel to perform all or portions of this work, management would ensure that it is operating in the most cost-effective and efficient manner.

Recommendations

1. Develop an automated company-wide leak survey and repair database to be utilized with the recommended main replacement prioritization procedure.
2. Develop a formalized main replacement procedure based on weighted factors in order to systematically prioritize main replacement candidates on a state-wide basis.
3. Conduct a cost/benefit study on a periodic basis to determine the appropriate mix of contractors and in-house personnel to perform annual leak survey work.

VI. DROUGHT CONTINGENCY PLANNING

Background

On July 20, 1999, the Governor of Pennsylvania declared a drought emergency in 55 Pennsylvania counties. This declaration imposed certain non-essential water use restrictions on the residents and businesses in the drought affected areas. The proclamation of a drought emergency implements the state's drought emergency plan whereby each water supplier in a drought emergency county must review their existing drought contingency plans (DCPs), develop plans if none exist, and submit the plans to the Department of Environmental Protection. The DCPs should also contain the adoption of local water rationing plans where considered necessary to meet local conditions.

DCPs had been previously developed for each of the Company's 32 operating districts; however, pursuant to the Governor's Drought Emergency Proclamation the Company forwarded updated DCPs to the Department of Environmental Protection in August 1999 for review and approval. Each plan includes elements relating to drought vulnerability assessments at each of the district systems, defined drought trigger points for each of the district sources of supply, defined drought stages based on river flow rates, pumping rates, pumping levels, precipitation levels, etc. Drought scenario planning is also conducted as part of the Company's comprehensive planning studies, which include assessing system performance for one-in 50 year drought conditions.

The Company's water supply is provided principally from surface supplies such as rivers, streams, and reservoirs, which account for approximately 96% of its statewide source of supply. This supply mix enabled the Company to maintain adequate supply levels even during the summer of 1999 drought declaration. Source of supply development planning is an on-going activity at PAWC with any projected capacity deficits integrated into its comprehensive planning studies in order to ensure reliability.

Finding and Conclusion

Our examination of the drought contingency planning function included a review of the Company's most recently filed drought contingency plans, comprehensive planning studies, water rationing plans, water purchase agreements, consumer education and awareness programs, etc. We found these areas to be satisfactory except as follows:

1. Internal management planning documents have not been developed to support the Company's staged supply extension and demand reduction measures outlined in its Drought Contingency Plans.

A review of the Company's August 1999 Drought Contingency Plans (DCPs) revealed operational measures to be taken by the Company during each drought stage. These operational measures consist of supply extension and demand reduction measures, which are both designed to extend existing water supplies, develop additional supplies, and reduce demands. Supply extension measures include the purchase of water from adjacent water suppliers via interconnection; increasing the efficiency of the existing distribution system through accelerated leakage and loss reduction programs; the development and utilization of emergency sources of supply including commercial and industrial customers utilizing their own emergency sources of supply; and approved reduction of conservation releases. Demand reduction measures include a call for voluntary conservation; installation of household water conservation devices; accelerated public education programs; water reuse and greywater recycling; mandatory nonessential water use bans; water rationing; the possible shedding of customers; and prioritizing competing uses.

Although the supply extension and demand reduction measures include the elements discussed above, some of the measures are stated in a generic manner with no corresponding detail on the how to implement the measures. For example, one particular supply extension measure simply states "intensification of leak detection efforts during each progressive drought stage". No documentation is available within the DCP or internally within the Company to support the incremental actions to be taken to meet this objective. Similar circumstances apply to additional supply extension measures including operational curtailment (i.e., hydrant flushing, blow-offs, etc.) and system surveillance of unauthorized usage with no specificity regarding the defined tasks required to effectively accomplish these objectives. Demand reduction measures that are not sufficiently addressed on a consistent basis include the identification of customers to be shed and the prioritization of competing uses within the districts.

Planning documents are management tools that should be developed in order to organize, direct, and control activities to accomplish specific objectives in an efficient and effective manner. Although the vast majority of the Company's raw water supply is derived from surface supplies with adequate capacity reported even during the 1999 drought declaration, the Company should assess those operating districts historically susceptible to drought conditions. Subsequent to this risk assessment, management action plans should be developed for each of those districts. The action plans should provide supporting detail to accomplish specific supply extension and demand reduction measures indigenous to each of

the high risk operating districts to ensure that the resources are available to achieve the desired results.

The Company delegated responsibility to develop and execute the subject DCPs to each Operating District Manager utilizing the PA Department of Environmental Protection's model plan as a guideline. This practice resulted in the preparation of numerous plans with varying levels of detail, many of which only meet the minimum language requirements of the DEP model plan. Prudent management practices would dictate that the plans include detailed provisions for executing critical elements of the plans in order to maximize the effectiveness of the their implementation.

Recommendation

1. Develop internal management action plans to support the staged supply extension and demand reductions measures for those districts evaluated for drought vulnerability on a risk assessment basis.

VII. CUSTOMER CALL CENTER CONSOLIDATION

Background

PAWC's September 1, 1999 organization chart (see Exhibit VII-1) for Customer Service included a total of 113 full-time support personnel assigned to one of three regional call centers (West, East, and Northeast), plus a Director and one administrative support Secretary. The Director of the Customer Relations (whose office was relocated to Hershey, PA in September 1999) reports to the Vice President and Treasurer. The Director has three Superintendents reporting to him. Reporting to the Superintendents are the field support personnel, who perform customer billing, compliance, inquiry, and collection activities.

The support personnel in the call centers generally work staggered shifts from 8:00 a.m. to 6:30 p.m. In the Northeast Region only, emergency phone calls received from 6:30 p.m. through 12:00 p.m. are handled by a Company employee, but emergency calls from midnight to 8:00 a.m. are received by a contract answering service. For all other locations and/or regions, after-hours emergency phone calls (after 6:30 p.m.) are handled solely by outside contractor answering services.

At the time of the last PAWC management audit, which was completed for the Commission by Davies Associates, Inc. in 1992, the Company had seven customer service call centers. Davies recommended that the Company consolidate all of its customer service functions at the Hershey, PA headquarters. The current three call center structure has resulted from PAWC's acquisition of numerous Pennsylvania water companies over the intervening years. PAWC has incorporated their operations while at the same time slowly centralizing the customer service activities.

In anticipation of the expiration of the lease on its existing facilities in November 2000, PAWC acquired an office building on June 30, 1999, in Wilkes-Barre for \$900,000. The Company had anticipated renovating it for use as office space for its Northeast operations and existing call center. However, the Company has since abandoned these plans and decided to sell the building.

Findings and Conclusions

Our examination of Customer Call Center Consolidation included a review of the roles and responsibilities of employees; customer service call center policies, practices, and procedures; management initiatives; customer service

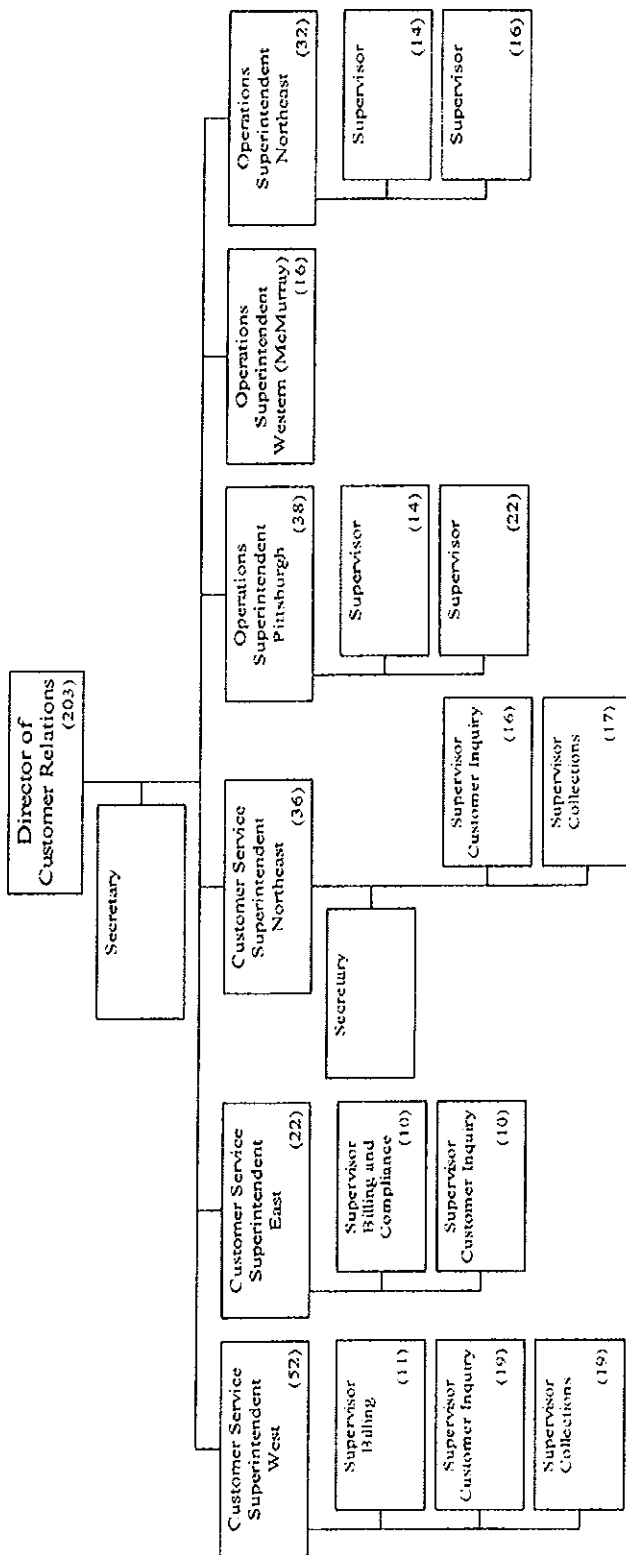
Exhibit VII-1

PENNSYLVANIA AMERICAN WATER COMPANY

CUSTOMER SERVICE

ORGANIZATION CHART

As of September 1, 1999



Source: Company Organization Charts

productivity measures; etc. We found these areas to be satisfactory except as following:

1. While the Company continues to take steps towards the consolidation of its call centers, management currently has no documented plan or cost/benefit analysis to support a particular consolidation strategy.

PAWC has continued to move forward with its efforts to consolidate the three remaining customer service call centers. Specifically, PAWC's senior management has visited other utility companies' call centers and attended seminars/conferences to better understand the efforts necessary to centralize to a single large call center. Management indicated that the knowledge gained from the experiences of others and a broad understanding of the capabilities of today's computerized technology will be of great value to the Company's consolidation efforts.

Although PAWC itself has no documented plans or analyses for consolidating the call centers, the Company informed the Audit Staff that a study was being prepared by American Water Works Company to evaluate the costs/benefits of a single, or several regional, call center(s) for the entire American Water System. Study results are anticipated in the third or fourth quarter of 2000.

Management is pursuing the consolidation of its call centers more vigorously than in the past due to a desire to stay competitive with other utilities and recognizing the economy and efficiency advantages which result. The Company indicated that it must maintain a strong customer service presence with its water and wastewater customers, and the best way to do so is to centralize its dispatching and call center operations. Management recognizes that all stakeholders will benefit from PAWC's efforts to develop a premier, cost-effective, highly productive customer service call center or centers that take advantage of a centralized workforce.

Consolidation of the call centers should enable PAWC to take advantage of at least five key technologies and/or capabilities:

- An Automatic Call Distribution (ACD) system with advanced capabilities, including skill-based routing which routes calls to the appropriate service representative based on the customer's response to recorded prompts.
- An automated forecasting/scheduling tool, to provide both real-time and historical data pertaining to worker productivity.

- Computer Telephony Integration (CTI), the marrying of the phone switch with the computer system, to enable a number of sophisticated applications such as intelligent routing and data mining.
- A quality monitoring device to record calls for performance review, and, in more advanced applications, measure callers' success at navigating their way through the Interactive Voice Response (IVR) menu selections, and
- Internet access through a web site that offers customers the option of taking care of utility business without making a phone call to the call center; i.e., reducing call center volumes through electronic (e)-commerce.

It appears that the overall result of consolidation to one call center, or several regional centers, would be more effective operations with efficiency gains and attendant cost savings.

Recommendations

1. Continue efforts to consolidate the existing customer service call centers. Management should complete and document detailed plans and cost/benefit analyses in support of the consolidation strategy chosen. Also, PAWC should formally track actual implementation costs and realized benefits from the consolidation, and retain these results for regulatory review.

VIII. METER READING

Background

PAWC has water customers in 31 Pennsylvania counties which are grouped into four regional service areas. The four service areas are Western, Pittsburgh, Eastern, and Northeast. There are 35 districts within these service areas which have field support personnel classified as Meter Readers, who perform meter reading functions on a full-time basis, and Utility Persons, who perform meter reading on a part-time basis and meter service and distribution duties the remainder of the time.

The full-time Meter Readers and other field personnel from the Pittsburgh and Northeast regional service areas, as well as a portion of the Western regional service area (McMurray only), are assigned to the Customer Service Department. These field personnel are from the more densely populated districts of PAWC's service territory. The Utility Persons are assigned to the Operations Department, and perform meter reading duties on a part-time basis in the Eastern regional service area and the remaining districts within the Western regional service area. These service areas contain PAWC's less densely populated or rural districts. Because such a large portion of PAWC's service territory encompasses rural communities throughout Pennsylvania, the Utility Persons report directly to an Operations Department Supervisor. This allows for more direct control and supervision of the employee's daily work and better use of the Operations Department workforce.

PAWC's number of full-time meter readers (see Table VIII-1) has been declining Company-wide as follows:

Pennsylvania American Water Company
Number of Full-Time Meter Readers
Table VIII-1

	1995	1996	1997	1998	1999 (through September)	% Decrease
PAWC	60	60	60	58	57	5.0%
PG&W acquisition	--	*18	17	16	15	*16.6%
Other acquisitions	--	--	--	--	--	--
Total PAWC	60	78	77	74	72	7.7%

* Because PG&W was purchased by PAWC in February 1996, the percent decrease reflects only a change from February 1996 through September 1999.

Note: Data does not include part-time readers and field support personnel performing activities such as meter repairs, replacements, and service orders.

Source: Company Data (DR MR-8).

As calculated in Chapter X, Table X-1, page 1 of 2, the Company's total average cost per employee is approximately \$57,000. Therefore, as a result of a reduction of six meter readers from 1996 through September 1999, PAWC realized annual cost savings of about \$342,000.

The decrease in meter reading personnel is attributable to increased productivity. PAWC has improved meter reading productivity by reducing the number of meter reading routes and the associated man-hours devoted to reading those routes. Since 1990, PAWC has installed remote mechanical encoder meters making meter readers more efficient and able to average a higher number of daily reads. In 1993, the Company began installing these in meter pits. This program was expanded into the Northeast service areas since PAWC's acquisition of PG&W in February of 1996 (see Chapter X). PAWC has also rerouted meter routes. For example, the Company eliminated almost 50% of the commercial routes in its Pittsburgh District by using pit and wall pads (which makes the reads readily accessible) and rerouting these accounts into the regular residential reading routes. As a result, the Pittsburgh District was able eliminate the need to have a second Meter Reader read within the same route. These efforts have helped the Company reduce the number of full-time man-hours devoted to reading meters shown below:

Pennsylvania American Water Company
Number of Full-Time Man-Hours Devoted to Reading Meters
Table VIII-2

	1997	1998	1999 (through September)
Total PAWC	184,586	165,566	117,245

Note: Data for 1995 was not available. Data for 1996 was only partially available because PG&W was purchased by PAWC in February 1996 resulting in two independent payroll systems in use at that time.

Source: Company Data (DR MR-9).

While this downward trend is not totally conclusive, the information available through September 1999 does indicate that man-hours for 1999 should be equal to, and probably less than those in 1998.

Rerouting in the Pittsburgh and McMurray service areas is continuing but on a much smaller scale, since routes in these areas have been reviewed many times in the past several years. Rerouting in the East and Northeast is ongoing, with significant progress made, especially in the old PG&W service territory. To assist management in these efforts, the Company uses ORCOM and EDIS software system packages to make the appropriate single account/premise modifications. As a result of PAWC's rerouting efforts, the Company has reduced the number of meter reading routes (see Table VIII-3) on a system-wide basis as follows:

Pennsylvania American Water Company
Number of Meter Reading Routes
Table VIII-3

	1995	1996	1997	1998	1999 (through September)	% Decrease
PAWC	1,359	1,222	1,152	1,140	1,139	16.2%
PG&W acquisition	--	*536	503	423	363	*32.3%
Other acquisitions	13	52	56	46	47	n/a
Total PAWC	1,372	1,810	1,711	1,609	1,549	n/a

* Because PG&W was purchased by PAWC in February 1996 the percent decrease reflects only a change from February 1996 through September 1999. Not applicable – n/a.

Source: Company Data (DR MR-8).

The above table shows that the largest recent impact has occurred in the service territories recently acquired by PAWC, especially in the areas added as a result of PAWC's purchase of PG&W in February 1996.

Findings and Conclusions

Our examination of Meter Reading was focused primarily on operations in the more densely populated districts and included a review of the roles and responsibilities of employees; meter reading policies, practices, and procedures; automatic meter reading (AMR) initiatives; etc. We found these areas to be satisfactory except as follows:

1. Further enhancements to meter reading productivity are still possible given the innovative automatic meter read (AMR) technologies available from outside vendors.

Since our management efficiency review in 1995, the Company has continued its AMR pilot programs by testing and employing new equipment and tools, evaluating emerging technology systems, and reviewing other practices currently used by the Company and other utilities to enhance the efficiency and effectiveness of the meter reading function. The results of these latest efforts and can be summarized as follows:

- The hand-held readers tested were too bulky for meter readers to hold with one hand; they processed data very slowly with the data itself frequently having to be entered manually because the probes did not properly connect to the outside receptacle; or the hand-held reader's software was not compatible with PAWC's customer service data base. As a result, PAWC is considering partial conversion to some form of wireless technology currently available on the market. Additionally AWWSC and PAWC are evaluating a written proposal to contract with a western Pennsylvania electric company and a meter network technology company to jointly read water and electric meters in the Pittsburgh area.
- The automatic telephone meter reading system was not year-2000 compatible (Y2K), and the manufacturer is no longer in business to upgrade the software. As a result, PAWC had to convert this pilot meter program to another, more user-friendly, system to achieve Y2K compliance.

- PAWC has achieved one of the lowest percentages of estimated bills of any AWWC operating subsidiary in the country, with such bills averaging only 1.3% of the monthly total water bills issued.

PAWC's management has been reluctant to adopt a system-wide AMR system until its state-of-the-art customer service software system is fully installed and tested. While the software was installed (October 1998) and functionally tested (through April 1999), some system software problems still exist, hindering efforts to make a decision on a fixed-network AMR system. Major AMR vendors continue to show a strong interest in meeting the PAWC's objectives by recalibrating their own equipment and software to become compatible with ORCOM. In fact, the new customer service software now operational at PAWC has become the standard, preferred software of choice for AWWSC and by other AWWC affiliated water and wastewater subsidiary companies.

In August, 1998, AWWSC established a five-member Ad-hoc Committee (PAWC's membership included the Director of Customer Service Department and a Operation's Superintendent from the Pittsburgh service area) to evaluate and report on the following:

- deployment of AMR technologies,
- expanding/improving customer service through AMR,
- development of financial models to allocate cost recovery if the cost of the system is borne entirely or partially by the local water company,
- identifying purchasing/contracting options which may facilitate installation of the equipment, and
- marketing options to other entities with the same service area; e.g., electric/gas utilities and home/office/business security systems.

The Ad-hoc Committee's Report, entitled *Advanced Meter Reading Report*, had been scheduled for submission to AWWSC's corporate executives by September 30, 1999; however, the Committee Chairman experienced delays in finalizing the report. The Committee was able to provide the Audit Staff with a confidential advance draft copy of this report in October 1999. The draft *Advanced Meter Reading Report* is an attempt at setting out a cost/benefit method and criteria for AWWC's water subsidiaries to evaluate the deployment of fixed-network AMR systems. The proposed cost/benefit evaluation process would provide PAWC and other AWWC subsidiaries with a means to systematically determine which routes can be cost effectively converted to an AMR system. In

addition, it would assist management to more accurately estimate the AMR installation and operating costs, and the anticipated short and long-term benefits.

The draft report indicates that appropriate AMR implementation could result in a significant reduction in the number of meter reading man-hours per year and ultimately, a reduction in the total number of Meter Readers. However, the report does not address labor, overhead, and fixed-system installation costs or implementation benefits. Nonetheless, the Audit Staff concurs with PAWC's stated intent to use the *Advanced Meter Reading Report* as the standard method for evaluating and comparing costs and benefits for deployment of the new technology within specific service area districts.

Recommendation

1. Perform, and document, a cost/benefit analysis for full and/or partial deployment of an automatic fixed-network meter reading (AMR) system; include an analysis of operating and capital expenses which reflect productivity improvements and staffing reductions that could be realized.

IX. COST ALLOCATIONS

Background

This chapter presents the results of the Audit Staff's review of the nature and extent of transactions between PAWC and its affiliates. As summarized in Chapter II – Background and shown on Exhibit II-2, PAWC is a subsidiary of American Water Works Company, Inc. (AWWC) and is an affiliate of American Water Works Service Company (AWWSC) which provides certain services to PAWC and 28 other AWWC subsidiaries. As AWWC's principal business is the ownership of the common stock of its subsidiary companies, its operating costs are fully absorbed directly by its shareholders with no charges billed to PAWC or any other subsidiary. However, American Water Works Service Company (AWWSC), AWWC's service subsidiary, does charge its operating companies, including PAWC, for the cost of the services it provides.

AWWSC's costs are assigned or allocated in accordance with the terms of uniform contracts the service subsidiary has with AWWC operating companies, including PAWC. The contracts provide that costs are to be directly assigned to specific operating companies to the extent possible, and costs not capable of direct assignment are to be allocated by applying a formula based on the relative number of water and/or wastewater customers served at the end of the previous fiscal year. The dollar amounts are electronically tracked using specific reference, account, and department numbers and accounting expense codes.

PAWC's current affiliated interest agreement, which defines the customer-based allocation process was filed with the Commission under the affiliated interest provisions of the Public Utility Code, and was approved by the Commission pursuant to an Order dated January 12, 1989, at Docket No. G-880131. The expenses resulting from this allocation formula are claimed by PAWC for general ratemaking purposes with the Commission.

The services provided by AWWSC to PAWC include: accounting, administrative, communication, corporate secretarial, engineering, financial, human resources, information systems, operations, rates and revenue, risk management, and water quality. These services are provided at actual cost and affords the affiliated companies professional and technical talent that may not otherwise be available from outside vendors more economically or on a timely basis. From 1995 through 1998, the total AWWSC expenses billed to Affiliates (including PAWC) grew by an annual compound rate of 0.9%. During this period of customer growth for PAWC, its share of AWWSC charges increased at an annual compound growth rate of 1.7%, and its percentage of AWWSC expenses at

a rate of 0.8%. AWWSC's expenses and PAWC's share of those expenses from 1995 through September 1999 are further summarized on Exhibit IX-1.

One of AWWSC's data centers leases a portion of the first floor of PAWC's Hershey headquarters building. This data center provides customer billing and envelope stuffing for PAWC and four other AWWC water utility subsidiaries. PAWC charges AWWSC for the related leasing of office space and computer equipment (see bottom of Exhibit IX-1).

AWWSC's Internal Audit (IA) Department has a staff of seven auditors who perform financial reviews of AWWSC and AWWC's water and wastewater operating subsidiaries. IA performs a review of the AWWSC's cost allocation and direct billing charges on a three-year cycle. The last audit report was issued February 18, 1998.

To supplement IA's three-year audit cycle, the PAWC Vice President and Comptroller personally reviews each month's AWWSC invoice billed to PAWC. According to the Vice President and Comptroller, any anomalies are brought to AWWSC's attention and corrected the next month. The Vice President indicated that the anomalies, if any, are usually minor (less than \$500).

Findings and Conclusions

Our examination of Cost Allocations was focused primarily on a review of cost allocation methodology; adherence to cost allocation policies, practices, and procedures; and intercompany billings. To better understand the billing process, the PUC Audit Staff performed a limited review of AWWSC's July 1999 invoice that was submitted to PAWC. This invoice, which summarized the month's \$488,996 of direct and allocated charges to PAWC, consisted of a detailed two-page computer generated document and was supported by 24 pages of cost details. To test that the charges were correct, the Audit Staff sampled vouchers and the allocation formulas, and traced the information back to the original source documentation. The Audit Staff found no discrepancies in the dollar charges or the formulas used to allocate the overhead costs. While our review was much more limited than the audit steps included in IA's audit program (see Finding and Conclusion No. IX-1), the Audit Staff found the allocation process was reasonable and that the resulting transactions reasonably reflected costs to PAWC. Overall we believe that PAWC's customer-based allocation system is reasonable given the volume of applicable transactions and the various allocation combinations.

Exhibit IX-1

Pennsylvania American Water Company
Statement of Expenses and Billed Charges To and From PAWC
For The Years Ended December 31, 1995 – 1998
And For 9-Months Ending September 30, 1999

<u>Description</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>Compound Growth 1995-1998</u>	<u>9-Months Ending Sept. 30, 1999</u>
Total AWWSC Expenses						
Corporate	\$ 10,352,793	\$10,065,316	\$18,858,357	\$21,029,834	26.6%	\$13,413,489
Executive Office	2,466,567	2,053,624	172,550	-	-100.0%	-
Regional Office	4,394,332	4,351,063	340,947	-	-100.0%	3,582,348
New Jersey	933,386	-	-	-	-100.0%	-
Indiana	842,884	-	-	-	-100.0%	-
Illinois	810,056	-	-	-	-100.0%	-
West Virginia	845,682	-	-	-	-100.0%	-
Pennsylvania	970,898	*	-	-	-100.0%	-
New England	1,078,221	1,015,251	916,698	717,133	-12.7%	587,440
California (Western)	3,567,495	3,724,140	4,284,006	4,581,748	8.7%	3,404,256
Laboratory (Belleville)	2,928,122	3,617,358	3,965,792	4,285,049	13.5%	3,621,143
Richmond Data Center	1,645,526	1,792,185	1,896,210	1,976,589	6.3%	1,260,493
Hershey Data Center	<u>2,350,317</u>	<u>1,819,844</u>	<u>1,567,642</u>	<u>1,519,908</u>	-13.5%	<u>1,005,519</u>
Total AWWSC Expenses Billed to All Affiliates, Including PAWC	<u>\$33,186,279</u>	<u>\$28,438,781</u>	<u>\$32,002,202</u>	<u>\$34,110,261</u>	0.9%	<u>\$26,874,688</u>
PAWC's Share of AWWSC Expenses						
PAWC's Share of Capital Construction	\$1,391,517	\$1,148,574	\$1,351,294	\$1,391,332	0.0%	\$916,637
PAWC's Share of Operation/ Maintenance Expenses	<u>4,704,238</u>	<u>4,215,771</u>	<u>4,841,192</u>	<u>5,023,148</u>	2.2%	<u>3,649,499</u>
Total PAWC's Share of AWWSC Expenses	<u>\$6,095,755</u>	<u>\$5,364,345</u>	<u>\$6,192,486</u>	<u>\$6,414,480</u>	1.7%	<u>\$4,566,136</u>
Total PAWC's % of AWWSC Expenses	18.37%	18.86%	19.35%	18.81%	0.8%	16.99%
PAWC Charges to AWWSC						
Total PAWC Expenses Billed to AWWSC for Office Space and Computer Equipment	<u>\$411,065</u>	<u>\$314,925</u>	<u>\$300,171</u>	<u>\$ 336,473</u>	-6.5%	<u>\$ 200,869</u>

* Key PA Executives were switched on 12/31/95 from AWWSC employee status to PAWC employee status.

Source: Company Supplied Financial and Operating Data (DR CA-4 and CA-8).

We also reviewed the roles and responsibilities of employees (including those of the Internal Audit Department) and the independent auditors with regard to cost allocations. We found these areas to be satisfactory except as follows:

1. Although the Internal Audit Department performs a periodic review of cost allocations and direct billing charges to/from AWWSC and PAWC, the audit report is not made readily available to PAWC and the other AWWC operating companies.

AWWSC's Internal Audit (IA) Department routinely performs financial audits on a three-year cycle. The basic components of IA's audit program to review cost allocation and billing issues include the following:

- Review the total billed charges for a test month and trace the billed charges to AWWSC's general ledger, the computer-generated billing and supporting cost details, and the operating companies' bills.
- Recalculate the basic overhead for the general, office, and equipment cost ratios; foot the payroll to the support totals; and then recalculate the ratios and trace them to the employee distribution report.
- Verify the formula percentages based upon the formula service allocation sheets.
- Test the operating companies and individual employee charges, and foot with monthly payroll amounts; then recalculate the totals and verify all hours and office expenses reported.
- Utilizing the same sample of tested individual employee charges and companies, verify the accuracy of expense statements, that the distributions to the companies were done correctly, and that the work orders were correctly stated.
- Foot the voucher/journal reports and compare with the detailed invoices for the month(s) sampled; and then test the voucher package, the amount distributed, the voucher register, and the journal entries from the register.

While the audit scope, work steps, and audit frequency appear reasonable, the current process for reporting and distributing the results could be improved. The latest audit report dated February 18, 1998 is brief (less than one page) and

not useful to operating company management as a business tool to assist in making operational decisions. Specifically, the audit report does not include a descriptive list of the transactions tested and reviewed, the accuracy of the recorded transactions, and whether they are consistent with management's authorization. The report simply lacks the detail necessary to adequately inform management of the audit scope and results. Moreover, while the 1998 audit report was submitted to senior executives of AWWSC, members of the management team at PAWC did not have a copy of it or even remember when the last audit was performed.

As AWWC and PAWC continue to acquire more water and wastewater companies, the IA audit program designed to review cost allocation and direct charge billings to/from AWWSC becomes more important to verify the accuracy and timing of changes to the allocation rates. As new customers are added to the AWWC system, the AWWSC costs are spread out over a larger customer base, thereby affecting the cost allocation formula percentages of all operating companies. PAWC's allocated costs are directly linked to the total number of AWWC customers.

For example, on July 1, 1999, PAWC's non-wastewater allocation percentage charge from AWWSC was reduced from 27.69% to 21.97% as a result of AWWC's merger with National Enterprises, Inc. (NEI). The merger added another 505,512 water customers to AWWC's existing customer base of 1,941,860. However, with PAWC's total customer base remaining relatively stable (537,662 non-wastewater customers), its share of the AWWSC cost allocation was reduced.

In addition to the recent purchase of NEI, AWWC has announced pending mergers with Citizens Utilities Company and SJW Corporation. The acquisition of Citizens would add 305,000 customers to the national customer base and 38,000 customers to PAWC's base, while the SJW acquisition and its subsidiary, San Jose Water Company of California, would add another 216,000 customers to the national customer base. Given these mergers the Audit Staff estimates that the impact to PAWC will be an additional allocation ratio decrease from 21.97% to approximately 19.39%.

Recommendations

1. Develop a more detailed internal audit report that clearly defines the audit scope and results, as well as any corrective actions recommended, for the periodic cost allocation and direct billing charge review. A copy of the audit

report should be routinely provided to PAWC and the other AWWC operating companies.

X. PG&W ACQUISITION

Background

PAWC purchased Pennsylvania Gas and Water Company's (PG&W) water operation on February 16, 1996, for \$409.4 million. This Northeast Pennsylvania acquisition increased PAWC's operating revenues by approximately 4.1% (\$7.4 million) and added approximately 4.6% (1.8 billion gallons) of water sales volume in 1996 as compared to 1995. PAWC accounted for the PG&W acquisition as a purchase, with the purchase paid by \$262.5 million in cash and the assumption of \$146.9 million in liabilities. The cash was obtained through issuance of short-term debt that was subsequently repaid with a portion of the proceeds from PAWC's offering of \$150.0 million of 30-year, 7.8% General Mortgage Bonds issued in 1996 and an equity infusion from American Water Works Company in that same year.

The water operations acquired from PG&W included 133,489 customers, 294 employees, 10 treatment plants, and 36 reservoirs. The tariff rates in the acquired territory were generally higher than PAWC's statewide tariff. The PAWC's most recent rate case submitted April 30, 1999, at R-00994638, proposed leveling the rates by converting its Northeast Pennsylvania customers from a multi-tiered tariff to a single tariff. PAWC has essentially operated the PG&W service area with former PG&W employees, except for two PAWC management employees who were transferred to the Northeast Region. While some general administrative and support functions were centralized in Hershey with PAWC's existing operations (i.e., general accounting, customer billing, financing, computer support, human resources, engineering, legal, etc.), other more basic field operation functions (i.e., meter reading, line maintenance and construction, customer inquiries and service calls, purchasing, etc.) remained in the Northeast Region. Overall, the Audit Staff found that this assimilation has gone smoothly.

Since the acquisition, the unaccounted-for-water percentages in the former PG&W service territory have decreased from 45.3% in 1996 to 22.5% for the first 6 months of 1999 (see Chapter V and Table V-1). This has, in part, resulted from PAWC honoring PG&W's requirement to annually invest \$4.9 million into distribution system improvements that resulted from a Commission order of August 1993, at Docket No. R-00922482. PAWC has proposed the elimination of this specific investment requirement in its most recent rate case filing, at R-00994638. The Company has established a \$16.6 million capital project to replace the Hillside Water Treatment Facility by the end of 1999, and also has established a five-year, \$14.02 million remote metering replacement program (see Chapter VIII) with completion scheduled by the end of the year 2000.

The addition of 133,489 customers from the acquisition has reduced the average cost per PAWC customer both for the allocation of costs from AWWSC the corporate service organization (see Chapter IX), and for PAWC executive management and other overhead activities. The acquisition has increased PAWC's customer base to over 525,000 active accounts.

Findings and Conclusions

Our examination of the PG&W Acquisition (water operations) was limited to a review of the operational impacts and the net savings and/or benefits achieved. This included the areas of: staffing levels, operations and maintenance payroll expenses, rate case expenses, financing costs, inventory management, fleet operations, unaccounted-for-water, and meter reading. Generally, we found that the acquisition has lowered PAWC's overall cost per customer and has had no negative impact on PAWC's original operations or those in the former PG&W service territory. In fact, the Audit Staff was able to identify improvements which have reduced the annual costs of the combined water operations by approximately \$7.6 million and inventory costs by \$253,805. The more significant savings are summarized in Exhibit X-1.

Exhibit X-1

Page 1 of 2

**Pennsylvania American Water Company
Impact of the PG&W Acquisition on Operations and
Maintenance Expenses for the Combined Companies**

<u>Function</u>	<u>Activity</u>	<u>Dollar Savings</u>
Staffing Levels	About one and one-half months before closing at December 31, 1995, PAWC had 827 employees and PG&W had 420 employees allocated to its water operations, or a total of 1,247 employees serving about 530,000 customers. PAWC's pro forma expense claim for the 1997 rate case (R-00973944) was based upon a workforce of 1,118, reflecting a reduction in the combined workforces of 129 employees, or 10.3%.	See O&M Payroll Expenses Below
O & M Payroll Expenses	PAWC's total payroll claim (capitalized and expensed) in the 1997 rate case was \$48,639,557. The average annual salary per employee was \$43,506, plus another 31% for benefit costs per employee (group insurance, 401(k), post-retirement benefits, payroll taxes, etc.), for a total average cost per employee of about \$57,000. Eliminating the need for 129 employees, as discussed in Staffing Levels above, has produced annual cost savings of approximately \$7.35 million which has been passed on to the ratepayers. Since about 13% of total payroll costs are capitalized, the immediate impact of this workforce reduction on annual operating and maintenance expenses is about \$6.39 million.	\$6,390,000 annual
Rate Case Expenses	PG&W maintained two primary rate tariffs and spent about \$1 million to process rate cases for the two. PG&W's financial plans indicated a need to process one rate case each year, alternating for each rate zone. Therefore, annual rate case expense savings were approximately \$500,000.	\$500,000 annual
Financing Costs	During the 1990s, PG&W issued \$129 million of first mortgage bonds and realized net proceeds of approximately \$123.4 million; financing costs consumed nearly \$5.6 million, or 4.3% of the nominal amount issued. PAWC issued \$412.9 million of long-term debt during that same period, and its financing costs were approximately \$4.47 million, or 1.1% of the gross issues. Assuming a \$10 million annual debt issuance, a 2.5% issuance cost decrease would result in an annual savings of \$250,000.	\$250,000 annual

Source: Company Data (DR AQ-1 and AQ-4).

Exhibit X-1

Page 2 of 2

Pennsylvania American Water Company
Impact of the PG&W Acquisition on Operations and
Maintenance Expenses for the Combined Companies

<u>Function</u>	<u>Activity</u>	<u>Dollar Savings</u>
Inventory Management	PAWC reduced PG&W's inventory level from \$1,038,115 (as of 2/96) to an average of \$783,310 (10/99) or by \$253,805. At a 10.62% cost to carry the inventory, annual savings would be \$26,954. PAWC indicated that additional improvements are still a possibility.	\$26,954 annual \$253,805 one-time
Fleet Operations	PAWC purchased 153 vehicles from PG&W on February 16, 1996, but eliminated 20 of them on June 28, 1996. Because PAWC is now leasing only 133 vehicles in PG&W's service territory, the annual lease savings is approximately \$151,388, plus an additional \$34,922 in annual variable operating savings. However, since 13% is capitalized (see O&M function), annual O&M savings equate to \$162,090 (\$186,310 x 87%).	\$162,090 annual
Unaccounted-For-Water (Chapter V)	PAWC's leak detection efforts within the former PG&W service territory resulted in a reduction in unaccounted-for-water from 45% in February 1996 to 22% by July 1999. Because of aggressive leak detection efforts and the ability to take advantage of bulk chemical purchasing/delivery, the Company, through 1998, was able to annually reduce its chemical costs by \$120,000 and carrying costs by \$12,744, for a total of \$132,744 in savings.	\$132,744 annual
Meter Reading (Chapter VIII)	Additional man-hours and expenses were initially needed to set up PG&W's meter rerouting schedules. However, since then, the rerouting efforts have decreased the number of routes from 536 (1996) to 363 (September 1999), and the number of meter readers has decreased from 18 to 15. Using the fully loaded rate of \$57,000 per reader (see O&M function), the annual savings are \$171,000.	\$171,000 annual
TOTAL SAVINGS	ANNUAL	\$7,632,788
	ONE-TIME	\$253,805

Source: Company Data (DR AQ-1 and AQ-4).

XI. DIVERSITY

Background

PAWC's President serves as the Equal Employment Opportunity (EEO) Officer while the Vice-President of Human Resources serves as the Company's EEO Coordinator and oversees the day to day implementation and monitoring of the Affirmative Action Plan (AAP). PAWC has been complying with the Commission's Diversity filing requirements last issued on May 23, 1994, at M-00940558 and updated in March 1997. The Company is submitting annual employee utilization statistics, annual AAPs, and annual procurement data related to use of Minority, Women and Persons with Disability Business Enterprise (MWDBE) vendors. The Company's AAP is updated annually to reflect changing diversity goals and objectives.

The latest Office of Federal Contract Compliance Program (OFCCP) audit report on PAWC's EEO program activities was issued on July 24, 1997. This audit, which focused on the Company's Pittsburgh operations, found no apparent deficiencies or violations of Federal Executive Order 11246. During our field work, the Company's Pittsburgh operations were undergoing another OFCCP audit.

PAWC's workforce statistics by EEO employment category, gender, and race for the years 1995 through 1998 are presented in Exhibit XI-1. The statistics show the impact of the 1996 PG&W acquisition on PAWC's female and minority employment levels in total, and as a percentage of the total workforce. From 1995 to 1998, the total number of PAWC employees increased from 824 to 1,085 or by 31.7%. The number of minority and non-minority employees increased from 56 to 57 or 1.8% and from 768 to 1028 or 33.9%, respectively, while the number of male and female employees increased 34% and 25%, respectively. As a percentage of the total workforce, female and minority employment levels both dropped.

Findings and Conclusions

Our examination of Diversity included a review of staffing trends; labor market comparisons; the procurement bidding process and purchasing trends; the Affirmative Action Plan; the latest diversity filings with the PUC; goals; policies and procedures; communication methods; management philosophy; and accountability. We found these areas to be satisfactory except as follows:

Exhibit XI -1
Page 1 of 3

PENNSYLVANIA - AMERICAN WATER COMPANY
Number of Employees By EEO Category, Gender, and Race
For the Years 1995 - 1998

<u>EEO Job Categories</u>	<u>Total Company</u>				<u>% of 1998 Total Company</u>	<u>Net Increase</u>	<u>% of Change 1995-1998</u>
	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>			
Officials and Managers	153	178	167	172	15.9%	19	12.4%
Professionals	20	37	27	29	2.7%	9	45.0%
Technicians	11	17	29	28	2.6%	17	154.5%
Sales Workers	0	0	0	0	0.0%	0	0.0%
Office and Clerical	196	262	259	245	22.6%	49	25.0%
Skilled	420	593	570	569	52.4%	149	35.5%
Semi-Skilled	21	23	38	40	3.7%	19	90.5%
Unskilled	3	3	2	2	0.2%	-1	-33.3%
Service Workers	0	0	0	0	0.0%	0	0.0%
Totals	<u>824</u>	<u>1113</u>	<u>1092</u>	<u>1085</u>	<u>100.0%</u>	<u>261</u>	31.7%

Source: Employer Information Reports (EEO - I)

Exhibit XI -1

Page 2 of 3

PENNSYLVANIA - AMERICAN WATER COMPANY
Number of Employees By EEO Category, Gender, and Race
For the Years 1995 - 1998

White Males

<u>EEO Job Categories</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>% of 1998 Total Company</u>	<u>Net Increase</u>	<u>% of Change 1995-1998</u>
Officials and Managers	128	151	146	146	84.9%	18	14.1%
Professionals	14	24	19	20	69.0%	6	42.9%
Technicians	6	7	13	12	42.9%	6	100.0%
Sales Workers	0	0	0	0	0.0%	0	0.0%
Office and Clerical	46	65	64	58	23.7%	12	26.1%
Skilled	359	525	499	503	88.4%	144	40.1%
Semi-Skilled	21	23	38	40	100.0%	19	90.5%
Unskilled	2	2	2	2	100.0%	0	0.0%
Service Workers	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	0.0%	<u>0</u>	0.0%
Totals	<u>576</u>	<u>797</u>	<u>781</u>	<u>781</u>	72.0%	<u>205</u>	35.6%
Totals as a Percent of Total Company	69.9%	71.6%	71.5%	72.0%		2.1%	

White Females

<u>EEO Job Categories</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>% of 1998 Total Company</u>	<u>Net Increase</u>	<u>% of Change 1995-1998</u>
Officials and Managers	20	21	16	23	13.4%	3	15.0%
Professionals	5	9	3	4	13.8%	-1	-20.0%
Technicians	5	10	16	16	57.1%	11	220.0%
Sales Workers	0	0	0	0	0.0%	0	0.0%
Office and Clerical	125	175	171	166	67.8%	41	32.8%
Skilled	36	40	43	38	6.7%	2	5.6%
Semi-Skilled	0	0	0	0	0.0%	0	0.0%
Unskilled	1	1	0	0	0.0%	-1	-100.0%
Service Workers	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	0.0%	<u>0</u>	0.0%
Totals	<u>192</u>	<u>256</u>	<u>249</u>	<u>247</u>	22.8%	<u>55</u>	28.6%
Totals as a Percent of Total Company	23.3%	23.0%	22.8%	22.8%		-0.5%	

Source: Employer Information Reports (EEO - 1)

Exhibit XI -1

Page 3 of 3

PENNSYLVANIA - AMERICAN WATER COMPANY
Number of Employees By EEO Category, Gender, and Race
For the Years 1995 - 1998

Minority Males

<u>EEO Job Categories</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>% of 1998 Total Company</u>	<u>Net Increase</u>	<u>% of Change 1995-1998</u>
Officials and Managers	3	4	4	3	1.7%	0	0.0%
Professionals	1	3	3	3	10.3%	2	200.0%
Technicians	0	0	0	0	0.0%	0	0.0%
Sales Workers	0	0	0	0	0.0%	0	0.0%
Office and Clerical	8	4	5	4	1.6%	-4	-50.0%
Skilled	20	23	23	23	4.0%	3	15.0%
Semi-Skilled	0	0	0	0	0.0%	0	0.0%
Unskilled	0	0	0	0	0.0%	0	0.0%
Service Workers	0	0	0	0	0.0%	0	0.0%
Totals	32	34	35	33	3.0%	1	3.1%
Totals as a Percent of Total Company	3.9%	3.1%	3.2%	3.0%		-0.9%	

Minority Females

<u>EEO Job Categories</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>% of 1998 Total Company</u>	<u>Net Increase</u>	<u>% of Change 1995-1998</u>
Officials and Managers	2	2	1	0	0.0%	-2	-100.0%
Professionals	0	1	2	2	7.4%	2	
Technicians	0	0	0	0	0.0%	0	0.0%
Sales Workers	0	0	0	0	0.0%	0	0.0%
Office and Clerical	17	18	19	17	6.6%	0	0.0%
Skilled	5	5	5	5	0.9%	0	0.0%
Semi-Skilled	0	0	0	0	0.0%	0	0.0%
Unskilled	0	0	0	0	0.0%	0	0.0%
Service Workers	0	0	0	0	0.0%	0	0.0%
Totals	24	26	27	24	2.2%	0	0.0%
Totals as a Percent of Total Company	2.9%	2.3%	2.5%	2.2%		-0.7%	

Source: Employer Information Reports (EEO - 1)

1. PAWC's utilization of females and minorities remains below the availability levels in some of the local labor markets from which the Company hires its workforce.

The Audit Staff compared PAWC's 1998 female and minority employment percentages with those of the labor force in eight Pennsylvania Primary Metropolitan Statistical Areas (PMSA) from which the Company hires a majority of its workforce. The latest available U.S. Census information from 1990 showed that, on average, females comprised 19% and minorities 3.0% of the eight PMSA labor force markets. While the Company's total female and minority utilization percentages, 25.0% and 5.3%, respectively, are slightly above the overall relevant PMSA's labor force availability percentages, PAWC's utilization of females and minorities remains below the availability levels in some of the local labor markets from which the Company hires its workforce (see Exhibit XI-2). Specifically, this exhibit reveals that PAWC's female employee levels are below those of the relevant labor market for six of the eight PMSA locations; and that the minority employee levels are below the labor market for two of the eight PMSA locations.

PAWC should be striving to bring female and minority employment levels more in line with the availability of those groups in its local labor markets. Currently, however, PAWC's recruiting initiatives do not specifically target females or minorities. Furthermore, while the Company claims there is accountability at the management levels it is informal at best. Also, at the time of our fieldwork, there were no formal initiatives to encourage female and minority employment in skilled positions. Without specific documented goals, plans, and management accountability, PAWC will have a difficult time improving its female and minority employment levels within the various geographic PMSA locations.

2. The Company has not established annual MWDBE procurement goals.

As shown in Exhibit XI-3, there are positive trends in total MWDBE procurement amounts. From 1994 through 1998, overall Minority Business Enterprise (MBE) purchases increased from \$18,936 to \$612,479, or at an annual compound rate of 139%. Overall Women Business Enterprise (WBE) purchases during that period increased from \$290,164 to \$3,836,277, or at an annual compound rate of 91%, while Disability Business Enterprises (DBE) purchases have remained virtually non-existent. Total MWDBE purchases over the time period increased from \$309,100 to \$4,448,981, or at an annual compound growth rate of 95%.

Exhibit XI -2

PENNSYLVANIA - AMERICAN WATER COMPANY
Comparison of 1998 Female and Minority
Employment Percentages with the
Relevant PMSA Labor Force

Females

<u>Geographic Headquarters Location</u>	<u>PAWC</u>	<u>Relevant PMSA Labor Force</u>	<u>PAWC Utilization as a % of PMSA Labor Force</u>
Pittsburgh	14.9%	22.4%	67%
McMurray	39.1%	22.2%	176%
New Castle	20.5%	26.9%	76%
Indiana	14.8%	18.3%	81%
Norristown	23.1%	30.7%	75%
Mechanicsburg	33.1%	16.6%	199%
Wilkes-Barre/Scranton	17.9%	19.5%	92%
Hershey-Corporate	36.1%	43.3%	83%
Weighted Average *	25.0%	19.0%	132%

Minorities

<u>Geographic Headquarters Location</u>	<u>PAWC</u>	<u>Relevant PMSA Labor Force</u>	<u>PAWC Utilization as a % of PMSA Labor Force</u>
Pittsburgh	10.5%	7.3%	144%
McMurray	7.7%	2.3%	335%
New Castle	6.8%	0.7%	971%
Indiana	1.9%	1.4%	136%
Norristown	5.8%	4.9%	118%
Mechanicsburg	5.5%	4.7%	117%
Wilkes-Barre/Scranton	1.0%	1.9%	53%
Hershey-Corporate	4.5%	6.2%	73%
Weighted Average *	5.3%	3.0%	177%

* Weighted average was calculated by PAWC using OFCCP guidelines.

Source: PAWC Report on Diversity to the PAPUC - April 1999

PENNSYLVANIA - AMERICAN WATER COMPANY
Total Utility Purchases for Minority, Women,
and Disabled Person Businesses
For the Years 1994 - 1998

TOTAL COMPANY

<u>YEARS</u>	<u>PAWC's Total Purchases*</u>	<u>MBE</u>		<u>WBE</u>		<u>DBE</u>		<u>Total MWDBE</u>	
		<u>Annual Purchases</u>	<u>% of Total Purchases</u>	<u>Annual Purchases</u>	<u>% of Total Purchases</u>	<u>Annual Purchases</u>	<u>% of Total Purchases</u>	<u>Annual Purchases</u>	<u>% of Total Purchases</u>
1994	\$51,274,698	\$18,936	0.0%	\$290,164	0.6%	\$0	0.00%	\$309,100	0.6%
1995	\$51,196,351	\$117,916	0.2%	\$638,258	1.2%	\$0	0.00%	\$756,174	1.5%
1996	\$64,440,486	\$67,264	0.1%	\$2,551,840	4.0%	\$26,063	0.04%	\$2,645,167	4.1%
1997	\$83,403,518	\$481,787	0.6%	\$2,967,880	3.6%	\$435	0.00%	\$3,450,102	4.1%
1998	\$95,537,839	\$612,479	0.6%	\$3,836,277	4.0%	\$225	0.00%	\$4,448,981	4.7%
Compound Growth	16.8%	138.5%		90.7%		0.0%		94.8%	66.7%
Net Increase/Decrease	\$44,263,141	\$593,543	0.6%	\$3,546,113	3.4%	\$225	0.0%	\$4,139,881	4.1%

* Excludes bank and transaction service fees, utility costs, and services purchased from AWWSC and other associated AWWC companies.

Exhibit XI-3

Source: Utility Procurement Diversity Reports filed with the PAPUC.

Despite the positive trends in total MWDBE procurement dollars, MWDBE purchases as a percentage of total Company purchases have remained relatively flat since the 1996 acquisition of PG&W. From 1996 to 1998, total MWDBE purchases as a percentage of total purchases increased from 4.1% to 4.7%, or by only 0.6%. Furthermore, MBE purchases as a percentage of total purchases increased modestly from 0.2% in 1995 to 0.6% in 1998, while WBE purchases as a percentage of total purchases remained relatively flat at 4%.

The Audit Staff found that the EEO Officer and Coordinator currently set the MWDBE policy and the Regional Operating Managers retain control over the procurement process in each of their respective regions. However, these personnel do not collectively establish procurement goals in order to measure the success of the program. Instead, the success of the program has been primarily measured with respect to increases in overall MWDBE dollar purchases and success in distributing the procurement dollars among as many vendors as possible.

Annual diversity procurement goals should be set for the Company as a whole and for each region with accountability established for each of the four Regional Operating Managers. The goals should be based on ratios such as MWDBE dollars as a percentage of overall purchases rather than on total MWDBE dollars alone. These goals would provide the stimulus to improve the diversity procurement levels relative to total purchases.

3. The Company's minority vendor listing is outdated and lacks integration with the purchasing process.

Subsequent to the Commission's Diversity Order in 1992, the Company retained a consultant in 1994 to identify MWDBE vendors. This work resulted in an initial MWDBE vendor list. The list, comprised of approximately 40-50 MWDBE vendors, is maintained in a database on the Company's purchasing system. However it has not been integrated into the purchasing process. Currently, the Company relies upon the Regional Operating Managers' discretion to manually peruse the minority vendor list and to incorporate these vendors into the bidding process.

In April 1998, PAWC, as a participant of the PUC's Utility Diversity Action Committee (UDAC), contributed to the development of a comprehensive list of MWDBE vendors used by every utility (i.e., gas, water, electric, and telephone) in Pennsylvania. This UDAC list reflects approximately 1,700 MWDBE vendors utilized by the four major utility groups in Pennsylvania. To date, PAWC has not reviewed and updated the UDAC list to reduce the number of vendors to an effective working list for its needs.

The Company should update its minority vendor list by identifying the

UDAC vendors applicable to its operations and integrate the updated list into the purchasing process in order for the Regional Operating Managers to accomplish the annual MWDBE procurement goals as per Recommendation No.2 below. To integrate the list with the purchasing process, MWDBE vendors should be automatically identified by service or commodity and incorporated into the bidding process as a means to elevate the diversity procurement levels.

The Company stated that it has not updated its minority vendor list due to the recent development of the UDAC list. Also, the Company was initially unsure if the MWDBE vendor list could be integrated into its purchasing system. Upon inquiry with its purchasing system vendor, the Company was informed that custom source code modifications could be made to accomplish the integration. However, the Company indicated that further research was necessary to determine the costs involved to perform the modifications.

By periodically updating the MWDBE vendor list and integrating it into the purchasing software, the Company should be able to increase the overall diversity procurement levels and potentially achieve procurement levels closer to those of two similar Pennsylvania water utilities. The most recent data available for those water utilities indicates overall MWDBE procurement levels of approximately 8%, or roughly 58% higher than PAWC's levels.

Recommendations

1. Set goals with timetables for increasing the Company's female and minority employment percentages, especially for the Pittsburgh, Wilkes-Barre/Scranton, and Hershey-Corporate geographic locations.

2. Develop annual MWDBE procurement goals with accountability established at the Regional Operating Manager level.

3. Update the Company's MWDBE vendor list and integrate it into the purchasing process, and establish a process to ensure that the MWDBE vendor list remains current in the future.

XII. ACKNOWLEDGEMENTS

We wish to express our appreciation for the cooperation and assistance given to us during the course of this Focused Management Audit by the officers and staff of the Pennsylvania American Water Company.

This audit was conducted by staff of the Bureau of Audits. Participants in the audit process were John Clista and J. Alan Gardocky.

XIII. APPENDIX

ITEM	APPENDIX NUMBER
<u>PAWC Internal Trending Data</u>	
Statement of Income	I
Balance Sheet Data	II
Utility Plant Data	III
Total Water Operating Expenses	IV
Customer Related Data by Classification	V
<u>Company Comparison Panel Data</u>	
Income Statement	VI
Balance Sheet Data	VII
Operating Data and Ratios	VIII

PENNSYLVANIA-AMERICAN WATER COMPANY
INCOME STATEMENT DATA
FOR THE YEARS ENDED DECEMBER 31, 1994 - 1998

Appendix I

Category	1994	1995	1996	1997	1998	Compound Growth
WATER REVENUES						
Residential	\$ 109,463,547	\$ 114,820,414	\$ 153,162,219	\$ 162,974,255	\$ 176,155,034	12.6%
Commercial	31,495,971	33,385,581	45,543,340	48,456,872	53,959,875	14.4%
Industrial	13,190,932	13,570,169	19,162,344	19,459,801	21,852,820	13.5%
Fire Protection	5,636,241	5,915,160	9,878,896	10,997,892	11,088,005	18.4%
Other Public Authorities	7,921,020	8,224,865	9,116,368	9,754,747	12,006,358	11.0%
Other Water Utilities	2,014,698	2,043,288	2,211,743	2,267,765	2,196,295	2.2%
Miscellaneous	2,833,479	2,478,943	3,217,222	3,551,216	3,358,800	4.3%
Total Water Revenues	172,555,888	180,438,420	242,292,132	257,462,548	280,617,187	12.9%
WATER OPERATING EXPENSES						
Source of Supply	6,596,535	6,792,641	5,963,666	3,226,830	2,889,246	-18.6%
Power and Pumping	9,651,325	9,422,978	11,047,721	11,227,026	10,374,434	1.8%
Purification	11,147,450	11,448,546	17,647,668	18,788,158	20,015,905	15.8%
Transmission and Distribution	15,346,793	14,643,892	18,969,882	21,211,501	20,664,307	7.7%
Customers' Accounting and Collecting	11,214,594	12,400,028	16,119,297	17,674,294	16,403,963	10.0%
Administration and General	28,697,696	29,602,497	35,923,664	34,407,817	36,174,017	6.1%
Total Water Operating Expenses	82,654,393	84,310,582	105,671,898	106,535,626	106,521,872	6.5%
OPERATING INCOME	\$89,901,495	\$96,127,838	\$136,620,234	\$150,926,922	\$174,095,315	18.0%

Source: Schedule 200C, Form PUC 244, Annual Report To The PA PUC

PENNSYLVANIA-AMERICAN WATER COMPANY
BALANCE SHEET DATA
FOR THE YEARS ENDED DECEMBER 31, 1994 - 1998

Appendix II
Page 1 of 2

Category	1994	1995	1996	1997	1998	Compound Growth
UTILITY PLANT	\$740,624,008	\$ 817,894,778	\$ 1,277,674,034	\$ 1,368,546,564	\$ 1,458,856,638	18.5%
INVESTMENT AND FUND ACCOUNTS						
Other Physical Property	1,264,808	1,054,308	965,083	968,654	913,461	-7.8%
Investments in Affiliated Companies						
Other Investments						
Sinking Funds						
Total Investment and Fund Accounts	1,264,808	1,054,308	965,083	968,654	913,461	-7.8%
CURRENT AND ACCRUED ASSETS						
Cash	0	0	5,225,646	0	0	
Special Deposits	73,500	111,850	191,340	293,975	136,172	16.7%
Working Funds	114,285	14,505	8,935	4,200	3,350	-58.6%
Temporary Cash Investments			1,195			
Notes Receivable						
Accounts Receivable	13,486,048	15,680,957	23,822,194	23,143,488	26,236,851	18.1%
Receivable from Affiliated Companies	66,289	12,886	279	9,400	4,379	-49.3%
Accrued Utility Revenues	9,294,544	9,156,363	15,141,321	15,983,681	17,119,464	16.5%
Materials and Supplies	1,284,207	1,371,713	2,473,485	2,615,864	2,806,023	21.6%
Prepayments	1,440,345	1,261,899	1,454,558	1,785,570	1,675,111	3.8%
Other Current & Accrued Assets	2,494,724	2,581,920	3,185,076	3,554,101	2,607,668	1.1%
Total Current and Accrued Assets	28,253,942	30,192,093	51,504,029	47,390,279	50,589,018	15.7%
DEFERRED DEBITS						
Unamortized Debt Discount and Expense	1,956,124	1,872,308	8,752,395	8,793,950	8,290,584	43.5%
Other Deferred Debits	102,072,551	100,057,666	120,291,187	119,202,812	123,788,767	4.9%
Total Deferred Debits	104,028,675	101,929,974	129,043,582	127,996,762	132,079,351	6.2%
Total Assets and Other Debits	\$874,171,433	\$951,071,153	\$1,459,186,728	\$1,544,902,259	\$1,642,438,468	17.1%

Source: Schedules 200-, 200B-, Form PUC 244, Annual Report To The PA PUC

PENNSYLVANIA-AMERICAN WATER COMPANY
BALANCE SHEET DATA
FOR THE YEARS ENDED DECEMBER 31, 1994 - 1998
Appendix H
page 2 of 2

Category	1994	1995	1996	1997	1998	Compound Growth
CAPITAL STOCK						
LONG-TERM DEBT						
Bonds	\$ 106,708,599	\$ 126,476,499	\$ 126,235,299	\$ 125,974,299	\$ 127,445,699	4.5%
	285,520,000	299,510,000	570,122,181	598,285,332	591,355,863	20.0%
CURRENT AND ACCRUED LIABILITIES						
Notes Payable	19,121,279	34,098,964	-	1,872,162	36,323,743	17.4%
Current Portion of Long-term debt	16,010,000	10,010,000	19,818,195	4,834,093	8,000,000	-15.9%
Accounts Payable	7,726,526	7,496,666	12,323,432	9,822,192	15,349,900	18.7%
Payable to Affiliated Companies	34,353	341,063	84,827	142,427	219,279	58.9%
Dividends Declared	354,785	348,810	345,585	341,952	338,720	-1.2%
Customers' Deposits	1,173	1,173	1,141	1,141	1,141	-0.7%
Taxes Accrued	1,062,956	107,230	3,498,314	4,308,855	4,646,903	44.6%
Interest Accrued	7,246,685	7,064,987	11,500,391	11,863,006	12,010,489	13.5%
Other Current and Accrued Liabilities	5,601,035	5,246,228	7,298,715	10,758,496	9,847,991	15.2%
Total Current and Accrued Liabilities	57,158,792	64,715,121	54,870,800	43,944,324	86,738,166	11.0%
DEFERRED CREDITS						
Deferred Income Taxes	118,202,412	120,942,979	131,044,622	146,466,331	159,958,851	7.9%
Customers' Advances for Construction	41,871,107	43,929,026	45,854,925	48,531,456	51,105,533	5.1%
Other Deferred Credits	17,741,590	16,199,933	18,270,486	19,810,117	21,044,876	4.4%
Investment Tax Credit	10,278,004	10,044,412	9,810,820	9,577,228	9,343,636	-2.4%
Total Deferred Credits	188,093,113	191,116,350	204,980,853	224,385,132	241,452,896	6.4%
RESERVES						
Reserve for Depreciation of Utility Plant	95,000,404	112,838,981	158,714,452	179,421,548	208,951,600	21.8%
Res. for Dep. & Amort. of Other Property	274,943	199,992	212,802	229,759	263,153	-1.1%
Reserve for Uncollectible Accounts	181,132	150,390	213,331	252,624	348,318	17.8%
Total Reserves	95,456,479	113,189,363	159,140,585	179,903,931	209,563,071	21.7%
CONTRIBUTIONS IN AID OF CONSTRUCTION						
Contributions in Aid of Construction	32,551,900	41,342,684	43,458,816	44,199,674	46,113,314	9.1%
SURPLUS						
Capital Surplus	7,452,325	7,452,326	182,565,831	199,580,491	199,596,924	127.5%
Earned Surplus	101,230,225	107,268,810	117,812,363	128,629,076	140,172,535	8.8%
Total Surplus	108,682,550	114,721,136	300,378,194	328,209,567	339,769,459	33.0%
Total Liabilities and Other Credits	874,171,433	951,071,153	1,459,186,728	1,544,902,259	1,642,438,468	17.1%

Source: Schedule 200, Form PUC 244, Annual Report To The PA PUC

PENNSYLVANIA-AMERICAN WATER COMPANY
UTILITY PLANT DATA
FOR THE YEARS ENDED DECEMBER 31, 1994 - 1998

Appendix III

Category	1994	1995	1996	1997	1998	Compound Growth
INTANGIBLE PLANT						
Organization	\$ 230,987	\$ 230,987	\$ 264,095	\$ 284,095	\$ 284,094	5.3%
Franchises and Consents	234,273	472,475	777,544	777,544	1,514,283	59.4%
Miscellaneous	56,181	1,429,150	1,480,881	1,501,075	1,513,081	127.8%
Total Intangible Plant	521,441	2,132,621	2,542,520	2,562,714	3,311,458	58.7%
TANGIBLE PLANT						
Water Rights	291,470	291,470	452,852	446,782		n/a
Reservoir Land	202,415	202,415	845,745	844,245		n/a
Other Source of Supply Land	406,213	425,501	431,043	461,359	1,757,388	n/a
Power and Pumping Land	574,274	597,831	823,125	545,993		n/a
Purification Land	1,060,909	1,105,324	2,157,956	1,234,877	1,956,376	n/a
T & D Land and Rights of Way	3,391,935	3,507,015	3,941,610	4,043,636	3,783,861	2.8%
Distribution Reservoir and Standpipe Land	601,930	639,018	961,471	961,471	1,467,057	24.9%
Office Land	1,293,572	1,290,411	1,290,411	1,290,411	2,050,610	12.2%
Stores, Shop, and Garage Land	423,983	423,983	422,649	695,536		n/a
Total Land and Land Rights	8,246,701	8,482,968	11,326,863	10,524,310	11,015,292	7.5%
Structures and Improvements:						
Collecting and Impounding Reservoirs	5,531,922	7,407,128	26,659,904	27,087,750	27,087,750	48.8%
Lake, River, and Other Intakes	3,965,878	5,927,896	6,095,880	16,305,663	16,545,470	42.9%
Wells and Springs	2,525,880	2,714,991	2,468,465	2,452,518	2,569,227	0.4%
Other Water Source Structures	703,250	840,347	1,001,280	996,884	1,039,602	10.3%
Power and Pumping Structures	11,022,066	13,190,265	18,587,379	23,807,042		n/a
Purification Buildings	40,090,785	42,143,425	98,685,475	109,088,983	134,980,397	35.5%
Distribution Reservoirs and Standpipes	25,907,204	26,798,985	47,112,508	50,273,329	51,752,743	18.9%
Office Buildings	12,875,857	13,038,043	13,095,545	13,034,346	21,035,192	n/a
Stores, Shop, and Garage Buildings	7,237,084	7,259,569	7,429,843	7,626,824		n/a
Miscellaneous Structures and Improvements	125,674	125,674	275,964	298,792	49,425	-20.8%
Total Structures and Improvements	109,985,580	119,446,323	222,312,243	250,972,131	255,059,806	23.4%
Additional Tangible Plant:						
Other Power Production Equipment	257,096	257,096	258,256	1,201,937	1,264,609	48.9%
Electric Pumping Equipment	22,336,670	25,062,653	32,831,168	36,717,712	38,970,498	14.9%
Oil Engine Pumping Equipment	330,682	319,809	389,690	390,067		n/a
Hydraulic Pumping Equipment			5,592	5,592		n/a
Other Power Production Equipment	14,855	14,855	19,994	19,994		n/a
Purification System	99,147,364	106,286,248	153,673,823	168,007,500	171,366,777	14.7%
Laboratory Equipment	1,774,997	2,015,298	3,285,601	3,710,283	3,847,595	21.3%
Mains and Accessories	330,909,706	349,297,863	551,463,049	581,097,231	622,569,064	17.1%
Services	77,396,760	86,900,547	144,869,713	154,851,565	165,455,504	20.9%
Meters	34,164,070	37,456,151	50,928,182	57,853,242	66,157,799	18.0%
Fire Hydrants	13,804,212	15,021,220	22,211,730	23,506,679	24,789,737	15.7%
Office Furniture and Equipment	12,365,096	13,348,138	15,188,589	16,803,060	21,775,139	15.2%
Transportation Equipment	98,446	161,411	2,413,665	1,718,422	906,914	74.2%
Stores Equipment	222,389	221,285	223,078	211,951	211,952	-1.2%
Shop Equipment						n/a
Tools and Work Equipment	4,053,670	4,357,812	6,480,625	6,681,517	7,051,531	15.0%
Communication Equipment	847,820	1,441,343	1,876,971	2,425,815	2,509,782	31.2%
Miscellaneous Equipment	2,527,807	2,748,669	3,374,845	3,715,596	4,417,045	15.0%
Total Additional Tangible Plant	600,221,640	664,906,438	989,494,451	1,058,730,663	1,151,213,946	17.2%
Total Water Plant in Service	718,975,562	794,908,350	1,235,676,176	1,322,789,818	1,400,600,502	18.1%

Source: Schedules NW, 200B, Form PLIC 244, Annual Report To The PA PUC

PENNSYLVANIA-AMERICAN WATER COMPANY
TOTAL WATER OPERATING EXPENSES
FOR THE YEARS ENDED DECEMBER 31, 1994 - 1998

Appendix IV

Category	1994	1995	1996	1997	1998	Compound Growth
Source of Supply:						
Operation	\$ 420,006	\$ 395,546	\$ 407,552	\$ 314,922	\$ 494,635	4.2%
Maintenance	166,371	117,900	260,262	270,347	323,577	18.1%
Miscellaneous	6,010,158	6,279,196	5,295,852	2,641,561	2,071,034	-23.4%
Total	6,596,535	6,792,641	5,963,666	3,226,830	2,889,246	-18.6%
Power and Pumping:						
Operation	751,626	694,586	973,168	791,806		1.8%
Maintenance	517,921	564,249	665,273	618,231		6.1%
Miscellaneous	8,381,778	8,164,143	9,409,281	9,816,988	10,374,434	5.5%
Total	9,651,325	9,422,978	11,047,722	11,227,025	10,374,434	1.8%
Purification:						
Operation	9,610,051	9,799,778	15,432,492	15,945,996	16,624,126	14.7%
Maintenance	1,513,342	1,638,630	2,164,857	2,774,909	3,390,847	22.3%
Miscellaneous	24,057	10,138	50,319	67,254	932	-55.6%
Total	11,147,450	11,448,546	17,647,668	18,788,159	20,015,905	15.8%
Transmission and Distribution:						
Operation	6,642,850	6,385,125	7,422,321	7,595,065	7,593,019	3.4%
Maintenance	8,470,203	8,067,523	11,108,892	13,161,819	13,071,288	11.5%
Miscellaneous	233,740	191,244	438,670	454,617	-	-100.0%
Total	15,346,793	14,643,892	18,969,883	21,211,501	20,664,307	7.7%
Customers' Accounting & Collecting:						
Supervision	688,297	877,918	1,191,716	1,174,827		19.5%
Customers' Contracts and Orders	1,387,314	1,420,460	1,501,126	1,426,297		0.9%
Meter Reading	2,472,334	2,600,761	3,198,690	3,250,399		9.5%
Collecting	1,342,527	1,415,486	1,712,041	1,784,483		10.0%
Customers' Billing and Accounting	2,339,372	2,610,198	3,137,983	2,965,006		8.2%
Miscellaneous	1,986,311	2,251,357	3,657,192	3,930,557	2,031,720	0.6%
Uncollectible Accounts	998,439	1,223,848	1,720,549	3,142,726	2,599,599	27.0%
Other					11,772,644	
Total	11,214,594	12,400,028	16,119,297	17,674,295	16,403,963	10.0%
Sales Promotion:						
Total	-	-	-	-	-	
Administration & General:						
Total	28,697,696	29,602,497	35,923,664	34,407,818	36,174,017	6.0%
Total Water Operating Expenses	82,654,393	84,310,582	105,671,900	106,555,628	106,521,872	6.5%

Source: Schedule 826., Form PUC 244, Annual Report To The PA PUC

PENNSYLVANIA-AMERICAN WATER COMPANY
CUSTOMER RELATED DATA BY CLASSIFICATION
FOR THE YEARS ENDED DECEMBER 31, 1994 - 1998

Appendix V

Category	1994	1995	1996	1997	1998	Compound Growth
Average No. of Customers:						
Residential	344,168	351,142	478,058	486,299	493,206	9.4%
Commercial	28,029	28,146	37,515	38,599	38,610	8.3%
Industrial	611	611	850	877	811	7.3%
Private Fire Protection	1,563	1,546	2,451	2,444	2,538	12.9%
Public Fire Protection	246	253	347	340	332	7.8%
Other Sales to Public Authorities	1,829	1,887	2,145	2,366	2,136	4.0%
Sales to other Water Utilities	32	32	32	32	29	-2.4%
Total	376,478	383,617	521,398	530,857	537,662	9.3%
Water Sold (Thousand Gallons):						
Residential	20,540,852	20,995,530	26,575,722	28,200,414	27,768,974	7.8%
Commercial	9,208,570	9,261,613	11,848,535	12,471,427	12,374,586	7.7%
Industrial	5,439,577	5,283,954	7,040,820	7,012,048	7,251,236	7.5%
Private Fire Protection	-	-	-	-	-	#DIV/0!
Public Fire Protection	-	-	-	-	-	#DIV/0!
Other Sales to Public Authorities	2,715,942	2,691,802	2,899,907	2,949,535	2,981,916	2.4%
Sales to other Water Utilities	1,247,424	774,697	766,461	718,178	574,379	-17.6%
Total	39,158,365	39,007,596	49,131,445	51,351,602	50,951,091	6.8%
Operating Revenues:						
Residential	\$ 109,463,547	\$ 114,820,414	\$ 153,162,219	\$ 162,974,255	\$ 176,155,034	12.6%
Commercial	31,495,971	33,385,581	45,543,340	48,456,872	53,959,875	14.4%
Industrial	13,190,932	13,570,169	19,162,344	19,459,801	21,852,820	13.5%
Private Fire Protection	1,539,304	1,517,667	3,588,988	4,131,164	4,109,060	27.8%
Public Fire Protection	4,096,937	4,397,493	6,289,908	6,866,728	6,978,945	14.2%
Other Sales to Public Authorities	7,921,020	8,224,865	9,116,368	9,754,747	12,006,358	11.0%
Sales to other Water Utilities	2,014,698	2,043,288	2,211,743	2,267,765	2,196,295	2.2%
Miscellaneous Water Revenues	28,334,779	2,478,943	3,217,222	3,551,216	3,358,800	4.3%
Total	172,555,888	180,436,420	242,292,132	257,462,548	280,617,187	12.9%
Revenue Per Customer:						
Residential	\$ 318	\$ 327	\$ 320	\$ 335	\$ 357	2.9%
Commercial	1,124	1,186	1,214	1,255	1,398	5.6%
Industrial	21,589	22,210	22,544	22,189	26,946	5.7%
Private Fire Protection	985	982	1,464	1,690	1,619	13.2%
Public Fire Protection	16,554	17,381	18,127	20,196	21,021	6.0%
Other Sales to Public Authorities	4,331	4,359	4,250	4,305	5,621	6.7%
Sales to other Water Utilities	62,959	63,853	69,117	70,868	75,734	4.7%
Total	458	470	465	485	522	3.3%

Source: Schedule 825, Form PUC 244, Annual Report To The PA PUC

APPENDIX VI
Page 1 of 17

PENNSYLVANIA AMERICAN WATER COMPANY
INCOME STATEMENT COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

Operating Revenues	1995	per MG	1996	per MG	1997	per MG	1998	per MG	Compound Growth
Philadelphia Suburban Water Co.	\$ 115,873,066	\$ 4.14	\$ 120,333,203	\$ 4.34	\$ 132,633,835	\$ 4.21	\$ 147,344,772	\$ 4.45	2.5%
Consumers Pennsylvania Water Co.	16,452,657	3.43	17,926,170	3.72	18,161,894	3.96	19,867,837	4.58	10.1%
United New Jersey Water Co.	119,337,713	3.82	118,447,585	3.95	121,627,867	4.02	125,507,201	4.05	2.0%
St. Louis County Water Co.	88,631,582	1.85	91,194,456	1.89	98,872,762	2.01	100,646,242	2.12	4.6%
New Jersey American Water Co.	184,931,394	4.11	199,235,152	4.88	221,696,435	4.89	231,645,448	4.96	6.5%
Panel Average	105,045,282	3.35	109,427,313	3.61	118,598,559	3.69	125,002,300	3.84	4.7%
Pennsylvania American Water Co.	180,947,927	4.64	243,312,808	4.95	258,512,855	5.03	282,059,219	5.54	6.1%

Production Expense	1995	per MG	1996	per MG	1997	per MG	1998	per MG	Compound Growth
Philadelphia Suburban Water Co.	\$ 3,961,889	\$ 0.14	\$ 13,567,840	\$ 0.49	\$ 15,315,344	\$ 0.49	\$ 15,982,666	\$ 0.48	50.6%
Consumers Pennsylvania Water Co.	1,102,953	0.23	1,146,201	0.24	1,036,809	0.23	273,470	0.06	-35.1%
United New Jersey Water Co.	13,393,867	0.43	14,545,985	0.48	16,269,430	0.54	17,050,150	0.55	8.7%
St. Louis County Water Co.	9,545,345	0.20	9,449,508	0.20	9,413,168	0.19	9,451,035	0.20	-0.1%
New Jersey American Water Co.	25,335,846	0.56	25,533,192	0.63	27,757,288	0.61	26,621,531	0.57	0.4%
Panel Average	10,667,980	0.34	12,848,545	0.42	13,938,408	0.43	13,875,770	0.43	7.9%
Pennsylvania American Water Co.	27,662,638	0.71	17,011,388	0.35	14,453,856	0.28	4,812,315	0.09	-48.9%

MG = Thousand Gallons Sold
NM = Not Meaningful

Source: National Association Of Water Companies, Financial and Operating Data

Transmission & Distribution Expense	1995	per Mile Of Main	1996	per Mile Of Main	1997	per Mile Of Main	1998	per Mile Of Main	Compound Growth
Philadelphia Suburban Water Co.	\$ 17,720,720	\$ 5.573	\$ 7,722,191	\$ 2.247	\$ 7,674,948	\$ 2.212	\$ 7,834,120	\$ 2.224	-26.4%
Consumers Pennsylvania Water Co.	1,124,960	1.953	1,240,425	2.067	1,301,655	2.159	1,488,029	2.464	8.0%
United New Jersey Water Co.	7,456,052	3.632	8,111,721	3.943	9,298,602	4.563	7,829,728	3.819	1.7%
St. Louis County Water Co.	12,106,577	3.064	14,316,522	3.598	13,818,274	3.436	13,074,011	3.251	2.0%
New Jersey American Water Co.	11,374,037	2.557	11,541,047	2.736	12,452,922	2.790	13,897,553	3.026	5.8%
Panel Average	9,956,469	3.504	8,586,381	3.004	8,909,280	3.057	8,824,688	2.983	-5.2%
Pennsylvania American Water Co.	14,644,788	2.617	18,969,883	2.564	21,211,501	2.841	20,956,664	2.772	1.9%

PENNSYLVANIA AMERICAN WATER COMPANY
INCOME STATEMENT COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VI
Page 3 of 17

Customers' Accounting and Collecting Expense	1995	per Customer	1996	per Customer	1997	per Customer	1998	per Customer	Compound Growth
Philadelphia Suburban Water Co.	\$ 5,301,652	\$ 21	\$ 5,128,090	\$ 19	\$ 5,796,167	\$ 20	\$ 5,305,927	\$ 17	-5.3%
Consumers Pennsylvania Water Co.	1,040,665	26	1,207,123	30	1,038,215	25	1,074,170	26	-0.1%
United New Jersey Water Co.	4,813,094	27	5,127,166	29	5,053,881	28	5,223,065	29	2.0%
St. Louis County Water Co.	3,417,920	11	3,521,764	12	3,772,403	12	3,780,653	12	2.8%
New Jersey American Water Co.	6,640,930	21	7,534,218	24	7,624,311	23	8,654,693	26	7.3%
Panel Average	4,242,852	20	4,503,672	20	4,656,995	20	4,807,702	21	2.0%
Pennsylvania American Water Co.	12,407,700	32	16,119,298	35	17,674,295	33	16,405,695	31	-1.8%

Administration and General Expense	1995	per Customer	1996	per Customer	1997	per Customer	1998	per Customer	Compound Growth
Philadelphia Suburban Water Co.	\$ 17,938,900	\$ 70	\$ 16,658,299	\$ 61	\$ 17,490,119	\$ 59	\$ 18,470,179	\$ 61	-4.4%
Consumers Pennsylvania Water Co.	3,031,223	77	3,238,719	79	3,055,964	75	3,431,647	84	3.0%
United New Jersey Water Co.	16,470,333	93	14,013,176	79	14,206,753	79	14,644,843	81	-4.6%
St. Louis County Water Co.	13,167,661	44	14,005,410	46	14,225,923	47	14,548,922	48	2.7%
New Jersey American Water Co.	25,099,399	80	22,953,762	72	19,335,258	60	20,761,040	63	-7.8%
Panel Average	15,141,503	70	14,173,873	64	13,662,803	60	14,371,326	62	-3.9%
Pennsylvania American Water Co.	29,594,825	77	35,923,664	77	34,407,817	65	36,247,597	68	-4.2%

PENNSYLVANIA AMERICAN WATER COMPANY
INCOME STATEMENT COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VI
Page 4 of 17

Total Operating & Maint. Expenses	1995	per Customer	1996	per Customer	1997	per Customer	1998	per Customer	Compound Growth
Philadelphia Suburban Water Co.	\$ 50,879,511	\$ 197	\$ 49,437,134	\$ 180	\$ 53,082,735	\$ 180	\$ 54,892,319	\$ 180	-2.9%
Consumers Pennsylvania Water Co.	7,527,118	191	8,282,508	203	7,773,530	190	8,174,385	200	1.6%
United New Jersey Water Co.	49,885,567	283	49,379,531	279	52,371,340	292	52,050,727	288	0.6%
St. Louis County Water Co.	47,024,258	157	50,783,261	168	50,476,571	167	50,911,833	167	2.0%
New Jersey American Water Co.	84,918,278	271	85,262,602	268	85,836,969	264	90,697,733	274	0.4%
Panel Average	48,046,946	221	48,629,007	219	49,908,229	218	51,345,399	221	0.0%
Pennsylvania American Water Co.	95,758,497	250	105,671,901	227	106,555,628	201	106,521,862	199	-7.3%

Depreciation and Amortization	1995	per Customer	1996	per Customer	1997	per Customer	1998	per Customer	Compound Growth
Philadelphia Suburban Water Co.	\$ 11,417,850	\$ 44	\$ 12,888,573	\$ 47	\$ 13,976,640	\$ 48	\$ 15,120,065	\$ 50	3.9%
Consumers Pennsylvania Water Co.	1,618,462	41	1,867,959	46	2,010,205	49	2,638,842	64	16.3%
United New Jersey Water Co.	9,607,407	54	9,854,043	56	10,516,445	59	11,302,033	63	4.7%
St. Louis County Water Co.	9,035,907	30	11,367,880	38	12,557,506	41	14,178,252	47	15.5%
New Jersey American Water Co.	18,321,070	58	20,446,301	64	23,011,302	71	24,935,376	75	8.8%
Panel Average	10,000,139	46	11,284,951	51	12,414,420	54	13,634,914	59	8.4%
Pennsylvania American Water Co.	19,026,458	50	27,769,013	60	31,021,210	58	37,861,151	71	12.6%

PENNSYLVANIA AMERICAN WATER COMPANY
APPENDIX VI
INCOME STATEMENT COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998
Page 5 of 17

Taxes/Other Operating Expenses	1995	per Customer	1996	per Customer	1997	per Customer	1998	per Customer	Compound Growth
Philadelphia Suburban Water Co.	\$ 20,205,296	\$ 78	\$ 22,045,602	\$ 80	\$ 24,543,652	\$ 83	\$ 30,035,019	\$ 99	8.0%
Consumers Pennsylvania Water Co.	2,871,703	73	2,988,471	73	3,328,058	81	3,795,832	93	8.4%
United New Jersey Water Co.	31,291,882	177	30,875,486	174	32,771,107	183	32,095,431	178	0.1%
St. Louis County Water Co.	12,520,191	42	11,811,219	39	14,826,197	49	15,038,737	49	5.6%
New Jersey American Water Co.	41,281,199	132	43,032,945	135	48,780,983	150	52,195,678	158	6.2%
Panel Average	21,634,054	100	22,150,745	100	24,849,999	109	26,632,139	115	4.8%
Pennsylvania American Water Co.	25,682,184	67	34,606,575	74	40,072,985	75	46,148,567	86	8.8%

Total Operating Expenses	1995	per Customer	1996	per Customer	1997	per Customer	1998	per Customer	Compound Growth
Philadelphia Suburban Water Co.	\$ 82,502,657	\$ 320	\$ 84,371,309	\$ 308	\$ 91,603,027	\$ 311	\$ 100,047,403	\$ 329	0.9%
Consumers Pennsylvania Water Co.	12,131,148	307	13,138,938	322	13,111,793	321	14,609,059	357	5.1%
United New Jersey Water Co.	\$ 90,784,856	515	90,109,060	509	95,658,892	533	95,448,191	528	0.9%
St. Louis County Water Co.	68,580,356	229	73,962,360	245	77,860,274	257	80,128,822	263	4.7%
New Jersey American Water Co.	144,520,547	460	148,741,848	467	157,629,254	485	167,828,787	506	3.2%
Panel Average	79,703,913	367	82,064,703	369	87,172,648	382	91,612,452	394	2.4%
Pennsylvania American Water Co.	140,467,139	366	168,047,489	361	177,629,823	335	190,531,580	356	-0.9%

PENNSYLVANIA AMERICAN WATER COMPANY
INCOME STATEMENT COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VI
Page 6 of 17

Utility Operating Income	1995	per Customer	1996	per Customer	1997	per Customer	1998	per Customer	Compound Growth
Philadelphia Suburban Water Co.	\$ 33,370,409	\$ 129	\$ 35,961,894	\$ 131	\$ 41,030,808	\$ 140	\$ 47,297,369	\$ 155	6.3%
Consumers Pennsylvania Water Co.	4,321,509	109	4,787,232	117	5,050,101	124	5,258,778	128	5.5%
United New Jersey Water Co.	28,552,857	162	28,338,525	160	25,968,975	145	30,059,010	166	0.9%
St. Louis County Water Co.	20,051,226	67	17,232,096	57	21,012,488	69	20,517,420	67	0.1%
New Jersey American Water Co.	40,410,847	129	50,493,304	158	64,067,181	197	63,816,661	193	14.4%
Panel Average	25,341,370	117	27,362,610	123	31,425,911	138	33,389,848	144	7.2%
Pennsylvania American Water Co.	40,480,788	106	75,265,319	162	80,883,032	152	91,527,639	171	17.5%

Other Income	1995	per Customer	1996	per Customer	1997	per Customer	1998	per Customer	Compound Growth
Philadelphia Suburban Water Co.	\$ (350,299)	\$ (1)	\$ (544,112)	\$ (2)	\$ (183,291)	\$ (1)	\$ 132,207	\$ 0	-168.4%
Consumers Pennsylvania Water Co.	173,089	4	170,755	4	391,905	10	407,101	10	31.4%
United New Jersey Water Co.	3,520,504	20	-	-	1,800,000	10	2,300,000	13	-13.9%
St. Louis County Water Co.	737,262	2	146,917	0	49,199	0	374,024	1	-20.7%
New Jersey American Water Co.	13,739	0	164,241	1	1,107,371	3	538,876	2	233.7%
Panel Average	818,859	4	(12,440)	(0)	633,037	3	750,442	3	-5.0%
Pennsylvania American Water Co.	149,552	0	59,070	0	69,619	0	49,813	0	-38.0%

PENNSYLVANIA AMERICAN WATER COMPANY
INCOME STATEMENT COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VI
Page 7 of 17

Gross Income	1995	per Customer	1996	per Customer	1997	per Customer	1998	per Customer	Compound Growth
Philadelphia Suburban Water Co.	\$ 33,020,110	\$ 128	\$ 35,417,782	\$ 129	\$ 40,847,517	\$ 139	\$ 47,429,576	\$ 156	6.8%
Consumers Pennsylvania Water Co.	4,494,598	114	4,957,987	121	5,442,006	133	5,665,879	138	6.7%
United New Jersey Water Co.	32,073,361	182	28,338,525	160	27,768,975	155	32,359,010	179	-0.5%
St. Louis County Water Co.	20,788,488	70	17,379,013	58	21,061,687	69	20,891,444	69	-0.5%
New Jersey American Water Co.	40,424,586	129	50,657,545	159	65,174,552	201	64,355,537	194	14.7%
Panel Average	26,160,229	120	27,350,170	123	32,058,947	140	34,140,289	147	6.9%
Pennsylvania American Water Co.	40,630,340	106	75,324,389	162	80,952,651	152	91,577,452	171	17.4%

Interest on Long-Term Debt	1995	per Customer	1996	per Customer	1997	per Customer	1998	per Customer	Compound Growth
Philadelphia Suburban Water Co.	\$ 14,404,320	\$ 56	\$ 15,072,991	\$ 55	\$ 17,316,816	\$ 59	\$ 18,426,467	\$ 61	2.7%
Consumers Pennsylvania Water Co.	2,234,509	57	2,503,360	61	2,483,946	61	2,464,620	60	2.1%
United New Jersey Water Co.	11,654,250	66	12,001,038	68	6,883,720	38	6,563,492	36	-18.1%
St. Louis County Water Co.	10,165,156	34	9,855,238	33	9,671,674	32	9,003,627	30	-4.6%
New Jersey American Water Co.	25,829,623	82	27,192,146	85	28,821,861	89	30,384,245	92	3.7%
Panel Average	12,857,572	59	13,324,955	60	13,035,603	57	13,368,490	58	-0.9%
Pennsylvania American Water Co.	26,352,518	69	36,540,504	79	45,033,436	85	46,755,971	87	8.4%

PENNSYLVANIA AMERICAN WATER COMPANY
INCOME STATEMENT COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VI
Page 8 of 17

Other Income Deductions	1995	per Customer	1996	per Customer	1997	per Customer	1998	per Customer	Compound Growth
Philadelphia Suburban Water Co.	\$ 294,492	\$ 1	\$ 401,567	\$ 1	\$ 426,320	\$ 1	\$ 471,989	\$ 2	10.8%
Consumers Pennsylvania Water Co.	395,829	10	223,743	5	316,590	8	432,826	11	NM
United New Jersey Water Co.	1,474,974		591,433	3	1,852,208	10	2,024,821	11	NM
St. Louis County Water Co.	96,875	0	114,716	0	(165,842)	(1)	(15,479)	(0)	-153.9%
New Jersey American Water Co.	2,756,993	9	2,899,543	9	3,037,900	9	2,315,876	7	-7.3%
Panel Average	1,003,833	5	846,200	4	1,093,435	5	1,046,007	5	NM
Pennsylvania American Water Co.	1,815,182	5	8,483,647	18	1,760,700	3	806,658	2	NM

Total Income Deductions	1995	per Customer	1996	per Customer	1997	per Customer	1998	per Customer	Compound Growth
Philadelphia Suburban Water Co.	\$ 14,698,812	\$ 57	\$ 15,474,558	\$ 56	\$ 17,743,136	\$ 60	\$ 18,898,456	\$ 62	2.9%
Consumers Pennsylvania Water Co.	2,630,338	67	2,727,103	67	2,800,536	69	2,897,446	71	2.0%
United New Jersey Water Co.	13,129,224	74	12,592,471	71	8,735,928	49	8,588,313	48	-13.9%
St. Louis County Water Co.	10,262,031	34	9,969,954	33	9,505,832	31	8,988,148	29	-4.9%
New Jersey American Water Co.	28,586,616	91	30,091,689	94	31,859,761	98	32,700,121	99	2.7%
Panel Average	13,861,404	64	14,171,155	64	14,129,039	62	14,414,497	62	-0.9%
Pennsylvania American Water Co.	28,167,700	73	45,024,151	97	46,794,136	88	47,562,629	89	6.6%

PENNSYLVANIA AMERICAN WATER COMPANY
INCOME STATEMENT COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VI
Page 9 of 17

Net Income Before Extr. Items	1995	per Customer	1996	per Customer	1997	per Customer	1998	per Customer	Compound Growth
Philadelphia Suburban Water Co.	18,321,298	\$ 71	\$ 19,943,224	\$ 73	\$ 23,104,381	\$ 79	\$ 28,531,120	\$ 94	9.7%
Consumers Pennsylvania Water Co.	1,864,260	47	2,230,884	55	2,641,470	65	2,768,433	68	12.7%
United New Jersey Water Co.	18,944,137	107	15,746,054	89	19,033,047	106	23,770,697	132	7.0%
St. Louis County Water Co.	10,526,457	35	7,409,059	25	11,555,855	38	11,903,296	39	3.5%
New Jersey American Water Co.	11,837,970	38	20,565,856	65	33,314,791	103	31,655,416	96	36.3%
Panel Average	12,298,824	57	13,179,015	59	17,929,909	78	19,725,792	85	14.5%
Pennsylvania American Water Co.	12,462,640	32	30,300,238	65	34,158,515	64	44,014,823	82	36.3%

Net Income	1995	per Customer	1996	per Customer	1997	per Customer	1998	per Customer	Compound Growth
Philadelphia Suburban Water Co.	\$ 18,635,501	\$ 72	\$ 20,326,499	\$ 74	\$ 23,629,719	\$ 80	\$ 29,284,390	\$ 96	10.0%
Consumers Pennsylvania Water Co.	2,466,172	62	2,699,445	66	2,801,207	69	3,181,990	78	7.6%
United New Jersey Water Co.	19,118,055	108	16,421,512	93	19,735,687	110	24,937,814	138	8.4%
St. Louis County Water Co.	10,768,075	36	7,750,416	26	12,101,503	40	12,667,978	42	4.9%
New Jersey American Water Co.	28,060,938	89	27,274,845	86	34,828,905	107	35,216,739	106	5.9%
Panel Average	15,809,748	73	14,894,543	67	18,619,404	81	21,057,782	91	7.6%
Pennsylvania American Water Co.	24,794,202	65	33,282,393	72	37,529,988	71	45,946,986	86	9.9%

PENNSYLVANIA AMERICAN WATER COMPANY
INCOME STATEMENT COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VI
Page 10 of 17

Production Expense/Revenue	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	3.4%	11.3%	11.5%	10.8%	46.9%
Consumers Pennsylvania Water Co.	6.7%	6.4%	5.7%	1.4%	-41.0%
United New Jersey Water Co.	11.2%	12.3%	13.4%	13.6%	5.2%
St. Louis County Water Co.	10.8%	10.4%	9.5%	9.4%	-4.5%
New Jersey American Water Co.	13.7%	12.8%	12.5%	11.5%	-5.7%
Panel Average	10.2%	11.7%	11.8%	11.1%	3.0%
Pennsylvania American Water Co.	15.3%	7.0%	5.6%	1.7%	-51.9%

Purification Expense/Revenue	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	5.1%	5.3%	5.1%	5.0%	-1.2%
Consumers Pennsylvania Water Co.	7.5%	8.1%	7.4%	9.6%	8.8%
United New Jersey Water Co.	6.5%	6.4%	6.2%	5.8%	-4.7%
St. Louis County Water Co.	9.9%	10.4%	9.4%	10.0%	0.3%
New Jersey American Water Co.	8.9%	8.9%	8.4%	9.0%	0.2%
Panel Average	7.7%	7.8%	7.4%	7.6%	-0.3%
Pennsylvania American Water Co.	6.3%	7.3%	7.3%	10.0%	16.3%

PENNSYLVANIA AMERICAN WATER COMPANY
INCOME STATEMENT COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VI
Page 11 of 17

T & D Expense/Revenue	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	15.3%	6.4%	5.8%	5.3%	-29.7%
Consumers Pennsylvania Water Co.	6.8%	6.9%	7.2%	7.5%	3.1%
United New Jersey Water Co.	6.2%	6.8%	7.6%	6.2%	-4.6%
St. Louis County Water Co.	13.7%	15.7%	14.0%	13.0%	-1.7%
New Jersey American Water Co.	6.2%	5.8%	5.6%	6.0%	-0.8%
Panel Average	9.5%	7.8%	7.5%	7.1%	-9.4%
Pennsylvania American Water Co.	8.1%	7.8%	8.2%	7.4%	-2.8%

Customers' Acc & Coll Exp/Rev	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	4.6%	4.3%	4.4%	3.6%	-7.7%
Consumers Pennsylvania Water Co.	6.3%	6.7%	5.7%	5.4%	-5.1%
United New Jersey Water Co.	4.0%	4.3%	4.2%	4.2%	-1.9%
St. Louis County Water Co.	3.9%	3.9%	3.8%	3.8%	-0.9%
New Jersey American Water Co.	3.6%	3.8%	3.4%	3.7%	1.3%
Panel Average	4.0%	4.1%	3.9%	3.8%	-1.6%
Pennsylvania American Water Co.	6.9%	6.6%	6.8%	5.8%	-5.3%

PENNSYLVANIA AMERICAN WATER COMPANY
APPENDIX VI
INCOME STATEMENT COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998
Page 12 of 17

A & G Expense/Revenue	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	15.5%	13.8%	13.2%	12.5%	-6.8%
Consumers Pennsylvania Water Co.	18.4%	18.1%	16.8%	17.3%	-2.1%
United New Jersey Water Co.	13.8%	11.8%	11.7%	11.7%	-0.7%
St. Louis County Water Co.	14.9%	15.4%	14.4%	14.5%	-0.9%
New Jersey American Water Co.	13.6%	11.5%	8.7%	9.0%	-12.9%
Panel Average	14.4%	13.0%	11.5%	11.5%	-7.3%
Pennsylvania American Water Co.	16.4%	14.8%	13.3%	12.9%	-7.7%

Total Operating Exp/Revenue	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	43.9%	41.1%	40.0%	37.3%	-5.3%
Consumers Pennsylvania Water Co.	45.8%	46.2%	42.8%	41.1%	-3.5%
United New Jersey Water Co.	41.8%	41.7%	43.1%	41.5%	-0.3%
St. Louis County Water Co.	53.1%	55.7%	51.1%	50.6%	-1.6%
New Jersey American Water Co.	45.9%	42.8%	38.7%	39.2%	-5.2%
Panel Average	45.7%	44.4%	42.1%	41.1%	-3.5%
Pennsylvania American Water Co.	52.9%	43.4%	41.2%	37.8%	-10.6%

PENNSYLVANIA AMERICAN WATER COMPANY
INCOME STATEMENT COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VI
Page 13 of 17

Utility Oper Inc/Revenue	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	28.8%	29.9%	30.9%	32.1%	3.7%
Consumers Pennsylvania Water Co.	26.3%	26.7%	27.8%	26.5%	0.3%
United New Jersey Water Co.	23.9%	23.9%	21.4%	24.0%	0.1%
St. Louis County Water Co.	22.6%	18.9%	21.3%	20.4%	-3.4%
New Jersey American Water Co.	21.9%	25.3%	28.9%	27.5%	8.0%
Panel Average	24.1%	25.0%	26.5%	26.7%	3.5%
Pennsylvania American Water Co.	22.4%	30.9%	31.3%	32.4%	13.2%

Net Income/Revenue	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	16.1%	16.9%	17.8%	19.9%	7.3%
Consumers Pennsylvania Water Co.	15.0%	15.1%	15.4%	16.0%	2.2%
United New Jersey Water Co.	16.0%	13.9%	16.2%	19.9%	19.7%
St. Louis County Water Co.	12.1%	8.5%	12.2%	12.6%	1.2%
New Jersey American Water Co.	15.2%	13.7%	15.7%	15.2%	0.1%
Panel Average	15.1%	13.6%	15.7%	16.8%	3.8%
Pennsylvania American Water Co.	13.7%	13.7%	14.5%	16.3%	5.9%

PENNSYLVANIA AMERICAN WATER COMPANY
INCOME STATEMENT COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VI
Page 14 of 17

Total Oper Exp/Thousand Gallons	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 1.82	\$ 1.79	\$ 1.69	\$ 1.66	-3.0%
Consumers Pennsylvania Water Co.	1.57	1.72	1.70	1.88	6.2%
United New Jersey Water Co.	1.60	1.65	1.73	1.68	1.1%
St. Louis County Water Co.	0.98	1.05	1.03	1.07	2.9%
New Jersey American Water Co.	1.89	2.09	1.89	1.94	1.0%
Panel Average	1.53	1.60	1.55	1.58	1.0%
Pennsylvania American Water Co.	2.45	2.15	2.07	2.09	-5.2%

Util Oper Inc/Thousand Gallons	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 1.19	\$ 1.30	\$ 1.30	\$ 1.43	6.3%
Consumers Pennsylvania Water Co.	0.90	0.99	1.10	1.21	10.3%
United New Jersey Water Co.	0.91	0.94	0.86	0.97	1.4%
St. Louis County Water Co.	0.42	0.36	0.43	0.43	1.0%
New Jersey American Water Co.	0.90	1.24	1.41	1.37	15.0%
Panel Average	0.81	0.90	0.98	1.03	8.3%
Pennsylvania American Water Co.	1.04	1.53	1.58	1.80	20.1%

PENNSYLVANIA AMERICAN WATER COMPANY
INCOME STATEMENT COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VI
Page 15 of 17

Net Income/Thousand Gallons	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 0.67	\$ 0.73	\$ 0.75	\$ 0.88	10.0%
Consumers Pennsylvania Water Co.	0.51	0.56	0.61	0.73	12.5%
United New Jersey Water Co.	0.61	0.55	0.65	0.81	21.3%
St. Louis County Water Co.	0.23	0.16	0.25	0.27	5.8%
New Jersey American Water Co.	0.62	0.67	0.77	0.75	6.5%
Panel Average	0.50	0.49	0.58	0.65	8.7%
Pennsylvania American Water Co.	0.64	0.68	0.73	0.90	12.4%

Water Sold - Thousand Gallons	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	28,022,000	27,695,000	31,482,000	33,111,000	5.7%
Consumers Pennsylvania Water Co.	4,793,000	4,814,000	4,582,000	4,342,000	-3.2%
United New Jersey Water Co.	31,214,000	30,017,000	30,256,000	30,964,000	-0.3%
St. Louis County Water Co.	47,847,000	48,351,000	49,125,000	47,490,000	-0.2%
New Jersey American Water Co.	45,026,000	40,823,000	45,372,000	46,726,000	1.2%
Panel Average	31,380,400	30,340,000	32,163,400	32,526,600	1.2%
Pennsylvania American Water Co.	39,008,000	49,132,000	51,352,000	50,951,000	9.3%

PENNSYLVANIA AMERICAN WATER COMPANY
INCOME STATEMENT COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VI
Page 16 of 17

Miles of Main	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	3,180	3,437	3,469	3,523	3.5%
Consumers Pennsylvania Water Co.	576	600	603	604	1.6%
United New Jersey Water Co.	2,053	2,057	2,038	2,050	0.0%
St. Louis County Water Co.	3,951	3,979	3,998	4,021	0.6%
New Jersey American Water Co.	4,448	4,218	4,463	4,593	1.1%
Panel Average	2,842	2,858	2,914	2,958	1.3%
Pennsylvania American Water Co.	5,596	7,398	7,466	7,560	10.5%

Average Number of Customers	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	257,937	274,368	294,089	304,259	5.7%
Consumers Pennsylvania Water Co.	39,498	40,848	40,876	40,953	1.2%
United New Jersey Water Co.	176,425	177,200	179,512	180,645	1.0%
St. Louis County Water Co.	299,068	301,386	303,152	304,707	0.6%
New Jersey American Water Co.	313,866	318,601	324,681	331,351	1.8%
Panel Average	217,359	222,481	228,462	232,383	2.3%
Pennsylvania American Water Co.	383,617	465,148	530,857	534,880	11.7%

PENNSYLVANIA AMERICAN WATER COMPANY
APPENDIX VI
INCOME STATEMENT COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998
Page 17 of 17

Thousand Gallons/Customer	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	109	101	107	109	0.1%
Consumers Pennsylvania Water Co.	121	118	112	106	-4.4%
United New Jersey Water Co.	177	169	169	171	-1.1%
St. Louis County Water Co.	160	160	162	156	-0.9%
New Jersey American Water Co.	143	128	140	141	-0.6%
Panel Average	142	135	138	137	-1.3%
Pennsylvania American Water Co.	102	106	97	95	-2.2%

Depreciation & Amortization Exp/ Net Plant (\$000's)	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 25.94	\$ 25.76	\$ 26.58	\$ 24.97	-1.3%
Consumers Pennsylvania Water Co.	\$ 25.84	\$ 27.17	\$ 28.50	\$ 37.32	13.0%
United New Jersey Water Co.	\$ 25.36	\$ 25.94	\$ 27.00	\$ 28.35	4.5%
St. Louis County Water Co.	\$ 27.62	\$ 31.00	\$ 36.44	\$ 39.75	12.9%
New Jersey American Water Co.	\$ 31.43	\$ 24.89	\$ 27.68	\$ 27.75	-4.1%
Panel Average	\$ 27.24	\$ 26.95	\$ 29.24	\$ 31.63	5.1%
Pennsylvania American Water Co.	\$ 27.35	\$ 25.69	\$ 26.77	\$ 31.37	4.7%

PENNSYLVANIA AMERICAN WATER COMPANY
BALANCE SHEET COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VII
Page 1 of 12

Net Utility Plant	1995	per MG	1996	per MG	1997	per MG	1998	per MG	Compound Growth
Philadelphia Suburban Water Co.	\$ 440,212,389	\$ 16	\$ 500,255,348	\$ 18	\$ 525,904,699	\$ 17	\$ 605,471,833	\$ 18	5.2%
Consumers Pennsylvania Water Co.	62,623,283	13	68,739,368	14	70,541,311	15	70,707,673	16	7.6%
United New Jersey Water Co.	378,819,093	12	379,890,879	13	389,565,260	13	398,617,740	13	2.0%
St. Louis County Water Co.	327,205,344	7	366,757,348	8	344,602,779	7	356,662,105	8	3.2%
New Jersey American Water Co.	582,931,296	13	821,356,150	20	831,298,297	18	898,410,250	19	14.1%
Panel Average	282,594,502	9	427,399,819	14	432,382,469	13	465,973,920	14	16.7%
Pennsylvania American Water Co.	695,724,687	18	1,080,852,729	22	1,158,650,999	23	1,207,026,112	24	9.9%

Investment and Fund Accounts	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 2,246,303	\$ 594,662	\$ 345,610	\$ 490,557	-39.8%
Consumers Pennsylvania Water Co.	531,578	525,103	466,835	505,147	-1.7%
United New Jersey Water Co.	20,669,308	20,669,308	20,669,308	20,669,308	0.0%
St. Louis County Water Co.	56,079	56,611	57,218	57,218	0.0%
New Jersey American Water Co.	2,222,093	4,133,292	1,812,993	770,020	-29.8%
Panel Average	5,145,072	5,195,795	4,670,393	4,498,450	-4.4%
Pennsylvania American Water Co.	857,736	755,703	742,316	653,729	-8.7%

MG = Thousand Gallons Sold
NM = Not Meaningful

Source: National Association Of Water Companies, Financial and Operating Data

PENNSYLVANIA AMERICAN WATER COMPANY
BALANCE SHEET COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VII
Page 2 of 12

Cash and Temp. Cash Investments	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 360,312	\$ 448,901	\$ 553,318	\$ 564,706	16.2%
Consumers Pennsylvania Water Co.	294,758	259,742	140,235	792,356	39.0%
United New Jersey Water Co.	472,419	2,451,755	3,924,109	32,001,563	261.3%
St. Louis County Water Co.	4,341,514	2,608,325	14,512,085	597,477	-48.4%
New Jersey American Water Co.	52,224	29,738	79,154	165,580	46.9%
Panel Average	1,104,245	1,159,692	3,841,780	6,824,336	83.5%
Pennsylvania American Water Co.	14,506	5,314,072	193,353	29,825	27.2%

Net Accounts Receivable	1995	per Customer	1996	per Customer	1997	per Customer	1998	per Customer	Compound Growth
Philadelphia Suburban Water Co.	\$ 9,497,422	\$ 37	\$ 9,967,557	\$ 36	\$ 9,330,050	\$ 32	\$ 12,701,503	\$ 42	4.3%
Consumers Pennsylvania Water Co.	2,163,530	55	1,786,960	44	1,783,436	44	1,807,278	44	-6.9%
United New Jersey Water Co.	12,850,260	73	12,428,394	70	11,393,467	63	11,034,718	61	-5.7%
St. Louis County Water Co.	4,922,056	16	4,463,829	15	4,927,504	16	5,382,310	18	2.4%
New Jersey American Water Co.	16,396,153	52	13,720,917	43	15,729,820	48	16,830,665	51	-0.9%
Panel Average	9,165,884	42	8,473,531	38	8,632,855	38	9,551,295	41	-0.9%
Pennsylvania American Water Co.	15,298,153	40	23,233,706	50	22,363,719	42	25,446,126	48	6.1%

PENNSYLVANIA AMERICAN WATER COMPANY
BALANCE SHEET COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VII
Page 3 of 12

Accrued Water Revenues	1995	per Customer	1996	per MG	1997	per MG	1998	per MG	Compound Growth
Philadelphia Suburban Water Co.	\$ 12,449,724	\$ 48	\$ 11,764,088	\$ 43	\$ 13,948,807	\$ 47	\$ 14,348,942	\$ 47	-0.8%
Consumers Pennsylvania Water Co.	1,133,006	29	1,206,907	30	1,143,833	28	1,241,400	30	1.9%
United New Jersey Water Co.	9,288,988	53	9,596,033	54	9,562,213	53	9,725,983	54	0.7%
St. Louis County Water Co.	10,586,374	35	10,907,071	36	10,832,336	36	11,663,510	38	2.6%
New Jersey American Water Co.	7,442,089	24	9,404,911	30	9,362,513	29	9,698,246	29	7.3%
Panel Average	8,180,036	38	8,575,802	39	9,009,940	39	9,335,616	40	2.2%
Pennsylvania American Water Co.	9,156,363	24	15,141,322	33	15,983,682	30	17,119,464	32	10.3%

Other Current Assets	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 2,314,631	\$ 645,385	\$ 540,501	\$ 503,729	-39.8%
Consumers Pennsylvania Water Co.	745,599	397,937	470,743	816,996	3.1%
United New Jersey Water Co.	8,869,364	12,480,983	1,492,676	1,261,051	-68.2%
St. Louis County Water Co.	2,207,400	9,581,173	1,295,603	1,305,551	-16.1%
New Jersey American Water Co.	5,483,037	7,056,773	6,586,156	6,290,237	4.7%
Panel Average	3,924,006	6,032,450	2,077,136	2,035,513	-19.7%
Pennsylvania American Water Co.	4,200,970	5,128,115	5,981,037	4,839,262	4.8%

PENNSYLVANIA AMERICAN WATER COMPANY
BALANCE SHEET COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VII
Page 4 of 12

Total Current Assets	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 26,499,801	\$ 24,771,217	\$ 26,219,457	\$ 30,028,085	4.3%
Consumers Pennsylvania Water Co.	4,678,147	4,061,566	3,920,199	5,005,141	2.3%
United New Jersey Water Co.	32,958,458	38,269,764	27,720,842	55,758,811	20.7%
St. Louis County Water Co.	24,579,527	30,299,646	34,275,628	27,141,667	3.4%
New Jersey American Water Co.	31,847,938	32,757,092	34,622,508	35,419,431	3.6%
Panel Average	24,112,774	26,031,857	25,351,727	30,670,627	8.3%
Pennsylvania American Water Co.	30,041,705	51,290,700	47,137,655	50,240,700	18.7%

Deferred Charges & Other Assets	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 53,792,072	\$ 54,358,274	\$ 57,931,093	\$ 59,620,357	3.5%
Consumers Pennsylvania Water Co.	7,776,641	7,226,060	7,637,544	7,337,531	-1.9%
United New Jersey Water Co.	62,042,536	52,851,866	62,362,568	67,877,508	13.3%
St. Louis County Water Co.	40,498,959	39,490,176	38,086,436	35,899,654	-3.9%
New Jersey American Water Co.	35,605,002	60,450,275	58,973,786	55,934,847	16.2%
Panel Average	39,943,042	42,875,330	44,998,285	45,333,979	4.3%
Pennsylvania American Water Co.	92,293,459	119,635,606	118,817,327	123,128,456	10.1%

PENNSYLVANIA AMERICAN WATER COMPANY
BALANCE SHEET COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VII
Page 5 of 12

Total Assets	1995	per MG	1996	per MG	1997	per MG	1998	per MG	Compound Growth
Philadelphia Suburban Water Co.	\$ 517,537,650	\$ 18	\$ 581,304,901	\$ 21	\$ 617,471,315	\$ 20	\$ 698,218,742	\$ 21	4.5%
Consumers Pennsylvania Water Co.	79,235,794	17	83,895,412	17	87,021,829	19	100,000,697	23	11.7%
United New Jersey Water Co.	497,230,927	16	507,726,130	17	509,108,415	17	553,645,800	18	3.9%
St. Louis County Water Co.	394,978,481	8	409,616,694	8	419,785,014	9	422,111,611	9	2.5%
New Jersey American Water Co.	839,405,919	19	920,152,262	23	960,481,640	21	1,008,758,420	22	5.0%
Panel Average	465,677,754	15	500,539,080	16	518,773,643	16	556,547,054	17	4.9%
Pennsylvania American Water Co.	828,245,277	16	1,290,638,170	18	1,355,818,892	16	1,423,924,503	17	2.0%

Total Common & Preferred Stock	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 24,543,000	\$ 23,043,000	\$ 21,614,500	\$ 17,400,000	-10.8%
Consumers Pennsylvania Water Co.	3,441,717	3,572,967	3,572,967	3,572,967	1.3%
United New Jersey Water Co.	45,525,730	45,465,730	45,405,730	45,345,730	-0.1%
St. Louis County Water Co.	31,900,000	31,900,000	31,900,000	31,900,000	0.0%
New Jersey American Water Co.	71,427,300	77,905,800	82,955,700	89,113,200	7.7%
Panel Average	35,367,549	36,377,499	37,089,779	37,466,379	1.9%
Pennsylvania American Water Co.	39,773,887	39,532,687	39,271,687	40,743,087	0.8%

PENNSYLVANIA AMERICAN WATER COMPANY
BALANCE SHEET COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998
APPENDIX VII
Page 6 of 12

Total Long-Term Debt	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 175,394,837	\$ 217,517,972	\$ 232,471,160	\$ 261,826,044	14.3%
Consumers Pennsylvania Water Co.	33,195,758	32,675,580	32,414,591	32,152,993	-1.1%
United New Jersey Water Co.	175,000,000	170,000,000	170,000,000	205,060,000	9.8%
St. Louis County Water Co.	133,563,000	137,568,000	134,314,000	128,118,000	-1.4%
New Jersey American Water Co.	336,000,000	381,000,000	424,000,000	464,000,000	11.4%
Panel Average	170,630,719	187,752,310	198,639,950	218,231,407	8.5%
Pennsylvania American Water Co.	309,520,000	589,940,376	603,122,181	599,355,863	24.6%

Notes Payable	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 13,870,243	\$ 12,553,865	\$ 2,477,812	\$ 2,452,117	-43.9%
Consumers Pennsylvania Water Co.	1,365,000	3,440,000	4,310,000	13,190,000	113.0%
United New Jersey Water Co.	10,500,000	22,000,000	25,000,000	19,500,000	0.0%
St. Louis County Water Co.	-	-	-	-	0.0%
New Jersey American Water Co.	63,022,000	70,782,000	20,554,000	4,545,000	-58.4%
Panel Average	17,751,449	21,755,173	10,468,362	7,937,423	-23.5%
Pennsylvania American Water Co.	34,098,964	-	1,872,162	36,323,743	2.1%

PENNSYLVANIA AMERICAN WATER COMPANY
BALANCE SHEET COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998
APPENDIX VII
Page 7 of 12

Accounts Payable	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 9,777,349	\$ 9,476,039	\$ 10,269,855	\$ 16,540,278	19.2%
Consumers Pennsylvania Water Co.	926,169	701,723	810,310	2,954,406	47.2%
United New Jersey Water Co.	7,146,975	7,889,041	4,193,604	11,080,225	18.5%
St. Louis County Water Co.	9,522,960	9,302,019	9,957,935	10,231,445	2.4%
New Jersey American Water Co.	19,597,275	4,858,301	11,955,582	7,087,580	-28.8%
Panel Average	9,394,146	6,445,425	7,437,457	9,578,787	0.7%
Pennsylvania American Water Co.	7,837,729	12,408,260	9,961,863	15,569,178	25.7%

Income Taxes Payable	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 2,664,428	\$ 3,353,507	\$ 4,082,317	\$ 6,664,983	35.7%
Consumers Pennsylvania Water Co.	521,464	411,618	199,093	313,100	-12.8%
United New Jersey Water Co.	21,844,589	14,083,347	22,729,604	20,289,675	20.0%
St. Louis County Water Co.	768,925	454,378	573,561	899,493	40.7%
New Jersey American Water Co.	6,108,509	222,596	216,356	261,085	8.3%
Panel Average	6,381,583	3,705,089	5,560,186	5,685,667	-3.8%
Pennsylvania American Water Co.	107,230	3,498,314	4,308,855	4,646,903	15.3%

PENNSYLVANIA AMERICAN WATER COMPANY
BALANCE SHEET COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998
APPENDIX VII
Page 8 of 12

Other Current Liabilities	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 12,437,830	\$ 13,583,267	\$ 15,029,175	\$ 15,591,123	7.8%
Consumers Pennsylvania Water Co.	1,187,582	1,276,432	1,455,108	1,113,228	-2.1%
United New Jersey Water Co.	2,935,031	8,798,492	8,230,755	1,332,851	-61.1%
St. Louis County Water Co.	6,239,704	6,840,732	8,051,217	7,965,600	8.5%
New Jersey American Water Co.	18,287,556	16,860,485	20,726,314	17,482,748	-1.5%
Panel Average	8,217,541	9,471,882	10,698,514	8,697,110	1.9%
Pennsylvania American Water Co.	12,312,389	18,800,448	22,622,642	21,859,623	21.1%

Total Current Liabilities	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 38,917,211	\$ 39,106,976	\$ 31,973,684	\$ 41,286,990	2.0%
Consumers Pennsylvania Water Co.	4,004,382	5,833,940	6,778,678	17,570,734	63.7%
United New Jersey Water Co.	42,426,595	52,770,880	60,153,963	52,202,751	-0.5%
St. Louis County Water Co.	16,531,589	16,597,129	18,582,713	19,096,538	4.9%
New Jersey American Water Co.	107,029,078	92,723,382	51,469,825	29,376,413	-35.0%
Panel Average	41,781,771	41,406,461	33,791,773	31,906,685	-8.6%
Pennsylvania American Water Co.	54,705,123	35,052,607	39,107,475	78,738,167	12.9%

PENNSYLVANIA AMERICAN WATER COMPANY
BALANCE SHEET COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VII
Page 9 of 12

Deferred Credits & Other Liabilities	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 81,153,994	\$ 85,143,803	\$ 91,685,537	\$ 99,483,645	7.0%
Consumers Pennsylvania Water Co.	9,980,641	10,496,362	10,986,816	11,057,537	3.5%
United New Jersey Water Co.	107,074,659	111,536,462	101,665,260	111,362,463	-0.1%
St. Louis County Water Co.	63,008,310	61,783,519	60,618,987	57,917,796	-2.8%
New Jersey American Water Co.	74,449,506	94,778,528	104,238,417	98,904,626	9.9%
Panel Average	67,133,422	72,747,735	73,839,003	75,745,213	4.1%
Pennsylvania American Water Co.	137,550,809	149,717,953	166,674,241	181,396,468	9.7%

Contributions in Aid of Construction	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 23,194,727	\$ 23,859,126	\$ 24,855,827	\$ 26,096,009	4.0%
Consumers Pennsylvania Water Co.	4,055,930	4,888,860	5,246,346	5,312,043	9.4%
United New Jersey Water Co.	5,419,911	5,806,833	6,615,999	6,958,349	9.5%
St. Louis County Water Co.	36,651,914	41,919,644	47,140,166	53,802,651	13.6%
New Jersey American Water Co.	28,682,464	32,165,665	35,012,473	36,441,509	8.3%
Panel Average	19,600,989	21,728,026	23,774,162	25,722,112	9.5%
Pennsylvania American Water Co.	41,342,684	43,458,816	44,199,674	46,113,314	3.7%

PENNSYLVANIA AMERICAN WATER COMPANY
BALANCE SHEET COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VII
Page 10 of 12

Additional Paid-In Capital	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 45,574,992	\$ 48,794,992	\$ 48,794,992	\$ 69,109,648	14.9%
Consumers Pennsylvania Water Co.	13,376,285	14,247,785	14,247,785	15,247,785	4.5%
United New Jersey Water Co.	81,180,948	81,180,948	81,886,746	81,886,746	0.4%
St. Louis County Water Co.	2,764,716	2,764,716	2,764,716	2,764,716	0.0%
New Jersey American Water Co.	125,682,523	144,087,023	158,920,123	177,645,623	12.2%
Panel Average	53,715,893	58,215,093	61,322,872	69,330,904	8.9%
Pennsylvania American Water Co.	94,154,938	269,268,443	286,283,103	286,299,536	44.9%

Retained Earnings	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 102,878,894	\$ 120,314,895	\$ 140,265,876	\$ 152,984,357	14.1%
Consumers Pennsylvania Water Co.	10,093,208	10,977,243	12,530,265	13,730,069	10.9%
United New Jersey Water Co.	36,979,808	37,350,070	39,581,881	46,452,445	11.5%
St. Louis County Water Co.	67,215,535	72,144,450	79,990,953	85,105,431	8.2%
New Jersey American Water Co.	65,882,283	72,571,943	82,071,663	91,089,603	11.4%
Panel Average	56,609,946	62,671,720	70,888,128	77,876,381	11.2%
Pennsylvania American Water Co.	107,268,810	117,812,363	128,629,075	140,172,535	9.3%

PENNSYLVANIA AMERICAN WATER COMPANY
BALANCE SHEET COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VII
Page 11 of 12

Total Common Equity	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 165,853,976	\$ 186,509,887	\$ 206,460,868	\$ 239,494,005	13.0%
Consumers Pennsylvania Water Co.	25,865,068	27,751,853	29,304,875	31,524,679	6.8%
United New Jersey Water Co.	138,966,486	139,336,748	142,274,357	149,144,921	3.5%
St. Louis County Water Co.	101,880,251	106,809,166	114,565,669	119,770,147	5.5%
New Jersey American Water Co.	260,502,106	292,191,766	321,691,486	355,709,426	10.9%
Panel Average	138,613,577	150,519,884	162,859,451	179,128,636	8.9%
Pennsylvania American Water Co.	22,930,635	408,587,693	436,419,065	447,978,958	169.3%

Total Liabilities and Net Worth	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 517,537,650	\$ 581,304,901	\$ 617,471,315	\$ 698,218,742	10.5%
Consumers Pennsylvania Water Co.	79,235,794	83,895,415	87,020,829	100,000,697	8.1%
United New Jersey Water Co.	497,230,927	507,726,130	509,108,415	553,645,800	4.4%
St. Louis County Water Co.	394,978,481	409,616,694	419,785,014	422,111,611	2.2%
New Jersey American Water Co.	839,405,919	920,152,262	960,481,640	1,008,758,420	6.3%
Panel Average	465,677,754	500,539,080	518,773,443	556,547,054	6.1%
Pennsylvania American Water Co.	828,245,277	1,290,638,170	1,355,818,892	1,423,924,503	19.8%

PENNSYLVANIA AMERICAN WATER COMPANY
BALANCE SHEET COMPARATIVE PANEL DATA
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VII
Page 12 of 12

Total Assets/Customer	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 2,006	\$ 2,119	\$ 2,100	\$ 2,295	4.6%
Consumers Pennsylvania Water Co.	2,006	2,054	2,129	2,442	6.8%
United New Jersey Water Co.	2,818	2,865	2,836	3,065	3.4%
St. Louis County Water Co.	1,321	1,359	1,385	1,385	1.6%
New Jersey American Water Co.	2,674	2,888	2,958	3,044	4.4%
Panel Average	2,142	2,250	2,271	2,395	3.8%
Pennsylvania American Water Co.	2,159	2,775	2,554	2,662	7.2%

Total Assets/Mile of Main	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 162,748	\$ 169,131	\$ 177,997	\$ 198,189	6.8%
Consumers Pennsylvania Water Co.	137,562	139,826	144,315	165,564	6.4%
United New Jersey Water Co.	242,197	246,828	249,808	270,071	4.6%
St. Louis County Water Co.	99,969	102,945	104,999	104,977	1.6%
New Jersey American Water Co.	188,715	218,149	215,210	219,630	5.2%
Panel Average	163,879	175,124	178,016	188,137	4.7%
Pennsylvania American Water Co.	148,007	174,458	181,599	188,350	8.4%

PENNSYLVANIA AMERICAN WATER COMPANY
APPENDIX VIII
COMPARATIVE OPERATING DATA AND RATIOS
Page 1 of 5
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

Unaccounted for Water	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	17.1%	19.7%	16.9%	16.6%	-1.0%
Consumers Pennsylvania Water Co.	28.7%	31.7%	27.9%	28.4%	-0.3%
United New Jersey Water Co.	19.3%	19.6%	22.2%	18.6%	-2.6%
St. Louis County Water Co.	16.1%	14.4%	15.1%	15.6%	-1.0%
New Jersey American Water Co.	4.6%	11.0%	9.3%	11.0%	33.7%
Panel Average	17.2%	19.3%	18.3%	18.0%	1.7%
Pennsylvania American Water Co.	25.6%	32.8%	29.3%	26.8%	1.5%

Customers/Employees	1995	1996	1997	1998	Compound Growth
Suburban Philadelphia Water Co.	490	517	563	571	5.2%
Consumers Pennsylvania Water Co.	420	435	452	506	6.4%
United New Jersey Water Co.	411	466	483	480	1.5%
St. Louis County Water Co.	521	517	519	496	-1.6%
New Jersey American Water Co.	527	553	559	576	3.0%
Panel Average	474	498	515	526	3.5%
Pennsylvania American Water Co.	468	418	487	493	1.7%

Source: National Association of Water Companies, Financial and Operating Data

PENNSYLVANIA AMERICAN WATER COMPANY
COMPARATIVE OPERATING DATA AND RATIOS
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VIII
Page 2 of 5

Gross Plant/Employees	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 1,008,511	\$ 1,144,520	\$ 1,235,664	\$ 1,386,051	11.2%
Consumers Pennsylvania Water Co.	803,626	883,790	1,028,909	1,084,697	10.5%
United New Jersey Water Co.	1,089,105	1,255,120	1,335,973	1,374,524	4.6%
St. Louis County Water Co.	722,589	745,691	778,154	779,826	2.6%
New Jersey American Water Co.	1,176,325	1,661,022	1,700,791	1,876,090	16.8%
Panel Average	960,031	1,138,029	1,215,898	1,300,238	10.6%
Pennsylvania American Water Co.	986,057	1,113,720	1,228,720	1,305,052	9.8%

Gross Revenues/Employees	1995	1996	1997	1998	Compound Growth
Suburban Philadelphia Water Co.	\$ 220,291	\$ 226,616	\$ 254,088	\$ 276,444	7.9%
Consumers Pennsylvania Water Co.	175,028	190,704	216,213	245,282	11.9%
United New Jersey Water Co.	278,176	311,704	326,957	333,796	3.5%
St. Louis County Water Co.	154,410	156,423	169,303	163,919	2.0%
New Jersey American Water Co.	310,288	345,894	381,577	402,862	9.1%
Panel Average	227,639	246,268	269,628	284,461	7.7%
Pennsylvania American Water Co.	220,668	218,610	237,386	259,962	5.6%

PENNSYLVANIA AMERICAN WATER COMPANY
COMPARATIVE OPERATING DATA AND RATIOS
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VIII
Page 3 of 5

Gross Plant/Customers	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 2,057	\$ 2,215	\$ 2,193	\$ 2,428	5.7%
Consumers Pennsylvania Water Co.	1,913	2,034	2,122	2,145	3.9%
United New Jersey Water Co.	2,648	2,692	2,769	2,861	3.1%
St. Louis County Water Co.	1,387	1,442	1,499	1,571	4.2%
New Jersey American Water Co.	2,234	3,003	3,043	3,256	13.4%
Panel Average	2,048	2,277	2,325	2,452	6.2%
Pennsylvania American Water Co.	2,108	2,665	2,521	2,647	7.9%

Gross Revenues/Customers	1995	1996	1997	1998	Compound Growth
Suburban Philadelphia Water Co.	\$ 449.23	\$ 438.58	\$ 451.00	\$ 484.27	2.5%
Consumers Pennsylvania Water Co.	416.54	438.85	444.31	485.13	5.2%
United New Jersey Water Co.	676.42	668.44	677.55	694.77	2.0%
St. Louis County Water Co.	296.36	302.58	326.15	330.30	3.7%
New Jersey American Water Co.	589.20	625.34	682.81	699.09	5.9%
Panel Average	485.55	494.76	516.36	538.71	3.5%
Pennsylvania American Water Co.	471.69	523.09	486.97	527.33	3.8%

PENNSYLVANIA AMERICAN WATER COMPANY
COMPARATIVE OPERATING DATA AND RATIOS
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VIII
Page 4 of 5

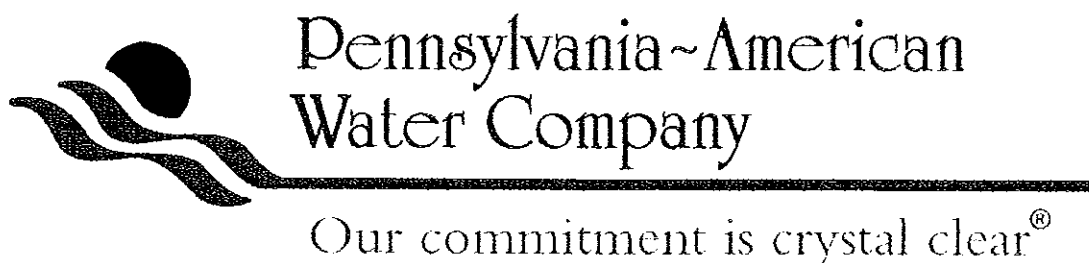
O & M Expenses/Customers	1995	1996	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 197.26	\$ 180.19	\$ 180.50	\$ 180.41	-2.9%
Consumers Pennsylvania Water Co.	190.57	202.76	190.17	199.60	1.6%
United New Jersey Water Co.	282.70	278.67	291.74	288.14	1.7%
St. Louis County Water Co.	157.24	168.50	166.51	167.08	2.0%
New Jersey American Water Co.	270.56	267.62	264.43	273.72	0.4%
Panel Average	219.67	219.55	218.67	221.79	0.3%
Pennsylvania American Water Co.	219.78	227.18	200.69	199.15	-3.2%

Gross Plant/Revenues	1995	1996	1997	1998	Compound Growth
Suburban Philadelphia Water Co.	\$ 4.58	\$ 5.05	\$ 4.86	\$ 5.01	3.0%
Consumers Pennsylvania Water Co.	4.59	4.63	4.78	4.42	-1.3%
United New Jersey Water Co.	3.92	4.03	4.09	4.12	1.1%
St. Louis County Water Co.	4.68	4.77	4.60	4.76	0.6%
New Jersey American Water Co.	3.79	4.80	4.46	4.66	7.1%
Panel Average	4.31	4.66	4.56	4.59	2.1%
Pennsylvania American Water Co.	4.47	5.09	5.18	5.02	3.9%

PENNSYLVANIA AMERICAN WATER COMPANY
COMPARATIVE OPERATING DATA AND RATIOS
FOR THE YEARS ENDED DECEMBER 31, 1995 - 1998

APPENDIX VIII
Page 5 of 5

Net Plant/Revenues	1995	1995	1997	1998	Compound Growth
Philadelphia Suburban Water Co.	\$ 3.80	\$ 4.16	\$ 3.97	\$ 4.11	2.6%
Consumers Pennsylvania Water Co.	3.80	3.83	3.88	3.56	-2.2%
United New Jersey Water Co.	3.17	3.21	3.20	3.18	-0.5%
St. Louis County Water Co.	3.69	3.69	3.49	3.54	-1.4%
New Jersey American Water Co.	3.15	4.12	3.75	3.88	7.2%
Panel Average	3.52	3.80	3.66	3.65	1.2%
Pennsylvania American Water Co.	3.84	4.44	4.48	4.28	3.7%



**PUC Focused
Management/
Operations Audit
(Implementation Plan)**

October 2000

Summary

Rec. No.	Recommendation	Acceptance	Status	Project Implementation Date	Personnel Responsible
	Fleet Operations				
1	Customize the vehicle exception parameters based on the Company's fleet profile. Management should periodically review and update the parameters on a timely basis to properly identify vehicles operating inefficiently and to enforce fleet operating standards.	Accepted	In Progress	April 2001	President, V.P. & Treasurer
2	Conduct and document fleet cost activity and operating practice benchmarking studies on a periodic basis.	Accepted	In Progress	October 2001	President, V.P. & Treasurer
3	Update the vehicle management operating policies and procedures manual and periodically review and revise as necessary.	Accepted	In Progress	October 2001	President, V.P. & Treasurer
	Energy Procurement				
1	Conduct a current preliminary energy survey for its 29 demand metered accounts in order to identify potential energy audit candidate sites. Prioritize, schedule, and conduct energy audits for these sites in a timely manner based on the cost-effective energy conservation measures.	Accepted	In Progress	October 2001	President, Vice Presidents of Operation Vice President of Engineering
	Unaccounted-for Water				
1	Develop an automated company-wide leak survey and repair database to be utilized with the recommended main replacement prioritization procedure.	Accepted	In Progress	October 2001	President, Vice Presidents Of Operation
2	Develop a formalized main replacement procedure based on weighted factors in order to systematically prioritize main replacement candidates on a state-wide basis.	Accepted	In Progress	October 2001	President, Vice Presidents Of Operation
3	Conduct a cost/benefit study on a periodic basis to determine the appropriate mix of contractors and in-house personnel to perform annual leak survey work.	Accepted	In Progress	April 2002	President, Vice Presidents Of Operation
	Drought Contingency Planning				
1	Develop internal management action plans to support the staged supply extension and demand reduction measures for those districts evaluated for drought vulnerability on a risk assessment basis.	Accepted	In Progress	October 2001	President, Vice Presidents Of Operation

Rec. No.	Recommendation	Acceptance	Status	Project Implementation Date	Personnel Responsible
	Customer Call Center Consolidation				
1	Continue efforts to consolidate the existing customer service call centers. Management should complete and document detailed plans and cost benefit analyses in support of consolidation strategy chosen. Also, PAWC should formally track actual implementation costs and realized benefits from the consolidation, and retain these results for regulatory review.	Accepted	In Progress	April 2001	President, V.P. & Treasurer
	Meter Reading				
1	Perform and document a cost/benefit analysis for full and/or partial deployment of an automatic fixed-network meter reading (AMR) system; include an analysis of operating and capital expenses which reflect productivity improvements and staffing reductions that could be realized.	Accepted	In Progress	October 2001	President, V.P. & Treasurer
	Cost Allocations				
1	Develop a more detailed internal audit report that clearly defines the audit scope and results, as well as the corrective actions recommended, for the periodic cost allocation and direct billing charge review. A copy of the audit report should be routinely provided to PAWC and other AWWC operating companies.	Accepted	In Progress	October 2001 (next audit)	Vice President & Comptroller, AWWSC; and Director of Internal Audits, AWWSC
	PG&W Acquisition				
	None	N/A	N/A	N/A	N/A
	Diversity				
1	Set goals with timetables for increasing the Company's female and minority employment percentages, especially for the Pittsburgh, Wilkes-Barre/Scranton, and Hershey-Corporate geographic locations.	Accepted	In Progress	April 2001	President, V.P. of Human Resources
2	Develop annual MWDBE procurement goals with accountability established at the Regional Operating Manager Level.	Accepted	In Progress	April 2001	President, V.P. & Comptroller
3	Update the Company's MWDBE vendor list and integrate it into the purchasing process, and establish a process to ensure that the MWDBE	Accepted	In Progress	October 2001	President, V.P.

Detail

Pennsylvania-American Water Company
IMPLEMENTATION PLAN

FLEET OPERATIONS

Recommendation No. 1

Customize the vehicle exception parameters based on the Company's fleet profile. Management should periodically review and update the parameters on a timely basis to properly identify vehicles operating inefficiently and to enforce fleet operating standards.

The new parameters will be established by type of vehicle and customized to meet PAWC's requirements by April 30, 2001.

Company Acceptance

The Company accepts this recommendation.

Discussion

The vehicle exception reports have been moved to the financial area of the company to determine what parameters are to be established for the different types of vehicles to monitor and distribute the exception reports. In conjunction with our fleet management company, the parameters used to determine exception reporting will be reviewed.

Implementation Date

The recommendation will be implemented by April 2001.

Personnel Responsible

President
Vice President & Treasurer

Pennsylvania-American Water Company
IMPLEMENTATION PLAN

FLEET OPERATIONS

Recommendation No. 2

Conduct and document fleet cost activity and operating practice benchmarking studies on a periodic basis.

Company Acceptance

The Company accepts this recommendation.

Discussion

In conjunction with its fleet manager, PAWC will develop benchmarking studies and annually conduct fleet cost activities.

Implementation Date

The recommendation will be implemented by October 2001.

Personnel Responsible

President
Vice President & Treasurer

Pennsylvania-American Water Company
IMPLEMENTATION PLAN

FLEET OPERATIONS

Recommendation No. 3

Update the vehicle management operating policies and procedures manual and periodically review and revise as necessary.

Company Acceptance

The Company accepts this recommendation.

Discussion

PAWC will review and update the vehicle management policy and procedures which will contain vehicle use criteria, safety guidelines, operating practices and vehicle determination needs.

Implementation Date

The recommendation will be implemented by October 2001.

Personnel Responsible

President
Vice President & Treasurer

Pennsylvania-American Water Company
IMPLEMENTATION PLAN

ENERGY PROCUREMENT

Recommendation No. 1

Conduct a current preliminary energy survey for its 29 demand metered accounts in order to identify potential energy audit candidate sites. Prioritize, schedule, and conduct energy audits for these sites in a timely manner based on the cost-effective energy conservation measures.

Company Acceptance

The Company accepts this recommendation.

Discussion

Pennsylvania-American Water Company intends to implement this recommendation by conducting the preliminary energy survey for its 29 demand metered locations. The objective of the survey will be to identify, prioritize and schedule energy audits for selected locations in a timely manner.

The ultimate goal of the selected energy audits will be to identify energy consumption patterns, identify and quantify energy conservation measures (ECMs) and to evaluate strategies to reduce energy usage.

The preliminary survey will be conducted by either internal expertise or a combination of internal and external (consultant) expertise.

Implementation Date

The Company will implement this recommendation by October 2001.

Personnel Responsible

President
Vice Presidents of Operation
Vice President of Engineering

Pennsylvania-American Water Company
IMPLEMENTATION PLAN

UNACCOUNTED-FOR WATER

Recommendation No. 1

Develop an automated company-wide leak survey and repair database to be utilized with the recommended main replacement prioritization procedure.

Company Acceptance

The Company accepts this recommendation.

Discussion

The Company's operating personnel maintain some form, i.e. paper (file folders), leak cards, computer spreadsheets, etc., of main break records. The Company will enhance a PC data-base program, already in use in one of the Company's operations, to develop a standardized data-base for use state-wide. Data currently available in PAWC's various operations will be reviewed to determine that the most meaningful and value-added data is included in this program.

Once the standardized program is developed, the data-base must be constructed going forward before it becomes a useful tool in planning capital main replacement projects. The data-base will be capable of being queried to provide information in a number of ways.

Implementation Date

The Company will develop the data-base program for state-wide use by October 2001.

Personnel Responsible

President
Vice Presidents of Operation

Pennsylvania-American Water Company
IMPLEMENTATION PLAN

UNACCOUNTED-FOR WATER

Recommendation No. 2

Develop an automated main replacement procedure based on weighted factors in order to systematically prioritize main replacement candidates on a state-wide basis.

Company Acceptance

The Company accepts this recommendation.

Discussion

The Company agrees to develop a uniform formula-based procedure to objectively prioritize main replacement candidates across the state. The formula will be developed based on input from operating personnel so as to include all necessary factors in identifying potential main replacement projects.

The formula-based approach will be used as soon as a meaningful database (unaccounted-for recommendation R-1) is constructed.

Implementation Date

The Company will develop the formula by October 2001.

Personnel Responsible

President
Vice Presidents of Operation

Pennsylvania-American Water Company
IMPLEMENTATION PLAN

UNACCOUNTED-FOR WATER

Recommendation No. 3

Conduct a cost/benefit study on a periodic basis to determine the appropriate mix of contractors and in-house personnel to perform annual leak survey work.

Company Acceptance

The Company accepts this recommendation.

Discussion

The Company will periodically conduct cost/benefit analyses to determine the benefits of external leak detection resources to supplement the Company's existing resources.

The cost of additional external resources and potential additional capital expenditures or maintenance expense will be analyzed against expected cost savings resulting from reduced unaccounted-for water, i.e., chemical, fuel and power and waste disposal costs.

Implementation Date

The Company will implement the recommendation by April 2002.

Personnel Responsible

President
Vice Presidents of Operation

Pennsylvania-American Water Company
IMPLEMENTATION PLAN

DROUGHT CONTINGENCY PLANNING

Recommendation No. 1

Develop internal management action plans to support the staged supply extension and demand reduction measures for those districts evaluated for drought vulnerability on a risk assessment basis.

Company Acceptance

The Company accepts this recommendation.

Discussion

The audit recommends development of internal management planning documents to support the Company's staged supply extension and demand reduction measures outlined in its Drought Contingency Plans.

The Company intends to implement this recommendation by including additional documentation as needed. PAWC will review each of its Drought Contingency plans and incorporate additional strategies to deal with high risk operations normally first affected by drought conditions. Management plans will be reviewed and additional language drafted as appropriate for each system. Support language will be added, as needed, to each plan so that objectives are sound and well-defined and action plans clearly documented.

Implementation Date

The Company will implement this recommendation by October 2001.

Personnel Responsible

President
Vice Presidents of Operation

Pennsylvania-American Water Company
IMPLEMENTATION PLAN

CUSTOMER CALL CENTER CONSOLIDATION

Recommendation No. 1

Continue efforts to consolidate the existing customer service call centers. Management should complete and document detailed plans and cost benefit analyses in support of the consolidation strategy chosen. Also, PAWC should formally track actual implementation costs and realized benefits from the consolidation, and retain these results for regulatory review.

Company Acceptance

The Company accepts this recommendation.

Discussion

A preliminary customer call center consolidation study, encompassing the entire American Water System has been completed. The study will be updated with more specific information once the site selection process is completed. It will include a cost/benefit analysis evaluating potential service improvements and cost savings as compared to the current decentralized system.

The consolidation study, as well as actual implementation costs and realized benefits, will be documented and made available for Commission review.

Implementation Date

The detailed implementation plan is currently in development and expected to be completed by year-end. It will begin merging the various companies' call centers in the first half of 2001. A final rollout schedule, including the order of merger, is not known at this time. If a decision not to consolidate System-wide is made, PAWC will resume its study to consolidate its three existing call centers into one for the state.

Personnel Responsible

President
Vice President & Treasurer

Pennsylvania-American Water Company
IMPLEMENTATION PLAN

METER READING

Recommendation No. 1

Perform and document a cost/benefit analysis for full and/or partial deployment of an automatic fixed-network meter reading (AMR) system; include an analysis of operating and capital expenses which reflect productivity improvements and staffing reductions that could be realized.

Company Acceptance

The Company accepts this recommendation.

Discussion

The Company regards this recommendation as in progress. In conjunction with an American Water System study, PAWC is studying the cost/benefits of a Ramar radio frequency system as well as Itron and Schlumberger handheld systems. PAWC received and analyzed proposals from Itron and Schlumberger to install an AMR system in the Pittsburgh operation. The analyses indicated that, although technologies continue to improve, the Company was not able to cost-justify an AMR system.

PAWC will continue working with the various vendors to update/redesign studies when prudent and incorporate new technologies into the studies when available. At the same time, the American Water System will continue to evaluate fixed network AMR systems.

Implementation Date

The Company will complete this recommendation by October 2001.

Personnel Responsible

President
Vice President & Treasurer

Pennsylvania-American Water Company
IMPLEMENTATION PLAN

COST ALLOCATIONS

Recommendation No. 1

Develop a more detailed internal audit report that clearly defines the audit scope and results, as well as the corrective actions recommended, for the periodic cost allocation and direct billing charge review. A copy of the audit report should be routinely provided to PAWC and other AWWC operating companies.

Company Acceptance

The Company accepts this recommendation.

Discussion

The Internal Audit Department of American Water Works Service Company, Inc. will comply with the recommendation by including its audit program as part of the audit report. The audit program will be paraphrased in the report to eliminate specific references to report identification numbers, etc. that are usually included in the audit program to make it easier for the staff auditors to follow.

The audit report will be distributed to all American System comptrollers. In the past, the report was only issued upon request. The next Service Company billing audit, scheduled for 2001, will incorporate the recommended changes.

Implementation Date

The Company will implement this recommendation by October 2001.

Personnel Responsible

Vice Presidents & Comptroller, AWWSC
Director of Internal Audits, AWWSC

Pennsylvania-American Water Company
IMPLEMENTATION PLAN

DIVERSITY

Recommendation No. 1

Set goals with timetables for increasing the Company's female and minority employment percentages, especially for the Pittsburgh, Wilkes-Barre/Scranton, and Hershey Corporate geographic locations.

Company Acceptance

The Company accepts this recommendation.

Discussion

PAWC agrees that hiring goals with timetables be established for every operating region in the state, with special oversight and emphasis in Pittsburgh, Wilkes-Barre/Scranton, and Hershey Corporate. An updated statistical review will be performed immediately by the Human Resource Department to identify underutilized job groups in all areas of the state.

As openings occur, Human Resource Managers, in conjunction with the appropriate department head, will take every step necessary in the hiring process to achieve appropriate representation of females and minorities in the associate population. The EEO Officer (President) and EEO Coordinator (Vice President Human Resources) will review the results quarterly and discuss the progress at scheduled managers' meetings.

Implementation Date

The Company will implement this recommendation by April 2001.

Personnel Responsible

President
Vice President of Human Resources

Pennsylvania-American Water Company
IMPLEMENTATION PLAN

DIVERSITY

Recommendation No. 2

Develop annual MWDBE procurement goals with accountability established at the regional operating manager level.

Company Acceptance

The Company accepts this recommendation.

Discussion

PAWC agrees that procurement goals with accountability be established. Goals will be established at the Company level with each manager held accountable for his or her contribution to reaching these goals.

Each manager will be required to submit quarterly reports to the EEO coordinator detailing procurement activity, including dollars spent, new vendors and other activity. The EEO coordinator will review the various reports and submit a consolidated report to the EEO officer (president). During scheduled managers' meetings, the EEO officer and coordinator will discuss the progress of the Company's MWBDE procurement program.

Implementation Date

The Company will implement this recommendation by April 2001.

Personnel Responsible

President
Vice President & Comptroller

Pennsylvania-American Water Company
IMPLEMENTATION PLAN

DIVERSITY

Recommendation No. 3

Update the Company's MWDBE vendor list and integrate it into the purchasing process, and establish a process to ensure that the MWDBE vendor list remains current in the future.

Company Acceptance

The Company accepts this recommendation.

Discussion

PAWC will update its vendor list by identifying minority vendors applicable to its operations. This will be accomplished using four sources; the internet, UDAC, affiliated Companies' vendor lists and contacts made by local operations personnel. The updated list will include existing and potential new vendors. New vendors added will be provided to the EEO coordinator and included in the quarterly reports to the EEO officer.

The vendor list will be maintained on a company wide computerized network. This will ensure that all individuals involved in the purchasing process have access to the current list of minority vendors. In order to ensure that the list contains current data, PAWC will contact each vendor annually to ascertain their current status.

The Company's financial software vendor does not provide or support modifications to the purchasing software. PAWC will explore other options, including custom modification to the software, to further integrate the vendor list into the purchasing process.

Implementation Date

The Company will implement this recommendation by October 2001.

Personnel Responsible

President
Vice President & Controller