



TENNESSEE REGULATORY AUTHORITY

460 James Robertson Parkway
Nashville, Tennessee 37243-0505

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June 11, 2009

Director Sara Kyle
Director Mary W. Freeman
Tennessee Regulatory Authority
460 James Roberson Parkway
Nashville, TN 37243-0505

RE: **Docket 08-00039** 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

Dear Directors Kyle and Freeman:

Please find the attached motion that I plan to make at our scheduled Authority Conference on June 15, 2009, in the above-referenced Authority Section 4 agenda item. For your convenience, I am filing this today in order that you have sufficient time for review before we deliberate.

Sincerely,

Eddie Roberson
Chairman

Attachment

Chairman Roberson's Motion

Docket No. 08-00039

On January 13, 2009, the panel issued its *Order* directing the Tennessee American Water Company ("TAWC") to develop a Request For Proposal ("RFP") for a comprehensive management audit by an independent certified public accountant. The RFP was ordered to include, but not be limited to, an investigation of American Water Works Company, Inc.'s ("AWWC") management performance and decisions relating to internal processes and internal controls with an attestation and recommendation of any needed management changes and implementation thereof. Further, the audit was to evaluate and attest to the charges allocated to TAWC, including the efficiency of processes and/or functions performed on behalf of TAWC, as well as the accuracy and reasonableness of the allocation factors utilized. The RFP was to be filed in this docket no later than six months from September 22, 2008, for approval by the Authority. The issuance of the RFP was to occur subsequent to an approval of the RFP by the Authority.

Further, the panel determined that if, during the bidding process, the RFP results in a bid which might not yield a benefit to TAWC customers, the Authority could order that the management audit not be performed. In this regard, the panel discussed other alternatives available to the Authority, including the participation in a multi-state audit which may be authorized by regulatory agencies in those states served by companies owned by AWWC. The benefit of a multi-state audit approach is the potential of sharing audit costs.

The Company filed its *Notice of Filing of Tennessee American Water Company's Request for Proposal for a Management Audit* on March 23, 2009. The RFP for a management audit is before the panel for consideration. Authority Staff has made some suggested changes to the RFP. Prior to our deliberating a final RFP, I would like to allow public comment.

I move the following:

- 1) that the Authority open a new docket for consideration of the RFP, and transfer all filings related to the RFP in Docket No. 08-00039 to the new docket;
- 2) that the Authority direct its Staff to contact other state regulatory agencies in states served by companies owned by AWWC to determine any interest in participation in a multi-state audit;
- 3) that the Authority appoint General Counsel or his designee as Hearing Officer to handle any preliminary matters and prepare the matter for final deliberations. The Hearing Officer is directed to handle preparation of this matter as expeditiously as possible;

- 4) that the Authority shall allow any interested parties to file comments on the proposed RFP with Authority Staff's suggested changes attached to this Motion no later than July 6, 2009.

REQUEST FOR PROPOSAL

Management Audit of Tennessee American Water

PROPOSAL DUE: _____, 2009

BACKGROUND

Tennessee-American Water Company ("TAWC"), a wholly owned subsidiary of American Water Works Company, Inc. ("AWW") requires a comprehensive management audit by an independent, certified public accounting ("CPA") firm of the affiliate relationship between TAWC and American Water Works Service Company ("AWWSC"). The referenced management audit is to be prepared for filing with the Tennessee Regulatory Authority ("Authority" or "TRA"). The management audit shall include, but not be limited to, an investigation of AWWSC's management performance and decisions relating to internal processes and internal controls with an attestation¹ and recommendations of any management process changes needed for those controls and implementation thereof. Further, the management audit shall evaluate and render an opinion with an attestation regarding the charges allocated to TAWC, including the efficiency of processes and/or functions performed on behalf of TAWC, as well as the accuracy and reasonableness of the allocation factors utilized. Attached is: (i) a copy of the relevant portion of the TRA Order from Docket No. 08-00039 that requires TAWC to conduct this management audit and (ii) the two most recent management audits performed for TAWC, the most recent of which is discussed in the TRA Order.

AWW is a publicly traded utility holding Company subject to the guidelines and requirements of the U. S. Securities and Exchange Commission ("SEC") and the New York Stock Exchange ("NYSE"). AWW owns and operates 73 subsidiaries, including regulated water and wastewater utilities in 20 states, and 46 non-regulated subsidiaries including AWWSC. AWWSC through affiliated interest agreements with the regulated subsidiaries that were approved by the state regulatory commissions provides services to the regulated subsidiaries. AWWSC also provides services to the non-regulated subsidiaries. Those services provided to the regulated subsidiaries, including TAWC, are defined in the 1989 Service Company Agreements. AWWSC is comprised of a number of offices and locations to address the services provided to the AWW subsidiaries in the most efficient manner possible. AWWSC corporate functions are located in Voorhees, NJ; the national Shared Services Center is located in Woodcrest, NJ, the national customer call centers are located in Alton, IL and Pensacola, FL, the national Water Quality Lab is located in Belleville, IL, and other offices are located in Hershey, PA, Charleston, WV, St. Louis, MO, Chula Vista, CA, Phoenix, AZ, and Woodcrest, NJ.

AWW's financial audit is performed by PricewaterhouseCoopers ("PwC"). AWW's Sarbanes-Oxley compliance work is performed by Ernst & Young ("E&Y"). The financial audit includes issuance of certified financial statements for

¹ Hereinafter, the terms "attest" and "attestation" for purposes of this RFP and proposed management audit shall be defined as: an opinion letter in accordance with Generally Accepted Auditing Standards (GAAS) concerning the Management Audit (report, findings and recommendations) signed by the independent licensed CPA in charge of the proposed engagement herein.

AWW on a consolidated basis as required by GAAP. As a publicly traded company, AWW files a quarterly 10-Q report with the SEC and the annual SEC 10-K report, including the annual certified financial reports of AWW on a consolidated basis. Audited annual financial statements are also issued for certain regulated subsidiaries, including TAWC. The financial audit of AWW on a consolidated basis includes the necessary review of all AWW subsidiary information, including AWWSC, required to conform to Generally Accepted Auditing Standards ("GAAS") and the issuance of the auditor's opinion on the consolidated financial information of AWW. The successful bidder ("Independent management auditor" or "Auditor"), will make best efforts not to duplicate the financial auditing functions already performed by AWW's financial auditor. Instead, the Independent management auditor may rely on AWW's audited financials and any financial auditing work already performed by PwC. Likewise, the successful bidder shall not duplicate the functions of AWW's SOX compliance testing. Instead, the Independent Management Auditor may rely on the work already performed by E&Y and PWC. If the Independent Management Auditor is not provided sufficient information from the PwC financial audit and E&Y internal control evaluation, the Auditor may perform such additional work as required to formulate their opinion.

To conduct the required management audit, TAWC and AWWSC will provide the Auditor with total AWWSC costs for 2008 for each functional area, and those AWWSC costs charged to TAWC. In addition to analysis and reports, TAWC and AWWSC will also make employees, officers, or other such personnel available for interview, as deemed necessary by the Auditor to form a comprehensive understanding of the costs incurred by AWWSC, and the basis for assignment and/or allocations of costs to TAWC and the other regulated and non-regulated subsidiaries. The review of the allocations will include limited testing at the level appropriate to test the reliability of the allocation methodology.

For costs charged to TAWC, TAWC/AWWSC will provide TAWC's supporting documents of (i) costs assigned directly to TAWC and (ii) costs allocated to TAWC, with an explanation of the allocation process. For each category of expense, AWWSC/TAWC will provide a discussion of the nature of the service provided, and an explanation of the benefits received by TAWC and its customers for each service. The Auditor will be authorized to communicate with AWWSC, TAWC and their affiliates as deemed necessary by the Auditor, including seeking responses or clarification to a draft of the Management Audit Report and draft of tentative findings, assessments and recommendations developed during the management audit.

Portions of the above referenced information may include business sensitive information and/or non-public information that would require appropriate confidential protection. An appropriate non-disclosure/confidential protection agreement will be made part of the final contract applicable to any successful bidder.

If recipients of this RFP are interested in preparing the management audit, please provide a proposal by _____, 2009.

SECTION A:

ROLE OF THE AUDITOR

Any Auditor who is selected to perform the management audit expressly agrees to perform the management audit as an independent contractor. Any conclusions, results, or recommendations formulated by the Auditor may be examined by any participant to the proceeding for which the management audit report was generated.

SCOPE OF WORK

TAWC is soliciting the services of a qualified independent CPA firm to conduct a management audit as set forth below. Given the nature of this engagement, the independent CPA firm may employ consultants with management audit experience to assist in conducting the management audit if that would minimize the cost of the management audit. The proposer shall identify any contemplated consulting arrangement in its response to this RFP. Any consultants used by the Auditor shall be subject to the same independence provisions included in Section B of this RFP. The management audit is to be performed in accordance with the provisions contained in the Order issued by the TRA on January 13, 2009 and detailed in this RFP and shall at a minimum be conducted under the supervision of an independent CPA firm who may direct the audit in order to issue a report, opinion and attestation.

The TRA has required TAWC to conduct an independent management audit to determine AWWSC's management performance and decisions relating to internal processes and internal controls, evaluate the charges allocated to TAWC, the efficiency of processes and/or functions performed on behalf of TAWC, and the accuracy and reasonableness of the allocation factors utilized.² The purpose of this management audit is to provide an independent, objective and comprehensive review of TAWC and the management fees paid to AWWSC. The Auditor shall develop findings and make appropriate conclusions and recommendations for specific areas with potential for improvement.

In addition to the scope of the work above, the Independent Management Auditor may be required to participate, as an independent party (not on behalf of any individual party) in a proceeding before the TRA concerning the

² By Order dated January 13, 2009 in Docket No. 08-00039, the TRA ordered the Company to develop a Request for Proposal ("RFP") for a comprehensive management audit by an independent certified public accountant. Pursuant to the Order, the issuance of the RFP shall occur subsequent to an approval of the RFP by the Authority.

management audit. Appearance for such proceeding before the TRA would include responding to data requests relating to the management audit, preparing pre-filed direct and rebuttal testimony, and testifying before the TRA if required. The cost estimate for completion of the requirements set forth in Section B below should be segregated to clearly identify the cost of the management audit from the subsequent costs that would be required for participation in a proceeding before the TRA. The hourly rates submitted under Section B shall be the basis for billing services performed beyond the filing of the management audit.

The Auditor shall be expected to enter into a contract with TAWC for performing the services outlined herein in order to deliver a complete and comprehensive Management Audit Report. Proposer shall cause to be delivered to TAWC a sealed bid to be inspected.. TAWC shall have no contact with the bidders regarding price. TAWC shall review the bids and submit proposal (with a copy of all bids) to the TRA for consideration within sixty (60) days of bid closing date.

CONTACT INFORMATION

The Auditor's principal contacts with TAWC will be Michael A. Miller and John Watson, or a designated representative, who will coordinate any assistance to be provided by TAWC/AWWSC. Michael A. Miller will have the primary responsibility for briefing any necessary parties during the management audit process.

TAWC's Project Leader is:

Michael A. Miller
P.O Box 1906
Charleston, WV, 25327
E-mail: mike.miller@amwater.com

The Project Leader will serve as the Auditor's main point of contact within TAWC, its parent and affiliates and will be responsible for providing all background materials, policies and procedures, reports and information that will be necessary for the completion of project work.

The Auditor will be responsible for maintaining contact with the Project Leader and taking the lead from him/her, as necessary. The Project Leader will work to further define any change in project scope as may be required. .

SPECIFIC REQUIREMENTS OF THE MANAGEMENT AUDIT

The management audit should include along with the Management Audit Report and working papers, the independent CPA's opinion and attestation to the following areas:

1. Assess the status and sufficiency of AWWSC's management performance and decisions relating to internal processes and internal controls;
2. Assess the efficiency of operating procedures and communication between TAWC and AWWSC;
3. Assess the AWWSC performance with industry standards and best management practices;
4. Assess the appropriateness of organizational structure of AWWSC/TAWC and reporting alignment;
5. Assess the development of AWWSC's long-range and short-range operational plans to assure the effective and efficient performance of the functions;
6. Assess the appropriateness of AWWSC's staffing and skill sets.
7. Assess TAWC's controls and systems to analyze and control costs from AWWSC;
8. Evaluate the accuracy and reasonableness of total AWWSC charges (including expenses) allocated to TAWC;
9. Evaluate the necessity, reasonableness/prudence, and efficiency of processes and/or functions performed by AWWSC on behalf of TAWC; and
10. Evaluate the accuracy and reasonableness of the allocation factors utilized to allocate AWWSC charges to regulated and non-regulated subsidiaries, and allocated regulated AWWSC charges to TAWC, including review of work previously performed regarding allocation methods which will be supplied by AWW.

The management audit will also address the following processes:

1. Perform the necessary audit steps, including random, statistically valid sampling, to determine whether the time and expenses charged or allocated to TAWC are accurate, reasonable and necessary and are accurately allocated to TAWC through the AWWSC accounting system;
2. Make specific recommendations and the estimated remediation costs regarding the findings of the management audit, if any;
3. Consider the work and avoid duplicating the work, analysis, findings, and/or certifications of PWC and E&Y to the extent deemed possible to keep the cost of the management audit and the cost to TAWC customers as low as possible while formulating an opinion in conformance with the management audit requirements;
4. Provide a draft Management Audit Report for review by TAWC prior to providing the final Management Audit Report. The Report should describe the methods and/or sources used and work undertaken to develop the information upon which the findings, conclusions and recommendations described above are based. The Report must include affirmation by the Independent Management Auditor that its management audit complies with: (i) generally accepted auditing standards (GAAS) related to issues of management economy, efficiency, and effectiveness as applicable to

- public utilities; and/or, (ii) as set forth in GAAP. The successful bidder shall be "independent" as set forth by GAAS and a "certified public accounting firm" as defined by GAAP;
5. Upon completion of the management audit, the Auditor shall deliver to TAWC two sets of working papers, indexed, bound and in orderly form, supporting the development of all calculations and recommendations by the Auditor and summarizing the procedures used in analyzing and evaluating all data, including proper treatment of any confidential information so designated during the development of the Management Audit Report. The Company shall be responsible for filing one set of working papers with the TRA, concurrent with the Management Audit Report. For purposes of this project, audit interview notes shall be deemed part of the auditor's work papers;
 6. Upon request of the Auditor, the Company shall furnish any and all documentation or information requested which is related to TAWC and AWWSC and is relevant to the scope of the management audit. The Company may conspicuously mark such documentation or information as being confidential if this data is closely held; and
 7. Nothing in the final written Contract will preclude the Auditor from performing tests, checks or other audit procedures if the Auditor does not deem the work of the predecessor audits mentioned above adequate.

PROPOSAL INFORMATION, CONDITIONS, INSTRUCTIONS & FORMAT

Proposers shall promptly notify TAWC of any ambiguity, inconsistency, conflict or error which they may discover upon examination of this RFP document. Verbal inquiries regarding this RFP are not permitted. All inquiries must be made in writing and received by the TAWC/AWWSC Project Leader who will provide copies of all such inquiries to the TRA in this docket.

After review and approval by the TRA, TAWC will respond to all or part of the written inquiries received by issuing a written Addendum to the RFP, if in the opinion of TAWC an Addendum to this RFP is deemed necessary for Proposers to submit proposals or if the lack of such addendum would be prejudicial to prospective Proposers. Any Proposer who attempts to make inquiries outside the process described in the previous paragraph may be disqualified.

PROPOSAL SUBMISSION DEADLINE

Sealed proposals must be received by TAWC no later than 3 pm, CST on _____, 2009 at:

Tennessee-American Water Company
1101 Broad Street
Chattanooga, TN 37401

Proposers are to submit an original and five (5) copies of each proposal.

Proposals received after the time and date set forth above shall be rejected. All proposals submitted in response to this RFP must be signed by an individual with the legal authority to submit the offer on behalf of the Proposer.

SECTION B:

RESPONSE TO THE RFP

The response to the RFP should include the following:

1. Total estimated cost "not to exceed" for work defined in Section A of this Request for Proposal. The cost estimate for this project should be broken down into as much detail as possible, including segregation of billable hours, hourly rates, travel costs, lodging and meals, printing, other incidentals, etc.;
2. Hourly rates for any and all employees and consultants who would provide service to the Company during the course of the preparation of the management audit;
3. An outline and narrative discussion of the scope of the services that will be provided in order to satisfy the project's requirements. The proposal should set forth a work plan, including an estimated timeframe to complete the services required of this RFP and to issue the final Management Audit Report and work papers. In developing the work plan, reference should be made to such sources of information as enabling legislation, bylaws, interviews, prior management audits, organizational charts, manuals and programs, financial and other management information systems, and other related materials. The work plan should also identify any proposed segmentation or phasing of the project and the level of staff and number of hours to be assigned to each proposed segment of the engagement;
4. Identification in specific detail of the methodologies that the Proposer will use (including the manner in which the Proposer will incorporate, utilize and rely on the sources described in Section A, SPECIFIC REQUIREMENTS, Paragraph 13 above to avoid duplication of effort). The Auditor will perform all requisite procedures to attest and render an opinion;
5. A definition section specifically defining all key terms used in the response to this RFP;
6. A discussion of additional steps and costs associated with Section A, SPECIFIC REQUIREMENT, Paragraph 17, if required;
7. A list of industry consultants who will work on the project in order to reduce cost, along with their qualifications;
8. A description of the resources that Proposer will utilize or make available for the project;

9. A description of the prior experience of the firm and individuals in preparing management audits that are related to or similar to this requested management audit, specifically addressing experience with regulated utility management audits during the last five years. Specifically, identify all management audit experience involving utility holding companies with service organizations that provide services to both regulated and non-regulated subsidiaries, service company organizations that direct charge or allocate costs among regulated and non-regulated companies, and publicly traded companies. Please indicate whether the Proposer has offered or given testimony before regulatory commissions and include reference to regulatory commission case numbers, orders, etc.; and
10. Identification of the principal in charge of the management audit (who must be a licensed certified public accountant), who shall attest to the management audit as set forth above and provide testimony to support the accuracy and validity of the analyses undertaken and conclusions and recommendations reached during the management audit, if required.

COST OF THE RFP

Each Proposer shall be solely responsible for all costs and expenses associated with the preparation and/or submission of its proposal, and TAWC shall have no responsibility or liability whatsoever for any such costs and expenses in the preparation of same. TAWC, its directors, officers, employees and authorized agents shall not be liable for any claims or damages resulting from the solicitation or collection of proposals. By submitting a proposal, a Proposer expressly waives (i) any claim(s) for such costs and expenses, and (ii) any other related claims or damages.

Pursuant to the language in the Order issued by the TRA on January 13, 2009 in docket number 08-00039, the TRA panel may determine during the bidding process that the RFP results in a bid that might not yield a benefit to TAWC customers, and the Authority can order that a management audit not be performed. By submitting a bid, a Proposer expressly acknowledges that it understands there is no guaranteed or implied promise that a contract will be awarded and any costs incurred in preparing the bid are and shall remain the sole responsibility of the Proposer.

PURCHASE OBLIGATION

TAWC and responding firms expressly acknowledge and agree that TAWC has made no expressed or implied promises to expend any certain dollar amounts with respect to the services addressed by this RFP. Submitting a proposal in response to this RFP, and/or any subsequent communication by TAWC in the selection process, shall not vest any right, privilege, or right of action in any Proposer.

QUALIFICATION OF PROPOSERS

Proposers will be evaluated by TAWC and also reviewed by the TRA based on their experience in performing the services requested, financial stability, appropriate personnel, responsiveness, technical knowledge and general organization, prior to being approved.

Proposers may be disqualified and their Proposals rejected for any reason deemed appropriate by TAWC or the TRA, including, but not limited to, the following:

1. Evidence of collusion between a Proposer and any other Proposer;
2. An unsatisfactory performance record on prior projects for TAWC, or any other organization;
3. The appearance of financial instability and or evidence that the Proposer may not be financially able to complete the work required by the Scope of Work in a satisfactory manner;
4. Evidence of the Proposer having failed to complete one or more public contracts in the past; and
5. The Proposer, or its agents or employees, have been convicted of a crime arising from illegal accounting practices associated with previous public contracts.

INDEPENDENCE

The firm, including any consultant used on this project, must provide an affirmative statement that it is independent of TAWC, AWWSC, AWW, the TRA, the Attorney General of Tennessee, the City of Chattanooga, and the Chattanooga Manufacturers Association as defined by Generally Accepted Auditing Standards (GAAS) and that firm will warrant in the engagement contract that they will not undertake an engagement that will impair their affirmation of independence during the term of the audit.

SECTION C:

SELECTION PROCESS & EVALUATION CRITERIA

The selection of the Independent Management Auditor will be based on the following criteria: widely recognized expertise in the utility management auditing field, the proposed scope, cost, adequacy and availability of resources to complete the project on schedule and the Auditor's experience and qualifications

in conducting similar management audits with particular weight given to the experience related to regulated utilities and experience in regulated utility work involving utility holding company service organizations and publicly traded companies. The selection will be made by TAWC with the approval of the TRA.

The following evaluation criteria category weights will be used for all proposals submitted:

Qualifications and Experience:	35%
Proposed Approach and Work Plan	25%
Proposed Key Personnel	15%
Pricing	25%

The selected Proposer will be required to meet all time requirements and deadlines for completion of the management audit as described above.

TAWC, with the approval of the TRA reserves the right to select the top ranked firm based solely on the scoring of the written proposals. At the discretion of the TRA panel, two or more of the highest ranked firms may be invited to make an oral presentation of their respective Proposal concurrently to TAWC and the TRA. The selected firms will have an opportunity to summarize the information provided in their written proposals, expand on their capabilities, experience, proposed approach, work plan and answer questions from the TRA. If firms invited to appear before the Authority do not appear, their bid may be set aside and not considered.

During the evaluation process, TAWC reserves the right subsequent to TRA approval, where it may serve TAWC's best interest, to request additional information or clarifications in written communications approved by the TRA from Proposers, or to allow corrections of errors or omissions.

Prior to approval of a bid, the TRA panel may determine during the bidding process that the RFP results in a bid that does not yield a benefit to TAWC customers and the Authority may order that a management audit not be performed.³

³ *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, p. 22 (January 13, 2009).*

CONTRACT CLAUSES AND PROVISIONS

Upon acceptance of the winning bid, the Proposer will be required to enter into a written contract with TAWC. The contract will be provided in its entirety to the winning Proposer including but not limited to, clauses pertaining to:

1. the scope of work, cost;
2. billing;
3. insurance requirements;
4. hold harmless;
5. cancelation/termination;
6. assignment;
7. payment of taxes;
8. application of laws and regulations;
9. jurisdiction and choice of law;
10. subletting;
11. confidentiality;
12. enforceability/severability;
13. proof of licensure (i.e., valid CPA license, etc.); and
14. completion date of audit.

After the written contract and terms are developed by TAWC and the Proposer, the Contract will be submitted to the TRA for ratification prior to the contract being signed by the parties and considered enforceable.

INDEPENDENT CONTRACTOR

The Auditor's and any consultant's relationship to TAWC in performing the contract is that of an independent contractor and nothing herein shall be construed as creating an employer/employee relationship, partnership, joint venture or other business group or concerted action. The personnel performing services under this contract shall at all times be under the Auditor's exclusive direction and control and shall be employees or consultants of the Auditor and not TAWC.

Sincerely,

Michael A. Miller
Director, Rates and Regulations