

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

March 24, 2010

IN RE:

**TENNESSEE AMERICAN WATER
COMPANY'S REQUEST FOR PROPOSAL
FOR A MANAGEMENT AUDIT**

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**DOCKET NO.
09-00086**

ORDER APPROVING CONTRACTOR TO PERFORM MANAGEMENT AUDIT

This matter came before Chairman Sara Kyle, Director Eddie Roberson and Director Mary W. Freeman of the Tennessee Regulatory Authority (the "Authority" or "TRA"), the voting panel assigned to this docket, at a regularly scheduled Authority Conference held on January 25, 2010 for consideration of the *Notice of Filing and Request for Approval of Tennessee American Water Company's Management Audit Contract with Schumaker & Company* ("TAWC Request to Approve Contract") filed by Tennessee American Water Company ("TAWC" or "Company") on January 4, 2010.

BACKGROUND

On March 14, 2008, TAWC filed a petition in Docket No. 08-00039¹ seeking an increase in its rates, including an increase in management fees of \$355,365 over the amount that was approved in its prior rate case.² In Docket No. 06-00290, the Authority granted the Company management fees in the amount of \$3,979,825 and ordered TAWC to have a management audit

¹ See *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 (hereinafter "Docket No. 08-00039").

² See Docket No. 08-00039, *Order*, p. 18 (January 13, 2009). TAWC requested recovery of \$4,335,190 for management fees. Management fees are charges from American Water Works Service Company ("AWWSC" or "Service Company") for services provided to affiliate companies under the 1989 Service Company contract. These services consist of accounting, administration, communication, corporate secretarial, engineering, finance, human resources, information systems, operations, rates and revenue, risk management, water quality and other "agreed upon" services.

performed to determine whether costs allocated to TAWC were the result of prudent management decisions by American Water Works Service Company.³ Specifically, the panel in Docket No. 06-00290 ordered:

. . . TAWC should have a management audit performed in compliance with Sarbanes-Oxley [“SOX”] requirements. . . 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.⁴

The audit report of Booz Allen Hamilton (“BAH”), ordered by the panel in Docket No. 06-00290, was filed as part of the Company’s petition for a rate increase in Docket No. 08-00039 and was sponsored by the testimony of Mr. Joseph Van Den Berg. In the pre-filed testimony and during the hearing, City of Chattanooga’s witness, consultant Mr. Michael Majoros, asserted that Mr. Van Den Berg’s firm did not conduct a management audit in compliance with SOX requirements. Mr. Majoros cited a list of reasons for his conclusion, the most notable that BAH is not an independent public accounting firm as required by SOX and that Mr. Van Den Berg’s report is not independent since he has also provided testimony on behalf of TAWC in other dockets, both before the TRA and before other utility commissions.⁵

Based on the evidence presented, the panel determined in Docket No. 08-00039 that the Company had not complied with the Authority’s directive in Docket No. 06-00290. The panel ordered TAWC to develop and submit for the Authority’s approval a Request for Proposal (“RFP”) for a comprehensive management audit performed by an independent certified public accountant. The panel stated:

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. 06-00290, *Order*, pp. 26-27 (June 10, 2008).

⁴ *Id.*

⁵ Docket No. 08-00039, *Order*, pp. 18-22 (January 13, 2009).

The RFP for the 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 attestation and recommendation of any needed management changes and implementation thereof. Further, the audit shall 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. This RFP should be filed in this docket no later than six months from September 22, 2008, for approval by the Authority. The issuance of the RFP shall occur subsequent to an approval of the RFP by the Authority.⁶

Further, the panel directed the Company to contact the Authority Staff in the event that the Company had any questions regarding the scope of the audit.⁷

TRAVEL OF THIS CASE

On March 23, 2009, TAWC filed its Request for Proposal for a Management Audit ("*Draft RFP*") in Docket No. 08-00039. The *Draft RFP* was considered at the regularly scheduled Authority Conference held on June 15, 2009. At that time, the panel voted to open a new docket for consideration of the *Draft RFP*; to have Authority Staff contact regulatory agencies in other states served by companies owned by American Water Works Company to determine potential interest in participating in a multi-state audit; and to permit interested parties to file comments concerning the Authority's proposed changes to the *Draft RFP*.⁸ This docket (No. 09-00086) was opened, and all filings related to the *Draft RFP* have been moved into this docket.

On June 19, 2009, the TRA sent a letter to eighteen state regulatory agencies requesting that any agency interested in participating in a multi-state audit contact Darlene Standley, Chief

⁶ Order, p. 22 (January 13, 2009).

⁷ *Id.*, footnote 68.

⁸ Docket No. 08-00039, *Order Moving Request for Proposal to New Docket*, pp. 3-4 (July 16, 2009).

of the TRA Utilities Division.⁹ On July 1, 2009, a status conference was held in this docket to consider the Company's filing. On July 20, 2009, the Company filed *Tennessee American Water Company's Comments Regarding Recent Communications Filed in this Docket Regarding a Multi-State Audit*. The Authority issued its *Order Approving Request for Proposal* on September 8, 2009.

On October 28, 2009, the Company filed the *Tennessee American Water Company's Request for Approval of Schumaker-Work & Greer to Perform the Management Audit*, in which the Company stated that it had issued the RFP to thirteen possible candidates and that three firms ultimately responded. The Respondents were WHN-Liberty, Schumaker-Work & Greer ("Schumaker-Work"), and NorthStar-TCBA-MFSG ("NorthStar"). The Company evaluated and scored each response on four categories: 1) qualifications, 2) proposed approach and work plan, 3) key personnel, and 4) pricing. According to the Company's evaluation, NorthStar and Schumaker-Work had similar and materially better scores than WHN-Liberty without considering price. Ultimately, the Company requested that the Authority approve Schumaker-Work to perform the management audit because Schumaker-Work's "not to exceed" price was significantly lower than the price submitted by the other two respondents.

At the December 14, 2009 Authority Conference, the panel voted unanimously to approve a Tennessee-specific management audit to be performed by Schumaker-Work. The panel also directed that the Company file with the Authority a copy of the executed contract between it and Schumaker-Work. On January 4, 2010, the Company filed the *TAWC Request to Approve Contract*.


⁹ Correspondence between the TRA and other regulatory agencies regarding the multi-state audit were filed in this docket on the following dates: June 19, 24, 25 and 30, 2009; July 7, 8, 9, 15, 24 and 29, 2009; and August 11 and 12, 2009. Additionally, during the August 4, 2009 Authority Conference, Director Roberson stated that he had had some brief conversations with other state representatives at the recent meeting of the National Association of Regulatory Utility Commissioners.

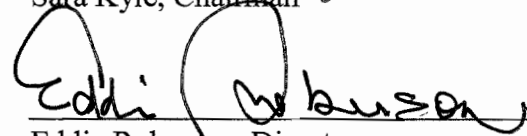
FINDINGS AND CONCLUSIONS

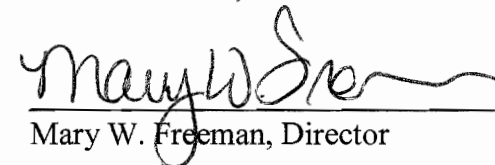
Based on the entire record, and after careful review and consideration, the panel found that the contract's terms and conditions are compliant with the Authority's order in Docket No. 08-00039 which mandated the audit and set forth the requirements. Thereafter, the panel voted unanimously to approve the executed contract for a management audit between TAWC and Schumaker & Company.

IT IS THEREFORE ORDERED:

The final, executed contract for a management audit between Tennessee American Water Company and Schumaker & Company is hereby approved.


Sara Kyle, Chairman


Eddie Roberson, Director


Mary W. Freeman, Director