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January 4, 2010

VIA HAND DELIVERY

Chairman Mary W. Freeman
c/o Sharla Dillon
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243

filed electronically in docket office on 01/04/11

**Re: Tennessee American Water Company's Management Audit
Docket No. 09-00086**

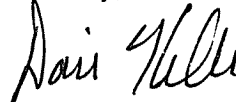
Dear Chairman Freeman:

Enclosed please find an original and five (5) sets of copies of Tennessee American Water Company's Motion to Approve and Adopt Schumaker & Company's Affiliate Audit Report of Tennessee American Water Company for the Tennessee Regulatory Authority.

Please file the original and four copies of the Motion and stamp the additional copy as "filed." Then please return the stamped copy to me by way of our courier.

Should you have any questions concerning this matter, please do not hesitate to contact me at the email address or telephone number listed above.

Sincerely,



David Killion

Enclosures

cc: Mr. David Foster, Chief of Utilities Division (w/o enclosure)
Vance Broemel, Esq. (w/enclosure)
J. Richard Collier, Esq. (w/enclosure)
Kelly Cashman-Grams, Esq. (w/enclosure)
Rebecca Montgomery, Esq. (w/enclosure)
Mr. John S. Watson (w/enclosure)
Mr. Michael A. Miller (w/enclosure)

**BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE**

IN RE:

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

Docket No. 09-00086

**MOTION TO APPROVE AND ADOPT SCHUMAKER & COMPANY'S
AFFILIATE AUDIT REPORT OF TENNESSEE AMERICAN WATER COMPANY
FOR THE TENNESSEE REGULATORY AUTHORITY**

Tennessee American Water Company ("TAWC") hereby moves the Tennessee Regulatory Authority (the "Authority") to approve and adopt the Affiliate Audit Report of Tennessee American Water Company conducted by Schumaker & Company (the "Audit") pursuant to the Orders of the Tennessee Regulatory Authority in this docket and in Docket No. 08-00039. TAWC filed the Audit with the Authority on September 10, 2010. Nearly four months have passed and no party has intervened to question or challenge the findings of the Audit, nor has the Authority taken any action with respect to the Audit. Therefore, TAWC respectfully requests that the Authority now issue an Order holding that the Audit has met all requirements set forth in this docket and Docket No. 08-00039, and approving and adopting the Audit and its findings.

In its 2008 rate case filed in Docket No. 08-00039, TAWC projected attrition period management fees of \$4,335,190 to be paid to its service company affiliate, American Water Works Service Company ("AWWSC") – an increase of \$355,365 over the \$3,979,825 of management fees authorized by the Authority panel in TAWC's 2006 rate case in Docket No. 06-00290. The Authority panel in the 2006 rate case had ordered TAWC to subsequently file a management audit, and so TAWC filed with its 2008 rate case a management audit by Booz

Allen Hamilton (“BAH”), which had been conducted and prepared at a cost to TAWC of \$285,000. A different panel of the Authority thereafter decided that the BAH audit did not meet the Authority’s expectations.¹ Accordingly, a majority of the panel in the 2008 rate case authorized the recovery of management fees only in the amount of \$3,529,933 – which was approximately \$450,000 *less* than the amount the Authority found reasonable and authorized in the 2006 rate case.² See Order at 26, Docket No. 06-00290. TAWC has been and is still operating under the severe revenue deficiency caused in large part by this more than \$800,000 under-recovery of management fees, which adversely affects its financial condition.

Nonetheless, it is clear from the record that the Authority in the 2008 rate case did not intend that \$3,529,933 was the maximum amount of management fees that TAWC was entitled to recover. Instead, the Authority ordered another management audit process to be conducted under the Authority’s supervision and subject to its approval. See Order at 21-22, Docket No. 08-00039. As Director Roberson noted in presenting the motion that was ultimately adopted as the majority position on management fees in Docket No. 08-00039:

Regarding the amount of management fees allowed, there is no doubt in my mind that legitimate expenses are incurred from the service company. The problem I had is in determining whether the amount requested by the company to pay its service company is a just and reasonable amount based on prudent expenditures.

The management audit ordered in 06-290 could have answered this important question if conducted properly....

I am anxious for the conclusion of the comprehensive audit ordered in 06-290 and restated in my motion for this docket. **I want to stress that if the management audit ultimately shows that the fees being allocated for services are prudent, the authority can on its own motion or the motion of a party revisit the issue of management fees.**

¹ The panel rejected the BAH Audit and refused to allow TAWC to recover the cost it incurred in obtaining it. See Order at 20-21, Docket No. 08-00039.

² Director Freeman did not vote with the majority. Instead, she found that management fees should have remained at the level set in the 2006 rate case. See Order at 21, n.67 Docket No. 08-00039.

Hrg. Tr. at 8-9, Docket No. 08-00039 (Sept. 22, 2008). Accordingly, a decision by the Authority that TAWC has now completed the required Audit in a manner acceptable to the Authority is critical to enabling the Authority to determine the proper amount of management fees that should be allowed to Tennessee American, either arising out of the 2008 rate case or TAWC's currently pending 2010 rate case in Docket No. 10-00189.

The Authority has overseen each step of the Audit process. On March 23, 2009, TAWC filed its draft RFP. On June 15, 2009, the Authority addressed the draft RFP and opened this new docket for consideration of the RFP. The Authority then considered the matter at multiple Directors' Conferences and made numerous revisions to the RFP originally submitted by TAWC. The Authority issued an Order approving the final version of the Request for Proposal on September 8, 2009 and reviewed all responses to the RFP and the recommendation and rationale for selecting an auditing proposal.

TAWC filed its request for approval of Schumaker & Company as the auditor on October 28, 2009. On December 14, 2010 the Authority approved Shumaker & Company as the auditor.³ On January 25, 2010 the Authority revised and approved the contract between TAWC and Shumaker & Company. The Authority later issued a written Order on March 24, 2010 documenting its approval of the contract and setting forth in detail all procedures, requirements, standards, terms, and conditions for the Audit.

TAWC respectfully submits that the Audit completed by Schumaker & Company, conducted pursuant to the RFP and contract approved by the Authority and filed on September 10, 2010, did in fact confirm that the fees charged by AWWSC are necessary to provide the level of quality service that TAWC's customers and the Authority expect. In fact, the Audit found, among other things, that each and every scope item that the RFP required to be studied was at or above adequate levels. The findings of the Audit were attested to by an independent certified

³ The Authority later issued this written Order on March 12, 2010.

public accountant as required by the Authority. As a result, it is now definitively established that TAWC is unfairly shouldering the burden of a large and growing deficiency between what TAWC must pay in reasonable management fees to provide the required level of quality service and what the Authority's 2008 Order is allowing TAWC to recover in revenue.⁴ Time was and still is of the essence in drawing this docket to a close and putting the issue of the Audit to rest, as every day of delay in providing rate relief to TAWC, for its appropriate level of management fees and the cost of the Audit, results in a growing impairment to TAWC's financial health.

The clear intent of the Authority in ordering this Audit was to reach a definitive conclusion about the prudence and reasonableness of the management fees TAWC pays to AWWSC. That is the very purpose of an audit: to "close the books." The Authority obviously wanted the added assurance provided by an outside independent audit in order to foster greater confidence in its decision-making about management fees in TAWC's rate cases going-forward. The Authority now has that assurance. It is therefore now prudent for the Authority to give finality to the matter by accepting and approving the Audit and its findings in the same manner it regularly accepts and approves audits performed for natural gas distribution companies under its jurisdiction. *See, e.g.,* Piedmont Natural Gas Company's Incentive Plan Account for the Plan Year Ended June 30, 2009, Docket No. 09-00125 (Order entered March 1, 2010).⁵

Accordingly, for all the foregoing reasons, TAWC respectfully requests that the Authority now address the completed Audit at its next regularly scheduled conference or as soon

⁴ In addition, the Audit was obtained at a cost to TAWC of \$184,964, which was approved in advance by the Authority, and which TAWC seeks to recover in its now pending 2010 rate case.

⁵ Increasing the urgency for action by the Authority in this matter is the threat to the necessary finality of the Audit asserted by counsel for the City of Chattanooga, an intervenor in TAWC's pending 2010 rate case. At a status conference in that matter held on December 13, 2010, the City's counsel stated: "Our position is there's a management audit, we've got a right to look behind it and to test the information and the conclusions that are contained in there." *See* Hearing Conf. Trans. at 18:7-18:10 (Dec. 13, 2010), Docket No. 10-00189. Although the City has chosen not to provide any input or comments with respect to the Audit throughout the entire 21 month history of the preparations by TAWC and this Authority, it appears the City now believes it can collaterally attack TAWC and the Authority with objections in a subsequent rate case. If allowed, this tactic would solely serve to frustrate TAWC's ability to recover the proper level of management fees and would also simultaneously impede the Authority's ability to obtain finality on this issue and unnecessarily increase rate case expense. The Authority should not allow the City to engage in such improper tactics.

thereafter as possible, and issue an Order holding that the Audit has met all requirements set forth in this docket and Docket No. 08-00039. TAWC also respectfully requests that the Order further approve and adopt the Audit and its findings, including those concerning the appropriateness and reasonableness of the management fees charged by AWWSC.

Dated: January 4, 2011.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "R. Dale Grimes", written over a horizontal line.

R. Dale Grimes (#006332)

E. Steele Clayton (#017298)

C. David Killion (#026412)

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Counsel for Petitioner

Tennessee American Water Company

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing has been served via U.S. Mail, overnight delivery and/or electronic mail, on this the 4th day of January, 2011, upon the following:

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