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January 18, 2011

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 01/18/11

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

Dear Chairman Freeman:

Enclosed please find an original and five (5) copies of a Tennessee American Water Company's Reply to the Consumer Advocate and Protection Division's Response in Opposition to Tennessee American Water Company's Motion to Approve and Adopt Schumaker & Company's Affiliate Audit Report. This material is being filed today by way of email to the Tennessee Regulatory Authority Docket Manager, Sharla Dillon also.

Please file the original and four copies of this material and stamp the additional copy as "filed." Then please return the file-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.

With kindest regards, I remain

Very truly yours,



R. Dale Grimes

RDG/smb
Enclosures

cc: Hon. Eddie Roberson (w/o enclosures)
Hon. Sara Kyle (w/o enclosures)
Mr. David Foster (w/o enclosures)

Chairman Mary Freeman
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**THE RELIEF REQUESTED IN TAWC'S MOTION TO APPROVE AND ADOPT THE
AUDIT REPORT SHOULD BE GRANTED**

purpose was to “determin[e] whether the amount requested by the company to pay its service company is a just and reasonable amount based on prudent expenditures.”) Accordingly, the debate is settled and the Authority should approve the findings and conclusions of its approved auditor by adopting the management audit, just as it does for natural gas distribution audits. *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).

While such relief is supported by the facts and is reasonable in light of the TRA’s unique role and oversight of this management audit, at a base minimum the Authority should enter an order that states that the audit met the requirements set forth in this Docket, that holds that it was procedurally proper, and that forecloses the parties from challenging the procedure, scope, or independence of the audit/auditors whether in this Docket or in Docket No. 10-00189.¹

The Schumaker management audit is the second management audit ordered by the TRA – both conducted and prepared at the Company’s expense² – to determine whether the Company’s management fees were reasonable and prudent. Unlike the first audit, however, this audit was overseen by the TRA throughout the audit procurement process including defining and approving the RFP, selecting the auditor, and defining the scope of the audit that was incorporated into the auditor’s contract with the Company (Attachment 1, Ex. E to the Audit Contract) at the Authority’s insistence. Despite these facts, the intervenors have already indicated an intent to litigate the procedural propriety and scope of the audit. *See, e.g.,* Pre-Filed Testimony of Terry Buckner, at 24-31 (Jan. 5, 2011) (challenging the audit’s scope and

¹ This is consistent with TAWC’s response in opposition to the CAPD’s Motion to Intervene in Docket No. 09-00086 filed on January 13, 2011 and TAWC’s Motion to Call Schumaker & Company in Docket No. 10-00189 filed on January 12, 2011.

² The Booz Allen Hamilton management audit required by the final Order entered in the 2006 rate case and submitted in the 2008 rate case cost the Company \$285,000; the TRA management audit ordered in this docket cost \$184,964.

allocation methods) (“In the opinion of the Consumer Advocate, the Schumaker & Company Report is somewhat limited in scope.”). Accordingly, it would be unfair and inefficient to now litigate whether the audit satisfied the procedural requirements, met the mandated scope of the audit, or was conducted by an independent auditor.

B. Contrary to the CAPD’s Argument, it is Appropriate to Render an Order on the Management Audit Now, Rather than After the 2010 Rate Case Hearing

It may well be in the interests of the Intervenor to continue to stir up uncertainty and to insinuate questions and doubts about TAWC’s management fees and the audits performed to show the prudence of those fees. That is, however, in sharp contrast to what the Authority said it wanted at the conclusion of the 2008 rate case and in its pursuit of this docket. If the parties were free to litigate this audit’s satisfaction of the procedural requirements of the RFP and contract, its compliance with the scope ordered specifically by this Authority, and the independence of Schumaker’s work, there is a danger that the audit will not meet the same fate as the audit in the 2008 case. Sufficient confidence in the prudence of the level of management fees might continue to elude the TRA, and TAWC will continue to be forced to operate with an unconstitutional level of operating revenues and returns. The prejudice of such a result to the Company and ratepayers is obvious.

Contrary to the “business as usual” approach promoted by the CAPD, there is every reason for this audit to be treated with deference by the Authority. Unlike the management audit submitted in the 2008 rate case, this management audit was overseen by the TRA throughout the audit procurement process.³ The TRA considered and substantially revised TAWC’s submitted RFP before approving the RFP on September 8, 2009. The TRA also reviewed all the RFP responses and bids and issued data requests for TAWC to answer regarding these bids. TAWC

³ TAWC maintains that the Booz Allen Hamilton auditors were independent and is awaiting the Court of Appeals decision on this issue.

answered the data requests on November 12, 2009. The TRA then approved the selection of Schumaker & Co. as the management auditor on December 14, 2009. The TRA also defined the scope of the audit and ordered that this scope be included in the auditor contract, which became Ex. E to the Audit Contract. *See* Contract between Schumaker & Co. and TAWC, Ex. E (Dec. 31, 2009). Finally, the TRA ordered TAWC to submit the final audit contract for approval (which included the TRA-defined audit scope) and approval of the contract was entered by Order on March 24, 2010. Because the TRA has overseen the entire procurement process, including approval of the audit's scope and the selection of the auditor, the time is ripe for approving the audit, and there is simply no basis to wait on entering at the least an order approving the propriety of the audit and precluding the parties from challenging its procedural propriety, the scope of the audit, and the auditor's independence.

Finally, contrary to the CAPD's argument, entering this order now will promote judicial economy and eliminate the time and expense of unnecessarily litigating resolved issues. Even if the intervenors are allowed to present evidence in this Docket or Docket 10-00189 regarding the substance of the auditor's findings in the 2010 rate case, the procedure, scope, and independence should not be an issue.⁴

C. Contrary to the CAPD's Argument, Docket 09-00086 is an Appropriate Forum to Consider the Relief Requested by TAWC

The CAPD's very limited depiction of the scope of the 09-00086 Docket is not supported by the facts.⁵ Docket 09-00086 has not been used as a mere "in-box" for filings related to the

⁴ If the intervenors are allowed to challenge the audit substantively, TAWC reiterates its request that the TRA call Pat Schumaker to present testimony.

⁵ Included in the CAPD's argument on the scope of Docket 09-00086 is an unsupported comment that TAWC "reads far too much into Director Roberson's statement from the 2008 rate case regarding revisiting the management fee issue...." (CAPD Response at 2.) Director Roberson's statement speaks for itself. If the TRA management audit shows that fees are prudent, either the parties or the TRA can revisit the issue of management fees by motion. The CAPD does not, and cannot, offer any facts or evidence suggesting that the Director meant anything other than what he explicitly stated.

RFP issuance process. As described in detail above, this Docket was used by the TRA to oversee and approve all aspects of the audit procurement process. The RFP draft, revisions, and approval were just the beginning. The TRA then addressed whether even to proceed with the audit once the RFP responses were received and reviewed. The TRA proceeded to submit data requests to TAWC regarding these responses in this Docket. Next, the TRA approved the selection of the management auditor in this Docket. Finally, the TRA required submission and approval of the Audit Contract, which included the TRA-defined audit scope in this Docket. Throughout this entire process, the CAPD had notice of each step contemplated or undertaken in the Docket. Clearly, this Docket has been used to oversee the procurement process from the beginning and it is the natural forum for entering an order approving the audit's results, or at least acknowledging the audit's procedural propriety.

Ultimately, regardless of whether the Authority enters the order in Docket 09-00086, Docket 10-00189, or both, an order needs to be entered for the reasons described herein.

CONCLUSION

For all the reasons contained herein and in TAWC's Motion to Approve and Adopt Schumaker & Company's Affiliate Audit Report and its Motion to Call Schumaker & Company, TAWC respectfully requests that the audit's findings and conclusions be approved. At a minimum, the TRA should enter an order now stating that the audit met the requirements set forth in this Docket, was procedurally proper, and that forecloses the parties from challenging the procedure, scope, or independence of the audit/auditors in the Hearing on the merits.

Respectfully submitted,

A handwritten signature in cursive script, reading "R. Dale Grimes". The signature is written in black ink and is positioned above a horizontal line.

R. Dale Grimes (#006223)

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing has been served via U.S. Mail, and electronic mail, on this the 18th day of January, 2011, upon the following:

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