

BEFORE 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. 10-00189

**CONSUMER ADVOCATE AND PROTECTION DIVISION'S RESPONSES TO
TENNESSEE AMERICAN WATER COMPANY'S SECOND DISCOVERY REQUESTS**

The Consumer Advocate and Protection Division of the Office of the Attorney General ("Consumer Advocate"), pursuant to the Scheduling Order entered in this Docket, hereby submits its responses and objections to the first discovery request of Tennessee American Water Company ("TAWC" or "Company").

GENERAL OBJECTIONS

1. The Consumer Advocate objects to the definitions and instructions contained in the Company's interrogatories to the extent that the definitions and instructions attempt to impose on the Consumer Advocate a burden or obligation greater than that required by the *Tennessee Rules of Civil Procedure* and applicable statutes and regulations governing contested case hearings.

2. The Consumer Advocate objects to the interrogatories to the extent they call for information and the production of documents which are protected from disclosure by the attorney-client privilege, the attorney work product doctrine or any other applicable privilege or protection. The Consumer Advocate objects to the data requests to the extent that the Company is attempting to impose on the Consumer Advocate obligations with regard to identification of privileged documents beyond those required by the *Tennessee Rules of Civil Procedure* and applicable statutes and regulations governing contested case hearings.

3. The Consumer Advocate objects to the Company's interrogatories to the extent they seek information not related to the subject matter involved in this litigation or to the extent they are not reasonably calculated to lead to the discovery of admissible evidence. By providing information in response to these requests, the Consumer Advocate does not concede that such information is relevant, material or admissible in evidence. The Consumer Advocate reserves all rights to object to the use of such information as evidence.

4. The Consumer Advocate objects to the Company's interrogatories to the extent that the Company is attempting to impose on the Consumer Advocate obligations to supplement its responses beyond those required by the *Tennessee Rules of Civil Procedure* and applicable statutes and regulations governing contested case hearings.

5. The Consumer Advocate objects to the Company's interrogatories to the extent that the Company is attempting to require the Consumer Advocate to provide information and produce documents beyond those in its possession, custody or control as that phrase is used in the *Tennessee Rules of Civil Procedure* and applicable statutes and regulations governing contested case hearings.

6. The Consumer Advocate objects to the Company's data requests to the extent they seek information and documents that are readily available through public sources or are in the Company's own possession, custody or control. It is unduly burdensome and oppressive to require the Consumer Advocate to respond or produce documents that are equally available to the Company.

7. The Consumer Advocate's objections and responses to these requests are based on information now known to it. The Consumer Advocate reserves the right to amend, modify or supplement its objections and responses if it learns of new information.

8. The Consumer Advocate's responses to these requests are made without waiving or intending to waive the right to object to the use of any information provided in response to any subsequent proceeding or trial of this or any other action. The Consumer Advocate's responses to these requests are also not a waiver of any of the foregoing objections or any objections it has made or may make with respect to any similar, related, or future data request, and the Consumer Advocate specifically reserves the right to interpose any objection to further requests notwithstanding any response or lack of objection made in this response.

9. The Consumer Advocate will supplement its responses in accordance with the requirements of state law.

10. The Consumer Advocate expressly incorporates these general objections into its responses set forth below.

Subject to and without waiving any objections stated above the Consumer Advocate responds to the specific requests as follows:

DISCOVERY REQUEST NO.1

Produce a copy of all CAPD witness work papers and exhibits in their native format with any formulas intact.

RESPONSE:

See attachments provided on enclosed CD.

DISCOVERY REQUEST NO.2:

With respect to page 24, line 19 of Terry Buckner's direct testimony, please explain what Terry Buckner means by the "correctness" of the allocation method between AWWSC and TAWC.

RESPONSE:

The word "correctness" in this sentence refers to the allocation method being in accordance with the Finding II-2 of the Schumaker Report, page 40.

DISCOVERY REQUEST NO.3:

With respect to page 24, line 20 of Terry Buckner's direct testimony, please explain what Mr. Buckner means by the "regulatory correctness" of the total amount generated by AWWASC before it is allocated.

RESPONSE:

The term “regulatory correctness” in this sentence refers to being in accordance with accepted regulatory standards in Tennessee. The accepted regulatory standards in Tennessee include prior decisions by the TRA and its predecessor, the Tennessee Public Service Commission.

DISCOVERY REQUEST NO.4:

With respect to page 25, line 3 of Terry Buckner’s direct testimony, please list the “other recent dockets” involving Tennessee utilities to which Mr. Buckner refers.

RESPONSE:

TRA Docket No. 08-00197 and TRA Docket No. 08-00202.

DISCOVERY REQUEST NO.5:

With respect to page 25, line 3 of Terry Buckner’s direct testimony, please state whether Mr. Buckner believes that all Tennessee utilities should use the same approach or cost allocation methodology for allocating indirect costs. If so, please explain why. If not, please explain why not.

RESPONSE:

The Consumer Advocate objects to this Request to the extent that it is overly broad, unduly burdensome, and excessively vague. Without waiving these objections, the Consumer Advocate responds as follows:

No, not necessarily, but the cost allocation methodology should be just and reasonable and based on cost-causative factors, unlike the method proposed by TAWC in this docket.

DISCOVERY REQUEST NO.6:

With respect to page 27, line 3 of Terry Buckner's direct testimony, please provide the reference or calculation that supports Mr. Buckner's statement that the Analysis ends up with "over 70%" of the costs subject to allocation being allocated to customers.

RESPONSE:

Index of work papers – Terry Buckner, P32: Customers at 63% plus Premises at 9% totaling 72%. Premises means, "The number of bills produced is primarily driven by the number of customers." (TAWC response TN-CAPD-01-PART III-Q110-SUPPLEMENTAL ATTACHMENT, Page 102 of 112.)

DISCOVERY REQUEST NO.7:

With respect to page 27, line 5 of Terry Buckner's direct testimony, please state whether it is Mr. Buckner's opinion that a single factor allocation method (e.g., number of customers) should never be used as a general allocator for allocating indirect costs. Please explain why or why not.

RESPONSE:

The Consumer Advocate objects to this Request to the extent that it is overly broad, unduly burdensome, and excessively vague. Without waiving these objections, the Consumer Advocate responds as follows:

No, not necessarily. The size of the public utility, the complexity of the public utility, i.e., regulated and non-regulated operations, and the financial capability of the public utility should be considered in the adoption of a cost allocation methodology. A single factor allocation method can lack transparency and be administratively inefficient.

DISCOVERY REQUEST NO.8:

Please state all facts that support the qualifications of each CAPD witness to testify as to the following topics: Service Company Fees, Cost of Service, Weather Normalization, Revenue Requirement, Taxes, Test Period, Cost of Equity and Capital Structure.

RESPONSE:

See CV and credentials in direct testimony of each witness for the Consumer Advocate.

DISCOVERY REQUEST NO.9:

With respect to page 30, line 19 of Terry Buckner's direct testimony, please explain why Mr. Buckner believes an allocation factor consisting of an equal weighting of Plant in Service, Direct Operations and Maintenance Expense and Number of Customers is the appropriate method for TAWC to allocate indirect costs.

RESPONSE:

Obviously, the equal weighting provides balance for each allocation factor. The allocation of indirect costs should follow the direct costs, which are the plant investment and the operation and maintenance expenses incurred in providing utility service to the customers. Therefore, it is more appropriate than a single allocation factor. However, the Consumer Advocate has recommended that management fees be calculated using the TRA's methodology in TRA Docket #08-00039.

DISCOVERY REQUEST NO.10:

With respect to page 30, line 19 of Terry Buckner's direct testimony, please state whether Mr. Buckner considered any other cost allocation factors for allocating TAWC's indirect costs. If no, explain why not.

RESPONSE:

The allocation factors of TAWC's Customer Based Cost Allocation Analysis were examined by the Consumer Advocate. The Consumer Advocate believes that revenues and employees are not appropriate allocation factors. Revenues for a Tier 2 allocation causes a perverse result for a regulated public utility, i.e., more revenues from rate increases results in more allocation of Management Fees. This would encourage wasteful use and abuse by the public utility. Employees were not considered due to their volatility, which is especially true with TAWC.

DISCOVERY REQUEST NO.11:

With respect to page 31, line 3 of Terry Buckner's direct testimony, please provide the "composite allocation factor" used by Chattanooga Gas Company for "many of the services" provided by its service company and identify: (a) the services allocated using the composite allocation factor; (b) the other services that are not allocated using the composite allocation factor referred to by Mr. Buckner; and (c) the allocation factors used to allocate such costs.

RESPONSE:

The composite allocation factor is applied to Internal Auditing, External Relations, Legal Services and Risk Management, Financial Services, Information Systems, Executive, Investor Relations, and Business Support.

A factor based on the number of customers is applied to Rates and Regulatory, Gas Supply, Capacity Planning and Capacity Management, Marketing, and Engineering.

A factor based on the Call/Phone Volumes is applied to Customer Services.

A factor based on the number of employees is applied to Employee Services.

Source: TRA Docket #09-00183 MFG No. 46.

DISCOVERY REQUEST NO.12:

Please state whether the CAPD believes that IRS regulations require the timing differences between book and tax depreciation to be normalized for rate recovery.

RESPONSE:

The Consumer Advocate objects to this discovery request to the extent that this Request asks the Consumer Advocate's non-legal expert witnesses to draw legal conclusions. Without waiving these objections, the Consumer Advocate responds as follows:

The Consumer Advocate is of the opinion that the Internal Revenue Code requires that most property-related temporary differences are normalized in order for the utility to be eligible for liberalized depreciation.

DISCOVERY REQUEST NO.13:

With respect to Terry Buckner's testimony, please state whether the CAPD considered any over/under capex spending due to timing in arriving at their determination of the attrition year utility plant balances embedded in the CAPD rate base calculation.

RESPONSE:

Given TAWC's recent history of deferring and or delaying capital expenditures and TAWC's inability to control costs, the Consumer Advocate is uncertain whether any of the capital expenditures included in its forecast will meet the expected timing during the attrition year.

DISCOVERY REQUEST NO.14:

Please explain in detail the CAPD's understanding of SFAS 109 accounting for income taxes and state whether the SFAS 109 accounting for income taxes is required under U.S. GAAP accounting guidelines.

RESPONSE:

The Consumer Advocate objects to this Request to the extent that it is overly broad, unduly burdensome, and excessively vague; in addition, the Consumer Advocate objects to this discovery request to the extent that this Request asks the Consumer Advocate's non-legal expert witnesses to draw legal conclusions. Without waiving these objections, the Consumer Advocate responds as follows:

GAAP includes SFAS 109. SFAS 109 is discussed on pages 54 and 55 of Terry Buckner's direct testimony. See SFAS 109.

DISCOVERY REQUEST NO.15:

Please explain in detail the purpose of rate base in the rate setting process.

RESPONSE:

The Consumer Advocate objects to this Request to the extent that it is overly broad, unduly burdensome, and excessively vague. Without waiving these objections, the Consumer Advocate responds as follows:

Rate Base has been defined as the investor-supplied plant facilities and other investments for the purpose of supplying utility service to customers, and is defined on Page 8, Lines 19-20 in Terry Buckner's direct testimony.

DISCOVERY REQUEST NO.16:

Please state whether the CAPD believes that TAWC's books and records are required to be maintained in compliance with U.S. GAAP and explain your answer.

RESPONSE:

The Consumer Advocate objects to this Request to the extent that it is overly broad, unduly burdensome, and excessively vague; in addition, the Consumer Advocate objects to this discovery request to the extent that this Request asks the Consumer Advocate's non-legal expert witnesses to draw legal conclusions. Without waiving these objections, the Consumer Advocate responds as follows:

The Consumer Advocate believes that GAAP includes specific coverage of regulated enterprises, indicating the applicability of GAAP to those enterprises and, in some instances, providing alternative procedures for them. GAAP for regulated enterprises are found in SFAS 71, SFAS 90, SFAS 92, SFAS 101, SFAS 106, SFAS 109, and SFAS 144.

DISCOVERY REQUEST NO.17:

Please state whether the CAPD believes that SFAS 109 requires the gross amount of ADITs related to book/tax timing differences to be reflected on the balance sheet as temporarily

contributed capital and/or as regulatory assets to be covered in future rates of a utility and explain your answer.

RESPONSE:

The Consumer Advocate objects to this Request to the extent that it is overly broad, unduly burdensome, and excessively vague; in addition, the Consumer Advocate objects to this discovery request to the extent that this Request asks the Consumer Advocate's non-legal expert witnesses to draw legal conclusions. Without waiving these objections, the Consumer Advocate responds as follows:

Consistent with GAAP, the Consumer Advocate believes that recognition of a deferred tax liability for tax benefits that flow through to customers should be reflected when the temporary differences originate and that an adjustment of a deferred tax liability or asset is required as a result of an enacted change in tax laws or rates. If as a result of an action by the TRA, it is probable that the future increase or decrease in taxes payable will be restored from or returned to customers through future rates, an asset or liability is recognized for that probable future revenue or reduction in future revenue in accordance with SFAS 71.

DISCOVERY REQUEST NO.18:

With respect to Terry Buckner's testimony, in the CAPD's recommendation regarding the rate base reduction for ADITs related to book tax timing differences, please explain whether the CAPD reduced the Company's per book balance sheet ADITs (gross ADITs) by the regulatory assets related to book/tax timing differences?

RESPONSE:

No. At this time, the Consumer Advocate is uncertain that the regulatory asset as required by SFAS 71 has been approved by the TRA or its predecessor, the Tennessee Public Service Commission. However, based on the financial statements of TAWC, the Consumer Advocate believes it has included deferred tax assets as required by SFAS 109.

DISCOVERY REQUEST NO.19:

With respect to Terry Buckner's testimony, please state whether the CAPD's recommendation regarding ADITs recognizes any future recovery of book/tax timing differences as they reverse.

RESPONSE:

In accordance with SFAS 109, book/tax differences are no longer referred to as "timing differences", but are now known as "temporary differences." Yes, the Consumer Advocate recognizes future recovery of temporary differences as they reverse. (TAWC response TN-TRA-02-Q92g-Attachment, pages 5 and 9)

DISCOVERY REQUEST NO.20:

Is it the position of the CAPD that Mr. Buckner's recommendation to not net the regulatory asset for book-tax depreciation timing differences (the turn around once the tax life expires) is an IRS normalization violation? If the CAPD contends this is not an IRS normalization violation, please explain in detail why not.

RESPONSE:

See response to discovery request No. 12.

DISCOVERY REQUEST NO.21:

Please provide a reconciliation of the total capital of TAWC on which the CAPD is basing its cost of service calculation in this case to the CAPD rate base, with detailed explanations for each item of the variance.

RESPONSE:

Short Term Debt \$6,875,542
Long Term Debt \$51,923,666
Preferred Stock \$1,321,810
Parent Short Term Debt \$458,369
Parent Long Term Debt \$10,073,468
Parent Common Equity \$35,944,694
Total \$106,597,549

Revised direct testimony and exhibits of Consumer Advocate witness Dr. Klein will be filed with the TRA. Additionally, revised Consumer Advocate Exhibits with revised direct testimony of Consumer Advocate witness Terry Buckner will be filed with the TRA.

DISCOVERY REQUEST NO.22:

Please provide a detailed reconciliation of the CAPD's recommended ADITs in this case to the ADITs utilized in the Commission Order in docket number 08-00039, with a detailed explanation of each element of the ADITs that decreased in this case, including any financial

literature, accounting principles, FASB pronouncements and regulatory commission orders that support the CAPD's approach or were referred to or relied upon in this case.

RESPONSE:

See attachments provided on enclosed CD.

DISCOVERY REQUEST NO.23:

Please state whether the CAPD agrees that any change in the allocation method of AWWSC costs would add costs to some AWWC subsidiaries and lower the cost to other subsidiaries and explain your answer.

RESPONSE:

Yes, a change in allocation method using the three tiered composite factor would raise the allocated Management Fees for California, New Jersey, and Pennsylvania. All other American Water regulated jurisdictions would result in lower Management Fees. (Index of work papers - Terry Buckner, page 21).

DISCOVERY REQUEST NO.24:

With respect to Terry Buckner's testimony, please provide any studies and/or analysis that Mr. Buckner has performed to determine that his allocation factors shown on page 21 of his work papers represent the cost of causative drivers for each function of AWWSC. Also provide any studies or analysis performed by Mr. Buckner that demonstrate those allocation factors are more appropriate than customer allocations.

RESPONSE:

The Consumer Advocate did not perform a study or analysis of cost causative driver for each function of AWWSC. However, each function is either accounted for as an Operation and Maintenance Expense or as a Capitalized Expenditure and charged to customers. Consistent with the Schumaker Report, Operation and Maintenance Expense and Plant in Service are self-evident direct costs incurred by the regulated companies. Therefore, it is entirely consistent for the indirect costs to follow the cost causative amounts.

DISCOVERY REQUEST NO.25:

With respect to Terry Buckner's testimony, please provide any studies or analysis that Mr. Buckner performed to determine which other regulated subsidiaries of AWW should pay more for AWWSC costs as the result of Mr. Buckner's proposed allocation formulas shown on page 21 of the work papers, and explain why this result is appropriate.

RESPONSE:

See response to No. 23. It is appropriate because it is cost causative and follows where the Operation and Maintenance Expense and Plant in Service cost are incurred by American Water. American Water's capital structure supports the Plant in Service, i.e., rate base, which is the investor-supplied plant facilities and other investments for the purpose of supplying utility service to customers.

DISCOVERY REQUEST NO.26:

With respect to Terry Buckner's testimony, please provide any studies or analysis on which the CAPD developed, referred to or relied upon to support their position that plant in service is a cost causative driver for the HR, call center, treasury, information technology, accounts payable or payroll functions provided by AWWSC.

RESPONSE:

The Consumer Advocate objects to this Request to the extent that it is overly broad, unduly burdensome, and excessively vague; in addition, the Consumer Advocate objects to this Request to the extent that it seeks to discover confidential work product and/or privileged communications. Without waiving these objections, the Consumer Advocate responds as follows:

All of those functions support the employees of each regulated company in the performance of their duties to operate, maintain, and install plant in service for the provision of utility service to customers.

DISCOVERY REQUEST NO.27:

Please provide any studies or analysis that the CAPD developed, referred to, or relied upon to support its position that O&M expenses (which include power, chemicals, waste disposal, insurance and customer accounting expenses) at the regulated subsidiary are a cost causative driver for the HR, call center, treasury, information technology, accounts payable or payroll functions provided by AWWSC.

RESPONSE:

See response to No. 26.

DISCOVERY REQUEST NO.28:

With respect to Terry Buckner's direct testimony, provide any studies and/or analysis to support the conclusion that the average of plant in service, customers and operation & maintenance expense are more accurate cost causative drivers for AWWSC costs rather than customers, employees, number of invoices, revenues, etc.

RESPONSE:

See responses to Nos.9, 10, 24, 25, and 26.

DISCOVERY REQUEST NO.29:

With respect to Terry Buckner's testimony, please state whether the CAPD agrees or disagrees that developing a cost causative driver for each of the various functions of the AWWSC would be more accurate than the three element allocation used in work paper 21 and explain your answer.

RESPONSE:

Perhaps, but given AWWSC's entrenchment to allocation by customers, it is unlikely that a true cost causative driver for each function of AWWSC would be the result. The Customer Base Cost Allocation Analysis is indicative of AWWSC's bias to allocation by customers.

DISCOVERY REQUEST NO.30:

With respect to Terry Buckner's testimony, please provide any studies and/or analysis performed by the CAPD that addresses the additional administrative costs and capital costs associated with multifaceted formulas for each function.

RESPONSE:

The Consumer Advocate did not recommend a multifaceted formula for each function. Therefore, the Consumer Advocate did not perform any studies and/or analysis on the subject. However, the application of an equally weighted percentage of Plant in Service, Operations and Maintenance Expense, and Customers would be readily available. Since the current allocation of Management Fees is based on Customers from the previous year end and each month's Management Fees is paid a month in advance, there is adequate time to develop the composite allocation factor.

DISCOVERY REQUEST NO.31:

With respect to Terry Buckner's testimony, if results of a detailed study to determine the cost causative factors of each function of AWWSC resulted in a nominal difference from the customer allocations, please state whether the CAPD would agree or disagree that the additional administrative and capital costs to develop and maintain the accounting system required to process the data in that manner for the multifaceted formulas should be recovered in rates.

RESPONSE:

See response to No. 30. Also, see page 28, lines 2 and 3 of Terry Buckner's direct testimony.

DISCOVERY REQUEST NO.32:

Produce a copy of all documents, information and material that Chris Klein relied upon or referenced in arriving at his opinions and conclusions.

RESPONSE:

The Consumer Advocate objects to this Request to the extent that it is overly broad, unduly burdensome, and excessively vague; in addition, the Consumer Advocate objects to this Request to the extent that it seeks to discover confidential work product and/or privileged communications. Without waiving these objections, the Consumer Advocate responds as follows:

Dr. Klein relied upon the following publicly available items concerning cost of capital:

Value Line, *Ratings and Reports*, October 22, 2010 (Water Companies) and December 10, 2010 (Gas Companies).

Wall Street Journal (WSJ.com), accessed on December 23, 2010.

Dr. Klein referenced the following articles in his remarks on weather normalization:

"Seasonal Residential Water Demand Forecasting for Census Tracts," Austin S. Polebitski and Richard N. Palmer, *Journal of Water Resources Planning and Management*, January/February 2010;

“Peak Daily Water Demand Forecast Modeling Using Artificial Neural Networks,” Jan Franklin Adamowski, *Journal of Water Resources Planning and Management*, March/April, 2008;

“Short Term Municipal Water Demand Forecasting,” John Bougadis, Kaz Adamowski, and Roman Diduch, *Hydrological Processes*, 19, 2005;

“On Weather Normalizing Customer Level Billing Data,” Anil Bamezai, *Water Resources Research*, 33(5), 1997.

Electronic copies are attached.

DISCOVERY REQUEST NO.33:

Please provide all documents that support the statement on page 11 of Mr. Novak’s testimony that all TAWC rate cases from 1991-2005 were resolved by “Black Box” settlements?

RESPONSE:

See direct testimony of Company witness Michael Miller, Page 50, Lines 5 – 6.

DISCOVERY REQUEST NO.34:

Please provide Mr. Novak’s explanation of the purpose of a weather normalization adjustment (“WNA”) in setting the rates of a utility.

RESPONSE:

As currently adopted by the TRA in setting rates for gas utilities, the purpose of the WNA is to adjust the actual usage of individual residential and commercial customers to a level of anticipated usage based upon the normal weather adopted in the last rate case. The WNA is then implemented for real time billing on a cycle by cycle basis. Therefore, the ultimate purpose

of the WNA is to reduce the impact that abnormal weather might have on the customers' bills.

In weather periods that are colder than normal, the customer receives a credit on his bill, while in periods of warmer than normal weather, the customer is billed a surcharge.

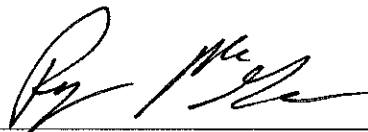
DISCOVERY REQUEST NO.35:

Please state whether the CAPD contends that a WNA is meant to determine the exact level of sales during the attrition year.

RESPONSE:

The WNA proposed by the Company would not determine an exact level of sales during the attrition year.

RESPECTFULLY SUBMITTED,

A handwritten signature in black ink, appearing to read 'Ryan L. McGehee', is written over a horizontal line.

Ryan L. McGehee BPR#025559
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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served via U.S. Mail or electronic mail upon:

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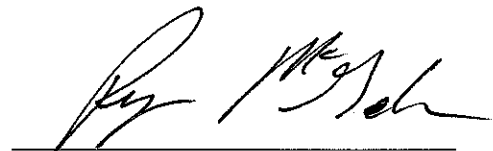
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on this the 20 day of January, 2011.



Ryan L. McGehee