

CITY OF KNOXVILLE, TENNESSEE

Notes to Financial Statements

June 30, 2004

(amounts expressed in thousands)

NOTE 16 - COMMITMENTS AND CONTINGENCIES (continued)

One of the requirements of the Tennessee Department of Environment and Conservation Agreed Order and the tentative agreement is development of a Corrective Action Plan and Engineering Report, that includes the capital and maintenance projects necessary for KUB to comply with the Agreed Order and the tentative agreement. Based on the draft Corrective Action Plan and Engineering Report, in order to comply with the Agreed Order and the tentative agreement, KUB is estimating its Wastewater Division will spend a total of \$530 million in capital investments over the next ten years, plus an additional \$37 million in operating and maintenance expenditures over total base level operating and maintenance over the next ten years.

During fiscal year 2003 and 2004 KUB was issued Notices of Violation and/or penalty assessments by the City for sanitary sewer overflows. KUB appealed all penalty assessments to the City of Knoxville Board of Environmental Appeals. The Board of Environmental Appeals held hearings and issued rulings on some, but not all, of the penalty assessments on appeal before it, affirming the City's right to issue penalties but modifying the amounts of some of those penalties. The remainder of the penalty assessments appealed to the Board of Environmental Appeals were pending as of June 30, 2004. Those penalty assessments, which had been ruled upon by the Board of Environmental Appeals, were appealed by KUB to the Circuit Court for Knox County, Tennessee ("Circuit Court") where they were also pending as of June 30, 2004. The City and KUB entered into facilitated negotiations to resolve the regulatory issues and all penalty assessments pending before the Board of Environmental Appeals and the Circuit Court. These negotiations were in progress as of June 30, 2004.

In November 2004, the City and KUB settled their dispute over regulatory issues and the associated notice of violations and/or penalty assessments by the City against KUB for sanitary sewer overflows. Under the terms of agreement with the City, the City will dismiss without prejudice all notice of violations issued against KUB to date and all penalties assessed against KUB to date totaling over \$600.

NOTE 17 - POST-RETIREMENT BENEFITS

Former City employees are allowed to maintain health care coverage comparable to what they had at retirement. Premium payments are the responsibility of the retiree.

In addition to providing pension benefits, the Knoxville Utilities Board provides certain health care and life insurance benefits for retired employees, their spouses and dependent children. The cost associated with the post-retirement benefits were incurred by the Knoxville Utilities Board Pension Plan. As of January 1, 2002, the pension plan no longer funds the retiree medical health benefits. The cost of retired health care and life insurance benefits is recognized as expense as claims are paid. Substantially all of the Knoxville Utilities Board's employees hired on or before July 1, 1999, are eligible for these benefits, if they meet the Rule of 80 upon termination of employment, with a minimum of 20 years of service or if they had 25 years of service as of January 1, 1998. Approximately 1,409 retirees and dependents were eligible to receive such benefits at June 30, 2004. Knoxville Utilities Board's portion of total benefits and related administrative expenses for 2004 was approximately \$5,313.

NOTE 18 - BUSINESS AND CREDIT CONCENTRATIONS

The Metropolitan Knoxville Airport Authority is dependent to a large extent on one major airline in that a significant portion of aviation revenue is generated by that airline. The airline accounted for approximately \$391 in aviation area revenue during 2004. In addition, a significant portion of terminal area revenue is directly and indirectly generated from that airline's passengers, which accounted for approximately 18% of 2004 passengers.