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RECEIVED

AUG 1 2006

TN REGULATORY AUTHORITY
UTILITIES DIVISION

MEMORANDUM

**To: Darlene Standley, Chief
Utilities Division, Tennessee Regulatory Authority**

**From: Don Scholes
Counsel for Lynwood Utility Corporation**

Re: Docket No. 06-00071 – Alternate Form of Financial Security

Date: August 1, 2006

After meeting with the Authority Staff, Lynwood Utility Corporation (Lynwood) contacted Tennessee Commerce Bank about the feasibility of providing Lynwood a letter of credit in an amount less than \$500,000. Under Rule 1220-4-13-.07(2), Lynwood is required to provide a letter of credit or corporate surety bond in the amount of its annual gross revenues which for 2005 were approximately \$500,000. Lynwood contacted Tennessee Commerce Bank because of the existing relationship John Ring and Tyler Ring, the owners of Lynwood, have with this bank. The owners believed that the existing relationship with Tennessee Commerce Bank would increase the chances of Lynwood being able to obtain a letter of credit in some amount.

Tennessee Commerce Bank has declined to issue a letter of credit to Lynwood with the terms set forth in Rule 1220-4-13-.08 for \$500,000, \$100,000 or \$50,000 due to the financial condition of Lynwood. I have attached a letter to Lynwood dated July 24, 2006, setting forth the reasons the bank is not willing to issue a letter of credit to Lynwood. Unfortunately, the current financial condition of Lynwood was not strong enough to allow Tennessee Commerce Bank to issue a letter of credit.

In its discussions with the Authority Staff, Lynwood understood that the primary purpose of the filing of financial security with the Authority is to insure that funds are available to continue to operate the Lynwood sewer system in the unlikely event the current owners simply stop operating the system. The Authority Staff's concern is consistent with the purpose of T.C.A. § 65-4-201(e) and Rule 1220-4-13-.09 which is to ensure the continued proper operation and maintenance of Lynwood in the event the owners are unwilling, unable or refuse to properly operate the system by permitting the Authority to make a claim against the financial security filed by Lynwood to continue the operation of the system.

Lynwood asserts that the following should provide the Authority with adequate financial security for the continued operation of its system should such events occur:

(1) Lynwood will establish and maintain a separate escrow account in the amount of \$20,000 with a local bank to be made available to the Authority or its designee in the event the Authority finds it necessary to make a claim against Lynwood's financial security. The escrow account will be funded by the owners of Lynwood and/or Tenn. Contractors, Inc. Lynwood will enter into an escrow agreement with the bank which provides that funds from this account shall only disbursed in the event the Authority issues an order pursuant to Rule 1220-4-13-.09 to make a claim against the account in accordance with the provisions of Rule 1220-4-13-.09. Lynwood

will file a copy of the bank statement of the account with the Authority after its is opened and with its annual report or at any other time specified by the Authority. Lynwood would request that the escrow account be included in its rate base since it would be working capital which would not be available for Lynwood's use.

(2) Lynwood will amend its existing billing and collection agreements with the City of Franklin, Tennessee and with H. B. & T. S. Utility District to provide that in the event the Authority takes action under 1220-4-13-09 to suspend or revoke Lynwood's CCN or to cause a forfeiture of Lynwood's funds, Franklin and H. B. & T. S. Utility District will agree to send all funds collected from their customers for Lynwood sewer service to the Authority, a court appointed receiver or other entity or person to whom the Authority may direct to continue the operation of Lynwood's sewer system.

Lynwood believes this alternate security will provide the Authority the financial security it seeks to guarantee the continued operation of Lynwood's system. All of Lynwood's charges for sewer service are billed and collected by the City of Franklin and H. B. & T. S. Utility District which provide water service to Lynwood's sewer customers. These utilities have been collecting Lynwood's monthly sewer revenues since 2001. After the monthly sewer charges are collected, these utilities then forward to Lynwood all funds collected each month less the contractual fee set forth in their respective agreements to Lynwood for providing billing and collection services. If Lynwood amends its billing and collection agreements with the City of Franklin and H. B. & T. S. Utility District to require that funds collected for Lynwood be sent to the Authority or the person or entity directed by the Authority when the Authority takes action as set forth in 1220-4-13-09, then the Authority will have full, immediate access to all of Lynwood's operating revenues in the unlikely event action is taken under 1220-4-13-09. The

Authority or its designee will be able to obtain all of Lynwood's monthly sewer revenues directly from the third parties which actually collect its monthly revenues to use to continue to operate the Lynwood system

To the extent the Authority or its designee incurs extra expenses in continuing the operation of Lynwood's system, the Authority has the ability to withdraw \$20,000 from the escrow account to cover these expenses.

Lynwood asserts that this alternate financial security is in the public interest for several reasons.

(1) The current financial condition of Lynwood will not permit it to obtain a letter of credit or corporate surety bond as contemplated by Rules 1220-4-13-07 and .08.

(2) Unlike several new sewer utilities certificated by the Authority, Lynwood was created and has been maintained primarily through debt and equity contributions from its owners. Lynwood has operated continuously since it received its original certificate in 1976. While Lynwood has not operated at a profit each year, there is no evidence to indicate that Lynwood will not continue to operate as an on-going concern as it has for almost 30 years.

(3) By Order dated January 4, 2006, the Authority approved a twenty year loan from Tenn. Contractors, Inc. to Lynwood for \$1,000,000 which was used to pay off a short term line of credit from Tenn. Contractors, Inc. which provided funds to Lynwood to upgrade and improve the Lynwood sewer treatment plant. John Ring, one of the owners of Lynwood, is the owner of Tenn. Contractors, Inc., and Tyler Ring is an officer of Tenn. Contractors, Inc. Therefore, the owners of Lynwood have a substantial financial interest in the continued viability of Lynwood to ensure that this \$1,000,000 loan is repaid.

(4) Because Lynwood's monthly revenues are collected by two governmental entities, amendments to those agreements which assure the Authority access to Lynwood's monthly revenues will provide the Lynwood system with an on-going stream of revenue in the unlikely event the current owners of Lynwood are unwilling, unable or refuse to continue to operate the Lynwood sewer system.

As discussed in the meeting with the Authority Staff, Lynwood anticipates filing a rate case in the near future. Lynwood will seek to incorporate in its rate case as an expense the cost of the financial security required by Rule 1220-4-13-07. As Lynwood's financial condition improves with any approved rate increase, Lynwood will seek to obtain a letter of credit or corporate surety bond in any amount financial institutions may be willing to issue based upon its improved financial condition. Lynwood is aware that it must seek approval of its financial security again before May 1, 2007.

Before Lynwood amends its Petition to request acceptance and approval of the alternate form of financial security set forth herein, Lynwood would like the Authority's Staff to review this alternate. If an additional meeting would be helpful, Lynwood is willing to meet again.

c: Tyler Ring
Jim Ford



July 24, 2006

Dear Tyler:

At your request I have reviewed again, the request of Lynwood Utility Corporation (Lynwood) for a \$500,000 letter of credit in favor of the Tennessee Regulatory Authority from Tennessee Commerce Bank (the Bank). You also requested that I advise Lynwood of the Bank's willingness to issue a letter of credit for lesser amounts of \$100,000 or \$50,000. The Bank is not willing to issue a letter of credit in any of these amounts for the following reasons:

- (1) The discretion of the Tennessee Regulatory Authority, as the beneficiary, to draw on the letter of credit is very broad and open ended. The proposed terms of the letter of credit do not allow for an appeal or time to cure any default. Therefore, the terms of the letter of credit require the Bank to assume a substantial amount of risk.
- (2) If the Bank decides not to renew the letter of credit and Lynwood is unable to get another financial institution to issue a replacement letter of credit, the Bank is obligated to fund the full amount of the letter of credit. Based upon the financial statements of Lynwood, the Bank has grave doubts that another financial institution would be willing to issue a replacement letter of credit for the same reasons the Bank is unwilling to issue any letter of credit. The Bank is not willing to run this risk in issuing a letter of credit for \$500,000, \$100,000 or \$50,000 to the Tennessee Regulatory Authority.
- (3) The financial statements of Lynwood and other information provided to me will not support the issuance of any letter of credit to the Tennessee Regulatory Authority on behalf of Lynwood. The 2005 annual report of Lynwood filed with the Tennessee Regulatory Authority shows Lynwood had a net loss for 2005 of \$34,325. For the 2004 Lynwood has net loss of \$185,988.
- (4) Since the end of the 2005 calendar year, Lynwood has signed a promissory note to Tenn. Contractors, Inc. for \$1,000,000 to be repaid over a 20

year period which has been approved by the Tennessee Regulatory Authority. The principal and interest payments on this note would appear to increase Lynwood's potential net loss for 2006 over its net loss for 2005. This note is secured by the land, sewer treatment plant and sewer collection system of Lynwood as it existed on December 31, 2004 and by 20% of any additions to its sewer system. Therefore, the Lynwood sewer system would provide little, if any, security to the Bank on the letter of credit.

As I indicated in my previous letter to you, if there were a way to structure an approval of a request for a letter of credit, it would impair your ability to support credit facilities for yourself and Tenn. Contractors, Inc. going forward.

Sincerely,

A handwritten signature in black ink, appearing to read 'J. Burton', with a long horizontal flourish extending to the right.

John Burton
Senior Vice President