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January 30, 2007

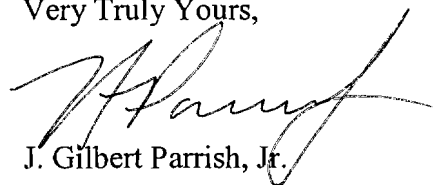
Ms. Sharla Dillon  
Docket Clerk  
Tennessee Regulatory Authority  
460 James Robertson Parkway  
Nashville, TN 37219

Re: Petition of Aqua Utilities Company for Approval of Adjustment of its  
Rates and Charges and Revised Tariff (Docket 06-00187)

Dear Ms. Dillon:

Please file the attached Response of Aqua Utilities Company to Director Miller's Motion of January 22, 2007. I am this date sending by Federal Express delivery the original and 5 copies. Thank you for your assistance in this matter.

Very Truly Yours,



J. Gilbert Parrish, Jr.

Enclosure

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TRA DOCKET 00187  
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STANLEY

January 30, 2007

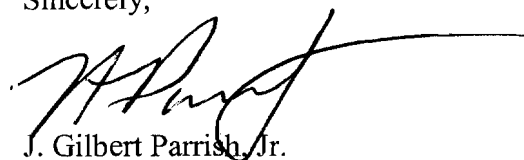
Ms. Sara Kyle, Chairman  
Tennessee Regulatory Authority  
460 James Robertson Parkway  
Nashville, TN 37219

Re: Petition of Aqua Utilities Company for Approval of Adjustment of its  
Rates and Charges and Revised Tariff (Docket 06-00187)

Dear Chairman Kyle:

In accordance with your request, please accept this letter to confirm that Aqua will not place its tariff into effect pending action by the panel on February 5, 2007. Enclosed you will find the Response of Aqua Utilities Company to Director Miller's Motion of January 22, 2007.

Sincerely,



J. Gilbert Parrish, Jr.  
Attorney for Aqua Utilities Company

Enclosure

Cc: Director Ron Jones  
Director Pat Miller  
TRA Docket Clerk

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

**IN RE:**

<b>PETITION OF AQUA UTILITIES</b>	)	
<b>COMPANY FOR APPROVAL OF</b>	)	
<b>ADJUSTMENT OF ITS RATES AND</b>	)	<b>DOCKET NO. 06-00187</b>
<b>CHARGES AND REVISED TARIFF</b>	)	

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**RESPONSE OF AQUA UTILITIES COMPANY TO  
DIRECTOR MILLER'S MOTION OF JANUARY 22, 2007**

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On January 22, 2007, Director Miller filed his proposed motion in Aqua Utility Company's ("Aqua's" or "the Company's") rate case filing. Because of the potential devastating consequences on the operations of the utility if Director Miller's motion is adopted, the Company has asked for a continuance in the TRA's decision on this matter until February 7<sup>th</sup>.

Through this Response, Aqua is seeking to demonstrate to the Panel the adverse impact to the Company from the proposals contained within Director's Miller's motion. Specifically, we will show that Director Miller's proposals related to the Company's Administrative & General Expense, Construction Work in Process, Accounting Treatment for Tap Fees, Requirement to Fund Grinder Pumps, and Rate of Return are all arbitrary and capricious, dismissive of past TRA decisions and practices in similar cases, and run contrary to the TRA's own accounting rules for water and wastewater utilities.

It is imperative to point out that Director Miller's motion suggest changes wherein no testimony is in the record to support the financial consequences of such proposal. In addition, we will also respond to Director Miller's proposals for Rate Design and Other Issues contained within his Motion.

**I. Administrative & General Expense**

The Company's Administrative & General ("A&G") Expense is composed entirely of the salary paid to the Company's owner; Mr. Eddie Clausel. As the Company's only employee, Mr. Clausel is responsible for all the day-to-day decisions of Aqua Utilities Company.

For all of the services provided to Aqua, Montana Management, LLC is paid a contract amount of \$2,500 per month. However, Director Miller's Motion contains a proposal to reduce this amount to \$500 per month without any rational explanation of either why or

how he came to this amount. In the direct testimony of Mr. Clausel, no question was presented nor has there ever been any challenge made to the value of these services and the rate of compensation. A copy of the management contract of Montana Management Inc. with Aqua has been duly filed in the record. This contract clearly identifies the duties involved in the management of Aqua Utilities. The duties and the liability and risk associated with the same certainly require more time than the proposed \$500 per month salary. We would therefore ask the Panel to reject Director Miller's motion on Administrative & General Expense.

## **II. Construction Work in Process**

Perhaps the most devastating piece of Director Miller's motion is his proposal to exclude from Aqua's Rate Base, all of the Construction Work in Process ("CWIP") investment related to extending the Company's service lines to serve a new development known as "The Preserve." As defined in the NARUC Uniform System of Accounts for water and wastewater utilities, CWIP "...includes the cost of wastewater plant in process of construction, but not ready for service."

The TRA has traditionally included CWIP as a component of a utility's rate base. In fact, in the TRA's most recent rate case decision in Docket 05-00258 involving Atmos Energy, Director Miller includes within his proposed motion an amount for CWIP. Also, the TRA included an amount for CWIP in Docket 04-00034 involving Chattanooga Gas Company and noted in its order that "CWIP represents the cost of investment that is currently under construction and will be transferred to plant in service when completed." Finally, to our knowledge, the TRA has never excluded CWIP from a utility's rate base as has been proposed here.

As stated on the website, the TRA's mission is to promote the public interest by **balancing** the interests of utility consumers and providers...". However, Director Miller's proposed motion would ask the TRA Directors to ignore this mission statement and long held precedent of recognizing CWIP in rate base solely for the purpose of significantly reducing the Company's rate request. This type of regulatory oversight certainly doesn't balance the utility's interests with those of the consumer and would cause the utility to suffer irreparable financial harm.

Instead of recognizing CWIP in this rate case, Director Miller proposes that the Company "transition" CWIP to plant based on a ratio of new customers added to the 650 total projected new customers. This proposal is without precedent or merit. Director Miller's proposal does nothing to reflect the cost recovery of the Company's investment in providing utility service and would force the Company into filing multiple rate cases as customers are added. In addition, his motion also runs contrary to the Authority's accounting rules which require that utility plant be transferred from CWIP to Plant in Service when construction is completed and ready to provide utility service.

To date, the Company has already invested over \$1.8 million to bring wastewater service to The Preserve development. This amount of investment was uncontested during the Company's hearing, and we would ask the TRA to properly recognize it as CWIP in the Company's calculation of Rate Base.

### **III. Accounting Treatment of Tap Fees**

Director Miller's motion also includes a proposal for the Company to book tap fees as Revenues instead of Contributions in Aid of Construction ("CIAOC") as required by the Authority's accounting rules. According to the TRA's accounting rules for water and wastewater utilities, CIAOC includes:

Any amount or item of money, services or property received by a utility, from any person or governmental agency, any portion of which is provided at no cost to the utility, which represents an addition or transfer to the capital of the utility, and which is utilized to offset the acquisition, improvement or construction costs of the utility's property, facilities, or equipment used to provide utility services to the public.

The Company's methodology to account for tap fees is not a "practice" unique to Aqua as Director Miller has indicated in his motion. Presently, tap fees are charged by the Company for installing collector lines from the Company's mains in the street to the each individual customer's residence. This type of accounting for tap fees is identical to that carried out by other utilities under the TRA's jurisdiction in order to comply with the TRA's accounting rules. The Company currently charges the customer a \$250 tap fee to pay for these collection lines and then uses all of the proceeds to pay an independent outside contractor for the installation. None of the proceeds from tap fees are retained by the Company. The yearly audits and filing with the TRA reflect that Aqua does not realize any income from tap fees.

Although the Company has no strong objection to booking tap fees as revenues instead of CIAOC, we do believe that it is a very poor regulatory policy. Director Miller's proposal is shortsighted in that the Company would be required to file for an increase in rates when the revenue stream from tap fees declines as all customers are placed on the system. Director Miller's motion would also require Aqua to adopt different accounting policies for tap fees from every other utility under the TRA's jurisdiction.

Aqua's preference would be for the TRA to continue to require the Company to book tap fees as CIAOC, and we would ask the Panel to reject Director Miller's proposal on this issue.

### **IV. Requirement to Fund Grinder Pumps**

Director Miller's motion to require Aqua to fund the cost of customer-owned Grinder Pumps along with their installation and maintenance is also without precedent and would leave the Company in a financially precarious position. No testimony, analysis or proof has been include in the rate case to determine the full effect that this would have on Aqua. To implement such a change without a proper analysis of the cost on Aqua would be reckless.

As pointed out in the Company's proposed tariff, the cost for providing and installing Grinder Pumps is \$3,700. At Aqua's present level of 27 customer additions per year, this change would require an annual capital addition of approximately \$100,000. Currently, Aqua does not have the capital resources to fund such a large capital requirement. Director Miller's proposal to force Aqua to fund Grinder Pumps would effectively result in a moratorium on new customers since no provision for funding is included.

#### **V. Rate of Return**

Director Miller has proposed a return on equity that is based on a "representative" group of natural gas companies of 8.77%. However, Director Miller's motion omits the source of this "representative" group and Aqua has no way of authenticating its source.

The TRA has long recognized that smaller utilities are generally much riskier than larger utilities, and have awarded higher returns on equity in smaller utility cases to compensate for this risk. After all, with approximately 200 customers on its system, it would only take the loss of a few customers to have devastating consequences on the earnings results of Aqua, while a "representative" gas utility with over 100,000 customers would have to lose many more customers to have an equal loss. The TRA has traditionally recognized this risk in other wastewater utility cases and awarded returns on equity of 15%.

In addition, Director Miller proposes that the TRA adopt methodology similar to that "utilized by the Florida Public Service Commission" and set the equity cost for Aqua using the CAPM and DCF models. However, Director Miller omits any statement as to just how such models would be adapted to Aqua. There is presently no evidence or testimony in the record as to how such models would apply to Aqua, and the Company was prohibited at hearing from cross-examining staff witnesses that would be familiar with such capital models.

Director Miller's proposal that the TRA adopt the return of a "representative" group of gas utilities is without merit and should be denied. Aqua is not a gas utility and only has approximately 200 customers. We are unable to see how any group of gas utilities with thousands of customers could possibly be "representative" of Aqua's operations. We would therefore ask the Panel to adopt Aqua's proposed return of 15%.

#### **VI. Rejection of TRA #2 portion of the Company's tariff**

The Company is puzzled by Director Miller's proposal to deny the TRA #2 portion of its proposed tariffs. TRA #2 of the tariff represents the Company's Rules and Regulations. To our knowledge there was no controversy over this portion of the tariff at the hearing. In fact, the language contained in TRA #2 has the same provisions (word for word) that already appear in many of the other water and wastewater utility tariffs on file with the TRA. TRA #2 already complies with all federal, state and local laws, as well as the TRA's Rules.

Aqua would ask the Panel to adopt its proposed language for the TRA #2 portion of its tariff in order to provide consistency with other water and wastewater utilities.

## **VII. Other Issues**

At the conclusion of his motion, Director Miller mentions that he is concerned about the amount of rate case expense for only a few hundred customers. We are likewise concerned about the cost of presenting this case.

However, it must be kept in mind that this is the only rate case filed by Aqua in over seventeen (17) years. In addition, the days of "mom and pop" wastewater utilities are over with in Tennessee, due in large part to the TRA's new wastewater rules. These new rules "raise the bar" for small utilities to a higher level where the use of outside experts to assist the utility with the rate case process are needed.

We are also puzzled by Director Miller's motion to have a staff member informally review a future Aqua case, apparently without a hearing. To our knowledge, such a procedure would run afoul of TCA requirements that a hearing be conducted for all changes in rates. In addition Aqua has tried to work informally with the Staff in the past, and found that it was not in their best interest. Finally it appears that Director Miller is forbidding Aqua from filing a future rate case, which we believe that we have a right to do as we first determine.

Admittedly we were unaware of TRA Rule requiring us to file our capital budgets with the Authority. Aqua will immediately file its capital budgets for 2007 with the TRA. However, no data request on this point was ever raised through the Staff's data request in this case or through prior compliance audits conducted by the Staff. It is also our understanding that the TRA has not enforced the provisions of this rule except for telecommunication companies.

## **VIII. Conclusion**

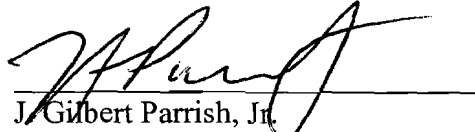
Finally, we would like to point out that the rates proposed by Aqua Utilities Company are **less** than the rates that the TRA has awarded for entirely new wastewater utilities with absolutely no capital investment of their own. In addition, the \$300,000 rate increase requested by Aqua Utilities Company is **less** than the rate of inflation since the

Company's rates were first established in 1990. By denying the Company's rate request, Director Miller's Motion would make it unfeasible for the Company to operate a safe and reliable water and wastewater system for its customers.

Also, it should further be noted that Public Notice was provided regarding the proposed rate increase. Further the Consumer Advocates Office was noticed regarding this rate case when it was initially filed. There has not been a public objection filed nor an intervention by the Consumer Advocates Office. As a result, it is a challenge for Aqua to understand why Director Miller has taken the position reflected in his motion.

For these reasons, Aqua would ask that the Panel reject Director Miller's motion.

Respectfully submitted this the 30 day of January, 2007.



J. Gilbert Parrish, Jr.  
Attorney for Aqua Utilities, Inc.