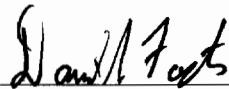



The TRA Wastewater Rules are intended to ensure continued adequate and reasonable service. This docket was opened to consider whether an escrow account should be established for Aqua Utilities Company and, if so, what monthly escrow amount is necessary.

The Utilities Division hereby files its Report with the Tennessee Regulatory Authority as a public record and requests approval of the recommendations contained therein. Staff members assisting in this report were Ron Graham and Mike Warner.

Respectfully Submitted:



David Foster, Deputy Chief
Utilities Division
Tennessee Regulatory Authority



Gary Hotvedt, Counsel
Legal Division
Tennessee Regulatory Authority

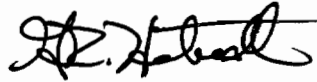
CERTIFICATE OF SERVICE

I hereby certify that on this 14th day of November, 2007, a true and exact copy of the foregoing has been either hand-delivered or delivered via U.S. Mail, postage pre-paid, to the following persons:

Eddie Roberson, Chairman
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243

James E. Clausel, Owner
Aqua Utilities Company
408 Main Street
Savannah, TN 38372

J. Gilbert Parrish, Jr.
Attorney at Law
60 Brazelton St., Unit #9
Savannah, TN 38372

A handwritten signature in black ink, appearing to read "G. Hotvedt", written over a horizontal line.

Gary Hotvedt

STAFF REPORT

CONCERNING THE RESERVE/ESCROW ACCOUNT

OF

AQUA UTILITIES COMPANY

DOCKET 07-00059

PREPARED BY

TENNESSEE REGULATORY AUTHORITY

UTILITIES DIVISION

NOVEMBER 14, 2007

INTRODUCTION

TRA Rule 1220-4-13-.07 requires a review of the financial condition of each wastewater utility in order to determine whether an escrow/reserve fund should be created to pay for non-routine operation and maintenance expenses for those companies that do not have such funds in place or adjusted for the companies that have an established escrow fund. The pertinent language of the aforementioned TRA Rule provides:

- (8) The requirement for a public wastewater utility to maintain a reserve/escrow account shall be determined by the Authority on a case by case basis. Within eighteen (18) months from the effective date of these rules, the Authority shall review the financial condition of any public wastewater utility holding a CCN to provide wastewater service as of the effective date of these rules to determine whether such wastewater utility shall establish or adjust the amount of a reserve/escrow account as described in this Chapter. Upon the filing of an initial CCN application, a determination shall be made regarding the establishment of a reserve/escrow account. The Authority may review the financial condition of any public wastewater utility at any time to determine whether a reserve/escrow account balance is adequate or an account should be established.
- (9) Reserve/escrow accounts established by the public wastewater utility to pay for non-routine operation and maintenance expenses shall meet the conditions as specified by the Authority. The public wastewater utility shall file bank statements and a report that details the expenses on all disbursements from the escrow account with its annual report or as the Authority may direct. Public wastewater utility employees having signature authority over such account may be subject to a fidelity bond. The public wastewater utility's tariff shall set forth the specific amount charged to customers to fund the reserve/escrow account.

SCOPE OF THE REPORT

Pursuant to the rules, the purpose of this report is to analyze Aqua Utilities Company's ("Aqua" or "Company") existing financial condition and determine (1) whether an escrow fund should be established and, if so, what monthly escrow amount is necessary and (2) the types of expenses and repairs that may be funded by the escrow.

IS AN ESCROW ACCOUNT NEEDED GIVEN THE FINANCIAL CONDITION OF AQUA UTILITIES COMPANY?

The most recent financial assessment of Aqua by the Authority was in Docket No. 06-00187, wherein Aqua petitioned the Authority for a \$300,000 rate increase. The Authority held a hearing in this docket on December 4, 2006 and rendered its decision at the January 22, 2007 TRA Conference. By a majority vote, the Panel determined that a rate increase of approximately \$115,000 was necessary for the utility to earn a fair return.¹ The adoption of the \$115,000 rate

¹ Director Jones dissenting.

increase as opposed to the Company's requested \$300,000 increase was primarily due to the Authority (1) disallowing of Construction Work In Progress totaling approximately \$2.5 million; (2) granting an 8.77% return as opposed to the Company's requested 15% return; and (3) disallowing \$24,000 of the owner's salary.

Although Aqua increased its sewer rates on March 1, 2007 in accordance with the decision in Docket No. 06-00187, the Authority will not receive updated financial information until the Company submits its December 31, 2007 annual report due April 1, 2008.

Aqua has stated that it does not want to establish an escrow until after it exercises its right of appeal of the Authority decision in Docket No. 06-00187. The timing of the appeal is unknown at this time, since the Company is awaiting the issuance of an order in the case. Specifically, the Company states:

At some point, the Company may well be willing to entertain creating an escrow/reserve account. However, the creation of such an account was not addressed by the TRA in Aqua's latest rate case (Docket 06-00187) where new rates became effective on March 1, 2007....At this time, the Company is awaiting the TRA's Order in this case so it can pursue its appeal options. As such, it is the Company's position that a change in rate structure to include escrow/reserve rates would not be appropriate at this time.²

Staff opines that the Authority will not know the true financial condition of the Company until after the appeals process and updated financial information is received reflecting the final rates adopted; therefore Staff contends that the establishment of an escrow is not appropriate at this time. Following the appeal, the Authority will have better information to determine whether the Company should establish an escrow account. **In sum, Staff recommends that the Authority not establish an escrow account for Aqua Utilities Company at this time.**

² Company March 26, 2007 data response to question 4.