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BEFORE THE TENNESSEE REGULATORY AUTHORITY

TRA DOCKET ROOM

NASHVILLE, TENNESSEE

November 15, 2007

IN RE: DOCKET TO DETERMINE THE)
 RESERVE/ESCROW REQUIREMENT)
 FOR LYNWOOD UTILITY CORPORATION) Docket 07-00179
 PURSUANT TO TRA RULE 1220-4-12-.07(8))

STAFF REPORT

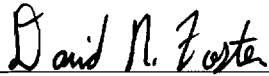
Background

As stated in TRA Rule 1220-4-13.07(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." TRA Rule 1220-4-13.07(9) states, "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."

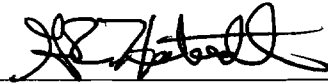
The TRA Wastewater Rules are intended to ensure continued adequate and reasonable service. This docket was opened to consider whether an escrow account should be established for Lynwood Utility Corporation and, if so, what monthly escrow amount is necessary.

The Utilities Division hereby files its Report with the Tennessee Regulatory Authority
as a public record and requests approval of the recommendations contained therein

Respectfully Submitted:



David Foster, Deputy Chief
Utilities Division
Tennessee Regulatory Authority



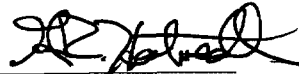
Gary Hotvedt, Counsel
Legal Division
Tennessee Regulatory Authority

CERTIFICATE OF SERVICE

I hereby certify that on this 15th 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:

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Gary Hotvedt

STAFF REPORT

CONCERNING THE RESERVE/ESCROW ACCOUNT

OF

LYNWOOD UTILITY CORPORATION

DOCKET 07-00179

PREPARED BY

TENNESSEE REGULATORY AUTHORITY

UTILITIES DIVISION

NOVEMBER 15, 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 Lynwood Utility Corporation's ("Lynwood" 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 LYNWOOD UTILITY CORPORATION?

As stated herein, the purpose of an escrow account established pursuant to Rule 1220-4-13-.07 is to assist utilities in meeting non-routine maintenance and expenses and to assist in funding plant additions/repairs that a utility might otherwise not be able to pay for. The utility's financial condition should be reviewed in order to determine whether an escrow account is necessary for the above stated purposes or if the utility will be able to fund necessary non-routine expenses and/or plant additions and repairs absent an escrow account.

The most recent financial assessment of Lynwood by the Authority was in Docket 07-00007, wherein the Company petitioned the Authority for a rate increase totaling \$177,471 annually. On July 11, 2007 a Proposed Settlement Agreement ("Agreement") was submitted jointly by Lynwood and the Attorney General's Consumer Advocate and Protection Division ("CAPD") in this docket. Pursuant to the Agreement, Lynwood would receive a rate increase totaling \$61,991 annually as opposed to its original request of \$177,471. The Authority conducted a public hearing in this docket on August 20, 2007 and rendered its decision to approve the Agreement at the September 10, 2007 Authority Conference.

Prior to and during the public hearing, several Lynwood customers voiced their concerns relating to odor issues. Subsequent to the hearing Lynwood submitted a letter explaining corrective actions that had been taken and outlined a short term and long term plan for addressing the odor problems. Furthermore, at the direction of the Authority, certain TRA Staff members filed a report on August 31, 2007 concerning odor control measures which incorporated Lynwood's proposed measures. The Staff report also stated that costs for these control measures were not included in the rate case proceeding (Docket No. 07-00007). During its September 10, 2007 deliberations, the Authority directed Lynwood to notify the Authority when corrective actions relating to odor were taken and determined that if the Company desired to defer and recover the odor elimination costs at a later date, the Company should file a petition for such recovery.

Lynwood's Petition and pre-filed testimony submitted on January 4, 2007 in Docket No. 07-00007 stated that if the Authority required an escrow account, the utility's revenue deficiency would increase and rates would need to be adjusted to take this into account.¹ The Agreement approved by the Authority, however, did not address whether an escrow was needed for Lynwood pursuant to TRA Rule 1220-4-13-.07. Lynwood does not currently have an escrow account, and the utility has historically paid for non-routine maintenance and plant additions without escrow funds.

Over the past several years Lynwood has been able to fund necessary plant additions via its own cash flows. For example, based upon Lynwood's 2004, 2005 and 2006 Annual Reports, the Company acquired \$1,000,000 in long-term debt in 2005 and had plant additions of approximately \$841,000 in 2006. Although Lynwood has been operating at a loss in recent years, the Company has recently received approval to increase rates by approximately \$62,000 annually. While increased revenue should allow Lynwood to earn a fair and reasonable return, it is difficult to ascertain the true financial condition of the Company until it has been operating at the new rates for an extended period of time. Furthermore, the Company will have costs associated with odor control measures that it may seek to recover; the magnitude of such costs and the impact on consumer rates is unknown at this time.

Staff contends that establishing an escrow account for Lynwood is not appropriate until such time that an evaluation of the overall financial condition of the Company subsequent to the approved rate increase can be made. Staff commits to further evaluate the earnings and overall financial condition of Lynwood in order to determine whether an escrow account is necessary in the future. For now, however, it appears that Lynwood's ability to fund recent plant additions, coupled with the additional revenue from the recent rate increase, significantly

¹ Petition at page 3, Pre-filed Direct Testimony of Tyler Ring at page 7.

mitigates the need to establish an escrow account at this time. Moreover, if plant additions are necessary, Lynwood, as a rate-of-return regulated utility, has the ability to seek increased rates from consumers to provide the owners with a fair return on the added plant.