IN THE TENNESSEE REGULATORY AUTHORITY
AT NASHVILLE, TENNESSEE

IN RE:	)	
	)	
LYNWOOD UTILITY CORPORATION'S PETITION FOR ADJUSTMENT OF RATES	)	**DOCKET NO. 09-00034**

POST-HEARING BRIEF OF THE CONSUMER ADVOCATE

Robert E. Cooper, Jr., Attorney General and Reporter for the State of Tennessee, by and through the Consumer Advocate and Protection Division of the Office of the Attorney General ("Consumer Advocate"), respectfully submits this Post Hearing Brief in Tennessee Regulatory Authority ("TRA," or "the Authority") Docket 09-00034, *Lynwood Utility Corporation's Petition for Adjustment of Rates.*

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INTRODUCTION

Throughout these proceedings, the Consumer Advocate has taken issue with a number of items in Lynwood Utility Corporation's ("Lynwood") proposed rate increase. These problems range from improper accounting treatment to errors in Lynwood's record keeping. It is the belief of the Consumer Advocate that addressing and correcting these problems should reduce the need of any proposed rate increase from the requested 33.82%, to a maximum increase of not more than 10.17%. Due to the overlapping nature of some of these issues, the Consumer Advocate has organized this brief into four primary sections: Issues with Lynwood's Stated Expenses; Issues with Lynwood's Proffered Rate Base; Odor Control Issues; and a Comparison of Lynwood's Rates to Neighboring Water Treatment Utilities.

ISSUES WITH LYNWOOD'S STATED EXPENSES

A. Purchased Power Adjustment

As stated by Mr. James Ford, Financial Consultant to Lynwood, in his March 5, 2009 Testimony, Lynwood's Purchased Power Expense included an increase of $10,465 from the 2008 test year, due to an "anticipated 20% rate increase by the Tennessee Valley Authority ("TVA")," *Direct Testimony of James B. Ford*, 4:14-15 (March 5, 2009). This proposed adjustment would increase Lynwood's Purchased Power Expense from $52,328 in 2008, to $62,794 in 2009. It is the opinion of the Consumer Advocate that Purchased Power Expense should be based on the 2008 test year and not on remote possibilities or speculation as to potential increases in this expense. Furthermore, Lynwood's proposed increase over the test year is not supported by either the facts provided or evidence of an "anticipated increase."

First, as stated in the testimony of Dave Peters, while it is true that the TVA announced a potential 20% rate increase in the Fall of 2008, the TVA's rates since that time have not increased, *Transcript of Proceedings,* 208:11-23; 217:9 – 218:25 (August 21, 2009). In fact, a thorough review will show that the TVA's rates have actually decreased, falling below the levels existing even at the time the potential 20% increase was announced. Id. The TVA's announcement was based in large part upon the soaring energy prices existing in mid to late 2008, and the expectation that those prices would continue to rise. Id. As we now know, energy price levels have since returned to normal and the TVA has subsequently cut rates, leaving current rates below 2008 levels, even when taking into consideration the existing TVA surcharge for "Coal Ash Clean-Up." Id. Therefore, any 'anticipation' of rate increases held by Lynwood is unsubstantiated and insufficient to justify a 20% rate increase in light of the fact that the TVA has actually lowered rates since the 2008 test year.

Lynwood's rebuttal argument, that its costs in the first half of 2009 are in excess of the same period in the 2008 test year, is equally unpersuasive. Mr. Ford stated that in the first six months of 2009, Lynwood's Purchased Power Expense totaled $36,830, "an actual increase of $4,725 for the first six months of 2009 representing a 14.7% increase," *Rebuttal Testimony of James B. Ford,* 1:21-22 (July 31, 2009). Once again, this argument does not support Lynwood's proposed increase. The data provided by Lynwood as to this alleged increase in Purchased Power Expense cannot be sufficiently traced to determine if the amounts paid were for any specific periods, *Transcript of Proceedings,* 217:9 – 218:25. Even if this information could be sufficiently traced, Mr. Ford himself admits that, based on his figures, the first six months of 2009 have demonstrated no more than a 14.7% increase in Purchased Power Expense, far from

the 20% increase alleged by Lynwood. Second, any actual increase in Lynwood's Purchased Power Expense in the first half of 2009 will almost certainly be offset by the lower rates in effect during the last half of 2009.

The common practice of basing expenses on a test year exists precisely to guard against the types of errors in calculation delineated above. If Lynwood is allowed to base its expected Purchase Power Expense on "anticipated" rate increases, predicted during some of the highest energy cost levels in history and despite the reality that rates are currently falling, ratepayers will be paying a Purchased Power Expense that far exceeds the actual cost of that power. Thus, while energy rates have since returned to normal levels, Lynwood's Purchased Power Expense will continue to be based on record high price levels. If rates do actually increase in the future, subsequent rate cases will address the need for increased Purchase Power Expense based upon actual increases and verifiable expenses; however, it is improper to arbitrarily increase this expense based on pure conjecture by Lynwood in the face of actual evidence to the contrary.

B. Regulatory Expense

The Consumer Advocate takes issue with Lynwood's calculations regarding Regulatory Expense. First, the Consumer Advocate has shown that Lynwood erred in its annual calculations as to Regulatory Expense. Second, the Consumer Advocate avers that Lynwood should be awarded no more than $18,000 in relation to this rate case, as opposed to the $36,000 requested by the utility.

In relation to Lynwood's calculation of Regulatory Expense, there is little doubt that errors have been committed in Lynwood's calculations. As addressed at the July 21, 2009 Hearing on the Merits, despite Lynwood's agreement to collect approximately 60% of its

regulatory expenses in its last contested case, TRA Docket 07-0007, Mr. Ford admitted that the company has continued to include the full amount of Lynwood's expenses from that Docket in its Regulatory Expense account, even if "not intentionally," *Transcript of Proceedings,* 199:22 - 202:3; See also *Rebuttal of Jim Ford,* 3:1-2. In Docket 07-00007, Lynwood's rate case expense was projected at $26,400. That Docket resulted in a settlement agreement in which there was no contested hearing nor was the company required to file rebuttal testimony or prepare for a contested hearing. The settlement agreement resolving Docket 07-00007 granted Lynwood rate case expenses of $26,400 amortized over three years, *Order Approving Settlement Agreement,* Docket 07-0007, Schedule 2-9[1] (December 11, 2007).

However, in present rate case, Lynwood has improperly persisted in seeking rate case expenses of $45,000 for Docket 07-00007, *Transcript of Proceedings,* 199:22 - 202:3; see also *Rebuttal of Jim Ford,* 3:1-2. This constitutes retroactive rate-making. It is simply improper and against public policy for a utility to be permitted to continue to seek prior rate case expense after previously agreeing to forgo those expenses. Furthermore, Lynwood has collected 2/3 of the rate case expense authorized by Docket 07-0007, leaving $8,800 left still to be properly recovered.[2] By recalculating the 2007 rate case expense in this matter at $45,000 and amortizing this amount over three years, Lynwood is apparently submitting that the true rate case expense for settling the

[1] In a July 17, 2009 response to the discovery request of Lynwood as to the rate case expense issue, the Consumer Advocate explicitly pointed out the level of rate case expense in Docket 07-00007 was $26,400, not the $45,000 claimed by the company.

[2] The rate case expense for Docket 07-00007 was $26,400, amortized over three years at $8,800 per year. The rates approved in Docket 07-00007 went into effect in September of 2007; thus as of September 2009, the company has already recovered 2/3 of the rate case expense approved in the 2007, with $8,800 remaining as properly recoverable from consumers. The additional $45,000 for the 2007 case sought in this matter should be considered in light of the rate case expense already recovered since September of 2007.

2007 case without a contested hearing was $62,600. The Consumer Advocate would also point out that this sum is nearly double the $32,000 in rate case expense Lynwood seeks in the case presently before the Authority. Thus, Lynwood would have the Authority believe a rate case that ends in a settlement is more expensive than a rate case which ends after a fully contested hearing. Furthermore, Lynwood has submitted no support in the record for this figure.

As to the amount of costs that Lynwood should be allowed to recover as a result of this Docket, the Consumer Advocate maintains that any recovery should be limited to no more than $18,000, rather than the $36,000 proposed by Lynwood.[3] Given the frequency of contested cases brought by Lynwood, three in the last three years, this company should be required to take steps to efficiently and economically dispose of these matters, see *TRA Dockets 07-00007, 08-00060, and 09-00034*. If, on the other hand, the company does not take steps to streamline its costs in the ratemaking process, or if Lynwood's figures do vary materially from year to year, the burden of resulting additional costs should be borne by the utility and not ratepayers.

Finally, if Lynwood is allowed to recover all, or substantially all, of its costs incurred in contested cases before the TRA, this will only provide the company (as well as other utilities) with an incentive to more frequently bring rate cases. If Lynwood fails to reduce its Regulatory Expense to a more reasonable level, it should be responsible for paying the excessive costs. After all, this case was brought for the benefit of Lynwood; it is only natural that the company bears some risk pending the outcome. Without a requirement that costs be kept within

[3] As noted in Consumer Advocate's Response to Discovery Request # 2 of Lynwood, the company has not provided the level of information it was able to provide to the Consumer Advocate in Docket 07-00007. Thus, the "burden" of discovery has been somewhat light for the company in this docket. Furthermore, the Consumer Advocate exercised restraint and did not file motions to compel discovery which would have required status conference hearings and responsive pleading by Lynwood.

reasonable levels and that some cost of bringing a rate case be borne by the utility, there is no incentive not to bring a new rate case every six months; there would be no real risk to the company because all of its costs would be recovered regardless of whether the requested increase was granted, and the matter might result in additional revenues. Essentially, there would be no potential downsides to consider in the decision of whether to petition the TRA for a rate increase. While the Consumer Advocate does not believe that it should be overly-burdensome for a utility to obtain a rate increase necessary to obtain a fair return on its investment, there should be some risk present to deter overly-frequent use or abuse of the rate-making mechanism. A public utility should bear some of the burden of the expense of a rate case, *Order*, TRA Docket 08-00039, 25 (January 23, 2009).

C. Annual Depreciation and Amortization Expense

The Depreciation Expense associated with Lynwood's "Collection System" within the proposed rate base should be disallowed. This is simply not "used and useful property." The Collection System, as it pertains to rate base, is nothing more than the "internal costs" incurred by the company in receiving tap fees. The improper methodology employed by the company assumes Lynwood spends twenty hours of labor to arrange to receive a tap to arrive at a figure of $500 per tap, *Transcript of Proceedings,* 174:20-24. There is simply no support before the Authority for this calculation, and no supporting documentation for this assignment of costs on every tap fee received by Lynwood: past, present and future. Id. 175: 8-14. The "Collection System" is not a plant addition to rate base; therefore, no depreciation or expense should be included in Lynwood's rates.

Furthermore, while Mr. Ring is paid a salary for management, the evidence demonstrates that arranging for Tap Fees with residential home developers of Legend's Ridge and other subdivisions does not provide a sufficient basis for the inclusion of portions of this salary as a capital asset. Mr. Ring is an officer of Tennessee Contractors, Inc., which helped to develop Legends Ridge and River Landing. Furthermore, Mr. Ring plays some role in L2R Management Group, a company that coordinates with developers and home builders. Given Mr. Ring's involvement and knowledge with the developers and contractors in the area, it is unlikely that installation of a single tap would require Mr. Ring to spend a full 20 hours solely in his role as an employee of Lynwood. The Consumer Advocate does not doubt that Mr. Ring spends a significant amount of time in communication with other developers and contractors, but would assume that, given his other business ventures, he likely spends the vast majority of his time in furtherance of his other business enterprises. Interestingly, even if Mr. Ring did spend this timely solely on the business of Lynwood, his salary is still not properly recorded as a depreciable asset to be included in rate base. As discussed more fully in the section below on the proper treatment of Tap Fees, these amounts are expenses of doing business, not capital assets or Contributions in Aide of Construction. Furthermore, Lynwood's argument that Tap Fees result from Mr. Ring's efforts only strengthens the argument that they should properly be treated as revenues. All of the "work" allegedly performed by Mr. Ring in relation to these "Tap Fees" is purely service-oriented and completely voluntary in an effort to earn more revenue. Thus, no portion is properly treated as anything other than revenues.

Lynwood's proposed rate increase also inappropriately includes amortized expense and depreciation expense allowing Lynwood to recover litigation costs stemming from a lawsuit with

the Tennessee Department of Environment and Conservation ("TDEC"). Id. at 96:20 - 98:18. However, based on the testimony at the August 21, 2009 Hearing, the Consumer Advocate urges the TRA to disallow this expense. In 2002, TDEC filed suit against Lynwood for environmental violations. Id. Under questioning at the rate case hearing, Mr. Ring acknowledged the TDEC lawsuit and the negligence of Lynwood. Id. at 96-97. The Consumer Advocate submits it is unfair for consumers to continue to pay rates which allow Lynwood to recover legal fees incurred by the company due to its own negligence.[4] The Consumer Advocate does not dispute or challenge the efforts of Mr. Ring to bring Lynwood's plant into compliance with TDEC requirements and to improve the operations of Lynwood. However, consumers should not be required to pay litigation costs for a lawsuit which was initiated because of the negligence of the prior owner.

D. Sludge Removal Expenses

The Consumer Advocate submits that Lynwood has failed to sufficiently prove the necessity of the recommended adjustment of $3,147 for sludge removal expenses. Lynwood has only provided documentation that Tennessee Waste Management intends to raise fees. However, Lynwood uses another sludge removal service, "Cooper Environmental," for which no support whatsoever was provided that sludge removal costs would be raised at any level for that entity, *Response to First Discovery Request of CAPD*, Schedule 36 (May 26, 2009). Furthermore, Lynwood's 2008 test year expense for sludge removal in this case includes $2,488 in sludge removal costs, which were already included as a non-recurring expense for recovery in the odor control surcharge for costs approved in Docket 08-00060. Id. If Lynwood is allowed to include

[4] The settlement agreement in Docket 07-0007 allowed for recovery of expenses related to the TDEC lawsuit.

these amounts in its recurring expenses, this would result in double recovery for the same expense from its ratepayers: once from the surcharge, and once as an expense calculated in rate-of-return.

Finally, an examination of the balance sheet approved by the company shows that half of Lynwood's projected sludge removal costs in 2008 were booked in account 186.7, a deferred costs account for "odor control." Id. These amounts were then included in Lynwood's 2008 test year.[5] The company has not shown that all of these charges are appropriately included as recurring expenses. Although the company provided invoices supporting sludge removal in Docket 08-00060, Lynwood did not provide, as requested, copies of invoices for sludge removal in this rate case. As Mr. Peters stated, if these expenses are truly recurring and are effective in reducing odor, the Consumer Advocate does not object to their inclusion, *Supplemental Testimony of Dave Peters*, 2:14-27 (August 14, 2009). However, there is currently no evidence to support an increase in the company's attrition year for sludge removal costs of $3,147 in this rate case.

E. Income Tax Expense

The Consumer Advocate would aver that Lynwood's inclusion of amounts for Income Tax Expense is improper and should be disallowed. As stated in the Direct Testimony of Dave Peters, "Lynwood is an S Corporation for Federal Income Tax purposes...therefore, any Federal Income Tax basis flows through to the owner's individual tax returns," *Direct Testimony of Dave*

[5] Lynwood did not provide any supporting invoices or breakdown of the test year amount of sludge removal expenses, however an examination of the company's balance sheet shows all sludge removal costs in 2008 were included in the company's projected sludge removal test year figure. See Schedule 36 of *Lynwood's Response to First Discovery Request of the CAPD.*

Peters, 6:18-25. Thus, any income tax liability should be carried on the books of Lynwood's sole owner, Southern Utility Corporation, *Direct Testimony of Tyler Ring*, 3:1-4 (March 5, 2009). Moreover, the return component, or alleged income, on which Lynwood would be liable for any Federal Income Tax represents sums paid on the interest expense of long-term debt obligations, and is thus tax deductible, "resulting in no taxable income to the company." *Direct Testimony of Dave Peters,* at 6:18-25. The facts make it quite clear that no income tax is likely to be due as a result of the operations of Lynwood; however, any taxes that may result are the sole responsibility of Lynwood's owner. Certainly, Lynwood does not expect ratepayers to bear the burden of its owner's income tax liability. This, without question, crosses the line and should be a disallowed expense for Lynwood.

F. Salary Expense of Tyler Ring

It is the position of the Consumer Advocate that Mr. Tyler Ring's annual salary of $33,000 should be reduced to at least $15,000, in light of the amount and nature of his work for Lynwood, as well as the going rate for similar services in the State of Tennessee. While the Consumer Advocate also takes issue with the accounting treatment of salary amounts paid to Mr. Ring, this discussion is best left for later portions of this brief. Mr. Ford testified that "Mr. Ring's annual compensation for 2008 was set by the owners [John Ring, his father, and Tyler Ring, himself] at $33,000 for 60 hours of work per month," *Rebuttal of James Ford*, 8: 22-23. This equates to 720 hours of authorized work per year, for an average of $45.83 per authorized hour of labor for Lynwood.

On June 2, 2009, Lynwood supplemented its discovery with a *2008 Salary & Benefit Survey*, compiled by the Tennessee Association of Utility Districts in relation to "Water,

Wastewater & Natural Gas Utilities," *First Supplemental Response to First Discovery Request of the Consumer Advocate and Protection Division to Lynwood Utility Corporation*, First Supplement to Schedule 6 (June 2, 2009). This filing was provided in response to a request for any information that may "support the factual assertions, conclusions or opinions of any Lynwood witness in this matter, as well as copies of all hearing exhibits that you will introduce, use, or reference during the hearing for this matter." Id. However, a review of Lynwood's filing supports the Consumer Advocate's recommended salary of no more than $15,000 and, in fact, even suggests that the Consumer Advocate's suggested salary may be too generous. Specifically, the *Salary and Benefit Survey* filed by Lynwood contains a schedule of "Wage Information – By Full-Time Employees" at Part G. Id. at 23. This schedule clearly shows that the statewide average hourly wage of a "General Manager" employed by a utility with less than five full time employees is only $19.52 per hour of work. Therefore, for a General Manager employed 720 hours per year in the State of Tennessee, the average wage is $14,054.40, almost a full $1,000 less than the amount recommended by the Consumer Advocate's witness and $18,000 less than the amount actually paid to Mr. Ring during the test year.

Furthermore, Lynwood's assertion that Mr. Ring actually worked 1,146 hours in 2008 is unpersuasive in the face of the wage information provided in their filing. Mr. Ford asserts that "Mr. Ring's time sheets reflect 1,146 hours worked for Lynwood...This amount is 366 hours **over his approved amount**, and no additional compensation was paid," *Rebuttal of James Ford*, 8:22 – 9:2 (Emphasis Added). It important for the TRA to review the entire statement of Mr. Ford. Even if Mr. Ring's time sheets are 100% correct, which is questionable considering he is the only party involved in the creation of these sheets and neither the TRA nor the Consumer

Advocate received copies of these records despite repeated requests for underlying records during the course of the discovery process, the 366 hours allegedly worked in excess of his "approved amount" were not paid to Mr. Ring. Therefore, the salary of $32,000 represents payment only for the 720 hours approved in advance by Mr. Ring and his father in their capacity as owners of Southern Utility Corporation, the sole owner of Lynwood. Thus, Mr. Ring is only expected to work 720 hours per year; this is the amount that he believes will be necessary to fulfill his duties, and he was only compensated for that number of hours, at a rate of $45.83 per hour. Even if Mr. Ring were compensated for every single hour he claims to have spent in the business of Lynwood, which he admittedly was not, at the average rate suggested by the *Salary and Benefit Survey* provided by Lynwood, he should have earned a total of only $22,003.20, almost $10,000 less than the amount he actually received.

No matter how the evidence in this record is viewed, Mr. Ring is clearly overpaid for the work he performs as an employee of Lynwood. Mr. Ring and his father, as the indirect owners of Lynwood, set the number of "approved" hours that Tyler Ring is to work in a given year in furtherance of Lynwood's business. In doing so, they certainly employ their knowledge of Lynwood's operations and past experience in determining what amount of time will be necessary to operate this utility. The bottom line is that during that process, Mr. Ring determined that it would only require 60 hours per month to perform these duties and he is compensated for that figure. While he may have worked more than anticipated during the test year in question, he may work less in another year. In any case, Mr. Ring and his father decided that 60 hours per month was sufficient to meet Lynwood's needs based on their experience as owners of this utility; just because Mr. Ring worked in excess of the average during the test year does not

justify an overall increase in pay. In light of the information provided by Lynwood during discovery, Mr. Ring's salary should, at a minimum, be reduced to the maximum of $15,000 recommended by the Consumer Advocate, if not to $14,054.40 as suggested by the *2008 Salary and Benefit Survey.*

G. Treatment of Tap Fee Cash Inflows

Under Lynwood's existing accounting treatment, Tap Fees are recognized as Contributions in Aid of Construction ("CIAC") at the time they are received by the company. While the Consumer Advocate will address whether Tap Fees are appropriately characterized as CIAC or revenues later in this brief, in this portion of the brief the Consumer Advocate takes issue with the timing of Lynwood's system of revenue recognition. In 2008, Lynwood recognized $17,500 in Tap Fees; this equates to only five new customers as the current fee is set at $3,500 per tap, *Direct Testimony of Dave Peters*, 6:27-32. However, Lynwood shows a net increase of eighteen customers in the test year, from 811 in 2007 to 829 in 2008. Id. This should have resulted in the recognition of $63,000 in Tap Fees, a difference of $45,500.

Under Lynwood's current system of record keeping, a contractor may require "taps" be put in place for multiple homes at one time during the construction process, *Transcript of Proceedings*, 175:15 - 176:10. Tap Fees are collected for each of the parcels of land connected to Lynwood's system at that time, but no customer begins service at that time and no usage of Lynwood's system will initiate. Furthermore, as will be discussed in more detail later in this brief, Lynwood does not actually install any physical connection to its system; the individual contractors do all of the installation of these taps and their connection to Lynwood's existing

system. Id. At most, Lynwood may have an employee present to ensure that the tap is installed properly. Id.

Generally Accepted Account Principles ("GAAP") require that revenue is not recognized until it is **both realized and earned**, *Statement of Financial Accounting Concepts No. 5*, Financial Accounting Standards Board (Emphasis Added). The Consumer Advocate avers that Lynwood's current system of Tap Fee recognition does not meet these well established criteria because Lynwood does not "earn" the fee until a customer utilizes its services, *Transcript of Proceedings*, 238:2-5. Lynwood does nothing to "earn" this fee at the time of tap installation. Further, Lynwood does nothing until a customer actually begins to use its service. Even if Mr. Ring's statements are accurate that he occasionally spends up to twenty hours with customers attempting to earn additional Tap Fees, the fees in question, installed in bulk by contractors, have no associated customers, and, thus, no time is required of Mr. Ring in that capacity, *Transcript of Proceedings,* 174: 20-24. Therefore, Lynwood should treat any Tap Fees received by contractors as Prepaid Revenue, only recognizing these amounts at the time that customers utilize Lynwood's services and Lynwood begins to earn its fee. This will result in at least a $45,500 increase in Lynwood's Tap Fees for the 2008 test year. It will also be necessary for Lynwood to make correcting entries to comply with proper accounting methodology, and it is the belief of the Consumer Advocate that these corrected records will be much more representative of Lynwood's actual results from operations.

ISSUES WITH LYNWOOD'S PROFERRED RATE BASE

A. Utility Plant in Service and Accumulated Depreciation

As discussed previously in this brief, it is simply not proper for Lynwood to include its Collection System for the purposes of calculating the proper rates to be paid by consumers. This system should not be included in either the Utility Plant in Service Account or the Accumulated Depreciation Account of Lynwood. There is little need to repeat here those arguments that have already been made in the preceding section on Depreciation Expense, or in the section of this brief dealing with Tap Fees or the Collection System, below. However, to summarize, Lynwood's Collection System is improperly treated as an addition to Contribution in Aid of Construction via Tap Fees received, and ultimately to Utility Plant in Service. In Mr. Ford's words, these amounts are "donated" by third-party contractors and thus not assets of Lynwood, *Transcript of Proceedings*, 175:21-24. Furthermore, both Federal Law and the prior rulings of the TRA have made clear that Tap Fees may not be included in CIAC, See *Section C. Tap Fees,* below. Therefore, these amounts should be included in Lynwood's Revenue, not as depreciable capital assets included in rate base.

B. Cash in Working Capital

The amount set aside as Cash in Working Capital is in excess of what is needed to meet Lynwood's operating expenses on an annual basis. The proper method used to calculate average monthly Cash in Working Capital is to take the utility's total expenses, in this case $599,166, less the amount representing non-cash expenses such as depreciation and amortization, $107,727, and divide the total, $491,439, by twelve months, which would result in average monthly Cash in

Working Capital of $40,953 for Lynwood's operations, *Direct of Dave Peters*, at 7:32 – 8:2; See also *Rebuttal of Jim Ford*, 7:17 – 8:8.

Mr. Ford urges the TRA to reject the calculation of the Consumer Advocate because Lynwood has allegedly based its calculation of Cash in Working Capital on a "lead/lag study" that is based on "actual time," and should be considered the proper amount, *Rebuttal of Jim Ford*, 7:17 – 8:8. However, if one looks closely at the "lead/lag study" in question, at Rebuttal Exhibit JBF – 8, it is clear that this alleged "study" is nothing more than a list of Lynwood's test year revenues and a set of arbitrary averages with regard to "time to receive" and "time to pay." Id. This "lead/lag study" is not supported by any calculations, figures, or documentation; in fact, the only calculation provided is the division of test year "revenue," $548,268, by 365 days. Id. Clearly, this "study" is questionable at best and its methodology is inherently flawed and should be rejected in its entirety by the TRA. Based on this calculation, Lynwood believes that its Cash in Working Capital needs should be calculated using test year revenues, rather than expenses.

In no way whatsoever is the amount of money Lynwood earns annually in revenues related to its Cash in Working Capital. The Cash in Working Capital account deals with the average amount of cash that will be needed to meet Lynwood's cash expenses throughout the year, not the amount of profit that it might expect to receive. Revenue simply does not relate to the cash needs of the utility. This is precisely why the Consumer Advocate calculated its figure by taking annual "cash expenditures" and dividing it by twelve months. The Consumer Advocate's approach results in an average amount of monthly expenditures based on Lynwood's actual expenses and cash needs. Lynwood's approach employs an unsubstantiated and unsupported "lead/lag study" and does not provide any information or documentation suggesting

that this "study" is anything more than test year revenues divided by 365, with arbitrary numbers representing "lead/lag" times which come from no discernable source. Lynwood's methodology certainly does not rise to the level necessary to meet the burden of proof required of it with regard to these expenses, and the TRA would be better served to adopt the approach of the Consumer Advocate in calculating Cash in Working Capital. This necessary and proper change in the amount of Cash in Working Capital will yield a monthly decrease of at least $12,729 in relation to Lynwood's cash needs, or an annual difference of $152,748.

C. Tap Fees

As alluded to previously in this brief, Lynwood does not employ the proper accounting treatment of amounts received as Tap Fees. Lynwood incorrectly records Tap Fees received as additions to the Contributions in Aid of Construction account, *Transcript of Proceedings*, 175:15 – 176:10. The Consumer Advocate avers that Tap Fees should be recorded as revenue when earned by Lynwood. The reasons for this treatment are clear. The Contribution in Aid of Construction account exists as a method of recording donated capital acquisitions and improvements. As Lynwood's representatives admitted, Lynwood does not actually install any capital structures or improvements when "taps" are installed. Id. The only installation of physical assets is done by the third-party contractors on property owned by them or their clients. Id. The only involvement Lynwood has in the physical installation is on those occasions where an employee of Lynwood observes the installation and attachment to Lynwood's system. Id. Therefore, there is no support for the contention that any capitalized or depreciable assets are added by Lynwood, and, thus, no support for the proposition that these Tap Fees should be booked as CIAC. Lynwood's argument that its employees may spend time helping potential

customers during this process similarly does not support inclusion of Tap Fees as CIAC or as capital assets. Any time and effort spent attempting to grow its customer base is a cost of doing business, or expense, for Lynwood, which it already deducts in the form of salaries. In no way do these actions add or improve any capital assets owned by the utility.

Most importantly, there is substantial and undisputable authority that Tap Fees should not be treated as Contributions in Aid of Construction. The United States Code specifically states with regard to "special rules for water and sewage disposal utilities...the term 'contribution in aid of construction' shall be defined by the Secretary, except that such term shall not include amounts paid as service charges for starting or stopping services," 26 USC § 118(c)(3(A). It is important to note that this is the only explicit exception that the United States Congress felt was significant enough not to leave within Secretary's discretion. In keeping with the aforementioned federal law, the TRA has also held that "Service Connection Charges should be booked as Revenue," and the Authority cited the Uniform System of Accounts as additional support for this position, *Final Order Approving Rate Increase and Rate Design*, TRA Docket 06-00187, 24 (November 27, 2007). The TRA set forth its reasoning in this decision when it held, "if the Service Connection Charges are booked as Revenue, the recurring revenue requirement would be greatly reduced." Id. at 24.

Tap Fees must be treated as revenues in keeping with federal regulations and TRA precedent because Lynwood creates no additional capital assets or improvements in relation to Tap Fees which would justify any other treatment of these receipts. In the 2008 test year, the proper classification and treatment of Tap Fees would significantly alter the revenue and rate of return calculations provided by Lynwood. Under the proper system of GAAP accounting,

recognizing revenues when "received and earned," and requiring Lynwood to comply with federal regulations and book Tap Fees as revenues, would result in an increase of $63,000 in revenue in the 2008 test year alone.

D. Collection System

There are a substantial number of charges Lynwood has improperly applied to the Collection System account and, ultimately, to Lynwood's rate base. The Collection System account should only include physical assets which are "donated" by third parties, and, therefore, not includable in rate base, *Transcript of Proceedings,* 175:20 – 176:5. Lynwood, however, attempts to include a great many items that properly should be treated as non-recurring expenses in its Collection System account; because these amounts are non-recurring and not properly included as additions or improvements to capital assets, they should be dissallowed in calculating the appropriate rates for Lynwood's customers. Mr. Ford explicitly stated that the Collection System was "donated" to Lynwood. Id. Obviously, it is improper to include an asset in rate base that is not created or even improved by the utility.

Some of the items included in Lynwood's Collection System account appear not to be accompanied by any rational explanation as to their inclusion. For example, during the August 21, 2009 Hearing, Mr. Ford admitted that Lynwood included amounts paid by Lynwood for the hotel stay of a customer displaced due to a broken pipe. Id. at 183:22 – 186:8. While the Consumer Advocate, without question, agrees that it was the appropriate action to assist the ratepayer under the circumstances described, the associated costs are neither additions to Collection System nor recurring expenses and should not be borne by Lynwood's ratepayers.

When asked about this, Mr. Ford attempted to explain that this extended hotel stay was properly included as a Collection System addition because of subsequently received payments which were applied to this account. Id. This assurance is of little comfort to the Consumer Advocate. Mr. Ford made no effort to explain why these types of expenses would be booked to the Collection System in the first place. Furthermore, even Mr. Ford admits that not all of these expenses were properly repaid to the Collection System account; specifically, he states that "subject to check, we incurred about $4,000 worth of expenses and costs and got an insurance payment of about $3,300 back." Id. at 184:11-13. The fact is that these expenses were booked to the Collection System account and neither the Consumer Advocate nor the TRA has been provided with any evidence that the items were subsequently removed or that any subsequent payments were applied to offset them, other than Mr. Ford's assurances. It is not the intention of the Consumer Advocate to impugn the veracity of these assurances, but Mr. Ford, in effect, admitted at the hearing that he has made "unintentional" errors with regard to Lynwood's accounting system. Id. at 199:22 – 202:3. Furthermore, this system of improperly booking expense items to the Collection System and later attempting to partially offset them with subsequent payments is unquestionably a mistake, and only results in an increased rate base for Lynwood, which will be repaid by its ratepayers.

More troubling are the items for which Mr. Ford does not attempt to provide any explanation. Specifically, Mr. Ford alleges that over one-third of Mr. Ring's pay, $1,000 from each paycheck, is properly attributable to the Collection System Account via the Construction Work In Process account ("CWIP"). Id. at 165:17 - 168:17. Furthermore, Mr. Ford admits that even portions of his own billings to Lynwood are attributed to the same account. Id. Obviously,

given the absence of any substantive capital additions or improvements in the 2008 test year, except for odor control expenditures which were provided for in the separate surcharge, this treatment of a significant portion of Mr. Ring's salary is troubling, and any portion of Mr. Ford's pay that is included as additions to Lynwood's Collection System is blatantly improper. Mr. Ford is a "Financial Consultant" to Lynwood; his role is purely administrative, but, according to his rationale, any time spent making accounting entries bearing any relation to items that themselves are related to capital assets, makes that time a capital asset. Id. at 170:9 – 171:17. In other words, because Mr. Ring, in a supervisory, administrative capacity, or Mr. Ford, in a financial, administrative capacity, contemplate or perform their regular duties and at the same time a capital asset is being either improved or added, this ordinary, everyday work itself becomes an addition to Lynwood's rate base. Thus, Lynwood's customers will pay increased rates because Mr. Ford performs routine accounting entries, and Mr. Ring performs the job which he is already paid to do.

Clearly, this is a slippery slope to which there is no end in sight. If these types of additions to the Collection System account are allowed, one may as well add the cost of a receptionist to CWIP because he or she answers the phones while her manager supervises a capital improvement; after all, if the capital improvement didn't take place there would be no need for the receptionist. Further, the cost of fuel and mileage to get to a job site where capital improvements are being installed should be included, even though the driver performs no special work upon his arrival, as well as business lunches for these employees. All of these things bear a tangential relationship to the capital project, but add nothing to the capital assets of the company; these items are expenses. If the approach suggested by Mr. Ford is allowed, there would be

virtually no end to the items includable as additions to CWIP and Lynwood's rate base and, thus, paid for by Lynwood's customers. The Consumer Advocate would aver that a Capital Asset may be any number of things, but at a bare minimum, one should be able to see and touch an item before it is allowed to be included as part of rate base and paid for by ratepayers.

Finally, during the 2008 test year, Lynwood attempts to move two items totaling $301,578 from the Contribution in Aid of Construction ("CIAC") account into Retained Earnings, *Direct Testimony of Dave Peters*, 8:9–16. There is simply no reason to make this adjustment. Under no circumstances is it proper for an item to be shifted from CIAC to Retained Earnings. Id. The amounts contained within the two accounts are dramatically different in nature; CIAC, as explained above, exists to provide additions and improvements to Lynwood's capital assets which were donated by third-parties, and Retained Earnings is effectively a measure of what funds Lynwood has acquired free and clear of all obligations other than those of the utility's owners. Mr. Ford attempts to explain this when he states that "consumers are responsible for an adequate rate of return on the rate base as defined," *Transcript of Proceedings*, at 190: 9-10. However, the Consumer Advocate asserts that Mr. Ford has improperly computed the rate base in the case in a number of ways. Furthermore, by the very nature of these accounts, there is no proper and justifiable explanation for the movement of capital additions and acquisitions into what is effectively an income account.

ODOR CONTROL

On August 18, 2009, the parties were notified of the sixty-three consumer complaints filed with the TRA. Most of these complaints were related to odor problems and Lynwood's

proposed rate increase. There is a lengthy history in relation to the odor issues of Lynwood. Odor problems with Lynwood's operation first came to light in Docket 07-00007. To address the odor issue, the Hearing Panel in that Docket ordered a report and plan of action to resolve the problem. The TRA further allowed Lynwood the option to petition to recover costs for odor control expenses. In Docket 08-00060, Lynwood sought to recover a total of approximately $45,000 in odor control expenses through a surcharge. These expenses included legal fees, accounting charges and additional salary for the owner. A settlement agreement between Lynwood and the Consumer Advocate was approved by the TRA authorizing the recovery of approximately $31,000.

The Consumer Advocate respectfully submits that the practice of allowing Lynwood to recover odor control costs via a surcharge, or other mechanism outside of a rate case, should not be repeated. Docket 08-00060 has proven very expensive for consumers, *Rebuttal Testimony of Dave Peters*, 2:14-27. In addition, the allowance of a surcharge does not promote or encourage efficiency in company operations. The legal fees, accounting charges and extra salary sought by the company in Docket 08-00060 are evidence to that effect. Furthermore, based on the consumer complaints, the measures taken thus far have not resolved the issue. The Consumer Advocate respectfully submits that the first priority should be to identify the most egregious source of odor and explore the means and costs to resolve the issue. Based on the testimony of the company and the consumers, the parties are aware a problem exists, but no concrete solution is apparently known. The source of the problem simply must be identified before it can be addressed.

Controlling odor is a part of the quality of the service Lynwood provides. It is not an extraneous action by the company to resolve the issue, but rather part of their duty to consumers. In the absence of an alternative solution in the near future, the Consumer Advocate would not object to the inclusion into rate base of the sludge box addition described by Lynwood on July 17, 2009 in response to the Consumer Advocate's Discovery Request #5. The Consumer Advocate's recommendation based solely on the company's representations that this plant addition would contribute to odor control and reduce sludge removal costs. However, continuing to allow Lynwood to recover future odor controls via a surcharge is not in the public interest.

COMPARISION TO SIMILAR NEIGHBORING SYSTEMS

Under Lynwood's current rates, prior to any increase as a result of this Docket, customers pay approximately $32.65 per 5,000 gallons of water use, *Direct Testimony of Dave Peters*, 7:1-18. These rates are higher than all but 17% of the wastewater systems in the State of Tennessee. Id. Furthermore, a look at the rates of other wastewater providers in Williamson County, Tennessee, shows that Lynwood's rates are significantly higher than other utilities who are similarly situated. In Franklin, Tennessee, the average rate is $20.49 per 5,000 gallons; in Spring Hill it is $14.34, and in the Harpeth Valley Utility District it totals $28.25, *Direct Testimony of Dave Peters*, 7:1-18. The overall state median rate of wastewater per 5,000 gallons of water is only $23.00. Id.

Despite Lynwood's relatively high rates for service, in this Docket the company seeks a 33.82% increase in price. This would result in Lynwood having higher rates than all but six water utilities in the entire State of Tennessee, ranking it 139th out of 145 utilities. Id. Given that the average customer of Lynwood uses 8,500 gallons of water per month, a Lynwood ratepayer's

average monthly bill for wastewater would increase to $76 per month. Id. As was stated by one of Lynwood's customers during the August 21, 2009 Hearing, "we understand that people have to make a living...but I can tell you too that I didn't get a 10 percent pay increase this year...I didn't get a 2 percent pay increase this year...I didn't get a pay increase at all...and I still continue to do my job and serve the people of this state," *Transcript of Proceedings*, 25:19-25; 43:12-22. Similarly, if Lynwood is unable to operate under its present rates, despite those rates being amongst the highest in the State, the utility should streamline operations, become more efficient, and cut unnecessary costs before demanding any more from ratepayers who already pay more than most ratepayers across the State.

CONCLUSION

For all of the reasons stated above, the Consumer Advocate would recommend that Lynwood be awarded no more than a 10.17% rate increase, rather than the 33.82% requested by the utility, and that the utility's submitted figures be adjusted in accordance with the issues described above.

RESPECTFULLY SUBMITTED,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Petition to Intervene was served via U.S. Mail or electronic mail upon:

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This the 11th day of September, 2009.

T. JAY WARNER