

**BEFORE THE TENNESSEE REGULATORY AUTHORITY**

**NASHVILLE, TENNESSEE**

**August 21, 2012**

<b>IN RE:</b>	)	
<b>PETITION OF BERRY'S CHAPEL UTILITY, INC. TO</b>	)	
<b>CHANGE AND INCREASE RATES AND CHARGES</b>	)	<b>DOCKET NO.</b>
	)	<b>11-00198</b>
	)	
<b>IN RE:</b>	)	<b>DOCKET NO.</b>
<b>PETITION OF BERRY'S CHAPEL UTILITY, INC. TO</b>	)	<b>11-00180</b>
<b>RECOVER COSTS TO REPAIR FLOOD DAMAGE AND</b>	)	
<b>TO REFUND CUSTOMER SERVICE FEES</b>	)	

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**FINAL ORDER**

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This matter came before Chairman Kenneth C. Hill, Director Sara Kyle and Director Mary W. Freeman of the Tennessee Regulatory Authority (the "Authority" or "TRA"), the voting panel assigned to this docket, at a regularly scheduled Authority Conference held on June 8, 2012 to consider the *Petition* seeking to increase its rates filed by Berry's Chapel Utility Inc. ("Berry's Chapel" or the "Company")<sup>1</sup> on November 15, 2011. In addition, the panel considered the *Petition To Recover Flood Damage Costs And To Refund Customer Service Fees* ("Flood Costs Petition") filed by Berry's Chapel in Docket No. 11-00180 on October 25, 2011.

Upon consideration of the entire record, including all exhibits and the testimony of the witnesses, the panel approved an annual revenue increase of \$180,840 for Berry's Chapel. This increase is based on a Rate Base of \$1,135,068, revenues at current rates of \$596,258, total operating expenses of \$681,668, a fair rate of return of 7.5% and a revenue conversion factor of

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<sup>1</sup> Berry's Chapel was formerly Lynwood Utility Corporation ("Lynwood"). The Authority approved the transfer of Lynwood's Certificate of Public Convenience and Necessity to Berry's Chapel on June 7, 2012. See *In re: Petition of Berry's Chapel Utility, Inc. to Transfer Authority Nunc Pro Tunc*, Docket No. 12-00046, *Order Approving Transfer of Authority Nunc Pro Tunc* (July 17, 2012).

1.0604.

To produce the total required annual operating revenues of \$777,098 for Berry's Chapel the Company is authorized to charge a monthly Customer Charge of \$30, a volumetric charge of \$6.37 per 1000 gallons. Charges for Walnut Grove Elementary School will continue to be capped at \$891. In addition, the Authority approved that \$90,345 in flood costs shall be recovered via a monthly surcharge of \$8.93 per customer for 12 months. These conclusions, as well as the TRA's determinations concerning Revenues, Expenses, Inflation Factor, Rate Base, Revenue Conversion Factor, and Rate of Return, are fully discussed below.

### **PETITION**

Berry's Chapel filed its *Petition* for a rate increase on November 15, 2011 stating that its "existing rates and charges do not provide it sufficient revenue to cover all of the costs it incurs in providing adequate sewer service to its customers, including its cost of capital."<sup>2</sup> The Company requested additional revenues of \$398, 853.<sup>3</sup> Berry's Chapel asserts that its "rates and charges must be revised to permit it to meet its operating expenses, to earn a fair rate of return, and to provide funds to maintain its sewer plant and facilities to serve existing and future customers."<sup>4</sup> On December 5, 2011, the Consumer Advocate and Protection Division of the Office of the Attorney General ("Consumer Advocate") filed a *Petition to Intervene*, which was granted by the Hearing Officer on January 18, 2012.<sup>5</sup>

### **THE HEARING**

The Hearing in this matter was held on May 31, 2012 and reconvened on June 7, 2012.<sup>6</sup> Participating in the Hearing were the following parties and their respective counsel:

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<sup>2</sup> *Petition*, p. 1 (November 15, 2011).

<sup>3</sup> *Id.* at 2.

<sup>4</sup> *Id.* at 1.

<sup>5</sup> See *Order Granting Petition To Intervene Of Consumer Advocate And Requiring The Parties To Submit A Proposed Procedural Schedule And Protective Order* (January 18, 2012).

<sup>6</sup> *Supplemental Notice of Hearing* (May 25, 2012).

**Berry's Chapel Utility, Inc.- Henry M. Walker, Esq.,** Bradley Arant Boult Cummings, PLC, 1600 Division Street, Suite 700, P.O. Box 340025, Nashville, TN 37203.

**Consumer Advocate and Protection Division- Scott Jackson, Esq. and Vance Broemel, Esq.,** Office of the Attorney General, 425 5th Ave. N., John Sevier Building, P.O. Box 20207, Nashville, TN 37202.

During the Hearing, the Company presented Jim Ford and Tyler Ring as witnesses. David Peters testified on behalf of the Consumer Advocate. By stipulation of the Parties, the testimony of Berry's Chapel witness, Scott Davis and the testimonies of Consumer Advocate witnesses, Christopher Klein and William Novak, were admitted into the record in lieu of the live presentation of the witness at the Hearing.

### **CRITERIA FOR ESTABLISHING JUST AND REASONABLE RATES**

In carrying out its ratemaking function, the Authority is obligated to balance the interests of the utilities subject to its jurisdiction with the interests of Tennessee consumers; it is obligated to fix just and reasonable rates.<sup>7</sup> The Authority must also approve rates that provide regulated utilities the opportunity to earn a just and reasonable return on their investments.<sup>8</sup>

The TRA is not bound to follow rate-making methodology that it has employed in the past.<sup>9</sup> Further, the Uniform Administrative Procedures Act authorizes the TRA to take notice of "generally recognized technical and scientific facts within the agency's specialized knowledge," and in the evaluation of evidence the agency is specifically authorized to utilize its "experience, technical competence, and specialized knowledge."<sup>10</sup> The TRA is not to be "hamstrung by the naked record" and can consider all relevant circumstances shown by the record, all recognized

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<sup>7</sup> Tenn. Code Ann. § 65-5-101 (Supp. 2011).

<sup>8</sup> See *Bluefield Water Works and Improvement Company v. Public Service Comm'n of West Virginia*, 262 U.S. 679 (1923).

<sup>9</sup> *Tennessee American Water Co. v. Tenn. Regulatory Auth.*, 2011 WL 334678, at \*25 (Tenn. Ct. App. Jan. 28, 2011); *CF Indus. v. Tennessee Pub. Serv. Comm'n*, 599 S.W.2d 536, 542-45 (Tenn. 1980).

<sup>10</sup> Tenn. Code Ann. §4-5-314 (2011).

technical and scientific facts pertinent to the issue under consideration and may superimpose upon the entire transaction its own expertise, technical competence and specialized knowledge.<sup>11</sup>

The Authority considers a petition for a rate increase filed pursuant to Tenn. Code Ann. § 65-5-103 (2004) in light of the following criteria:

1. The investment or rate base upon which the utility should be permitted to earn a fair rate of return;
2. The proper level of revenues for the utility;
3. The proper level of expenses for the utility; and
4. The rate of return the utility should earn.

It is settled law that the TRA has discretion with regard to setting rates and may exercise this discretion in selecting among the test periods proposed or the use of different test periods altogether.<sup>12</sup> The TRA is not limited to adopting a single test period in order to make known and measurable adjustments to produce just and reasonable rates.<sup>13</sup>

The TRA has the discretion to use a historical test period, a forecast period, a combination of these where necessary, or any other accepted method of rate-making necessary to arrive at a fair rate of return.<sup>14</sup> The Tennessee Supreme Court has noted in this regard:

[T]here is no statutory nor decisional law that specifies any particular approach that must be followed by the Commission. Fundamentally, the establishment of just and reasonable rates is a value judgment to be made by the Commission in the exercise of its sound regulatory judgment and discretion.<sup>15</sup>

There is no single, precise measure of the fair rate of return a utility is allowed an opportunity to earn. Therefore, the TRA must exercise its judgment in making an appropriate

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<sup>11</sup> *Tennessee American Water Co.*, 2011 WL 334678, at \*26.

<sup>12</sup> *Tennessee American Water Co.*, 2011 WL 334678, at \* 20, citing *Powell Tel. Co. v. Tennessee Pub. Serv. Comm'n*, 660 S.W.2d 44, 46 (Tenn. 1983); *Am. Ass'n of Retired Persons v. Tennessee Pub. Serv. Comm'n*, 896 S.W.2d 127, 133 (Tenn. Ct. App. 1994).

<sup>13</sup> *Tennessee American Water Co.*, 2011 WL 334678, at \*3.

<sup>14</sup> *Id.* at \*20.

<sup>15</sup> *Powell Tel. Co. v. Tenn. Pub. Serv. Comm'n*, 660 S.W.2d 44, 46 (Tenn. 1983); citing *CF Industries v. Tennessee Pub. Serv. Comm'n*, 599 S.W.2d 536 (Tenn. 1980).

determination. The Authority, however, is not without guidance in exercising its judgment:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.<sup>16</sup>

In addition, the United States Supreme Court has determined that regulated firms are entitled to a return that is "just and reasonable."<sup>17</sup> The rate a firm is permitted to charge should enable it "to operate successfully, to maintain its financial integrity, to attract capital, and to compensate investors for the risks assumed."<sup>18</sup>

The general standards to be considered in establishing the fair rate of return for a public utility are financial integrity, capital attraction and setting a return on equity that is commensurate with returns investors could achieve by investing in other enterprises of corresponding risk.<sup>19</sup> The utility's fair rate of return is the minimum return investors expect, or require, in order to make an investment in the utility.<sup>20</sup> The proper level of return on the Company's capital, including equity capital, must be commensurate with returns on investment in other enterprises having corresponding risk.<sup>21</sup>

Applying these criteria, and upon consideration of the entire record, including all exhibits and the testimony of the witnesses, the panel makes the following findings and conclusions.

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<sup>16</sup> *Bluefield Water Works & Improvement Company v. Public Service Commission*, 262 U.S. 679, 692-93 (1923); see also *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989).

<sup>17</sup> *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 605 (1944).

<sup>18</sup> *Id.*

<sup>19</sup> *Id.* at 603.

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

## **INFLATION FACTOR**

The Company originally used an inflation factor of 3.2% derived from the change in the Consumer Price Index (“CPI”) as of April 30, 2011.<sup>22</sup> In his Rebuttal Testimony, Mr. Ford states that after a meeting with the Consumer Advocate, Berry’s Chapel changed its factor to 4%.<sup>23</sup> The Consumer Advocate used an inflation factor of 2%, developed from the latest 2012 US Inflation Calculator (<http://www.usinflationcalculator.com/>).<sup>24</sup> This factor was applied to both normalized and adjusted 2011 actual results for those operating expenses that are primarily driven by inflation.

The “all items” index rose 3.2% for the twelve months ended April 2011, the highest increase since October 2008. This rate is driven by the following increases: energy index of 19.0%, the energy commodities index of 32.7%, the gasoline index of 33.1% and the fuel oil index of 35.1%. Based on the same report presented by the Company, “all items less food and energy” index increase is only 1.3% and the “commodities less food and energy commodities” index is only 0.7%.<sup>25</sup>

The panel adopts the Consumer Advocate’s Inflation Factor of 2.0%, since it better reflects the 1.3% index increase in “all items less food and energy” and not the “all items” index which includes soaring gasoline costs.

## **REVENUES**

In its *Petition*, the Company applied current rates to the historical volumes for the 12-months ended March 31, 2011<sup>26</sup> to arrive at Revenue at current rates of \$580,265, plus

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<sup>22</sup> James B. Ford, Pre-Filed Direct Testimony, p. 5 and attached Schedule E-1 (November 15, 2011).

<sup>23</sup> James B. Ford, Pre-Filed Rebuttal Testimony, p. 6 (May 22, 2012).

<sup>24</sup> Dave Peters, Pre-Filed Direct Testimony, p. 3 (April 23, 2012).

<sup>25</sup> *Response of Berry’s Chapel Utility, Inc. to Staff Data Request*, #38 (February 2, 2012).

<sup>26</sup> James B. Ford, Pre-Filed Direct Testimony, p. 5 (November 15, 2011).

Inspection and Tap Fees of \$3,750, plus Late Charges<sup>27</sup> of \$9,394 to arrive at total Revenues of \$593,409.<sup>28</sup> In his Rebuttal Testimony, Mr. Ford updates the Company's case to coincide with the test period utilized by the Consumer Advocate (December 31, 2011) and changes his Revenue forecast to \$576,502.<sup>29</sup>

The testimony, schedules, and calculations provided by the Consumer Advocate's witness, Mr. Novak, support a forecast Revenue at current rates of \$596,258.<sup>30</sup> Mr. Novak states he used the Company's test period billing determinants for the residential, commercial and special contract customers and applied the current TRA approved billing rates. In addition, he included the Company's proposed attrition period inspection fee and tap fee revenue of \$3,750 but excluded late fees, which he maintained should be disallowed. Since the Company's current contract with the City of Franklin includes a late payment charge, Mr. Novak recommended that the Authority approve a late payment charge for Berry's Chapel.<sup>31</sup>

The difference between the Company's revised forecast and the Consumer Advocate's forecast is \$19,756. Mr. Ford did not provide the Authority with a detailed price-out of his revenue forecast, either in his Direct Testimony or Rebuttal Testimony. He also did not discredit the price-out of the Consumer Advocate in his Rebuttal Testimony nor did he address the price out of revenues when he testified at the Hearing on May 31, 2012. Based on the evidence presented, the panel adopts the Consumer Advocate's Revenues at current rates since Mr. Novak provided detailed work papers and testimony to support his forecast of \$596,258. However, the panel does not adopt a late fee for customers billed directly by Berry's Chapel because terms of

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<sup>27</sup> There is no late fee in the Company's current tariff and Consumer Advocate maintains that it is an unlawful charge. There is, however, a section in the Rules and Regulations of the Company's tariff (TRA No. 1, First Revised Page No. 4, Non-Payment Penalties) that permits the City of Franklin and H.B. & T.S. Utility District under the current contracts to pass on "any penalty for late payment of sewer charges, fees related to the termination of water service to enforce the payment of sewer charges, and reconnection fees" to the Utility's customers.

<sup>28</sup> James B. Ford, Pre-Filed Direct Testimony, Schedule R/E (November 15, 2011).

<sup>29</sup> James B. Ford, Pre-Filed Rebuttal Testimony, Schedule JBF-5 (May 22, 2012).

<sup>30</sup> William H. Novak, Pre-Filed Direct Testimony, pp. 4-5 and attached CAPD Exhibit, Schedule 5 (April 23, 2012).

<sup>31</sup> William H. Novak, Pre-Filed Direct Testimony, p. 10 (April 23, 2012).

the City of Franklin's tariff are not known and those terms are subject to change in the future. Therefore, there is no way to craft a comparable and/or fair late payment assessment for those customers billed directly by Berry's Chapel.

### **OPERATING EXPENSES**

Generally, the Consumer Advocate's methodology for forecasting operating expenses consists of starting with actual test period expense, normalizing for non-recurring items, out-of-period expense and accruals, eliminating non-documented and/or inappropriate expenses and adjusting for known changes during the attrition period. For those expenses that are driven primarily by inflation, the Consumer Advocate then applied its inflation factor. The panel finds that this is the correct approach to use and adopts the inflation factor used by the Consumer Advocate, as noted previously.

After reviewing the Company information, along with the Consumer Advocate's adjustments, the panel adopts the Consumer Advocate's forecasts for the following operating expenses: Purchased Water of \$7,462, Sludge Removal of \$39,691, Purchased Power of \$62,171, Chemicals of \$44,093, Engineering Inspections of \$4,027, Testing of \$14,326, Repairs & Maintenance of \$49,404, Operations Management of \$56,001, Billing & Collection Fees of \$35,559, Bad Debt Expenses of \$6,868, Accounting & Bookkeeping of \$16,274, Tax Accounting of \$857, Accounting-Other of \$8,670, Legal of \$12,695, Taxes Other Than Income of \$41,040, and Depreciation Expense of \$145,116.

For five of the expense categories, however, the panel finds that the Company made compelling rebuttal arguments to some of the expense amounts eliminated by the Consumer Advocate. Accordingly, the panel adopts amounts different than the Consumer Advocate's forecast for the following expense categories: Materials and Supplies, Rent, Insurance, Other Miscellaneous Expense, and Regulatory Expense.



**Materials and Supplies** - Mr. Ford's Exhibit shows the Company's test period normalized amount was increased by the application of the Company growth rate of 3.2% resulting in the forecast amount of \$58,379.<sup>32</sup> The Consumer Advocate normalized its test period amount and applied an inflation factor of 2% to produce the forecasted expense of \$21,731.<sup>33</sup>

The Consumer Advocate excluded an invoice from Spectrum Equipment Partners in the amount of \$1,648 as a non-recurring expense when normalizing its test period.<sup>34</sup> In his rebuttal testimony, Mr. Ford clarified the noted invoice and stated it was an on-going expense.<sup>35</sup> This clarification was reiterated by Mr. Ford in the summary of his testimony at the Hearing held on May 31, 2012.<sup>36</sup> Therefore the Authority adopts the Consumer Advocate's normalized test period expense of \$21,305, adjusts it upward by \$1,648 and applies the 2% inflation factor to arrive at an attrition period Materials and Supplies expense of \$23,412.

**Rent** - Mr. Ford's Exhibit shows a forecast of \$12,000 for the attrition period.<sup>37</sup> This amount is based on an office lease of \$20,000 per year. Forty percent of the lease was capitalized and 60% was expensed.<sup>38</sup> At the Hearing, Mr. Ford explained that this allocation procedure has been in place since 2005. Each year, the Company determines the allocations based on the amount of construction during the year.<sup>39</sup> The Consumer Advocate states that based on its observations during site visits, it believes that 50% is a more equitable allocation. This would reduce rent expense from \$12,000 down to \$10,000.<sup>40</sup>

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<sup>32</sup> James B. Ford, Pre-Filed Direct Testimony, Schedule E-1 (November 15, 2011).

<sup>33</sup> Dave Peters, Pre-Filed Direct Testimony, pp. 6-7 (April 23, 2012).

<sup>34</sup> Dave Peters, Pre-Filed Direct Testimony, p. 7 and attached workpaper Schedule 6 (April 23, 2012).

<sup>35</sup> James B. Ford, Pre-Filed Rebuttal Testimony, p. 8 (May 22, 2012).

<sup>36</sup> Transcript of Proceedings, p.18 (lines 17-23) (May 31, 2012).

<sup>37</sup> James B. Ford, Pre-Filed Direct Testimony, Schedule E-3 (November 15, 2011).

<sup>38</sup> James B. Ford, Pre-Filed Rebuttal Testimony, p. 9 (May 22, 2012).

<sup>39</sup> Transcript of Proceedings, p. 54 (lines 18-24) (May 31, 2012).

<sup>40</sup> Dave Peters, Pre-Filed Direct Testimony, p. 11 (April 23, 2012).

The Consumer Advocate did not offer any tangible evidence to support its rent reduction, but rather relied on observations made during its site visits. The panel adopts the Company forecast of \$12,000 for Rent Expense, since it is the actual amount paid by the Company based on an existing allocation methodology that was not discredited by the Consumer Advocate.

**Insurance** - Mr. Ford's Exhibit shows he used a 6% growth factor to arrive at the forecasted amount of \$31,042 for the attrition period.<sup>41</sup> The Consumer Advocate normalized and adjusted its test period amount, eliminating the premiums on the Tyler Ring and John Ring life insurance policies totaling \$10,833<sup>42</sup> and two journal entries totaling \$1,348, which were not explained, to arrive at a projected attrition period amount of \$16,547.<sup>43</sup>

The panel adopts the Consumer Advocate's adjustment for the two unexplained journal entries but rejects the exclusion of the life insurance policies. These policies were required as personal guarantees on working capital lines of credit obtained from Tennessee Commerce Bank and approved by the Authority in Docket Nos. 07-00263<sup>44</sup> and 09-00042.<sup>45</sup> Based on these facts, the panel adopts a forecast of \$27,380 for Insurance Expense, since the amount is based on a more current, properly normalized test period plus the inclusion of expense related to the Rings' life insurance policies.

**Miscellaneous Expense** - Miscellaneous Expense includes Customer Accounting, Telephone, Office Supplies, Injuries and Damages, and Other Miscellaneous.<sup>46</sup> Using the sum of these individual expenses, the Company's total attrition period forecast for this category is

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<sup>41</sup> James B. Ford, Pre-Filed Direct Testimony, Schedule E-3 (November 15, 2011).

<sup>42</sup> Tyler Ring is the President and 50% owner of Berry's Chapel, and John Ring owns 50% of the Company.

<sup>43</sup> Dave Peters, Pre-Filed Direct Testimony, p. 11 (April 23, 2012).

<sup>44</sup> See *In re: Petition Of Lynwood Utility Corporation For Approval Of A Loan In An Amount Not To Exceed \$1,000,000 To Refinance Existing Indebtedness And For Approval Of A Working Capital Line Of Credit Not To Exceed \$250,000 Pursuant To T.C.A. 65-4-109*, Docket No. 07-00263, Order Approving Financing Transaction (February 19, 2008).

<sup>45</sup> See *In re: Petition Of Lynwood Utility Corporation For Approval Of An Additional \$250,000 Loan From Tennessee Commerce Bank Pursuant To T.C.A. 65-4-109*, Docket No. 09-00042, Order Approving Financing Transaction (July 8, 2009).

<sup>46</sup> James B. Ford, Pre-Filed Direct Testimony, Schedules E-2 and E-3 (November 15, 2011).

\$48,613 in the original filing. In his Rebuttal Testimony, Mr. Ford increases the total to \$71,780.<sup>47</sup> The Consumer Advocate started with 2011 actual expense, normalized and made adjustments for unsupported items, non-recurring expense, duplications, and inappropriate expense and then grew this amount by 2% for inflation to arrive at the forecasted attrition period amount of \$18,409.<sup>48</sup>

It was discovered that a missing invoice for office supplies in the amount of \$261 was inadvertently deducted twice in the Consumer Advocate's normalizing process.<sup>49</sup> With this correction, the calculation of the normalized test period is \$18,309. When grown by 2% inflation, the corrected Consumer Advocate attrition period expense is \$18,675.<sup>50</sup> At the Hearing on May 31, 2012, Mr. Ford clarified that the invoices for gas that the Consumer Advocate disallowed (totaling \$3,931) were for the truck used for utility business.<sup>51</sup> The panel adopts the corrected Consumer Advocate amount of \$18,675 plus \$4,010<sup>52</sup> for gas to arrive at an attrition period expense of \$22,685 for Other Miscellaneous Expense.

**Regulatory Expense** - Mr. Ford's testimony indicates that he grew the \$48,898 test period amount by \$21,500<sup>53</sup> to arrive at his forecasted amount of \$70,398 for the attrition period.<sup>54</sup> In Rebuttal Testimony, Mr. Ford adjusted this expense downward to \$51,937 to include, in addition to rate case expense, the actual 2011 booked regulatory expenses of \$19,937.<sup>55</sup> The regulatory expense of \$19,937 includes TRA Inspection Fee, Tennessee Department of Environment and Conservation ("TDEC") permit fee, the cost of TRA reporting, the cost of Comptroller's assessment reporting, the cost of monthly reporting to TDEC, and other

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<sup>47</sup> James B. Ford, Pre-Filed Rebuttal Testimony, Schedules JBF-5/3 and JBF-5/4 (May 22, 2012).

<sup>48</sup> Dave Peters, Pre-Filed Direct Testimony, p.12 and attached workpaper Schedule 2 (April 23, 2012).

<sup>49</sup> Transcript of Proceedings, pp. 10-11 (June 8, 2012).

<sup>50</sup> Id. at 11.

<sup>51</sup> Transcript of Proceedings, pp. 97-99 (May 31, 2012).

<sup>52</sup> This amount is \$3,931 increased by 2% inflation factor.

<sup>53</sup> This amount is derived from current rate case expense of \$43,000 amortized over 2 years.

<sup>54</sup> James B. Ford, Pre-Filed Direct Testimony, Schedule R/E (November 15, 2011).

<sup>55</sup> James B. Ford, Pre-Filed Rebuttal Testimony, Schedule JBF-5/6 (May 22, 2012).

miscellaneous expenses related to regulatory reporting.<sup>56</sup> Mr. Peters' testimony outlines the significant differences between the Consumer Advocate and the Company in Regulatory Expense for the attrition period. Further, Mr. Peters states that the Company's amount of \$70,398 is more than a 100% increase over the amount awarded for regulatory expenses in the Company's last rate case.<sup>57</sup> The 2011 actual amount is \$57,037.<sup>58</sup> The Consumer Advocate, therefore, included only the current rate case expense of \$43,000, amortized over three years or \$14,333.<sup>59</sup>

In its Rebuttal Testimony, the Company adjusted attrition period expense to include actual booked regulatory expenses for 2011, as noted above, and a forecasted amount of \$64,000 for this rate case, amortized over two years.<sup>60</sup> At the hearing on May 31, 2012, Mr. Ford enumerated the regulatory expenses that made up the \$14,000 excluded by the Consumer Advocate.<sup>61</sup> Additionally, during Cross Examination by the Consumer Advocate, Mr. Ford testified that the \$41,000 for legal expense was low, since he already had bills totaling \$55,000 - \$60,000.<sup>62</sup>

Based on Mr. Ford's testimony at the Hearing, the panel adopts the Company position on rebuttal of \$51,937 for Regulatory Expense as it compares favorably to the actual 2011 expense discussed in the Consumer Advocate's Direct Testimony. This amount includes a total of \$64,000 in rate case expense amortized over two years.

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<sup>56</sup> James B. Ford, Pre-Filed Rebuttal Testimony, p. 10 (May 22, 2012).

<sup>57</sup> Dave Peters, Pre-Filed Direct Testimony, p. 14 (April 23, 2012).

<sup>58</sup> *Id.*

<sup>59</sup> *Id.*

<sup>60</sup> James B. Ford, Pre-Filed Rebuttal Testimony, Schedule JBF-5/6-1 (May 22, 2012).

<sup>61</sup> Transcript of Proceedings, p. 22 (lines 22-25) through p. 23 (lines 1-9) (May 31, 2012).

<sup>62</sup> Transcript of Proceedings, p. 71 (lines 14-22) (May 31, 2012).

## **GROSS REVENUE CONVERSION FACTOR**

The Company uses a gross revenue conversion factor of 1.1025 (1/.907) based on 7.5% billing expense and 1.8% bad debt.<sup>63</sup> Mr. Novak's amended testimony uses a gross revenue conversion factor of 1.0604 (1/.943) based on the Franklin portion of billing expense (52% of 7.5%) or 3.9% and 1.8% bad debt.<sup>64</sup>

Since the Consumer Advocate appropriately includes only the Franklin portion of billing expense, the Authority adopts the Consumer Advocate's gross revenue conversion factor of 1.0604 (1/.943).

## **FAIR RATE OF RETURN**

The Company states a fair rate of return of 8.8% is required based on a test period rate base of \$1,139,310 and interest expense of \$101,175.<sup>65</sup> The Consumer Advocate proposes using the contractual interest rate of the Company's long-term debt with Tennessee Commerce Bank or 7.5%. The Consumer Advocate states that a conventional approach to determining the capital structure is not feasible for nonprofit companies.<sup>66</sup> The Consumer Advocate avers that the rate of return should equal the actual cost of debt, since the Company is a non-profit corporation that cannot attract new capital by issuing stock.<sup>67</sup>

The Company filed a rate of return rate case.<sup>68</sup> Under that methodology of determining revenue deficiency, a proper rate of return must be established based on the Company's equity and weighted cost of debt. As Dr. Klein points out in his testimony, the rate of return for a non-profit corporation such as Berry's Chapel can be calculated directly from the annual interest rates

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<sup>63</sup> James B. Ford, Pre-Filed Direct Testimony, Schedule A (November 15, 2011).

<sup>64</sup> William H. Novak, Supplemental Testimony, CAPD Exhibit, Schedule 13 (June 5, 2012).

<sup>65</sup> James B. Ford, Pre-Filed Direct Testimony, p. 7 (November 15, 2011). The actual calculated return is 8.9% (1,139,310 divided by 101,175).

<sup>66</sup> Christopher Klein, PhD, Pre-Filed Direct Testimony, p. 8 (April 23, 2012).

<sup>67</sup> Christopher Klein, PhD, Pre-Filed Direct Testimony, p. 5 (April 23, 2012).

<sup>68</sup> James B. Ford, Pre-Filed Direct Testimony, p. 7 and attached Schedule A (November 15, 2011).

on its debt, since there are no stockholders or common equity.<sup>69</sup> If the Company had filed a rate case asking to cover its expenses plus a reasonable profit margin, then the actual interest expense paid in the test period would be considered. Therefore, the Authority adopts the proper rate of return is 7.5% based on the carrying cost of debt, since it approximates the actual interest paid to Tennessee Commerce Bank.

### **RATE DESIGN**

The Company did not offer a specific rate design but alluded to the possibility of using the same customer charge billed by the City of Franklin. Mr. Ford did, however, express that the rate design needed to be as simple as possible to lower customer costs and customer billing complaints.<sup>70</sup> The Consumer Advocate offered a complex, detailed rate design as shown on CAPD Exhibit, Schedule 6.<sup>71</sup>

The goal of a rate design is to develop rates that will generate the required amount of attrition period revenues. This determination is a policy decision and there is no absolute correct manner or method to rate design. For Berry's Chapel, the panel adopts a rate design that generates a larger portion of revenues from fixed rates, since it should help stabilize revenues. Accordingly, the panel adopts a base rate of \$30.00. This rate does not include any water usage. Because of additional revenue collected via fixed rates, the volumetric charge for water usage will be lowered to \$6.37 per 1000 gallons. All usage shall be billed on a pro-rata basis. For example, a customer using 6,400 gallons will be billed 6.4 multiplied by the rate of \$6.37. Finally, the panel determined that the existing \$891 monthly cap for Walnut Grove Elementary School should remain in place.

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<sup>69</sup> Christopher Klein, PhD, Pre-Filed Direct Testimony, p. 9 (April 23, 2012).

<sup>70</sup> James B. Ford, Pre-Filed Rebuttal Testimony, p. 3 (May 22, 2012).

<sup>71</sup> William H. Novak, Pre-Filed Direct Testimony, pp. 7-8 (April 23, 2012).

## **FLOOD COSTS**

The Company did not include Flood Costs for recovery in its rate case. Instead, Berry's Chapel filed a separate petition in Docket No. 11-00180.<sup>72</sup> In the Order dated May 7, 2012, the Hearing Officer, at the request of the parties to both dockets and in an effort to promote efficiency, consolidated Docket Nos. 11-00180 and 11-00198.

The Company submitted for recovery \$190,327 in costs, which it proposed to amortize over three years as a separate surcharge.<sup>73</sup> The Consumer Advocate analyzed these costs and included in its expense forecast only those costs it considered acceptable. Under this methodology, the recovery of flood costs would take place in the Company's base rates. The Consumer Advocate rejected a portion of the summary expense report, all overhead, interest and future repairs to arrive at the forecasted amount of \$90,944, which it proposes to amortize over three years.<sup>74</sup>

Specifically, the Consumer Advocate eliminated the following costs:

1. Twenty percent capitalized overhead costs of \$24,303.27 on expenses already incurred;
2. Twenty percent capitalized overhead costs of \$9,753.28 for estimated future expenses;
3. Interest expense of \$14,112.48 for 18 months based on an eight percent rate;
4. Estimated future repairs expense of \$48,766.42;
5. Legal fees of \$1,437.50; and
6. Meals and fuel costs for Tennessee Contractors, Inc. and other third party vendors in the amount of \$680.70 and \$838.49 respectively.<sup>75</sup>

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<sup>72</sup> See *In Re: Petition of Berry's Chapel Utility, Inc. to Recover Costs to Repair Flood Damage and to Refund Customer Service Fees*, Docket 11-00180 (October 25, 2011).

<sup>73</sup> In Docket No. 11-00180, the Company also requested permission to net the refund of illegally charged service fees against the surcharge to recover its flood costs. The refund of service fees is being addressed in the show cause Docket No. 11-00065.

<sup>74</sup> Dave Peters, Pre-Filed Direct Testimony, p. 20 and Schedule 23 (April 23, 2012).

<sup>75</sup> Dave Peters, Pre-Filed Direct Testimony, p. 19 (April 23, 2012).

The Consumer Advocate's reasoning is that only actual costs paid should be eligible for recovery. Arbitrary increases for overhead related to repairs by an affiliated company and estimated future costs are not costs actually paid by the Company. Also, had the Company sought recovery in a more timely manner, interest would not have been incurred. The Consumer Advocate could not find any decision by the Authority which would allow interest expense to be recovered. The Consumer Advocate also maintains that it is not appropriate to include legal expense in the recovery of flood damage expenses or to allow recovery of incidental costs for meals and fuel for its affiliate Tennessee Contractors, Inc. and other third party vendors who billed the utility for parts, labor and use of equipment.<sup>76</sup>

The panel finds that it is proper to exclude the costs recommended by the Consumer Advocate because they are inappropriate and unreasonable. Under Generally Accepted Accounting Principles, expenses from a third party vendor are not allowed to be increased for overhead by the Company receiving the service, since the Company receiving the service does not incur overhead. Further, nothing prevented the Company from filing for recovery immediately after incurring the flood expenses. It is not the fault of the ratepayer that the Company failed to file for recovery in a timely manner and by no means should interest be incurred.

Due to financial stress of the Company and the need for additional cash flow, the panel finds that the flood costs should be recovered over a twelve month period. The Authority adopts the Consumer Advocate's proposed adjusted flood damage costs of \$90,944 less \$599 for a total of \$90,345,<sup>77</sup> to be recovered over twelve months via a separate surcharge on customers' bill

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<sup>76</sup> *Id.*

<sup>77</sup> Dave Peters, Pre-Filed Direct Testimony, pp. 18-19 and attached workpaper Schedule 23 (April 23, 2012). The supporting detail provided in the written testimony does not tie to Schedule 23. The difference between the Company and the Consumer Advocate in the Summary Expense Report category was \$2,957, not \$2,358 found on the schedule. This was a \$599 discrepancy.



because customers will better understand a separate line item charge for flood costs rather than have it included in base rates. The amount of the tariff surcharge per customer is \$8.93 per month. The panel noted that if additional expenses are incurred by Berry's Chapel in the future, which are specifically related to the flood in May 2010, the Company may petition the Authority for possible recovery. The panel also instructed the Company to propose tariff language establishing the monthly surcharge, which should include the specific 12-month period over which recovery will take place.


**IT IS THEREFORE ORDERED THAT:**

1. The rates filed by Berry's Chapel Utility, Inc. on November 15, 2011 are denied.
2. For purposes of the rates set forth herein:
  - (a) The rate base is set at \$1,135,068 and annual operating revenues are \$777,098, which represents an annual revenue increase of \$180,840.
  - (b) The total operating expenses are \$681,668.
3. The Revenue Conversion Factor is 1.0604 and the fair rate of return is 7.5%.
4. The Revenue Deficiency shall be implemented through a monthly customer charge of \$30.00 and a volumetric charge per 1000 gallons (billed pro rata) of \$6.37.
5. The monthly charge for Walnut Grove Elementary School will continue to be capped at \$891.
6. Recovery for Flood Costs is approved at \$90,345. This recovery shall take place via a monthly surcharge of \$8.93 per customer for twelve months.
7. If additional charges are incurred in the future, which are specifically related to the Middle Tennessee flood of May 2010, Berry's Chapel Utility, Inc. may petition the Authority for possible recovery.

8. Berry's Chapel Utility, Inc. is directed to file a tariff with the Authority containing the approved charges prior to implementing the charges. The tariff shall specify the twelve months beginning and ending dates for the Flood Cost Recovery surcharge.

9. Any party aggrieved by the decision of the Tennessee Regulatory Authority in this matter may file a Petition for Reconsideration within fifteen days of the date of this Order.

10. Any party aggrieved by the decision in this matter has the right to judicial review by filing a Petition for Review in the Tennessee Court of Appeals, Middle Section, within sixty days of the date of this Order.



Kenneth C. Hill, Director



Sara Kyle, Director

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Mary W. Freeman, Director<sup>78</sup>

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<sup>78</sup> Director Mary W. Freeman voted in agreement with the other Directors but resigned her position with the Authority prior to the issuance of this Order.