BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

February 22, 2007

IN RE:	)	
	)	**DOCKET NO.**
PETITION OF CARTWRIGHT CREEK,	)	**06-00062**
LLC FOR EXEMPTION FROM	)	
FINANCIAL SECURITY AS REQUIRED	)	
BY THE TENNESSEE REGULATORY	)	
AUTHORITY'S PROPOSED	)	
WASTEWATER REGULATIONS	)	

DISSENT OF DIRECTOR RON JONES TO THE *ORDER APPROVING AN ALTERNATE FINANCIAL SECURITY ARRANGEMENT*

The above-styled docket came before a panel of the Tennessee Regulatory Authority ("Authority") during an Authority Conference on May 30, 2006. At the Conference, a majority of the panel voted to approve the alternative financial security submitted by Cartwright Creek, LLC ("Cartwright"). For the reasons stated herein, I respectfully dissent from the majority's decision. I write this dissent with the primary intention of providing insight into my decision to reject a proposal agreed to by Cartwright and Tennessee Regulatory Authority ("Authority") Staff.

I. RELEVANT LEGISLATIVE AND ADMINISTRATIVE HISTORY

Recent legislative and administrative changes are the genesis of this docket. In 2005, the Tennessee General Assembly passed Chapter 62, now codified as Tennessee Code Annotated section 65-4-201(e). The section requires:

> The authority shall direct the posting of a bond or other security by a public utility providing wastewater service or for a particular project proposed by a

> public utility providing wastewater service. **The purpose of the bond or other security shall be to ensure the proper operation and maintenance of the public utility or project.** The authority shall establish by rule the form of such bond or other security, the circumstances under which a bond or other security may be required, and the manner and circumstances under which the bond or other security may be forfeited.[1]

As directed by the statute, the Authority drafted and adopted public necessity rules regarding the security requirement. Pursuant to Rule 1220-4-13-.01(2), the purpose of the public necessity rules is "to define acceptable practices for the provision of wastewater service" and "**to ensure continued adequate and reasonable service.**"[2] In pursuit of the statutory and regulatory purposes, the rules require all public wastewater utilities holding a certificate of convenience and necessity at the time of the effective date of the rules to furnish to the Authority a bond or letter of credit in an amount equal to $20,000 or 100% of the gross annual revenue reported on the most recent UD20 form, whichever is greater.[3] Paragraph 5 of Rule 1220-4-13-.07 permits public wastewater utilities to propose an alternative form of security, but there is no provision in the rules to waive the bonding requirement. Upon the filing of a request to approve an alternative, the Authority must conduct a hearing to determine the amount of the security and whether the proposal is in the public interest. It is the utility's burden to establish that the proposal is in the public interest.[4]

During the March 6, 2006 Authority Conference, the Directors voted unanimously to adopt permanent rules to take effect upon termination of the public necessity rules on June 12, 2006. The intent of the rules as stated in the permanent rules is the same as that in the public necessity rules. As to the specifics of the security requirement in the permanent rules, there are

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[1] Tenn. Code Ann. § 65-4-201(e) (Supp. 2006) (emphasis added).
[2] Tenn. Comp. R. & Regs. 1220-4-13-.01(2) (December 2005) (effective until June 12, 2006) (emphasis added).
[3] *Id.* 1220-4-13-.07(1)-(3). In the event that the utility has not filed a UD20 form the estimated gross annual revenue provided in the CCN application shall be the amount of the security unless such estimate is less than $20,000. *Id.* 1220-4-13-.07(2).
[4] *Id.* 1220-4-13-.07(5).

certain alterations to the wording of the public necessity rules, but the substantive requirements remain the same.[5]

II. RELEVANT PROCEDURAL HISTORY

Cartwright filed a petition on March 20, 2006, requesting that the Authority exempt it from providing financial security as required by the Authority's public necessity and permanent rules. The Company argued that it should be exempt pursuant to 1220-4-13-.07(5) because it was "created and maintained through an equity contribution from its owners and not from any third-party developer."[6] During the April 3, 2006 Authority Conference, the panel asked numerous questions and eventually suggested the company work with Authority Staff to clarify the Company's proposed security alternative.[7]

On May 2, 2006, Cartwright filed a second petition. In the petition, the company again requested exemption from the security requirement citing the uniqueness of its capital structure as support and, in the alternative, requested the Authority accept the establishment of a $300,000 construction escrow fund as financial security in lieu of the bond or letter of credit required by Rule 1220-4-13-.07(3). According to the petition, use of the escrowed funds will be limited to paying the direct construction costs of a Sheaffer Sludge Elimination System and repairs to the collection system. Petitioner further asserts that its proposed security alternative serves the public interest by "facilitating the construction of needed capital improvements at the existing facility" and by allowing the company to become "self-sustaining on a prospective cash flow basis."[8]

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[5] *See In re: Rulemaking for the Regulation of Wastewater Companies*, Rulemaking Hearing Rules of the Tennessee Regulatory Authority, Rule 1220-4-13-.01 & .07 (Mar. 29, 2006) (filed with the Tennessee Secretary of State on Mar. 29, 2006) (effective June 12, 2006).
[6] *Petition*, 3 (Mar. 20, 2006).
[7] Transcript of Proceeding, Authority Conference, pp. 52-54 (Apr. 30, 2005).
[8] *Petition*, 4 (May 2, 2005).

During the May 30, 2006 Authority Conference, I concluded that Cartwright failed to demonstrate that it is entitled to exemption. As part of my justification for this conclusion, I noted that despite the fact that the proposal goes a long way to ensure the proper operation and maintenance of the utility and to ensure the provision of adequate and reasonable service, the proposal misses the mark in three important respects. First, I found that the proposal fails to include any provision that would permit the Authority to draw on the funds if necessary to maintain the day-to-day operations of the utility in the case of any management default. Second, I determined that the proposal fails to include any reporting criteria to allow the Authority to monitor construction progress. Third, I found that the proposal does not provide a date in 2007 by which Cartwright will provide a bond or letter of credit. Thereafter, I moved for approval of the proposal with certain conditions. Of particular relevance to this dissent is my recommendation that the escrow agreement include language permitting the Authority to access funds in the account in the event that the Authority determines that such funds are necessary to ensure the proper operation and maintenance of the utility and the provision of adequate and reasonable service to consumers.[9]

After a brief recess and before voting on the motion, it was requested that Mrs. Darlene Standley, Chief of the Utilities Division, provide a summary of the discussion between Cartwright and the Authority Staff. Mrs. Standley explained the $300,000 escrow account would be used to upgrade the system, which would enable the Company to file the required bond in one year, and that the bank will notify the Authority of all disbursements from the escrow account. Mrs. Standley also explained that the Company will file a $20,000 bond for any requested expansion into a new area.

[9] Transcript of Proceedings, Authority Conference, pp. 7-9 (May 30, 2006).

After Mrs. Standley's presentation of the summary, Director Miller concluded that there is nothing unreasonable about the proposal and that the Authority Staff and company worked together in "good faith." Based on these conclusions, he moved for the panel to adopt Cartwright's proposal. Director Kyle voted in favor of the motion also citing the good faith of the Authority Staff and Cartwright.[10]

Despite the rejection of my motion and the approval of the alternative security proposal, I asked Mrs. Standley whether the bank would notify the Authority as to the application of the disbursement in addition to notifying the Authority that a disbursement was made. Mrs. Standley answered negatively. Cartwright then spoke up and agreed to modify the escrow arrangement to provide the Authority with copies of the disbursement requests that are sent to the escrow agent.[11]

On February 22, 2007, the majority filed its *Order Approving an Alternative Financial Security Arrangement*. In the order, the majority concludes that the "alternative financial security serves the best interest of Cartwright Creek's customers."[12]

III. DISCUSSION

Although two of my criticisms of the proposal were mitigated by the clarification of Mrs. Standley and the agreement of Cartwright, my primary criticism that the proposal fails to include any provision to permit the Authority to draw on the funds if necessary to maintain the day-to-day operations of the utility in the case of any management default remains. It is the omission of this critical provision that I address through this dissent.

As discussed earlier herein, there are two purposes for obtaining the required security. The first is that set forth by the General Assembly "to ensure the proper operation and

[10] *Id.* at 12.
[11] *Id.* at 12-13.
[12] *Order Approving an Alternative Financial Security Arrangement*, 5 (Feb. 22, 2007).

maintenance of the public utility or project."[13] The majority fails to cite this statute in its order. The second purpose is included within Authority Rule 1220-4-13-.01(2), which states that the rules as a whole are intended "to ensure continued adequate and reasonable service." The majority cites this provision, but then attempts to ascribe a particular purpose to the specific rule requiring the filing of financial security. Specifically the majority, without citation or explanation, describes the purpose of the rule requiring the filing of financial securities by all wastewater utilities as ensuring "that consumers receive continued reliable service."[14] I do not understand the distinction intended by the majority in crafting this specific purpose and, further, see no reason to do so given the stated general purpose in .01(2). Thus, I choose to rely on the express language of section 65-5-201(e) and 1220-4-13-.01(2).

Earlier I described the omission of any provision to permit the Authority to draw on the funds if necessary to maintain the day-to-day operations of the utility in the case of any management default as critical. I use the term "critical" deliberately. Before an alternative to the .07 financial security requirement can be approved, the panel must determine that the proposed alternative is in the public interest. To be in the public interest the alternative must achieve the purposes of Tennessee Code Annotated section 65-4-201(e) and Authority Rule 1220-4-13-.01(2). Absent such achievement, the proposal cannot be approved.

While I recognize that the proposal to the extent that it is intended to result in an improved system that is better able to serve customers does achieve to some degree the statutory and regulatory purposes, the proposal falls far short, in my opinion, in ensuring the utility's proper operation and maintenance in the case of any management default. A bond or irrevocable letter of credit *as required by the Authority's rules* provides the Authority access to funds. Such

[13] Tenn. Code Ann. §65-4-201(e) (Supp. 2006).
[14] *Order Approving an Alternate Financial Security Arrangement*, 3 (Feb. 22, 2007).

access is essential in the event that the utility is unable for whatever reason to function and the Authority or its agent as a result of the inability is forced to oversee the day-to-day operations of the utility.[15] The proposal offers nothing to this end. My suggestion cures this fatal defect. Requiring Cartwright to include language in the escrow agreement permitting the Authority to access funds in the event that the Authority determines that such funds are necessary to ensure the proper operation and maintenance of the utility and the provision of adequate and reasonable service to consumers fully accomplishes the purposes of the statute and the Authority's rules. Anything less is unacceptable because it is not in the public interest.

In addition to my determination that the proposal is not in the public interest, I must also take issue with the majority's reliance on the "good faith" of the Authority Staff and Cartwright as a basis for their decision.[16] I do not question that Cartwright and the Authority Staff worked together on the proposal in good faith. Moreover, I do not question that Authority Staff is of the opinion that the proposal is a sufficient alternative to the financial security requirement contained in Authority Rule 1220-4-13-.07(3).[17] I will not, however, permit those discussions and any resulting agreements to control the outcome of my decision. I recognize the benefits of a party and the Authority Staff working together and hope that such efforts will continue in the future. Nonetheless, when called upon to render a decision in a docket, that decision will be firmly supported, as was done here, by the prevailing rules, laws and public policy and independent of

[15] This is not a mere hypothetical. In 2005, the Authority requested and received in chancery court the appointment of a receiver for RBS Gas, Inc. In the case of that utility, the management had failed to pay its gas supplier resulting in the untenable possibility that wholesale gas service would be terminated to the utility and, therefore, retail gas service would be terminated to the citizens of Red Boiling Springs. In this instance, there were no funds available to the Authority to secure the receiver with the exception of the few remaining liquid assets of the company and future receivables. A lesson learned from this experience is that in the event of the failure of a public utility ready access to funds to accomplish the Herculean task of taking over the day-to-day operations of the public utility is an invaluable tool.

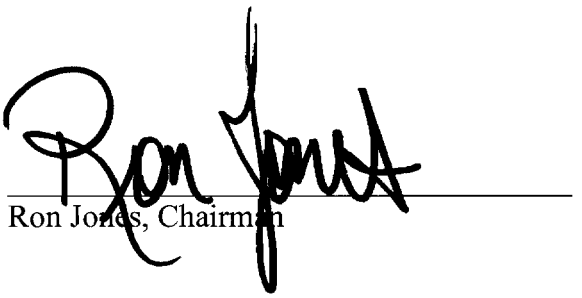
[16] Transcript of Proceedings, Authority Conference, p. 12 (May 30, 2006).

[17] Tenn. Comp. R &Regs. 1220-4-13-.07(3) (Dec. 2005).

the fact that the Authority Staff worked with a party to reach a particular proposal, alternative, or plan.

III. CONCLUSION

For the foregoing stated reasons, it is my opinion that the panel incorrectly voted to approve the proposal.



Ron Jones, Chairman