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BEFORE THE TENNESSEE REGULATORY AUTHORITY

T.R.A. DOCKET ROOM

NASHVILLE, TENNESSEE

August 31, 2006

IN RE:

**HICKORY STAR WATER COMPANY
COMPLIANCE AUDIT)**

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)

Docket No. 06-00176

**NOTICE OF FILING BY THE UTILITIES DIVISION OF THE TENNESSEE
REGULATORY AUTHORITY**

Pursuant to Tenn. Code Ann. §§65-4-104, 65-4-111 and 65-3-108, the Utilities Division of the Tennessee Regulatory Authority ("Authority") gives notice of its filing of Hickory Star Water Company's compliance audit in this docket and would respectfully state as follows:

1. The present docket was opened by the Authority to hear matters arising out of the compliance audit of Hickory Star Water Company (the "Company").
2. The compliance audit of the Company was conducted on-site on June 20 through June 22, 2006 and the Staff completed its audit of same on August 14, 2006.
3. On August 18, 2006, the Utilities Division submitted its preliminary compliance audit findings to the Company via e-mail. The Company responded on August 25 and August 29, 2006 via e-mail and its responses have been incorporated into the final compliance audit report.

4. The preliminary compliance audit report was modified to reflect the Company's responses and a final compliance audit report (the "Report") resulted therefrom. The Report is attached hereto as Exhibit A and is fully incorporated herein by this reference. The Report contains the audit findings of the Utilities Division, the Company's responses thereto and the recommendations of the Utilities Division in connection therewith.

5. The Utilities Division hereby files its Report with the Tennessee Regulatory Authority for deposit as a public record and approval of the recommendations and findings contained therein.

Respectfully Submitted:

A handwritten signature in cursive script that reads "Ron Graham". The signature is written in black ink and is positioned above a horizontal line.

Ron Graham
Utilities Division of the
Tennessee Regulatory Authority


CERTIFICATE OF SERVICE

I hereby certify that on this 31st day of August, 2006, a true and exact copy of the foregoing has been either hand-delivered or delivered via U.S. Mail, postage pre-paid, to the following persons:

Sara Kyle
Chairman
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243

Mike Churchill
Hickory Star Water Company
1360 Hickory Star Rd.
Maynardville, TN 37807

William W. Geary, Jr.
President of Hickory Star Water Company
Carlsberg Management Company
6171 West Century Boulevard, Suite 100
Los Angeles, CA 90045



Ron Graham

COMPLIANCE AUDIT REPORT
OF
HICKORY STAR WATER COMPANY
DOCKET NO. 06-00176

PREPARED BY
TENNESSEE REGULATORY AUTHORITY
UTILITIES DIVISION
AUGUST 2006

EXHIBIT A

COMPLIANCE AUDIT

HICKORY STAR WATER COMPANY

DOCKET NO. 06-00176

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I. INTRODUCTION

The subject of this audit is Hickory Star Water Company's ("Company" or "Hickory Star") compliance with the Rules and Regulations of the Tennessee Regulatory Authority ("TRA" or the "Authority"). At the direction of the Chief of the Utilities Division, the compliance audit was conducted by Gary Lamb and Ron Graham of the Utilities Division. The Company's books and records were reviewed at the Company's physical location at 1356 Hickory Star Road, Maynardville, Tennessee. The Staff's findings and recommendations resulting from the audit can be found in section V. of this report.

II. BACKGROUND

Hickory Star is a small water and wastewater system located near Maynardville, Tennessee in Union County on Norris Lake. It is a wholly-owned subsidiary of Hickory Star, LLC. The company has approximately 109 water and 49 wastewater customers.

Hickory Star was originally granted approval for a Certificate of Public Convenience and Necessity (CCN) in Tennessee Public Service Commission ("TPSC") Docket No. 99-00485. The last time this company appeared before this agency was in Docket No. 04-00044. In that Docket, the Authority granted, in part and denied, in part Hickory Star's petition for an increase in its rates. Specifically, Hickory Star was allowed to increase monthly minimum water rates from \$18.38 to \$36.76 for the first 2000 gallons consumed. Additionally, the Company was allowed to increase tap fees for new customers from \$585 to \$850. The Authority denied a request for an automatic wholesale water pass-through mechanism to flow through any changes in its cost of water from the City of Maynardville.

III. JURISDICTION OF THE TENNESSEE REGULATORY AUTHORITY

Tennessee Code Annotated (T.C.A.) gives jurisdiction and control over public utilities to the Tennessee Regulatory Authority. T.C.A. §65-4-104 states that:

The [A]uthority has general supervisory and regulatory power, jurisdiction, and control over all public utilities, and also over their property, property rights, facilities, and franchises, so far as may be necessary for the purpose of carrying out the provisions of this chapter.

Further, T.C.A. §65-4-105 grants the same power to the Authority with reference to all public utilities within its jurisdiction as chapters 3 and 5 of Title 65 of the T.C.A. have conferred on the Department of Transportation's oversight of the railroads or the Department of Safety's oversight of transportation companies. By virtue of T.C.A. §65-3-108, this power includes the right to audit:

The department is given full power to examine the books and papers of the companies, and to examine, under oath, the officers, agents, and employees of the companies and any other persons, to procure the necessary information to intelligently and justly discharge its duties and carry out the provisions of this chapter and chapter 5 of this title.

The TRA's Utilities Division is responsible for auditing those gas, electric, and water companies under its jurisdiction, to ensure that each company is abiding by Tennessee statute as well as the Rules and Regulations of the Authority. Gary Lamb and Ron Graham of the Utilities Division conducted this audit.

IV. SCOPE OF AUDIT

The Staff examined Hickory Star's books and records for the twelve months ended December 31, 2005, and conducted tests of accounts as considered necessary to determine if the Company is complying with the Uniform System of Accounts (USOA) for Class C Water and Wastewater utilities as well as TRA rules, regulations, and other directives.

V. AUDIT FINDINGS

Staff audit resulted in three (4) findings. A discussion of those findings along with Staff's recommendation to remedy the findings and the Company's responses to the findings are found below.

EXPLANATION OF FINDINGS

FINDING # 1:

Exception

The Company does not keep its accounting books in accordance with the Uniform System of Accounts.

Discussion

TRA Rule 1220-4-1-.11(1)(g) and (h) for Class A, B, and C water and sewer companies requires utilities to follow the USOA as adopted and amended by the National Association of Regulatory Utility Commissioners (NARUC). This uniform record keeping ensures the integrity, reliability and comparability among similar companies of financial data contained in financial reports submitted to the Authority. It provides the TRA one of its most useful regulatory tools for establishing just and reasonable rates.

Staff audit revealed that the Company does not use the USOA chart of accounts in recording its financial transactions on Hickory Star's books. The Company does however convert its account numbers to the USOA account numbers when filing financial reports with the TRA.

Recommendation

Staff recommends that the Company make the necessary changes in its accounting methods and procedures for Hickory Star to comply with the USOA for Class C Wastewater Utilities and Class C Water Utilities, beginning with calendar year 2007.

Company Response

The company will use the U.S.O.A. chart of accounts starting in 2007 and then correct the accounts to the company's own chart of accounts so that can consolidate the company's financial results with it's parent company so it can file it's tax returns and the reports required by the parents lenders and owners.

It is a major inconvenience to the company, but we will comply with the request of the T.R.A.

FINDING # 2:**Exception**

The Company's tariff filed with the Authority is not in compliance with TRA regulations.

Discussion:

TRA Rules 1220-4-1-.02 and .03 describe the required form and style of tariffs. Staff discovered the following deficiencies during a review of the Company's tariff:

1. There is no name and title of the issuing officer on the pages of the tariff.
2. There is no issue date or effective date included on the tariff pages.
3. The tariff pages are not numbered as required.

Recommendation:

The Company should work with the TRA Staff to re-file Hickory Star's tariff in a format that complies with TRA regulations.

Company Response:

We will work to correct these errors.

FINDING # 3:**Exception:**

The Company consistently under-charged one customer for sewage service.

Discussion:

The Company's approved rate for sewage service is \$15.00 per month for the first 2000 gallons of water used by a customer and \$6.83 per 1000 gallons for the next 8000 gallons of water usage. For several months in 2005, Hickory Star billed customer #WC56 the minimum sewage charge of \$15.00, even though the customer used more than 2000 gallons in those months.

Recommendation:

Hickory Star should correct its billing process to insure all customers are being charged according its TRA approved rate schedule.

Company Response

These errors have been corrected on the billings for September-06.

FINDING # 4:**Exception:**

The Company overcharged its affiliate, Hickory Star, LLC for sewer service of the Campground's bathhouse facility.

Discussion:

The Company had 47 wastewater customer accounts at its campground during the audit period for sewer service. The campground consists of 9 privately owned sites, 37 sites owned by Hickory Star, LLC, and a bathhouse owned by Hickory Star, LLC that serves the campground and marina. The Company charged Hickory Star, LLC the correct amount for sewage (usually the minimum of \$15 per month) for each of its 37 sites. They also charged each private customer the correct amount for sewage (usually the minimum of \$15 per month).

Beginning in July 2005, the Company charged its affiliate, Hickory Star, LLC, for water usage of the bathhouse based on its current tariff rates. The Company, however, charged Hickory Star, LLC a flat rate of \$650.00 per month for the bathhouse sewage usage. Since each site that the bathhouse serves at the campground is charged \$15 per month, plus any additional charge for excess water, there is no basis for this charge in the Company's current tariff. In addition, the Company could not explain the calculation of this flat rate.

Recommendation:

Hickory Star should only charge its affiliate, Hickory Star, LLC for sewage usage at the bathhouse facility the minimum charge of \$15 per month plus any additional amount for excess water usage allowed in its tariff rate schedule.

Company Response:

We will correct this error.

VI. ESCROW DETERMINATION PURSUANT TO TRA RULE 1220-4-13-.07(8)

Issue:

Whether a need exists for Hickory Star to maintain an Escrow Account.

Discussion:

As stated in TRA Rule 1220-4-13.06(8), "The requirement for a public wastewater utility to maintain a reserve/escrow account shall be determined by the Authority on a case by case basis..." During the audit review, Staff noted that the Company does not maintain an escrow account for the purpose of non-routine or emergency system repairs.

On April 15, 2005 in response to a TRA Staff data request in Docket No. 04-00434, Hickory Star stated that "...in the event of the need for extensive repairs, such repairs would be funded by the parent company, Hickory Star, LLC."

Recommendation:

Hickory Star Water Company's wastewater service is limited to a campground area serving 47 sites. Wastewater treatment consists of septic tanks. Staff recommends that the Company not be required to maintain an escrow account, because of the limited physical assets of the wastewater system and the owner's assertions that any extensive or emergency repairs will be funded by the owner as needed.

Company Response:

We agree with your findings.

VII. STAFF SUMMARY

The audit of the Company revealed four (4) primary findings that Audit Staff feel need to be addressed and corrected as soon as possible. The Audit Staff also developed a recommendation as to the need of the Company to maintain an escrow account as directed by TRA Rule 1220-4-13-.06(8).

Finding one addresses non-compliance with the USOA chart of accounts as directed by TRA Rule 1220-4-1-.11. The Company agrees to begin using the USOA chart of accounts 2007. Hickory Star has access to outside accounting personnel to assist in maintaining financial compliance.

Finding two addresses the deficiencies in the Company's tariff when compared with the requirements found in TRA Rules 1220-4-1-.02 and .03. The Company agrees to work with Authority Staff to file an amended tariff that corrects any deficiencies.

Findings three and four addresses the Company's incorrect billing of two customers. The Company agrees and will correct these billing errors.

Finally, the Audit Staff reviewed the need for the establishment of an escrow account by Hickory Star. Because of the limited physical assets of the wastewater system and the owner's assertions that any extensive or emergency repairs will be funded by the owner as needed, Audit Staff does not recommend that the Authority require an escrow account.