

**BEFORE THE TENNESSEE REGULATORY AUTHORITY**

**NASHVILLE, TENNESSEE**

**November 1, 2007**

**IN RE:**

**HICKORY STAR WATER COMPANY  
COMPLIANCE AUDIT**

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**DOCKET NO.  
06-00176**

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**ORDER ADOPTING COMPLIANCE AUDIT REPORT OF  
TENNESSEE REGULATORY AUTHORITY'S  
UTILITIES DIVISION**

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This matter came before Chairman Sara Kyle, Director Eddie Roberson, and Director Pat Miller of the Tennessee Regulatory Authority (the "Authority"), the voting panel assigned to this docket, at a regularly scheduled Authority Conference held on December 4, 2006 for consideration of the report of the Authority's Utilities Division (the "Staff") resulting from the Staff's compliance audit of Hickory Star Water Company ("Hickory Star" or the "Company") for the twelve (12) months ended December 31, 2005. The Compliance Audit Report (the "Report"), attached hereto as Exhibit A, contains the audit findings of the Staff, the responses thereto of the Company, and the recommendations of the Staff to the Company in addressing the findings.

On August 18, 2006, the Staff completed its compliance audit of Hickory Star and issued its preliminary audit findings to the Company. The Company responded to these findings on August 25 and August 29, 2006. Hickory Star provided the Staff with an additional response on September 29, 2006. The Staff filed its Report with the Authority on November 8, 2006. The Report states that Hickory Star is a small water and wastewater system located near

Maynardville, Tennessee. The Company is a wholly-owned subsidiary of Hickory Star, LLC whose corporate office is located in Los Angeles, California. Hickory Star currently has approximately 109 water and 49 wastewater customers.

The Report contains four findings. The first finding is that the Company does not keep its books in accordance with the Uniform System of Accounts (“USOA”) as required by TRA Rules 1220-4-1-.11(1)(g) and (h). The Report recommends that the Company make the necessary changes in its accounting methods and procedures to comply with the USOA for Class C Wastewater Utilities beginning with calendar year 2007. The Company agreed with the Staff’s recommendation.

The second finding is that the Company’s tariff did not meet the requirements of TRA Rules 1220-4-1-.02 and .03. Staff recommended that Hickory Star file a corrected tariff within sixty (60) days of TRA approval of the Report. The Company agreed to re-file a corrected tariff.<sup>1</sup>

The third finding is that the Company improperly applied tariff rates which resulted in a customer being under-charged for sewage service. Hickory Star’s response to this finding is that the Company corrected the billing errors.

The fourth finding is that Hickory Star improperly over-charged its affiliate, Hickory Star, LLC for sewer service due to a flat rate charge. The Company recorded a credit to the affiliate to correct the error.

Staff also examined whether a need exists for Hickory Star to establish an escrow account under TRA Rule 1220-4-13-.07(8). The Company has filed a surety bond for \$20,000 to ensure

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<sup>1</sup> Hickory Star filed a tariff on February 7, 2007 and a revised tariff on February 12, 2007.

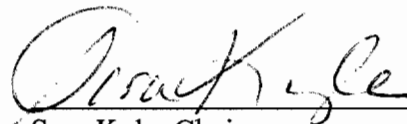

financial security and viability for the utility. Staff recommended that the TRA not require an escrow account for Hickory Star at this time because of the surety bond.

After consideration of the Report, the voting panel assigned to this docket voted unanimously to approve and adopt the findings and recommendations contained therein.

**IT IS THEREFORE ORDERED THAT:**

1. The Compliance Audit Report, a copy of which is attached to this Order as Exhibit A, is approved and adopted, and the findings and recommendations contained therein are incorporated in this Order as if fully rewritten herein;

2. Any party aggrieved by the Authority's decision in this matter may file a Petition for Reconsideration with the Authority within fifteen (15) days from the date of this Order.

  
Sara Kyle, Chairman  
Eddie Roberson, Director  
Pat Miller, Director

750-111-1111  
601-253-1111  
TUESDAY, NOVEMBER 7, 2006

**BEFORE THE TENNESSEE REGULATORY AUTHORITY**

**NASHVILLE, TENNESSEE**

**November 8, 2006**

**IN RE:**

**HICKORY STAR WATER COMPANY  
COMPLIANCE AUDIT )**

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)  
) **Docket No. 06-00176**

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

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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.

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. An additional Utilities Division request led to a Company response that was received September 29, 2006.

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, reading "Ron Graham", is written over a horizontal line.

Ron Graham  
Utilities Division of the  
Tennessee Regulatory Authority

### **CERTIFICATE OF SERVICE**

I hereby certify that on this 8th day of November, 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

  
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Ron Graham

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

**PREPARED BY**  
**TENNESSEE REGULATORY AUTHORITY**  
**UTILITIES DIVISION**  
**NOVEMBER 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, this 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 TRA Compliance Audit Staff's ("Staff") 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 whose corporate office is located in Los Angeles, California. The utility 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 utility appeared before the TRA 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 all TRA rules, regulations, and other directives.

## **V. AUDIT FINDINGS**

Staff audit resulted in four (4) findings. A discussion of those findings, along with Staff's recommendations to remedy the findings and the Company's responses to the findings, are reported below.

### **EXPLANATION OF FINDINGS**

#### **FINDING # 1:**

##### **Exception**

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

##### **Discussion**

TRA Rules 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 companies of similar size 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, however, converts its account numbers to the USOA account numbers when filing financial reports with the TRA.

In its preliminary report issued to the Company, Staff recommended that the Company make the necessary changes in its accounting methods and procedures for Hickory Star to comply with Authority Rules which require the use of the USOA for Class C Wastewater Utilities and Class C Water Utilities, beginning with calendar year 2007.

##### **Company Position**

The Company states that it will use the USOA chart of accounts starting in 2007 and then correct the accounts to the Company's own chart of accounts so that Hickory Star can consolidate financial results with its parent company. This will allow the parent company to file the appropriate tax returns and reports required by the parent company's lenders and owners.

Although Hickory Star finds this accounting requirement a major inconvenience to the company, the Company will comply with the request of the Authority.

**Staff Recommendation**

The Staff is satisfied with the Company's response and therefore recommends that the Hickory Star begin following the USOA. Although, Hickory Star has not been complying with TRA rules regarding the USOA, it has not presented any difficulties in evaluating the Company's financial condition. Accordingly, Audit Staff is not recommending that any fines be levied for failure to comply with TRA rules.

## **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; and
3. The tariff pages are not numbered as required.

In its preliminary report to the Company, Staff recommended that the Company should work with the Authority Staff and re-file Hickory Star's tariff in a format that complies with TRA regulations.

### **Company Position**

The Company stated that it would correct these errors.

### **Staff Recommendation**

Staff is satisfied with the Company response and therefore recommends that the Company file an amended tariff within sixty (60) days of the TRA's approval of the Staff AuditReport.

### **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.

A data request was sent to the Company on September 21, 2006 asking if a corrected bill was sent to customer W56 to collect the amount of undercharge that resulted from misapplication of the company's tariffed rates. The Company responded on September 26, 2006 that a corrected bill was sent and the undercollection received.

In its preliminary report issued to the Company, Audit Staff recommended that Hickory Star should correct its billing process to insure all customers are being charged according to its TRA approved rate schedule.

#### **Company Position**

The Company responded that all errors have been corrected on the billings for September-06.

#### **Staff Recommendation**

Staff is satisfied that the appropriate action was taken by the Company and the customer is now being billed according to the Company's tariff rates. No further action is recommended.

## **FINDING # 4:**

### **Exception**

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

### **Discussion**

The Company had 47 wastewater customer accounts for its campground during the audit period. 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 began charging its affiliate, Hickory Star, LLC, for water usage at 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 the flat rate charge for the bathhouse. When asked, the Company could not explain the calculation of this flat rate.

A follow-up data request was sent to the Company on September 21, 2006 asking if the customer was issued a refund for the overcharge. The Company responded on September 26, 2006 that a credit was recorded for Hickory Star, LLC.

In its preliminary report issued to the Company, Staff recommended that Hickory Star should 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 as approved in its tariff rate schedule.

### **Company Position**

The Company stated that it will correct this error and begin assessing the correct rates.

### **Staff Recommendation**

Staff is satisfied that the appropriate action was taken by the Company and the customer account is now being billed according to the Company's tariff rates. Accordingly, no further action is recommended at this time.

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

**Issue:** Authority determination whether a need exists for Hickory Star to maintain an Escrow Account.

As stated in TRA Rule 1220-4-13.07(8), “The requirement for a public wastewater utility to maintain a reserve/escrow account shall be determined by the Authority on a case by case basis. Within eighteen (18) months from the effective date of these rules, the Authority shall review the financial condition of any public wastewater utility holding a CCN to provide wastewater service as of the effective date of these rules to determine whether such wastewater utility shall establish or adjust the amount of a reserve/escrow account as described in this Chapter.” TRA Rule 1220-4-13.07(9) states, “Reserve/escrow accounts established by the public wastewater utility to pay for non-routine operation and maintenance expenses shall meet the conditions as specified by the Authority.” The TRA Wastewater Rules are intended to ensure continued adequate and reasonable service.

### **Discussion**

During the audit review, Staff noted that the Company does not currently maintain an escrow account for the purpose of non-routine or emergency system repairs.

As previously stated in this report, Hickory Star Water Company’s wastewater service is limited to a campground area serving 47 sites. Of those sites, nine are owned by individuals and the remainder are owned by Hickory Star Water Company’s parent company Hickory Star, LLC. Hickory Star, LLC is manager of the campground, marina, restaurant, and motel. The campground has wastewater connections that serve mobile camping trailers, a few cabins, and a campground bathhouse. The wastewater flows by gravity to septic tanks be treated, eliminating any costs associated with pump operation, maintenance, or replacement. Wastewater treatment facilities for the campground area consist of three septic tanks and associated field lines. These tanks have an occasional routine expense when the solids from these tanks are pumped.

The above facts are significant in considering the need for an escrow account for Hickory Star. There is a low probability that any significant expense would occur that would jeopardize the continued viability of this wastewater treatment system. In addition, Hickory Star, LLC has a significant self-interest to continue operation of the wastewater treatment system, since it serves the campground sites that generate its rental revenue. This fact provides additional assurances to the Authority.

In addition, Hickory Star Water Company has filed a Corporate Surety Bond in the amount of \$20,000 in favor of the State of Tennessee in compliance with TRA Rule



1220-4-13.07. Continuance of this financial security will also ensure the viability of this wastewater utility.

### **Company Position**

On April 15, 2005, in response to a 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." Following this audit, Staff sent another data request sent to Hickory Star, LLC related to the establishment of an escrow account. In his response dated September 26, 2006 in this docket, Mr. William Geary, President of the Company, strongly objected to the establishment of an escrow account. Mr. Geary went on to state that the wastewater system, consisting of septic tanks, does not have emergency or non-routine maintenance expenses and that the Company will pay for any repairs from its own (Hickory Star, LLC) funds.

### **Staff Recommendation**

Based upon the limited physical assets of the wastewater system, any emergency repairs should not be overly financially burdensome to the Company. This together with the owner's assertions that any extensive or emergency repairs will be funded by the owner as needed and an existing Corporate Surety Bond in the amount of \$20,000, leads Staff to recommend that the Company not be required to maintain an escrow account.

## **VII. STAFF SUMMARY**

The audit of Hickory Star revealed four (4) primary findings. Staff also developed a recommendation as to the need for the Company to maintain an escrow account pursuant to TRA Rule 1220-4-13-.07(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 in 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 pursuant to 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 address the Company's incorrect billing of two customers. These findings have been satisfactorily addressed by the Company and Staff accepts the Company's responses.

Finally, Staff reviewed the need for the establishment of an escrow account by Hickory Star. Because of the limited physical assets of the wastewater system, any emergency repairs should not be overly financially burdensome to the Company. This, together with (1) the owner's assertions that any extensive or emergency repairs will be funded by the owner as needed and (2) the Company's existing Corporate Surety Bond in the amount of \$20,000, leads Staff to recommend that the Authority not require an escrow account for this utility.