

**BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE**

AUGUST 28, 2007

*In re: Petition of Tennessee Wastewater
Systems, Inc. to Amend its Certificate of
Convenience and Necessity*)
)
)

Docket No. 06-00259

TENNESSEE WASTEWATER SYSTEMS, INC.'S POST HEARING BRIEF

Pursuant to the "Notice of Filing Briefs" issued August 22, 2007, Tennessee Wastewater Systems, Inc. ("TWS") submits this post-hearing brief in support of its petition to classify as "commercial" customers approximately 412 owners of "overnight rental properties" located in Sevier County, Tennessee.

SUMMARY

This is not a rate case. It is a classification case. It is not about whether the current "residential" or "commercial" rates charged by TWS are just and reasonable. It is about who should be paying those rates. It is not about the annual revenue requirement of TWS. It is about whether the owners of "overnight rental properties" should be classified as commercial or residential customers.

The TRA has already answered this question many times. Just two months ago, Chairman Kyle and Director Roberson voted to charge commercial rates to overnight rental properties in "The Landing at Bird's Creek Subdivision," which is also located in Sevier County. See TRA Docket 07-00090. As Mr. Jeffrey Cox of IRM explained to the agency, the owners of overnight rental property should be charged a commercial rate "due to the transient nature and the management of those types of systems." Transcript of TRA agenda conference on June 25, 2007.

In numerous other dockets, the TRA has also approved charging commercial rates to owners of overnight rental properties. For example, the TRA has approved charging commercial rates to

overnight rental properties served by TWS in each of the following developments: Brigadoon (Docket No. 05-00241), Elk Springs (Docket No. 05-00211), German Creek (Docket No. 05-00138), Happy Creek (Docket No. 06-00104), Legacy Mountain East (Docket No. 03-00329), Legacy Preserve (Docket No. 03-00329), Settlers Ridge (Docket No. 06-00081), Sugar Loaf Ridge (Docket No. 06-00022), Summit View (Docket No. 06-0078) and The Villages at Norris (Docket No. 06-00277). There are currently about 223 overnight rental properties in these ten developments, all classified as commercial customers. More such properties are under construction. The properties in these developments are, for all intents and purposes, identical to the 412 overnight rental properties which are the subject of this reclassification proceeding.

These 412 properties range from one and two bedroom cabins to huge “cabin hotels” sleeping forty and fifty people. They are not – and do not pretend to be – private homes. All are commercial businesses. Each one has a state business license and must pay state sales taxes. They already pay commercial rates for electric and water service. All are required to pay federal income taxes and are allowed to deduct as a business expense their operating costs, including their bills from TWS.

It is clearly unreasonable for these commercial operations to pay residential rates and it is clearly discriminatory for TWS to charge commercial rates to some overnight rental properties while other, identical properties are charged residential rates. TWS therefore asks that this petition be granted and that the overnight rental properties located in the eight developments listed in the petition be properly classified as commercial customers.¹

¹ Property owners in the Starr Crest developments have already agreed to be re-classified as commercial customers as part of a settlement with TWS. Under the parties’ agreement, TWS amended its commercial tariff to create a new sub-category of commercial customers called “overnight rental properties” and proposed rates for those customers that are cheaper than the rates for other commercial users and terms and conditions that are specifically tailored for overnight rental properties. On August 20, 2007, the TRA approved the settlement and the amended tariff but voted to apply the amended tariff only to the Starr Crest developments pending a decision on this petition and the issuance of notice to other potentially affected property owners.

DISCUSSION

1. There is no dispute that the 412 "overnight rental properties" at issue in the case are "commercial" customers.

Under Tennessee law, "overnight rentals" are classified as business properties and must pay both business and sales taxes. (Hines, Exhibit 4). TWS has adopted the same definition of "overnight rentals" used in state tax laws (see T.C.A. §67-4-702(a)(11)) and will apply the commercial tariff to any "overnight rental property" meeting that description.² As pointed out by TWS witness Mike Hines, the 412 overnight rental properties described in the petition are already classified as commercial properties by the Sevier County Electric System (Hines, Exhibit 2), and by the Pigeon Forge Utility Department which provides water service (Hines, Exhibit 3).³

Mr. Lynn Hedrick, the developer of the Smoky Cove Subdivision, testified that he was speaking only for himself and not representing the cabin owners in his development (tr., 104). Nevertheless, he provided in response to a discovery request from TWS copies of advertisements from twenty of the rental properties located in Smoky Cove. According to the advertisements, the largest of those twenty properties is a 4,800 square foot "cabin" called "Mountain Jubilee" which sleeps twenty-eight people. The cabin rents for \$675.00 to \$975.00 per night. The smallest of these twenty is called "Great Escape" and sleeps four people at a nightly rate of \$128.00 to \$175.00. The average cabin among these twenty rental properties sleeps twelve people, according to the advertisements. A cabin that sleeps twelve is clearly not "typical of residences built in this area," as Mr. Hedrick testified (pre-filed testimony, at 1) nor are these advertisements consistent with Mr. Hedrick's testimony that "we

² Any cabins which are used for residential purposes and are not available for overnight rental will be classified as residential customers and charged the residential rate.

³ Despite the testimony of developer Lynn Hedrick about his conversation with the manager of the city water department (tr., at 94), it is clear from the published tariffs of the department that "cabins" are classified as "commercial" properties and pay a higher connection fee than "residential" customers. See Hines, Exhibit 3.

have more two bedroom [cabins] than we do anything else.” Tr., at 93. These are large, commercial investments, even the smallest of which is capable of producing more than \$50,000 in annual revenue.

2. It is unreasonable and discriminatory to classify these overnight rental properties as residential customers.

The residential rate for all TWS customers is currently \$35.00 per month, regardless of usage. It is clearly unreasonable for overnight rental properties, some of which sleep as many as fifty guests, to be charged this residential rate. Furthermore, these rental cabins experience higher “peak” usage than residential properties (tr. 59-62) and are more expensive to maintain because of the transient nature of the overnight guests.⁴ Tr., 36.

Finally, it is clearly discriminatory for TWS to charge a residential rate to 412 overnight rental properties while other, identical properties are classified as commercial customers. As Mr. Hines explained, TWS erred in its initial understanding of how these overnight rental properties would be used, the size of the cabins, and the increased number of maintenance problems. Tr., at 59-61. Having learned from that experience, TWS now classifies – with the TRA’s approval – overnight rental cabins as commercial properties. The purpose of this petition is to correct this error, treat all similarly situated customers the same, and put an end to the continued subsidization of those 412 overnight rental properties who continue to pay residential rates.

3. There is no contract between TWS and Smoky Cove which requires TWS to continue charging residential rates or prevents TWS from charging a cabin owner for installing larger facilities to serve that cabin.

⁴ To address these differences, the “commercial” tariff of TWS applicable to overnight rental properties charges cabin owners based on actual usage, rather than on a flat-rated bases, and allows TWS to charge the cabin owner for repairs and, if needed, the addition of larger facilities needed to serve a particular property. Tr. 77, 54. On the other hand, the overnight rental tariff also recognizes that a rental property may remain vacant for periods of time and provides that cabins using less than 300 gallons per day during a thirty day period will be billed only the minimum rate of \$55.00. Other commercial customers are billed on the basis of capacity, not usage, and are charged a higher minimum bills.

During the hearing in this case, counsel for Mr. Hedrick insinuated several times that there was a contract between TWS and Smoky Cove which “was for residential” rates (tr., 18) and which prohibited TWS from charging a cabin owner for any necessary enlargements to the cabin’s wastewater treatment system. Tr. at pp.18, 32, 33, 45, and 46.

Those insinuations are not true. The contract between Smoky Cove and Utility Capacity Corporation, Inc., dated September 28, 2003, is a standard agreement used for all the properties served by TWS in that area. A copy of the contract was introduced by counsel for Mr. Hedrick. There is nothing in the document which describes Smoky Cove as either a “residential” or “commercial” development or says anything about rates. Furthermore, the contract makes TWS responsible for the “design, development, building, construction, and expansion of the wastewater system for the property.” (Paragraph 2, emphasis added.) That provision refers to the wastewater system which serves the entire development. It does not apply to a septic tank built to serve a particular customer. The contract does not, for example, prohibit TWS from charging a restaurant owner for installing a larger septic tank when the restaurant expands from thirty customers to fifty (tr. 54), nor would it prevent TWS from charging a commercial cabin owner for the replacement of a small septic tank with a larger one where the cabin has consistently exceeded the capacity of the smaller tank. Tr. 53-54.

The commercial tariff of TWS has always provided that TWS may charge a property owner for enlarging the septic tank serving that owner’s property. Nothing in the contract with Smoky Cove, which is the same contract TWS has used for other developments in the area, states otherwise. To make this point even clearer, the recently amended “overnight rental property” tariff filed by TWS

states expressly that a commercial customer may be charged only for “increasing the capacity of that portion of the system designed and dedicated to serve that customer.”⁵

4. Smoky Cove is already classified as having both residential and commercial properties.

Mr. Lynn Hedrick, the developer of Smoky Cove, is the only party still objecting to the petition of TWS. He testified that he was told by Mr. Mike Hines of TWS that all the cabins in Smoky Cove would be classified as residential properties. Tr. 90-91. However, a review of the TRA’s files on this property demonstrate that Smoky Cove is classified as having both residential and commercial properties and, therefore, that Mr. Hedrick has been on notice since he began the development that the rental properties in Smoky Cove could be charged the commercial rate.

The application of TWS (then called On-Site systems, Inc.) to provide wastewater service to Smoky Cove was filed June 2, 2003, and assigned docket number 03-00377. The application includes revised tariff pages which list Smoky Cove as containing both residential and commercial properties.⁶

The other seven developments listed in this reclassification petition were originally described as residential properties. Unlike the Smoky Cove petition, the tariffs filed with those other seven petitions contained only residential rates.

Under the “filed rate” doctrine, a utility is required to charge its tariffed rates, even in situations where an agent of the utility has misrepresented those rates. See Maslin Industries v. Primary Steel, 497 U.S. 116, 126-138 (1990) and cases cited therein. A utility may also recover undercharges from customers in cases where the utility failed to bill the correct rates. Ibid.

⁵ Even if there were a private contract between TWS and Smoky Cove which purported to set forth rates or terms of service, a private contract cannot supplant a utility’s lawfully approved tariffs. See New River Lumber Co. v Tennessee Ry. Co., et al., 238 S.W. 867 (1922).

⁶ The Order approving the application states that the proposed rates “for wastewater service to Smoky Cove shall be listed in the rate schedule filed with On-Site’s Petition and as set forth in this Order.” Order issued February 24, 2004, at 3. In another section, the Order describes the residential rates but not the commercial rates. See p. 2. In light of the petition, this omission is apparently an oversight.

In other words, even though owners of overnight rental property in Smoky Cove Subdivision have been billed at the residential rate, TWS could legally have billed them at the commercial rate at any time since the development was built. Even today, TWS could retroactively bill those owners at the commercial rate under the “filed rate” doctrine. TWS has not chosen to take that action because of Mr. Hines’ concerns about treating some rental cabin owners differently than other, similarly situated owners. But as the developer of a property already classified as having commercial customers, Mr. Hedrick is hardly in a position to complain if other owners of overnight rental property are treated the same way.

5. There is no requirement that TWS present data regarding the cost of serving these 412 overnight rental properties.

As previously discussed, this is not a rate case. It is simply about which rate schedule – the utility’s commercial or residential rates – ought to apply to overnight rental properties. Nevertheless, the principal argument of the one individual who still opposes the reclassification petition is that TWS must prove that it costs more to serve these overnight rental properties than it does to serve residential customers.

First, even if this were a rate case, which it is not, there is no legal requirement that rates be designed based on cost-of-service data. See CF Industries v. Tenn. P.S.C., 599 S.W.2d 536, 542 (Tenn. 1980). (“There is no requirement in any rate case that the commission receive and consider cost of service data.”) The TRA, for example, does not require a telephone company to demonstrate that it costs more to provide service to a business than to a residential customer. If a telephone company and a customer disagreed as to whether that customer should pay the business or residential rate, the TRA’s decision would turn to the nature of the customer’s service, not the cost to the company of providing that service.

Second, TWS did, in fact, present uncontradicted testimony that transient users of overnight rental properties cause more maintenance problems than occur with residential customers. Moreover,

there is no dispute that many of these overnight rental properties are far larger than residential houses and should be paying a usage-based rate, not the flat-rated price charged to homeowners. This evidence supports the argument of TWS that these 412 property owners should be classified as commercial customers, but TWS is not required to offer cost data “proving” that it costs more to serve a two-bedroom rental property than a two-bedroom home, no more than a telephone company has to “prove” what it costs to serve a business or residential customer before deciding what rate schedule to apply.

Finally, it is important to remember that the tariffs of TWS have never been set based on the costs of serving a particular class of customers or a particular development. The company’s residential and commercial rates, which generally apply to all customers of TWS across the state, were established years ago based on discussions between TWS and the TRA Staff. They are average rates designed to meet the company’s estimated annual revenue requirement. They also reflect the pattern typically followed by all utilities that commercial rates should be higher than residential rates in order to make residential service more affordable.

Given that history, it makes no sense to pretend that the existing rates of TWS accurately reflect the costs of serving a particular class of customers or to demand cost data to show why a customer belongs in one class or another. This case has never been about “costs” but about whether it is reasonable or not, and whether it is discriminatory or not, to continue charging “residential” rates to these 412 owners of overnight rental properties.

CONCLUSION

For these reasons, TWS asks that this petition be approved, that the owners of overnight rental properties in the eight developments listed in the petition be classified as commercial customers, and that all owners of overnight rental properties served by TWS be charged under the amended, commercial tariff applicable to “overnight rental properties.”

Respectfully submitted,

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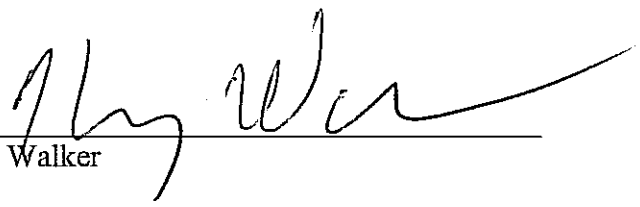
CERTIFICATE OF SERVICE

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on this the 24 day of August, 2007.



Henry Walker