BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE
May 16, 2012

IN RE:	)	
	)	**DOCKET NO.**
PETITION OF DSH & ASSOCIATES, LLC FOR	)	**11-00162**
APPROVAL TO AMENDS ITS RATES AND	)	
CHARGES	)	

FINAL ORDER APPROVING RATE PETITION

This matter came before the Tennessee Regulatory Authority (the "Authority" or "TRA") during a regularly scheduled Authority Conference held on January 9, 2012, for hearing and consideration on the *Petition of DSH & Associates, LLC for Approval to Amend Its Rates and Charges* filed on September 16, 2011 *("Original Petition")*, and subsequent amendments to the *Petition* filed on November 4, 2011 *("Revised Petition")*,[1] and November 29, 2011 *("Amendment to Petition")*,[2] (collectively referred to as *"Petition")* by DSH & Associates, LLC ("DSH" or the "Company"). Thereafter, this matter again came before the Authority for deliberations on the *Petition* during a regularly scheduled Authority Conference held on January 23, 2012.

Upon consideration of the entire record, including all exhibits, the testimony of the witnesses, and the written and verbal comments of members of the public, the panel unanimously concluded that the Company's requested annual increase in the amount of $11,944 was just and reasonable and should be recovered as reflected in the Company's proposed tariff pages amended on November 29, 2011. Further, the panel directed DSH to establish a separate escrow

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[1] *Revised Petition Pages for DSH & Associates, LLC, Request to Amend Its Rates and Charges* (November 4, 2011).
[2] *Amendment to Petition* (November 29, 2011).

account and required that all utility employees having signature authority on the account shall obtain a fidelity bond. Proof of compliance with this requirement shall be filed and kept up-to-date with the Authority. In addition, the panel held that DSH shall file with the Authority all monthly escrow account statements with its Annual Report on April 1 each year. These conclusions, as well as other decisions concerning the Revenues, Expenses, Taxes Other Than Income, Rate Design and other issues are fully discussed below.

I. TRAVEL OF THE CASE

DSH is a limited liability company formed under the laws of the State of Tennessee and authorized by the Secretary of State to conduct business in Tennessee. On July 11, 2011, DSH was granted its Certificate of Public Convenience and Necessity ("CCN") to provide wastewater services for Lakeside Estates ("Lakeside") of Campbell County, Tennessee, in Docket 11-00020.[3] The decentralized wastewater disposal system that serves the area was previously owned and operated by LaFollette Utilities Board ("LUB") and was already in need of expansion when it was transferred to DSH. DSH currently serves 3 residential customers and 23 commercial customers, who predominantly own large rental units consisting of up to ten (10) bedrooms.

On September 16, 2011, DSH filed its petition for an overall rate increase of $11,944 and asserted its initial rates, approved on July 11, 2011, will not provide, and cannot be made to provide, revenues sufficient to cover all of the costs incurred in providing safe and adequate wastewater service. Further, the Company stated that it is operating at a significant loss, and will be unable to continue to exist without alteration to its existing rate structure. Without an increase in rates, its ability to meet the present and future requirements of its customers and ensure that adequate funding

[3]*See In re*: *Petition of DSH & Associates, LLC, to Obtain a CCN for the Service of the Part of Campbell County, Tennessee Known as Lakeside Estates,* Docket No. 11-00020, *Order Approving Petition for a Certificate of Public Convenience and Necessity* (June 28, 2011).

is available for maintaining system plant and equipment at an efficient operating level is threatened.[4] In support of its *Petition,* DSH filed the Pre-filed Direct Testimony of Doug Hodge, Operations Manager and Owner of DSH, a comparative five (5) year build-out cost analysis that includes tap fees for the needed expansion of the system at current rates[5] and utilizing its proposed rates,[6] and proposed revised tariff pages.[7]

In its *Petition,* the Company requested a new rate design to include a flat fixed rate for residential customers and volumetric rates for rental properties.[8] DSH contends that the increased rates and new rate structure will allow the Company to meet the necessary costs incurred in providing adequate service to overnight rental units of up to ten (10) bedrooms and residential customers.[9] As to residential customers, the Company proposes to reduce the monthly rate by $9.95, from $54.48 to $44.53. The residential customer monthly charge includes a base rate of $30.73, a bonding charge of $3.56, and an escrow amount of approximately 23% of the total rate for non-routine maintenance expenses.[10]

The rates proposed by DSH for Commercial/Overnight Rental Units are based on monthly average daily flow. Commercial/Overnight Rental Units (currently includes houses with 4-10 bedrooms used as rental property) will be charged a minimum of $69.53 per month for the first 300 gallons of flow per day. For each additional 100 gallons per day of average daily flow, up to 1,000 gallons per day, an additional charge of $15.00 per month per 100 gallons will be charged. For average daily flows over 1,000 gallons per day, an additional monthly charge of $157.95 per 1,000 gallons will be applied. The Commercial/Overnight Rental Units monthly charge includes a bonding

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[4] *Original Petition* (September 16, 2011).
[5] *Revised Petition*, Exhibit 1-A Revised Pages (November 4, 2011).
[6] *Revised Petition*, Exhibit 1-B Revised Pages (November 4, 2011).
[7] *Amendment to Petition,* Revised Tariff Pages (November 29, 2011).
[8] *Revised Petition*, Exhibit 1-A Revised Pages & Exhibit 1-B Revised Pages (November 4, 2011).
[9] *Original Petition* (September 16, 2011).
[10] Non-routine maintenance expenses are not included in normal operating expenses. *Amendment to Petition*, Revised Tariff Pages, TRA No. 1, Section 3, Rev. Page 2 (November 29, 2011).

charge of $3.56, and an escrow amount of approximately 23% of the total rate that will be used for non-routine maintenance.[11]

In addition, the *Petition* proposes an annual sewer system access fee of $120 for property owners that have not yet built homes. The sewer access fee would be payable each July 1. After the customer has signed up for service, the access fee would be pro-rated for that year and would not be charged thereafter.[12] Finally, the Company seeks to increase the miscellaneous disconnection and reconnection fees from a total of $75 to $90.[13]

From December 20, 2011 through January 23, 2012, several DSH customers filed comments and complaints in the docket file concerning the *Petition*. On December 22, 2011, the Hearing Officer issued a *Notice of Hearing* setting the matter for a hearing on the merits during a regularly scheduled Authority Conference scheduled to be held on January 9, 2012. On January 3, 2012, the Company filed a copy of a letter that it sent to customers on December 8, 2011, notifying them of the hearing on its *Petition,* its confidential customer list, which was filed under seal, and proof of its publication of public notice of the hearing in the LaFollette Press on December 22, 2011.

II. THE HEARING & PANEL DELIBERATIONS

At a regularly scheduled Authority Conference held on January 9, 2012, the voting panel assigned to the docket convened the hearing in this matter. In support of the Company's *Petition,* Mr. Douglas Hodge, Operations Manager and Owner of DSH, ratified and summarized his pre-filed testimony and was subject to questioning by the panel.

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[11] *Amendment to Petition,* Revised Tariff Pages, TRA No. 1, Section 4, Rev. Page 2 (November 29, 2011)

[12] *Amendment to Petition,* Revised Tariff Pages, TRA No. 1, Section 2, Rev. Page 2 (November 29, 2011).

[13] *Amendment to Petition,* Revised Tariff Pages, TRA No. 1, Section 3, Rev. Page 2 (November 29, 2011) (reflecting a disconnection fee of $40.00 and a reconnection fee of $50.00).

In addition to several written comments filed by the public/homeowners in Lakeside Estates of Campbell County, Tennessee, in the docket file, the panel also received comments from members of the public in attendance during the hearing. Mr. and Mrs. Mark and Michele Fehring, the owners of a commercial rental home in Lakeside Estates of Campbell County, Tennessee, appeared personally during the hearing and provided comment in opposition to the rate increase requested in the *Petition.* In summary, the Fehring's stated that they rented out their house in Lakeside Estates of Campbell County, Tennessee, only a few months during the summer and have little to no wastewater flow during other times of the year. As a result, they asserted that they should be treated no differently than a residential homeowner who lives in the home year-round, and that a higher monthly charge is not warranted because the house is vacant for several months of the year.

In response, Mr. Hodge explained the operational functioning of the biological wastewater system and asserted that the system must accommodate a peak flow of the system, taking into account the large rental units with up to ten (10) bedrooms on the system. He described the stress placed on the system when it has to ramp up from a low flow during the off-season to the maximum flow during the rental season. According to Mr. Hodge, the dramatic change or shift in flow contributes to early wear and tear on various components of the system. In addition, proper functioning of the wastewater treatment system depends on a certain level of biologic particulate matter, which must be carefully monitored during the rental season to avoid a failure of the system.

Upon conclusion of the hearing and public comment, the panel unanimously voted to take the matter under advisement and to reschedule the docket for deliberations during the next scheduled Authority Conference. Thereafter, during a regularly scheduled Authority Conference held on January 23, 2012, the voting panel assigned to the docket deliberated the merits of the *Petition* and voted unanimously to approve DSH's request for a rate increase.

III. 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.[14] The Authority must also approve rates that provide regulated utilities the opportunity to earn a just and reasonable return on their investments.[15]

The TRA is not bound to follow rate-making methodology that it has employed in the past.[16] 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."[17] The TRA is not to be "hamstrung by the naked record" and can consider all relevant circumstances shown by the record, all recognized 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.[18]

The Authority considers a petition for a rate increase filed pursuant to Tenn. Code Ann. § 65-5-103 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

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[14] Tenn. Code Ann. § 65-5-101 (Supp. 2011).
[15] *See Bluefield Water Works and Improvement Company v. Public Service Comm'n of West Virginia*, 262 U.S. 679 (1923).
[16] *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).
[17] Tenn. Code Ann. §4-5-314.
[18] *Tennessee American*, 2011 WL 334678, at *26.

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 using different test periods altogether.[19] 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.[20]

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 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.[21]

In addition, the United States Supreme Court has determined that regulated firms are entitled to a return that is "just and reasonable."[22] 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."[23]

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

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[19] *Tennessee American*, 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).
[20] *Tennessee American*, 2011 WL 334678 at *3.
[21] *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).
[22] *Federal Power Comm'n v. Hope Natural Gas Co.* 320 U.S. 591, 605 (1944).
[23] *Id.*

commensurate with returns investors could achieve by investing in other enterprises of corresponding risk.[24] The utility's fair rate of return is the minimum return investors expect, or require, in order to make an investment in the utility.[25] 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.[26]

Applying these criteria, and upon consideration of the entire record, including all exhibits, testimony, and the comments offered by members of the public, the panel makes the following findings and conclusions.

IV. TEST PERIOD AND ATTRITION PERIOD

The role of the TRA in determining a just and reasonable rate of return for a utility requires, in part, forecasting what the utility's operating expenses will be in the near future. Establishing a "test period," or "test year," allows the Authority to measure a utility's financial operations and investments over a specific twelve-month period. The Authority typically selects a test period consisting of a recent twelve-month historical period that is then adjusted for certain known changes, normalizing adjustments, and other necessary ratemaking adjustments. The adjusted historical test period forms the basis for developing an attrition year.

The attrition year is the projection of a utility's earnings for the period of time which the new rates will be in effect. The attrition period consists of a twelve-month period in the future upon which the utility's operations are forecasted based upon its historical results, trends, and any changes that can reasonably be expected to occur through the end of the attrition period. The results of the attrition period are used to determine the revenue (i.e., rates) necessary to allow the utility an opportunity to earn a fair return. In setting rates, Tennessee courts have acknowledged

[24] *Id.* at 603.
[25] *Id.*
[26] *Id.*

that the TRA has discretion to choose a historical test period, forecast period, a combination of the two, or any other accepted ratemaking methodology.[27]

As DSH is a new owner of the system, the availability of historical information and past financial results is limited. Therefore, the Authority finds that the available 2011 data is the appropriate starting point and represents the most accurate test period results. In addition, DSH provided earnings projections for years 2012, 2013, 2014 and 2015. Often, a twelve-month attrition period is used to forecast operations. Nevertheless, in this case, the data for 2012 and 2013 appears relatively predictable, and the Authority finds an average of these years appropriate as the attrition period on which to set rates. While an average is not its preferred methodology, the Authority has broad discretion in choosing the test and attrition periods that most effectively accomplish its goal of establishing rates based on the periods that best reflect the anticipated operations of the utility. Therefore, the Authority finds that the results of 2011, although estimated in part, reflect the best data available for use as the test period and, further, that a two-year average of forecasted years 2012 and 2013 is the best data available on which to establish rates.

V. REVENUES

In its *Petition,* the Company forecasted overall attrition period revenues at its current rates of \$19,729 in 2012, and \$21,663 in 2013, to arrive at average annual revenue in the amount of \$20,696.[28] These numbers included revenues derived from monthly residential charges, monthly commercial overnight rental charges, returned check fees, late fees, disconnection and reconnection fees. The average revenues at current rates for the attrition period are broken down as follows:

[27] *American Association of Retired Persons v. Tennessee Public Service Comm'n*, 896 S.W. 2d. 127, 133 (1994).
[28] *Revised Petition,* Exhibit 1-A Revised Pages (November 4, 2011).

	Attrition Period Revenues Using Current Rates 2012/2013 Average
Residential Revenues:	$ 2,288.00
Commercial Overnight Rental Revenues:	18,305.50
Access Fees:	0.00
Miscellaneous Fees:	102.50
Total Revenues:	$ 20,696.00

V(A). RESIDENTIAL REVENUE

Based on its current rates, the Company forecasted residential revenues to be $1,961 and $2,615 for 2012 and 2013, respectively. The Company multiplied the current number of residential customers and adjusted, for known growth, the current monthly rate of $54.48 over an annual period. The Company forecasted residential growth of one customer in 2013.[29] The result of averaging these two years is an attrition period revenue of $2,288. The Authority has reviewed the current number of customers and accepts DSH's forecast of one new customer.

V(B). COMMERCIAL OVERNIGHT RENTAL REVENUE

Using current rates, DSH forecasted commercial overnight rental revenues of $17,652 and $18,959 for 2012 and for 2013, respectively. The Company multiplied its approved rate of $54.48 by the actual and known additions of customers.[30] The Authority has reviewed the current number of customers and accepts the Company's forecast of an average of 3 new customers.

V(C). ACCESS FEES

Upon taking ownership of the wastewater system, the Company adopted LUB's rates, which did not include an access fee. Therefore, DSH forecasted $0 at current rates for Access Fees in the attrition period.[31] The Authority finds this forecast to be reasonable.

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[29] *Id.*
[30] *Id.*
[31] *Id.*

V(D). MISCELLANEOUS FEES

Using current rates, the Company forecasted Miscellaneous Fees of $116 in 2012, and $89 in 2013. These results are based on an average annual forecast of 1.5 Returned Check Fees at $25.00 each, 1.5 Late Fees and Back Payments at $2.00 (approximately 5% of rate), one (1) Disconnection Fee at $40 each, and one (1) Reconnection Fee at $35 each.[32] The Authority finds these amounts accurate and reasonable.

Based on the information contained in the *Petition,* as noted herein above, and the record as a whole, the Authority concludes that the Company's forecast of $20,696 for attrition period revenues is reasonable and appropriate.

VI. ESCROW

Escrow is a means by which ratepayers can prepay the costs of non-routine system maintenance and minimize future financial impact of such maintenance on the rate payer and the utility. In its *Petition,* DSH proposed that 23% of its customer rates be placed into an escrow account for non-routine maintenance such as replacing pumps, alarm systems, and tank pumping.[33] The Company will escrow a minimum of $15.95 for commercial customers with escalating rates based on usage, and approximately $10.24 for residential customers.[34]

The Authority finds that the proposed escrow rates are consistent with other similarly situated wastewater companies and are necessary to protect the ratepayers. Although the Company has demonstrated that it is financially capable of operating the wastewater system, this does not presuppose that the Company will be able to obtain a loan to perform necessary non-routine maintenance. Therefore, the Authority finds that an escrow account is warranted to (1) ensure that some funds are available when major system replacements are necessary, and (2) lessens the impact

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[32] *Id.*

[33] *Amendment to Petition*, Revised Tariff Pages, TRA No. 1, Section 3, Rev. Page 2 (November 29, 2011).

[34] *Amendment to Petition*, Revised Tariff Pages, TRA No. 1, Sections 3 & 4, Rev. Page 2 (November 29, 2011).

of such maintenance on ratepayers. Further, utilization of an escrow account helps to ensure that viable, affordable, wastewater service is maintained consistent with TRA rules.

The Authority concludes that DSH should establish a separate escrow bank account for non-routine maintenance of the wastewater system, and that utility employees with signature authority on the escrow account shall obtain a fidelity bond. Further, the Authority requires that DSH file monthly the escrow bank account statement with its Annual Report on April 1 of each year for review and determination of the adequacy of the escrow under current market conditions by the Authority Utilities Division.

VII. <u>EXPENSES</u>

VII(A). MAINTENANCE OPERATOR EXPENSE

The Company projected Maintenance Operator Expense in the amount of $6,256 and $6,857 in 2012 and 2013, respectively, for an average annual Maintenance Operator Expense in the amount of $6,557.[35] This expense is based on the maintenance operator contract filed in this docket at $55 per labor hour, $35 per hour for equipment, and cost plus 5% fee on all materials and supplies.[36] As a result of its discussions with the previous manager of the Utility and with the new Maintenance Operator, DSH estimates this cost will be $500 per month. The Authority finds the amounts Maintenance Operator Expense reasonable because the maintenance is outsourced to a certified operator at what appear to be reasonable or customary hourly rates for equipment and labor. Therefore, the Authority approves and adopts the projected Maintenance Operator Expense amounts utilized by DSH.

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[35] *Revised Petition*, Exhibit 1-A Revised Pages (November 4, 2011).
[36] *Response to Data Request Dated 10/26/11*, Attachment B (November 4, 2011).

VII(B). ACCOUNTING EXPENSE

The Company forecasted an average annual Accounting Expense in the amount of $1,200.[37] The Company calculated its Accounting Expense using the hourly fee multiplied by approximately two (2) labor hours per month. The Authority finds that the labor hour rate is reasonable and is based the contractual rate charged to DSH by its accountant and, therefore, adopts Accounting Expense in the amount of $1,200.

VII(C). TAX EXPENSE

The Company forecasted Tax Expense in the amount of $691 and $760 in 2012 and 2013, respectively, for an average annual Tax Expense in the amount of $726. DSH demonstrated that the calculation included franchise, excise, and federal taxes.[38] The Authority finds that the expense calculation is accurate and reasonable, and therefore, approves Tax Expense in the amount of $1,103.

VII(D). PLANT OPERATOR EXPENSE

The Company forecasted an average annual Plant Operator Expense in the amount of $5,196.[39] This amount was calculated using the contract rate executed between Environmental Management Group and the Company of $433 per month to operate and maintain the plant in accordance with State, County, and local regulations. The rate includes the performance of on-site inspections, testing and reporting for regulatory requirements, and supervision of sludge removal expense.[40] Upon finding that the contracted rate is reasonable and comparable to other wastewater companies, the Authority adopts $5,196 for Plant Operator Expense.

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[37] *Revised Petition*, Exhibit 1-A Revised Pages (November 4, 2011).
[38] *Id.*
[39] *Revised Petition*, Exhibit 1-A Revised Pages (November 4, 2011).
[40] *Response to Data Request Dated 10/26/11*, Attachment B (November 4, 2011).

VII(E). PERFORMANCE BOND EXPENSE

The Company forecasted an average annual Performance Bond Expense in the amount of $1,280.[41] This amount was calculated using an annual premium of $1,080 and a collateral handling fee of $200, as reflected in correspondence from the bonding insurance agency to DSH.[42] The Company included this expense in its *Petition* calculations, but as Performance Bond Expense is properly collected as a pass-through charge separate from customer monthly rates, the Authority approves the expense as a separate flow-through charge to customers.

VII(F). INSURANCE EXPENSE

DSH forecasted an average Insurance Expense in the amount of $3,319. This calculation was based on the actual cost of insurance provided to DSH by P&C Risk Services, LLC.[43] As the record includes the actual invoice from the insurance company and the amount appears to be reasonable, the Authority approves and adopts Insurance Expense in the amount of $3,319.

VII(G). TDEC PERMIT EXPENSE

The Tennessee Department of Environment and Conservation ("TDEC"), Division of Water Pollution Control, Water Quality Control Board, requires payment of a Permit Annual Maintenance Fee in the amount of $2,770 annually.[44] While this amount was not included in DSH's original forecast of expenses, it is a known expense that will be incurred annually by DSH. The Authority finds that the TDEC Permit Annual Maintenance Fee must be paid annually, and, therefore, adopts a TDEC Permit Expense in the amount of $2,770.

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[41] *Revised Petition*, Exhibit 1-A Revised Pages (November 4, 2011).
[42] *Response to Data Request Dated 10/26/11*, Attachment 2 (November 4, 2011).
[43] *Id.*
[44] Tenn. R. & Regs. 1200-04-11-.02(c)(10)(ii) (2009); *see also In Re*: *Petition of DSH & Associates, LLC to Obtain a CCN for the Service of the Part of Campbell County, Tennessee, known as Lakeside Estates*, Docket No. 11-00020, Attachment 5, Lakeview Estates TDEC Permit (SOP 07073), pg. 50 (reflecting that the design capacity of the system is .123MGD) (June 28, 2011).

VII(H). TELEPHONE EXPENSE

The Company projected an average annual Telephone Expense in the amount of $1,320.[45] Upon consideration of the tariff rates of AT&T Tennessee for two (2) business lines, the amount calculated by DSH appears accurate and reasonable. Therefore, the Authority approves and adopts Telephone Expense in the amount of $1,320.

VII(I). MANAGEMENT EXPENSE

The Company projected Management Expense in the amounts of $1,728 and $1,900 in 2012 and 2013, respectively, to arrive at an average annual Management Expense in the amount of $1,815.[46] This calculation is based on the number of homes serviced (30 in 2012, and 33 in 2013) multiplied by the number of work hours anticipated to be performed by management each month, 2.0 hours (local management work performed) and 2.8 hours (corporate management work performed), or a total of 4.8 hours, at a billing rate of $35/hour. The expense will be billed according to signed weekly timesheets identifying the project name, number of hours, daily hourly rate and weekly cost.[47] The Authority finds reasonable the number of hours and types of work anticipated to be performed by utility management and the hourly billing rate. Therefore, the Authority approves the expense and adopts an average annual Management Expense in the amount of $1,815.

VII(J). TRA INSPECTION FEE EXPENSE

The Company projected an average Inspection Fee Expense in the amount of $250 annually. DSH asserted that this amount was estimated based on the TRA's published rates.[48] According to the Authority's calculations, the amount of the TRA Inspection Fee Expense is estimated to be

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[45] *Revised Petition,* Exhibit 1-A Revised Pages (November 4, 2011).
[46] *Revised Petition,* Exhibit 1-A Revised Pages (November 4, 2011).
[47] *Response to Data Request Dated 10/26/11*, No. 14, p. 6 of 14 (November 4, 2011).
[48] *Revised Petition,* Exhibit 1-A Revised Pages (November 4, 2011).

$53.00. Nevertheless, under Tenn. Code Ann. § 65-4-304, the minimum inspection fee required to be paid shall not be less than $100.[49] Therefore, the Authority approves $100 for allocation to the TRA Inspection Fee Expense.

VII(K). ELECTRIC EXPENSE

DSH forecasted an Electric Expense of $554 and $580 in 2012 and 2013, respectively, to arrive at an average annual Electric Expense of $567. This calculation is derived from the current electric rates charged by LaFollette Utilities and multiplied by the anticipated kilowatt hours (KWH) needed to operate the system.[50] In support of its costs, the Company filed copies of past invoices that have been paid to maintain the wastewater system.[51] Finding the estimated expense just and reasonable, the Authority approves and adopts $567 in Electric Expense.

VII(L). BILLING EXPENSE

The Company forecasted Billing Expense in the amount of $1,404 and $1,527 in 2012 and 2013, respectively, for an average annual Billing Expense in the amount of $1,466.[52] The Company's calculation includes printing, postage, paper, and hourly labor rates, based on past hourly rates and its experience on similar projects.[53] The Authority finds the amount to be reasonable and therefore adopts $1,466 for Billing Expense.

VII(M). PROPERTY TAX

DSH forecasted Property Tax in the amount of $2,113 based on information that it received from the developer's attorney.[54] In considering the property tax rate in Campbell County,

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[49] Tenn. Code Ann. §65-4-304 (2004).
[50] *Revised Petition*, Exhibit 1-A Revised Pages (November 4, 2011).
[51] *Response to Data Request Dated 10/26/11*, Attachment 3 (November 4, 2011).
[52] *Revised Petition,* Exhibit 1-A Revised Pages (November 4, 2011).
[53] *Response to Data Request Dated 10/26/11*, Attachment 3 (November 4, 2011).
[54] Emails from Doug Hodge of DSH & Associates, LLC (December 29, 2011) (providing property tax in the amount of $2,113).

Tennessee, in conjunction with the 25.3 acres deeded to DSH for the wastewater system,[55] the Authority finds $2,113 to be a reasonable estimate in this category. Therefore, the Authority approves and adopts Property Tax in the amount of $2,113.

VIII. Rate Base and Net Operating Income

DSH did not pay a purchase price for the wastewater system when it was transferred from LUB. As such, there is no established rate base for the Company. Accordingly, it is not appropriate to utilize standard rate of return ratemaking principles in order to determine a fair and reasonable return on earnings for the Company. As the Authority has done in other similar circumstances,[56] establishing a return on margin, i.e., an allowable return on a utility's operating margin (revenues minus expenses and taxes), is an acceptable method of establishing a fair return for a utility. Using this methodology, the utility recovers its expenses and earns a reasonable profit for its investors/owners.

The Authority notes that DSH is a new operation, which originated in response to the distressed utility operations of the wastewater system's previous provider. Similarly, as revenue generated from commercial overnight rentals are usage sensitive, economic downturns that result in decreased travel could adversely impact DSH's overall operating revenues. The potential for the occurrence of such a situation creates a degree of uncertainty as to DSH's financial projections. In cases of other wastewater utilities, the TRA has awarded operating margins of or exceeding 6.5%. Therefore, to ensure sufficiency of revenues, the Authority finds an operating margin of 6.5% for DSH is just and reasonable.

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[55] *See In re: Petition of DSH & Associates, LLC, to Obtain a CCN for the Service of the Part of Campbell County, Tennessee Known as Lakeside Estates,* Docket No. 11-00020, Financial Requirements, p. 23 (June 28, 2011).

[56] *See In re: Petition of Tennessee Wastewater Systems, Inc., for Approval to Amend Its Rates and Charges,* Docket No. 08-00202, *Order Approving Revised Settlement Agreement* (July 8, 2009) (the Authority approved the settlement agreement of the parties that included an operating margin of 6.5% for Tennessee Wastewater Systems).

As demonstrated in its *Petition*, DSH's annual revenue deficiency using its current rates is anticipated to be $14,080 annually (negative 52.83% margin) during the attrition period. DSH has proposed an increase in rates in the amount of $11,944 annually (the average of 2012 and 2013). In order to generate a 6.5% margin, the Company will need to increase overall revenues by $19,895. Accordingly, the Company will be operating at a slight loss even with its requested rate increase. Nevertheless, the Company has provided information demonstrating that additional residential and rental homes are planned to be built after 2013 and that the additional revenues generated from these homes should enable DSH to make a reasonable profit. In the event that these additional customers do not materialize, the Company may seek additional relief by filing an appropriate and timely petition with the Authority. Therefore, the Authority finds the revenue increase proposed by DSH, to be just and reasonable, and approves an increase in rates in the amount of $11,944 annually.

IX. RATE DESIGN

In order to generate an additional $11,944 in annual revenues, DSH requested that residential rates be reduced and that the Authority establish a separate rate class for commercial customers (overnight rentals) with increased rates.

IX(A). RESIDENTIAL RATES

DSH proposed a reduction to residential rates from $54.48 to $44.53 per month. This monthly customer charge includes a base rate of $30.73, bonding charge of $3.56, and an escrow for non-routine maintenance expenses of approximately 23% of the total rate. This residential rate aligns DSH's residential rates with the current rates of other Authority regulated wastewater utilities.[57] Therefore, the Authority approves a $44.53 monthly rate for residential customers.

[57] For purposes of comparison, Tennessee Wastewater Systems, Inc.'s rate for a residential customer on a standard fixed film wastewater system is $44.53, and Integrated Resource Management charges $35.11 for a customer on the same type of wastewater system. *See In re Petition of Tennessee Wastewater, Inc. for Approval to Amend Its Rates*

IX(B). COMMERCIAL RATES

Under the current rate structure, commercial customers of DSH are charged a flat fee of $54.48 monthly. Most of the houses in Lakeside Estates are owned by investors who live out of state and rent out their houses during part of the year.[58] For this reason, DSH's petition proposed a new commercial class for overnight rental units with a higher monthly charge and volumetric rates based on the average daily flow. The home owners who provided comment during the hearing stated that they rent their house for only a few months during the summer and have little to no flow during the remainder of the year. Those home owners are of the opinion that based on that scenario they should be treated no differently than residential home owners who live there year round, and a higher monthly charge is not warranted for months the house is vacant.

During the hearing, Mr. Hodge explained the way in which the biological wastewater system operates, and further noted that the system must be built to accommodate the peak flow from the large rental units with up to ten (10) bedrooms. He further described the stress that is placed on the system when it has to ramp up from a low flow during the off season to the maximum flow during the rental season. Mr. Hodge asserted that this dramatic change contributes to the early wear and tear on various components of the system. In addition, the proper functioning of the wastewater treatment depends on a certain level of biologic particulate matter that has to be carefully monitored during the rental season to avoid failure of the system.[59]

In determining its requested rate, the Company considered the historical monthly flow rates for the rental homes and correlated those flow rates to monthly proposed billing rates to arrive at an

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and Charges, Docket No. 08-00202; *see also In re Petition of IRM Utility, Inc. to Amend Certificate of Convenience and Necessity,* Docket No. 04-00101.

[58] Lakeside Estates has twenty-three (23) commercial customers predominantly made up of large overnight rental units, compared with only three (3) residential customers.

[59] Transcript of Authority Conference, pp. 87-88 (January 9, 2012).

average monthly rate of $90.83.[60] Next, the average commercial rate was multiplied by the number of customers to calculate its proposed revenues. Commercial overnight rental units (currently includes houses with 4-10 bedrooms that are used as rental property) will be charged a minimum of $69.53 per month for the first 300 gallons of flow per day. For each additional 100 gallons per day of average daily flow, up to 1,000 gallons per day, an additional charge of $15.00 per month per 100 gallons will be charged. For average daily flows over 1,000 gallons per day, an additional monthly charge of $157.95 per 1,000 gallons will be applied. The monthly rate includes a bonding charge of $3.56, and an escrow for non-routine maintenance of approximately 23% of the total rate.

In the past, the Authority has approved a similar type of rate structure for overnight rental properties requested by another regulated wastewater utility, Tennessee Wastewater Systems, Inc., in Docket No. 06-00259.[61] In that docket, the Authority found that the creation of a separate commercial class for overnight rental properties is reasonable in light of their unique characteristics. Flow rates and size are prime examples of the differences between a commercial overnight rental customer and a residential customer. During the busy rental months, commercial overnight rental properties might use double or more of the flow than a residential customer uses based on the size of the house.

The Authority finds that an overnight rental tariff is needed to provide the funds required to maintain the system year round, and appropriately places higher rates on those customers that are more expensive to serve. Therefore, the Authority approves the creation of a separate commercial class for overnight rental units with a higher monthly charge and volumetric rates based on the average daily flow as proposed by DSH.

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[60] *Response to Data Request Dated 10/26/11*, No. 7 (November 4, 2011).

[61] See *In re: Petition of Tennessee Wastewater Systems, Inc. to Reclassify Specific Resort Areas in Sevier County from Residential to Commercial,* Docket No. 06-00259, *Order Granting Reclassification of Properties and Approving Revised Tariff* (January 25, 2008).

IX(C). ACCESS SEWER FEE

In its *Petition,* the Company proposed the implementation of a sewer system access fee in the amount of $120.00 per year for lot owners not connected to the system.[62] This fee pays for the maintenance of the lines in the streets and the treatment plant components. The rationale for this charge is that even if a lot owner has not built his/her home, wastewater facilities have already been built to serve the customer. Although not currently used by the customer, the utility must provide continued maintenance and conduct certain tests and maintain records to meet state requirements. The sewer system access fee is intended to offset these costs and is identical to a similar charge approved by the Authority for TWS. Therefore, the Authority finds this fee reasonable and approves a sewer system access fee in the amount of $120.00.

IX(D). MISCELLANEOUS FEES

The Company proposed that the total of the disconnection and reconnection fees be increased from $75 to $90. Miscellaneous fees such as late fees and back payments, returned check fees, disconnection fees, and reconnection fees are intended to encourage customers to behave responsibly and timely pay for the services that they receive. Therefore, the Authority finds the request reasonable and approves an increase in the total of the combined disconnection and reconnection fees to $90.

IT IS THEREFORE ORDERED THAT:

1. The rates filed by DSH & Associates, LLC, on September 16, 2011, later revised on November 4, 2011, and as amended on November 29, 2011, are approved.

2. For purposes of the rates herein, the test period shall consist of the actual, and partially estimated, financial results of the twelve months ended December 31, 2011.

3. The forward looking attrition period shall be a two-year average of the forecasted

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[62] *Original Petition* (September 16, 2011).

years ending December 31, 2012 and 2013.

4. For purposes of the rates herein, the revenue forecast is $20,696 and the net operating income is ($14,080) at current rates.

5. For purposes of the rates herein, the fair return on margin is set at 6.5%.

6. DSH & Associates, LLC, shall remedy its revenue deficiency by implementing new rates that reflect a decrease in monthly residential rates from $54.48 to $44.53, and to establish a commercial rate class for overnight rental units at $69.53/monthly up to 300 gallons of flow per day with an increasing volumetric rate of an additional $15.00/monthly for each additional 100 gallons of average daily flow up to 1000 gallons, and an additional 157.95/monthly for average daily flows over 1000 gallons per day.

7. DSH & Associates, LLC, shall implement a sewer system access fee in the amount of $120.00 per year for lot owners that have not yet connected to the system as a means of offsetting system maintenance costs.

8. DSH & Associates, LLC, shall increase its total combined disconnection and reconnection fees to $90.

9. DSH & Associates, LLC, is directed to establish an escrow account for deposit of the portion of its rates (23%) designated to be held in escrow for non-routine maintenance of the wastewater system.

10. DSH & Associates, LLC, shall file and maintain proof that a fidelity bond has been obtained as to all employees with signature authority on the escrow account established in accordance with ordering clause number 9 above.

11. DSH & Associates, LLC, shall file all monthly escrow account statements each year with its Annual Report on April 1 for review and determination of the adequacy of the escrow under current market conditions.

12. DSH & Associates, LLC, is directed to file tariffs with the Authority that are consistent with this Order.

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

14. Any party aggrieved by the Authority's 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 from the date of this Order.

Kenneth C. Hill, Chairman

Sara Kyle, Director

Mary W. Freeman, Director