

**BEFORE  
THE TENNESSEE REGULATORY AUTHORITY**

Petition Of Laurel Hills Condominiums )  
Property Owners Association for a )  
Certificate of Public Convenience and )  
Necessity )  
)  
)  
)  
)

\*filed electronically in the  
docket office on 12/13/12

Docket No. 12-00030

**DIRECT TESTIMONY**  
of  
**WILLIAM H. NOVAK**

ON BEHALF OF  
THE CONSUMER ADVOCATE AND PROTECTION DIVISION  
OF THE  
TENNESSEE ATTORNEY GENERAL'S OFFICE

*December 13, 2012*

IN THE TENNESSEE REGULATORY AUTHORITY  
AT NASHVILLE, TENNESSEE

IN RE: )  
PETITION OF LAUREL HILLS )  
CONDOMINIUMS PROPERTY OWNERS )  
ASSOCIATION FOR A CERTIFICATE )  
OF PUBLIC CONVENIENCE AND )  
NECESSITY )

DOCKET NO. 12-00030

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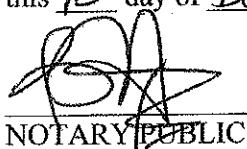
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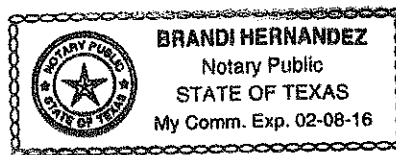
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I, William H. Novak, CPA, on behalf of the Consumer Advocate Division of the Attorney General's Office, hereby certify that the attached Direct Testimony represents my opinion in the above-referenced case and the opinion of the Consumer Advocate Division.

  
WILLIAM H. NOVAK

Sworn to and subscribed before me  
this 10<sup>th</sup> day of Dec, 2012.

  
NOTARY PUBLIC



My commission expires: 02/08/16

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## ATTACHMENTS

Attachment WHN-1  
Attachment WHN-2

William H. Novak Vitae  
Supporting Workpapers.

1 ***Q1. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND***  
2 ***OCCUPATION FOR THE RECORD.***

3 A1. My name is William H. Novak. My business address is 19 Morning Arbor Place,  
4 The Woodlands, TX, 77381. I am the President of WHN Consulting, a utility  
5 consulting and expert witness services company.<sup>1</sup>  
6

7 ***Q2. PLEASE PROVIDE A SUMMARY OF YOUR BACKGROUND AND***  
8 ***PROFESSIONAL EXPERIENCE.***

9 A2. A detailed description of my educational and professional background is provided  
10 in Attachment WHN-1 to my testimony. Briefly, I have both a Bachelors degree  
11 in Business Administration with a major in Accounting, and a Masters degree in  
12 Business Administration from Middle Tennessee State University. I am a  
13 Certified Management Accountant, and am also licensed to practice as a Certified  
14 Public Accountant.  
15

16 My work experience has centered on regulated utilities for over 30 years. Before  
17 establishing WHN Consulting, I was Chief of the Energy & Water Division of the  
18 Tennessee Regulatory Authority where I had either presented testimony or  
19 advised the Authority on a host of regulatory issues for over 19 years. In  
20 addition, I was previously the Director of Rates & Regulatory Analysis for two  
21 years with Atlanta Gas Light Company, a natural gas distribution utility with  
22 operations in Georgia and Tennessee. I also served for two years as the Vice  
23 President of Regulatory Compliance for Sequent Energy Management, a natural

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<sup>1</sup> State of Tennessee, Registered Accounting Firm ID 3682.

1 gas trading and optimization entity in Texas, where I was responsible for ensuring  
2 the firm's compliance with state and federal regulatory requirements.

3  
4 **Q3. ON WHOSE BEHALF ARE YOU TESTIFYING?**

5 A3. I am testifying on behalf of the Consumer Advocate & Protection Division  
6 ("CAPD" or "the Consumer Advocate") of the Tennessee Attorney General's  
7 Office.

8  
9 **Q4. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**  
10 **PROCEEDING?**

11 A4. My testimony will support and address the CAPD's positions and concerns with  
12 respect to the Petition of Laurel Hills Condominiums Property Owners  
13 Association ("Laurel Hills" or "the Company"). Specifically, I will address the  
14 following:

- 15 i. CAPD's recommendation on issuing a CCN;  
16 ii. CAPD's proposed cost of service;  
17 iii. CAPD's proposed rates to recover the Company's cost of service; and  
18 iv. Other CAPD recommendations for this case.

19  
20 **Q5. WHAT DOCUMENTS HAVE YOU REVIEWED IN PREPARATION OF**  
21 **YOUR TESTIMONY?**

22 A5. I have reviewed both the Company's original and amended petitions respectively  
23 filed on April 10, 2012 and August 3, 2012, along with the exhibits presented

1 with their filing. In addition, I have reviewed both the Company's and  
2 intervenor's testimony. Finally, I have also reviewed the party's responses to the  
3 data requests submitted by the TRA as well as the CAPD's discovery.  
4

5 **I. CAPD'S RECOMMENDATION ON ISSUING A CCN**  
6

7 ***Q6. WHAT RELIEF HAS LAUREL HILLS ASKED OF THE TRA?***

8 A6. In its Amended Petition, Laurel Hills asks the TRA for a Certificate of Public  
9 Convenience and Necessity ("CCN") to operate what it refers to as the Renegade  
10 Mountain Water System ("the Water System") in addition to approval of a  
11 residential rate of \$134.26 per month.  
12

13 ***Q7. HAS LAUREL HILLS DEMONSTRATED THAT IT POSSESSES THE***  
14 ***FINANCIAL, MANAGERIAL AND TECHNICAL EXPERTISE***  
15 ***NECESSARY TO BE GRANTED A CCN?***

16 A7. Not at this point. Furthermore, although I am not a lawyer and am not offering a  
17 legal opinion, it appears that there are significant issues related to the  
18 management and ownership of the Water System that must be answered by a  
19 court of law before a decision on a CCN can be rendered. Nevertheless, the  
20 Water System is currently providing service and therefore must have rates  
21 approved that will cover their anticipated costs.  
22

1    **II.    CAPD'S PROPOSED COST OF SERVICE**

2  
3    ***Q8.    HAVE YOU REVIEWED THE COMPANY'S CALCULATIONS***  
4    ***SUPPORTING THEIR RATE PROPOSAL OF \$134.26 PER MONTH?***

5    A8.    Yes. The basis for the Company's rate proposal is their estimated monthly budget  
6    included as Exhibit 10 to their Amended Petition and totaling \$18,125. When this  
7    amount is divided by the 135 Water System customers<sup>2</sup> it produces the monthly  
8    rate of \$134.26 proposed by Laurel Hills.

9  
10   ***Q9.    WHAT TEST PERIOD DID LAUREL HILLS USE IN DEVELOPING ITS***  
11   ***PROPOSED BUDGET?***

12   A9.    The Company has not used a test period, but instead developed a budget around  
13   their average monthly anticipated expenditure. Traditionally, the TRA examines  
14   utility costs over a twelve month time period or test year. However in this case,  
15   the Company only had financial data available from May 2011. Therefore,  
16   selecting a representative test period is simply not feasible, and the development  
17   of an average monthly budget is probably the best alternative.

18  
19   ***Q10.   DO YOU AGREE WITH THE COMPANY'S PROPOSED RATE***  
20   ***CALCULATION OF \$134.26 PER MONTH BASED ON ITS AVERAGE***  
21   ***MONTHLY BUDGET?***

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<sup>2</sup> According to the Company's response to CAPD Data Request, Item 26 the monthly customer count has been reduced from 135 to 120.

1 A10. No. My own calculations show that a monthly rate of \$30.61 will be sufficient to  
2 cover the anticipated operating costs of the Water System until the remaining  
3 legal questions regarding its ownership and operation can be answered. However,  
4 this proposed monthly rate of \$30.61 only provides sufficient funding for current  
5 anticipated operating costs. It does not provide any funding for replacement or  
6 expansion of the Water System plant.  
7

8 ***Q11. HOW DID YOU CALCULATE YOUR PROPOSED MONTHLY RATE OF***  
9 ***\$30.61?***

10 A11. I began with the Company's monthly budget that it included as Exhibit 10 to its  
11 Petition. Next I analyzed each component of this budget based on the Company's  
12 response to TRA Data Request 1, Item 1. I have included the detailed workpapers  
13 from this analysis in Attachment WHN-2, and summarized the results below in  
14 Table 1.



**LAUREL HILLS WATER COMPANY**

**TABLE 1 - CAPD ANALYSIS OF PRO FORMA COST OF SERVICE**

TABLE 1 - CAPD REVIEWER'S PRO FORMA COST OF SERVICE				Company Monthly Pro Forma	CAPD Monthly Pro Forma	
Item	Expense Type					
	<b>O&amp;M Expenses:</b>					
1	Engineering & Labor			\$2,500	\$333	
2	Construction Contracts			1,400	0	
3	Water Testing			600	600	
4	Depreciation			500	88	
5	Real Estate Tax			200	0	
6	Telephone			125	61	
7	Permits & Penalties			1,200	25	
8	Interest Expense			1,900	0	
9	Legal Expense			2,500	0	
10	Accounting & Management Services			1,550	300	
11	Office Expenses			200	20	
12	Insurance Expense			700	433	
13	Postage Expense			50	8	
14	Equipment Rental Expense			150	8	
15	Maintenance & Repair Expense			2,000	0	
16	Wholesale Water Expense			1,750	1,671	
17	Electricity Expense			800	467	
18	<b>Total Monthly O&amp;M Amount</b>			<b>\$18,125</b>	<b>\$4,014</b>	
19	<b>Total Annual O&amp;M Amount</b>			<b>\$217,500</b>	<b>\$48,168</b>	
	<b>Rate Base:</b>					
20	Plant in Service				\$15,757	
21	Accumulated Depreciation				-525	
22	Working Capital (1/8 of O&M Expenses)				6,021	
23	<b>Total Rate Base</b>				<b>\$21,253</b>	
24	Hypothetical Rate of Return				6.668%	
25	<b>Return on Invested Capital</b>				<b>\$1,417</b>	
26	<b>Total Cost of Service</b>				<b>\$49,585</b>	
				<b>Monthly Bills</b>	<b>Annual Bills</b>	<b>Resulting Rate</b>
27	Projected Units/Rates Based on MCCLung Testimony			135	1,620	\$30.61
28	Projected Units/Rates Based on CAPD DR #26			120	1,440	\$34.43

1 ***Q12. PLEASE EXPLAIN HOW YOU CALCULATED EACH COMPONENT OF***  
2 ***YOUR PROPOSED MONTHLY BUDGET.***

3 A12. **Line 1 – Engineering & Labor \$333.** This item represents the amount that the  
4 Company expects to pay for engineering services. The Company proposed a  
5 monthly budget amount of \$2,500 (\$30,000 annually). However most of this  
6 amount (\$26,000) relates to the payment for work previously performed for the  
7 Company's pump replacements and is not an indication of a going level amount  
8 for determining rates. Although the Company did not indicate exactly how they  
9 derived their monthly budgeted amount of \$2,500, they do say that they "added an  
10 additional amount to cover anticipated engineering services [they] will incur in  
11 the projected year of operations."<sup>3</sup> Therefore, the CAPD proposes to only include  
12 \$4,000 (\$30,000 - \$26,000) or \$333 per month as the going level amount for  
13 Engineering & Labor.

14 **Line 2 – Construction Contracts \$0.** According to the Company, this item  
15 represents the anticipated cost of installing valve boxes at each customer  
16 connection so that service can be shut off for nonpayment. The Company has  
17 budgeted \$1,400 per month for its affiliate leasing company to install these valve  
18 boxes. However, although I am not a lawyer and am not offering a legal opinion,  
19 it seems unclear which entity owns the Water System, so including an amount for  
20 the installation of valve boxes would be inappropriate.<sup>4</sup> Therefore, the CAPD has  
21 included \$0 in its going level amount for Construction Contracts.

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<sup>3</sup> Company response to TRA Data Request 1, Item 1.

<sup>4</sup> In addition, this type of expenditure would normally be capitalized and depreciated over its useful life.

1        **Line 3 – Water Testing \$600.** This item includes the monthly charge of the  
2        Company's certified operator. An analysis of the Company's response to TRA  
3        Data Request 1, Item 1 reveals that the Company's pays a certified operator \$500  
4        per month for water testing. The remaining \$100 per month includes the cost of  
5        miscellaneous supplies and water testing costs. The CAPD has therefore included  
6        the Company's \$600 monthly projection for Water Testing as a going level  
7        amount.

8        **Line 4 – Depreciation \$88.** From page 62 of 192 in the attachment to the  
9        Company's response to TRA Data Request 1, Item 1, this item appears to relate to  
10       the capitalization of the pump station expenditures in the amount of \$15,757.  
11       According to the depreciation schedule, this plant expenditure has a 15 year life.  
12       Therefore, the first half year of depreciation expense would be \$525 and the full  
13       year depreciation expense would be \$1,050. The \$525 first year depreciation  
14       expense can also be verified on row 293 of the "Profit and Loss Detail-Water-  
15       011.xls" spreadsheet included as an attachment to TRA Data Request 1, Item 2.  
16       In addition, the \$15,757 capitalized amount for the pump station expenditures  
17       appears to tie very closely to the amount recorded on the ledger on lines 2100-  
18       2103 of the "General Ledger-2011-2012.xls" spreadsheet file included as an  
19       attachment to TRA Data Request 1, Item 4. There appears to be no support for  
20       the Company's pro forma budget amount of \$400 in monthly depreciation  
21       expense.

22       The CAPD has recognized the \$15,757 amount capitalized for the pump station  
23       expenditures as an addition to rate base net of the \$525 first year depreciation on

1 lines 20 and 21 of our proposed monthly budget. The annual depreciation  
2 expense on the pump station of \$1,050 (\$88 monthly) is also recognized by the  
3 CAPD as an ongoing expense on line 4 of our proposed monthly budget. The  
4 remaining plant of Laurel Hill is assumed to be fully depreciated by the previous  
5 owner given that it was originally installed sometime in the '70's. The CAPD  
6 therefore includes nothing in rate base or associated depreciation expense for the  
7 original cost of the Water System.

8 **Line 5 – Real Estate Tax \$0.** According to the Company, this item covers the  
9 real property taxes paid and allocated to the water operations. The Company has  
10 included \$200 in their monthly budget for this item, however there is no support  
11 for real estate taxes or property taxes, either in whole or an allocated part,  
12 included in the documents or financial statements attached to TRA Data Request  
13 1, Items 1, 2, 3 or 4. In addition, utility property typically receives special  
14 assessments from the Tennessee Comptroller's office and is generally not  
15 comingled with other real property. Therefore, it is unlikely that any of the  
16 Company's property taxes are properly allocated to the utility. The CAPD has  
17 therefore excluded all amounts for Real Estate Taxes in its proposed monthly  
18 budget.

19 **Line 6 – Telephone Expense \$61.** According to the Company, this item covers  
20 the telephone expenses allocated to the water operations. The Company included  
21 \$125 for this item in their monthly budget, however there is no support for  
22 telephone expense, either in whole or an allocated part, in the financial statements  
23 attached to TRA Data Request 1, Items 2, 3 or 4. Instead, the only support for

1 telephone expense appears on page 15 of 192 in the attachment to TRA Data  
2 Request 1, Item 1 in the form of a monthly invoice from Frontier  
3 Communications for \$61. Although the CAPD feels that this support is less than  
4 adequate, we are inclined to include this amount as a reasonable going level in the  
5 monthly budget for Telephone Expense.

6 **Line 7 – Permits & Penalties \$25.** The Company has included \$1,200 as the  
7 monthly budgeted expense for this item. According to the Company, this item  
8 represents the amount paid to the State of Tennessee to obtain the dismissal of the  
9 TDEC enforcement proceeding against the Water System in the amount of  
10 \$11,282.50 plus the \$300 annual fee paid to TDEC as a public water system.  
11 Since any penalty for past violations would not be recoverable in a proceeding to  
12 set rates on a going forward basis, the CAPD has only included the annual \$300  
13 (\$25 monthly) TDEC fee in its proposed monthly budget.

14 **Line 8 – Interest Expense \$0.** The Company has included \$1,900 per month  
15 (\$22,800 annually) for this item. According to the Company, this item includes  
16 the interest paid to Moy Toy, LLC on the \$400,000 promissory note on the  
17 purchase of the water system and the interest paid to Renegade Mountain  
18 Timeshares, LLC for the funds borrowed to help finance the water operations.  
19 Irrespective of the amounts actually recorded on the Company's books, interest  
20 expense is never included as an operating expense for determining utility rates on  
21 a going forward basis. Instead, the amount of original plant in service would be  
22 included in rate base at the appropriate cost rate. As already pointed out above in  
23 Line 4 – Depreciation Expense, the original Water System plant is assumed to be

1 fully depreciated. Therefore, interest expense would also be \$0, which is what the  
2 CAPD has included in its proposed monthly budget.

3 **Line 9 – Legal Expense \$0.** The Company has included \$2,500 as their monthly  
4 budget for this amount. According to the Company, this item represents the legal  
5 expenses paid to Branstetter, Stranch & Jennings. A review of the attachments to  
6 TRA Data Request 1, Items 2 and 4 reveal that the Company paid legal fees of  
7 \$4,407 in 2011 and \$21,108 in 2012 for a total \$25,515 or an average of \$2,126  
8 per month. A review of the individual invoices on pages 17-61 of 192 included in  
9 the attachment to TRA Data Request 1, Item 1 reveal that these legal fees are  
10 related to the Company's lawsuit in Cumberland County Chancery Court and  
11 filings with the TRA although not necessarily related to this rate case. The CAPD  
12 believes that it is inappropriate to consider included any of these legal fees in rates  
13 until the legal issues surrounding the ownership and operation of the water system  
14 is complete. The CAPD has therefore included \$0 for this amount in its proposed  
15 monthly budget.

16 **Line 10 – Accounting & Management Services \$300.** The Company has  
17 included \$1,550 as their monthly budget for this account. According to the  
18 Company, this item represents payments to a certified public accounting firm  
19 which handles the billing, collecting, record keeping, bookkeeping and tax  
20 preparation services for the Water System. An examination of the invoices  
21 included on pages 63-77 of 192 of TRA Data Request 1, Item 1, reveals that the  
22 accounting firm charges Laurel Hills \$300 per month for accounting work. In  
23 addition to this \$300 monthly fee, the accounting firm also separately charged

1       Laurel Hills \$365 for preparing the federal corporate income tax return and \$200  
2       for preparing the homeowner dues invoices. A review of the financial statements  
3       included as attachments to TRA Data Request 1, Items 2 and 4 reveal that Laurel  
4       Hills paid \$1,700 in accounting fees for 2011 and \$2,165 in accounting fees  
5       through August of 2012 (\$3,865 total or an average of \$322 per month). It is  
6       unclear how the Company came up with their projected monthly budget for this  
7       item of \$1,550. Also, it is not entirely clear how much of these accounting fees  
8       are related to the Water System and how much are related to the Company's other  
9       operations. However, a monthly fee of \$300 per month appears to be reasonable  
10      for billing, collecting, record keeping, bookkeeping and tax preparation services.  
11      Therefore, the CAPD has included \$300 per month as its monthly forecast for  
12      Accounting & Management Expense.

13      **Line 11 – Office Expenses \$20.** According to the Company, this item covers  
14      office supplies used in the water operation. However, there is no support for the  
15      Company's monthly budget amount of \$200 included in their response to TRA  
16      Data Request 1, Item 1. In addition, a review of the financial statement  
17      attachments to TRA Data Request 1, Items 2 and 4 reveal that the Company only  
18      spent \$169 in office supplies for 2011 and \$52 in office supplies for 2012 (\$221  
19      total or an average of approximately \$20 per month). It appears to the CAPD that  
20      most of the office expenses would already be included in Line 10 – Accounting &  
21      Management Services, since it is the CPA firm that performs the billing and  
22      collection function for the Company. The CAPD has therefore only included the

1 current average monthly office supply expenditures of \$20 as a going level  
2 amount.

3 **Line 12 – Insurance Expense \$433.** The Company included \$700 in their  
4 monthly budget for this account. According to the Company, this item covers the  
5 payment of premiums for public liability insurance and director's and officer's  
6 liability insurance for which they have allocated 50% of the cost to the Water  
7 System. An analysis of the charges from the Company's insurance agent on page  
8 7 of 192 of the attachment to TRA Data Request 1, Item 1 reveals that for the 12  
9 months ended March 2012, the Company was charged \$780 for general liability  
10 insurance and \$9,623 for tailored protection for a total of \$10,403. We are  
11 assuming that these are gross amounts from the insurance carrier before any  
12 internal allocation between the Water System and the Company's other  
13 operations. We are also unsure of the distinguishing characteristics between the  
14 general liability policy and the tailored policy. Nevertheless, the CAPD desires to  
15 include the appropriate amount of insurance in the cost of service for the Water  
16 System. The CAPD therefore accepts the cost for both of these policies as well as  
17 the Company's proposed 50% allocation factor. As a result, the CAPD's  
18 projection for insurance expense begins with the annual expense of \$10,403 and  
19 applies the 50% allocation factor to get \$5,202 or a monthly budget amount of  
20 \$433.

21 **Line 13 – Postage Expense \$8.** The Company included \$50 in their monthly  
22 budget for this account. According to the Company, this item covers the rental of  
23 the POA's post office box for water operations and postage needed for customer



1 correspondence and general business purposes. There is no support for the  
2 Company's proposed budget amount of \$50 for this item. The postage associated  
3 with billing has already been included in Line 10 – Accounting & Management  
4 Services. In 2011, the Company had \$6 in postage costs and through August of  
5 2012, the Company only had \$96 in postage costs.<sup>5</sup> The \$96 charge for 2012  
6 appears to be the annual post office box rental charge. Therefore, the CAPD has  
7 included the \$96 annual (\$8 monthly) post office box rental cost in its proposed  
8 budget.

9 **Line 14 – Equipment Rental Expense \$8.** The Company states that this item  
10 includes equipment and machinery which has to be rented to repair and maintain  
11 the Water System. However, there is no support for the Company's budgeted  
12 amount of \$150 per month in their responses to the TRA's data requests. For  
13 2011, the Company had \$98 in rental expense and through August of 2012, the  
14 Company had \$0 in rental expense.<sup>6</sup> The CAPD is therefore only including \$98  
15 (\$8 monthly) as a going level amount for Equipment Rental Expense.

16 **Line 15 – Maintenance & Repair Expense \$0.** The Company included \$2,000  
17 in their monthly budget for this item. According to the Company, this item  
18 includes anticipated work to be done for water tank rehabilitation at a cost of  
19 \$183,000. The CAPD believes that it is inappropriate to include this amount as an  
20 operating expense. Normally, this type of expenditure would be capitalized and  
21 included in rate base and then depreciated over its expected useful life. However,

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<sup>5</sup> See line 332 of the financial statement detail attachment to TRA Data Request 1, Item 2 and line 2613 of the financial statement detail attachment to TRA Data Request 1, Item 4.

<sup>6</sup> See line 335 of the financial statement detail attachment to TRA Data Request 1, Item 2 and line 2619 of the financial statement detail attachment to TRA Data Request 1, Item 4.

1 in this case, although I am not a lawyer and am not offering a legal opinion, it  
2 appears there are serious questions regarding the ownership and operation of the  
3 Water System that must be resolved before any type of plant expenditure can be  
4 completed. Furthermore, the Company has indicated that they have no ability to  
5 borrow funds for capital expansion making this type of expenditure unlikely.<sup>7</sup>  
6 Therefore, the CAPD has included \$0 as its projection in the monthly budget.

7 **Line 16 – Wholesale Water Expense \$1,671.** This item represents the monthly  
8 wholesale water purchases from the Company's water supplier. The Company  
9 included \$1,750 in their monthly budget for this item. The Company included a  
10 copy of their billing history from their water supplier on page 13 of 192 in the  
11 attachment to TRA Data Request 1, Item 1. This billing history shows that for the  
12 12 months ended August 2012, the Company was billed \$20,060 for water and  
13 \$1,942 in late payment penalties. The history also shows that the Company has  
14 an overdue balance to their water supplier of \$18,091. Based upon the limited  
15 information included in this billing history, it is impossible to know if the \$20,060  
16 for water purchases represents a normalized amount that can be expected as a  
17 going level. However, the CAPD believes that this amount is the best predictor  
18 currently available for water expense for the next 12 months. The CAPD does not  
19 intend to allow for recovery of the \$1,942 in penalty amounts since this represents  
20 a past penalty of the Company's refusal or inability to pay their water bill.  
21 Neither does the CAPD intend to allow for recovery in rates of the outstanding  
22 balance of \$18,091 since the customers have already paid for this amount in their

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<sup>7</sup> Direct testimony of Company witness McClung, Page 16, Line 5-6.

1 previous water bills. Therefore, the CAPD adopts \$20,060 (\$1,671 monthly) as  
2 the going level amount to include in its proposed budget.

3 **Line 17 – Electricity Expense \$467.** The Company included \$800 in their  
4 monthly budget for this item. According to the Company, this is the anticipated  
5 amount to be paid to their electric provider for power to the Water System's pump  
6 station. The Company included a copy of their billing history from their electric  
7 provider on page 6 of 192 in the attachment to TRA Data Request 1, Item 1. This  
8 billing history shows that for the 12 months ended August 2012, the Company  
9 was billed \$5,603 for electricity to the pump station. Based upon the limited  
10 information included in this billing history, it is impossible to know if the \$5,603  
11 for electricity represents a normalized amount that can be expected as a going  
12 level. However, the CAPD believes that this amount is the best predictor  
13 currently available for electricity expense for the next 12 months. Therefore, the  
14 CAPD adopts \$5,603 (\$467 monthly) as the going level amount to include in its  
15 proposed budget.

16 **Line 20 – Plant in Service \$15,757.** The calculation of this amount has already  
17 been discussed in Line 4 – Depreciation Expense.

18 **Line 21 – Accumulated Depreciation \$-525.** The calculation of this amount has  
19 already been discussed in Line 4 – Depreciation Expense.

20 **Line 22 – Working Capital \$6,021.** The TRA has traditionally allowed utilities  
21 an amount for working capital to bridge the gap between the time that expenses  
22 are paid and when revenues to cover these expenses are received from customers.

1 The \$6,021 amount included here represents 1/8 of the total budget for annual  
2 operating and maintenance expenses included on Line 19.

3 **Line 24 – Hypothetical Rate of Return 6.668%.** This rate of return represents  
4 the result of the hypothetical return from the cost of capital example included on  
5 page 10 of CAPD witness Dr. Klein.<sup>8</sup>

6  
7 ***Q13. PLEASE EXPLAIN HOW THE DIFFERENT COMPONENTS ARE***  
8 ***AGGREGATED TO PRODUCE YOUR TOTAL COST OF SERVICE.***

9 A13. Lines 1 through 18 are first summed to get the budgeted monthly operating  
10 expense of \$4,014 as shown on line 18. This amount is then multiplied by 12 to  
11 get the annualized budget for operation and maintenance expense of \$48,168 on  
12 line 19. Next, lines 20 through 22 are added together to get \$21,253 in rate base  
13 as shown on line 23. This rate base is then multiplied by the hypothetical rate of  
14 return of 6.668% on line 24 to produce the return on invested capital of \$1,417 as  
15 shown on line 25. Finally, the annual budgeted operation and maintenance  
16 expense of \$48,168 on line 19 is added to the return on invested capital of \$1,417  
17 on line 25 to produce \$49,585 as the projected cost of service on line 26. This  
18 projected cost of service represents the annual amount of revenues that the  
19 Company must have in order to provide water service.

20  
21  

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<sup>8</sup> No actual recommendation for cost of capital was made by Dr. Klein in this case. We have only used his hypothetical example because the CAPD's recommendation in rates results in a decrease from present rates.

1   **III.   CAPD'S PROPOSED RATE DESIGN**

2  
3   ***Q14.   WHAT IS THE CAPD'S PROPOSED RATE DESIGN FROM THIS***  
4   ***TOTAL COST OF SERVICE?***

5   A14.   On page 12 of his direct testimony, Company witness McClung states that there  
6       are 135 residential billing units.  However, in response to CAPD Data Request,  
7       Item 26, the Company states that they have lost 15 of their original 135 billing  
8       customers for various reasons leaving only 120 residential billing units.  At this  
9       point, it is unclear which amount is correct.  If the 15 disconnected customers can  
10      be retained then the proposed rate design would be \$30.61 per month as shown on  
11      line 27.  However, if the disconnection of these 15 customers is permanent, then  
12      the proposed rate design would be \$34.43 per month as shown on line 28.

13  
14   **IV.   OTHER RECOMMENDATIONS**

15  
16   ***Q15.   DO YOU HAVE ANY FURTHER RECOMMENDATIONS FOR THE TRA***  
17   ***ON THIS CASE?***

18   A15.   Yes.  First, our analysis of the Company's financial statements revealed that they  
19       are not following the uniform system of accounts ("USOA") that the TRA  
20       requires for regulated water utilities.  The CAPD would ask the TRA to order the  
21       Company to convert their books to USOA as quickly as possible in order to be in  
22       compliance with TRA rules.

1 Also, it is readily apparent from the pre-filed testimony that there is a great deal of  
2 animosity between Laurel Hills and its customers. Because of this, there appears  
3 to be a complete lack of trust in the Company that is necessary for a successful  
4 utility operation. As mentioned earlier, although I am not a lawyer and am not  
5 offering a legal opinion, it seems that it may well be some time before all of the  
6 questions concerning the ownership and operation of the Water System can be  
7 finally decided. The CAPD would therefore urge the TRA to consider a  
8 recommendation to the court that the operation of the utility be turned over to an  
9 independent trustee or receiver until these legal decisions can be made.  
10

11 ***Q16. DOES THIS COMPLETE YOUR TESTIMONY?***

12 A16. Yes it does. However I reserve the right to incorporate any new information that  
13 may subsequently become available.

**ATTACHMENT WHN-1**

**William H. Novak Vitae**

**William H. Novak**

19 Morning Arbor Place  
The Woodlands, TX 77381

Phone: 713-298-1760

Email: halnovak@whnconsulting.com

**Areas of Specialization**

Over twenty-five years of experience in regulatory affairs and forecasting of financial information in the rate setting process for electric, gas, water and wastewater utilities. Presented testimony and analysis for state commissions on regulatory issues in four states and has presented testimony before the FERC on electric issues.

**Relevant Experience****WHN Consulting – September 2004 to Present**

In 2004, established WHN Consulting to provide utility consulting and expert testimony for energy and water utilities. Complete needs consultant to provide the regulatory and financial expertise that enabled a number of small gas and water utilities to obtain their Certificate of Public Convenience and Necessity (CCN) that included forecasting the utility investment and income. Also provided the complete analysis and testimony for utility rate cases including revenues, operating expenses, taxes, rate base, rate of return and rate design for utilities in Tennessee. Assisted American Water Works Company in preparing rate cases in Ohio and Iowa. Provided commercial and industrial tariff analysis and testimony for an industrial intervenor group in a large gas utility rate case. Industry spokesman for water utilities dealing with utility commission rulemaking. Consultant for the North Carolina and Illinois Public Utility Commissions in carrying out their oversight functions of Duke Energy and Peoples Gas Light and Coke Company through focused management audits. Also provide continual utility accounting services and preparation of utility commission annual reports for water and gas utilities.

**Sequent Energy Management – February 2001 to July 2003**

Vice-President of Regulatory Compliance for approximately two years with Sequent Energy Management, a gas trading and optimization affiliate of AGL Resources. In that capacity, directed the duties of the regulatory compliance department, and reviewed and analyzed all regulatory filings and controls to ensure compliance with federal and state regulatory guidelines. Engaged and oversaw the work of a number of regulatory consultants and attorneys in various states where Sequent has operations. Identified asset management opportunities and regulatory issues for Sequent in various states. Presented regulatory proposals and testimony to eliminate wholesale gas rate fluctuations through hedging of all wholesale gas purchases for utilities. Also prepared testimony to allow gas marketers to compete with utilities for the transportation of wholesale gas to industrial users.



**Atlanta Gas Light Company – April 1999 to February 2001**

Director of Rates and Regulatory Analysis for approximately two years with AGL Resources, a public utility holding company serving approximately 1.9 million customers in Georgia, Tennessee, and Virginia. In that capacity, was instrumental in leading Atlanta Gas Light Company through the most complete and comprehensive gas deregulation process in the country that involved terminating the utility's traditional gas recovery mechanism and instead allowing all 1.5 million AGL Resources customers in Georgia to choose their own gas marketer. Also responsible for all gas deregulation filings, as well as preparing and defending gas cost recovery and rate filings. Initiated a weather normalization adjustment in Virginia to track adjustments to company's revenues based on departures from normal weather. Analyzed the regulatory impacts of potential acquisition targets.

**Tennessee Regulatory Authority – Aug. 1982 to Apr 1999; Jul 2003 to Sep 2004**

Employed by the Tennessee Regulatory Authority (formerly the Tennessee Public Service Commission) for approximately 19 years, culminating as Chief of the Energy and Water Division. Responsible for directing the division's compliance and rate setting process for all gas, electric, and water utilities. Either presented analysis and testimony or advised the Commissioners/Directors on policy setting issues, including utility rate cases, electric and gas deregulation, gas cost recovery, weather normalization recovery, and various accounting related issues. Responsible for leading and supervising the purchased gas adjustment (PGA) and gas cost recovery calculation for all gas utilities. Responsible for overseeing the work of all energy and water consultants hired by the TRA for management audits of gas, electric and water utilities. Implemented a weather normalization process for water utilities that was adopted by the Commission and adopted by American Water Works Company in regulatory proceedings outside of Tennessee.

**Education**

B.A, Accounting, Middle Tennessee State University, 1981  
MBA, Middle Tennessee State University, 1997

**Professional**

Certified Public Accountant (CPA), Tennessee Certificate # 7388  
Certified Management Accountant (CMA), Certificate # 7880  
Former Vice-Chairman of National Association of Regulatory Utility Commission's Subcommittee on Natural Gas

# ATTACHMENT WHN-2

## Supporting Workpapers

## Laurel Hills Water Company

## CAPD Analysis of Pro Forma Cost of Service - Summary

Item	Expense Type	Historical Monthly Amount	Company Monthly Pro Forma	CAPD Monthly Pro Forma
<b>O&amp;M Expenses:</b>				
1	Engineering & Labor	\$0	\$2,500	\$333
2	Construction Contracts	0	1,400	0
3	Water Testing	0	600	600
4	Depreciation	525	500	88
5	Real Estate Tax	0	200	0
6	Telephone	0	125	61
7	Permits & Penalties	25	1,200	25
8	Interest Expense	535	1,900	0
9	Legal Expense	2,126	2,500	0
10	Accounting & Management Services	322	1,550	300
11	Office Expenses	20	200	20
12	Insurance Expense	433	700	433
13	Postage Expense	8	50	8
14	Equipment Rental Expense	8	150	8
15	Maintenance & Repair Expense	0	2,000	0
16	Wholesale Water Expense	1,671	1,750	1,671
17	Electricity Expense	467	800	467
18	<b>Total Monthly O&amp;M Amount</b>	<b>\$6,140</b>	<b>\$18,125</b>	<b>\$4,014</b>
19	<b>Total Annual O&amp;M Amount</b>	<b>\$73,680</b>	<b>\$217,500</b>	<b>\$48,168</b>
<b>Rate Base:</b>				
20	Plant in Service			\$15,757
21	Accumulated Depreciation			-525
22	Working Capital (1/8 of O&M Expenses)			6,021
23	<b>Total Rate Base</b>			<b>\$21,253</b>
24	Hypothetical Rate of Return			6.668%
25	<b>Return on Invested Capital</b>			<b>\$1,417</b>
26	<b>Total Cost of Service</b>			<b>\$49,585</b>
		<b>Monthly Bills</b>	<b>Annual Bills</b>	<b>Resulting Rate</b>
27	Projected Units/Rates Based on MCClung Testimony	135	1,620	\$30.61
28	Projected Units/Rates Based on CAPD DR #26	120	1,440	\$34.43

## Laurel Hills Water Company

## CAPD Analysis of Pro Forma Cost of Service - Engineering &amp; Labor

Item	Expense Type	Historical Amount	Company Pro Forma	CAPD Pro Forma
1	Engineering & Labor	\$0	\$2,500	\$333

**From TRA DR-1, Item 1:**

This item is the amount that the POA projects it will need in revenues to pay off the outstanding bill it has from Darrel McQueen, P.E. for engineering services performed of \$26,000 which remains unpaid.

The POA has also added an additional amount to cover anticipated engineering services it will incur in the projected year of operations.

**CAPD Analysis:**

From the evidence in response to TRA DR-1, Item 1 it appears that Mr. McQueen submitted a single invoice in June 2012 for the previous year (52 weeks @ \$500 per week).

Since the \$26,000 amount is for previous work, and not an indication of a going level amount the CAPD proposes to discard this.

Instead, the CAPD only intends to include the amount for the projected attrition year. In this case, the Company included \$2,500 which would provide \$30,000 per year. Although the Company did not indicate how they came up with the \$2,500 amount, they do say that they "added an additional amount to cover anticipated engineering services it will incur in the projected year of operations." It is precisely this "additional amount" that the CAPD wishes to only include in its Pro Forma projects and not the historical liability.

Therefore, the CAPD proposes to include only \$4,000 (\$30,000 - \$26,000) as the going level annual amount or \$333 per month.

**Laurel Hills Water Company****CAPD Analysis of Pro Forma Cost of Service - Construction Contracts**

<u>Item</u>	<u>Expense Type</u>	<u>Historical Amount</u>	<u>Company Pro Forma</u>	<u>CAPD Pro Forma</u>
2	Engineering & Labor	\$0	\$1,400	\$0

**From TRA DR-1, Item 1:**

This item is the projected amount the POA anticipates it will spend to install individual valve boxes at the individual customer connections so that it can discontinue water service to customers for nonpayment. The POA has installed one valve box which cost approximately \$1,000. The valve boxes will be installed by persons from the employee leasing company, Renegade Resources.

**CAPD Analysis:**

At this point it is not clear who legally owns the water system, so including an amount for valve boxes is inappropriate. Furthermore, this type of expenditure would be capitalized and depreciated and NOT charged to expense.

The CAPD therefore excludes this amount in its entirety as a going level amount.

**Laurel Hills Water Company****CAPD Analysis of Pro Forma Cost of Service - Water Testing**

<b>Item</b>	<b>Expense Type</b>	<b>Historical Amount</b>	<b>Company Pro Forma</b>	<b>CAPD Pro Forma</b>
3	Water Testing	\$0	\$600	\$600

**From TRA DR-1, Item 1:**

This item includes the monthly charge of the POA's certified operator, Gerald Williams and the cost of getting water samples tested.

**CAPD Analysis:**

An analysis of TRA DR-1, Item 1 indicates that Laurel Hills pays Mr. Williams \$500 per month. This amount appears reasonable, however the CAPD is curious as to why Laurel Hill's water needs to be tested since it is already purchasing wholesale water that is already tested. Nevertheless, the CAPD has opted not to question this figure as a going level amount. The remaining \$100 per month includes the cost of miscellaneous supplies and water testing costs which also appear reasonable.

The CAPD therefore includes this amount in its entirety as a going level amount.

## Laurel Hills Water Company

## CAPD Analysis of Pro Forma Cost of Service - Depreciation

Item	Expense Type	Historical Amount	Company Pro Forma	CAPD Pro Forma
4	Depreciation Expense	\$525	\$400	\$88
20	Plant in Service	15,747	0	15,757
21	Accumulated Depreciation	525	0	525

**From TRA DR-1, Item 1:**

See attached depreciation schedule. From page 62 of 192 in the attachment to TRA DR-1, Item 1, this item appears to relate to the capitalization of the pump station in the amount of \$15,757. According to the depreciation schedule this item has a 15 year life, therefore the first half year depreciation is 525 and the full year depreciation would be \$1050. The 525 depreciation amount can also be verified on row 293 of the "Profit and Loss Detail - Water -011.xls" spreadsheet included as an attachment to TRA DR-1, Item 2. The \$15,757 amount for the pump station appears to tie very closely to the amount recorded on the ledger on lines 2100 - 2103 of the "General Ledger - 2011 - 2012.xls" file included as an attachment to TRA DR-1, Item 4. There is no support for the Company Pro Forma amount of \$400.

**CAPD Analysis:**

The \$15,757 amount capitalized for the Pump Station should be recognized as an addition to rate base net of the \$525 first year depreciation. The annual depreciation expense on this pump station of \$1,050 (\$88 monthly) should be recognized as an expense. The remaining plant of Laurel Hill is assumed to be fully depreciated by its previous owner since it was first installed sometime in the '70's. The CAPD therefore includes nothing in rate base (and associated depreciation expense and accumulated depreciation) for the original cost of the system.

The CAPD therefore includes plant in service of \$17,757 related to the pump station; \$525 for accumulated depreciation on the pump station; and \$88 as a monthly amount of depreciation expense.

Laurel Hills Water Company

CAPD Analysis of Pro Forma Cost of Service - Real Estate Taxes

Item	Expense Type	Historical Amount	Company Pro Forma	CAPD Pro Forma
5	Real Estate Taxes	\$0	\$200	\$0

From TRA DR-1, Item 1:

This item covers real property taxes paid and allocated to the water operations.

CAPD Analysis:

There is no support for real estate taxes, either in whole or an allocated part in the financial statements attached to TRA DR-1, Items 2, 3 or 4. There is also no support for any property taxes, either in whole or in part in the attachment to TRA DR-1. Utility property typically receives special assessments from the state comptroller's office and is generally not subject to allocation from other real property.

The CAPD therefore excludes this amount in its entirety as a going level amount.



Laurel Hills Water Company

CAPD Analysis of Pro Forma Cost of Service - Telephone

Item	Expense Type	Historical Amount	Company Pro Forma	CAPD Pro Forma
6	Telephone	\$0	\$125	\$61

**From TRA DR-1, Item 1:**

This item covers telephone expenses allocated to the water operations.

**CAPD Analysis:**

There is no support for telephone expense, either in whole or an allocated part in the financial statements attached to TRA DR-1, Items 2, 3 or 4. The only support for telephone expense in the attachment to TRA DR-1 appears as a monthly invoice from Frontier Communications on page 15 of 192 for \$60.55. Therefore, the CAPD will only include this figure as a going level amount.

**Laurel Hills Water Company****CAPD Analysis of Pro Forma Cost of Service - Permits and Penalties**

Item	Expense Type	Historical Amount	Company Pro Forma	CAPD Pro Forma
7	Permits & Penalties	\$25	\$1,200	\$25

**From TRA DR-1, Item 1:**

This item is the amount which the POA had to pay to the State of Tennessee to obtain the dismissal of the TDEC enforcement proceeding against the water system in Davidson County Chancery Court in the amount of \$11,282.5 plus the \$300 annual fee paid to TDEC as a public water system. See attached.

**CAPD Analysis:**

Any penalty paid to TDEC for past violations would not be recoverable in a proceeding to set going forward rates. The CAPD has therefore excluded the \$11,282.50 penalty paid by Laurel Hills to TDEC. However, the \$300 annual fee does represent a bonafide expenditure and cost of service. The \$300 fee is supported on 12 of 192 of TRA DR-1, Attachment 1. This amount is also supported on row 298 of the "Profit and Loss Detail - Water - 2011.xls" spreadsheet included as an attachment to TRA DR-1, item 2.

The CAPD therefore includes \$300 (\$25 per month) for penalties and permits.

## Laurel Hills Water Company

## CAPD Analysis of Pro Forma Cost of Service - Interest Expense

Item	Expense Type	Historical Amount	Company Pro Forma	CAPD Pro Forma
8	Interest Expense	\$535	\$1,900	\$0

**From TRA DR-1, Item 1:**

This item includes the interest paid to Moy Toy, LLC on the \$400,000 promissory note on the purchase of the water system and interest paid to Renegade Mountain Timeshares, LLC for the funds borrowed to help finance the POA's water operations. See attached.

**CAPD Analysis:**

The CAPD is unable to find any support for \$1,900 per month (\$22,800 annual) for interest expense. The promissory note from Moy Toy, LLC on page 3 of 192 refers to monthly payments of \$4,008, and there appears to be no support at all for any funds borrowed from Renegade Mountain Timeshares. The attachments to TRA Data Request 1, Items 3 and 4 do show interest expense of \$6,420 (\$535 monthly average) recorded as a single entry on April 13, 2012 but there is no interest expense recorded as payment to Renegade Mountain Timeshares.

Irregardless of the amounts recorded, interest expense is never included in the calculations for determining rates. Instead, the amount of original plant in service would be included in rate base which would then be multiplied by the cost of this debt. However, in this case the original cost of plant has been fully depreciated.

The CAPD therefore includes \$0 for interest expense.

**Laurel Hills Water Company****CAPD Analysis of Pro Forma Cost of Service - Legal Expense**

<u>Item</u>	<u>Expense Type</u>	<u>Historical Amount</u>	<u>Company Pro Forma</u>	<u>CAPD Pro Forma</u>
9	Legal Expense	\$2,126	\$2,500	\$0

**From TRA DR-1, Item 1:**

Attached are the legal expenses paid to "Branstetter, Stranch & Jennings, PLLC."

**CAPD Analysis:**

According to the Attachments to TRA DR-1, Items 2 and 4, the Company paid legal fees of \$4,407 in 2011 and \$21,108 in 2012 for a total of \$25,515 or \$2,126 per month. A review of the individual invoices included in TRA DR-1, Item 1 indicates that these legal fees are related to the Company's lawsuit in Cumberland County Chancery Court and filings with the TRA although not necessarily related to this rate case.

The CAPD believes that the appropriateness of considering these legal expenses cannot be completed until the legal issues surrounding the ownership and operation of the water system are complete. The CAPD therefore has included \$0 as a going level amount for the provision of water service.

**Laurel Hills Water Company****CAPD Analysis of Pro Forma Cost of Service - Accounting & Management Services**

<u>Item</u>	<u>Expense Type</u>	<u>Historical Amount</u>	<u>Company Pro Forma</u>	<u>CAPD Pro Forma</u>
10	Accounting & Management Expense	\$322	\$1,550	\$300

**From TRA DR-1, Item 1:**

This account includes payments to Lansford and Stephens, CPAs, a certified public accounting firm which handles the POA's billing, collection, record keeping, bookkeeping and tax preparation services for the POA's water operations. The account includes the amounts paid to Roger Goins, CPA who has assisted the POA in its review of its historical and projected expenses which the POA used in developing the rates needed to cover its cost of service. See attached.

**CAPD Analysis:**

An examination of the invoices included in the attachment to TRA DR-1, Item 1 reveals that the accounting firm charges Laurel Hills \$300 per month for accounting work. In addition to this amount, the accounting firm also charged Laurel Hills \$365 for preparing the federal corporate income tax return and \$200 for preparing the homeowner dues invoices. A review of the financial statements included as attachments to TRA DR-1, Items 2 and 4 reveal that Laurel Hills paid \$1,700 in accounting fees for 2011 and \$2,165 (\$3,865 total or \$322 per month) in accounting fees through August of 2012.

It is unclear how the Company came up with its projected monthly amount of \$1,550. Also, it is not entirely clear how much of these accounting fees are related to the water system and how much are related to the POA. However, a monthly fee of \$300 per month appears to be reasonable for billing, collecting, record keeping book keeping and tax preparation services. The CAPD therefore includes \$300 per month in accounting fees as a going level amount.

**Laurel Hills Water Company****CAPD Analysis of Pro Forma Cost of Service - Office Expense**

<b>Item</b>	<b>Expense Type</b>	<b>Historical Amount</b>	<b>Company Pro Forma</b>	<b>CAPD Pro Forma</b>
11	Office Expense	\$20	\$200	\$20

**From TRA DR-1, Item 1:**

This item covers office supplies used in the water operation.

**CAPD Analysis:**

There is no support for any office expense included in TRA DR-1, Item 1. In addition, a review of the financial statement attachments to TRA DR-1 Items 2 and 4 reveal that the Company spent \$169 in Office Expense for 2011 and \$52 in Office Expense for 2012 for a total of \$221 or approximately \$20 per month. It appears to the CAPD that most of the office expense would be included in the accounting services expense since the cpa firm performs the billing and collecting function. The CAPD therefore has only included \$20 per month as a going level amount for office supplies.

## Laurel Hills Water Company

## CAPD Analysis of Pro Forma Cost of Service - Insurance Expense

Item	Expense Type	Historical Amount	Company Pro Forma	CAPD Pro Forma
12	Insurance Expense	\$433	\$700	\$433

**From TRA DR-1, Item 1:**

This item covers the payment of premiums for public liability insurance, and Directors and officers liability insurance which should be allocated to the water operations. See attached.

Further from page 13 of Mr. McClung's testimony, he indicates that 50% of the insurance premium cost should be allocated to water operations.

**CAPD Analysis:**

An analysis of insurance expense from the agent on page 7 of 192 of the attachment to TRA DR-1, Item 1 shows the following insurance charges:

	General Liability	Tailored Protection	Total
March 16, 2011		775.00	775.00
May 3, 2011		1,383.00	1,383.00
June 10, 2011		1,122.66	1,122.66
July 11, 2011		561.33	561.33
August 9, 2011		563.33	563.33
September 12, 2011		561.08	561.08
October 18, 2011		561.08	561.08
November 18, 2011		561.08	561.08
November 21, 2011		576.08	576.08
November 23, 2011		138.13	138.13
December 27, 2011	69.08		69.08
January 17, 2012	69.08	561.09	630.17
February 21, 2012	69.08	661.09	730.17
February 29, 2012	483.60		483.60
March 2, 2012		1,037.18	1,037.18
March 27, 2012	89.08	561.09	650.17
<b>Total</b>	<b>779.92</b>	<b>9,623.22</b>	<b>10,403.14</b>

We are assuming that these are the gross amounts from the insurance carrier before any internal allocation between the water company and the POA. We are also, unsure of the distinguishing characteristics between the general liability policy and the tailored protection policy. Nevertheless, the CAPD desires to include the appropriate amount of insurance in the cost of service, therefore we accept the cost for both of these policies. In addition, the CAPD accepts the Company's internal allocation factor of 50% as reasonable.

Therefore, the CAPD's projection for insurance expense takes the annual amount of \$10,403.14 and multiplies it by 50% allocation factor to get an annual insurance expense for the water company of \$5,202 or \$433 on a monthly basis.

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Laurel Hills Water Company

## CAPD Analysis of Pro Forma Cost of Service - Postage Expense

Item	Expense Type	Historical Amount	Company Pro Forma	CAPD Pro Forma
13	Postage Expense	\$8	\$50	\$8

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From TRA DR-1, Item 1:

This item covers rental of the POA's post office box for water operations and postage needed for customer correspondence and general business purposes.

---

CAPD Analysis:

The postage associated with billing is already included in the accounting costs. The Company had \$5.92 in postage costs for all of 2011 according to line 332 of the financial statement detail attachment to TRA DR-1, Item 2. The Company had \$96 in postage expense for all of 2012 according to line 2613 of the financial statement detail attachment to TRA DR-1, Item 4. The \$96 charge for 2012 appears to be the annual post office box rental charge. It also appears that the original check for \$96 was to be allocated but all of it has wound up on the water utility books. The CAPD believes that it is probably best for the water company to have its own post office box on a going forward basis. Therefore, we will include the annual post office box rental fee of \$96 (\$8 monthly) as a pro forma expense.



**Laurel Hills Water Company****CAPD Analysis of Pro Forma Cost of Service - Equipment Rental Expense**

<u>Item</u>	<u>Expense Type</u>	<u>Historical Amount</u>	<u>Company Pro Forma</u>	<u>CAPD Pro Forma</u>
14	Equipment Rental Expense	\$8	\$150	\$8

**From TRA DR-1, Item 1:**

This item includes equipment and machinery which has to be rented to repair and maintain water lines and the pump station.

**CAPD Analysis:**

There is no basis for the Company's projection included in the data request responses. For 2011, the Company had \$97.68 in equipment rental expense according to line 335 of the financial statement included in response to TRA DR-1, Item 2. For 2012, the Company had \$0 in equipment rental expense according to line 2619 of the financial statement included in response to TRA DR-1, Item 4. The CAPD therefore will only include \$97.69 as an annual going level amount (\$8.00 per month) for equipment rental expense.

**Laurel Hills Water Company****CAPD Analysis of Pro Forma Cost of Service - Maintenance & Repair Expense**

<u>Item</u>	<u>Expense Type</u>	<u>Historical Amount</u>	<u>Company Pro Forma</u>	<u>CAPD Pro Forma</u>
15	Maintenance & Repair Expense	\$0	\$2,000	\$0

**From TRA DR-1, Item 1:**

This item includes work done for the repair and maintenance of the water system's water lines, pump station and water tank. The majority of the maintenance and repair includes a portion of the anticipated cost of the water tank rehabilitation which is \$183,000. See attached. TDEC wants the POA to go ahead and rehabilitate the tank for the reasons set forth in the attached email from Sherwin Smith of TDEC to Mike McClung. TDEC regulations require that the water system have at least 24 hours of storage. Currently, the water system has none. The customers want the tank to be rehabilitated so that water will be available for fire protection.

**CAPD Analysis:**

This amount is inappropriate to include as an operating expense. Normally, this type of expenditure would be capitalized and included in rate base and then depreciated over its expected useful life. However in this case, there are serious legal questions regarding the ownership that must be resolved before any type of plant expenditures can be complicated. Furthermore, the Company has indicated that they have no ability to borrow funds for capital expansion making this type of expenditure unlikely. Therefore, the CAPD has included \$0 as its projection for a going level amount.

## Laurel Hills Water Company

## CAPD Analysis of Pro Forma Cost of Service - Water Expense

Item	Expense Type	Historical Amount	Company Pro Forma	CAPD Pro Forma
16	Wholesale Water Expense	\$1,671	\$1,750	\$1,671

## From TRA DR-1, Item 1:

This item is the monthly water purchase requirements from Crab Orchard Utility District. See attached.

## CAPD Analysis:

The water billing history schedule included on page 13 of 192 to the attachment to TRA DR-1, Item 1 shows the following:

	Water Billing	Penalty Billing	Water Payment	Balance
Beginning Balance				\$16,847.93
August 16, 2011		\$114.02		16,961.95
August 18, 2011			\$2,150.00	14,811.95
August 29, 2011	\$2,895.35			17,707.30
September 15, 2011			3,500.00	14,207.30
September 16, 2011		263.81		14,471.11
September 28, 2011	3,525.86			17,996.97
October 18, 2011		321.26		18,318.23
October 20, 2011			3,525.86	14,792.37
October 26, 2011	1,178.97			15,971.34
November 16, 2011		107.42		16,078.76
November 16, 2011			2,310.00	13,768.76
November 28, 2011	1,276.75			15,045.51
December 16, 2011		116.33		15,161.84
December 23, 2011			1,500.00	13,661.84
December 27, 2011	1,513.81			15,175.65
January 11, 2012			43.20	15,132.45
January 18, 2012		137.93		15,270.38
January 24, 2012			-43.20	15,313.58
January 27, 2012	2,193.98			17,507.56
February 16, 2012		199.91		17,707.47
February 27, 2012	1,795.26			19,502.73
March 16, 2012		163.58		19,666.31
March 29, 2012	1,493.72			21,160.03
April 17, 2012		136.10		21,296.13
April 26, 2012	963.24			22,259.37
May 16, 2012		87.77		22,347.14
May 29, 2012	999.73			23,346.87
June 18, 2012		91.09		23,437.96
June 27, 2012	1,154.54			24,592.50
July 1, 2012			6,704.05	17,888.45
July 17, 2012		105.20		17,993.65
July 24, 2012	1,069.26			19,062.91
August 16, 2012		97.43		19,160.34
August 17, 2012			1,069.26	18,091.08
<b>Total</b>	<b>\$20,060.47</b>	<b>\$1,941.85</b>	<b>\$20,759.17</b>	

Based upon the limited information received, it is impossible to know if the billing of \$20,060.47 for the most recent 12 months represents a normalized amount. However, the CAPD believes that this amount is the best predictor available for water expense for the next 12 months. The CAPD does not intend to allow for recovery of the \$1,941.85 in penalty amounts since this represents a past penalty of the Company's refusal or inability to pay the water bill. Neither does the CAPD intend to allow recovery of the outstanding balance of \$18,091.08 since the customers already paid for this amount in their water billing. Therefore, the CAPD adopts \$20,060.47 (\$1,672 monthly) as a going level amount for wholesale water expense.

## Laurel Hills Water Company

## CAPD Analysis of Pro Forma Cost of Service - Electric Expense

Item	Expense Type	Historical Amount	Company Pro Forma	CAPD Pro Forma
17	Electric	\$467	\$800	\$467

**From TRA DR-1, Item 1:**

This item is the anticipated amount to be paid to Volunteer Electric Cooperative for the electric meter which serves the pump station. See attached.

**CAPD Analysis:**

The electric payment (not billing) history schedule included on page 6 of 192 to the attachment to TRA DR-1, Item 1 shows the following:

	Electric Payment
September 9, 2011	\$773.55
October 13, 2011	935.14
November 14, 2011	308.04
December 12, 2011	624.41
December 27, 2011	499.65
February 17, 2012	613.65
February 29, 2012	175.26
April 24, 2012	390.82
May 8, 2012	292.44
June 18, 2012	263.29
July 13, 2012	246.46
July 23, 2012	210.58
August 23, 2012	269.89
<b>Total</b>	<b>\$5,603.18</b>
<b>Monthly Average</b>	<b>\$466.93</b>

Based upon the limited information received, it is impossible to know if the billing of \$5,603.18 for the most recent 12 months represents a normalized amount. In addition, the books of the water utility appear to show an allocation for some months on electricity expense for the water utility and the other POA facilities - therefore it appears that the books are overstated and include both utility and other POA facilities for electric expense. It is impossible to ascertain from the limited information here whether or not these amounts represent "utility only" electricity. However, the CAPD believes that this amount is the best predictor available for electric expense for the next 12 months. Therefore, the CAPD adopts \$5,603.18 (\$466.93 monthly) as a going level amount for electric expense.