

BRANSTETTER, STRANCH & JENNINGS, PLLC

ATTORNEYS AT LAW  
227 SECOND AVENUE NORTH  
FOURTH FLOOR

NASHVILLE, TENNESSEE 37201-1631  
TELEPHONE (615) 254-8801 ~ FACSIMILE (615) 250-3937

CECIL D. BRANSTETTER, SR.  
C. DEWEY BRANSTETTER, JR.  
RANDALL C. FERGUSON  
R. JAN JENNINGS\*  
JOE P. LENISKI, JR.  
DONALD L. SCHOLES  
MIKE STEWART  
JAMES G. STRANCH, III  
J. GERARD STRANCH, IV  
MICHAEL J. WALL

ASSOCIATES:  
KARLA M. CAMPBELL  
BEN CASTEL\*  
STACEY K. SKILLMAN \*\*

OF COUNSEL:  
ROBERT E. RICHARDSON, JR. \*\*\*

March 15, 2013

\* ALSO ADMITTED IN GA  
\*\* ALSO ADMITTED IN KY  
\*\*\* ONLY ADMITTED IN OH

Ms. Sharla Dillon  
Docket Room Manager  
Tennessee Regulatory Authority  
460 James Robertson Parkway  
Nashville, TN 37243-0505

*Via Hand Delivery*

Re: Petition of Laurel Hills Condominiums Property Owners Association for a  
Certificate of Public Convenience and Necessity  
Docket No. 12-00030

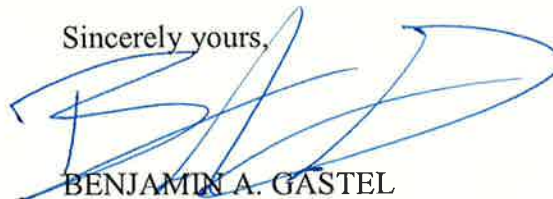
Dear Sharla:

I have enclosed an original and five copies of the Post-Hearing Brief.

This Brief and this cover letter are being filed electronically by electronic mail this same date. Please return the additional copy of the Brief stamp filed to me.

Thank you for your assistance.

Sincerely yours,



BENJAMIN A. GASTEL

Enclosure

c: Shiva Bozarth  
Charlena S. Aumiller  
Melanie Davis  
Robert Schwerer  
Michael McClung

**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**

---

**PETITIONER'S POST HEARING BRIEF**

---

Petitioner, the Laurel Hills Condominiums Property Owners Association ("Laurel Hills" or "Petitioner") hereby files its post-hearing briefs requested by the Tennessee Regulatory Authority ("TRA" or "Authority") at the February 13, 2013 hearing (the "Hearing") on Laurel Hills' Amended Petition for a Certificate of Public Convenience and Necessity ("CCN") under Tenn. Code Ann. § 65-4-201 (the "Amended Petition"). Laurel Hills respectfully requests that the Authority grant Laurel Hills a CCN and establish a rate for service as detailed below.

**I. Introduction**

Laurel Hills is a Tennessee nonprofit corporation with a volunteer board of directors. It was originally formed as the property owners association for the Laurel Hills Condominium complex, a condominium complex located on Renegade Mountain, and is a customer of the water system that it now owns. (McClung Direct at 2.) Although the Renegade water system has been in operation for over thirty years, previous owners of the water system had failed to properly operate, maintain and update the water system in accordance with the regulations of the Tennessee Department of Environment and Conservation ("TDEC") for public water systems. As a result, the water system was in a state of utter disrepair (which is undisputed) when Laurel Hills acquired the system in May of 2011. Prior to Laurel Hills' acquisition of the water system,

TDEC had instigated an enforcement action against the prior owners of the system for several ongoing violations of its rules and regulations for public water systems, including the failure of the system to have a certified operator in charge of the system. Without a certified operator the prior owners of the water system had placed the system in a very precarious situation and placed the customers of the system at risk for unsafe drinking water. The task for Laurel Hills was monumental upon its acquisition of the water system.

Rather than continue to let the water system deteriorate and operate in violation of TDEC regulations, Laurel Hills immediately began meeting with TDEC and developed a plan of action to bring the system into a full compliance as quickly as possible. Within seven months of taking over the system, they had managed, in conjunction with TDEC, to implement a substantial system redesign, bring about an end to pending the TDEC enforcement action and achieved a score of 98 out of 100 on its first sanitary survey after taking over the water system. During this process, Laurel Hills kept TDEC fully informed of the actions it was taking and continued to work with TDEC on how best to address the issues with the water system. This monumental achievement, however, was not without cost which its customers failed to recognize because of the low rates they had been paying for water service for many years with no rate increases to cover increased operating costs and needed capital improvements. Rather than pay the costs to have their public water system operated as mandated by TDEC, the customers seemed determined to prefer bankrupting the entity which had worked diligently to address critical operational issues and to improve the water system. While the water system's customers desire to keep their rates low is understandable, the actual costs to operate, maintain and improve a small, nonprofit water system on the side of a mountain in rural Tennessee with less than 50

water connections necessitates that significantly higher rates be charged to cover these costs than have historically been charged.

When Laurel Hills acquired the Renegade Mountain water system, it was presented with a unique situation for the operation of a small water utility in Tennessee. Neither the intervening customers nor the Consumer Advocate's witness, Hal Novak, seem to appreciate this difficulty in the positions they have taken in this proceeding on the grant of a certificate or the rates which the Authority should approve. Mr. Novak, as discussed in greater detail below, imposes upon this situation a rather rigid, inflexible approach which fails to take into account the unique nature of the Laurel Hills water system, the historical difficulties associated with running the system and that Laurel Hills is a nonprofit homeowners association. As a result, Mr. Novak's proposed rates ignore normal operating expenses for a water utility and numerous valid debts of the system and provide no avenue for legitimate and prudently incurred expenses to be recovered through rates. Mr. Novak's approach seems no different than the approach of the water system's previous owners, who ignored the actual costs associated with running this very small water system with very few customers.

For the water system to meet the requirements of the Authority and TDEC for a public water system, it must change the poor operating practices of the past, and in the future operate and maintain the system as necessary to ensure a safe and adequate drinking water for all of the system's customers.

## **II. Water System Background And Laurel Hills' Attempts To Maintain Service**

### **a. Laurel Hills takes over a poorly run system and brings it into TDEC compliance in six months**

Laurel Hills took over a very poorly managed and unmetered water system in May 2011. (Hearing Tr. 60; McClung Direct at 3, 8, 16.) Although the system had been operated for

decades, no previous owner had obtained a certificate to operate the water system from the Authority or its predecessor the Tennessee Public Service Commission. (Hearing Tr. 60.) Prior to taking over the system, Laurel Hills and the then existing owner of the system, Moy Toy LLC, attempted to find another entity to take over and operate the system. (*Id.*) Moy Toy and Laurel Hills approached Crab Orchard Utility District to take over the system, but Crab Orchard stated it did not want it. (*Id.*) Needing to ensure that it could provide water to market and maintain its timeshare units, Laurel Hills decided to purchase and run the water system. (*Id.*; McClung Direct at 3.)

A substantial part of the system's water transmission line up the mountain is above ground. When Laurel Hills took over the system, the existing pumps were outdated, and the water tank was not in compliance with TDEC requirements. (*Id.*; McClung Direct at 3, 5.) As a result of this and other problems with the system, TDEC had instigated, years before Laurel Hills took over the system, an enforcement action against the water system. (*Id.*) Among other violations, the water system could not maintain the minimum pressure required by TDEC in the system, had failed to properly maintain the water system and existing water tank requiring it to be brought offline, had failed to conduct required water testing and did not even have a certified operator for the system. (Amended Petition, Ex. 2 at ¶¶ 40-53.) These were serious violations, and the water system was subjected to \$5,000 per day in civil penalties, in addition to the over \$10,000 in civil penalties already assessed by TDEC. (*Id.* at Prayer for Relief, ¶¶ 4, 8); *see also* T.C.A. § 68-221-713.

Understanding the seriousness of the action, Laurel Hills met with TDEC and began developing an action plan in conjunction with TDEC to improve the system. (McClung Direct at 3, 5-6.) Even before it finalized taking over the system, Laurel Hills began meeting with

TDEC to discuss bringing the system into compliance with TDEC requirements. (*Id.*) Laurel Hills aggressively began making improvements to the system and putting procedures and systems in place to begin bringing the system into compliance with TDEC requirements to ensure it could begin providing safe, affordable drinking water to all customers served by the system. (Hearing Transcript at 61; McClung Direct at 4-5.) Working with its engineer, Darryl McQueen, who is a customer of the water system, and TDEC staff, Laurel Hills took significant steps to improve the system. (*Id.*)

Specifically, Laurel Hills along with Mr. McQueen performed the following tasks:

- 1) Prepared a map of the water system to the specifications requested by TDEC;
- 2) Contracted with a supplier to install a new variable speed pump and to modify the pump station as needed to accommodate the new pump so the noncompliant water tank could be taken offline for refurbishing;
- 3) Conducted many pressure tests on the water system and implemented a flushing program; and
- 4) Hired a certified operator and began conducting several water quality tests of the system.

(McClung Direct at 5-6.)

Satisfied with the efforts being made by Laurel Hills, TDEC agreed to dismiss the enforcement action upon the payment of a small civil penalty by Laurel Hills. (McClung Direct at 6.) The civil penalty TDEC agreed to let Laurel Hills pay was small in light of the potential liability Laurel Hills could have faced as a result of the prior violations of the water system's operators. (McClung Direct at 6.)

Within six months after Laurel Hills had taken over the system, Laurel Hills scored a 98 on its first TDEC sanitary sewer survey which represented a remarkable turnaround in a very short period of time given the utter disarray of the system when Laurel Hills had taken over the system in May of 2011. (*Id.* and Ex. 2.)

**b. Laurel Hills' Upgrades However Necessitated A New Approach To Rates, Which Angered Laurel Hills' Customers**

Laurel Hills' upgrades to the water system were not free or cheap. The new pump station cost over \$15,000 to construct. (Laurel Hills' Responses to TRA Staff Data Request at Response 1 (filed Sept. 7, 2012) "LH TRA Staff Responses.") Additionally, Laurel Hills contracted with Mr. McQueen to design and install the pump station and put him on retainer to handle engineering and maintenance system issues, including ongoing meetings and communications with TDEC throughout 2011 and 2012. (McClung Direct at 6; McClung Rebuttal at 5; *See* Laurel Hills Supplemental Response to Second Discovery Requests from Customer Intervenors, Response No. 19 (filed on November 19, 2011) the "LH Supplemental Cust. Response".) Pursuant to this agreement, Darryl McQueen has provided significant engineering, consulting and maintenance services to Laurel Hills. Mr. McQueen had historically provided some support to the water system prior to Laurel Hills assuming operational responsibility of the water system. Laurel Hills decided to maintain this relationship because of Mr. McQueen's familiarity with the rather unique water system of Laurel Hills and its operational deficiencies. (*See* LH Supplemental Cust. Response, Response No. 19.) Given historical problems with the water system and its aging pump station, Laurel Hills and Mr. McQueen determined, in conjunction with TDEC, that the water system needed to be redesigned. (*Id.*) Beginning in or around May of 2011, Mr. McQueen designed the current two-variable speed pump configuration which is the backbone of the water system and replaced the prior pumps which were in place since 1972.

(*Id.*) Mr. McQueen then met with officials of TDEC and provided consulting services to ensure that TDEC approved the two-variable speed pump configuration. (*Id.*) After TDEC signed off on Mr. McQueen's design, Mr. McQueen performed the physical installation of the pumps and brought the new pumps online. (*Id.*) Mr. McQueen responded to TDEC data requests that from time to time are required. (*Id.*) Mr. McQueen inspected and located the water lines of the system and placed this information into a GPS/CAD system to provide the system mapping mandated by TDEC rules. This mapping system allowed Laurel Hills to have a better understanding of the location and placement of the system and to give Mr. McQueen information necessary to maintain the system. (*Id.*)

Mr. McQueen continues to work approximately 20 hours per week on the water system. (*Id.*) Specifically, Mr. McQueen is responsible for monitoring the chlorine levels of the water system as required by TDEC regulations. (*Id.*) This work requires Mr. McQueen to travel to various points along the water system and take water samples which are analyzed and tested. Mr. McQueen provides the results to Laurel Hills' certified operator. (*Id.*) He does sampling work approximately five times per week. (*Id.*) Mr. McQueen travels to the pump house approximately three times per week to inspect the pumps and ensure they remain operational. (*Id.*) Mr. McQueen has installed a gauge at his residence to help him monitor the pumps. (*Id.*) This gauge allows Mr. McQueen to know whether the pumps are online and functioning properly. When Mr. McQueen sees that the pumps are not functioning properly, he is responsible for investigating the cause. (*Id.*) The pumps may not be operating properly due to power outages, problems or changes in the water system of Crab Orchard Utility District or other mechanical issues with the pumps. To discover the problem, Mr. McQueen must go to the pump station to see if a power outage or mechanical problem has shut down the pumps. (*Id.*) Mr.



McQueen takes responsibility for seeing that power is restored. Once power is restored, he must physically restart the pumps. (*Id.*) If a mechanical problem exists with the pumps, Mr. McQueen determines how to fix the pumps and see that the repair is done. Mr. McQueen will contact Crab Orchard Utility District to see if the problems in the water system are related to operational issue in Crab Orchard's system. Mr. McQueen inspects the ten miles of water line for leaks and is called upon to find leaks when reports of water pressure problems come to him. Mr. McQueen helps coordinate and often helps in performing the construction work to repair leaking or broken lines. (*Id.*) Mr. McQueen also bleeds fire hydrants to ensure water quality and pressure as required by the water system's flushing program approved by TDEC. (*Id.*) Mr. McQueen uses his own personal vehicle for his travel. Laurel Hills pays Mr. McQueen \$500 per week for his engineering and consulting services along with the maintenance services detailed above. (*Id.*)

TDEC requested that Laurel Hills take the existing water tank offline once the new pumps were installed to refurbish the tank. (McClung Direct at 9.) The water tank is critical part of the water system. The tank ensures the water system can provide consistent water pressure, provides storage to provide water when the new pumps go out or problems in the Crab Orchard system affects its ability to serve the system and provides water for fire protection, (*Id.*) Laurel Hills obtained a bid from a tank contractor to refurbish the tank. This tank contractor provided a bid of \$183,000 to perform the necessary water tank repairs. (LH TRA Staff Responses, Response 1.)

These capital improvements, operation and maintenance expenses, legal costs and past due accounts (including an inherited \$18,000 debt to its water provider, Crab Orchard (Hearing Tr. Ex. 9) required Laurel Hills to set an initial rate to ensure that it could run the system in a

financially prudent way. Laurel Hills set the initial rate for service at \$86.40.<sup>1</sup> (McClung Direct at 8.) Customers were not pleased, and Laurel Hills permitted the Cumberland Point Condominium Association to pay a lower rate for a few months which other customers began to pay as well. When Laurel Hills determined that the \$86.40 service rate was necessary after several months of operations, it began requiring the payment of the \$84.40 rate. As a result many customers stopped paying their bills altogether, and others continue to pay the lower rate of \$42.20. The financial position of Laurel Hills significantly deteriorated over this time as it was unable to pay critical vendors with little to no money coming in. (McClung Direct at 15-16.)

**c. Laurel Hills Attempts To Terminate Service For Lack Of Funds To Operate The System, But Is Prevented From Doing So By the Cumberland County Chancery Court**

As a result, Laurel Hills was forced to reluctantly inform customers that it would have to terminate service. Because Laurel Hills could not terminate service to individual customers (as the system it inherited did not have individual shut off valves at each customer location), Laurel Hills would have to terminate service to the entire, or at least most, of its system. (McClung Direct at 10-11; 15; Hearing Tr. 89-90.) It informed customers of this expected shutoff in December of 2011. (Hearing Tr. 89-90.) Customers still did not remit payment during this

---

<sup>1</sup> The Customer Intervenors incorrectly claim that this initial rate was an illegal "rate increase." However, this was the initial rate set by Laurel Hills in June of 2011 and therefore from Laurel Hills' perspective was simply the setting of an initial rate, not a rate increase. McClung Direct at 15. Moreover, in June 2011 Laurel Hills had a reasonable basis to believe that it was not subject to the Authority's regulation because of the uncertain regulatory environment. McClung Direct at 15. At that time, the Authority had, to Laurel Hills knowledge, never regulated any Tennessee non-profit corporation, and this remained an unresolved legal issue, even from the Authority's perspective until August of 2011. See e.g., Final Order, TRA Docket No. 11-0005 (August 5, 2011). Up until December of 2012 this issue remained outstanding, and there still remains a question of whether or not non-profit property owner's associations are subject to the Authority's regulation. See e.g., *Berry's Chapel Util. v. Tenn. Regulatory Auth.*, 2012 Tenn. App. LEXIS 896 (December 21, 2012). Additionally, although Laurel Hills had numerous conversations with TDEC, TDEC never advised or required that Laurel Hills obtain a CCN from another public agency to continue to operate the system. McClung Rebuttal at 22. At that time the Company's primary concern was improving the system to try to bring the system into compliance with TDEC water quality standards, and the Company believes that it operated in good faith in an attempt to comply with Tennessee law during the uncertainty of this regulatory environment.

time. Therefore, Laurel Hills had no choice except to terminate water service to get paid, and terminated water service for four customers of the water system on February 1, 2012. (Hearing Tr. 89-90.) Some discussion was raised as to the timing of this notice and whether it was sent as a result of another action filed on December 21, 2011. (Hearing Tr. 43.) This is not consistent with the correspondence sent to customers however. Based on Laurel Hills' October 31, 2011 notice, it is clear that Laurel Hills was in need of funds and requested that customers pay in full their bill. (Hearing Tr., Ex. 1 at Tab 5.) When customers failed to meet the requirement stated in this notice (i.e. bring their account current by the end of November), it follows that Laurel Hills would send a termination the next month if customers failed to meet that stated obligation. (*Id.*) In short, almost two full months before the lawsuit was filed, Laurel Hills signaled its intent to send termination notices to those customers who failed to bring their accounts current at the \$86.40 rate. (*See id.*) This belies the Customer Intervenors unsupported allegation that these two incidences, although close in time, are in any way related.

Concerned that Laurel Hills' water system may be tampered with as a result of this termination, Laurel Hills' board of directors filled the shut off valve with sediment to make it appear that the valve was unreachable, a tactic a board member had learned through his robust experience in the construction industry. (Hearing Tr. 92-95.) These concerns proved valid, as customers did in fact tamper with the system by making an illegal cross connection which they ultimately were forced to abandon after TDEC threatened those customers with an enforcement action for violation of TDEC regulations. (Hearing Tr. 321-22.) Moreover, Laurel Hills' customers admitted at the Hearing that they considered tampering with the shut-off valve in the event Laurel Hills terminated water service. (*Id.*)

Thereafter, certain customers sought relief at the Cumberland County Chancery Court alleging that Laurel Hills' termination for nonpayment violated T.C.A. § 68-221-711(9), which is a state statute which permits public water systems to give certain notices before terminating or abandoning water service. The Chancellor ultimately decided that this statute applied to the termination of service. Laurel Hills to resume service to its entire water system for 60 days to allow it to give the 60 day notice required by this statute. The Chancellor also required Laurel Hills to contact the Authority to determine whether it was subject to the Authority's regulatory jurisdiction<sup>2</sup>, and the Chancellor set an initial rate of service of \$43.20 per month, or half of Laurel Hills proposed rate, without reviewing any of Laurel Hills' financial information to determine if this rate was adequate to cover the costs of service. (Hearing Tr. 233.)

**d. Laurel Hills Maintains Service Pending Resolution of the Amended Petition,  
Despite Lacking Sufficient Funds To Pay Needed Vendors**

Despite operating for over a year at a rate that was set without examining the actual financial cost of operating the system, Laurel Hills has managed to maintain water service to its customers, principally because some vendors continued to provide goods and services without payment. Laurel Hills has not made any payment to Renegade Mountain Timeshares, LLC on the \$50,000 note (which has an outstanding balance of approximately \$36,000 (McClung Rebuttal at Ex. 2; Hearing Tr. 139). Laurel Hills has an outstanding balance to its attorneys for over \$100,000 (Branstetter, Stranch, and Jennings, LLC Response to Staff Data Requests, (filed February 7, 2013) "BSJ Response"). Laurel Hills has an outstanding balance to Gold Mountain Golf, Inc. in the amount of \$17,000 for services rendered to install shut off valves at residents

---

<sup>2</sup> Although there was some discussion at the Hearing as to whether Laurel Hills violated this Order, the Chancellor ruled in the subsequent case brought by the Authority that Laurel Hills did not violate that order. A copy of this Order is part of the record at Exhibit 1, Tab 8(2). Specifically, the Chancellor held that "The Court further finds that Laurel Hills did not violate this Court's Order issued on February 28, 2012 in a separate but related matter, *Haiser v. Laurel Hills Property Owners' Association*, No. 2012-CH-513.

that have failed to pay for water service and appear to be abandoned, at least temporarily or permanently (McClung Rebuttal at Ex. 1; Hearing Tr. 229). Laurel Hills had an outstanding balance of over \$25,000 to Crab Orchard (Hearing Tr. at Ex. 9), but to ensure continued water service to its customers, Laurel Hills managed to obtain financing from a related entity to pay this balance in its entirety to ensure that water continued to flow to its customers.<sup>3</sup>

Laurel Hills anticipated these mounting costs in May of last year. Laurel Hills did not want its timeshare unit owners to bear the brunt of these expenses; Therefore, Laurel Hills sought to abandon the portion of the water system that served members other than Laurel Hills in the hopes of limiting the financial damage it was incurring in having to operate a financially non-viable water system. (Hearing Tr. 134.) The Authority obtained an order from the Chancery Court requiring Laurel Hills to maintain service pending resolution of the previously instigated CCN proceeding, and Laurel Hills returned to the Authority and filed an Amended Petition. (Hearing Tr., Ex. 1, Tab 8.). This case is still pending, and Laurel Hills believes the Chancellor's order in this case violates the Tennessee constitution in that it is requiring that Laurel Hills property has been taken with no compensation.

### **III. Laurel Hills Possesses The Technical, Financial, and Managerial Expertise Necessary To Operate The System**

At the outset, Laurel Hills must point out that there is nothing within Tennessee law or the Authority's regulations that require a nonprofit water company like Laurel Hills to demonstrate that it has the "managerial, financial and technical abilities" necessary to operate a water system. Tenn. Code § 65-4-201(a) sets for the following standard for obtaining a certificate to operate a utility, in relevant part:

---

<sup>3</sup> This is not in the record because this occurred after the Hearing, but all parties are aware that Laurel Hills paid off this balance in full and it is not reasonably disputed.

No public utility shall...operate any line, plant, or system, or route in or into a municipality or other territory already receiving a like service from another public utility, or establish service therein, without first having obtained from the authority... a certificate that the present or future public convenience and necessity require or will require such...operation, and no person or corporation not at the time a public utility shall commence the construction of any plant, line, system, or route to be operated as a public utility...

As is clear from the above, this section does not explicitly require a water company demonstrate the managerial, financial and technical ability to obtain a certificate to operate a water utility, it only requires that a system demonstrate that the public convenience and necessity require the operation. Given that Laurel Hills' water system is the only available water source on the mountain, this alone should justify granting Laurel Hills a certificate under Tenn. Code § 65-4-201(a).

The term "managerial, financial and technical abilities" appears once in Title 65 of the Tennessee Code, and that section is clearly limited to telephone companies. *See* T.C.A. § 65-4-201(c)(2). This alone suggests that to demonstrate "managerial, financial and technical abilities" to obtain a certificate is an additional requirement to those outlined in T.C.A. § 65-4-201(a) to obtaining a CCN that is applicable only to telephone companies, and not water utilities.

Additionally, there is nothing in the Authority's rules that imposes this requirement on a water utility. *See generally* Chapter 1220-4-03 of the Authority's Rules related to water regulations. Chapter 1220-4-13 does impose an obligation on a wastewater utility to demonstrate that it possesses the "managerial, financial, and technical abilities" to provide wastewater service. T.R.A. Rule 1200-4-12-.04(1)(b). But since this requirement is not found in the Authority's water regulations, demonstrating the "managerial, financial, and technical abilities" appears to be an additional requirement for wastewater utilities, but not water utilities regulated by the Authority.

Nevertheless, even if the Authority requires water utilities to demonstrate the managerial, financial and technical abilities necessary to operate a water utility, Laurel Hills can satisfy these requirements. In assessing whether Laurel Hills has the managerial, financial and technical abilities necessary to operate the Renegade Mountain water system, the Authority must consider the size of the water system and must take into account that it is owned by a property owners association.

**A. Laurel Hills Possesses The Technical Expertise To Operate The System**

Laurel Hills has demonstrated the technical expertise necessary to run this water system. Laurel Hills contracted with an experienced engineer and immediately upon taking over the system, redesigned the system to allow it to bring an unmaintained water tank offline and institute a variable speed pump station to deliver water while the water tank received much needed upgrades. (*See discussion supra.*) Laurel Hills maintains this relationship with this engineer through an agreement, and Mr. McQueen has effectively kept this system operational for the past several years, even before Laurel Hills took over the system. (LH Supplemental Cust. Response at Response 19.)

Additionally, Laurel Hills contracted with Gerald Williams, a certified operator, to act as the certified operator for Laurel Hills. (LH TRA Staff Response at 1; 6.) Mr. Williams has the expertise necessary to ensure that Laurel Hills is able to meet TDEC water quality standards. (*Id.*; Hearing Tr. 105.)

In fact, although Laurel Hills took over a system that was subject to a TDEC enforcement action for failure to follow even the most basic TDEC requirements, Laurel Hills brought that system into almost full compliance with TDEC requirements in only six months and as its recent sanitary survey demonstrates (where Laurel Hills received a score of 98 out of 100), Laurel Hills

has demonstrated the technical expertise necessary to run a water system. (McClung Direct at Ex. 2.)

Granted, Mr. McClung at the Hearing testified that he personally did not have technical expertise to operate the water system (Hearing Tr. 82-83), but Laurel Hills has been able to procure the necessary technical expertise through its contracts with Mr. McQueen and Mr. Williams. There is nothing in the Authority's rules or regulations that require that the manager or a board member of a public utility personally possess the technical expertise necessary to operate a water system. The Authority is well aware that the small water and sewer systems regulated by the Authority are not large enough to hire fulltime employees. The owners of these systems and the managers of small nonprofit public utilities across the state must hire independent contractors with the necessary certifications and experience to operate their utilities. They do not have the technical expertise necessary to run public utilities, but, like Laurel Hills, those utilities find competent, skilled individuals that do possess that knowledge and coordinate their work to provide the technical expertise necessary to operate a public utility. Laurel Hills has done that. Its sanitary survey demonstrates that it has the technical expertise to operate the system, and the Authority should not deny the CCN on this basis alone.

**B. Laurel Hills Possesses the Financial Expertise To Operate The System, If It Can Get A Rate To Cover Actual Expenses**

When Laurel Hills took over the water system, it immediately recognized the huge financial burden it assumed in trying to operate this water system. As a result, Laurel Hills set an initial rate of service of \$86.40 to help it meet those financial obligations. Unfortunately, as explained above, Laurel Hills never collected this much needed rate. As a result Laurel Hills' financial condition has deteriorated over the course of the past year, but that is not the fault of Laurel Hills. Rather, it is the result of having a rate of service established without any regard to



the actual expenses necessary to operate this water system. On its best months, under its current rate structure, Laurel Hills received only about \$4500 per month to operate the system. The following are the irrefutable, uncontested expenses of the water system:

<b>Expense</b>	<b>Amount</b>
Electricity	\$467 (taken from Mr. Novak's Direct Testimony)
Water	\$1,671 (taken from Mr. Novak's Direct Testimony)
Certified Operator	\$500 (taken from Laurel Hills Responses to Staff Data Requests)
Accountants	\$300 (taken from Mr. Novak's Direct Testimony)
<b>Total</b>	<b>\$2,928</b>

Under this scenario, there is only \$1,561 per month to cover the following unavoidable costs of any water system: insurance, maintenance expenses, operation expenses (including required water testing), attorneys' fees, taxes, depreciation, working capital, and interest expenses or rate of return. Laurel Hills incurred the following amounts per month to operate the water system in 2012:

<b>Expense</b>	<b>Amount</b>
Insurance	\$433 (taken from Mr. Novak's Direct Testimony)
Maintenance and Operations (which includes amount due and owing to Mr. McQueen and amounts due and/or paid to Renegade Resources)	\$3,183 (taken from Mike McClung's rebuttal testimony and the 2012 general ledger, arrived at by taking the \$18,935 paid to Renegade Resources, averaging that out to a monthly expense and dividing by 2 to allocate 50% of the expense to water operations, then adding the \$500 per week owed to Mr. McQueen)
Attorneys Fees (including only amounts due for TRA proceeding and excluding over \$50,000 in other legal expenses associated	\$2,923.33 (taken from BSJ's response to staff data requests showing that 2012 attorneys' fees for this rate case were \$35,080)

with operating the water system)	
Taxes	\$200 (taken from McClung's Rebuttal Testimony and Laurel Hills' response to TRA Staff Data Requests, Responses 1 and 4)
Depreciation	\$88 (taken from Mr. Novak's Direct Testimony)
<b>Total</b>	<b>\$6,627</b>

Obviously the parties dispute the amount of these remaining expenses, but it is indisputable that the expenses exist and should be born by the water system's customers. When the water system is owned by a property owner's association, these expenses can only be born by the water system's customers. After all, someone must maintain and operate the system, insurance must be carried, attorneys fees will be incurred, taxes assessed, and assets must be paid for – regardless of who is paying them and to whom. And even assuming that the system could be operated with half the amount of maintenance and operational expenses and that the amount of attorneys fees are spread out over two years (as proposed by Mr. Novak), the system would still have been bleeding money in excess of \$2,000 per month, and that is without paying any of the following expenses: \$18,000 due to Crab Orchard for back due amounts that predated Laurel Hills' operation of the water system (Hearing Tr., Ex. 9); 2) the loan to Renegade TimeShares, LLC (which the Attorney General's own expert testified constituted a very favorable deal for Laurel Hills and cover the fine paid to TDEC to clear that expense from the books and to Laurel Hills) (Hearing Tr. Ex. 1, Tab 16); and 3) the capital improvements necessary to operate the system including refurbishment of the water tank and the installation of valves and back flow preventers at customer residences (Hearing Tr., Ex. 1, Tab 12; Response to TRA Staff Data Request, Response No. 1, Proposal from Pittsburgh Tank). All of these expenses will have to be born whether Laurel Hills operates the water system or the Authority denies them that

opportunity and a receiver would be appointed (a receiver, of course, would be an additional expense that would then have to be paid in the event things take that unfortunate turn).

Laurel Hills recognized this state of affairs very early on in 2012, and reluctantly did the only thing it could: it informed its customers it could not financially operate under the current rate structure and that it would have to abandon operations of portions of the system. The Authority, understandably, was unwilling to let that happen, and successfully prevented Laurel Hills from taking that path. Although this was understandable, the Authority can hardly now deny Laurel Hills a CCN on the basis that it is not a financially viable operation when Laurel Hills itself recognized that and tried to correct it but was prevented from doing so by both a Court and the Authority.

Laurel Hills is a nonprofit, and it does not have shareholder equity to tap when it needs funds. Its only available avenues of financial viability are from its customers (through rates or other contributions) and/or through debt markets. (Hearing Tr. 281.)

Laurel Hills, in its early attempts to prudently and financially manage the system did tap the only debt market available to it: a related company who was willing to loan Laurel Hills money notwithstanding the uncertainty of its financial position. The Customer Intervenors, TRA Staff, and the Attorney General see this as an “affiliated transaction” subject to strict scrutiny because it believe that Laurel Hills got a bad deal and the customers should not have to pay for that suspect transaction. The deal was a loan, money was exchanged (no one can deny that, TDEC got paid, the pumps got installed, money flowed out to vendors) at a 6.5% interest rate. The Attorney General’s own witness acknowledged this was the rate that far more financially robust companies than Laurel Hills received for the cost of their debt. (Hearing Tr. 252-54.) In other words, it was a bad deal, for the lender, not the borrower. Laurel Hills got a

better interest rate than it could have ever obtained from anyone else to pay much needed expenses, and as a nonprofit these types of transactions are the only real way to generate revenue in a short amount of time. (Hearing Tr. 252-54.) Importantly, to date, Renegade Mountain Timeshares<sup>4</sup> has not been paid one single dime under this note. Unfortunately given the state of affairs that has persisted for the past year, Laurel Hills' affiliated companies were simply not willing to continue to put more money in given the state of affairs and the uncertainty of the regulatory environment. That was certainly not unreasonable.

In short, to the extent Laurel Hills does not possess the financial resources to operate the system, it is in that position through no fault of itself. The water system was woefully mismanaged long before Laurel Hills came onto the scene. Laurel Hills is simply in the unfortunate position of holding this proverbial bag when it came time to start doing things the right way (and doing things the right way is going to cost a lot more money than \$43.20 per month per customer). To deny them that opportunity in light of the huge risks it has assumed, and the sheer amount of debt it has assumed in trying to operate this system would be patently unfair. And there is a simple and obvious path to financial viability: establishing a rate that covers the actual expenses of the water system.

### **C. Laurel Hills Possesses The Managerial Expertise Necessary To Operate The System**

Laurel Hills, like virtually every nonprofit, has a volunteer board of directors and possesses no employees of its own. (Hearing Tr. At 221.) This is normal for the structure of

---

<sup>4</sup> Much has been made about Laurel Hills' loan transaction with this related entity, but as Mr. McClung has repeatedly testified, Laurel Hills was not in a position to borrow money on the open market. Hearing Tr. 65; McClung Direct 15-16. Far from being an improper transaction as alleged both by the Consumer Advocate and the Customer Intervenors, this was a transaction out of necessity of which the Consumer Advocates own expert testified that Laurel Hills got a more than fair interest rate. Hearing Tr. 252-55.

nonprofit organizations like Laurel Hills. Nevertheless, Laurel Hills' President, Mike McClung has demonstrated managerial experience sufficient to run an operation the size of Laurel Hills.

Mr. McClung has been active in the construction industry for over fifty years. (Hearing Tr. 221-222.) He currently owns and operates his own recycling operation in Florida with revenues in excess of \$5 million per year and moves approximately 7 million tons of material. (*Id.*) He has owned and managed an engineering firm that moved 40 million yards of material per year. (*Id.* at 222.) He owned and managed a trucking company that had over 100 trucks and revenues in excess of \$5 million per year. (*Id.*) He has over thirty years of management experience and has been a business owner and entrepreneur for over thirty years. (*Id.*)

Although Mr. McClung did testify that he had no specific managerial experience running a public utility, Laurel Hills' operations are far smaller in scope and scale than his experience running his recycling, engineering, and trucking companies. (*Id.*) Laurel Hills had revenues only in the tens of thousands and has no employees. (LH TRA Staff Responses at Response 2 and 3 (detailing the income received by Laurel Hills in 2011 and 2012))

Admittedly, there have been problems managing Laurel Hills' water operations, but these management problems are principally driven by the consistent lack of funding received by Laurel Hills to operate the system, and the poor state of the system as it existed when Laurel Hills took it over. Had Laurel Hills been able to obtain the necessary funds, it could have properly staffed its operations to ensure consistency in managing the operations of the utility.

It was also raised that Laurel Hills should be denied a certificate for failing to obtain one previously. However, as demonstrated at the Hearing, Laurel Hills as a nonprofit entity running a public utility service without a certificate is not that unusual in this state. In fact, Laurel Hills is not the only nonprofit operating without a certificate on *Renegade Mountain*, as the

Cumberland Point Condominium Property Owners' Association – a customer of Laurel Hills - admitted that it operates a sanitary sewer system that is subject to the Authority's regulatory jurisdiction. (Hearing Tr. 367-68).

Additionally, it was raised that Laurel Hills should be denied a certificate because it attempted to terminate water service to its customers in February of 2012 for non-payment. Obviously there was a disagreement as to the amounts owed for the relevant period, but Laurel Hills' attempts to terminate service for nonpayment without giving sixty days notice is not that unusual. In fact, the Authority's own rules allow a water company to terminate water service on at least seven days of notice for non-payment. *See* T.R.A. Rule 1220-4-3.19(1)(h). Laurel Hills' current temporary tariff allows it to terminate service to customers for nonpayment on 20 days notice. (*See* Tariff filed with Amended Petition.) In other words, failing to give sixty days of notice for termination for non-payment is not unusual and certainly not grounds for denying the certificate, even if the Chancery Court ultimately decided that sixty days of notice should have been given.

Mr. Novak suggests that it might be appropriate for the system to be operated by a receiver. Any receiver must obtain a CCN under the language of Tenn. Code Ann. § 65-4-101. The ratepayers will still incur the same costs to operate the system and must still hire qualified contractors to operate the system. In addition, a receiver will have to be paid for the services it provides to the system which will only increase the system's cost of service.

#### **IV. Laurel Hills Requests The Authority Set A Reasonable Rate For Service**

Although when Laurel Hills first filed its Petition, Laurel Hills had approximately 135 rate paying customers, Laurel Hills has since lost 15 customers bringing the total number of customers to 120. (McClung Rebuttal at 15; Laurel Hills Response to Second Discovery

Requests of Customer Intervenors, Ex. 1) Therefore the costs of the system must be spread across these remaining ratepayers.

At the Hearing, Laurel Hills proposed the following rate structure to cover its operating expenses, capital costs and debt payments:

**LAUREL HILLS WATER COMPANY**

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

ITEM	EXPENSE TYPE	CAPD MONTHLY PRO FORMA	COMPANY REVISED MONTHLY PRO FORMA	COMPANY REVISED MONTHLY PRO FORMA WITH SURCHARGE
	<b>O &amp; M Expenses</b>			
1	Engineering & Labor	\$333	\$2,500	\$333
2	Construction Contracts	0	1,400	1,400
3	Water Testing	600	600	600
4	Depreciation	88	500	88
5	Real Estate Tax	0	200	200
6	Telephone	61	61	61
7	Permits & Penalties	25	1,200	25
8	Interest Expense	0	1,900	1,900
9	Legal Expense	0	2,500	500
10	Accounting & Management Services	300	1,550	1,550
11	Office Expenses	20	200	200
12	Insurance Expense	433	433	433
13	Postage Expense	8	8	8
14	Equipment Rental Expense	8	150	150
15	Maintenance & Repair Expense	0	2,000	2,000
16	Wholesale Water Expense	1,671	1,750	1,750
17	Electricity Expense	467	467	467
18	<b>Total Monthly O &amp; M Amount</b>	<b>\$4,014</b>	<b>\$17,419</b>	<b>\$11,665</b>
19	<b>Total Annual O &amp; M Amount</b>	<b>\$48,168</b>	<b>\$209,028</b>	<b>\$139,980</b>
	<b>Rate Base:</b>			
20	Plant Service	\$15,757	\$15,757	\$15,757
21	Accumulated Depreciation	-525	-525	-525
22	Working Capital (1/8 of O & M Expenses)	6,021	\$26,128.50	\$17,497.50
23	<b>Total Rate Base</b>	<b>\$21,253</b>	<b>\$41,885.50</b>	<b>\$33,254.50</b>
24	Hypothetical Rate of Return	6.668%	6.668%	6.668%
25	<b>Return on Invested Capital</b>	<b>\$1,417</b>	<b>\$2,798</b>	<b>\$2,217</b>
26	<b>Total Cost of Service</b>	<b>\$49,585</b>	<b>\$211,821</b>	<b>\$142,197</b>
	<b>Rate</b>	<b>\$30.61</b>	<b>\$147.10</b>	<b>\$88.75</b>

The Attorney General's witness, Hal Novak, took exception with many of these proposed expenses which will be addressed in greater detail below, and Laurel Hills is willing to agree to some modifications of the rate structure to ensure a lower rate. As explained in greater detail below, Mr. Novak's proposed rate structure suffers from a harsh rigidity that failed to take into consideration the unique problems posed by Laurel Hills, a nonprofit utility that has been operating a water system for some time, but not within full compliance of the Authority's regulatory regime. For Mr. Novak, the solution to the unique nature of the problems created by Laurel Hills' situation is to simply ignore costs and not give any rate recovery. This will leave valid vendors of Laurel Hills unpaid, subjecting Laurel Hills to significant additional expenses if and when Laurel Hills is pushed into collections of these debts. Laurel Hills does not believe this is a valid approach, or even one in the best interest of its customers. In contrast to Mr. Novak's rigidity, Laurel Hills is willing to propose a more flexible approach as proposed in greater detail below.

**Line 1 (Engineering & Labor):** Mr. Novak has only proposed \$333 per month because he excluded from Laurel Hills' proposed amount the ongoing \$500 per week amount owed Darrell McQueen. Laurel Hills already outlined the significant services provided by Mr. McQueen, and the only question is whether Mr. McQueen is going to be compensated for that effort. He should be. The \$500 per week covers all services provided by Mr. McQueen, including his engineering services, and Mr. McQueen provides these engineering services at a rate which was significantly less than Laurel Hills could have hired a consulting engineer to perform the same work. Mr. McQueen's willingness to perform work for the water system, even when Laurel Hills lacked funds to pay him, was one of the primary reasons the water system was able to obtain its favorable score of 98 on its sanitary survey, and that Laurel Hills was able to



negotiate the dismissal of the TDEC enforcement proceedings against the water system, which had been ongoing for several years before Laurel Hills acquired the water system. Additionally Laurel Hills proposes that the past-due amount due to Mr. McQueen be collected through a surcharge.

Mr. Novak's proposed solution to this problem is strange. He claims that this expense should be rolled into rate base, but because it has not been paid it cannot be included in the rate base. (Hearing Tr. 280-281.) But when Laurel Hills incurred this cost, it simply lacked the funds to pay Mr. McQueen. Mr. Novak's solution to this problem (that Laurel Hills should simply come up with the money) ignores the practical solution facing a nonprofit entity like Laurel Hills. (Hearing Tr. 281.) Mr. Novak readily acknowledged this and simply says Laurel Hills should "borrow money or it depends on its customers for contributions." (*Id.*) Laurel Hills borrowed as much money as it could – from related entities – but that was not enough to cover all operational and capital expenses. (Hearing Tr. 139; McClung Rebuttal at Exhibit 2) Laurel Hills attempted to obtain this from customers through rates, but its rate increase was denied by the Chancellor in Cumberland County. (*See discussion supra.*) In other words, Laurel Hills is in an impossible solution under Mr. Novak's proposed scenario for it cannot obtain the funds it needs to roll this expense into rate base, but Mr. Novak does not believe it should be treated as an operational expense. This is an interesting abstract accounting problem, but its practical application is that Mr. McQueen goes unpaid for a valid debt. Laurel Hills does not believe that is fair, and accordingly believes this expense should be recovered through an expense passed onto its rate payers (either through a surcharge or an operational expense).

**Line 2 (Construction Contracts):** Mr. Novak has excluded the amount the Company has requested of \$1,400 a month for construction contracts and his initial reason for doing so, an

alleged issue concerning the ownership of the water system – was soundly rejected by the Hearing Officer. Mr. Novak also takes issue with putting this expense in the operating budget. Mr. Novak excludes this expense altogether again because of the same reason he excludes the amounts due to Mr. McQueen. (Hearing Tr. 283)

Laurel Hills is willing to roll these expenses into a capital account to offset some of the impact on rates, but Laurel Hills can only do that if it contracts with vendors who are willing to provide services on a credit basis. The only entities willing to do that are entities associated with Laurel Hills. This would decrease the line item expense to zero, increase depreciation expenses by approximately \$119 (through a 30 year straight-line depreciation) and increase plant in service by \$43,000 (McClung Direct at 11; McClung Rebuttal at Ex. 1). This would reduce the monthly rate by approximately \$9.00 per month.

Importantly, the installation of these valve boxes is necessary to permit the Company to terminate service to individual customer connections for nonpayment. (McClung Direct at 10-11.) Otherwise, the system could risk having a leak at one of its abandoned residences that could go unnoticed for weeks at a time. (*Id.*) In addition, these valve boxes must be installed for the Company's customers to install backflow preventers which TDEC has recommended for all of the Company's service connections. (*Id.*) This is a valid expense of the Company, must be incurred for the prudent management of the system, and the only real question is how to pay for it. (*Id.*) Mr. Novak's proposal would leave this expense unpaid, and therefore the work unperformed. Laurel Hills' approach on the other hand would allow for this necessary work to move forward.

**Line 3 (Water Testing).** This expense is not reasonably contested and should be included in rates. (McClung Rebuttal Testimony at 6.)

**Line 4 (Depreciation).**<sup>5</sup> Laurel Hills will use the \$88 per month proposed by Mr. Novak for depreciation of the system. To the extent that the Authority wishes it to capitalize other expenses (as detailed in other sections of this brief), this line item would have to be adjusted accordingly.

**Line 5 (Real Estate Taxes).** Mr. Novak has excluded any expense for the Company for real estate taxes because this expense was not in the test period, a puzzling position given the nature of this system. (Hearing Tr. 284-285) Laurel Hills will pay a property tax and that tax will be assessed on a number of factors. *See* T.C.A. § 67-5-1311. To exclude this expense is, like Mr. Novak's consideration of the McQueen expense, an improper and rigid application of rules routinely applied in the normal public utility sphere, but have no practical application here. (Hearing Tr. 287-88.) Laurel Hills reasonably estimated its property taxes based on its historical costs. (*See* Laurel Hills Response to TRA Staff Data Request, Response 1 and 4 (showing amounts historically paid for property taxes).) Again, this cost will be assessed and charged, it is a valid expense of the system, the only question is whether Laurel Hills will have the funds necessary to pay these expenses. Accordingly, this expense should be included in the rate structure.

**Line 6 (Telephone Expenses).** This expense is not reasonably in dispute. (McClung Rebuttal Testimony at 8.)

**Line 7 (Permits & Penalties).** Mr. Novak again proposes here form over substance, rigidity over flexibility, and decries any practical solution to a problem uniquely posed by Laurel Hills. Mr. Novak provides no recovery for the amounts paid to the State of Tennessee in order to settle a TDEC enforcement proceeding because "the TRA does not include fines and penalties in

---

<sup>5</sup> Laurel Hills disagrees with the Hearing Officer's contention that the \$400,000 note to Moy Toy should be excluded from rates, but for Authority's convenience will exclude all rate amounts associated with this valid debt from its calculations.

setting rates.” (Hearing Tr. 287) However, that is in the normal context of a for-profit entity that has a “pool of investors” in which to step in and pay such a fine. (Hearing Tr. 288) That is not available to Laurel Hills.

Laurel Hills agreed to pay the civil penalty amount it negotiated with the Assistant Attorney General representing TDEC in the enforcement proceeding. (McClung Rebuttal Testimony at 8) While the violations which were the subject of the enforcement proceedings occurred long before Laurel Hills purchased the water system, TDEC took the position that the water system itself was responsible for any civil penalties awarded to TDEC by the court. (*Id.*) Taking into account the costs of defending against the enforcement proceeding and Laurel Hill’s inability to defend against the actions of the prior owners of the water system, the payment of the negotiated civil penalty amount was in the best interest of water system’s customers. (*Id.*)

In other words, if Laurel Hills did not pay the penalty and get the enforcement action dismissed, the cost to the system would have far exceeded the \$11,282.50 actually paid. Therefore, Laurel Hills should be able to recover the civil penalty amount paid through its rate structure or through a surcharge because this was a reasonably prudent expense of the system.

The Company understands that this expense will not be a recurring expense and may be more appropriately recovered by a surcharge to the monthly rate for water service approved until the entire amount is recovered. The prudent operation of the water system mandated the civil penalty be paid. Laurel Hills had no funds available to pay the civil penalty and borrowed funds to pay the civil penalty from Renegade Mountain Timeshares. The loan from Renegade Mountain Timeshares, Inc. is a valid debt of the water system. If Laurel Hills is not able to pay the balance of the note off through its water operations, Renegade Mountain Timeshares, LLC

may foreclose on the note, costing Laurel Hills significant legal and other expenses which will only increase Laurel Hills' cost of service.

**Line 8 (Interest Expense).** Laurel Hills' interest expense on the loan to Renegade Mountain Timeshares can be paid through the proposed rate of return, as proposed by Mr. Novak in his testimony at the Hearing. Given the Hearing Officer has excluded expenses related to the \$400,000 note to Moy Toy, Laurel Hills is willing to concede that this budget item should be removed.

**Line 9 (Legal Costs).** Once again Mr. Novak's approach suffers from the same rigidity as many of his other proposed cost recovery approaches, and would leave Laurel Hills unable to pay a vendor for services rendered for its water operations. Mr. Novak provides \$0 for legal expenses incurred by the Company related to its water operations, a position Mr. Novak readily acknowledges is unusual. (Hearing Tr. 290-91) All of the legal expenses incurred by the Company in this proceeding are properly recoverable. *Tenn. Am. Water Co. v. Tenn. Regulatory Auth.*, 2011 Tenn. App. LEXIS 51 (overturning Authority decision to deny rate recovery of legal expenses incurred in a rate case). While Laurel Hills acknowledges the amount of legal expenses which have been incurred and will be incurred in this proceeding are high in comparison to the number of persons served by the Laurel Hills water system, the sizable costs of this proceeding have been driven primarily by the CAPD and intervenors in multiple discovery requests and depositions. (McClung Rebuttal at 9-10; Branstetter Stranch and Jennings Response to TRA Staff Data Requests (filed February 8, 2013), Ex. 1 ("BSJ Response"))

Mr. Novak also claims that attorneys fees associated with a proceeding of this nature should be recovered over a two or three year period. (Hearing Tr. 291-92) But Mr. Novak fails to recognize that is what the Laurel Hills' proposed operating expense does. Laurel Hills has

incurred (or at least will incur) approximately \$50,000 in legal expenses related to this case. (BSJ Response at 2) The proposed budget allocates \$2,500 for legal fees per month meaning that over a two year period, Laurel Hills would accrue approximately \$60,000 in revenue for attorneys' fees. Allocating \$50,000 of that amount for fees strictly for this proceeding leaves Laurel Hills with approximately \$10,000 in operational expenses related to legal fees unrelated to this case - a reasonable estimate for an entity regulated by the Authority and TDEC.

Additionally, Laurel Hills asserts that all legal expenses related to the first case Laurel Hills was required to defend in the Cumberland Chancery Court are properly included as an expense in this case. (McClung Rebuttal at 10) The actions taken by Laurel Hills which prompted the filing of the lawsuit by some of the intervenors was prompted by the concerted effort of a majority of the Company's customers not to pay the monthly bills for water service in the late fall of 2011. (McClung Rebuttal at 10) The actions of the Laurel Hills' customers resulted in the Company having no revenue on which to operate and left the Company with no option except to terminate water service to the four customers which the Company could terminate service, without terminating service to all of its customers. (McClung Rebuttal at 10)

Disallowing these legal expenses would leave Laurel Hills defenseless to any claim brought by a customer at any time. This is simply not a reasonable path forward for any business entity. Funds are necessary to defend against actions, regardless of whether or not Laurel Hills ultimately succeeds in those actions. Accordingly, at a minimum the expenses related to the first Chancery Court case should be recoverable through rates.

Similarly, the second Chancery Court case brought by the Authority should also be recoverable. Laurel Hills took actions it reasonably believed necessary given its deteriorating financial position, and although it has not yet prevailed in that action, the legal expenses derived

from reasonable prudent attempts to operate the water system in a financially reasonable method should be recovered.

Including these expenses into the cost and setting a monthly cost of \$2,500 per month would then allow Laurel Hills close to four years to recover the attorneys' fees it has prudently incurred. (*See* BSJ Response at 2) This is consistent with Mr. Novak's proposal that attorneys' fees of this nature should be recovered over a two or three year period. (Hearing Tr. 291)

**Line 10 (Accounting & Management Services).** This amount includes the amounts paid to Lansford & Stephens for monthly billing, collection and accounting services. Mr. Novak properly allocates an amount of \$300 per month paid to Lansford & Stephens as a valid expense. (McClung Rebuttal at 10) However, Mr. Novak's failure to allocate any money for maintenance expense once again demonstrates unnecessary rigidity. He claims that Laurel Hills did not incur this expense during the "test period." (Hearing Tr. 294) Although a review of the Laurel Hills general ledger reveals that Laurel Hills paid Renegade Resources over \$13,000 in 2011, and \$18,935 through August 2012 (Laurel Hills Response to TRA Staff Data Request at 4).<sup>6</sup>

Mr. Novak limited this expense only to the invoices provided by Lansford & Stephens, but this item also includes the amounts allocated from Renegade Resources, LLC for work performed by it on the Company's water system. As explained in Laurel Hills' response to discovery requests from the Consumer Advocate Division, Renegade Resources provides

---

<sup>6</sup> Much has also been raised regarding Laurel Hills' use of Renegade Resources, a related entity also providing services to other entities on the mountain. Compare Hearing Tr. Ex. 1, Tab 13 (showing Renegade Resources payments of over \$34,000 in 2011) with LH Staff Response, Response 4 (showing Laurel Hills payment of only \$13,000 to Renegade Resources for 2011). However, Laurel Hills is clearly paying market rates for Renegade Resources labor. Renegade Resources pays its employees between \$8 and \$15 per hour. Hearing Tr. Ex. 1, Tab 13. There is no evidence that this is inconsistent with prevailing market rates in the area. Moreover, as explained by Mr. McClung, this arrangement provides liability cover for Laurel Hills in the event that a person is injured on the job. (Hearing Tr. 109-112.) And because this is a related company, Laurel Hills can ensure that needed labor is available and on call if and when it needs it. In other words, contracting out its operations and management labor is a reasonably prudent business decision. (*Id.*) In any event, Laurel Hills' management expenses for operations and management of water operations seeks \$1200 per month for this expense, or only 120 man hours at \$10 per hour. This is a reasonable amount for a water utility of this size, and hardly supports the Customer Intervenor's and Attorney General's position that these affiliated transactions should be ignored altogether.

significant labor resources to Laurel Hills in the management of the system. Someone must conduct routine maintenance on the water system, respond to emergency calls, fix leaks in the system, assist the certified operator as needed, handle customer inquiries and perform other customer service functions other than the billing and collection done by Lansford & Stephens. Both TDEC and the Company's customers expect these job tasks to be performed for the system. If the Company is not permitted to use Renegade Resources to perform these functions, then it must hire outside contractors and vendors to perform these functions which will increase the costs the Company has been paying Renegade Resources to perform these job tasks. Accordingly, the amount which the Company seeks to recover for accounting and management services is reasonable and necessary.<sup>7</sup>

**Line 11 (Office Expenses).** Mr. Novak incorrectly assumes that office supplies for the office is only \$20 per month. As can be seen from a review of the Exhibit 1 to Mr. McClung's Direct Testimony, TDEC itself requires Laurel Hills to maintain significant records and to do that requires significant office expenses. Accordingly, Mr. Novak's position is untenable as it would leave Laurel Hills without resources to maintain records in accordance with TDEC and the Authority's regulations. (McClung Rebuttal at 11)

**Line 12 (Insurance Expense).** Laurel Hills does not challenge Mr. Novak's allocation of the insurance expense and attached as Exhibit 1 hereto is a certificate of insurance for one of

---

<sup>7</sup> Mr. Novak also requests that Laurel Hills convert its financial statements to the uniform system of accounts ("USOA"); however, Mr. Novak provides no money in his proposed expenses for the conversion and the continuing education by Lansford & Stephens to use the USOA. In addition, the Company will need to use the services of Lansford & Stephens to meet other requirements the Company will have as a regulated utility. The Company will need to use Lansford & Stephens to prepare and submit the quarterly and annual financial reports to the Authority as required by its rules and regulations. The Company will need to use Lansford & Stephens to prepare and submit its annual ad valorem report to the Tennessee Comptroller's office. The Company anticipates it will need to consult with Lansford & Stephens periodically on other TRA regulatory matters to respond to inquiries by the Authority. Lansford & Stephens are not familiar with the USOA and therefore a new accountant would have to be found, and Laurel Hills suspects that having that accountant maintain the financial statements in accordance with the USOA would be far more expensive than the services currently offered by Lansford & Stephens. McClung Rebuttal at 10-11.



Laurel Hills' policies. (McClung Rebuttal at 12) This allocation allocates 50% of the incurred insurance expenses between Laurel Hills' timeshares operations and its water budget. (*Id.*) Accordingly, Mr. Novak's and Laurel Hills' allocation of the insurance expenses are consistent.

**Line 13 (Postage Expense).** This expense is not reasonably in dispute. (McClung Rebuttal at 13)

**Line 14 (Equipment Rental Expense).** Mr. Novak improperly reduced this amount. Laurel Hills does not own equipment like backhoes in order to perform maintenance on the system. (McClung Rebuttal at 12) The system, although relatively small, requires a relatively larger amount of maintenance because of the fact that the system is located on the side of a mountain and part of its main service line is above ground (because it is prohibitively expensive to bury the line going up the side of the mountain). (*Id.*) As a result, Laurel Hills needs to regularly rent equipment to help individuals from Renegade Resources, LLC perform maintenance when leaks or other issues arise. Obviously, it is very important when equipment needs to be leased for funds to be immediately accessible for that expense. (*Id.*)

**Line 15 (Maintenance & Repair Expense).** Once again, Mr. Novak demonstrates his utter inflexibility in his approach to how Laurel Hills should operate this system. The majority of this line item relates to rehabilitation of the system's water tank, which is needed in order to ensure the system is able to meet TDEC requirements (McClung Direct at 9-10). The estimated rehabilitation cost is \$183,000 (LH TRA Staff Responses at Response 1; McClung Direct at 9-10), but Mr. Novak provides no monies for this expense – under the same flawed logic that lead him to fail to provide for Mr. McQueen's expenses. Although capitalizing the expense is without doubt the best method of paying for the tank rehabilitation, Laurel Hills cannot borrow

money to pay for this expenditure and does not have sufficient available funds to pay for this expenditure, and therefore, has no choice but to pay for this out of the operating budget.

The expense could be capitalized and depreciated over time if Laurel Hills could find a vendor willing to finance this type of operation. Laurel Hills believes this may be possible, but it needs to demonstrate that it can pay for this expense through rates – and it is indisputable that its current \$43.20 per month rate right now is inadequate to demonstrate that type of financial capability. If the tank could be capitalized, then depreciation expense would increase by approximately \$508 per month (\$183,000 straight-line depreciated over 30 years), plant in service would increase, and as a result Laurel Hills' proposed rates could be reduced by approximately \$14.00 per month.

**Line 16 (Water Expense).** The difference between Mr. Novak's line item and Laurel Hills' is Mr. Novak improper exclusion of late-payment penalty amounts from his calculation. (McClung Rebuttal at 13) However, those penalty amounts are assessed by Laurel Hills' water provider and are valid expenses of the system, and have been imposed because the water system has not been current with its water provider since at least 1999. (Hearing Tr., Ex. 9) Without cost recovery of those expenses, Laurel Hills will not be able to pay its water bills in full and will face termination of water service from its water provider. (McClung Rebuttal at 14)

**Line 17 (Electricity Expense).** This expense is not reasonably in dispute.

**Line 20 (Plant in Service).** This expense is not reasonably in dispute and may need adjustment depending on whether certain expenses are capitalized.

**Line 21 (Accumulated Depreciation).** This line item is not in dispute.

**Line 22 (Working Capital).** Laurel Hills does not dispute Mr. Novak's use of 1/8 of its operating budget as proper allocation for working capital, but Laurel Hills, as explained above,

disputes the amount of its operating budget used by Mr. Novak in his calculation. Accordingly, Laurel Hills proposes \$25,510.50 based on the above discussion for working capital.

**Line 24 (Rate of Return).** Laurel Hills will not dispute a 6.5% rate of return.

Additionally, as further explained in Mike McClung's rebuttal testimony certain historical expenses should be recovered through a surcharge. For instance, the past-due amount owed to Crab Orchard – which was over \$18,000 when Laurel Hills took over the system and over \$25,000 at the time of the Hearing – should be recovered through a rate surcharge. (McClung Rebuttal at 23-24) This surcharge could be anywhere from \$8.21 to \$47.49 depending on the costs included in the surcharge. (*Id.*)

As a result of these proposed changes, Laurel Hills proposes the following three possible rate schedules:

LAUREL HILLS WATER COMPANY  
TABLE - CAPD ANALYSIS OF PRO FORMA COST OF SERVICE

ITEM	EXPENSE TYPE	COMPANY PRO FORMA NO SURCHARGE	COMPANY REVISED MONTHLY PRO FORMA WITH SURCHARGE	COMPANY REVISED MONTHLY - With Capitalized Expenses And Surcharge
<b>O &amp; M Expenses</b>				
1	Engineering & Labor	\$2,500	\$333	\$333
2	Construction Contracts	1,400	1,400	0
3	Water Testing	600	600	600
4	Depreciation	88	88	716
5	Real Estate Tax	200	200	200
6	Telephone	61	61	61
7	Permits & Penalties	1,200	25	25
8	Interest Expense	0	0	0
9	Legal Expense	2,500	500	500
10	Accounting & Management Services	1,550	1,550	1,550
11	Office Expenses	200	200	200
12	Insurance Expense	433	433	433
13	Postage Expense	8	8	8
14	Equipment Rental Expense	150	150	150
15	Maintenance & Repair Expense	2,000	2,000	0
16	Wholesale Water Expense	1,750	1,750	1,750
17	Electricity Expense	467	467	467
18	<b>Total Monthly O &amp; M Amount</b>	<b>\$15,107</b>	<b>\$9,765</b>	<b>\$6,998</b>
19	<b>Total Annual O &amp; M Amount</b>	<b>\$181,284</b>	<b>\$117,180</b>	<b>\$83,913</b>
<b>Rate Base:</b>				
20	Plant Service	\$15,757	\$15,757	\$226,000
21	Accumulated Depreciation	-525	-525	-525
22	Working Capital (1/8 of O & M Expenses)	\$22,660.50	\$14,647.50	\$10,489.17
23	<b>Total Rate Base</b>	<b>\$38,417.50</b>	<b>\$30,404.50</b>	<b>\$236,489.17</b>
24	Hypothetical Rate of Return	6.500%	6.500%	6.500%
25	<b>Return on Invested Capital</b>	<b>\$2,497</b>	<b>\$1,976</b>	<b>\$15,372</b>
26	<b>Total Cost of Service</b>	<b>\$183,781</b>	<b>\$119,156</b>	<b>\$99,285</b>
	<b>Rate</b>	<b>\$127.63</b>	<b>\$82.75</b>	<b>\$68.95</b>

Laurel Hills understands that these numbers are large, and unfortunate. But regardless of who operates the system, significant capital improvements need to be made (including refurbishment of the water tank and installation of valve boxes) and significant operational expenses are required (including payment of staff like Mr. McQueen to run the day to day operations of the system). Unfortunately, the previous owners of the system allowed this water system to

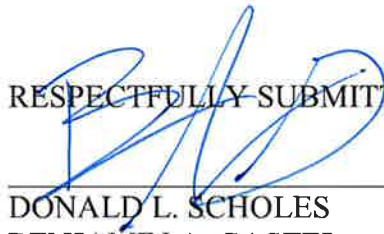
deteriorate to this condition requiring significant capital improvements and significant maintenance expenses to fix this problem. Laurel Hills understands this is expensive, and the only true way to reduce these amounts is to grow the size of the customer base, which can only been done when a consistent, safe, adequate drinking water system is in place. Laurel Hills is prepared to be that partner, and it is up to the Authority to allow it to do so.

### **CONCLUSION**

For the foregoing reasons, Laurel Hills respectfully requests that its Amended Petition be granted, and the Authority set a rate of service consistent with the options detailed above.

**DATED:** March 15, 2013

RESPECTFULLY SUBMITTED,



---

DONALD L. SCHOLES  
BENJAMIN A. GASTEL  
Branstetter, Stranch & Jennings, PLLC  
227 Second Avenue North  
Fourth Floor  
Nashville, TN 37201-1631

**CERTIFICATE OF SERVICE**

The undersigned hereby certifies that a true and exact copy of the foregoing was served upon  
the following via United States Mail:

Shiva Bozarth, General Counsel  
Tennessee Regulatory Authority  
460 James Robertson Parkway  
Nashville, TN 37243-0505

Charlena S. Aumiller, Esq  
Consumer Advocate Division Office of  
the Attorney General  
P.O. Box 20207  
425 5th Avenue North, 2<sup>nd</sup> Floor  
Nashville, TN 37243-0500

Melanie Davis  
Kizer & Black Attorneys, PLLC  
329 Cates St.  
Maryville, TN 37801

This the 15th day of March, 2013.

  
\_\_\_\_\_  
Benjamin A. Gastel