BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

April 18, 2013

IN RE:	)	
	)	
PETITION OF LAUREL HILLS CONDOMINIUMS PROPERTY OWNERS ASSOCIATION FOR A CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY	)	**DOCKET NO. 12-00030**

ORDER DENYING CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY AND REQUIRING DIVESTITURE OF WATER SYSTEM

This matter came before Chairman James M. Allison, Director Kenneth C. Hill and Director David F. Jones[1] of the Tennessee Regulatory Authority (the "Authority" or "TRA"), the voting panel assigned to this docket, at a regularly scheduled Authority Conference held on April 8, 2013 for the purpose of considering the *First Amended Petition* filed by Laurel Hills Condominium Property Owners Association ("Laurel Hills" or the "Petitioner") on August 3, 2012.

BACKGROUND AND TRAVEL OF THE CASE

Laurel Hills is the property owners association for timeshare units of the Laurel Hills timeshare condominium complex.[2] On May 1, 2011, Laurel Hills acquired a water system from Moy Toy, LLC ("Moy Toy") and began operating the water system serving customers within a development known as Renegade Mountain in Cumberland County, Tennessee.[3] The water system has approximately 50 customer connections; one customer, Cumberland Point Condominiums Association, purchases water for 84 residential units.[4]

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[1] Director Sara Kyle was assigned to the panel and participated in the Hearing held on February 13, 2013. Thereafter, Director Kyle left the agency, and Director David F. Jones was assigned to the panel. Director Jones reviewed the existing record pursuant to Tenn. Code Ann. § 4-5-314 prior to deliberations. *See* Transcript of Authority Conference, pp. 12-13 (April 8, 2013).

[2] *First Amended Petition*, p. 1 (August 3, 2012).

[3] *Id.* at 1-2.

[4] *Id.* at 3.

Laurel Hills purchases its water from Crab Orchard Utility District and resells the water to its customers.[5] When Laurel Hills acquired the water system, the monthly flat rates in effect were $20 for each residential unit of Cumberland Point Condominiums Association and $25 for other customers.[6] For water service beginning June 2011, Laurel Hills raised its rates to $86.40 per residential unit for monthly service.[7] No valves or other equipment to permit Laurel Hills to terminate individual customers for non-payment were installed at that time.[8] The Petitioner sent a notice to its customers dated December 30, 2011 with its January 2012 monthly bill, stating that because the "majority of customers" had stopped paying their bills, Laurel Hills had no choice but to suspend water service effective January 31, 2012, for lack of funds to operate the system.[9]

After the Petitioner cut off water service for five days beginning on February 1, 2012, six customers of Laurel Hills filed suit in the Chancery Court of Cumberland County seeking a temporary restraining order and a temporary injunction against Laurel Hills to prohibit the termination of water service.[10] In his order granting a temporary injunction entered on February 28, 2012, Chancellor Ronald Thurman directed Laurel Hills to contact the TRA within twenty days of February 14, 2012 regarding the Authority's regulation of the water system.[11] Counsel for Laurel Hills wrote a letter dated February 16, 2012 to the TRA's General Counsel, notifying the Authority that Laurel Hills intended to file a petition for a certificate of public convenience and necessity ("CCN").[12]

Laurel Hills filed a petition for a CCN in this docket on April 10, 2012.[13] On May 1, 2012,

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[5] *Id.* at 3.
[6] *Id.* at 2.
[7] *Id.* at 3.
[8] *Id.* at 4.
[9] *Id.* at 4.
[10] *Id.* at 5. *See also Customer Intervenors' Brief/Closing Argument*, p. 4 (March 15, 2013).
[11] *Id.* at 5.
[12] *Id.* at 5 and Ex. 6.
[13] *See Petition* (April 10, 2012).

a group of Laurel Hills' customers ("Customer Intervenors") filed a petition to intervene.[14] Laurel Hills concluded that the water system was not financially viable and decided to terminate service to all customers other than itself so that it would no longer be a "public utility" as defined in Tenn. Code Ann. § 65-4-101(6).[15] Thereafter, on May 7, 2012, Laurel Hills filed with the Authority a *Notice of Voluntary Dismissal and Withdrawal* of the *Petition.*

On May 11, 2012, the Authority issued a *Notice to Appear* to Laurel Hills, requiring the Petitioner to appear at the TRA's May 21, 2012 Authority Conference and show cause as to why a contested case should not be convened to impose penalties for various violations of Tennessee statutes.[16] On May 18, 2012, the Petitioner filed a Response to the *Notice to Appear*, stating that since Laurel Hills was discontinuing service to its customers, it would not be a public utility after July 9, 2012 and had no funds budgeted to defend itself against a proceeding for the imposition of civil penalties.[17]

At the May 21, 2012 Authority Conference, no representative of Laurel Hills appeared.[18] The panel voted unanimously to appoint a Hearing Officer and to authorize the Hearing Officer to make a determination whether to issue a Show Cause in this matter based upon any evidence presented by TRA Investigative Staff; and, if a Show Cause were issued, to prepare the matter for hearing before the Directors. In addition, the panel authorized Investigative Staff to take any necessary measures, including filing for injunctive relief in the Chancery Court for Cumberland County, to maintain water service for all customers of Laurel Hills, including the homeowners in

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[14] *Petition of Gary Haiser; John Moore; Gerald Nugent; Roy Perry; John Peters; Joel Matchak; Robert Adkins; Joe Garner; Terry Cope; Robert Schwartz; Onus Williams; Gene Maners; Michael Krabousanos; Wendell Blair; Luke Dunn; David Breg; Kent Latham; Cortez Investment Group, Inc.; Jimmy Douglas; Thomas Bauer; Donald Sandlin; Judy Scales Patterson; Isaac Gamble; Renee Todd; Richard Knapp; John Chambers; John P. Peters Revocable Trust; and Cumberland Point Condominium Owners Association to Intervene in Docket No. 12-00030* (May 1, 2012).

[15] *First Amended Petition*, p. 6 (August 3, 2012).

[16] *Notice to Appear* (May 11, 2012). The *Notice to Appear* listed potential violations for operation of a public utility without a CCN in violation of Tenn. Code Ann. § 65-4-201; failure to pay annual inspection fees in violation of Tenn. Code Ann. § 65-4-301(a); failure to file a tariff in violation of Tenn. Code Ann. § 65-5-102; charging rates not approved by the Authority in violation of Tenn. Code Ann. § 65-5-101 and/or Tenn. Code Ann. § 65-5-103; and withholding or refusing to provide service to its customers in violation of Tenn. Code Ann. § 65-4-115.

[17] *Response to Notice to Appear*, pp. 2 and 5-6 (May 18, 2012).

[18] Transcript of Authority Conference, p. 13 (May 21, 2012).

Renegade Resort, pending resolution of the Show Cause proceeding.[19] On June 28, 2012, the Consumer Advocate Division of the Office of the Attorney General ("Consumer Advocate") filed a petition to intervene in this docket.

After Laurel Hills again asserted their intention of discontinuing water service to their customers on July 9, 2012, TRA Investigative Staff filed a Petition for Injunctive Relief in the Chancery Court of Cumberland County on June 29, 2012. Chancellor Thurman issued a Temporary Restraining Order setting the matter for hearing on July 12, 2012. At the July 12, 2012 hearing, the Chancellor ruled from the bench that the injunction would remain in effect and that Laurel Hills must re-file its petition with the TRA.

On July 17, 2012, the Hearing Officer issued a Show Cause Order, which was filed in this docket and subsequently transferred to a new docket, TRA Docket No. 12-00077.[20]

On July 20, 2012, Laurel Hills filed a *Notice of Reinstatement of Petition, Tariff Filing and Intent to File an Amended Petition.* On August 3, 2012, Laurel Hills filed the *First Amended Petition.*

Subsequently, on August 8, 2012, a written Proposed Agreed Order reflecting his July 12, 2012 decision was issued by the Chancellor Thurman. The Chancellor's Order set a flat water rate of $43.20 for individual customers until such time as the TRA made a determination of the appropriate rate.

On August 22, 2012, TRA Investigative Staff was designated as a party in the CCN proceeding.[21] At the August 20, 2012 Authority Conference, the panel convened a contested case and appointed a Hearing Officer to prepare the matter for hearing before the panel.[22] On September

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[19] *Order Appointing Hearing Officer*, pp. 3-4 (June 21, 2012).

[20] The Show Cause Proceeding in TRA Docket No, 12-00077 has been held in abeyance by agreement of Laurel Hills and TRA Investigative Staff since August 8, 2012. *See In re: Show Cause Proceeding Against Laurel Hills Condominiums Property Owners Association for Alleged Violations of Tenn. Code Ann. §§ 65-4-201, 65-4-301(A), 65-5-102, 65-4-101 and/or 65-4-103, and 65-4-115,* Docket No. 12-00077, *Agreed Order* (August 8, 2012).

[21] *See* Memorandum from Jean Stone, TRA General Counsel, to Docket File (August 22, 2012).

[22] *Order Convening a Contested Case and Appointing Hearing Officer* (August 31, 2012).

19, 2012, the Hearing Officer granted the intervention requests by the Customer Intervenors and the Consumer Advocate.[23]

FIRST AMENDED PETITION

In its *First Amended Petition* filed on August 3, 2012, Laurel Hills requested that the Authority issue to it a CCN to operate the water system.[24] The Petitioner also proposed a tariff for Authority approval, with a flat monthly rate of $134.26 per residential unit,[25] based upon Laurel Hills' assertions that it costs $18,125 per month to operate the water system.[26] The proposed tariff also included a $100 connection fee, a $500 reconnection fee and a $30 returned check fee.[27]

FEBRUARY 13, 2013 HEARING, APPEARANCES AND POST-HEARING FILINGS

The Hearing in this matter was held before the voting panel on February 13, 2013, as noticed by the Authority on February 1, 2013.[28] Participating in the Hearing were the following parties and their respective counsel:

> Laurel Hills Condominium Property Owners Association – **Benjamin A. Gastel, Esq.**, and **Donald L. Scholes, Esq.**, Branstetter, Stranch & Jennings, PLLC, 227 Second Avenue North, Nashville, TN 37201-1631.
>
> Customer Intervenors – **Melanie Davis, Esq.**, Kizer & Black, PLLC, 329 Cates Street, Maryville, TN 37801.
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> Consumer Advocate – **John J. Baroni, Esq.**,[29] **Vance Broemel, Esq.** and **Charlena Aumiller, Esq.**, Office of the Attorney General, 425 Fifth Avenue North, Fourth Floor, John Sevier Building, P.O. Box 20207, Nashville, TN 37202.
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> TRA Investigative Staff – **Shiva Bozarth, Esq.**, Tennessee Regulatory Authority, 460 James Robertson Parkway, Nashville, TN 37243.

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[23] *Order Granting, in Part, Petitions to Intervene and Establishing a Procedural Schedule* (September 19, 2012).
[24] *First Amended Petition*, p. 9 (August 3, 2012).
[25] *Id.* Laurel Hills later revised the requested monthly rate to $147.71, with certain items recovered through a surcharge. *See* Michael McClung, Pre-Filed Rebuttal Testimony, p. 15 (January 14, 2013). In its post-hearing brief, Laurel Hills proposed three different rate structures. *See Petitioner's Post Hearing Brief*, p. 35 (March 15, 2013).
[26] *First Amended Petition*, Ex. 10 (August 3, 2012).
[27] *Id.* at Ex. 9.
[28] *See Notice of Hearing* (February 1, 2013).
[29] Mr. Baroni left the Office of the Attorney General, and the Consumer Advocate withdrew Mr. Baroni as counsel of record in this docket on March 7, 2013. *See* Letter from Vance Broemel to Hearing Officer Monica Smith-Ashford (March 7, 2013).

Michael McClung appeared as the witness for Laurel Hills. Witnesses for the Consumer Advocate were Dr. Christopher Klein and William H. Novak. Witnesses for the Customer Intervenors were John Moore, Everett Bolin, Jr., Ronnie Hill and Robert Adkins. Witnesses were subject to cross-examination by the other parties and questions from the panel. In addition, at the start of the Hearing, members of the public were given an opportunity to present comments to the panel.[30] Following the Hearing, the panel took the matter under advisement, and the parties filed post-hearing briefs on March 15, 2013.

FINDINGS AND CONCLUSIONS

The panel deliberated the matter at a regularly scheduled Authority Conference held on April 8, 2013. Upon consideration of the entire record, including all testimony and exhibits, the panel made the following findings and conclusions:

Laurel Hills' Water System is a Public Utility

Non-profit homeowners associations are generally excluded from regulation as a public utility if the water system is for the "exclusive use of that subdivision" pursuant to Tenn. Code Ann. § 65-4-101(B)(i). In this instance, however, the sale of water to customers outside the homeowners association nullifies this exclusion and instead means that the water system is "dedicated for public use" within the meaning of Tenn. Code Ann. § 65-4-101(6)(A). Therefore, the panel found that the water system owned by Laurel Hills Condominium Property Owners Association is a "public utility" as defined in Tenn. Code Ann. § 65-4-101(6)(A) and is subject to the jurisdiction of the TRA.[31]

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[30] *See* Transcript of Proceeding, pp. 7- 31 (February 13, 2013).

[31] Laurel Hills seems to concede that it is a public utility, although it bases its concession on an amendment to Tenn. Code Ann. § 65-4-101(6)(E) (now codified as Tenn. Code Ann. § 65-4-101(6)(A)(v)) that clarified the Authority's jurisdiction over non-profit corporations that are not cooperatives. Laurel Hills states: "As a result of the enactment of Public Chapter 430 of the 2011 Tennessee Public Acts, it appears that Laurel Hills became a public utility as defined in T.C.A. § 65-4-101 and became subject to regulation on the effective date of Public Chapter 430, June 6, 2011." *First Amended Petition*, p. 6 (August 3, 2012).

Laurel Hills is Required to Have a CCN to Operate a Public Utility

Tenn. Code Ann. § 65-4-201 requires a public utility to obtain a CCN from the Authority. Specifically, Tenn. Code Ann. § 65-4-201(a) states:

> No public utility shall establish or begin the construction of, or 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, after written application and hearing, a certificate that the present or future public convenience and necessity require or will require such construction, establishment, and 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, or the operation of which would constitute the same, or the owner or operator thereof, a public utility as defined by law, without having first obtained, in like manner, a similar certificate; provided, however, that this section shall not be construed to require any public utility to obtain a certificate for an extension in or about a municipality or territory where it shall theretofore have lawfully commenced operations, or for an extension into territory, whether within or without a municipality, contiguous to its route, plant, line, or system, and not theretofore receiving service of a like character from another public utility, or for substitute or additional facilities in or to territory already served by it.[32]

Thus, the panel found that, as a public utility, the water utility owned by Laurel Hills is required to have a certificate of public convenience and necessity to operate in Tennessee pursuant to Tenn. Code Ann. § 65-4-201(a).

Laurel Hills Must Prove It Has the Ability to Operate a Water Utility

Laurel Hills must obtain "a certificate that the present or future public convenience and necessity require or will require such construction, establishment, and operation."[33] For a water utility, however, the statute is silent on exactly how the Authority is to evaluate whether or not a CCN should be granted.

To determine whether the award of a CCN benefits the present or future public convenience and necessity, the Authority analyzes the evidence to determine if the applicant has the managerial, financial, and technical ability to operate the utility. That standard is used for evaluating the awarding of a CCN to both competing telecommunications providers (Tenn. Code Ann. § 65-4-

[32] Tenn. Code Ann. § 65-4-201(a).
[33] *Id.*

201(c)) and wastewater companies (TRA Rule 1220-4-13-.04(1)(b)). The TRA has adopted the same standard for water companies, as has been made clear in previous orders of the Authority, as well as in the information and application for a certificate for water utilities on the TRA's web site.[34] In addition, Tenn. Code Ann. § 65-4-204 allows the TRA to require, as part of a CCN proceeding, the applicant to "provide such other reasonable information as may be called for at the hearing" and gives the Authority "the full power to issue or refuse the certificate of public necessity and convenience..." Thus, the TRA has the full authority to analyze whether the applicant possesses the managerial, financial, and technical ability to operate the utility as the basis for awarding or denying a CCN and has given Laurel Hills and other water utility applicants notice through its application procedures that it intends to perform that analysis. Therefore, in reviewing an application for a CCN, the Authority must obtain reasonable assurance from evidence presented that the applicant possesses the managerial, financial, and technical ability to operate the utility.

The Authority also looks at evidence of whether the applicant "has demonstrated that it will adhere to all applicable Authority policies, rules and orders" in determining whether to grant or deny a CCN.[35] This requirement is not only used for evaluating the awarding of a CCN to competing telecommunications providers by statute (Tenn. Code Ann. § 65-4-201(c)), but is also contained in the water utility application for a CCN. Specifically, the water utility application requires the applicant "to [a]ttest that the applicant is aware of and will abide by all applicable Tennessee statutes and TRA Rules governing water utilities ...."[36]

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[34] *See In re: Joint Petition of Tennessee American Water Company and Marion County, Tennessee, for Approval of Purchase Agreement*, Docket No. 03-00388, *Order Approving Order, Report and Recommendation of Hearing Officer, CCN, Purchase and Franchise Agreements*, p. 14 of Exhibit A (October 31, 2005). *See also In re: Application of Hickory Star Water Company, LLC for a Certificate of Public Convenience and Necessity for a Regulated Water and Sewer Company Operating in Union County, Tennessee*, Docket No. 99-00485, *Order Granting Certificate of Public Convenience and Necessity*, p. 2 (November 24, 1999). *See also* the following TRA web pages: http://www.tn.gov/tra/telecomfiles/clecapplication.html (water application information) and http://www.tn.gov/tra/telecomfiles/WaterApplication.pdf (Certificate of Public Need and Necessity (CCN) Water Utility Application, Version 1.00 II(C)(3) (June 23, 2006)).

[35] Tenn. Code Ann. § 65-4-201(c)(1).

[36] *See* http://www.tn.gov/tra/telecomfiles/WaterApplication.pdf (Certificate of Public Need and Necessity (CCN) Water Utility Application, Version 1.00, II(C)(4) (June 23, 2006)).

As the applicant, the burden of proof is on Laurel Hills to demonstrate by the evidence in the record that it meets these qualifications.

Laurel Hills Lacks the Managerial Ability to Operate a Water Utility

To determine a public utility's managerial ability, the Authority considers a number of factors, including prior utility experience of the management team. Because the water utility has been operated by Laurel Hills since May 1, 2011, the Authority also considered the Petitioner's operations of the water utility to determine its managerial ability.

At the Hearing, the person responsible for the day-to-day operations of the water utility, Laurel Hills' president Michael McClung, was asked if he had any experience managing a utility; he responded "I have none."[37]

A substantial part of managing a utility involves being able to receive communications from customers. Unfortunately, customers are unable to reach Laurel Hills by telephone because the Petitioner's telephone service was disconnected for nonpayment.[38] Mr. McClung indicates that either he or his wife, though not guaranteed, may check an email address every day that is found on Laurel Hill's billing statements.[39] Even though Mr. McClung or his wife checks for email from customers daily, neither responds to such emails.[40] Mr. McClung testified that Laurel Hills does not have a website, Facebook page or a Twitter account to communicate with its customers.[41]

While it appears practically impossible to communicate by telephone or electronically with Laurel Hills management, it is also impossible to communicate with Laurel Hills management on site. Although disputed, the Petitioner claims to have an on-site office that previously was staffed several days a week. Mr. McClung described the role of this staff at the on-site office as "the lady

[37] Transcript of Proceeding, p. 82 (February 13, 2013).
[38] *Id.* at 79.
[39] *Id.* at 80.
[40] *Id.*
[41] *Id.* at 80-81.

that managed the timeshare units."[42] The staff responsible for managing the on-site office was fired in November 2012.[43]

The management of Laurel Hills also appears to lack familiarity with the operations of the water utility. For example, Mr. McClung admitted that he was not aware of the Tennessee Department of Environment and Conservation ("TDEC") requirement that a customer complaint log be maintained. Mr. McClung then admitted that he did not read correspondence from TDEC but "gave it to the people that were in charge of keeping those records...."[44] Only when confronted with the observation that Laurel Hills no longer had an employee looking after the operations on site did Mr. McClung admit that he was responsible for maintenance of the complaint log.[45]

The evidence in the record shows that the Petitioner has made decisions that demonstrate a lack of managerial qualifications to run a utility. Notably, when purchasing the system, Laurel Hills chose to obtain a revocable license for the placement of utility infrastructure.[46] Under later questioning, Mr. McClung admitted that he did not know the difference between a revocable license and an easement and further did not know what either term meant.[47] When asked if he was aware that Moy Toy could revoke the license to place utility infrastructure at any time, Mr. McClung indicated that he did not and that "I'm going to have trouble sleeping tonight."[48]

In addition, the decisions made by Laurel Hills in the prioritization of payment of its bills show a lack of managerial acumen. Notably, Laurel Hills refused to pay its water bills and instead paid vendors that were not essential to ongoing utility operations. When asked about the imminent shut off of its water supply by Crab Orchard Utility District for non-payment, Mr. McClung indicated that he did not believe that water would be shut because opposing counsel would prevent

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[42] *Id.* at 79.
[43] *Id.* at 115.
[44] *Id.* at 208.
[45] *Id.* at 209.
[46] *Id.* at 73.
[47] *Id.* at 166.
[48] *Id.*

the cut-off.[49] Similarly, the record supports that the Petitioner chose to pay for insurance rather than electricity although non-payment for electricity would disrupt water service.[50] These decisions of Laurel Hills' management could lead to the disruption of water service, endangering the health and safety of customers and violating one of the primary duties of a public utility, which is to preserve the continuity of service.

Further, actions by Laurel Hills reveal a pattern of deliberate attempts to discontinue utility service to its customers. Laurel Hills either has shut off or attempted to shut off water service to its customers on several occasions.[51] As noted above, Laurel Hills chose not to pay for electric service even though it would disrupt water service. The customers of Laurel Hills then were required to take over payment of the utility's electric service account to ensure continuity of water service.[52] After filing its initial CCN application, Laurel Hills withdrew its petition, stating that it would cease providing water service to its customers other than itself.[53] Thus, Laurel Hills' managerial behavior indicates that they have been unwilling to operate a public utility.

With respect to the ownership and management of Laurel Hills, conflicts of interest on the board of Laurel Hills represent an incurable impediment to awarding the Petitioner a CCN. This conflict of interest results from the connections between Laurel Hills and Moy Toy. Although counsel for Laurel Hills identifies Mr. Phillip Guettler as the managing member of Moy Toy,[54] it appears that Mr. McClung is actually the managing member of Moy Toy. Mr. McClung identified

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[49] *Id.* at 163.
[50] *Id.* at 129-131.
[51] *Id.* at 130-131.
[52] *Id.* at 313-314.
[53] *Notice of Voluntary Dismissal and Withdrawal* (May 7, 2012).
[54] Transcript of Proceeding, pp. 19-20 (November 7, 2012). Counsel for Laurel Hills describes the conflict at November 7, 2012 Status Conference as: "So there's a lot of corporate veils that have to be pierced in order to simply say that Mr. Guettler can, upon demand, have a legal right to obtain the tax return of Moy Toy. In fact, to the extent that he is wearing his hat as director of that LLC that is the general partner of the limited partnership that is the managing member of Moy Toy -- and, obviously, that's a lot to sort of process, but he has a duty to the shareholders and owners of Moy Toy and all of those entities that sort of distance himself up the Moy Toy chain, if you will, and – and as a result, he sort of might be, in fact, in conflict between his roles as the Laurel Hills director in providing information in this proceeding. You know, he might, in fact, open up himself to liability under a director and officer fiduciary duty to the extent that providing that information in this proceeding would somehow prejudice the interests of Moy Toy."

himself of the managing member of Moy Toy in his direct testimony only to recant this in his rebuttal testimony. At the Hearing, Mr. McClung admitted he submitted paperwork to the Secretary of State's Office indicating he was the managing member of Moy Toy but claimed to not know what it means to be a managing member.[55] When asked why he claimed not to be the managing member of Moy Toy in his pre-filed rebuttal testimony, he indicated he was instructed by counsel to do so.[56]

Mr. McClung is further conflicted as he represents himself as the managing member of Renegade Mountain Timeshares, LLC, a creditor of Laurel Hills.[57] Mr. McClung testified that in his position at Renegade Mountain Timeshares, LLC, he rescinded the line of credit extended to Laurel Hills because "They're a bad risk. It was a fiduciary responsibility."[58] Similarly, Mr. McClung is involved in the business operations of a customer of Laurel Hills that chose to disconnect its water service. Mr. McClung claimed that this business, Standing Rock, LLC, was "in protest of the rate."[59] Therefore, the evidence clearly indicates that Mr. McClung and the other Laurel Hills board members cannot operate the water utility because of conflicts of interest due to their involvement in Moy Toy or other related parties. At a minimum, it shows the Mr. McClung has little understanding of his own business dealings and terms commonly used in business. Because of the scope of the conflicts of interest and other evidence demonstrating a total lack of managerial ability and willingness to manage a water utility, any conditions placed upon the CCN to provide sufficient managerial ability would be ineffective.

In addition, Laurel Hills has not presented any plan to hire managers, consultants or others with the ability, expertise or experience to run the utility or to rid itself of these inherent conflicts. Therefore, the panel found that, based on its lack of experience, its unwillingness and inability to

[55] Transcript of Proceeding, pp. 141-143 (February 13, 2013).
[56] *Id.* at 143.
[57] *Id.* at 147.
[58] *Id.* at 179-180.
[59] *Id.* at 238.

provide continuous utility service, and the conflicts of interests inherent in its dealings with related entities, Laurel Hills lacks the managerial ability to operate a water utility, and Laurel Hills has presented no plans to secure the necessary resources to obtain that ability.

Laurel Hills Lacks the Financial Ability to Operate a Water Utility

To determine a public utility's financial ability, the Authority considers a number of factors, including the utility's ability to pay its bills, borrow money and attract capital, keep accurate accounting records, and the management team's ability to make sound financial decisions. At the Hearing, Mr. McClung asserted that he is the day-to-day operating manager of the water system, yet freely admitted that he has no experience managing a water system.[60] Specifically in regard to Laurel Hills' financial ability, Mr. McClung states: "I'm learning, but I don't have probably the level that Tennessee is expecting of POAs and government utilities."[61]

Although Laurel Hills did not provide detailed information regarding the transaction, the evidence indicates that Laurel Hills paid $400,000 for the water system without any written independent appraisal and while allowing Moy Toy to retain a revocable license for the property used by the water system.[62] Further, Laurel Hills admits that it does not have complete financial records of the previous owners, except for billing records for the months of November and December 2011.[63] Such records would have been crucial in determining a fair purchase price. Further complicating this transaction is the fact that Mr. McClung is both President of Laurel Hills and a Managing Member of Moy Toy.

The Hearing Officer in this docket entered an order on January 25, 2013, granting the Customer Intervenors' Motion to Compel information regarding this transaction.[64] The Hearing

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[60] *Id.* at 82.
[61] *Id.* at 83-84.
[62] *Id.* at 72-73.
[63] Michael McClung, Pre-Filed Direct Testimony, p. 4 (September 6, 2012).
[64] *Motion to Compel Responses of Laurel Hills Condominiums Property Owners Association to First Discovery Requests of the Customer Interveners or, Alternatively, Request for Subpoena Duces Tecum for Moy Toy, LLC.* (October 3, 2012).

Officer also ordered that if Laurel Hills did not provide the information, the $400,000 promissory note would be excluded in determining the Petitioner's rate base. Laurel Hills still did not provide any information regarding this transaction.

Laurel Hills also has a note payable recorded at $53,038 to Renegade Mountain Timeshares, LLC, of which Mr. McClung is also a Managing Member. Laurel Hills claimed there is a note payable in the amount of $50,000 to $53,000 in the balance sheet provided in response to TRA Staff data requests.[65] At the Hearing, however, Mr. McClung stated that only $38,000 had been borrowed and that the alleged note was a "line of credit, so to speak."[66] Thus, the president of the utility is unsure of the alleged note amount and unsure as to whether it is a note payable or a line of credit.

As previously noted, Laurel Hills refused to pay its water bills and instead paid vendors that were not essential to ongoing utility operations. At the time of Hearing, Laurel Hills owed approximately $28,000 to Crab Orchard Utility District for water.[67] In addition, past due amounts were owed for services by engineer Darrell McQueen, legal fees and a civil penalty imposed by TDEC.[68] Laurel Hills has presented no reasonable plan for extinguishing past utility debts which it chose not to pay. Rather, to obtain the necessary funds, Laurel Hills has proposed to raise the rates paid by customers or to add a separate monthly surcharge to recover from its customers past due amounts that Laurel Hills chose not to pay.[69]

Additionally, Mr. McClung stated that pursuant to the Chancery Court's order, customers' water service could not be turned off for non-payment unless shutoff valves were installed.[70] Instead of paying its bills - including the water bill owed to Crab Orchard - to ensure continued water service for its paying customers, Laurel Hills chose to contract with a related third party to

[65] *Laurel Hills Data Response*, Item 3 (September 7, 2012).
[66] Transcript of Proceeding, pp. 138-139 (February 13, 2013).
[67] *Id.* at 344.
[68] Michael McClung, Pre-Filed Rebuttal Testimony, p. 23 (January 14, 2013).
[69] *Id.* at 23-24.
[70] Transcript of Proceeding, p. 108 (February 13, 2013).

install shut-off valves at an expense of $17,425.52[71] to allow Laurel Hills to disconnect service for nonpayment.

In his testimony, Mr. McClung states that Laurel Hills needs to rehabilitate a water tank it owns in order to provide continuous service to its customers.[72] Mr. McClung states that the utility obtained a bid from Pittsburg Tank and Tower Maintenance POA, Inc. in the amount of $183,000.[73] Laurel Hills, however, did not seek any other bids to determine whether the one bid was fair and reasonable.[74] In fact, Mr. Everett Bolin, General Manager of Crab Orchard Utility District, stated that it rehabilitates a water tank each year at a cost of approximately $54,000.[75] Laurel Hills' failure to attempt to seek additional bids and secure the best price for rehabilitating the tank indicates a lack of ability to make sound financial decisions.

Laurel Hills admits that it cannot borrow funds to finance upgrades for the utility,[76]and the utility has borrowed funds from an affiliate.[77] As the Consumer Advocate points out in its brief, while the inability to borrow funds is a serious problem, the reason why it cannot borrow funds is far more serious. The Consumer Advocate contends that the reason Laurel Hills cannot borrow money is because of the affiliate debt, citing the negative equity balance of $373,954 resulting from the $400,000 note payable to Moy Toy.[78] The inability to borrow money could seriously impede the utility's ability to provide water service.

Although Mr. McClung states Laurel Hills has separate accounting for the timeshare rental business and the water system, he admits that only one bank account exists for both business segments.[79] Laurel Hills presents no testimony regarding the priority given to monies taken from

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[71] Michael McClung, Pre-Filed Rebuttal Testimony, Ex. 1 (January 14, 2013).
[72] Michael McClung, Pre-Filed Direct Testimony, p. 9 (September 6, 2012).
[73] *Id.* at 9-10.
[74] Transcript of Proceeding, p. 196 (February 13, 2013).
[75] Everett Bolin, Pre-Filed Deposition, p. 17 (December 17, 2012).
[76] Transcript of Proceeding, p. 65 (February 13, 2013).
[77] *Id.* at 61.
[78] *Brief of Consumer Advocate*, pp. 12-13 (March 18, 2013).
[79] Transcript of Proceedings, p. 186 (February 13, 2013).

the joint account to pay expenses, and the record is void of any safeguards in place to prevent the cross-subsidization of the timeshare rental business by water customers.

Laurel Hills has not shown the ability to make sound overall financial decisions by entering into questionable affiliated third-party financial transactions, by being unable to borrow money from an unaffiliated source and by not maintaining adequate accounting records. Therefore, the panel found that the Petitioner lacks the financial ability to operate a water utility, and Laurel Hills has presented no reasonable plans to secure that ability.

Laurel Hills Currently Has the Technical Ability to Operate a Public Utility

To determine a public utility's technical ability, the Authority considers a number of factors, including its technical experience, ability to obtain technical expertise, and compliance with technical rules and regulations.

As previously indicated, Mr. McClung admits he has no experience in managing a water system.[80] Specifically in regard to technical ability, Mr. McClung states he has no technical expertise or knowledge necessary for operating a utility.[81] However, Laurel Hills apparently has secured the resources to obtain the necessary technical expertise.

Mr. McClung states that at the time Laurel Hills took over the system, it was out of compliance with several rules and regulations of TDEC due to failure of the previous owners to properly maintain the system.[82] To address these concerns, Laurel Hills: (1) hired an engineer, Mr. Darrell McQueen, P.E., to prepare a map of the water system for the specifications requested by TDEC; (2) contracted with Walter A. Wood Supply to install a new variable speed pump as needed; (3) conducted pressure tests and implemented a flushing program; and (4) hired a certified operator, Gerald Williams, and began conducting water quality tests.[83]

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[80] Transcript of Proceeding, p. 82 (February 13, 2013).
[81] *Id.* at 83.
[82] Michael McClung, Pre-Filed Direct Testimony, p. 5 (September 6, 2012).
[83] *Id.* at 5-6.

Laurel Hills also states that it received a score of 98 out of 100 on a Sanitary Survey conducted by TDEC on October 19, 2011, which it maintains brought the water system an approved TDEC designation. Further, TDEC dismissed the pending enforcement action against the water system after it paid TDEC $11,282.50.[84]

As previously indicated, Laurel Hills employs an engineer, Darrell McQueen, to provide its technical expertise. Mr. McClung states that Mr. McQueen is uniquely qualified to provide engineering and maintenance of the water system due to his historical knowledge of the system, and since he had performed these services prior to Laurel Hills acquiring the water system.[85] Laurel Hills, however, has not paid Mr. McQueen for past services provided and admits owing him $36,500.[86] Without payment, Mr. McQueen is under no obligation to continue providing the requisite technical services, and it is quite possible that Mr. McQueen will sever his ties with Laurel Hills. The interim monthly rate set forth below contains no provision for paying past due amounts, since this would result in retroactive ratemaking.[87] Absent Mr. McQueen's services, Laurel Hills puts forth no back-up plan for sustaining the requisite technical expertise.

Therefore, the panel found that Laurel Hills has retained personnel such that it has the technical ability to operate a utility at present. However, based on the Petitioner's non-payment of its technical personnel and its lack of plan if its current personnel discontinues his services, the panel found that it is unlikely that Laurel Hills will maintain its technical ability going forward.

Laurel Hills Has Not Demonstrated Adherence to Applicable Statutes, Rules or Orders

In determining whether to grant or deny a CCN, the Authority looks at evidence of whether the applicant "has demonstrated that it will adhere to all applicable Authority policies, rules and

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[84] *Id.* at 6.
[85] Michael McClung, Pre-Filed Rebuttal Testimony, p. 5 (January 14, 2013).
[86] *Id.* at 23-24.
[87] To allow for such recovery would result in retroactive ratemaking – a fundamental ratemaking concept that prohibits future ratepayers from paying for past use. *See Porter v. South Carolina Public Service Comm'n,* 328 S.C. 222, 493 S.E.2d 92 (S.C. 1997); *See South Central Bell Telephone Co. v. Tenn. Pub. Serv. Comm'n*, 675 S.W.2d 718, 719 (Tenn. App. 1984).

orders"[88] and requires the applicant "to [a]ttest that the applicant is aware of and will abide by all applicable Tennessee statutes and TRA Rules governing water utilities ...."[89] The Petitioner has made no such attestation in the *First Amended Petition*, pre-filed testimony or elsewhere in the evidentiary record and has made no demonstration of the likelihood that Laurel Hills will adhere to or abide by relevant statutes, rules or orders. In fact, as previously noted, Laurel Hills did not appear at an Authority Conference when directed to do so by the TRA and, although being held in abeyance, has allegations of violations of various state statutes pending against it in TRA Docket No. 12-00077.[90] Therefore, the panel found that Laurel Hills has not demonstrated that, by its actions or by the evidence in the record, it will adhere to all applicable Authority policies, rules and orders.

The *First Amended Petition* is Denied

As a result of the above findings, the panel found that the award of a certificate to Laurel Hills will not benefit the present or future public convenience and necessity and, further, is not in the public interest. Therefore, the panel denied the *First Amended Petition*.

Laurel Hills' Incurred Debts Are Not Prudent Debts of the Water Utility

In cases when a promissory note is the purchase consideration, the purchase price becomes the level of indebtedness. Thus, when promissory notes, like the $400,000 note apparently exchanged between Laurel Hills and Moy Toy,[91] are used to finance an acquisition, a review of the prudence of the purchase amount (amount of indebtedness) is necessary. When related parties, like

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[88] *See, e.g.* Tenn. Code Ann. § 65-4-201(c)(1).

[89] *See* http://www.tn.gov/tra/telecomfiles/WaterApplication.pdf (Certificate of Public Need and Necessity (CCN) Water Utility Application, Version 1.00, II(C)(4)) (June 23, 2006)).

[90] Transcript of Authority Conference, p. 13 (May 21, 2012); *In re: Show Cause Proceeding Against Laurel Hills Condominiums Property Owners Association for Alleged Violations of Tenn. Code Ann. §§ 65-4-201, 65-4-301(A), 65-5-102, 65-4-101 and/or 65-4-103, and 65-4-115*, TRA Docket No. 12-00077, *Order Requiring Laurel Hills Condominiums Property Owners Association to Appear and Show Cause Why A Cease And Desist Order and Civil Penalties and Sanctions Should Not Be Imposed Against It for Violations of State Law* (August 8, 2012). Laurel Hills is charged with six counts of violations of Tennessee law, including violations of Tenn. Code Ann. §§ 65-4-201, 65-4-301(a), 65-5-102, 65-5-101, 65-5-103 and 65-4-115.

[91] Transcript of Proceeding, p. 72 (February 13, 2013).

Laurel Hills and Moy Toy, are involved in the transaction, scrutiny of the purchase price is important as there are potentially incentives to exchange assets at inflated values to benefit one of the parties.[92]

Mr. McClung testified that the $400,000 value was determined through negotiations between himself representing Laurel Hills and Phillip Guettler representing Moy Toy.[93] Mr. McClung defends his valuation as reasonable. His method to determine fair value was to determine the replacement value of the system and then apply a factor used for operational equipment after it's been fully depreciated.[94] The replacement value was not based upon written estimates but of verbal estimates from three firms --- two of which Mr. McClung could not identify.[95] Mr. McClung estimated that it would cost $2 million to replace the water tank and water lines.[96] In comparison, the Comptroller of the Treasury assesses taxes on utility plant valued at $15,000.[97] Similarly, Consumer Advocate witness William H. Novak recommends a rate base of $21,253.[98] Laurel Hills has not provided sufficient information to determine that the sales price of the utility evidenced by the amount of the promissory note is based upon the market value of the water system.[99] Because there is insufficient evidence to support a valuation of $400,000 for the water system, a promissory note for that amount cannot be considered a prudent debt.

In addition, public utilities must receive approval from the Authority prior to entering into financing agreements like those entered into by Laurel Hills. The applicable statue is Tenn. Code Ann. § 65-4-109, which reads, in part:

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[92] *Id.* at 255.
[93] *Id.* at 73.
[94] *Id.* at 73-74.
[95] *Id.* at 74.
[96] *Id.* at 73.
[97] *Id.* at 286-287.
[98] William H. Novak, Pre-Filed Direct Testimony, p. 6 (December 13, 2012).
[99] Transcript of Proceeding, p. 256 (February 13, 2013).

> No public utility shall issue any stocks, stock certificates, bonds, debentures, or other evidences of indebtedness payable in more than one (1) year from the date thereof, until it shall have first obtained authority from the authority for such proposed issue. It shall be the duty of the authority after hearing to approve any such proposed issue maturing more than one (1) year from the date thereof upon being satisfied that the proposed issue, sale and delivery is to be made in accordance with law and the purpose of such be approved by the authority.

The requirement that financing transactions be approved by the Authority stems from the impact that interest expense can have on consumer rates. Laurel Hills did not present the $400,000 promissory note between itself and Moy Toy for approval by the Authority. As such, it is not a valid utility debt under Tenn. Code Ann. § 65-4-109.

With respect to the $53,038 loan from Renegade Mountain Timeshares, LLC, Laurel Hills did not request approval of the transaction as required by Tenn. Code Ann. § 65-4-109.[100] Mr. McClung attached the note to his Pre-Filed Rebuttal Testimony.[101] However, in the September 25, 2012 First Discovery Response to the Consumer Advocate the Laurel Hills stated: "There is not written agreement between Renegade Mountain Timeshares, LLC for the $53,038 loan detailed in the Direct Testimony of Michael McClung."[102]

The panel found that these debts incurred by Laurel Hills Condominium Property Owners Association were not approved by the Authority as required by Tenn. Code Ann. § 65-4-109 and, therefore, are not prudent debts of the water utility.

Interim Monthly Rate for Water Service

In carrying out its ratemaking function, the Authority is obligated to balance the interests of the utilities subject to its jurisdiction with the interests of Tennessee consumers; it is obligated to fix just and reasonable rates.[103] The Authority must also approve rates that provide regulated

[100] Because the loan has not been approved, it should not be considered for rate-setting purposes. Only if the utility can demonstrate that the funds were used for appropriate utility costs should any amount be recovered from customers.
[101] Michael McClung, Pre-Filed Rebuttal Testimony, Ex. 2 (January 14, 2013).
[102] *First Discovery Response to the Consumer Advocate*, p. 5 (September 25, 2012).
[103] Tenn. Code Ann. § 65-5-101 (Supp. 2011).

utilities the opportunity to earn a just and reasonable return on their investments.[104] The TRA is not bound to follow ratemaking methodology that it has employed in the past.[105] Further, the Uniform Administrative Procedures Act authorizes the TRA to take notice of "generally recognized technical and scientific facts within the agency's specialized knowledge," and in the evaluation of evidence the agency is specifically authorized to utilize its "experience, technical competence, and specialized knowledge."[106] The TRA is not to be "hamstrung by the naked record" and can consider all relevant circumstances shown by the record, all recognized technical and scientific facts pertinent to the issue under consideration and may superimpose upon the entire transaction its own expertise, technical competence and specialized knowledge.[107]

There is no single, precise measure of the fair rate of return a utility is allowed an opportunity to earn. Therefore, the TRA must exercise its judgment in making an appropriate determination. The Authority, however, is not without guidance in exercising its judgment:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.[108]

In addition, the United States Supreme Court has determined that regulated utilities are entitled to a return that is "just and reasonable."[109] The rate a public utility is permitted to charge should enable it "to operate successfully, to maintain its financial integrity, to attract capital, and to

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[104] *See Bluefield Water Works and Improvement Company v. Public Service Comm'n of West Virginia*, 262 U.S. 679 (1923).
[105] *Tennessee American Water Co. v. Tenn. Regulatory Auth.*, 2011 WL 334678, at *25 (Tenn. Ct. App. Jan. 28, 2011); *CF Indus. v. Tennessee Pub. Serv. Comm'n*, 599 S.W.2d 536, 542-45 (Tenn. 1980).
[106] Tenn. Code Ann. § 4-5-314.
[107] *Tennessee American*, 2011 WL 334678, at *26.
[108] *Bluefield Water Works & Improvement Company v. Public Service Commission*, 262 U.S. 679, 692-93 (1923); *see also Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989).
[109] *Federal Power Comm'n v. Hope Natural Gas Co.* 320 U.S. 591, 605 (1944).

compensate investors for the risks assumed."[110]

The Chancery Court of Cumberland County's Proposed Agreed Order entered on August 8, 2012 set a monthly rate of $43.20 for individual customers until such time as the TRA made a determination of the appropriate rate. Therefore, although the panel denied the *First Amended Petition*, to the extent allowable by the Proposed Agreed Order entered by the Chancery Court of Cumberland County, the Authority made a determination of a just and reasonable interim monthly rate based upon the evidence contained in the record.

Uncontested Expenses

Laurel Hills presented various monthly expenses that were not contested by the Consumer Advocate. The panel also agreed the expenses were appropriate to be included in rates. Therefore, the panel adopted the following expenses: Water Testing - $600; Property Tax - $200; Telephone Expenses - $61; Insurance Expense - $433; and Postage Expense - $8. Other expenses were disputed and are discussed in further detail below.

Engineering and Labor Expense

Laurel Hills includes $2,500 a month, or $30,000 annually, for Engineering and Labor Expense.[111] The annual amount includes $26,000 in past-due payments to Mr. McQueen.[112] The Consumer Advocate eliminates the $26,000 owed to Mr. McQueen, leaving Laurel Hills with an ongoing expense of $4,000 annually, or $333 per month for Engineering and Labor Expense.[113] The panel adopted $333 per month for Engineering and Labor Expense, since it is based on actual invoices and properly excludes expenses barred from recovery due to retroactive ratemaking.

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[110] *Id.*
[111] Michael McClung, Pre-Filed Rebuttal Testimony, p. 14 (January 14, 2013).
[112] William H. Novak, Pre-Filed Direct Testimony, p. 7 (December 13, 2012).
[113] *Id.* at 7.

Construction Contracts

Laurel Hills includes $1,400 per month for the installation of valve boxes, which will allow the utility to shut off service to individual customers for nonpayment and to install backflow preventers to all service connections as recommended by TDEC. Laurel Hills does not have the funds necessary to contract out the work and lacks credit needed to borrow money. Therefore, Laurel Hills asserts these funds must be paid out of its operating budget.[114] The Consumer Advocate points out that the $17,425.52 invoice supplied by Laurel Hills was from an affiliated company. The Consumer Advocate also contends that locating and marking thirty-nine valves can be done by a standard operator, Mr. McQueen. According to the Consumer Advocate, since Mr. McQueen's labor costs are included in Engineering and Labor Expense, it should not be duplicated here. The Consumer Advocate also states that if valves were installed, then those costs should be capitalized and depreciated over time as a rate base item.[115] The panel adopted $0 for Construction Costs, since capital costs should not be included in expenses.

Depreciation Expense

Laurel Hills includes $500 per month for depreciation.[116] The utility states, however, that it will accept the $88 per month depreciation proposed by the Consumer Advocate's witness, Mr. Novak.[117] The Consumer Advocate considers the depreciation of only the known and measurable assets (the pumps), using a value of $15,757 and a 15-year useful life, as utilized by Laurel Hills for tax purposes. If the valuation of rate base changes, the Consumer Advocate points out this expense will change.[118] The panel adopted $88 per month for Depreciation Expense, since it is based on the only known and measurable capital assets, the pumps.

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[114] Michael McClung, Pre-Filed Rebuttal Testimony, p. 6 (January 14, 2013).
[115] *Post-Hearing Brief of the Consumer Advocate*, p. 44 (March 15, 2013).
[116] Michael McClung, Pre-Filed Rebuttal Testimony, p. 14 (January 14, 2013).
[117] *Petitioner's Post Hearing Brief*, p. 26 (March 15, 2013).
[118] William H. Novak, Pre-Filed Direct Testimony, pp. 8-9 (December 13, 2012).

Permits and Penalties

Laurel Hills includes $1,200 per month for Permits and Penalties Expense, or $14,400 annually.[119] Most of this annual amount ($11,282.50) stems from the negotiated civil penalties imposed as a result of the TDEC enforcement action. Of the $14,400 annual expense requested, the Consumer Advocate includes only the $300 annual fee charged by TDEC, or $25 per month, which is a known and measurable recurring cost. The Consumer Advocate excludes the $11,282.50 in TDEC penalties and the remaining unexplained $2,817.50.[120] The Consumer Advocate states that recovery of fines and penalties incurred in the past from current ratepayers represents retroactive ratemaking, which is prohibited. Further, the Consumer Advocate states that recovery of fines and penalties resulting from environmental infractions are against public policy, and these costs should not be shifted to punish ratepayers for the violations made by Laurel Hills.[121] The panel adopted $25 per month for Permits and Penalties, for the known and recurring annual TDEC fee expense. The additional amounts included by Laurel Hills for penalties were excluded, since the panel determined they are barred from recovery due to retroactive ratemaking and place the burden of Laurel Hills' bad acts inappropriately upon the ratepayers.

Interest Expense

Laurel Hills includes $1,900 per month for interest expense on its debts,[122] consisting of $400,000[123] to Moy Toy for purchase of the water system and $53,038[124] to Renegade Mountain Timeshares, LLC for funds to help finance the water operations.[125] Laurel Hills concedes that interest expense on the note to Renegade Mountain Timeshares, LLC can be recovered through the

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[119] Michael McClung, Pre-Filed Rebuttal Testimony, p. 4 (January 14, 2013).
[120] William H. Novak, Pre-Filed Direct Testimony, pp. 8-9 (December 13, 2012); *see also Response of Laurel Hills Condominium Property Owners Association to Staff Data Request, Data Response No. 1*, p. 12 of 192, Attachment 1 (September 7, 2012).
[121] *Post-Hearing Brief of the Consumer Advocate*, pp. 40-42 (March 15, 2013).
[122] Michael McClung, Pre-Filed Rebuttal Testimony, p. 4 (January 14, 2013).
[123] William H. Novak, Pre-Filed Direct Testimony p. 10 (December 13, 2012).
[124] Michael McClung, Pre-Filed Rebuttal Testimony, p. 9 (January 14, 2013).
[125] *Petitioner's Post Hearing Brief*, p. 35 (March 15, 2013).

rate of return, as proposed by the Consumer Advocate's witness, Mr. Novak, in his testimony at the Hearing. Further, since the Hearing Officer excluded expenses related to the note to Moy Toy, Laurel Hills also concedes that this budget item should be removed.[126] Accordingly, the panel adopted $0 for Interest Expense.

Legal Expense

Laurel Hills includes $2,500 per month or $30,000 per year in Legal Expenses.[127] The Petitioner states that it will incur approximately $50,000 in legal fees for the CCN proceeding alone, which is properly recoverable. Further, Laurel Hills takes the position that all of the legal expenses incurred by the Petitioner in the two Chancery Court proceedings were prudently incurred expenses and properly recoverable from ratepayers through utility rates. Further, it cites the testimony of the Consumer Advocate's witness, Mr. Novak, that prudently incurred attorney's fees related to proceedings of this nature (CCN Hearings and rate cases) should be recovered and are typically recovered over a two to three year period.[128] Laurel Hills contends that its proposal is consistent with Mr. Novak's position. Recovering $2,500 per month would total $60,000 over a two year period. That would provide $10,000 above the estimated $50,000 in legal fees for Laurel Hills to use in its regular operational legal budget.[129]

The Consumer Advocate recommends $0 recovery for Legal Expenses. According to the Consumer Advocate, if the CCN application is denied, then the expenses related to this proceeding will never benefit current and future ratepayers and are not "used and useful" reasonable and prudent costs.[130] If the Authority allows recovery, however, the Consumer Advocate recommends exclusion of any costs that are unreasonable, imprudent, unnecessary or wasteful that would result in an unfair burden placed on customers. In that instance, after reviewing all costs, the Consumer

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[126] *Id.* at 28.
[127] Michael McClung, Pre-Filed Rebuttal Testimony, p. 4 (January 14, 2013).
[128] Transcript of Proceeding, pp. 291-292 (February 13, 2013).
[129] *Petitioner's Post Hearing Brief*, p. 28-30 (March 15, 2013).
[130] William H. Novak, Pre-Filed Direct Testimony p. 11 (December 13, 2012).

Advocate recommends consideration of only $33,690 amortized over 15 years.[131] The Consumer Advocate starts with the Petitioner's $51,045.39 in fees and reduces that amount by $17,355.49 for the following items: $3,722.89 for costs in the Chancery Court proceedings; $540 for the Show Cause proceeding; $547.50 for discovery avoidance and motions to compel; $8,295 for drafting and revising Mr. McClung's pre-filed testimony; and $4,250 in anticipated legal expenses.[132]

The panel adopted $46,783 for Legal Expenses. The panel disallowed recovery of $3,722.89 for the Chancery Court proceedings and $540 for the Show Cause proceeding, all of which were initiated by the Petitioner's attempts to abandon water service to its customers. The panel determined that these activities did not benefit the customers of Laurel Hills and their costs should not be borne by those customers. Because the legal expenses are for a CCN proceeding and not a rate case, the panel adopted a 15 year amortization period, for an annual expense of $3,119.

Accounting and Management Services

Laurel Hills includes $1,550 per month for Accounting & Management Services.[133] The utility states this amount includes the $300 per month paid to Lansford & Stephens for monthly billing, collection and accounting services. It also includes $13,000 in 2011 and $18,935 through August 2012 allocated from Renegade Resources, an affiliate company, for maintenance expenses. Renegade Resources provides significant labor resources to Laurel Hills in the management of the system. Laurel Hills asserts that these functions include necessary routine maintenance on the water system, response to emergency calls, leak repair, assistance to the certified operator as needed, handling customer inquiries and other customer service functions that are expected by TDEC and customers. Laurel Hills states it would likely cost more for the utility to hire outside contractors and vendors to perform these function. The Consumer Advocate recommends $242 per month for

[131] *Petitioner's Post Hearing Brief*, p. 48 (March 15, 2013).
[132] *Id.* at 61.
[133] Michael McClung, Pre-Filed Rebuttal Testimony, p. 4 (January 14, 2013).

Accounting & Management Services.[134] The Consumer Advocate's witness, Mr. Novak, reviewed the actual accounting fee invoices for the period May 2011 through August 2012, which totaled $3,865. While it is not entirely clear how much of the accounting fees are related to the water system and how much are related to Laurel Hills' other operations, the Consumer Advocate maintains it is reasonable to allocate a portion of these costs to the non-utility operations of Laurel Hills. Such allocation would include a portion of the $365 fee to prepare Laurel Hills' federal corporate income tax return and the entire $200 fee for preparing homeowner dues invoices.[135] The panel adopted $242 per month for Accounting and Management Services, determining that it is reasonable to allocate some of the accounting invoices to the non-utility operations of Laurel Hills. Further, the panel determined that none of the $13,000 in 2011 and $18,935 through August 2012 allocated from Renegade Resources for maintenance expense properly should be included in Accounting and Management Services Expense, due to the affiliate nature of the transactions, coupled with the lack of evidence that the amounts were negotiated in good faith.

Office Expense

Laurel Hills includes $200 per month for Office Expense.[136] According to Laurel Hills, without adequate resources, Laurel Hills could not maintain its records in accordance with TDEC and Authority regulations.[137] The Consumer Advocate recommends $14 per month for Office Expenses, since Laurel Hills provided no documentation to support its budgeted amount. The Consumer Advocate reviewed the actual offices expenses for the period May 2011 through August 2012, which totaled $221 (or $14 per month for 16 months). The Consumer Advocate, therefore, recommends inclusion of only the known and measureable office expenses.[138] The panel adopted

[134] *Petitioner's Post Hearing Brief*, p. 43 (March 15, 2013).
[135] *Post-Hearing Brief of the Consumer Advocate*, pp. 49-50 (March 15, 2013).
[136] Michael McClung, Pre-Filed Rebuttal Testimony, p. 4 (January 14, 2013).
[137] *Id.* at 10-11.
[138] *Post-Hearing Brief of the Consumer Advocate*, p. 50 (March 15, 2013).

$14 per month for Office Expenses, determining that it is reasonable to limit recovery to actual amounts documented in the review period.

Equipment Rental Expense

Laurel Hills includes $150 per month for Equipment Rental Expense.[139] Laurel Hills asserts this amount is needed to rent equipment for Renegade Resources personnel to perform maintenance for leaks or other issues. Since the utility does not own equipment like backhoes to perform this maintenance, sufficient funds are needed on a regular basis for equipment rental.[140] The Consumer Advocate recommends $6 per month for Equipment Rental Expense, since Laurel Hills provided no documentation to support its budgeted amount. The Consumer Advocate reviewed the actual equipment rental expenses for the period May 2011 through August 2012, which totaled $98 (or an average of $6 per month for 16 months). The Consumer Advocate, therefore, recommends inclusion of only the known and measureable office expenses in any interim rates.[141] The panel adopted $6 per month for Equipment Rental Expense, determining that it is reasonable to limit recovery to actual amounts documented in the review period.

Maintenance and Repair Expense

Laurel Hills includes $2,000 per month for Maintenance and Repair Expense.[142] The Petitioner states the majority of this expense is for rehabilitation of the system's water tank, which Laurel Hills estimated to cost $183,000.[143] Laurel Hills concedes capitalizing the expense is the best method of paying for the tank rehabilitation; however, it states it cannot borrow the money and does not have sufficient funds on hand to pay this expense, so it must pay for the tank rehabilitation out of its operating budget.[144] The Consumer Advocate recommends $0 per month for Maintenance & Repair Expense, since the $2,000 per month proposed by Laurel Hills is for rehabilitating the

[139] Michael McClung, Pre-Filed Rebuttal Testimony, p. 4 (January 14, 2013).
[140] *Id.* at 12.
[141] *Post-Hearing Brief of the Consumer Advocate*, p. 50 (March 15, 2013).
[142] Michael McClung, Pre-Filed Rebuttal Testimony, p. 5 (January 14, 2013).
[143] Michael McClung, Pre-Filed Direct Testimony, pp. 9-10 (September 6, 2012).
[144] *Petitioner's Post Hearing Brief*, pp. 32-33 (March 15, 2013).

water tank. Laurel Hills provided no documentation for any additional amounts above the cost for the water tank; therefore, the Consumer Advocate suggests that any other repair and maintenance expenses have been accounted for in a different category, such as Labor or Equipment Rental Expense. The Consumer Advocate states that the costs needed to rehabilitate the water tank should be capitalized and recovered through depreciation expense. The panel adopted $0 per month for Maintenance & Repair Expense, providing no recovery for the water tank rehabilitation in expenses, primarily because these costs would be capitalized as incurred.

Wholesale Water Expense

Laurel Hills includes $1,750 per month for Wholesale Water Expense.[145] Laurel Hills states its budgeted amount includes late-payment penalties that have been imposed, since the utility has not been current on its account with the water provider, Crab Orchard Utility District, since at least 1999.[146] The Consumer Advocate recommends $1,528 for Wholesale Water Expense. Since the Consumer Advocate filed its direct testimony, Crab Orchard made Laurel Hills' account history available. Based on actual monthly water expense from May 2011 through November 2012 (the last month available on the account history), the total expense (and related sales tax) for the nineteen months was $29,025.20, or $1,527.64 average per month. The Consumer Advocate contends this actual account history provides more accurate and reliable information as to monthly water expense going forward.[147] The Consumer Advocate recommends denial of past due amounts owing to Crab Orchard, so as to not violate the prohibition of retroactive ratemaking for an entirely avoidable expense.[148] The panel adopted $1,528 per month for Wholesale Water Expense, determining it is reasonable to limit recovery to actual amounts documented in the review period. Further, the panel determined that ratepayers should bear no burden either for late-payment penalty

[145] Michael McClung, Pre-Filed Rebuttal Testimony, p. 5 (January 14, 2013).
[146] Transcript of Proceeding, Ex. 9 (February 13, 2013).
[147] *Id.*
[148] *Post-Hearing Brief of the Consumer Advocate*, p. 39 (March 15, 2013).

amounts caused by mismanagement of Laurel Hills or for prior outstanding debts, which would constitute retroactive ratemaking.

Electricity Expense

Laurel Hills includes $467 per month for Electricity Expense.[149] Laurel Hills agrees with the amount originally recommended by the Consumer Advocate's witness, Mr. Novak, and states the amount is not "reasonably in dispute."[150] However, the Consumer Advocate recommends $274 per month for Electricity Expense. The Consumer Advocate states that following the utility's response to a Customer Intervenor data request, it discovered that the electric bills included all of Laurel Hills' operations in 2011. Only the summary for the 2012 bills was limited to the meter that serves the water system's pumps. Laurel Hills, therefore, should not have agreed with the Consumer Advocate's initial recommendation of $467, since it knew, or should have known, this amount included subsidization of its unregulated operations. The Consumer Advocate recommends including the calculated monthly average for the twelve months ended August 2012, excluding amounts related to unregulated operations.[151] The panel adopted $274 per month for Electricity Expense, determining that it is inappropriate to include for recovery from ratepayers any amount related to the unregulated operations of Laurel Hills.

Rate of Return or Margin Regulation

Laurel Hills did not propose a rate of return. The Consumer Advocate's witness, Mr. Novak, proposed a hypothetical rate of return of 6.668%, which Laurel Hills did not dispute.[152]

Typically the Authority sets rates for large utilities using rate of return regulation. Under this methodology, rates are set to cover the known and reasonable forecasted attrition period expenses plus a fair and reasonable rate of return on rate base. However, for smaller companies

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[149] *Petitioner's Post Hearing Brief,* p. 35 (March 15, 2013).
[150] *Id.* at 33.
[151] *Post-Hearing Brief of the Consumer Advocate*, p. 53 (March 15, 2013).
[152] *Post-Hearing Brief of the Consumer Advocate*, p. 71 (March 15, 2013); Michael McClung, Pre-Filed Rebuttal Testimony, p. 13 (January 14, 2013).

with little or no rate base, the Authority generally sets rates on the margin (i.e., a rate to cover monthly expenses and in addition possibly provide a small margin or profit). The margin set for these companies has been historically set at 6.5%.[153]

Due to insufficient records, there is no method possible to accurately determine an appropriate rate base for Laurel Hills, or if in fact a rate base exists. Therefore, consistent with previous decisions for these smaller utilities, the panel adopted a margin of 6.5% for Laurel Hills.

Based upon the above findings, the panel further found that, based upon the best evidence available that is contained in the record, a just and reasonable monthly rate for water service is $33.10. The Chancery Court of Cumberland County's Proposed Agreed Order entered on August 8, 2012 set the monthly rate at $43.20 for individual customers until such time as the TRA made a determination of the appropriate rate. Therefore, to the extent allowed by the Chancery Court, the panel determined that the appropriate interim rate pending either divestiture of the water utility to a non-public utility or further action of this Authority shall be $33.10.

IT IS THEREFORE ORDERED THAT:

1. The *First Amended Petition* filed by Laurel Hills Condominium Property Owners Association is denied.

2. Laurel Hills Condominium Property Owners Association shall divest itself of the water utility within 60 days, or no later than June 7, 2013.

3. Laurel Hills shall submit evidence of such divestiture to the Authority for its approval.

4. If Laurel Hills is unable to divest its water utility by no later than June 7, 2013, Laurel Hills shall file a notice with the Authority of its inability to divest itself of the water utility

[153] *See, e.g. In re: Petition of Tennessee Wastewater Systems, Inc. for Approval to Amend Its Rates and Charges,* Docket No. 08-00202; *Order Approving Revised Settlement Agreement*, p. 4 (July 8, 2009); *In re: Petition of Cartwright Creek, LLC to Change and Increase Rates and Charges,* Docket No. 09-00056, *Order Approving Settlement Agreement and Determining Contested Issues*, p. 3 (March 2, 2010).

and shall appear before the Authority at the time and date which may be ordered by the Authority to explain its efforts to divest itself of the water utility.

5. Pending divestiture of its water utility, Laurel Hills remains a public utility and shall follow all applicable statutes, rules and procedures. Specifically, Laurel Hills shall furnish safe, adequate and proper service and keep and maintain its property and equipment in such condition as to enable it to do so pursuant to Tenn. Code Ann. § 65-4-114.

6. To the extent allowable by the Proposed Agreed Order entered by the Chancery Court of Cumberland County, Laurel Hills shall bill and collect at the monthly interim rate of $33.10 pending either divestiture of the water utility to a non-public utility or further action of this Authority.

7. The Show Cause proceeding opened as Docket No. 12-00077 will be held in abeyance until after the June 7, 2013 deadline for divestiture has passed. If Laurel Hills has not divested itself of the water utility by the deadline, the Hearing Officer and Investigative Staff shall resume proceedings against Laurel Hills for the violations set forth in the Show Cause Order issued by the Hearing Officer in this Docket and in Docket No. 12-00077 on July 17, 2012, and shall give notice to Laurel Hills of any additional violations before any additional counts are added to the Show Cause proceedings.

8. Authority Staff shall request the Comptroller of the Treasury, Office of State Assessed Properties, to appraise and value the property of the water utility pursuant to Tenn. Code Ann. § 65-4-117(2).

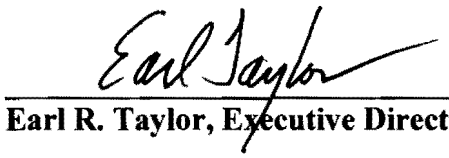
9. TRA Investigative Staff shall take whatever actions may be necessary against Laurel Hills in any Court to protect the customers of the water utility and to enforce this Order.

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

11. Any party aggrieved by the Authority's decision in this matter has the right to judicial review by filing a Petition for Review in the Tennessee Court of Appeals, Middle Section, within sixty days from the date of this Order.

Chairman James M. Allison, Director Kenneth C. Hill and Director David F. Jones concur.

ATTEST:



Earl R. Taylor, Executive Director