

**IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE NORTHERN DISTRICT OF ALABAMA  
SOUTHERN DIVISION**

<b>In re:</b>	)	
	)	
<b>JEFFERSON COUNTY, ALABAMA,</b>	)	<b>Case No. 11-05736-TBB</b>
<b>a political subdivision of the State of</b>	)	
<b>Alabama,</b>	)	<b>Chapter 9</b>
	)	
<b>Debtor.</b>	)	

**SECOND PERIODIC STATUS REPORT  
CONCERNING THE SEWER RATEMAKING PROCESS**

Pursuant to the *Interim Order on Motion to Lift or Condition the Automatic Stay Filed by Financial Guaranty Insurance Company* [Docket No. 967] entered May 7, 2012 (the “Interim Order”), Jefferson County, Alabama (the “County”), the debtor in the above-captioned chapter 9 case, respectfully submits this Second Periodic Status Report Concerning the Sewer Ratemaking Process (the “Status Report”).<sup>1</sup>

**1. The Second Public Hearing**

On July 24, 2012, at the Bessemer Courthouse, the Jefferson County Commission (the “Commission”) held the second of several scheduled public hearings regarding sewer rates. The County published official notice of the hearing in several editions of the *Birmingham News* and by docket notice in this case, *see Notice of Second Sewer Rate Hearing* [Docket No. 1125], and the local press again provided news coverage in the week prior to the hearing. Commissioner Sandra Little Brown, President Pro Tempore of the Commission, presided over the hearing in Commission President David Carrington’s absence. Commissioners Bowman, Stephens and Knight were present and actively participated, as well.

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<sup>1</sup> The County’s *First Periodic Status Report Concerning the Sewer Ratemaking Process* [Docket No. 1070] was filed June 18, 2012. It is available free of charge at [www.jeffcosewerhearings.org](http://www.jeffcosewerhearings.org), under the “Documents” tab.

Following Commissioner Brown’s opening remarks, Eric Rothstein (a Principal of the Galardi Rothstein Group) testified.<sup>2</sup> Mr. Rothstein provided an overview of his extensive experience in this field, *see* Tr. at 7:1-8:12, and then used several sample Jefferson County sewer bills as the starting point for a broader discussion of sewer utility capital financing and industry-standard principles of utility ratemaking. *Id.* at 13:4-15:12.<sup>3</sup> Among other topics, Mr. Rothstein discussed the various options available for funding major capital projects of the scope required by the 1996 consent decree, including the declining availability of grants and an overview of typical bond indenture provisions. *Id.* at 15:18-27:3.

Mr. Rothstein then turned to Jefferson County’s situation specifically. He discussed the historical development of the System, including how the “process of consolidation of a diverse set of different sewer systems of varying quality” has the current effect of “distort[ing] information on the balance sheet.” *Id.* at 45:7-22. Mr. Rothstein also discussed the System’s “extraordinary” amount of debt and “quite atypical” portfolio of debt instruments utilized. *Id.* at 48:1-8. Among other metrics, he contrasted the amount of long-term indebtedness per customer of typical utilities (in the \$1,100 to \$2,000 range) to the amount of long-term indebtedness per customer in Jefferson County – which is more than \$21,000.<sup>4</sup> In this regard, Mr. Rothstein concurred with certain of the conclusions reached by John Young in his First Interim Receiver Report and his November 2011 trial testimony concerning the impossibility of raising rates to a

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<sup>2</sup> A complete transcript of the July 24, 2012 sewer rate hearing is attached hereto as Exhibit A. The transcript and this report are also available free of charge at [www.jeffcosewerhearings.org](http://www.jeffcosewerhearings.org), under the “Documents” tab.

<sup>3</sup> Mr. Rothstein’s discussion of particular line items on sample sewer bills is best reviewed by reference to his accompanying PowerPoint slides, which the Commission and those in attendance at the hearing viewed on a projection screen. A copy of Mr. Rothstein’s PowerPoint presentation is available free of charge at [www.jeffcosewerhearings.org](http://www.jeffcosewerhearings.org), under the “Documents” tab.

<sup>4</sup> The transcript of the hearing does not capture the \$21,000 figure, but it is referenced on the PowerPoint slide projected on the screen during the hearing. *See supra* note 3.

level high enough to repay \$3.2 billion.<sup>5</sup> Mr. Rothstein advised the Commission that “[i]t’s just not reasonable, appropriate, or . . . likely even possible for the County to increase rates to pay for the outstanding debt as it becomes due and payable, and to pay for the expenses of operating the system in compliance with applicable law.” Tr. at 57:2-7.

Next, Mr. Rothstein discussed how the Commission might approach one of the three constituent components of standard municipal utility revenue requirements – debt service – in light of the fact that full repayment of the County’s outstanding sewer indebtedness is not possible.<sup>6</sup> His ideas in this regard include looking for guidance in “how private utilities are regulated,” such as the concept of disallowing certain imprudently incurred costs:

Private utilities don’t have the same way of establishing their costs. They don’t add operating expenses and annual capital expenses and debt service and come up with a cash requirement that needs to be met through revenues, through rate revenues. What they do is they look at operating expenses and they look at the amount of invested rate base, and calculate a return on that invested rate base; the concept being that those who’ve invested in the system are entitled to receive a return on their investment. One of the fundamental princip[les] of that is the rate of return is earned on *used* and *useful* assets.<sup>7</sup>

Mr. Rothstein noted that the Commission might look to this parallel regulatory scheme for guidance: “We may want to ask ourselves, what would be the debt levels associated with a reasonable[,] prudently incurred cost [of building the System] as opposed to where the system is

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<sup>5</sup> Mr. Young’s First Interim Receiver Report and November 2011 trial testimony are available free of charge at [www.jeffcosewerhearings.org](http://www.jeffcosewerhearings.org), under the “Documents” tab.

<sup>6</sup> “A utility’s revenue requirement is the amount of revenue necessary to meet the utility’s costs of providing service. In simplest terms, the revenue requirement is the sum of the following costs: (1) O&M expenses; plus (2) required capital expenditures; plus (3) debt service costs (required principal and interest payments and specified reserves).” First Interim Receiver Report at 53.

<sup>7</sup> Tr. at 62:1-18 (emphasis added). Cf. *Union Springs Tel. Co. v. Ala. Pub. Serv. Comm’n*, 437 So. 2d 485, 486 (Ala. 1983) (“A regulated utility’s cost of service consists of two basic components: [1] a reasonable return on its property devoted to public service, [*i.e.*] its cost of capital; and [2] its operating expenses, including taxes and depreciation. The property upon which the Company is permitted to earn a specific rate of return is its statutory rate base. Generally, the . . . rate base [is] the reasonable value of its property devoted to the public service, calculated by its original cost, less the accrued depreciation.”).

now[?]" Tr. at 63:21-64:1. *See also id.* at 63:14-21 ("Are there assets that are not really at the value that's recorded in the fixed asset records? . . . Are there assets [for which] the book value has been artificially inflated because of the graft and corruption that occurred[?]").

Finally, Mr. Rothstein discussed the concepts of reasonableness and non-discrimination, and how those concepts might apply in the context of Jefferson County's unique situation. After noting that "[t]here is not a bright line standard for reasonableness," *id.* at 65:8-9; *see also id.* at 65:10-12 (observing that "[t]here is not some place that we can look to . . . that says \$10 per CCF is reasonable and \$10.05 is not"), Mr. Rothstein outlined some criteria for assessing reasonableness and non-discrimination. *See, e.g., id.* at 65:23-66:1 ("the same reasonable rates need to be applicable to everyone in the same class of customers"); *id.* at 66:5-7 (rates must be "generally applicable to everybody"); *id.* at 67:7-9 ("smooth, nondisruptive rate increases . . . that people can plan for, people can manage, people can understand"); *id.* at 67:9-12 ("Rate increases that don't ask customers to pay for something that's not being used or some costs that were not prudently incurred"); *id.* at 67:17-21 ("It doesn't make sense to set rates that will only pay for operating expenses and debt service costs, but not provide the annual renewal and rehabilitation necessary to keep the system in good working order."); *id.* at 68:1-4 ("[I]t doesn't make sense to establish rates that deny customers access to a vitally needed service required to maintain public health.").

When Mr. Rothstein's testimony concluded, the Commission heard from six members of the public about how sewer rates affect the community and how the Commission should proceed in its constitutional task. Although the Commission invited each of the major sewer creditors to testify or otherwise submit their views on appropriate sewer rates as part of the public hearing process, *see Notice of Invitations to Address the Jefferson County Commission at the Next Sewer*

*Rate Hearing* [Docket No. 1090], each has declined. *See Response of Indenture Trustee and the Named Warrantholders and Insurers to Jefferson County's Invitation to Address the Jefferson County Commission at the Next Sewer Rate Hearing* [Docket No. 1131] (“[T]he Invitees do not intend to participate in the Debtor’s Sewer Rate Hearings.”). The Commission’s invitation to the sewer creditors remains open.

## **2. Final Public Hearing**

The Commission has scheduled what it plans as the final public hearing regarding sewer rates for August 20, 2012, at Samford University. The County will announce the exact time and location of the hearing by publication and docket notice at least one week prior to the hearing.

Once again, the Commission invites testimony, presentations and comments at the final hearing about, *inter alia*, (i) the costs of operating and maintaining the sewer system in a sound, responsible manner, including appropriate renewal and rehabilitation of existing infrastructure; (ii) elasticity and the probable outcomes (in terms of both revenue and public health) of various levels of rate adjustments; (iii) the advisability and feasibility of adopting the GASB 34 modified approach on a going-forward basis; (iv) the adverse impact on the revenue stream generated by the system absent appropriate levels of capital expenditures; (v) the advisability or necessity of a low income assistance program and the funding of such a program consistent with the requirements of Alabama law governing reasonableness and non-discriminatory rates; and (vi) creditor concerns. This topic listing is illustrative rather than exhaustive and the order in which they are listed above does not convey their relative importance.

The Commission continues to welcome information from any interested persons – including customers, ratepayers, taxpayers, members of the community, employees and creditors – about any topic pertaining to sewer system rates and charges. It is important to note that the

Commission has determined to exercise its constitutional obligations in respect of sewer rates and charges on the basis of the testimony, evidence and public comments received during and in connection with these public sewer rate hearings.

**3. Next Steps**

After the final public sewer rate hearing, the Commission – in consultation with the County’s experts and sewer professionals – will fully consider the facts, opinions and comments gathered during the public hearing process. Once a specific proposal has been formulated, the County will make it available to all interested parties, and the Commission will hold one or more public hearings to consider the proposal. Although the timing may change, the County currently anticipates releasing a specific proposal in September 2012, and holding a final hearing on the proposal in October 2012.

**4. Conclusion**

The County will file its next Status Report on or before September 17, 2012, consistent with the Interim Order.

Respectfully submitted this 2nd day of August, 2012.

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