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August 31, 2012

VIA HAND DELIVERY
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Re: Jefferson County, Alabama Public Sewer Rate Hearings

Gentlemen:

As you know, on June 22, 2012, Mr. Petelos, in his capacity as Chief Executive Officer of Jefferson County (the "County"), sent letters to the Indenture Trustee and certain of the sewer warrant holders and insurers (collectively, the "Invitees") inviting them to appear and be heard on July 24 at the second of three announced public hearings to be held by the County Commission regarding sewer rates (the "County's Invitation"). Mr. Petelos stated that the purpose of the County's Invitation was "to hear whatever information [the Invitees] would like [the Commission] to consider as [it] undertake[s] this important process." While reserving all their rights, the Indenture Trustee and the Invitees responded to the County's Invitation by reiterating their position that the County is both obligated and able to raise rates to a level sufficient to pay all of the County's sewer obligations in full. The Invitees have made this position clear in no less than three separate court proceedings over the last four years. The Indenture Trustee also reminded the County of (and listed) at least seven reports prepared by the County's consultant's, the Special Masters, and the Receiver advising the County of the need and ability to raise its sewer rates.

August 31, 2012

Page 2

We assumed the Commission would consider all relevant, reliable information already in its possession or otherwise provided to them regardless of the forum in which it was provided; this includes the information referenced in the Invitation Response. Indeed, the referenced reports are in the County's possession, and have been created by the County's own consultants or Court appointed officials. However, based on statements made by the County since the filing of its First Periodic Status Report Concerning the Sewer Ratemaking Process, it is unclear whether the Commission intends to consider any information that is not separately provided as part of the purported "record" in the "public hearing process." Although such an approach is not supportable as a matter of law, in accordance with the directions contained on the website established for the public hearings, this letter, together with the reports, documents, and other information referenced herein, is being submitted to be included in the "record" of the public "hearings." This written submission is being provided, however, with full reservation of all of the Invitees' rights under the Indenture and applicable law, including all of their rights to seek relief from the Bankruptcy Court or in state court at any time with respect to the Commission's failure to set sewer rates adequate to meet the County's obligations. Without limiting the foregoing reservation of rights, the following is being submitted for the Commission's consideration:

(a) the Indenture (which includes the "Rate Covenant" at Section 12.5);

(b) the Invitation Response;

(c) the following reports: (i) the Red Oak Consulting Final Technical Report for the Jefferson County Environmental Services Department dated January 31, 2007; (ii) the Raftelis Financial Consultants, Inc., Jefferson County Commission Comprehensive Wastewater Cost of Service and Rate Study Report dated February 3, 2010; (iii) the BE & K Engineering Company 2003 Final Report; (iv) the Paul B. Krebs & Associates, Inc., Analysis of Sources of Revenue for the Jefferson County Environmental Services Department dated March 31, 2002; (v) the Paul B. Krebs & Associates, Inc., Report to the Commission of Jefferson County dated November 5, 2002; (vi) the Paul B. Krebs & Associates, Inc., Draft Report of Analysis of Sources of Revenue for the Jefferson County Environmental Services Department dated March 13, 2003; (vii) the Raftelis Financial Consultants, Inc., 2008 draft report; (viii) the Report of the Special Master's Assessment of the Jefferson County Environmental Services Department dated January 20, 2009 (Trial Exhibit M.3 to the November 2011 stay hearing, Doc. No. 257); and (ix) the Receiver's First Interim Report on Finances, Operations, and Rates of the Jefferson County Sewer System filed in State Court Action CV-2009-02318 dated June 14, 2011 (Trial Exhibit M.4 to the November 2011 stay hearing, Doc. No. 257);

(d) the enclosed copy of the County Resolution, dated as of December 16, 2008, whereby the Commission suspended the Rate Adjustment Resolution so the Commission could "act directly on System rates after consulting with and considering the recommendations of the Special Masters and the County's consultants";

(e) the enclosed chart describing the consultants', Special Masters', and Receiver's rate setting recommendations between 2002 and 2011, as compared to the County's actual rates during that period;

August 31, 2012
Page 3

(f) the enclosed Memorandum Opinion of United States District Judge David Proctor, dated June 12, 2009, in the case styled: *The Bank of New York Mellon, et al., v. Jefferson County, Alabama*, Civil Action No. 2:09-CV-01702-RDP, finding, among other things, that the Warrantholders were being irreparably harmed every day Sewer rates were not increased;

(g) the enclosed Receiver Order entered on September 22, 2010, by Circuit Judge Albert L. Johnson in the case styled: *The Bank of New York Mellon, as Indenture Trustee v. Jefferson County, Alabama, et al.*, Case No. CV-2009-02318, finding, among other things, that the Warrantholders were being irreparably harmed by the loss of System Revenues and Net Revenues Available for Debt Service that the System could generate, but was not generating, and appointing the Receiver with rate making authority;

(h) the term sheet dated as of September 14, 2011, pursuant to which the County proposed "approximate rate increases of 8.2% for each of the first three years beginning November 1, 2011 (or as soon thereafter as possible), and future projected annual increases of no more than 3.25% for operating expenses and capital requirements until such time as the debt service requirements related to the Refinancing are met"¹; and

(i) excerpts from testimony of the County's consultants Peiffer Brandt and Eric Rothstein (who testified under oath and were subject to cross-examination).

The Invitees urge the Commission and its consultants to review and consider carefully all relevant information, including the information contained in and being submitted with this letter. The referenced information makes clear that System Revenues can and should be increased, and that the County has an obligation to do so. In addition, this letter is being submitted in an effort to correct a number of the County's current assumptions and conclusions about sewer bills and the impact on System customers. For example, in Mr. Rothstein's presentation at the July 24 public hearing he presented two slides in an effort to show that average sewer bills for Jefferson County customers are higher by comparison to other communities. In doing so, he calculated that a monthly bill for a Jefferson County customer would be almost \$63.00 if that customer used 10 ccf of water per month. However, the average water usage for Jefferson County sewer customers is closer to 6 ccf per month, which would result in an average monthly sewer bill closer to \$38.00. Because of this significant discrepancy, the figures for Jefferson County in Mr. Rothstein's chart are materially inflated in relation to the other communities. An accurate comparison would put Jefferson County much lower on Mr. Rothstein's chart. Dr. Rauterkus seems to have made a similar error in her presentation of June 12. She correctly assumed the average water usage for Jefferson County Sewer customers is approximately 6 ccf per month. However, she then assumed that 6 ccf is the same average monthly usage for the other communities in her comparison. We believe a number of the other

¹ These proposed rate increases assumed the outstanding principal balance of the Warrants would be reduced voluntarily by certain of the Warrantholders by more than \$1 billion in the aggregate as part of a refinancing of the Warrants. The Commission chose not to pursue that settlement and refinancing, and instead commenced the County's chapter 9 case, thereby rejecting the offered concessions. Without those concessions, the County would have to raise rates even higher to meet its obligations under the Indenture.

waller

August 31, 2012
Page 4

communities she used have higher average usage than Jefferson County. Atlanta's average usage, for example, is approximately 8 ccf. Therefore, Dr. Rauterkus appears to have materially understated the average sewer bills for other communities in her comparison to Jefferson County. These are but two significant errors uncovered to date in the information disseminated at the public hearings and upon which the Commission apparently intends to rely.

Based on the information referenced above and on currently available information, the Indenture Trustee believes the County can, consistent with Alabama law and recognized models of financial capacity, implement revenue increases over the next several years that, if done in conjunction with effective and efficient administration and operation of the System, and proper planning for future capital needs and utilization of all available resources, will allow the County to fulfill its obligations to the Warrantholders and the residents of Jefferson County. The County will have to increase rates to achieve the revenues necessary to meet its obligations. However, there may be a number of different rate structures that could be implemented that would allow the County to meet its obligations to the Warrantholders and to its residents.² Moreover, if the County were to increase revenues from sources other than rate increases, such as through mandatory hook up, reserve capacity fees, clean water fees, or other non-user fees, the rate increases needed to achieve the necessary revenue increases may be reduced. Finally, as the settlement term sheet from last September demonstrates, a negotiated resolution may also be a way for the County and the Warrantholders to address these matters in the context of a consensual plan of adjustment.

The Invitees repeat their offer to meet with the County to discuss future rate structures the County can and should implement, and to engage in good faith negotiations regarding the terms of a plan of adjustment.

Thank you for your attention to this matter.

Sincerely,


David E. Lemke
Waller Lansden Dortch & Davis, LLP

DEL:ct

cc: The Bank of New York Mellon,
as Indenture Trustee

Counsel for Liquidity Banks
and Insurers

² In the past, the County has stated that the Trustee is calling for rate increases of 400% or more. The basis for those statements is not clear, but the Trustee has never called for such increases in the past and is not doing so now