

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

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

**THIRD 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 Third Periodic Status Report Concerning the Sewer Ratemaking Process (the “Status Report”).¹

1. The Third Public Hearing

On August 20, 2012, in the John L. Carroll Moot Courtroom at Samford University’s Cumberland School of Law, the Jefferson County Commission (the “Commission”) held the third of several contemplated public hearings regarding sewer rates. The County published official notice of the hearing in the August 11, 2012 edition of the *Alabama Messenger*, at the County Courthouse, in several editions of the *Birmingham News*, and by docket notice in this bankruptcy case, *see Notice of Third Sewer Rate Hearing* [Docket No. 1229].

¹ The County’s *First Periodic Status Report Concerning the Sewer Ratemaking Process* [Docket No. 1070] (the “First Report”) was filed June 18, 2012. The County’s *Second Periodic Status Report Concerning the Sewer Ratemaking Process* [Docket No. 1190] (the “Second Report”) was filed August 2, 2012. The First and Second Reports are available free of charge at www.jeffcosewerhearings.org, under the “Documents” tab.

In his opening remarks, Commission President David Carrington explained that he and Commissioners Brown, Bowman, Knight and Stephens have “found this process to be very valuable, . . . both because [of] the testimony we have heard from the invited witnesses and because of the citizen comments.” Tr. at 2:5-9.² Commissioner Carrington also extended the Commission’s thanks to John Carroll, Dean of the Cumberland School of Law and former United States Magistrate Judge, who graciously volunteered to moderate the first three public sewer hearings. *Id.* at 2:12-3:1.

Following these opening remarks, Lance LeFleur, Director of the Alabama Department of Environmental Management (“ADEM”), testified. Mr. LeFleur began by explaining ADEM’s role, mission and relationship with the federal Environmental Protection Agency (“EPA”). *Id.* at 8:14-9:19; *see also id.* at 14:3-15:17 (relationship of ADEM and EPA in connection with setting Total Maximum Daily Load levels for certain substances). Mr. LeFleur explained that under the federal Clean Water Act, 33 U.S.C. §§ 1251, *et seq.*, a treatment facility is prohibited from discharging any wastewater except in strict compliance with that facility’s National Pollutant Discharge Elimination System (“NPDES”) permit. Tr. at 9:19-10:4.

The County’s sewer system has nine NPDES permits – one for each wastewater treatment plant. *Id.* at 10:4-7. “These permits include specific and detailed requirements addressing discharge limits, monitoring, recordkeeping, and reporting, and notification.” *Id.* at 10:7-10. If a particular facility is not in compliance with its NPDES permit, each and every discharge of wastewater from that facility is a violation of the Clean Water Act, with potentially serious consequences. *Id.* at 10:11-20. Accordingly, Mr. LeFleur advised the Commission that

² A complete transcript of the August 20, 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, under the “Documents” tab.

“resources spent by the County to comply with [its nine] NPDES permits are a wise and prudent investment.” *Id.* at 10:21-23.

Mr. LeFleur testified that “the County has done a good job with its compliance efforts,” and he praised “the professionals who operate the County sewer system” for having “done an excellent job” and for their “cooperative spirit and dedicated efforts” in working with ADEM. *Id.* at 11:2-14. He cautioned, however, that “NPDES permits are not static,” *id.* at 11:22, and that “the renewal permits ADEM anticipates issuing in the near future for two of the County’s treatment plants . . . will contain stricter limitations on the amount of total phosphorous, or TP, present in the treated wastewater discharge[d] by these two plants.” *Id.* at 13:1-7. These wastewater treatment plants discharge into the Cahaba River, which has been determined to be “impaired with regard to [phosphorous].” *Id.* at 15:22. That impairment – and the strict new phosphorus regulations designed to correct it – “has profound and far-reaching implications for the citizens of Jefferson County.” *Id.* at 16:8-10.

Specifically, Mr. LeFleur explained that meeting the “new [phosphorus] target will not be easy nor will it be cheap.” *Id.* at 16:19-20. That is the case even though ADEM has phased in the new target “over the *maximum time period available.*” *Id.* at 16:11-14 (emphasis added). Compliance will cost approximately \$150 million, *id.* at 16:21-17:4, and Mr. LeFleur warned that even after that substantial outlay, “the Jefferson County sewer system can anticipate that significant additional expenditures will be necessary to ensure compliance with the increasingly stringent requirements of NPDES permits.” *Id.* at 17:7-12.

When Mr. LeFleur’s testimony concluded, Dean Carroll noted that no members of the public had signed up to comment. *Id.* at 18:16-23. Accordingly, the third public hearing was adjourned.

2. August 20, 2012 Submission

On the same date as the third public hearing, an ad hoc group of creditors (the “GLC Group”) stating that they hold approximately \$700 million of sewer system debt provided a detailed, 36-page submission (the “GLC Submission”) for the Commission’s consideration as part of the rate-setting process.³ The GLC Submission compares Jefferson County’s system to 28 other sewer systems also operating under EPA consent decrees, *see* GLC Submission at 9 & App’x A; including by miles of sewer pipe, *id.* at 12 & 14; number of customers, *id.* at 13-14; operating expenses by customer, *id.* at 15; sewer fees as a percentage of median income, *id.* at 17 & 19; property tax as a percentage of median income, *id.* at 18-19; and projected sewer fee increases for 2013-2015, *id.* at 21-22.

Additionally, among other topics, the GLC Group discusses:

- The fixed nature of most sewer costs and the consequence that a smaller base of customers will shoulder higher per-account costs as compared to a larger customer base, *id.* at 4 & 11;
- The comparability of the sewer rate increases contemplated as part of a draft September 2011 settlement term sheet to average projected increases of comparable sewer systems operating under EPA consent decrees, *id.* at 4;
- Today’s historically low interest rates, *id.* at 5-6; *see also id.* at 7 (overview of municipal financing market); and the County’s potential ability to access such rates through legislative measures (including the creation of a GUSC and the backing of a State moral obligation pledge), *id.* at 5 & 32-33; and

³ A copy of the GLC Submission is attached hereto as Exhibit B, and is also available free of charge at www.jeffcosewerhearings.org, under the “Documents” tab.

- The legality and desirability of requiring mandatory hook-ups for new construction within proximity to existing sewer lines, *id.* at 31 (citing ALA. CODE § 11-3-11(a)(15)).

The GLC Group further notes that, according to the 2009 Special Master’s Report, “[s]ewer fees for Jefferson County currently represent 96% of total [system] funding,” whereas other systems under EPA consent decrees generate only 93% of their revenue from sewer fees. GLC Submission at 24. Accordingly, the GLC Group recommends that the County consider additional revenue generation from other sources, including clean water charges for septic system owners and potential revenue enhancements outlined in the 2009 Special Master’s Report. *Id.*

3. August 31, 2012 Submission

On August 31, 2012, the Indenture Trustee, JPMorgan Chase Bank, N.A., Bank of America, Bank of Nova Scotia, Société Générale, Bank of New York Mellon, State Street Bank and Trust Company, Lloyds TSB Bank plc, Assured Guaranty Municipal Corp. and Syncora Guarantee Inc. (collectively, the “Responding Creditors”) submitted a 4-page letter (the “August 31 Letter”) with 1,112 pages of exhibits (collectively with the August 31 Letter, the “August 31 Submission”) for the Commission’s consideration as part of the rate-setting process.⁴

The August 31 Letter states 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.” Aug. 31 Letter at 1. It

⁴ A copy of the August 31 Letter is attached hereto as Exhibit C. The complete August 31 Submission (including the August 31 Letter) is available free of charge at www.jeffcosewerhearings.org, under the “Documents” tab. The August 31 Letter indicates that it was sent on behalf of “the Indenture Trustee and certain of the sewer warrant holders and insurers,” which the August 31 Letter defines as the “Invitees.” The “Invitees,” in turn, are identified in the *Response of Indenture Trustee and the Named Warrant holders and Insurers to Jefferson County’s Invitation to Address the Jefferson County Commission at the Next Sewer Rate Hearing* [Docket No. 1131] (the “Invitation Response”) as the Indenture Trustee, JPMorgan Chase Bank, N.A., Bank of America, Bank of Nova Scotia, Société Générale, Bank of New York Mellon, State Street Bank and Trust Company, Lloyds TSB Bank plc, Assured Guaranty Municipal Corp. and Syncora Guarantee Inc.

“urge[s] the Commission and its consultants to review and consider carefully all relevant information, including the information” comprising the August 31 Submission, *id.* at 2; to wit:

- the Trust Indenture between Jefferson County, Alabama, and AmSouth Bank of Alabama, dated as of February 1, 1997 (the “Indenture”);
- the Invitation Response;
- the Red Oak Consulting Final Technical Report, dated January 31, 2007 (the “Red Oak Report”);
- the Comprehensive Wastewater Cost of Service and Rate Study Report, dated February 3, 2010 (the “Raftelis Report”);
- the BE&K 2003 Final Report (the “BE&K Report”);
- the Paul B. Krebs & Associates Report, dated November 5, 2002 (the “Krebs Report”);
- the Paul B. Krebs & Associates Revenue Analysis, dated March 31, 2003 (the “Krebs Revenue Analysis”);
- an earlier draft of the Krebs Revenue Analysis, dated March 13, 2003 (the “Krebs Draft”);
- a draft expert report from Raftelis Financial Consultants, dated 2008 (the “Raftelis Draft”);
- the Report of the Special Master, dated January 20, 2009 (the “Special Master Report”);
- the Receiver’s First Interim Report on Finances, Operations, and Rates of the Jefferson County Sewer System, dated June 14, 2011 (the “Receiver Report”);
- a Resolution of the Commission, dated December 16, 2008;

- a “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” (the “Trustee Comparison Chart”);
- a memorandum opinion (the “Proctor Decision”), dated June 12, 2009, in the case captioned *The Bank of New York Mellon, et al. v. Jefferson County, Alabama, et al.*, Case No. 2:08-cv-01703-RDP (N.D. Ala.) (the “Federal Receivership Case”);
- an order (the “Receiver Order”), dated September 22, 2010, in the case captioned *The Bank of New York Mellon, et al. v. Jefferson County, Alabama, et al.*, Case No. CV-2009-02318 (Ala. Cir. Ct.) (the “State Receivership Case”);
- a draft settlement term sheet dated as of September 14, 2011 (the “September 2011 Term Sheet”);
- excerpts from the transcript of Peiffer Brandt’s May 10, 2010 deposition in the State Receivership Case;
- excerpts from the transcript of Eric Rothstein’s August 23, 2010 deposition in the State Receivership Case;
- a letter from Peiffer Brandt to Patrick Darby, dated March 5, 2009;
- excerpts from the transcript of a hearing held February 25, 2009 in the Federal Receivership Case;
- excerpts from the transcript of a hearing held June 1, 2009 in the Federal Receivership Case; and
- a set of typed notes, dated October 15, 2009.

Aug. 31 Letter at 2-3. The Responding Creditors state that these materials “make[] clear that System Revenues can and should be increased, and that the County has an obligation to do so.”

Id. at 3.

Additionally, the Responding Creditors state that the August 31 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.” *Id.* In this regard, the August 31 Letter states that Eric Rothstein (a witness at the second public sewer rate hearing) and Professor Stephanie Rauterkus (a witness at the first public sewer rate hearing) used inaccurate figures when comparing sewer rates in Jefferson County to sewer rates elsewhere. *Id.* at 3-4. Specifically, the Responding Creditors state that Mr. Rothstein “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,” whereas “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.” *Id.* at 3. Similarly, the Responding Creditors assert that although Dr. Rauterkus “assumed the average water usage for Jefferson County Sewer customers is approximately 6 ccf per month,” she “then assumed that 6 ccf is the same average monthly usage for the other communities in her comparison” – notwithstanding that other communities may have different levels of water usage. *Id.* at 3-4.

Finally, the August 31 Letter notes that “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,” including “mandatory hook up [requirements], reserve capacity fees, clean water fees, or other non-user fees,” which could reduce “the rate increases needed to achieve the necessary revenue increases” urged by the Responding Creditors. *Id.* at 4.

The August 31 Letter concludes by observing that “a negotiated resolution may also be a way for the County and the Warranholders to address these matters in the context of a consensual plan of adjustment.” *Id.*

4. Next Steps

The Commission greatly appreciates the contributions to the public hearing process made by the four invited witnesses (Prof. Rauterkus and Messrs. Denard, Rothstein and LeFleur), the 18 concerned citizens and ratepayers who personally appeared over the course of three public hearings, and the key creditor constituencies who offered detailed discussions of the issues and collected and submitted more than 1,000 pages of pertinent materials. As expressed in the County Manager’s personal invitations to assist and participate in this process, “[t]he Commission is committed to proceeding on the basis of the very best information and expertise available, gleaned [through] public hearings at which everyone affected by the sewer system and sewer rates and charges has the opportunity” to be heard. *Notice of Invitations to Address the Jefferson County Commission at the Next Sewer Rate Hearing* [Docket No. 1090] Exs. A-K at 1. By providing their considered testimony, commentary and evidence, the distinguished witnesses, public, and creditors have greatly assisted the Commission in undertaking this important task.

All of the public hearing transcripts, witness presentations, and materials submitted by interested parties are now being assembled into a single complete, official record (the “Record”), which will form the basis on which the Commission will act. As noted previously, this procedural safeguard is intended to ensure that the rate-setting process is open and transparent, and that the basis on which the Commission acts is clearly articulated and not open to question.⁵

⁵ See generally First Report at 6 (“[T]he Commission is committed to ensuring that whatever result it reaches is supported by substantial evidence, and is not arbitrary or discriminatory. Thus, Commission will examine the relevant data and articulate a satisfactory explanation for its action, including a rational connection between the facts
(footnote continued on next page)

The Commission is guided in this regard by analogous principles set out in the Alabama Administrative Procedure Act, ALA. CODE §§ 41-22-1, *et seq.* (the “APA”), including the fundamental belief that proper procedures lead to better substantive results. *E.g.*, ALA. CODE § 41-22-2(c) (“[The APA] is not meant to alter the substantive rights of any person or agency. Its impact is limited to procedural rights with the expectation that better substantive results will be achieved in the everyday conduct of state government by improving the process by which those results are attained.”).

The Commission – in consultation with the County’s experts and professionals – is now considering the Record and applicable law, and will consider an amendment to the *Jefferson County Sewer Use/Pretreatment Ordinance* adopted May 11, 1982, as amended through March 31, 2009 (the “Sewer Use and Pretreatment Ordinance”).⁶ The proposed amendment will be released, considered and acted upon in accordance with all applicable rules and practices of order and procedure, including the requirement in section 6(a) of Act 619, 1949 Ala. Laws 949, *et seq.* (approved Sept. 19, 1949), of a “public hearing or hearings” held by the Commission “at least seven days after . . . published notice” of the proposal. Notice will include docket notice in this case.

found and the choice made. The record being developed at the public hearings will ensure that the Commission does not entirely fail to consider an important aspect of the problem, offer an explanation for its decision that runs counter to the evidence before it, or rely on any impermissible factors.” (internal quotation marks, citations and alterations omitted); Second Report at 5-6 (reiterating the Commission’s intent to act “on the basis of the testimony, evidence and public comments received during and in connection with [the] public sewer rate hearings”).

⁶ A copy of the Sewer Use and Pretreatment Ordinance is attached hereto as Exhibit D, and is also available free of charge at www.jeffcosewerhearings.org, under the “Documents” tab.

5. Conclusion

The County will file its next Status Report on or before October 28, 2012, consistent with the Interim Order.

Respectfully submitted this 12th day of September, 2012.

By: /s/ Patrick Darby

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