

March 21, 2024

Board of Directors
Tellico Village Property Owners Association, Inc.
112 Chota Center
Loudon, TN 37774

VIA EMAIL ONLY

**RE: Tellico Village Property Owners Association, Inc.
Authority to Implement Water and Sewer Capital Improvement Fee**

CONFIDENTIAL AND PRIVILEGED ATTORNEY WORK PRODUCT

Dear Board of Directors:

You have asked this law firm to render a legal opinion regarding the authority of the Tellico Village Property Owners' Association, Inc. ("TVPOA") to implement a water and sewer capital improvement fee for property owner customers receiving water and sewer services. Specifically, TVPOA has proposed to implement a water and sewer capital improvement fee for all property owner customers receiving water and sewer services in order to provide adequate funding for necessary maintenance, repairs, and capital improvements to the water system distribution infrastructure and sewer system collection infrastructure (collectively referred to as the "Systems").

To begin with, TVPOA's authority to operate the Systems for the use and benefit of the property owners of Tellico Village is established pursuant to the Declaration of Covenants and Restrictions for Tellico Village, Tennessee (the "Declaration"). Specifically, Article VI, Section 1 of the Declaration provides, in pertinent part, that "the water system distribution infrastructure and sewer system collection infrastructure serving the Project shall be constructed by the Developer but will be part of the Common Properties." Because the Systems are established as part of the Common Properties, TVPOA is charged with the operation thereof pursuant to Article VII Section 1 of the Declaration, which expressly designates TVPOA as "the operating entity for the Common Properties within the Project." This Section further provides that TVPOA "shall have all powers and duties set forth therefor in this Declaration, its Articles of Incorporation and Bylaws, applicable laws, statutes, ordinances and governmental rules and regulations, and all other lawful powers and duties deemed by its Board of Directors as advisable to carry out its functions", which necessarily include operation of the Systems.

As the designated operator of the Systems, TVPOA is granted broad authority under the Declaration to establish appropriate water and sewer customer rate and fee structures in order to properly fund the maintenance, repairs and capital improvements to the Systems. Specifically, Article VI, Section 1 of the Declaration provides, in pertinent part, that “the cost of the acquisition of treated water and sewer treatment from third party sources, *construction of water storage facilities* and booster chlorinators as needed, maintenance, *capital improvements*, operation, taxes and other expenses incident to *the water system and sewer system* and operation of same, *shall be paid from Assessments and from charges made to Owners* for furnishing such services at such prices as shall be fixed from time to time by the Board of Directors” (emphasis added). The use of the mandatory term “shall” in this provision makes clear that capital improvements to the Systems must necessarily be funded either through 1.) Assessments or 2.) charges made to Owners for furnishing such services. By including two authorized funding mechanisms for capital improvements to the Systems, this provision affords TVPOA reasonable latitude to determine both the appropriate manner and amount of any charges to Owners therefor.

Pursuant to the pertinent provisions of the Declaration cited above, it is evident that the Board of Directors (the “Board”) is duly authorized (and in fact reasonably obligated) to charge property owner customers receiving water and sewer services sufficient rates and fees to cover the expenses associated with both maintenance and capital improvements to the Systems. Under well-established Tennessee law, “rules governing the construction of covenants imposing restrictions on the use of land are generally the same as those applicable to any contract or covenant, including the rule that where there is no ambiguity in the language used, there is no room for construction, and the plain meaning of the language governs.” *Bernier v. Morrow* (Tenn. Ct. App. Apr. 26, 2013) (citing 20 Am. Jur. 2d Covenants, Etc. § 168). “Primarily, the question is one of intention, subject to the further principle that restrictive covenants are strictly construed in favor of the free use of property. *Id.* Where a matter involves the interpretation of restrictive covenants, a court “should apply well-established rules of construction and law in order to construe the terms of the covenants.” *Parks v. Richardson*, 567 S.W.2d 465, 467 (Tenn. Ct. App. 1977). Thus, if the “meaning of the covenant is reasonable and unambiguous, there is no need to seek further clarification outside its language.” *Shea v. Sargent*, 499 S.W.2d 871, 874 (Tenn. 1973). Therefore, based upon the plain and unambiguous provisions of the Declaration, it appears that the Board is within its designated authority to implement a water and sewer capital improvement fee as proposed.

In addition to the provisions of the Declaration expressly authorizing the Board to charge property owner customers sufficient rates and fees to cover the expenses associated with both maintenance and capital improvements to the Systems, there do not appear to be any other conflicting provisions of the Declaration which would preclude the Board from implementing a water and sewer capital improvement fee. It is noted that Article X, Section 4 of the Declaration independently authorizes TVPOA to levy special assessments providing, in pertinent part, that TVPOA “*may* levy in any assessment year a Special Assessment, applicable to that year only,...for the purpose of defraying, in whole or in part, the cost of any construction or reconstruction, *unexpected repair or replacement of the water system, sewer system* and streets within the Project...and also any desired repair, replacement or improvement of facilities of the Association

and/or the construction, of any *capital improvement* upon the Common Properties...” (emphasis added). The use of the permissive term “may” in this provision clearly indicates that a special assessment is not a mandatory funding mechanism for any desired maintenance, repairs, or capital improvements to any of the Common Properties. Accordingly, it is evident that a special assessment is a permissive funding mechanism broadly available to TVPOA in order to provide an alternative funding source for the repair, replacement or improvement of *any* Common Properties, including the Systems. This interpretation allows for the alternative funding mechanisms set forth in Article VI, Section 1 and Article X, Section 4 of the Declaration to be construed in harmony under well-established rules of contract construction. To otherwise interpret the special assessment provision of Article X, Section 4 of the Declaration as the exclusive means to fund capital improvements to the Systems would directly conflict with the express funding mechanism for capital improvements to the Systems set forth in Article VI, Section 1 and could render this provision meaningless. Thus, applying well-established rules of contract construction, it does not appear that Article X, Section 4 of the Declaration or any other provision thereof would preclude the Board from implementing a water and sewer capital improvement fee.

In addition to the foregoing analysis of the Declaration, this firm also reviewed any applicable Tennessee laws and regulations which could potentially impact the Board’s proposed imposition of a water and sewer capital improvement fee. To begin with, although TVPOA is subject to certain State regulation regarding the functional operation of the Systems by the Tennessee Department of Environment and Conservation (“TDEC”), it does not appear that TVPOA is subject to any direct rate regulation by either TDEC or the Tennessee Comptroller. This is evidenced by the fact that TVPOA does not disclose its water and sewer rates for review or approval by either TDEC or the Tennessee Comptroller. Further, TVPOA is expressly exempted from rate regulation by the Tennessee Public Utility Commission pursuant to Tenn. Code Ann. § 65-4-101, as a “public utility” subject to regulation thereby does not include the following: “nonprofit homeowners associations or organizations whose membership is limited to owners of lots in residential subdivisions...which construct, operate or maintain water systems...for the exclusive use of that subdivision” and “any nonprofit corporation, as defined in § 501(c)(4) of the Internal Revenue Code, which owns and operates a wastewater system primarily for the use of the members of the corporation...” Accordingly, it does not appear that there are any applicable Tennessee laws or regulations which would subject TVPOA to direct rate regulation or would otherwise preclude the Board’s proposed imposition of a water and sewer capital improvement fee.

In conjunction with its review of applicable laws and regulations, this firm also consulted directly with the Tennessee Comptroller’s office regarding TVPOA’s proposed imposition of a water and sewer capital improvement fee. Specifically, this firm received guidance from Ross Colona, Assistant Director of the Comptroller’s office and designated manager for the Tennessee Board of Utility Regulation (“TBOUR”), which provides utility rate oversight for public utilities. Mr. Colona confirmed that because TVPOA operates the Systems as a nonprofit homeowners association for the exclusive benefit of its property owners, “there is no State regulatory body which regulates the rates and fees that are charged to residents of the community that utilize the utility.” He noted that even for public utilities regulated by TBOUR, “there is no calculation in

statute for how rates must be calculated since every utility finds itself in a unique position.” Accordingly, he said that the generalized rate standard for public utilities under the oversight of TBOUR is simply that “rates have to be reasonable and justifiable.” For this reason, he stated that public utilities “generally contract with a 3rd party for a rate study to be performed using guidance from the AWWA M1 Manual: Principles of Water Rates, Fees, and Charges.” In determining rates for public utilities, Mr. Colona emphasized that public utilities are required to “recoup funds for capital improvements” and that “the operating revenues (rates and fees) must be enough to cover everything including the cost of infrastructure improvements.” From an administrative standpoint, Mr. Colona clarified that capital improvement fees are more commonly allocated as part of the minimum bill charged to each public utility customer as opposed to a separate line item on a utility invoice. However, he noted that “it is not unheard of” for public utilities to include flat fees for capital improvements as separate line items on public utility invoices. Ultimately, although there is no independent rate study requirement applicable to TVPOA as a private nonprofit homeowners association, it may be advisable in the future for TVPOA to consider conducting an independent rate study in order to continue to ensure that its rates and fees remain “reasonable and justifiable.”

Finally, this firm also consulted directly with the Tennessee Association of Utility Districts (“TAUD”) regarding TVPOA’s proposed imposition of a water and sewer capital improvement fee. Specifically, this firm received guidance from Don Scholes, Interim Executive Director and General Counsel for TAUD. Mr. Scholes also confirmed that there do not appear to be any applicable Tennessee laws or regulations which would subject TVPOA to direct rate regulation or would otherwise preclude the Board’s proposed imposition of a water and sewer capital improvement fee. Mr. Scholes expressly stated that “I see no problem with having a monthly surcharge to each customer to help finance future capital improvements.” However, he noted that from a nomenclature standpoint, he would prefer to describe such fee as a “capital improvement fee” as opposed to a “surcharge”. As a general matter, Mr. Scholes stated that “utility districts and utility authorities must establish rates and fees sufficient to support their utility systems” and thus, “funding capital improvements is part of being self-sufficient.” He stated that “capital improvements can be financed by monthly service rates, debt, or a fee like TVPOA is considering.” Accordingly, he believed that TVPOA “will have no problem defending the fee as long as it can show the anticipated amounts collected will be spent on planned capital improvements.”

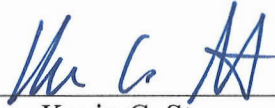
Based upon the foregoing analysis of TVPOA’s governing documents, applicable Tennessee laws and regulations, and guidance from Tennessee regulatory authorities, it is the opinion of this law firm that TVPOA is duly authorized to impose a water and sewer capital improvement fee. In establishing the proposed water and sewer capital improvement fee, TVPOA must exercise appropriate due diligence in order to ensure that the fee is “reasonable and justifiable” in light of the ongoing costs of operating and maintaining the Systems and the expenses associated with completing necessary capital improvements thereto. From an administrative standpoint, TVPOA should ensure that it independently accounts for funds obtained through the imposition of the capital improvement fee and clearly segregates such funds for allocation directly to finance the necessary costs of capital improvements to the Systems. Please do not hesitate to

contact this law firm if you have any further questions regarding TVPOA's proposed imposition of a water and sewer capital improvement fee.

Very truly yours,

KENNERLY, MONTGOMERY & FINLEY, P.C.

By: _____



Kevin C. Stevens