BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Petition for an Order to Show Cause Regarding Exemption from Commission Regulation of Boulder King Ranch Estates Water Company	)))))))	**DOCKET 02-2254-01** **Exhibit No. DPU 1.0 S** **Supplemental Testimony Of** **WESLEY D. HUNTSMAN**

FOR THE DIVISION OF PUBLIC UTILITIES
DEPARTMENT OF COMMERCE
STATE OF UTAH

December 31, 2002

Supplemental Testimony of Wesley D. Huntsman

Q. Please state your name and where you are employed.

A. Wesley D. Huntsman. I am employed by the Utah Division of Public Utilities ("Division") as Manager of the Customer Service and Water Section.

Q. Are you the same Wesley D. Huntsman who previously filed direct testimony in this case dated May 29, 2002?

A. I am.

Q. Are your education, qualifications, and current responsibilities at the Division detailed in that previously filed testimony?

A. They are.

Q. What is the purpose of your supplemental direct testimony in this case?

A. This testimony will replace the testimony I previously filed regarding rate making recommendations for Boulder King Ranch Estates Water Company ("Boulder King" or the "Water Company"). I will recommend an equitable method for computing system connection fees for lot owners, recommend disposition of outstanding connection fees, and discuss the Company's financial status including delinquent assessments, interest charges, liabilities, rate base, and revenue requirement. I have concluded that the Water Company's current rates are not just and reasonable. I will recommend reasonable and fair ongoing monthly charges for unmetered water usage and monthly standby, or ready to serve fees, for lots currently not connected to the system. I will also address the issue of whether, and if so how much, refunds should be made to customers by Boulder King in response to the Commission's October 15, 2002 order.

Q. Why was it necessary to replace the rate making testimony you previously filed in this case?

A. The testimony I previously filed was based upon audit work I performed in April, 2002. I performed additional audit work in December, 2002 which disclosed material information which needed to be considered for rate making. Also, I was able to analyze updated financial information and recommend rates based upon a test period ending November 30, 2002 rather than the period ending March 31, 2002 which I used in first testimony I filed.

Q. What portions of your previous testimony are you changing?

A. This Supplemental testimony replaces certain pages of my previous testimony addressing rate making issues. Specifically, pages 14 through 30 of the testimony I filed on May 29, 2002 should be discarded and replaced by this supplemental testimony. Also, the related Exhibits have been updated and should replace Exhibits DPU 1.6, 1.7, and 1.9 through 1.17 previously filed. I have marked the updated Exhibits as "Revised" and will refer to them that way in my testimony to avoid confusion.

Q. Has the Division completed its investigation of the Boulder King Ranch Estates Water Company pursuant to the Commission's October 15, 2002 order in this Docket?

A. Yes. The Division staff examined the Water Company's records supporting costs, revenues, and operations from April 1, 2002 through November 30, 2002. The

Company's records associated with prior operations were examined previously by the Division staff.

<u>Recovery of Improvement Costs from Lot Owners</u>

Q. What issues do you feel the Commission needs to address at this time regarding the recovery of improvement costs from lot owners?

A. First, the Commission should decide what improvement costs made to date in the subdivision are recoverable in future rates charged by Boulder King to its customer/ members and what improvement costs should be apportioned to Mr. Clarkson as the subdivision developer, either as non-water system improvements or as Contribution in Aid of Construction. Second, the Commission needs to address the manner in which interest charges have been assessed by Mr. Clarkson on behalf of the Water Company and whether or not recovery of past interest on delinquent assessments should be allowed, i.e. may the Water Company refuse service or terminate current service if past interest is not paid. Third, the Commission needs to rule on the reasonableness of proposed rates and resolve several ratemaking treatment issues. Such as, specifically, the amount of allowable rate base for rate making, the level of debt service, and related interest which should be allowed for ratemaking. Fourth, the Commission should determine the proper disposition of any future connection fees collected from owners of dry lots. Finally, the possible refunds of excessive fees charged to Boulder King customers for "Improvement Packages" needs to be addressed by the Commission.

Rebuttable Presumption of Recovery:

Q. Please explain the Commission's presumption of recovery of initial system costs and its impact on rate making in this case.

A. The Commission has a longstanding policy, extending back over more than 20 years, of requiring that real estate developers pay all costs of privately-owned water systems up front and recover their costs for such improvements in the price of lots. In a 1994 case involving SCSC, Inc. the Commission concluded:

> The Commission has, in a number of cases, enunciated the so-called 'Dammeron Valley' principle, which is that in situations in which a real estate developer has installed a water system in conjunction with a development, there is a rebuttable presumption that the developer has or will recover the costs of the system through lot sales. It must be emphasized that the presumption is rebuttable, and if it is successfully rebutted, the system costs are properly includable in rate base. . . . The Dammeron Valley Principle applies only to initial system costs. It has never been extended to include necessary capital expenditures made after the system is first constructed. Accordingly, the only issue that can be raised in regard to such expenditures is their verification and propriety.[1]

Commission Administrative Rule R746-330-6 states: "There is a rebuttable presumption that the value of original utility plant and assets has been recovered in the sale of lots in a development to be served by a developer-owned water or sewer utility." For rate making purposes, the costs of such improvements are allocated to a "Contribution in Aid of Construction" account which is not part of a utility's rate base, upon which it is allowed to earn a return. In most cases, the water system is owned by the

[1] Order dated December 21, 1994, Docket No. 94-2196-01 - Certification proceeding for SCSC, Inc., Applicant.

developer and is installed before lots in the subdivision are sold, which makes the implementation of the policy simple. This case presents a complication in implementing this policy because the system is owned by Boulder King, not the developer. A similar situation occurred in a recent complaint case against Wilkinson Water Company where a developer wanted the water company to pay to extend the system into his subdivision. In that case, the Commission found that the policy still applied, stating:

> The instant case presents a novel feature in that the developer is not the owner. However, in principle we see no reason why we should create an exception. The same hazards exist as to the interests of existing and future ratepayers as well as system integrity and viability. The developer has the same opportunity to set his lot prices so as to recover his costs. And the developer, if the project is viable at all, has better financing resources than the utility. In short, we do not believe existing ratepayers should be made unwilling participants in Complainant's speculation.[2]

The Division believes that a substantial amount of evidence exists to show that Dale Clarkson, as the owner/developer of the subdivision, recovered a substantial amount of the costs associated with the improvements from lot sales and the appreciation of value for the lots he still owns. Therefore, we believe it is fair and reasonable to apportion a substantial amount of the water system costs which Mr. Clarkson proposed to recover from rate payers to "Contribution in Aid of Construction," which is not recoverable in utility rates.

Water System Connection Fees:

Q. Describe the manner in which you have computed the appropriate connection fees

[2] Order dated January 4, 2001, Docket No. 00-019-01 - Complaint of David L Bradshaw against Wilkinson Water Company, page 4.

for Boulder King customers and your recommendations.

A. Boulder King has installed the current water system in two phases. In the late 1980's, Dale Clarkson installed a four inch water line from a well on a neighboring property along the exterior roads of the subdivision which would have only allowed 44 of the total 61 lots in the present subdivision to obtain service. Exhibit 1._3_, attached to my testimony filed on May 29, 2002, is a diagram of the original water system designed and installed by Mr. Clarkson without Division of Drinking Water design or installation approval. In 2000, Mr. Clarkson, on behalf of Boulder King, installed six inch water lines along the interior roads and southern road of the subdivision to allow the remaining 17 lots in the subdivision to obtain water service. Exhibit 1._4_, attached to my testimony filed May 29, 2002, is a diagram showing the 17 lots for which the water system was expanded. Exhibit 1._5_, also attached to my testimony filed May 29, 2002, is a diagram showing the completed water system with the two phases marked separately and the new well, pump house and storage tank shown.

The Commission has consistently found that even though rates are normally set on an average cost basis, existing ratepayers should not subsidize the provision of service to new customers in a substantial system expansion. In determining that the developer needed to defray the costs of a proposed expansion in Wilkinson Water Company's system, the Commission noted:

> The consideration is not limited to the impacts upon the developer and the utility. We must also consider the impact the terms and conditions may have on the existing and future customers of the utility. See U.C.A. § 54-3-1. Costs and risks not allocated to the

> developer or utility owners end up being shouldered by the utility's customers.[3]

In resolving that dispute, the Commission found that:

> The record does not develop a reason to depart from the Commission's past practice of placing the financial responsibility upon the real estate developer, with the concomitant developer opportunity to recover these costs in the sale of the developed property lots. In resolving this dispute, one must consider the direct costs of additional facilities and equipment and costs of their construction or installation; the costs incurred in the temporal disparities from the timing of preparation to provide utility service . . . and the allocation of these costs and risks associated with their incurrence and recovery. As indicated in the prior Order, the Commission has concluded that it is just and reasonable to have the real estate developer shoulder the financial burden and risks associated with his own development. Otherwise, a small water utility's customers must be exposed to the detritus of the developer's possible failure or lack of profitable success.[4]

In 1987, the Commission authorized Mountain Fuel Supply Company to include a $7.50 monthly surcharge to customers served in the expanded service territory in Southern Utah in addition to the rates charged to existing Mountain Fuel customers on the other parts of its system. The Commission approved surcharge avoided a subsidy from existing Mountain Fuel Supply customers to new customers in the expansion area. A Mountain Fuel Supply Company official testified that the proposed rates were designed to cover the costs of the new system. The gas company collected the monthly surcharge for fifteen years to recover the additional incremental costs of serving that area, after

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[3] Order dated February 26, 2002, Docket 00-019-01 - Complaint of David L Bradshaw against Wilkinson Water Company, page 7.

[4] Id, page 8.

which the surcharge was discontinued and customers receiving service on the Southern Utah expansion have paid the same rates as other Mountain Fuel customers. The Commission concluded that: "The surcharge over rates in the present service area is necessary because of the substantial cost of bringing service to the new area."[5]

Consequently, the Division believes that it is equitable to allocate the costs associated with each phase of the Boulder King system to the specific lots the phase was installed to serve. The resulting costs allocable to each lot must also be adjusted to account for the amounts properly charged to "Contributions in Aid of Construction" for Mr. Clarkson as the developer. It should also be noted that the Water Company did not install lateral lines to each lot, but instead requires lot owners to install their own saddle valves on the main line in the road adjacent to their property to hook-up for water service. The system does not have installed water meters. Consequently, there are no incremental costs to Boulder King when a lot owner connects to their system.

Mr. Dan Bagnes, representing the Division, has examined the specific costs incurred by Boulder King, Dale Clarkson Investments, and Dale Clarkson personally, for improvements in the subdivision. He has addressed cost verification, adjustments to the costs for ratemaking purposes, and the method used to allocate specific costs to specific lots in the subdivision in more detail. I used the allocated water system improvement costs for each lot computed by Mr. Bagnes to determine the amount I am recommending

[5] Order dated January 5, 1987, Docket No. 86-057-03 - Certification proceeding for Southern Utah Expansion of Mountain Fuel Supply Company, pages 8 and 21.

that the Commission allow Boulder King to charge for each lot in the subdivision to hook-up to the water system. Due to the relatively few (10) current water users on the system, I recommend that the Commission allow Boulder King to recover the costs of water system improvements in one time connection fees rather than in ongoing usage and standby fees. Exhibit 1._6_ Revised, attached is a spread sheet showing the proposed allocation and recommended connection fee by lot number. Column (1) shows the costs Mr. Bagnes recommends allocating to lots served by the old system phase (the number was reduced from 44 to 43 because no costs should be allocated to the lot on which the well and storage tank are located). Column (2) shows the costs of system improvements which are allocable to 60 lots. The Division is recommending that the Commission allow full recovery of those costs in hook-up fees for lots which were never served by the old system, but Mr. Bagnes recommends a 20% reduction in the amount allowed to be recovered from lots which were sold with the promise of water or those who purchased water rights and the right to hook-up to the old system because the old system was never an approved system by the Utah Division of Environmental Quality ("DEQ") and the developer had a responsibility to provide an adequate system to the water users. Column (3) shows the allocation for the cost of the system expansion to serve the 17 additional lots in the subdivision which were never served by the old system. Columns (4) and (5) show the value of water rights transferred to the lots at the time the two phases were installed and the amounts allocable to each lot. Column (6) is a sum of the costs which the Division believes would support a connection fee for each lot. Columns (7) and (8) show "Improvement Package" payments to Boulder King as of November 30, 2002 by each lot owner and the amount the Division recommends that the Commission recognize as payments to cover water system hook-up fees. The next two columns, (9) and (10), show the current amounts the Division believes would be properly assessed as hook-up fees for each lot and whether that receivable is for a water using account or a standby member account. Again, the Division believes that once Mr. Clarkson decided to install a water system in the subdivision, it was his responsibility, as the developer, to install the original system and to recover the cost of the original system from lot sales. The only exceptions would be for those seven dry lots which were previously sold, when and if the lot owners subsequently wanted water service. When Mr. Clarkson decided to expand the system to serve the remaining 17 lots, the Division believes he again had a developer's responsibility and should not be allowed to require existing customers to shoulder those costs. Mr. Clarkson still effectively owns 30 lots in the subdivision, 29 of which are titled to his TASC retirement Trust. For these reasons, the Division believes that it is fair and reasonable to allocate $235,370 of the total $321,957 cost incurred for water system installation and improvement costs by Mr. Clarkson and Boulder King to the developer's "Contributions in Aid of Construction." In addition, Boulder King has already recovered $30,506 from Boulder King customers as of November 30, 2002 for water system connections by collecting so called "Improvement Package" assessments (DPU 1.6 Revised, column 8). The Division believes that it is fair and reasonable to account for that $30,506 as customer paid "Contributions in Aid of Construction." The Division recommends that the Commission authorize Boulder King to collect the remaining $56,081 invested by Mr. Clarkson and the Water Company as allowable water system connection fees. However, six of the lots which were sold in the subdivision as dry lots may or may not ever request water from Boulder King. Both DEQ and Boulder City required Mr. Clarkson to include those six dry lots in computing the amount of water rights and storage capacity required for the system. Absent a provision to make Mr. Clarkson bear the risk of potential non-recovery from those dry lots, current and future water system customers shoulder that risk. In the Wilkinson case referenced earlier, the Commission found such risk shifting to existing customers to be unreasonable. Column (9) of Exhibit 1.6 Revised, shows $40,668 in potential connection fees from lot owners who are not currently connected to the system excluding the unsold lots in inventory in the TASC retirement Trust. The Division believes that $30,773 representing the potential connection fees from the six dry lots should be accounted for as deferred Contributions in Aid of Construction and should be excluded from rate base. The $30,773 should also be accounted for as a deferred payable to the developer, Dale Clarkson, if and when the owners of those lots ever decide to request water service and connect to the system. The remaining $9,895 in connection fees from unconnected lots and the $15,413 in uncollected connection fees from lots actually hooked up to the system (Exhibit 1.6 Revised, column 10) total the $25,308 system improvements which the Division recommends the Commission recognize for rate base treatment (Exhibit 1.6 Revised, column 11). Exhibit 1.7 Revised, summarizes the plant in service related to each improvement which totals $25,308 and the appropriate account from the Uniform System of Accounts to which they would be properly charged. This amount is a significant reduction from the computation in previously filed testimony due to the correction of an error found in the prior computation and the recognition of customer contributions in aid of construction paid in connection charges since the prior testimony was filed.

<u>Interest on Delinquent Accounts:</u>

Q. What recommendations are you making regarding the accrued interest on past due accounts of Boulder King and the interest rate the Company should be allowed to charge customers on an ongoing basis?

A. The Commission needs to address the issue of interest accrued on delinquent assessments to date by Mr. Clarkson on behalf of Boulder King. The accrued interest amounts are substantial and are a major issue of dispute between Mr. Clarkson and many of the other lot owners. Mr. Clarkson has defended the accrued interest charges by referring to Section 8.2 of the Water Company by-laws, which provides:

> Delinquent Assessments. The Company shall have a lien on the owner's shares of stock for all assessments, rates and charges for water furnished to the owners of shares of stock or persons holding under them. Delinquent monies shall bear interest at eighteen percent (18%) per annum; said interest shall begin to accrue thirty (30) days after notice of assessment is mailed.

In mid-1993, when Dale Clarkson organized the Boulder King Water Company, he began billing lot owners for a $2,000 "Improvement Package," and he later raised the cost to $2,500. Many lot owners did not pay the "Improvement Package" assessment. At that time, Mr. Clarkson, on behalf of Boulder King, also began charging a $5 standby fee each month for lots not connected to the water system, regardless of whether or not they wanted water and a flat $15 per month fee to connected members for unmetered water usage. Shortly thereafter, periodic billings to lot owners showed interest accrued at 18% per year on unpaid assessments. At that time, the water system was operating without operating approval from the DEQ or certification by the Commission. The lots within the subdivision were marketed prior to September 1, 1994 pursuant to a Utah Department of Business Regulation, Real Estate Division's Public Report #121 dated October 31, 1966 which indicated that: "The subdivider makes note that there is no water supply to the property. If water is to be brought to property it would [be] at the expense of the purchaser." However, lots in the subdivision were sold by Mr. Clarkson as early as August, 1989 with the promise of water delivered to the buyer's lot. In March, 1993, Mr. Clarkson formed the Water Company as a nonprofit corporation to provide culinary water to the subdivision.

Utah Code Ann. § 54-4-25 requires any private water system which will offer service to the public to obtain a certificate of convenience and necessity or establish that it qualifies for an exemption prior to initiating construction and operation:

> [A] water corporation, or sewerage corporation may not establish, or begin construction or operation of a line, route, plant, or system or of any extension of a line, route, plant, or system, without having first obtained from the commission a certificate that present or future public convenience and necessity does or will require the construction.

Utah Code Ann. § 19-4-104 (1) empowers the Utah Drinking Water Board within DEQ to adopt rules and standards regarding design, construction, operation and maintenance of public water systems to assure an adequate and safe water supply. From 1994 to 1999, Mr. Clarkson battled state regulatory agencies who attempted to enforce compliance with applicable state statutes and administrative rules. In early 1999, Mr. Clarkson reached a compromise with the Utah Division of Drinking Water to work toward compliance with water quality requirements. Shortly thereafter on April 19, 1999, the Commission issued a Letter of Exemption for Boulder King to operate as a mutual water company. It is the Division's position that prior to April 19, 1999, Mr. Clarkson and Boulder King were operating as a public utility without Commission authorization. Utah Code Ann. § 54-3-1 provides that:

> All charges made, demanded or received by any public utility, or by any two or more public utilities, for any product or commodity furnished or to be furnished, or for any service rendered or to be rendered, shall be just and reasonable. Every unjust or unreasonable charge made, demanded or received for such product or commodity or service is hereby prohibited and declared unlawful.

It is the Division's position that all charges and accrued interest billed by Mr. Clarkson and Boulder King prior to April 19, 1999 were unlawful and therefore the Commission should order the Water Company to cease efforts to collect all unpaid assessments and interest accrued prior to that date. At the same time, however, in view of the fact that the Water Company incurred operating costs during that period, assessments or interest collected were likely used to defray current operating costs at the time. The Commission did not require refunds for previously collected assessments and interest when the Letter of Exemption was issued in 1999. During the period when Boulder King operated under the Commission's Letter of Exemption, I believe that Company was within its rights to bill and collect water assessments and interest at 18% in accordance with its by-laws and board of trustee resolutions, with one exception. That exception relates to the manner in which connection fees were billed to customers who had expressed no intent or interest in obtaining water from the Water Company. In all instances that I am aware of, utilities have only been allowed to assess a connection or hook-up fee when a customer has applied for service. Mr. Clarkson's past practice of billing connection fees without regard for whether or not the lot owner desired or intended to request water service directly conflicts with established industry practice and the Commission's established precedent in the case of other utilities. The Water Company's practice in billing both standby fees and monthly flat fees for water usage appears to be consistent with established industry practices. One problem that Boulder King does need to address is the circumstance where lot owners with substantial delinquent standby fees sell their lot to a new person. Ordinarily, the utility would be barred from collecting delinquent standby fees from the new property owner. Therefore, Boulder King needs to determine whether it is prudent to file a lien with the county to protect the Company in situations when a delinquent lot owner sells.

Prospectively, the Commission needs to establish a reasonable payment period over which current water users will be expected to pay Boulder King for the connection fee authorized in this case by the Commission which have not been paid to date. I do not believe it is fair and reasonable to expect customers to pay the full amount of unpaid connection fees immediately or be subject to service termination. When Silver Springs

Water Company incurred over $400 per customer in costs to install water meters, the Commission did not require customers to pay the full amount for the upgrade all at once. The Commission authorized a monthly surcharge to recover the costs to install water meters at Silver Springs Water Company. The Commission allowed customers to spread the cost over five years to avoid rate shock.[6] In this case, customers have been connected and receiving water service for many years without paying a connection charge. I believe it would be fair and reasonable to require outstanding connection fees due to Boulder King to be brought current within one year or risk service termination. Additionally, the Commission needs to address the rate of interest currently charged by Boulder King on delinquent accounts. The by-laws currently provide for an 18% charge on delinquent accounts; however, in today's economy, interest rates are much lower than they were in 1993 when the Company was formed and the by-laws were drafted. In the last two years, the Division has twice recommended that the Commission approve tariffs for small water companies which provided for late fees at an annual interest rate of 18%.[7] However, the current tariffs approved by the Commission for both Questar Gas[8] and Utah Power[9] provide for finance charges on past due bills of 1% per month, or 12% annually. Based

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6 Order dated June 15, 1998, Docket No. 96-570-03 - Upgrade of Silver Springs Water Company System, page 2.

7 Docket No. 01-2209-01 for East Kanab Water Company and Docket No. 01-2199-T01 for White Hills Water Company.

8 Questar Gas Company tariff PSCU No. 300 Section 8.03, page 71.

9 Utah Power tariff PSCU No. 44, Schedule No. 300, Sheet 8R.2.

upon the interest rates the Commission has allowed other utilities to charge on delinquent accounts; and the fact that significant balances have accumulated past due from Boulder King customers due to questionable charges by the Water Company, I believe the Commission should authorize Boulder King to charge 12% per annum on past due accounts in the future.

Bank Loan:

Q. Were all the funds used to finance water system development and improvements provided by Dale Clarkson from his personal funds?

A. No. In early 2000, Dale Clarkson obtained two loans from the Bank of Ephraim totaling over $150,000 and executed personal promissory notes to obtain the loans. In November, 2000, Dale Clarkson, under the business name of "Clarkson Investments, L.C.," obtained an additional $66,000 loan from the Bank of Ephraim with the stated purpose: "To complete water system for state approval and roads so marketing can begin." On August 29, 2001, Dale Clarkson obtained a fourth loan from the Bank of Ephraim for $50,977.10 in the name of "Boulder King Ranch Estates Water Company" (Water Loan). Mr. Clarkson signed the Promissory Note for that loan as the "Authorized Signer for Boulder King Ranch Estates Water Company" and as "Registered Agent of Boulder King Ranch Estates Water Company" (Refer to Exhibit DPU 1. 8 attached to my testimony filed May 29, 2002). During our investigation, we specifically requested that Mr. Clarkson provide all Boulder King board of trustees meeting minutes for our review. Our examination of board meetings minutes disclosed no documentation of a resolution by the board of trustees authorizing Mr. Clarkson to execute the Water Loan on behalf of the Water Company.

Q. What ratemaking recommendations are you making regarding the Water Loan and the associated interest.

A. As a practical matter, the size of the Boulder King system, the number of paying members, and the financial viability of Boulder King make it unlikely that operations will support the debt service on the Water Loan. The promissory note provides for repayment over 60 months with monthly payments until August 2006 of $1058.33 each. Since Mr. Clarkson executed the Water Loan without proper authorization and with the stated purpose of enhancing his real estate marketing ventures, I believe that he properly bears the risk that operating revenues of the Water Company may not be sufficient to cover principal and interest payments on the Water Loan. The promissory note provides that as collateral, the Water Loan is secured by a deed of trust dated August 29, 2001 in favor of the Bank of Ephraim on real property located in Kane County. I have yet to obtain a copy of the deed of trust securing the Water Loan, but Boulder King does not own any plant or property in Kane County; all its assets are located in Garfield County.

Dale Clarkson represented to the Division staff that proceeds from the loans were used to finance improvements made in the Boulder King subdivision. However, due to the manner in which the finances of the system improvements were handled, it was difficult to verify the amount of Water Loan funds properly allocable to the system improvements recognized for ratemaking purposes and the system improvements which were the developer's responsibility and properly charged to "Contributions in Aid of Construction." The amount of the Water Loan, executed in Boulder King's name, exceeded the amount of the water system improvements which the Division is recommending be recognized as rate base for ratemaking purposes. Therefore, it was necessary to determine the amount appropriately allocable to the developer to finance his contributions in aid of construction.

The Division analyzed Dale Clarkson's capital account in Boulder King in Exhibit DPU 1._9_, page 1. The Boulder King subdivision development costs, system improvements, and water rights total $459,709 (line 3). Boulder King bank records show that $6,832 in development costs were paid out of Water Company operating funds (lines 6 to 8). In addition, $50,977 was funded from the Water Loan in the name of the Water Company (line 10). Therefore, the total amount supplied by Dale Clarkson from other equity and loan sources was $401,900 (line 11). In DPU 1.7 Revised, the Division recommended that the total system improvements for rate treatment be limited to $25,308. Therefore, the total investment from the Water Loan which the Division recommends be recognized for ratemaking be limited to $18,476 ($25,308 less the $6,832 funded from operations) as shown on lines 12 and 13. This calculation results in $32,501 of the Water Loan amount being allocated to Dale Clarkson to finance his contributions in aid of construction (line 12 column 3). The Division then made adjustments to Dale Clarkson's capital account for the other adjustments recommended by Mr. Bagnes (lines 16 thru 21) resulting in the total funds from Dale Clarkson Investments of $264,148 plus the allocated $32,501 from the Water Loan (line 29) totaling $296,649. This amount equals the total Contributions in Aid of Construction amount calculated in DPU 1._6_ Revised (line 79 column 11). To determine any amount due to or from the Water Company and Dale Clarkson, I first deducted the system and water rights costs properly allocable to "Contributions in Aid of Construction" (lines 32 through38). I allocated it first to the Water Loan and then his equity capital to show that only $30,506 was owed to Dale Clarkson after the developer related costs were removed.

During our audit, I found that the Boulder King customer account records showed no amounts due for several lots controlled by Mr. Clarkson, even though bank records disclosed that the Water Company had received no cash receipts for those accounts prior to 2002. Mr. Clarkson also told me that he credited the connection charge for Mr. Keith Gailey on lot No. 5 for work he had done on the system over the years. There was no documentation of the board approving such a credit, even though Mr. Clarkson and Mr. Gailey make up two-thirds of the board members. Therefore, I accounted for both the amounts credited but not paid for Mr. Clarkson's lots and Mr. Gailey's connection charge as constructively received by the Water Company and charged those amounts against Mr. Clarkson's capital account (lines 43 through 49) reducing Mr. Clarkson's capital by $11,233. Finally, I accounted for payments to Mr. Clarkson by Boulder King and deposits of capital funds by Mr. Clarkson in the Water Company (lines 53 through 65). I found that Dale Clarkson has received net capital payments of $22,023 from the Water Company. However, $5,672 of those payments were for improvements in the subdivision in excess of the proposed water system connection fee (DPU 1. 19). Therefore, I deducted that amount from the payments to Mr. Clarkson charged against his capital account. The analysis disclosed that as of November 30, 2002, Mr. Clarkson had $2,922 more invested in the water system than he had recovered from the Water Company (line 73). Therefore, I recognized a $2,922 account payable to Mr. Clarkson on the Water Company's balance sheet as of November 30, 2002.

Due to the allocation of the Water Loan between the Water Company and Mr. Clarkson for ratemaking purposes, I prepared an amortization schedule to compute the loan interest and balance of the two components (Refer to the loan amortization schedule on Exhibit DPU 1. 9 page 2 of 2 Revised).

Operating Results & Rate Making:

Q. What did you do to analyze Boulder King's financial records to support rate making recommendations?

A. The Division's investigation disclosed that existing financial statements provided by Mr. Clarkson did not provide the basis for rate making because they were incomplete and that the Water Company's financial dealings were combined with other business ventures and contained costs not associated with the water system. Mr. Bagnes addressed our effort to segregate water system costs from the other costs associated with the Boulder King Ranch Estates subdivision. Additionally, the Division has made various policy recommendations in this case which affect Boulder King's financial statements for ratemaking purposes. Therefore, it was necessary to reconstruct financial statements from which rate making recommendations could be made. To reconstruct financial statements for a ratemaking "test period," I used the most recent bank records, financial notes, budgets, and statements provided by Mr. Clarkson. I used two worksheets which I have previously referenced to begin reconstructing financial statements. Exhibit DPU 1._6_ Revised shows the connection fees recovered and receivable from each lot owner. Exhibit DPU 1._7_ Revised shows the computed the plant in service of $25,308 and Contribution in Aid of Construction of $295,434 when the system improvements were completed and customer contributions accounted for, essentially, without consideration of depreciation and amortization of these amounts over the asset lives.

To obtain valid financial numbers for rate making, I needed to convert from the cash basis financials provided by Mr. Clarkson to accrual based financial statements required by the Uniform System of Accounts prescribed by the National Association of Regulatory Utility Commissioners and adopted by the Utah Commission. To do that I needed to determine the receivables and payables for the Water Company. Exhibit DPU 1._10_ Revised, shows my computation of connection fees, water usage fees, standby fees, and applicable interest charges receivable on November 30, 2002 from each lot owner. Exhibit DPU 1._11_ Revised, contains my computation of the maximum interest due on November 30, 2002 given the Division's recommendation to limit recovery back to April 19, 1999, the date the Commission issued a Letter of Exemption to the Company. Also, the Division believes it would be inappropriate for the Commission to allow

Boulder King to recover interest on past due “improvement packages.” Therefore, I recommend that the Commission disallow any interest on connection fees prior to the time an allowable connection fee is ordered in this case. That is why I have reflected zero interest on connection fees on line 3.

To obtain financial statements for rate making, I also needed to reconstruct depreciation and amortization relating to plant in service and Contributions in Aid of Construction. Exhibit 1.12 Revised, shows my computation of annual depreciation expense, accumulated depreciation of plant in service system components at November 30, 2002. Exhibit 1.13 Revised, shows my computation of the annual amortization for contributions in Aid of Construction. The offsetting nature of these two accounts results in an annual net reduction of $716 for the existing plant in service of the Water Company (line 23).

For rate making purposes, I prepared a Pro Forma Balance Sheet at November 30, 2002 using the best available information (attached Exhibit 1.14 Revised). I also prepared a Pro Forma income statement for the year ended November 30, 2002, which disclosed that for the test period Boulder King did not have sufficient revenues to cover its operating expenses and to pay interest on the Water Loan (Attached Exhibit 1.15 Revised). I believe it is significant for the Commission to note that for a company with ten active customers, Boulder King incurred legal expenses of $8,889, paid or due to Barry Clarkson, during the test period. The legal expenses represent 70 percent of the Water Company’s operating expenses during the test period (line 18). Exhibit DPU 1.16

Revised is an worksheet I used to compute the amounts received from customers and constructively received from Dale Clarkson in computing the total receivables.

Once I had the Pro Forma financial statements for the Water Company to work from, I prepared a Pro Forma Rate Base computation (DPU 1. 17 Revised). For rate making purposes, I included 45 days working capital in the rate base computation (line 13), consistent with the Division's recommendations in the most recent KWU rate case[10]. Based upon my analysis, I believe that the $25,025 rate base amount I have computed is reasonable and should be recognized for ratemaking by the Commission.

Revenue Requirement:

Q. What accounting adjustments are you recommending to Boulder King's results of operations during the test period in determining a revenue requirement?

A. First, I would recommend a reduction in the revenues from customers for interest on past due accounts to recognize the recommended reduction in the allowable interest rate from 18 percent to 12 percent (DPU 1. 18 page 1, footnote 1). Second, I recommend recognition of interest on the approved connection fees at 12 percent for a one year period assuming that customers will pay the existing balance in equal monthly installments reducing the outstanding connection fees to zero over that one year period (DPU 1. 18 page 1, footnote 2).

Third, I recommend that the Commission recognize that repair and maintenance

[10] Division Recommendations to the Commission dated November 29, 2002 in Docket No. 02-2181-01, Attachment 2.

costs and legal costs incurred during the test period do not represent normal operations. The customers have testified that the system has not been adequately maintained and repaired. In addition, Mr. Clarkson has informed me that Mr. Gailey has made repairs to the system without obtaining reimbursements. Boulder King is now regulated by the Commission and should be expected to perform maintenance and make repairs necessary to provide adequate service. The Company must also retain a licensed operator to comply with DEQ requirements. Therefore, I am recommending an $800 annual increase in maintenance and repair costs for ratemaking (DPU 1. 18 page 1, footnote 3). At the same time, almost 70 percent of the Water Company's operating expenses during the test period were for legal fees. Those legal fees were incurred to Dale Clarkson's son Barry Clarkson to represent the Water Company during the earlier phases of this proceeding. I believe that the record shows that Barry Clarkson represented the interests of Dale Clarkson as a developer and his desire not to be regulated by this Commission. I do not believe the legal costs incurred during the test period are normal or represent reasonable expenses for the Water Company. I also understand that Dale Clarkson and the board of Boulder King have retained current counsel, Mr. Gary Sackett, at a considerable cost and may wish revenue requirement to reflect those costs for ratemaking purposes. At the time of my review, no payments had been made to Mr. Sackett and the operating results at November 30, 2002 do not reflect any of those costs. The Division's experience has been that these small water companies do not require rate proceedings frequently. KWU for example recently completed its first rate proceeding in the ten years it has been a regulated water company[11]. Therefore, even if the Commission wished to recognize the legal fees related to this rate proceeding in establishing rates for Boulder King, I would recommend an amortization which would result in the recommended $1,200 annual legal costs for revenue requirement consideration (DPU 1. 18 page 1, footnote 4).

Fifth, I believe that when regulated, Boulder King will incur expenses which it did not incur as an unregulated company. The Company has shown no costs associated with materials and supplies. I believe that such costs have been incurred by Mr. Clarkson through his other enterprises, have been incurred by Mr. Gailey, or have been paid by other customers and have not been reimbursed by the Water Company. I believe it is reasonable to expect Boulder King to incur costs for material and supplies and based upon the per customer costs experienced by other small water companies[12], I would expect those costs to approximate $250 (DPU 1. 18 page 1, line 13). I also noted that Boulder King incurred no expenses for the preparation of financial statements and have testified that its financial records are inadequate and do not meet the standards adopted by the Commission. I believe that the Commission should include a reasonable amount for revenue requirement to reflect the need for financial statement preparation (DPU 1. 18 page 1, line 17). Boulder King only reflects a cost of $20 for water testing during the test period. I believe that figure significantly understates the necessary annual cost for

[11] Id, page 1.

[12] Docket No. 00-014-01 for Storm Haven Water Company, Docket No. 02-2194-01 for Durfee Creek Water Company, and Docket 01-071-01 for Wolf Creek Water & Sewer Company.

Boulder King to comply with DEQ requirements and recommend that the amount be increased to $400 annually to reflect more reasonable water testing procedures (DPU 1. 18 page 1, line 19). Additionally, as a regulated utility, Boulder King will be required to pay the minimum Utah Utility Regulatory Fee of $50 required under UCA § 54-5-1.5. I made an adjustment to recognize that cost in the computation of revenue requirement (DPU 1. 18 page 1, line 20). To date, the Water Company has not accounted for customer accounts on an accrual basis and therefore has not had the need to recognize bad debts. I believe it is unrealistic to expect that all customers will pay their past due assessments and current assessments in a timely fashion. In fact, this Company's experience would suggest that they may have problems collecting assessments even after they are approved by the Commission. I am recommending a $600 annual allowance for bad debts in the computation of revenue requirement which represents about five percent of annual revenues (DPU 1. 18 page 1, line 21).

Q. What capital structure and return on rate base are you recommending?

A. As shown on Lines 31 to 35 of Exhibit DPU 1. 18 page 1, I have recognized the current unpaid balance of the Water Loan allocated to Boulder King DPU 1. 9 page 2, column 12 at the nine percent loan interest and the remainder of the rate base as equity capital at 12 percent which has been used by the Commission as a reasonable return on equity for small water companies.[13] Using the computed weighted cost of capital of 10.17

[13] Order dated June 22, 2000, in Docket No. 00-014-01, application by Storm Haven Water Company, at page 2; Order dated March 25, 2002, in Docket No. 01-071-01, application by Wolf Creek Water & Sewer Company, at page 2; and Order dated January 29, 2002 in Docket No. 01-

percent times the $25,025 rate base amount from DPU 1. 17 , I computed an authorized return on rate base of $2,545.

Q. With the adjustments you are proposing, what changes are you recommending in Boulder King's rates for the deficiency in revenue requirement?

A. With the above detailed adjustments and rate making considerations, the operating results during the test period produce a revenue deficiency of $4,444 (DPU 1.18 page 1), rendering the current rates charged by Boulder King inadequate and unreasonable. Therefore, I have concluded that increased rates are necessary for Boulder King following certification for both unmetered water usage and standby customers. I analyzed test period costs to determine if any were unique in their application to either using customers or standby customers and found that cost allocation between classes based upon the number of customers was appropriate in all but three cases. First, I believe that the expense of retaining a licensed system operator and performing repairs should be recovered from customers using water (DPU 1. 18 , page 2, line 16, column 8). Second, I also believe that the cost of water testing should be recovered from customers using water (DPU 1. 18 , page 2, line 19, column 8). Third, I believe that the power costs associated with Kw demand charges and kwh power usage charges need a unique allocation to be equitable. When the new pump was installed, the DEQ required a pump sized to serve all 60 lots in the subdivision. The Kw demand charge is dependent upon the size of motor

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098-01, application by Community Water Company, at page 2 and application Exhibit B return on equity computation.

used. Since the pump and motor installed were sized to serve all the lots in the subdivision it is unreasonable to allocate all demand costs to customers who receive water. I recommend allocating Kw demand charges based upon the total 60 lots in the subdivision. At the same time, the standby customers should not be allocated any of the kwh power usage expenses; therefore, I recommend allocating all kwh charges to those customers receiving water on the system (DPU 1. 18 , page 2, line 12, columns 8 and 9).

The class cost of service analysis I prepared shows that customers using unmetered water needed a $16.38 monthly increase and the standby customers needed a $4.69 monthly increase to provide a 10.17 percent return for each class (DPU 1. 18 , page 2 footnotes 6 and 7).

In the interest of simplicity, I am recommending that the Commission approve a $5 per month increase in the monthly standby fee for lots in the service territory, excepting the six dry lots and the lot upon which the well is located. Making new monthly standby rates $10 each month. I also recommend an increase of $15 per month in the fee for unmetered water usage for customers connected to the system, which makes new monthly fees for unmetered water usage $30 each month (DPU 1. 18 , page 3).

Even though these recommended rates double the current fees, they are not unreasonable when compared to other small water utilities in the state; indeed, I believe that the proposed rates are just and reasonable. The proposed rates should also reduce the necessity for Mr. Clarkson to continue to subsidize the system's operations or for Boulder King to borrow funds to meet current operating costs.

Possible Refunds:

Q. In its October 15, 2002 order, the Commission instructed the Division to examine whether or not Boulder King should be required to refund connection charges and monthly assessments previously collected from customers. Please explain your analysis regarding potential refunds.

A. As I have previously indicated, Dale Clarkson has attempted to recover a portion of the costs he incurred to develop the Boulder King Ranch Estates property from other property owners through "Improvement Packages" assessed in the name of the Water Company. Our examination disclosed that seven Water Company customers have paid amounts to Boulder King in excess of the connection fees, water usage charges, standby fees, and finance charges the Division is recommending be recognized and authorized by the Commission for ratemaking (refer to DPU 1. 19). In three of those cases, the overpayment amounts are less than $100. The excessive amounts paid by the other four customers range from $800 to over $1,600.

Mr. Clarkson has stated that some of the other property owners in the Boulder King Ranch Estates subdivision verbally agreed to participate in subdivision improvements and have not objected to paying "their fair share" of the improvement costs. However, other customers testified in the hearing on May 29, 2002 in this proceeding that they never agreed to pay Mr. Clarkson for the improvements he made in the Boulder King subdivision. In addition, several letters from customers to Mr. Clarkson which the Division staff reviewed indicate that the property owners objected to paying for subdivision improvements. I believe that Mr. Clarkson may have a valid claim that other property owners have been unjustly enriched by not paying a fair portion of the improvement costs for those improvements they wanted and encouraged him to make. However, the recovery of such improvement costs through the Water Company assessments was improper. The Division believes that Mr. Clarkson must take action to recover the cost of subdivision improvements excluded from water system costs in the Division's recommendations through civil court actions.

For ratemaking purposes, I have recognized only the proposed authorized connection fees as received or receivable by Boulder King in reconstructing the financial statements. To the extent the amounts in excess of the proposed authorized connection fees were paid to Boulder King for non-water-system-improvements, they were also passed on to Mr. Clarkson (Refer to DPU 1. 9 , line 68). For instance, Boulder King bank account records show a deposit of $4,017 from John Drain on April 19, 2002 and a check (No. 121) paid to Clarkson Investments on April 20, 2002 for $4,000. The excess collections from Boulder King customers occurred either while the water system was operated without proper Commission authority (i.e. prior to the April, 1999 Letter of Exemption), or during the period in which the Water Company operated as an Exempt Mutual Water Company while it in fact did not function as a mutual company.

Q. Are you recommending that the Commission order Mr. Clarkson or Boulder King to make refunds to customers?

A. No. I believe it is clear that at least four customers have a valid claim to date that they have paid Improvement Package assessments in excess of what is now being recommended as reasonable water system connection fees. At the same time, those excessive assessments were passed through to Mr. Clarkson. Therefore, if refunds are now to be required by the Commission, Mr. Clarkson and not Boulder King should be held accountable to make those refunds. However, just as I believe that Mr. Clarkson would need to take civil action to recover improvement costs which were not related to the water system from other property owners, I also believe that other property owners would have recourse through civil action to recover any "Improvement Package" assessments which Mr. Clarkson has received which may be excessive. I recommend that the Commission ignore the amounts paid by Boulder King customers in excess of the amounts authorized for rate making and leave it to Mr. Clarkson and other property owners to resolve such issues in civil actions if they so choose.

Q. Is your recommendation consistent with actions taken in other similar instances?

A. Yes. Similar situations have recently occurred in two cases. In Docket No. 01-2370-01, the Division brought action to regulate the Shadow Mountain Estates private culinary water system. Also in Docket No. 01-2364-01, the Division also brought action to regulate the water system operated by the Iron Town Property Owner's Association. In both instances, the water systems had operated for many years without obtaining a Letter of Exemption or a Certificate of Convenience and Necessity from the Commission. The Division did not recommend that the water companies be required to refund any portion of the connection fees collected from customers prior to their certification in either of those cases. In neither case did the Commission order adjustments or refunds retroactively. The Commission only required the Companies to correct water system deficiencies to comply with DEQ requirements and set rates on a prospective basis.

Q. Does that conclude your testimony?

A. Yes.