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** **Testimony Of WESLEY D. HUNTSMAN**

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

May 29, 2002

Testimony of Wesley D. Huntsman

Introduction

Q. Please state your name and business affiliation.

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. How long have you been employed by the Division of Public Utilities?

A. Since February 22, 1982.

Q. What are your current responsibilities?

A. Since November 1997, I have supervised the Division staff responsible for providing internal and external customer service. Those responsibilities include processing information inquiries and complaints filed with the Division, addressing Division computer hardware and software needs, including the Internet home page, coordinating receipt of utility annual reports and regulatory fees, internal Division technical and management consulting, and coordination of administrative support. Also, in March 2000, I assumed responsibility for supervising the regulation of water and sewer utility operations on behalf of the Division. Prior to that time, I performed and supervised management, cost, financial and economic analyses on behalf of the Division. In these capacities, I have participated in numerous evaluations of utility functions and have testified in many proceedings before the Utah Public Service Commission.

Q. What is your educational background, expertise and experience?

A. I have a college degree with emphasis in Accounting and I am a licensed Certified

Public Accountant. Over the last 31 years I have participated in audits, evaluations and investigations ranging from small rural government facilities to nationwide programs. I have participated in many utility rate cases and directed major investigations into utility practices and management. I have presented papers, evaluation results, investigation reports, and appeared as an expert witness on utility matters for more than 20 years.

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

A. I will provide a brief history of the water system and present the Division's position regarding whether or not The Boulder King Ranch Estates Water Company should continue to be exempt from Commission oversight and regulation; or in the alternative, become fully regulated as a public utility. I will also address issues regarding Dale Clarkson's responsibility as the subdivision developer, 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.

Q. Has the Division completed its investigation of the Boulder King Ranch Estates Water Company pursuant to the Commission's May 10, 2002 order in this Docket?

A. Yes. The Division staff examined the Company's records supporting costs, revenues and operations from the time the subdivision was first platted in 1966 until the present. The Company President, Dale Clarkson was very cooperative in providing access to information and also in providing additional explanations and answering questions. The following is a brief history of this development and the issues which prompted this case.

History

In 1962, the Boulder King Ranches, Inc. purchased the old Rawlins homestead near Boulder, Utah. In 1966, the Boulder King Ranch Estates subdivision was recorded in Boulder Town including 72 one-acre dry lots with no improvements. Over the next 17 years, 13 lots were sold with no promise of culinary water or other improvements at an average price of around $1300.

In the early 1980's, Mr. Dale Clarkson acquired the interests of other investors in Boulder King Ranches, Inc. and assumed control of the subdivision development. Between 1989 and 1990, nine lots were sold with the promise of culinary water for inside seasonal use and the availability of power hookups at prices around $5,000. In the late 1980's, Mr. Clarkson sold eleven lots to a neighboring landowner and the eleven lots along the South end of the subdivision were removed from the recorded subdivision plat, leaving the 61 current lots in the subdivision. During the period 1989 to 1994, seven previously dry lot owners paid Dale Clarkson for a $2,000 “Improvement Package” to purchase .25 acre feet of water rights for their lots, and power and water service to the front of their lots. Additionally, several lots were sold both as dry lots and with water rights that were later reconveyed back to the Dale Clarkson or his retirement Trust and were resold or are currently titled to the “TASC Trust”.

In 1993, Mr. Clarkson formed the Boulder King Ranch Estates Water Company (Hereafter referred to as Boulder King or the Water Company) as a nonprofit corporation. Keith Gailey, Dale Clarkson, and his son, Larry Clarkson (who at the time did not own a

lot in the subdivision) were appointed to the board of the new water company. Mr. Clarkson provided shares in the new Water Company to lot owners in the subdivision who had either bought a lot with the promise of water right rights, or had paid $2,000 for the Improvement Package which included water. At that time, pursuant to a board resolution, Dale Clarkson began billing all lot owners who had not paid for a $2,000 Improvement Package. On July 1, 1994, Mr Clarkson increased the cost of the Improvement Package to $2,500 to cover increased construction costs and carrying charges. Many dry lot owners had never asked for water or power hookups and refused to pay for the $2,000-$2,500 Improvement Package. At that time, Dale Clarkson, on behalf of the Water Company, also began charging a $5 month standby fee for lots not hooked-up to the water system and a flat $15 per month fee for water usage to lots where water hookups had occurred. Dale Clarkson, on behalf of the Water Company, began accruing interest at 18% on unpaid improvement package, standby fee and monthly usage fee balances pursuant to new company By-Laws.

In September, 1994, the developer revised the Public Offering Statement for the remaining lots in the subdivision and stated that water and power would be installed to each lot. In November, 1994, the Utah Department of Environmental Quality notified Dale Clarkson that he was not in compliance with Utah Public Drinking Water Rules regarding the water system constructed to serve the Boulder King Ranch Estates subdivision, and corrective actions were required to avoid enforcement action by the Drinking Water Board. The Drinking Water Board issued Notice of Violation and Order

to Comply to Dale Clarkson regarding the water system serving the Boulder King Ranch Estates subdivision on August 25, 1995. The Utah Drinking Water Board issued an Order on July 19, 1996 upholding the Notice of Violation and finding that the water system was unapproved. In July 1996, Dale Clarkson and the Water Company appealed the Utah Drinking Water Board decision to the Utah Court of Appeals. After several meetings with Utah Division of Drinking Water (DDW) staff, and substantial agreement to comply with the Drinking Water Board Order, the parties agreed to dismissal of the appeal on December 26, 1996. The DDW staff monitored the company's efforts to comply with their regulations for the next four years. On December 7, 2000, the DDW issued an Order to Cease Construction regarding the plans and specifications for expansion of the Boulder King water system. Later that month, Dale Clarkson agreed to drill a new well, transfer sufficient water rights to the system to meet inside-use year-round use requirements of .45 acre ft/yr for each of the 61 lots in the subdivision and install sufficient tank storage capacity to meet fire suppression requirements. In September, 2001, the DDW approved plans for the water system and in October, 2001, issued an operating permit for the well serving the system. In March, 2002, the DDW notified the company that their water system rating was subject to potential downgrading due to failure to comply with monitoring and testing requirements. On May 1, 2002, DDW downgraded the Boulder King water system to "Not Approved"

In 1994, the Division of Public Utilities also initiated an investigation of Dale Clarkson and Boulder King for operating a public utility water system without a

certificate from the Public Service Commission. In May, 1998, the Division of Public Utilities filed a Petition for an Order to Show Cause against Dale Clarkson and Boulder King for operating as a public utility without proper authority. Mr Clarkson argued that Boulder King was organized and intended to operate as a mutual water company and should be exempt from Commission regulation. Following an investigation by the Division staff, the Division agreed to recommend that the water company be issued a Letter of Exemption. On April 19, 1999, the Public Service Commission issued a Letter of Exemption to the Boulder King. Since that time, the water company has operated without intervention or regulation from the Public Service Commission or the Division of Public Utilities until the current case.

Between 1994 and 1999, seven lots were sold in the Boulder King Ranch Estates subdivision with the promise of culinary water rights for inside seasonal use and the availability of power hookups at prices ranging from between $5,000 and $13,000. Additionally, several lots sold with water rights were later reconveyed back to Dale Clarkson or his Trust and were resold or are currently titled to the TASC Trust.

Dale Clarkson made additional improvements to the Boulder King Ranch Estates subdivision in 2000 and 2001. Water lines were installed to lots which previously had no access to the original water system, telephone lines were installed to all lots, subdivision roads were graded, widened and graveled, and the subdivision was fenced. In addition, Pursuant to the agreement with DDW to install an approved water system, a new well was developed to replace the old well which was not approved by DDW, a well house,

storage tank, pressurizing pumps, and fire hydrants were installed to meet demands of both DDW and the Boulder Fire Marshall. Since that time, five lots have been sold at prices ranging from $20,000 to $30,000. In July, 2000, Dale Clarkson, on behalf of the water company, began billing lot owners who had not previously obtained a water right $5,900 and those who previously had .25 acre feet of water rights $3,900 for an "Improvement Package" for those improvements. Interest was again accrued annually at 18% on unpaid improvement package, standby fee and monthly usage fee balances pursuant to the water company By-Laws. The dispute between Mr. Clarkson and lot owners over accrued delinquent assessments, the accountability of the Water Company and Mr. Clarkson for the necessity and cost of the improvements, and Mr. Clarkson's alleged continuing control of the Boulder King prompted complaints to the Division of Public Utilities and the Petition which is the basis for this proceeding.

Letter of Exemption

Q. After investigating the issues raised in the Division's Petition for an Order to Show Cause, does the Division believe that Boulder King currently qualifies for exemption from regulation by the Commission under Administrative Rule 746-331-1?

A. No. Three factors lead me to that conclusion: (1) Dale Clarkson effectively remains in control of the water company despite his efforts to show otherwise. (2) Customer/ members of the Water Company have been billed assessments for costs which would not be recoverable from ratepayers in a normal rate-making proceeding, indicating that the

rate regulation is not superfluous. (3) The water system has currently been downgraded to a "Not Approved" status due to the failure to properly monitor and test in accordance with DDW requirements.

Control of the Water Company:

In my opinion, Dale Clarkson did not limit his influence in the policy making and managing the affairs of the Water Company to eliminate his "developer control" over Boulder King. One of the primary criteria for Exemption under Rule R746-331-1 involves ownership and voting control of the entity. The Rule provides that voting control of the entity must be distributed in a way that each member enjoys a complete commonality of interest, as a consumer, such that rate regulation would be superfluous. Dale Clarkson was one of the organizers of Boulder King and was appointed to the initial Board of Trustees where he has served ever since. Mr. Clarkson was elected President of the Water Company and has exercised authority in that position since the company was formed. Over the last 20 years, Dale Clarkson has consistently taken actions on behalf of the subdivision and the Water Company without required prior approval of the Boulder King Board or membership. He decided in the late 1980's to install water and power to the previously unimproved subdivision without any documented approval or consideration for other lot owners in the subdivision. He then formed Boulder King in 1993 and proceeded to bill lot owners for the "improvement package" on behalf of the Water Company. The further improvements in 2000 and 2001 were undertaken by Mr. Clarkson without prior approval of lot owners, water company members, or the Water

Company Board. The improvements were accepted after the fact by the Board, along with an approval to assign future hook-up fees to Mr. Clarkson to repay the cost of the improvements.

Article V, Section 5.2 of Boulder King's By-Laws states: "No loans shall be contracted on behalf of the Company and no evidences of indebtedness shall be issued in its name unless authorized by a resolution of the Board of Trustees." On August 29, 2001, Mr. Clarkson executed a loan with the Bank of Ephraim for $50,977.10 in the name of "Boulder King Ranch Estates Water Company". Mr. Clarkson signed the Promissory Note for the loan as the "Authorized Signer for Boulder King Ranch Estates Water Company" and as "Registered Agent of Boulder King Ranch Estates Water Company". 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 authorizing Mr. Clarkson to execute the loan on behalf of the Water Company.

On August 29, 1996, the By-Laws of the Water Company were amended by its members to state: "The Developer shall be limited to one (1) vote for control purposes as it relates to policy making and managing the affairs of the company." Mr. Clarkson relied upon that By-Law change and the fact that title to the unsold lots in the subdivision had been transferred to an IRA Trust Account to persuade the Division staff in 1999 that the Boulder King functioned as a mutual water company and qualified for a Letter of Exemption. However, our investigation disclosed three circumstances which cause me to

seriously doubt the effectiveness of the purported limitation. There are 61 lots in the subdivision, but due to the six remaining dry lots, the actual number of voting members in the Water Company total 55. Members and observers at a recent annual meeting of Boulder King reported that Mr. Clarkson announced that proxy votes for shares held in the name of his TASC retirement Trust were valid and would be recognized in any vote taken. The minutes of the December 8, 2001 annual membership meeting indicate that "Approximately 44+ lots were represented personally or by proxy with eight members present." At that time, the 28 TASC Trust votes and Dale Clarkson's one vote for the lot owned in his own name represented a majority of the outstanding votes in the Water Company as well as those represented at the meeting. He currently owns one lot jointly with his wife (Lot #1). One lot is owned by his son Larry Clarkson who is also a founding member of the Board and his wife (Lot # 38). In addition, Mr. Clarkson's TASC retirement Trust currently holds title to 29 lots, one of which has the water system's well, pump house and water storage tank on it (Lot #13).

On March 13, 2002, the Boulder King Board of Trustees authorized a ballot by mail for members to vote on proposed changes to both the Company's By-Laws and Articles of Incorporation. Ballots containing proposed amendments were mailed to all members and ballots returned by the due date were counted and approved by the Board. A representative of the First Regional Bank signed and returned a ballot for 26 votes representing the lots/memberships held in the TASC retirement Trust for Dale Clarkson (See Exhibit DPU 1._1_). Even though those 26 votes did not change the results of the

vote on any of the proposed amendments, the fact that they were exercised and recognized by the Board indicates the failure of the purported limit on Mr. Clarkson's voting influence in the company. In many ways, Dale Clarkson still exercises influence and control over the TASC retirement Trust even though he did not exercise the votes. When one of the lots held in the Trust's name is sold, Dale Clarkson instructed the Trust to transfer title to the buyer. When funds are obtained from the sale of Trust owned lots, Dale Clarkson instructs the Trust on the dispossession of the proceeds. In two instances in November, 2001 lots in the name of the Trust were sold. In each case $10,000 cash was paid at closing and was transferred to the Trust account. In both instances, Mr. Clarkson instructed the Trust to return the cash to him to cover specific costs of water system improvements and FAXed invoices to document the covered costs.

One of the March, 2002 changes to Boulder King's By-Lays seriously alters the commonality of interest among the members of the Water Company. The change to Article 3.9 adds the provision that: "In order to vote, the outstanding share must be in good standing; and to be in good standing the shareholder must be current on all water bills and assessments." The proposed amendment was approved on a vote of 35 to 6 by ballots returned by members. The resultant provision eliminates the "complete commonality of interest, as a consumer" required by Administrative Rule R746-331-1.

Improper Costs in Assessments:

No place in the Articles of Incorporation or By Laws is Boulder King empowered to engage in any activity or assess its members for any costs, other than the provision of

water to its members. Article III of the Articles of Incorporation provides: "This Company is organized solely for the purpose of delivering water to its stockholders at cost, and shall supply water to no one except its stockholders and to them only at cost, and only on and for use on the real property owned or leased by shareholders. The Company shall not sell, distribute, or lend water for profit." However, beginning in 1989, Dale Clarkson began assessing member/customers $2,000 for an "Improvement Package" which included provisioning water and power to subdivision lots. In July, 2000, Dale Clarkson, on behalf of the Water Company, began billing lot owners who had not previously obtained a water right $5,900 and those who previously had .25 acre feet of water rights $3,900 for another "Improvement Package" which included the cost of installing telephone lines to lots in the subdivision; widening, grading and graveling roads in the subdivision; improving paths and trails to Forest Service property and fencing the subdivision. Several lot owners objected to paying for the improvements which they claim were never asked for, authorized, or wanted. If a public utility attempted to recover such non-utility costs in a rate proceeding, I suspect that the utility would be required to charge such costs below the line, to the expense of stockholders rather than recovering them from ratepayers. Costs properly allocable to non-utility operations of regulated utilities have consistently been removed from rate consideration by the Public Service Commission. The fact that these costs, which were unrelated to the water system, were included in the billings rendered by the Water Company indicates a need for regulatory oversight and shows that rate regulation is not superfluous.

Compliance with State Requirements:

The Public Service Commission requires water utilities operating in Utah to comply with State water quality standards. Administrative Rule R746-330 provides that: "Water furnished by utilities for culinary purposes shall be agreeable to sight and smell and be free from disease-producing organisms and injurious chemical or physical substances. The standards to be applied in meeting these criteria shall be those of the Utah Drinking Water Board." When the Division recommended that Boulder King be issued a Letter of Exemption on March 11, 1999, it was with the understanding that the Water Company had made significant progress toward complying with DDW requirements and that full compliance only depended upon completion of the planned system improvements. Current Water Company management has failed to perform monitoring and testing required by the DDW. Consequently, on May 1, 2002, DDW downgraded the Boulder King water system to "Not Approved" (See Exhibit DPU 1.2). The Not Approved status results in lot owners not being able to obtain loans on their property and makes it impossible to obtain a permit from Boulder City to build a dwelling or install a septic system in the subdivision. The Water Company's failure to comply with State water quality standards adopted by the Commission indicates a need for closer regulatory oversight and direction from the Commission at this time. Therefore, I am recommending that the Commission revoke the Letter of Exemption issued to Boulder King on April 19, 1999 and issue a Certificate of Convenience and Necessity to Boulder King to provide service to the 61 lots in their existing service territory.

Recovery of Improvement Costs from Lot Owners

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 the improvements which should be allocated 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 service if past interest is not paid. Third, the Commission needs to rule on the reasonableness of proposed rates and resolve several rate-making treatment issues. Specifically, the amount of allowable rate base for rate making, the level of debt service interest allowed for rate-making, and the disposition of any future connection fees collected from owners of dry lots all need to be resolved.

Rebuttable Presumption of Recovery:

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 the Utility's rate base on which it is allowed to earn a return. In most cases, the water system is owned by the 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

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

> 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 allocate a substantial portion of the water system costs which Mr. Clarkson proposed to recover from lot owners to "Contribution in Aid of Construction", which is not recoverable in utility rates.

Water System Connection Fees:

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 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

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

service. Exhibit 1._4_ Attached is a diagram showing the 17 lots for which the water system was expanded. Exhibit 1._5_ Attached 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 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. 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 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."[3] In determining that the developer needed to defray the costs of a proposed expansion in Wilkinson Water Company's system, the Commission noted:

[3] 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.

> "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."[4]

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."[5]

Consequently, the Division believes it is equitable to allocate the costs associated with each phase of the Boulder King system with 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" by Mr. Clarkson as the developer. It should also be noted that the water company did not install lateral lines to each lot and requires lot owners to install their own saddle valves on the main line in

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

[5] IBID, page 8.

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 the Water Company when a lot owner connects to their system.

Mr. Dan Bagnes, representing the Division, has examined the specific costs incurred by Boulder King and Dale Clarkson for improvements in the subdivision. He will address cost verification, adjustments to the costs for rate-making 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 per lot computed by Mr. Bagnes to determine the amount I am recommending that the Commission allow the Water Company to charge for each lot in the subdivision to hook-up to the system. Due to the relatively few (10) current users on the system, I recommend allowing Boulder King to recover the costs of improvements in connection fees rather than ongoing usage and standby fees. Exhibit 1. 6 Attached is a spread sheet showing the proposed allocation 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 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. 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 date by each lot owner and the amount properly allocated to cover water system hook-up fees. The final 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 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 recover the cost of the original system for lot sales. The only exceptions would be for those dry lots which were previously sold when 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. The Division believes that it is fair and reasonable to allocate $235,370 of the total $321,957 water system installation and improvement costs incurred by Mr. Clarkson and Boulder King to the developer's "Contributions in Aid of

Construction". In addition, Mr. Clarkson has already recovered $20,021 from members to date for water system connections by collecting so called "Improvement Package" assessments. The Division believes that it is fair and reasonable to account for that $20,021 as member "Contributions in Aid of Construction". The Division recommends that the Commission authorize Boulder King to collect the remaining $66,566 invested by Mr. Clarkson and the Water Company as allowable water system connection fees. However, six lots were sold in the subdivision as dry lots and may or may not ever request water. 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 Docket 00-019-01 referenced earlier, the Commission found such risk shifting to be unreasonable. Columns (9) of Exhibit 1._6_ shows $47,534 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 $31,988 representing the potential connection fees from the dry lots should be accounted for as deferred Contributions in Aid of Construction and excluded from rate base. The remaining $15,546 in connection fees from unconnected lots and the $19,032 in uncollected connection fees from lots actually hooked up to the system (Exhibit 1._6_ column (10)) total the allowable $34,578 rate base recommended at this time. Exhibit 1._7_ summarizes the rate base related to each improvement which totals $34,578 and the

appropriate account from the Uniform System of Accounts they would be properly charged to.

Interest on Delinquent Accounts:

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 Water Company, he began billing lot owners for a $2,000 "Improvement Package", and he later raised the cost $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 month standby fee for lots not connected to the water system and a flat $15 per month fee to connected members for water usage. Shortly thereafter, periodic billing 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 prior to April 19, 1999 all charges and accrued interest billed by Mr. Clarkson and Boulder King were unlawful and therefore the Commission should order the Water Company to cease efforts to collect all unpaid assessments and accrued interest 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's failure to require refunds for previously collected assessments and interest when the Letter of Exemption was issued in 1999 may preempt such a requirement today.

During the period when Boulder King operated as a mutual company under the Commission's Letter of Exemption, I believe that Company was within its rights to bill and collect assessments and interest at 18% in accordance with its By-Laws and Board of Trustee resolutions with one exception. 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 when 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 repayment period over which current water users will be expected to pay off their existing connection fee or be subject to service termination. When a surcharge was authorized to install water meters at Silver Springs, the Commission allowed customers to spread the cost over two years to avoid rate shock. 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 to be brought current within one year. 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 drafted. Based upon the interest rate the Commission has allowed other utilities to charge on delinquent accounts, I believe the Commission should authorize Boulder King to charge 12% per annum of delinquent accounts in the future.

Bank Loan:

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 to 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". 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 attached Exhibit DPU 1._8_). 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 loan on behalf of the Water Company.

As a practical matter, the size of the Water Company 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 existing Bank 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 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 loan. The promissory note provides that as collateral for the 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 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 Division representatives that proceeds from the loans were used to finance improvements made in the Boulder King subdivision. However, the amount of the loan executed in the Water Company's name exceeded the amount of the water system improvements which the Division is recommending be recognized as rate base for rate-making purposes. After allocating appropriate amounts to developer and member "Contributions in Aid of Construction", the Division computed the remaining rate base amount at the time construction was completed to be $34,578 (Refer to Exhibit DPU 1. 7). The amount recognized as rate base for rate making is significantly less than the original amount of the loan ($50,977) and the current balance confirmed by the Bank to be $45,677.27 (also Refer to the loan amortization schedule on Exhibit DPU 1. 9).

Operating Results & Rate Making:

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 Water Company financials were combined with other business ventures and

contained costs not associated with the water system. Mr. Bagnes will address 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 rate making purposes. Therefore it was necessary to reconstruct financial statements from which rate making recommendations could be made. To reconstruct financial statements for a rate making "test period", I used the most recent 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 shows the connection fees recovered and receivable from each lot owner. Exhibit DPU 1. 7 shows the computed the rate base of $34,578 and contribution in aid of construction of $287,379 when the system improvements were completed; 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 shows my computation of connection fees, water usage fees, standby fees, and applicable interest charges receivable on March 31, 2002 from each lot owner. Exhibit DPU 1. 11 contains my computation of the maximum interest due on March 31, 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. Exhibit 1._12_ shows my computation of annual depreciation expense, accumulated depreciation of system components at March 31, 2002. Exhibit 1._13_ shows my computation of the annual amortization for contributions in aid of construction. The offsetting nature of these two accounts results in an annual depreciation expense of $2,107 for existing rate base for the Water Company. For regulatory purposes, I prepared a Pro Forma Balance Sheet at March 31, 2002 using the best available information (Attached Exhibit 1._14_). It was not surprising to find that the Water Company actually owed Mr. Clarkson for operating expense he has paid when you consider the amount of delinquent assessments from members. One potentially complicating issue for rate making was the note payable to the Bank of Ephraim which Mr. Clarkson failed to show on any of the financial statements provided. Normally, notes payable are either equal to or less than rate base, but in this case the current balance of the loan exceeds the recommended rate base by almost $10,000. In such cases, it has been the Division's practice to recommend including the loan at the actual level but limiting the utility's return to the cost of debt. I also prepared a Pro Forma income statement for the year ended March 31, 2002, which disclosed that for the year Boulder King did not have sufficient revenues to cover its operating expenses and pay interest on the Bank loan (Attached Exhibit 1._15_).

Once I had the Pro Forma financial statements for the Water Company to work from, I prepared a Pro Forma revenue requirement schedule to determine the level of

rates necessary to meet expected operating expenses and provide a return on rate base (Attached Exhibit 1._16_ Revenue Requirement and Exhibit 1._17_ Rate Base Computations). Based upon the available information from Mr. Clarkson and by making informed estimates, I have concluded that increased rates are necessary for Boulder King following certification. I recommend increasing the monthly standby fee for lots in the service territory, excepting the six dry lots and the lot upon which the well is located to $10 per month. I also recommend increasing the monthly fee for unmetered water usage for those members connected to the system to $25 per month. Even though these recommended rates almost double current fees, they are not unreasonable when compared to other small water utilities in the State. They also avoid 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.

Q. Does that conclude your testimony?

A. Yes.