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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.))	<u>DOCKET NO. 02-2254-01</u>
)	BRIEF OF DIVISION OF PUBLIC UTILITIES

I. Background

On April 11, 2002, the Division of Public Utilities (“Division”) filed a Petition for an Order to Show Cause why the Letter of Exemption issued by this Commission on April 19, 1999 to Boulder King Estates Water Company (“Boulder King” or “Water Company”) should not be revoked, and why the Water Company should not be certificated and regulated as a Public Utility by this Commission. The Division’s Petition included the results of its investigation and requests from seven customers for a Commission investigation were also attached.

On May 10, 2002, the Public Service Commission, having concluded that the Division’s Petition justified further inquiry, issued a Notice of Hearing and Order to Show Cause. The Commission convened a hearing in Boulder, Utah, on May 29, 2002 and heard testimony from the Division, the Water Company, and its customers. At the conclusion of the hearing, in response to a request by counsel for the Water Company, the Administrative Law Judge requested briefs by June 12, 2002 on whether the Letter of Exemption previously issued to Boulder King should be revoked.

II. Commission Authority to Regulate Water Companies

Utah's Public Utility Code authorizes the Public Service Commission to regulate public utilities. The definition of "Public utility" includes "water corporations" ... "where the service is performed for, or the commodity delivered to, *the public generally*...." (emphasis added) § 54-2-1(5). A "Water corporation" includes "every corporation and person, their lessees, trustees, and receivers, owning, controlling, operating, or managing any water system for *public service* within this state." (emphasis added) § 54-2-1(27). This section exempts "private irrigation companies engaged in distributing water only to their shareholders...." but does not explicitly exempt water companies which provide non-irrigation water to their shareholders.

In a mutual water company, legal title to the water rights and distribution facilities is in the company, but held in trust for the stockholders who own beneficial use of the water. The stockholders run the company by electing a board of directors. The board determines the costs of running the company and assesses the shares of stock to cover the costs. Mutual water companies are generally distinguishable from public utilities in that: (1) the beneficial use of the water rights and distribution facilities is owned by the stockholders; and (2) the company can serve only its own stockholders. If a member of the public desires service, he or she must purchase stock in the company.

One cannot, however, avoid Public Service Commission jurisdiction by simply "calling" oneself a mutual company. The most important Utah case in this area is *Garkane Power Company v. Public Service Commission*, 98 Utah 466, 100 P.2d 571 (1940). In *Garkane*, the plaintiff was a non-profit electric cooperative organized to generate and distribute electricity to its stockholder members. One had to be a member of the cooperative in order to receive service.

The issue was whether or not the company was a public utility subject to Commission jurisdiction. The Court held that Garkane was not a public utility because it did not hold itself out to serve the general public, but only a specific class.

But more importantly for the instant case, the Court noted that “The distinction between a public service corporation [public utility] and cooperative [mutual] is a *qualitative* one. In a cooperative

the principle of mutuality of ownership among all users is substituted for the conflicting interests that dominate the owner vendor--non owners vendee relationship. In a cooperative all sell to each. The owner is both seller and buyer. So long as a cooperative serves only its owner-members and so long as it has the right to select those who become members, ordinarily it matters not that 5 or 100 people are members or that a few or all the people in a given area are accorded membership, *provided the arrangement is a bona fide cooperative or private service organization and is not a device prepared and operated to evade or circumvent the law. The courts will always scrutinize closely to determine whether or not a certain organization or method of conduct has for its purpose evasion of the law, and where it finds such evasion will declare such organization to be what it truly is.* (Emphasis added)

100 P.2d 571, 573.

The Court went on to state that

there is no need for regulation of true cooperatives.... There is no conflict of consumer and producer interests--they are one and the same. If rates are too high the surplus collected is returned to the consumers pro rata. If rates are too low the consumers must accept curtailed service or provide financial contribution to the Corporation. If service is not satisfactory the consumer-members have it in their power to elect other directors and demand certain changes.

Id.

The Court further stated that “what a corporation actually does, and not what its Articles say it can do, determines its status as a public utility.” Id.

In order to indicate which water corporations were subject to Commission jurisdiction,

and which were not, the Commission promulgated Rule R746-331, which substantially memorializes and incorporates the Utah Supreme Court's reasoning in *Garkane*. Under Rule R746-331, the following are examined to determine whether Commission regulation is required:

1. the organizational form of the entity;
2. ownership and control of the assets necessary to furnish water service, including sources and plant;
3. ownership and voting control of the entity.

The Commission may exempt a water company from regulation if it concludes that:

- (1) The company is a non-profit corporation in good standing with the Corporation Division; and
- (2) That the entity owns or otherwise adequately controls the water company water sources and plant; and
- (3) That voting control is distributed so that each member has "complete commonality of interest, as a consumer, such that rate regulation would be superfluous."

In applying these criteria to the facts in a particular case, the Commission necessarily performs the type of "qualitative" analysis directed by the Court in *Garkane*, "scrutinizing closely to determine whether or not a certain organization or method of conduct has for its purpose evasion of the law" and, where it finds evasion, "declar[ing] such organization to be what it truly is."

If the Commission concludes that a developer is controlling a non-profit water company,

it has typically asserted its jurisdiction. For example, in a 1996 proceeding,¹ where the developer was going to control the water company until there were enough connected customers to take voting control, the Commission regulated the company in the interim:

Since there is a potential conflict of interest between the Developer and water users until such time as the connected users have voting control of [the water company], Commission regulation is required by law.

III. Boulder King Ranch Estates Has Not Complied With All of the Conditions for Exemption and Should be Regulated by the Commission.

A review of the record in this case indicates that at least two of the three criteria for exemption have not been satisfied: (1) Ownership and control of water rights and distribution facilities; and (2) Voting control and commonality of interest.

A. Ownership and control of water rights and distribution facilities.

Division witness Wesley Huntsman testified at the hearing in Boulder that he had verified that water rights associated with the 1993 provision of .25 acre feet of water for each lot, for seasonal use, had been deeded to the Water Company by Mr. Clarkson. (*Transcript* at 99-100) However, Mr. Huntsman did not recall ever seeing a deed for the water rights associated with the later provision of .20 acre feet of water for each lot for year-round usage. Mr. Huntsman also indicated that the Division had been unable to document that the water system well, pump, tank, and distribution line facilities were owned by Boulder King even though payments for the facilities were made by Mr. Clarkson. Mr. Clarkson asserted that the remaining .20 acre feet of water rights had been transferred to Boulder King, but neither Mr. Clarkson, nor any other

¹ *In the Matter of the Application for a Certificate of Convenience and necessity to Operate as a Public Utility Rendering Water Service of East Kanab Water Company*, Docket No. 95-2209-01, Report and Order issued January 22, 1996.

witness, has placed evidence on the record which contradicts Mr. Huntsman's findings regarding title and control of the water system facilities.

B. Voting Control and Commonality of Interest.

Of equal or greater concern than the ownership of the water rights and distribution facilities is the refusal of Mr. Clarkson to relinquish control of the water company. On August 29, 1996, the By-Laws of the Water Company were amended to state: "The Developer [Clarkson] shall be limited to one (1) vote for control purposes as it relates to policy making and managing the affairs of the company." Relying upon that provision, and the fact that title to the unsold lots in the subdivision, together with their voting rights, had been transferred to an IRA Trust Account, the Division was persuaded in 1999 that the Water Company qualified for a Letter of Exemption. (See *Transcript* at 63, 66)

Yet Boulder King members/customers testified that during the December 2001 and January 2002 meetings of the Water Company, Mr. Clarkson announced that he was prepared to vote his proxy votes for shares held in the name of the IRA Retirement Trust. (See *Transcript* at 150, 162, 176, 184) The minutes of the December 8, 2001 meeting indicate that "Approximately 44+ lots were represented personally or by proxy with eight members present."² Mr. Clarkson testified that meeting minutes dated December 11, 2001 were actually for a meeting held on January 21, 2002. Those minutes indicate that forty lots were represented personally or by proxy.³ At that time, the 28 votes in the Trust and Mr. Clarkson's one vote for the lot owned in his name represented a controlling interest in the Water Company.

² See DPU Cross Examination Exhibit No. 5.

³ See DPU Cross Examination Exhibit No. 4.

Thus, despite Mr. Clarkson's apparent transfer of the voting rights to the unsold lots to the Trust, he continues to exercise his control over the Trust to cast votes for the unsold lots. For example, on March 13, 2002, the Boulder King Board of Trustees authorized a ballot by mail for members to vote on proposed changes to 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 retirement Trust for Dale Clarkson.⁴ Mr. Huntsman testified (*Transcript* at 68) that Clarkson controls the retirement Trust. For example, when funds are obtained from the sale of Trust owned lots, Mr. Clarkson instructs the Trust on the disposition of the proceeds. In two instances in November, 2001, lots in the name of the Trust were sold and in each case \$10,000 cash paid at closing was transferred to the Trust account. In both instances, Mr. Clarkson instructed the Trust to return the cash to him to cover water system improvement costs. Under cross-examination, Mr. Clarkson acknowledged that the Trust administrator has a fiduciary responsibility to him [Clarkson] for the trust. (*Transcript* at 140)

The record also shows other instances where Mr. Clarkson has continued to exercise his control over the Water Company. Mr. Huntsman testified (*Transcript* at 65) that Mr. Clarkson executed a loan on behalf of Boulder King without proper authorization. Boulder King's By-Laws state: "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." Nevertheless, 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

⁴ See Exhibit DPU 1.1

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”⁵. The Division’s investigation disclosed no Board meetings minutes or documentation of a resolution by the Board authorizing Mr. Clarkson to execute the loan on behalf of the Water Company, and no evidence to the contrary was presented by any party at the hearing.

IV. Conclusion

Evidence presented by the Division and customers/members of the Water Company in this docket shows that the Water Company, despite the pretense to the contrary, is not functioning as an exempt mutual company in two respects: First, it is undisputed that the Water Company does not hold title to the distribution facilities used to furnish water service. Second, Mr. Clarkson is circumventing the voting limitation established by the change in By-Laws which the Division and Commission relied upon when the original Letter of Exemption was issued. Mr. Clarkson’s exercise of the voting rights to the lots held in his retirement Trust to control the Water Company make a sham of any pretense of commonality of interest. The assertion of Commission jurisdiction to regulate Boulder King as a public utility, and to set just and reasonable rates and conditions of service, is not only not superfluous, but is mandated by the record in this case and by the public interest.

Dated this 12th day of June, 2002.

Kent Walgren
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⁵ DPU Exhibit 1.8.

CERTIFICATE OF SERVICE

I certify that on the 12th day of June, 2002, I mailed a copy of the *Brief of the Division of Public Utilities*, by First Class Mail, to the following:

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