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MEMORANDUM

To: Public Service Commission

From: Division of Public Utilities
Philip Powlick, Director
Bill Duncan, Telecommunications / Water Manager
Ron Slusher, Utility Technical Consultant

Date: July 14, 2009

Re: Application of Deepwater Distribution Company, Inc., for Exemption, Case No. 86-999-08.

RECOMMENDATION:

The Division recommends that the Commission deny Deepwater Distribution Company's (Deepwater or Company) request for an exemption from regulation. The Division's main concerns focus on the lack of specificity concerning potential shareholders, the Company's three classes of shares, with varying responsibilities for costs incurred, and that a shareholder's voting rights are directly proportionate to the number of water shares held. Given these circumstances, and the high degree of uncertainty concerning future development and assignment of shares, the Division does not believe that the Company has shown that each member enjoys a complete commonality of interest as a consumer that would make rate regulation superfluous, as required by Commission rule to support an exemption. Thus, the Division recommends that the exemption request be denied.

EXPLANATION:

In an application dated December 5, 2008, Deepwater applied for an exemption from Public Service Commission regulation. In addition to reviewing the submitted application for exemption, the Division asked data requests, received correspondence, and spoke with a member of Deepwater's board and its attorney on the phone and in person.

In its application, Deepwater represented that it was serving three connections. Deepwater does not have a certificate of public convenience and necessity. Deepwater could not specify the number of connections it anticipated, but noted that there were approximately 220-450 residential connections possible. Commercial connections are also allowed by Deepwater's bylaws.

Deepwater's bylaws establish three classes of stock: development stock, use stock, and irrigation stock. Development stock and use stock have voting rights; irrigation stock does not have voting rights. Voting rights for development stock and use stock are proportional to water shares held. Directors, who cannot number fewer than three, are elected by a simple majority of outstanding shares present, or by proxy, entitled to vote at the annual meeting. A quorum is determined by a simple majority of outstanding shares present to vote, in person or through proxy.

Currently Deepwater has issued 24 shares of stock. According to its application, lot ownership is as follows:

Robert/Tanya Powel - 6 lots (development and use shareholders)

Sean/Bridget Brown - 2 lots (development and use shareholders)

Brad/Annabelle Lewis - 2 lots (development shareholders)

Ingrid Nygaard/Charles Saltzman - 2 lots (development shareholders)

Furthermore, from the November 2009 board minute meeting minutes, it appears as if there are five irrigation shareholders.

Deepwater's bylaws allow the following: 3,000 development shares may be issued - voting rights of one per share; 2,000 use shares may be issued - voting rights of one per share; and 5,000 irrigation shares may be issued, each of which is a non-voting share

In its December 5, 2008 board of directors meeting, Deepwater voted not to allow the issuance of shares in excess of the Company's source capacity. To date Deepwater has issued 24 shares but did not specifically identify each stockowner along with classifications and numbers of shares owned or specify the assignment of shares to classes of stock,

Responsibility for cost incurrence differs between the classes of stock. Development stock is not generally assessable and bears no responsibility for operation and maintenance expenses or standby fees, and seemingly bears no responsibility for general administrative costs but only bears responsibility for "holding costs" and charges related directly to this class of stock. Use stock is fully assessable, and bears cost responsibility for operation and maintenance fees, standby fees, costs directly pertaining to its class of shares, and is subject to a water development fee. Irrigation shares are not subject to general assessments, but only to charges associated with the irrigation system and a proportionate share of administrative charges.

Analysis

Deepwater has requested an exemption from Commission jurisdiction. The Commission is granted specific jurisdiction by statute. Water companies providing public service within this state are subject to Commission jurisdiction and are required either to have a certificate of public convenience and necessity or an exemption from such certification requirement. Irrigation companies providing only

irrigation services to only their stockholders are exempt from regulation pursuant to specific statutory language. R746-3331 addresses the determination of a water company's exempt status this rule states that an exemption shall be granted if "each member enjoys a complete commonality of interest, as a consumer, such that rate regulation would be superfluous," and the company complies with certain other requirements. In addition to satisfying the commonality of interest requirement to support an exemption, the entity also must be a non-profit corporation in good standing and own or control assets, including water sources and plant, adequate for providing members culinary water service.

In analyzing the facts and circumstances in this case, the Division has concluded that exemption from regulation is not warranted, and that regulation of Deepwater is necessary. Of particular import are the existence of various classes of shares, with their differing cost responsibilities and the proportion of votes being tied directly to water shares. Although at the time of application, all three board members were use shareholders, it is possible, depending upon development of the area, that board composition could change and board decision-making rest only with holders of development shares. In particular, this could occur because Deepwater's bylaws permit 3,000 development shares to be issued but only 2,000 use shares to be issued. The 5,000 irrigation shares permitted by the bylaws do not have voting rights. Also, because the number of permitted development shares exceeds the number of permitted use shares, it is possible that under the applicable bylaws pertaining to establishing a quorum at a meeting, development shareholders could determine actions that would be paid for only by use shareholders. There are also significant uncertainties concerning the nature and scope of the water service to be provided. Note that at this point, the Company is providing service, without a certificate or an exemption, to three connections, and has not provided meaningful information concerning the number of potential connections. Based upon the information provided by Deepwater, no commonality of interest, as

consumers, appears to exist such that rate regulation would be superfluous. Thus, Deepwater has not shown that the requirements for exemption are met. Accordingly, the Division recommends that the Commission deny Deepwater's request for exemption. Indeed, the Division suggests that the Commission order the Division to file an order to show cause addressing the required certification obligations of Deepwater. If in the future, as development of and service by the Company is more defined, and it can be demonstrated that a commonality of interest exists rendering rate regulation superfluous, the Company again can seek an exemption.

The Division notes that there is at least one exempt water company, Summit Water Distribution Company (Summit) that has bylaw provisions virtually identical to those of Deepwater discussed above. The Division believes that the circumstances of the two companies are distinguishable, and that the Commission is not bound to exempt Deepwater from regulation because Summit is exempt from regulation. Significant factual and other differences exist between the two companies. For example, Summit is a large, established water company whose structure was determined, at least in part, as a result of a settlement stemming from a highly contentious lawsuit. Deepwater is at an extremely early stage of development, having only three connections currently, and has far more uncertainties such as when, if, and how it will be further developed, and by whom. In addition, Deepwater's application and additional materials, from which information supporting the exemption must be derived, lack specificity. Also, Utah Code Ann. § 54-7-13 and other aspects of administrative law establish that the Commission is not bound by former decisions, and thus Summit would not be controlling. Lengthy discussion of these legal issues are more properly discussed in legal proceedings before the Commission.

The Division recommends that the Commission deny Deepwater's request for exemption from regulation.