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Attorneys for South Duchesne Culinary Water, Inc.

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

INVESTIGATION OF SOUTH DUCHESNE CULINARY WATER, INC.'S COMPLIANCE WITH APPLICABLE ADMINISTRATIVE RULES AND TARIFF	**SOUTH DUCHESNE CULINARY WATER, INC.'S REPORT TO THE PUBLIC SERVICE COMMISSION** Docket No.: 18-2372-01

On September 4, 2019, the Public Service Commission of Utah (the "Commission") issued an Order in the above captioned Docket (the "Order") and requested that South Duchesne Culinary Water, Inc. ("SDCW") file a report by November 1, 2019 answering the two questions set forth below.

SDCW hereby files this Report in response to the Commission's Order.

QUESTION NO. 1 – "Did SDCW's failure to charge its owners and its development company affect the rates SDCW charged it paying customers, and if so, what was the impact on those customers?

<u>ANSWER</u>: No. The development company, Duchesne Land L.C., and Mr. & Mrs. Steed subsidized the operating costs for SDCW in amounts that were greater than what their monthly standby fees or water fees would have been. Thus, if there was any impact on the other customers, it was to their benefit.

The tariff for SDCW was issued on August 14, 2003. Per the tariff, SDCW was authorized to charge a minimum of $40 per month for lots that were connected to the water system and receiving water, and a standby charge of $15 per month for lots that were not receiving water. *SDCW Tariff*, Sheet No. 3 (Aug. 2003). The authorized $40 and $15 fees are the only fees that have ever been charged to SDCW customers and these fees have never been increased.

The Department of Public Utilities ("DPU") asserts that the Developer and the Steeds received a preference in not having to pay the standby fees on certain unsold lots they owned and a $40 monthly fee on a cabin owned by the Steeds. The DPU asserts that the Developer and Steeds should have paid SDCW the $15 standby fee on 110 lots they owned from July 2012 through December 2018. This would have amounted to $19,800 annually ($15 x 110 x 12 months). The DPU also asserts that the Steeds should have paid $15,121.18 in water fees for the cabin they owned from 2003 to 2018. This would have amounted to $986 annually ($15,121.18 ÷ 184 months x 12 months). The combination of these two amounts is $20,786 annually ($19,800 + $986) during the identified time periods.

SDCW does not believe that the Developer and the Steeds received a preference in relation to the above fees because over the years the Developer and the Steeds paid more for SDCW's operating expenses than they would have paid in monthly fees. In the initial years of the utility, SDCW did not generate sufficient revenues to pay all of its expenses, thus the Developer and the Steeds contributed the capital necessary to pay those expenses. The

Developer and Steeds continued to contribute to the operating expenses of SDCW in order to allow it to retain some funds and become revenue adequate. For example, in 2017 and 2018, the Developer and the Steeds estimate that they contributed more than $31,600[1] each year just for rent, emergency telephone service, and wages. The total amounts contributed would be even larger if the Developer's and the Steeds' contributions for legal fees and other items were included. Consequently, the Developer and the Steeds have not received a preference in relation to the subject fees. Had the Developer and Steeds not contributed to pay SDCW's expenses in this manner, it is likely SDCW would have had to increase the fees paid by other customers.

In responding to this question, the PSC also asked SDCW to explain the utility's revenue requirement and how SDCW structured it rates to meet the requirement. The $40 and $15 amounts were originally selected because they were the same rates that were being charged by the neighboring City of Duchesne at that time and SDCW believed that these rates would be sufficient to meet the basic operating expenses of the water utility once established. SDCW is unaware of any documents from the 2003 time period that identify how its revenue requirement was originally estimated to establish the rates identified in the tariff. However, the owners of SDCW recall that they expected that they would likely have to invest in excess of $1,000,000 in plant to construct the water system and that they would have to pay a significant amount of the operating expenses for the SDCW utility for a

[1] In 2017 and 2018, the Developer and Ms. Steed contributed: office space to SDCW valued at about $500 a month (approximately $6,000 annually), shop space for mechanic work and related equipment and supply storage valued at about $500 a month (approximately $6,000 annually), funds for the emergency telephone service (approximately $1,200 annually); and funds for wages and contractor fees (of approximately $18,400 in 2017 and $21,600 in 2018).

number of years until the land could be subdivided into lots, the lots could be sold and then cabins could be constructed thereon and connected to the water system. Based on the riskiness of the investment in creating the development, the owners of SDCW hoped to be able to earn a return on their investment in the water utility in the 10% - 20% range.

Although this is merely an estimate, below, SDCW has attempted to recreate an estimate of what the revenue requirement estimates might have looked like back in the 2003 time period under three scenarios: (1) if all 900 contemplated lots were connected and paying the $40 minimum fee, (2) if half of the lots were connected and half were on standby and (3) if 100 lots were connected and 800 were on standby.

	900 Connected Units 0 Standby Units	450 Connected Units 450 Standby Units	100 Connected Units 800 Standby Units
Estimated Revenues per Lot			
Per connected lot -10,000 gal.	$40.00	$27.50	$17.78
Estimated Expenses per Lot			
Purchased water	-$7.06	-$3.53	-$0.88
Power	-$5.80	-$2.90	-$0.73
Rent	-$1.90	-$1.90	-$1.90
Salaries & Wages	-$5.00	-$3.50	-$2.00
Professional Services	-$2.80	-$2.00	-$2.00
Materials/Supplies/Tel./etc.	-$1.90	-$1.90	-$1.90
Repairs/Capital Exp./Interest	-$4.00	-$3.00	-$2.00
Taxes & Miscellaneous	-$1.90	-$1.90	-$1.90
Insurance	-$0.50	-$0.50	-$0.50
Bad Debt Allowance	-$1.90	-$2.50	-$3.00
Total Estimated Expenses per Lot	-$32.76	-$23.63	-$16.81
Estimated Profit per Lot	$7.24	$3.87	$0.97
Estimated Return	18%	14%	5%

As noted, the original plan was to develop 900 lots that could be connected to the water system. This expectation was never realized. The development started well. Hundreds of the lots were sold during the first couple of years, and more than 100 cabins were constructed in the first four or five years. During this time period, SDCW collected $40 monthly water fees from the cabin owners who had completed cabins and were using water and the Developer and Steeds paid all of the remaining operating costs for the utility.

In 2008, the Utah State Tax Commission levied tax charges against Mr. & Ms. Steed and froze all of the Developer's and the Steed's financial assets. Although the Steeds were ultimately acquitted of the charges in 2011, the damage of freezing the operating capital was fatal to the Developer. The Developer was not able to pay its workers and the development shut down. Additionally, as a result of the asset freeze and the asserted charges, many lot purchasers became concerned and cancelled their purchase contracts and requested refunds of the amounts they had previously paid toward the purchase of lots.

By late 2011 and early 2012, the Developer had significant debts and was required to sale 2000 acres of undeveloped land in the development to an oil exploration entity in order to pay its accumulated obligations. This land sale reduced the potential total number of lots in the development from 900 to 607.

In late 2011 or early 2012, SDCW gave notice to lot owners that it would begin collecting the $15 monthly standby fee in 2012. There are currently 607 lots in the SDCW system – 147 lots are connected to the water system and are using water and 460 lots are standby lots. SDCW's average collections per month per lot over the past three years has been approximately $17.26 (((($112,200 + $128,027 + $136,970) ÷ 3) / 607 units) / 12 months). *See 2018, 2017 and 2016 Annual Report to the PSC*. While SDCW believes these collections are sufficient to operate and maintain the water system they are not currently generating a material return to the owners of the utility.[2]

QUESTION NO. 2 – "Is SDCW adequately capitalized, and what effect, if any, has SDCW's failure to charge its owners and their development company had on SDCW's finances?

ANSWER: SDCW is unaware of any standard for what constitutes "adequate capitalization." In the initial years, SDCW did not generate sufficient revenues to pay all of its expenses, thus the Developer and the Steeds contributed the capital necessary to pay the operating expenses. Over the years, the Developer and Steeds continued to contribute to the operating expenses of SDCW in order to allow it to retain some funds and become revenue adequate. SDCW believes it is revenue adequate and has attempted to maintain a reserve balance equal to about two months of operating expenses.

RESPECTFULLY SUBMITTED this 31st day of October 2019.

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/s/ David J. Crapo
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[2] The Developer and the Steeds invested $981,528 in utility plant to establish SDCW. *See 2018 and 2017 Annual Report to the PSC*. During 2017 and 2018, SDCW averaged a profit of $53,064 (($44,956 + $61,172) ÷ 2). *Id.* This profit would represent approximately a 5.41% return on the investment ($53,064 ÷ $981,528). If the profit numbers were adjusted to account for at least part of the expenses paid for by the Developer and Steeds during these two years, the average profit would have been approximately $42,250 ($53,064 – say $31,600 + 20,786). This profit would represent approximately a 4.30% return on the investment ($42,250 ÷ $981,528).

CERTIFIC ATE OF SERVICE

I HEREBY CERTIFY that on the 31st day of October 2019, a true and correct copy of the foregoing **SOUTH DUCHESNE CULINARY WATER, INC.'S REPORT TO THE PUBLIC SERVICE COMMISSION** was served in the manner and upon the recipients named below:

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/s/ Katie McDowell
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