State of Utah

Department of Commerce
Division of Public Utilities

FRANCINE GIANI
Executive Director

CHRIS PARKER
Director, Division of Public Utilities

GARY HERBERT
Governor

SPENCER J. COX
Lieutenant Governor

Comments

To: Utah Public Service Commission

From: Utah Division of Public Utilities

Chris Parker, Director

Artie Powell, Manager

Brenda Salter, Utility Technical Consultant Supervisor

Shauna Benvegnu-Springer, Utility Technical Consultant

Date: December 13, 2019

Re: **Docket No. 18-2372-01,** Investigation of South Duchesne Culinary Water, Inc.'s Compliance with Applicable Administrative Rules and Tariff

Recommendation: Order

The Division of Public Utilities (Division) recommends the Utah Public Service Commission (Commission) order the South Duchesne Culinary Water, Inc. (SDCW or Company) to file a general rate case during calendar year 2020. The Division recommends the Commission order the remaining penalty fees of $14,175.00 to be paid because SDCW continues to be deficient in its accounting practices and payments from owners and other customers, in addition to its water quality problems.

Issue

During the Division's compliance review (audit) in May 2019, the Division noted "Standby fees were not charged or paid by the developer and owner of 125 lots that had water service but were not connected to the system, yet all other customers in the same situation were charged and paid standby fees."[1] Water charges for the Steed cabin were not charged nor paid.[2] SDCW has explained that "unsold lots were not assessed monthly standby fees until they were sold by the Developer."[3] The Commission issued an Order, dated September 4, 2019, on this docket requesting additional evidence from the Division and SDCW. The Commission asked:

1) whether the preferential treatment SDCW granted its owners and their development company (Duchesne Land) impacted the rates of the Company's paying customers at any time and the extent of any such impact; and,

2) whether SDCW is adequately capitalized and how SDCW's failure to charge its owners and their development company has affected SDCW's capitalization.[4]

The Commission directed, "In its response, the DPU should discuss what, if any, remedy it recommends the PSC institute to address any issues associated with SDCW's failure to charge its owners and their development company."[5] The Division files these comments in response to the Commission's Order and the report of SDCW filed on October 31, 2019.

Background

The Division regulates 24 water utilities. Many of these water companies are subsidized by the developer whose development is supported by the water company. Developer subsidies, as well as all initial infrastructure paid for by the developer, are properly recorded as Contribution in Aid of Construction (CIAC). The assets are donated by the developer to the water company free and clear of any obligation to the water company. The annual report form has a prominent section explaining CIAC and proper recording of transactions. The public interest may allow various rate structures for water companies. It can be in a developer's best interest to subsidize the water company. This can keep rates (artificially) low, encouraging the sale of lots based, in part, on cheap water rates. However, the financial integrity of the water company, which may include minimal or no debt, must be maintained. This is typically done until full build-out of the

[1] Docket 18-2372-01, DPU Memorandum Audit Findings, dated May 30, 2019, page 12.
[2] Ibid.
[3] Email for Mr. Jeff Schnars, dated November 21, 2018 to (sliebert@utah.gov), page 2.
[4] Utah Public Service Commission, Docket 18-2372-01, Order dated September 4, 2019, page 12.
[5] Ibid.

development, when the water company has an adequate number of customers to be fully self-sufficient. It appears SDCW is reporting on a cash basis of accounting, although it operates with an accrual system.

Question 1 "Did SDCW's failure to charge its owners and its development company affect the rates SDCW charged its paying customers, and if so, what was the impact on those customers?"

Answer

The Division acknowledges that the rates charged the paying customers have stayed the same throughout SDCW's business tenure. SDCW states "Duchesne Land LLC and Mr. & Mrs. Steed (owners of both Duchesne Land and SDCW) subsidized the operating cost for SDCW in amounts greater than what their monthly standby fees or water fees would have been."[6] SDCW states "the Developer and the Steeds estimate that they contributed more than $31,000 each year…"[7] The report did not include documentation to support its estimates. SDCW states that legal fees on behalf of the Company were paid by Duchesne Land and the Steeds, yet there is neither an amount nor documentation to support this claim. The Division discovered the preferential and discriminatory practice in its review in September 2018. The practice benefited the Steeds and Duchesne Land. Since the actual rates paid by the customers have not changed, the amount of net losses and debt accumulated over the years is significant. A properly managed utility would have required payments by the Steeds and Duchesne Land, just like it would have required from all customers. Revenue from all lots should be credited to SDCW, even if there are required subsidies. If it were necessary to subsidize SDCW, proper entries in SDCW's books should reflect that as well clearly showing payments, loans, and the like.

---

[6] Docket 18-2372-01, South Duchesne Culinary Water, Inc., Report to the Public Service Commission dated October 31, 2019, page 1-2.
[7] Ibid, page 3.

SDCW's annual report for 2018 shows [redacted] in assets, yet liabilities include a note payable (long term debt) of $[redacted].[9] Equity of the Company is a negative $[redacted].[10] The report showed no cash or accounts receivable reported,[11] yet the Division's review of billing records in May of 2019 disclosed that SDCW's customers are 45% delinquent.[12] At the end of its Income Statement, SDCW reports a net profit of $[redacted].[13] If SDCW's owners, the Steeds, estimate subsidies of $31,000, why did they not expense the amount against the profit? No reason is given to explain the poor state of SDCW's records.

SDCW asserts that its developer's contributions more than outweigh the funds that should have been collected had the developer paid its standby and water service fees. Because SDCW included no documentation or accounting records to verify its estimated subsidization in its answer to the Commission, the Division is unable to verify these amounts.

Additionally, SDCW states, "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." But there is no record of these contributions the Division has seen. A review of SDCW's Annual Reports shows that it incurred long-term debt in its initial years from 2001 to 2008 of $[redacted]. Again, the lack of documentation or accounting records leaves the Division unable to determine if the developer's alleged subsidies are included in that debt. Furthermore, to the extent the loans are with owners or affiliates, there is insufficient documentation to ensure the rates are fair. Traditionally, such rates should be the lower of cost or market.

On the other hand, the Division's calculation of the $146,250 and $15,121 unpaid standby and water service fees, respectively, are supported by the absence of records of payment and lack of accounts established in the billing system for Duchesne Land or the

---

[8] SDCW 2018 Annual Report, Balance Sheet, page 15.
[9] Ibid, page 16.
[10] Ibid.
[11] Ibid, Page 15.
[12] Division of Public Utilities, Docket 18-2372-01, and Memorandum dated May 30, 2019.
[13] SDCW 2018 Annual Report, Income Statement, page 17.

Steeds. The calculations are not in dispute by SDCW. Although the rates have stayed the same, the impact on the customers of these uncollected amounts is negative. SDCW is currently saddled with over $[redacted] dollars of debt, which greatly affects its financial viability and future rates to customers. Regardless of the source of the debt, the proper collection of water bills from the developers and the Steeds can and should reduce this debt.

In February 2014, the Division conducted an internal assessment of SDCW's annual reports filed in 2008 through 2012. The Division reviewed the current tariff rates and calculated a revenue requirement based on the 2012 annual report. It was determined that the rates were adequate assuming all customers (including Duchesne Land and the Steeds) were paying customers. The Division observed at that time that the utility plant was completed. The amount of water utility plant recorded as assets are $[redacted][14] as follows:

[redacted]

Revenue Requirement Calculation

The Division calculated what a revenue requirement might be based on the 2018 SDCW annual report as a test year, expenses SDCW said they subsidized, taxes and a weighted return on investment of 7.95% The revenue requirement would equal $207,636.00. Assuming all 804 authorized connections were paying either a standby or water service fee there should have been no deficit if the Company had been well-managed. See the calculation as shown in Table 1. Standby fees were calculated using 804 lots (all lots) for 12 billing periods at $15.00 per month.

[14]SDCW 2009 Annual Report, page 12.

This equals $[redacted] in revenue for fixed system costs. Water connections were calculated using 167 cabins (as reported in the 2018 SDCW Annual Report) for 12 billing periods at $25.00 per month. This equals $[redacted] in revenue for fixed water delivery costs. Projected overage use of [redacted] gallons at $2.00 per 1,000 gallons equals $[redacted] in variable revenue for water and treatment costs annually.

[redacted]

To demonstrate the effect of not requiring Duchesne Land and the Steeds to pay water bills, the costs remain the same, their lot counts and water counts were subtracted from the total counts, leaving the Company with only 607 lots. This represents the loss of revenue on 197 lots, which include the Steed cabin and other lots owned or sold by Duchesne Land. The loss of that revenue generates a $[redacted] loss, as shown in Table 2.

[redacted]

To correct this loss, the rates on the 607 lots would need to be increased, resulting in a standby fee of $20.00 and water service of $45.00 per month as shown in Table 3. These are significant increases of 33.333% for all customers.

[redacted]

The Company believes that although current revenue "collections are sufficient to operate and maintain the water system they are not currently generating a material return to the owners of the utility."[15] The 2018 SDCW annual report showed revenue collected of $[redacted], limited expenses of $[redacted], and a profit of $[redacted].[16] The Company claims its owners subsidized an estimated $31,600.00.[17] Using the current population of customers (including the Steeds and Duchesne Land's remaining lots) and the current rates, the Company is not earning enough to pay all operating costs, pay taxes, and provide a reserve to recover the original cost for infrastructure replacement (see table 2). These items are not recorded in the annual report. With those assumptions the Company will collect only $[redacted] to pay the $[redacted] revenue requirement. The likely result is more under-spending or increasing rates, or both.

Question 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

It appears that SDCW is not adequately capitalized and SDCW's failure to charge owners and the development company has a negative effect on SDCW's finances. The Division refers back to the long-term debt of $[redacted] as reported on the SDCW 2018 Annual Report and the Division's inability to ascertain what is included in that debt. SDCW currently has over $[redacted] in debt with assets worth $[redacted]. As discussed above, the revenues from all lots should be available to pay SDCW debts. The ability to properly collect past due developer standby fees and the Steeds water rates will significantly improve the bottom line.

---

[15] Docket 18-2372-01, South Duchesne Culinary Water, Inc., Report to the Public Service Commission dated October 31, 2019, page 5-6.
[16] SDCW 2018 Annual Report, page 18.
[17] Docket 18-2372-01, South Duchesne Culinary Water, Inc., Report to the Public Service Commission dated October 31, 2019, page 3.

Additional Discussion

The Commission asked that SDCW's report include an explanation of the utility's revenue requirement and how SDCW structured its rates to meet the requirement. The Commission requested that SDCW's report also include the underlying financial data to support its conclusion. SDCW claims its owners copied what Duchesne's municipal water system was doing, because they knew that they would have to subsidize the Company until full build-out. A municipal water system has a much different revenue requirement than a private for-profit corporation. A municipal water system does not earn a return on investment or pay taxes, nor is it regulated by the Commission.

The few numbers the Company provided and discussed in its report to the Commission were estimates, not actual numbers. Supporting documentation for the estimated subsidies was not provided by the Company. The Company's attempt to back into numbers, such as the estimated numbers on page 4 of its report, is not reliable. The Division is concerned about the Company's financial viability. The Division is also concerned about the information reported in the annual reports. Several items are not reported, such as taxes, accounts receivable, rent, emergency phone service, staff costs, etc., in its annual report. Had the Company subsidized losses, revenue from the developer/owner would be reported as a private contribution, but the annual reports do not report a private contribution. The assets that were donated by developers are reported as CIAC. The Company has negative equity, no cash, no reserves for the replacement of infrastructure when the time comes, and a $[redacted] debt.

Water utility companies typically run very lean operations. It appears as though SDCW has purposely maintained low water rates. The information provided to the Division does not substantiate the number of contributions the Steeds and Duchesne Land have provided to the Company. The Division recommends the Commission order SDCW to file a general rate case during the calendar year 2020 to determine what the rates should be for SDCW to be a viable water company for its customers, and to define the amount of owner/developer contributions, if any.

Water Quality

The Division reported on May 30, 2019, the issue of SDCW not having an approved water system with Division of Drinking Water (DDW).[18] The Company's water purity problems continue to place customers at risk. After a report of illness was filed, DDW took water samples and confirmed the presence of coliform bacteria. The Division talked with Colt Smith, Environmental Scientist at the DDW, on Monday, December 9, 2019 and received an email on Wednesday December 11, 2019.[19] He stated the following:

- SDCW water system remains an unapproved water system;
- DDW issued a "boil order"[20] to SDCW on November 8, 2019;
- the DDW is continuing to monitor the water system; and,
- the boil order remains in effect as of December 11, 2019.

Samples are showing improvement but bacteria are still present.[21] The current Monthly Compliance Bacteria Summary Report[22] from Duchesne Valley Water Treatment Plant shows three sites where coliform bacteria was present, i.e., sample D19315 on November 18, 2109, and samples D19421, D19422 and D19423 on November 20, 2019.[23] According to the report those particular sample sites did not report sample results through the rest of the month. A copy of the boil order and the sample results log cited below are attached as Exhibit 1, page 3 and 4. This is a violation of the water purity standard in Utah Admin Code R746-330-2 requiring that the water not "contain disease-producing organisms."

Conclusion

Based upon the information requested by the Commission and the report of SDCW, the Division recommends a general rate case be ordered for SDCW during the calendar year 2020. The

[18] Docket 18-2372-01, DPU Memorandum to PSC, dated May 30, 2019, page 12.
[19] Email from Colt Smith regarding South Duchesne Boil Order, Wednesday, December 11, 2019.
[20] Drinking Water Order, issued by DDW on November 8, 2019. See Exhibit 1, page 1 & 2.
[21]Duchesne Valley Water Treatment Plant NELAC Laboratory, Monthly Compliance Bacteria Summary Report for South Duchesne Culinary Water.
[22]Ibid, page 2.
[23] Ibid, page 1.

information provided in SDCW's report was estimated and not supported by documentation. A general rate case will allow exploration of SDCW's true finances, provide an accurate understanding of its needs, and establish rates for the Company to be financially fit. The Division recommends the Commission order the remaining penalty fees of $14,175.00 to be paid because the Company continues to be deficient in its accounting practices and payments from owners and other customers, in addition to its water quality problems.

cc: Joan A Steed, SDCW
David J Crapo, CRAPO|DEEDS PLLC
Patricia Schmid, Assistant Attorney General