PACKSADDLE DEVELOPMENT CORPORATION

CASE NO. GNR-W-95-1

STAFF REPORT

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in Consultation with

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&

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INTRODUCTION

This case was initiated in response to a petition received on January 17, 1995 from water customers of Packsaddle Development Corporation (Company or Packsaddle) requesting an Idaho Public Utilities Commission (Commission) investigation of the Company's water service.  By its Order No. 25908 (Order) dated February 24, 1995, the Commission opened a formal investigation into whether Packsaddle is selling water to the public for compensation, and therefore operating as a public utility.

The Commission, by its Order, directed the Commission Staff (Staff) to "...issue production requests, written interrogatories or other forms of discovery as well as pursue its statutory right to examine and audit the records of Packsaddle Development Corporation as they relate or pertain to the sale of water."  The Commission seeks to determine, through the investigation, whether the Company is a public utility subject to the Commission’s jurisdiction under Idaho Code, Title 61.  This report was prepared in response to the Commission’s directive.

This report was completed after visiting the Packsaddle Creek Estates subdivision and interviewing representatives of the Company and several residents who had contacted the Commission regarding the water system.  This report is organized in two major parts.  Part One is a general background of the Company, its development of the Packsaddle Creek Estates Subdivision, and a summary of the findings of the Staff during the course of its investigation.  Part Two presents the Staff recommendations regarding the status of the Company as a public utility, the jurisdiction of the Commission and alternatives for the future operation of the water system.

This report serves two purposes.  It was written to provide the Commission with facts regarding the case and to make recommendations regarding action by the Commission.  It was also written to inform the Company and the petitioners as to what is required of a public utility and how regulation of the water system would affect them.

PART I:  BACKGROUND & STAFF FINDINGS

The Packsaddle Development Corporation was originally incorporated under the laws of the State of Idaho on July 10, 1970.  Its business is listed as land development.  The Company has subdivided a plat of land approximately ten (10) miles southwest of the town of Tetonia in Teton County, Idaho.  The subdivision is known as Packsaddle Creek Estates Division #1 (recorded in Teton County on August 10, 1970) and Packsaddle Creek Estates Division #2 (recorded in Teton County on March 19, 1973).  The two divisions compose the entire subdivision and include a total of eighty-nine (89) residential lots.  The subdivision is located on a hillside on the west side of the Teton Valley.  The terrain is relatively steep with more than 400 feet of elevation difference between the lowest part of the subdivision and the top where the wells and storage reservoirs are located.

Also on file in Teton County are copies of the Protective Covenants For Packsaddle Estates Division No. 1 recorded September 9, 1970, and a Domestic Water Agreement between the Company and the Board of County Commissioners of Teton County recorded

November 6, 1970.  Neither the protective covenants nor the water agreement mention Division #2.

A copy of the Domestic Water Agreement was provided to all original purchasers of lots within both divisions of Packsaddle Creek Estates.  It provides a perpetual right, running with the land, to lot owners relative to the supply of water by the sellers.  It also specifies that the sellers would bear all costs associated with the installation of a water system from the wells to the lot lines, and purchasers would bear the cost of repair, maintenance, and installation of water lines from the lot line to structures.  In addition, the purchaser is required to pay a monthly rate of $6.00 per month for water service after hookup.

Another document entitled "Property Report, Notice and Disclaimer, By Office of Interstate Land Sales Registration, U.S. Department of Housing and Urban Development" (HUD) was provided to the Staff by the Company.  The Company maintains this document was signed by all original purchasers of land within the subdivision.  The Washington D.C. office of HUD has informed me that Packsaddle Estates was registered with HUD in November of 1970.  HUD suspended the registration in January of 1973.  Due to administrative changes affecting the registration, modifications were required.  The Company did not respond to correspondence requesting modifications to the registration and therefore, the registration was suspended.  Use of the HUD document in the sale or marketing of a piece of property either before the effective date of November 1970 or subsequent to the suspension in January of 1973 is illegal.

The HUD report contains several statements which are pertinent to the status of the water system.  Page 4 of the report, item 7, indicates that property buyers are not required to pay any special assessments or make payments of any kind for the maintenance of common facilities within the subdivision, nor are there any property owner association payments required.  Page 5 and 6, item 10, states that culinary water only is available within the subdivision; that the developer is responsible for extending water lines to lot lines; there will be no charge to purchasers to hookup to the water lines; that water rates charged are $6.00 per month; that the developer has a report from a cognizant health officer on the quality and purity of water; and that there are no bonds or escrows to assure completion of the water facilities and therefore there is no assurance that such service will be available.

During development of the property, the Company built roads and installed a domestic water system.  The backbone of the water system is almost completed, with only a short extension of 400 feet (more or less) required for completion of the water mains.  This last extension is planned for completion during 1995 to reach two lots that have recently been sold.  The water system was installed as necessary to reach lots as they were sold and requests for water service were received.  The costs of installing the water system were not capitalized as part of the subdivision development costs but, instead, were expensed for both book and tax purposes.  Only 24 of the 89 lots have been developed and connected to the system at this time.  I understand two additional lots are expected to be improved this summer.  Many of the improved lots are summer or part-time second homes.  The Idaho Division of Environmental Quality (DEQ) lists this subdivision as a "Transient" (part-time occupancy) system which limits the required water quality tests significantly.  When the subdivision exceeds 25 full-time residents, the number, type and cost of required water quality tests will increase.  Laboratory fees could increase by as much as $1,000 annually while DEQ fees will increase from the current minimum $25 annual fee to $5 per customer.  A significant amount of additional time will be required to administer test sampling and documentation.

The water system is composed of two wells with a total production capacity of 100 gallons per minute, a concrete 80,000 gallon storage tank, a steel 7,500 gallon storage tank, a pressure pump and 50 gallon pressure tank, and approximately 20,000 feet of main line.  The two wells, storage tanks and pressurization system are located on lot No. 63.  Copies of the water system schematic diagram have been provided to the Staff by the Company's engineering consultant Benton Engineering.  The design of the system as depicted by the schematic diagram appears to be adequate to serve the subdivision.  There may be some discrepancy between the schematic diagram of the system and the actual plant buried and out of sight.  One customer asserts that the main line in front of his property is a 2 inch line.  The water system map indicates the line is a 3 inch line.  The Company can neither confirm nor deny this allegation.  It is possible a necessary repair to the line was made using two inch line that was on hand at the time.  The main line just above this customer is a 3 inch line.  The two inch "repair" to a 3 inch line does obviously create a restriction.  However, there are only 2 lots downstream from this location which should not be adversely affected by the restriction.

Several residents question the quality of the installation and the accuracy of the schematic diagrams.  They fear that the system has numerous leaks and allege that several of the water mains are installed outside the indicated easements and may traverse lots in locations incompatible with the construction of homes.  The schematic diagrams prepared by Benton Engineering indicate the drawings "...represent the existing water system, as near as we are able to determine."  The Staff must rely upon the engineering firm’s drawings as the best information available.  If, however, there are discrepancies of this nature, which are impossible to determine without excavating the lines and/or easements, the Company should be required to relocate the lines within the easements.  The Company maintains that residents have, through various activities, disturbed survey markers making it difficult to precisely determine the exact lot lines.  A new survey could be required in order to precisely determine the exact location of the easements.

I sampled several locations for water pressure and found that pressure on the system is quite good.  Likewise, these tests showed that maximum pressures on the system at the lowest elevations are adequately controlled to protect residents from the damage that may be caused by extremely high pressures.  If leaks are present, they were not apparent from the static pressure tests taken.  The only way to precisely determine if leaks are present on the system is a controlled test with the cooperation of the residents measuring water flow from the reservoir over a period of time when customers were not using water.  The system has no flow meters installed at this time to enable that kind of testing.  The portion of the system connected to the pressure pump and tank did not indicate any leakage.  While testing that portion of the system, it was necessary to intentionally waste water in order to activate the pressure switches to determine the high/low settings.

The question was raised by one resident regarding the adequacy of the system to support fire flow should the county eventually require the installation of fire hydrants.  The system is not sized for this purpose.  Generally fire districts require a minimum size of 8 inches for mains supporting fire hydrants.  The largest main on this system is 6 inch and represents only a small portion of the system.  The majority of the mains are 4 inch and 3 inch.  The question regarding the eventual requirement by the county for installation of fire hydrants is best addressed to the county.  Normally once a subdivision has been approved, county planning and zoning commissions do not years later require retrofit of the water system.

During 1992 and 1993, the Company was experiencing water supply problems due primarily to the drought.  The original Well #1, which is 385' in depth, was sloughing at the bottom and getting dangerously close to drying up.  The owners of the Company, Mr. and Mrs. Earl Bainbridge, installed a separate water supply system to provide water from a spring owned individually by them while repairs to the well were accomplished.  In 1993 a new pump was installed in the well at a cost of $2,395.44.  This original well, even with its new pump, only has a pumping capacity of 30 gallons per minute, which is inadequate to serve the subdivision when completely developed.

The Company installed a second well (Well #2) in 1994 at a cost of $21,341.43.  The well was paid for through the issue of a note payable to The Bank of Commerce in Driggs, Idaho in the Amount of $20,475.00.  The note carries an interest rate of 9% and is payable in three installments of $8,084.42 in August of 1995, 1996 and 1997.  The second well has a pumping capacity of 70 gallons per minute which, when combined with Well #1, brings the total pumping capability to 100 gallons per minute.

Other major repairs to the system in recent years include replacing a pressure pump in 1993 at a cost of $403.89 and replacing the pressure tank in 1994 at a cost of $482.79.  With the replacement of the pump in Well #1, replacement of the pressure pump and tank in 1993 and 1994, and the addition of Well #2 in 1994, the system’s water supply system is practically new and should serve for a number of years without major expense.

Customers on the system have expressed both dissatisfaction and suspicion of the water system and its owners.  The owners (Mr. and Mrs. Bainbridge) formed a second corporation on December 27, 1993 known as the Packsaddle Creek Estates Homeowners Association, Incorporated (Association).  The owners have attempted to transfer the water system to the Association.  Residents indicate the Association was formed without their knowledge and consent.  Many refuse to be a part of the Association and maintain they cannot be forced to join an association formed well after their purchase of property.  All the aforementioned documents are silent regarding a homeowners association.

Accusations have been made, both by residents and the Company, that water consumption is disproportionate among the customers.  Some homes are permanently occupied, others only on weekends or seasonally.  The water system is a culinary system not intended for landscape irrigation, ponds or other aesthetic exterior purposes.  Despite the alleged disproportionate use, all customers have been charged the same monthly rate whether water is actually consumed or not.  The only way to overcome this problem is the installation of water meters and a rate design based upon measured consumption.  This of course would require additional investment which would result in even higher revenue requirements.

The residents' concerns go well beyond the operation of the water system.  The Association by-laws do not address the water system at all, but do address maintenance and snow removal from roads within the subdivision.  Homeowners have indicated that the owners represented that the roads have been dedicated to Teton County and the County has accepted them.  The residents are reluctant to join an association which may, they suspect, have responsibility for the roads.  They feel they need legal assurance that indeed the county has accepted responsibility for the roads.

The restrictive covenants of the subdivision have not been strictly enforced by the owners.  Residents claim favoritism on the part of the owners regarding enforcement of the covenants.  Some residents feel the formation of the Association is simply an attempt by the owners to sidestep responsibility for policing the covenants and maintaining the roadways and water system.

Discussion with several residents revealed that they may be willing to entertain the formation of an association of some type if limited to the control and management of the culinary water system.  They still have reservations regarding any responsibilities transferred that rightfully should (in their opinion) be retained by the development company.

The rate history of the system has been relatively stable until last year.  There are only three meters on the system at this time, and they are on the newest installations.  The Company charges customers a flat monthly rate and meters are not read.  Initially, the Company provided water at the $6.00 per month rate indicated by both the Domestic Water Agreement filed with the county and the HUD report.  In 1987, the rate was increased to $15.00 per month and seems to have been accepted by the customers.  The Company does not charge new customers for providing a connection to the water system.  The Domestic Water Agreement and the HUD report both include provisions for connection at no charge.  This is not normal for most regulated water utilities.  Generally a connection fee is charged which is at least large enough to pay the direct cost of actually making the connection and often includes an additional increment to offset some of the cost of backbone water supply and transmission facilities.  The Company has been absorbing its direct cost for these connections as normal operating costs for supplying water.

The Company notified customers by a letter dated December 20, 1994 that the rates were going to increase in February of 1995 to $28.00 per month and again in May 1995 to $74.00 per month.  This notice was the catalyst that led to the numerous calls to the Commission and the petition that was filed seeking Commission intervention.

The justification for the increase provided in the December 1994 letter was to recover through rates "...all back debts incurred against the water system..."  Additional justification provided to the Staff indicates that the rates are intended to recover the cost of the new Well #2, the new pump in the #1 well, the new pressure tank and the new pressure pump over a two-year period.  In addition the Company indicated the rate was designed to provide for  $500 per month to pay maintenance labor costs and $174 per month for electricity and provide funds for unforeseen emergencies.

STAFF RECOMMENDATIONS

In my opinion, the Packsaddle Development Corporation is, and has been, operating a domestic water system that clearly comes under the Commission’s jurisdiction as a public utility as defined in Title 61, Idaho Code.  However, I firmly believe the customers and the owners of the system would be better off if the system were to be organized as a cooperative non-profit system operated and managed by the residents of the subdivision.  There is no assurance of continuity into the future with a small family-owned water corporation.  Should something happen to Mr. & Mrs. Bainbridge, their heirs may not be willing or able to accept responsibility for maintenance of the system.  A cooperative association whose membership goes with ownership of the land provides continuity of the organization.  I note that the protective covenants of the subdivision are binding until August of this year at which time they will automatically be extended for successive periods of ten years unless the majority of the property owners agree to change them.  The timing may make it possible to modify those covenants to provide for operation of the water system.

I have identified four alternative solutions to the water supply problem in the Packsaddle Estate Subdivision.  Three of those alternative are under the regulated jurisdiction of the Commission.  The fourth is the unregulated operation of the water system through an organization composed of the subdivision residents.  The attachment to this report compares the cost to the homeowners under each of the alternatives.

PUC REGULATED OPTIONS

The Company could continue as operator of the water system under the Commission’s jurisdiction.  This scenario requires a finding by the Commission regarding just and reasonable rates for the Company.  To reach that finding, the Commission must first determine the amount of the Company's investment in the water system, a reasonable return on that investment, and reasonable operating expenses.

The Commission policy regarding developer-installed water systems is to assume that the developer recovers all of the initial investment in the system through the sale of lots.  This policy is premised on two basic assumptions:  either the water system was required by local officials before the subdivision was allowed, which means the lots were unsalable absent the system, or the fact that a system was in place increased the value of the lots.  Therefore the developer has no initial investment in the system upon which to earn a return, and rates are based simply upon reasonable operating costs, including compensation for time spent managing and maintaining the system.  When major replacements of facilities are required due to age and failure, the replacement cost is treated as new investment and a return is allowed.

The Packsaddle Estates original supply system and the transmission mains represent the initial investment assumed to have been recovered through the sale of lots.  The rehabilitation of Well #1 and the new pump in that well, the replacement of the pressure tank, and the replacement of the pressure pump are replacement investments upon which the Commission would normally allow a return.

The large investment in the new Well #2 presents another problem.  This well is not a replacement.  It is a new well and is necessary in order to complete the system for adequate service to the entire subdivision.  The subdivision is only about one-third developed.  The existing customers could be adequately served by the original well assuming drought conditions did not threaten to dry up the well.  Of course this is exactly the condition experienced in 1992 and 1993 that led to the temporary connection to the private spring and the drilling of the new deeper well in 1994.  Therefore at least part of the cost of Well #2 could be assumed to represent an investment in system reliability for the benefit of not only new customers but existing customers as well.

The Commission must decide:  1) Was the second well a necessary obligation of the development company to complete the system for which compensation has already been received through the past sales of lots?  2) Was the second well required simply to maintain service to existing customers and therefore an investment upon which a return should be allowed?   3) Is the new well an investment made in order to assure service to existing as well as provide service to future customers in which case a return is allowed on a prorata share of the new well in proportion to the fill ratio of the subdivision?

Reasonable operating costs must be allowed in any rate structure approved by the Commission.  These operating costs include not only repair materials and supplies but also depreciation expense, water testing expense, taxes (including corporate income taxes), electricity for pumping, reasonable compensation for labor costs to maintain the system and perform administrative functions including customer accounting.  Since no corporate vehicles exist, a reasonable mileage allowance for the use of private vehicles to perform water system business should also be added.  Note that at the current time the Company has no payroll and individuals are not being compensated for either labor or use of private vehicles.

The Idaho Public Utilities Commission Customer Relations Rules and Regulations apply to all public utilities in the state.  These rules prescribe the terms and conditions under which regulated utility customers receive service.  The utility is required to adopt the provisions of the rules that identify the policies and practices including deposits, disconnections and billing.  With the filing of this report, copies of these rules are being provided to the owners of Packsaddle Development Corporation and to Mr. Don Lingle as the designated contact for the petitioners.  A regulated utility is also required to file its proposed rate schedules, line extension policies and general service provisions with the Commission for its approval.  Finally, an Annual Report containing the financial statement of the utility must be filed with the Commission.

UNREGULATED OPTION

The final option is the formation of a homeowners cooperative water system.  The Commission has no jurisdiction over this type of water system, which is self governing through its membership.  Certain benefits are available to this type organization which help minimize the cost of providing water.  First, and the most obvious, is there are no income taxes to pay.  Second, because it is a non-profit organization, there is no return on investment required to compensate owners.  Rates may be increased or decreased quickly simply by a majority vote of the membership.  Many of the management functions for which a private corporation must receive compensation may be accomplished free through the officers of the organization or other volunteer efforts by the members.

CONCLUSION

I strongly urge the Company and the residents of Packsaddle Estates to  investigate the formation of a cooperative system.  Should the Commission ultimately exercise jurisdiction over the system as a public utility, I believe the rates set forth in the Attachment under alternate #1 are just and reasonable for this system.  I would support them in a formal hearing.  Strong argument could also be made in support of alternative #3 as well.  In my opinion, alternative #2 is patently unfair to the customers of a system that is currently overbuilt for the existing number of customers.

The Commission Staff has in the past conducted meetings less formal than official Commission hearings in an effort to expedite resolutions to complaints or proceedings.  I believe we stand ready to do the same in this case should the Commission, the Company and the residents believe such a process would be beneficial and result in a stipulated resolution to this case.  Such a meeting could be held soon assuming a suitable meeting location could be scheduled in the Tetonia-Driggs area.

Respectfully Submitted,

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Robert E. Smith

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