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REPORT OF STAFF INVESTIGATION
Case Nos. SC-2005-0083 and SC-2005-0099
Blue Lagoon Sewer System, Inc.

Missouri Public
Service Commission

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~~Staff~~ Exhibit No. 17
Case No(s) SC-2008-0358
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Overview of the Formal Complaints

Two customers of a sewer utility that provides service generally in an area that includes a subdivision known as Lost Valley Subdivision, near Monroe City, Ralls County, Missouri, have filed formal complaints before the Commission. The sewer utility is not regulated by the Public Service Commission (Commission) at present. The formal complaints pertain to both quality of service, and jurisdictional oversight. More specifically, with regard to quality of service, the Complainants allege service matters including sewage backup events, and inferior construction of the sewer system. Indeed, the Missouri Department of Natural Resources (DNR) is addressing issues of construction and permitting with the owner of the system.

Background of the Sewer Utility

As stated above, part of the sewer utility's service area includes Lost Valley Subdivision, which has approximately 37 lots, 35 of which have been sold, and 31 on which homes have been constructed. A person involved with the subdivision development, Mr. Ken Jaeger perhaps through one or more corporations and perhaps with other partners, is also an owner of the sewer system, or a corporation that owns it. The Complainants in the instant cases have property in Lost Valley. The sewer system also serves commercial developments that include a recreational vehicle (RV) campground called Salt River Campground with 72 sites, five cabins, a theater, a motel with 21 rooms, and a convenience store with a restaurant. The Staff estimates that there may be approximately 36 customers, though there could be up to 139 identifiable users if campground lots and motel rooms are separately counted. The area is largely recreational, being near the Mark Twain Lake.

The Missouri Department of Natural Resources (DNR) had issued a Letter of Approval for the construction of a "no-discharge" system in August of 1990, meaning the treatment facility was constructed so as not to discharge treated sewage to a creek, and therefore did not need a discharge permit. The original owners, according to DNR's information, were Robert Vanderbeck and Ken Jaeger. Sometime in approximately 1999 the owners filed bankruptcy. It appears that Mr. Jaeger either bought back, or retained ownership of the lagoon real estate, since information indicates that in June of 2001 Mr. Jaeger made an agreement with Ralls County State Bank, part of which addresses charging the RV campground lots for sewer service.

Exhibit A

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Although Mr. Jaeger apparently acquired ownership of the lagoon, the lagoon and sewer system appears to have been constructed to provide sewer utility service to properties that Mr. Jaeger did not acquire, namely the theater, the motel, and the RV campground. Since the system was constructed in proximity to them, and the properties are apparently actually connected, the Staff presumes that the owners of these properties have a claim to treatment capacity in the lagoon.

Much of this information as presented herein was collected in pieces by the Staff by field observation, by DNR correspondence, and by word of mouth from DNR and customers. Thus, the Staff is not absolutely certain about ownership history and details of involved properties. Regardless of some of the background facts, the real question is whether or not the sewer utility today is subject to regulation, and also how to address the technical issues, which is also DNR's concern.

Some of the technical issues include sewer pipeline size, treatment facility effluent discharge in spite of being constructed as a no-discharge facility, and sewage overflows from a lift station.

Background of Staff Involvement – Informal Complaints

The Staff first became aware of this system through an informal complaint from Mr. Mike Knepper, the owner of the RV campground and the store, in approximately May 2003. Martin Hummel took and handled this matter. There were fewer than ten homes constructed in Lost Valley Subdivision at that time. The primary concern of the complainant was the amount charged for sewer service and the availability of the service.

Later, in March 2004, a person who purchased one of the RV campground lots initiated an informal complaint, which was taken and handled by Jim Merciel, although the complaint was actually made against Mr. Knepper. In addition to being a customer of the sewer utility, Mr. Knepper, or specifically the RV campground, is a customer of a water district and an electric cooperative. He, or perhaps a corporation he controls, was arguably acting as a water, sewer and electric utility by re-distributing those services to campground lots, some of which have been sold to individuals. Within the context of this complaint, Mr. Knepper inquired of the Staff the need to regulate Mr. Jaeger's sewer utility. At the time of this complaint, the Staff contacted Mr. Jaeger, who stated he was consulting with his attorney regarding how to properly set up the sewer utility. There was limited discussion with him regarding types of sewer utilities, but Mr. Jaeger indicated he was relying on his attorney for advice on what to do, but also indicated that they were seriously considering a non-profit sewer corporation. Additionally, during the time this complaint was being addressed, Mr. Jaeger caused the campground to be disconnected from the sewer system, and in response Mr. Knepper was able to get a restraining order and resume sewer service for the store and campground.

In September 2004, the Staff received three informal complaints regarding the sewer system, quality of service, its operation, and the jurisdiction question, two of them from the people who filed the instant formal complaints. It was during the handling of these informal complaints that the Staff learned that Mr. Jaeger had formed, and was operating the sewer system, as a corporation called Blue Lagoon Sewer System, Inc., set up as a non-profit corporation. Another

event of the time was a meeting that customers had requested with DNR for the purpose of discussing technical issues regarding construction and operation of the sewer system, and regulations. This meeting was held on September 17, 2004 at DNR's Northeast Regional Office in Macon. Having discussed the issues with DNR, the PSC Staff was invited to attend. Martin Hummel of the PSC Staff attended the meeting, answered questions regarding PSC regulation, and provided the customers information about filing formal complaints with the PSC.

The Staff believed that, given the events and informal complaints of the past year and a half, and considering the apparent need for some negotiation and dialogue among the involved parties, a satisfactory resolution would more likely be reached through the formal complaint process, and the result is the two subject Formal Complaints.

Jurisdiction including not-for-profits, and non-profit issues

The Public Service Commission regulates sewer utilities that are operated "for gain" as per Missouri statutes. From a layman's point of view, "for gain" and "for profit" as used to describe types of corporations sound similar, but that is not necessarily the case. Clearly, a for-profit corporation that is able to meet expenses and provide a return to the stockholders is a "for gain" operation. On the other hand, any corporation, whether for-profit or non-profit, with insufficient revenue to meet more than the most basic expenses, arguably is not a for-gain operation. Although non-profit corporations are contemplated such that the owners/incorporators do not realize any profit, they could still be for-gain operations if someone benefits by the proceeds from revenue. As an example, the Staff and the Commission once dealt with a water utility owned by a man named Bill Beeney, Case No. WC-92-77, along with an associated case in Warren County Circuit Court. Mr. Beeney owned a -non-profit corporation that provided water service to the public, but proceeds from the water service revenue not only paid expenses but were also sent to the owner's religious mission in Mexico. While the corporation and its owners may not have realized a profit as such, there was a gain realized by persons other than the bill-paying water customers.

Thus, Blue Lagoon Sewer System, Inc. may or may not realize revenue that meets more than its basic operating expenses, but the Staff believes that as an entity solely under the control of the incorporators, there is potential for it to be a for-gain operation.

A series of Missouri Statutes, specifically 393.825 through 393.861 and 393.175 contemplate what are called "nonprofit sewer corporations" as defined in 393.825. The statutes specify for such corporations, among other things, that there be five (5) incorporators, that the entities be set ups as nonprofit membership corporations, and that they are not subject to PSC regulation. The statutes also provide for election of a board of directors among the corporation members, and how to deal with excess revenue. From a practical standpoint, the Staff regularly advises developers and others contemplating water and sewer utilities that in order to eliminate any question about the need for regulation, the utility should be controlled equally by and only by the customers. The nonprofit sewer corporations as defined in 393.825 clearly are not subject to regulation; however since Blue Lagoon Sewer System, Inc. does not meet the requirements of

the statutes that define nonprofit sewer corporations, even though it is incorporated as a non-profit entity, the Staff does not believe that it is exempt from regulation.

Conclusions and Recommendations

The Staff believes that, regarding regulation, the following options are available:

- Blue Lagoon Sewer System, Inc. could file an application for a Certificate of Convenience and Necessity and become a regulated sewer utility. Although it might be able to do so as it exists as a non-profit corporation, an option would be for the owners to form a for-profit corporation to own and operate the system and become the regulated sewer utility, so that they have an opportunity to earn a return on their investment if there is any.
- Blue Lagoon Sewer System, Inc. could be reorganized as another entity that meets the definition of nonprofit sewer company in 393.825.
- A property owners association could be formed, although this alternative may not be practical since some customers are not a part of a subdivision under which most such associations commonly exist.

Since the Staff believes that there is no firm determination regarding the type of utility that will ultimately legitimately exist, the Staff is not able to study rates or charges that would be necessary to properly operate and manage the sewer utility. The Staff does not anticipate studying rates unless and until a proposal for a regulated utility is presented. Such a proposal, most likely in the form of an application for a Certificate of Convenience and Necessity, would need to include financial information including documentation of how capital funding has been provided in the past, how capital funding for needed improvements will be handled, and operating expense information, so that justifiable rates may be set. Such an application would need to also include a plan to address the technical concerns, address service problems that may exist, and properly operate the system in compliance with state regulations. Among the possible issues, there could be differences in funding for capital improvements within Lost Valley Subdivision, which could legitimately be made by the developer, versus funding improvements for customers outside the subdivision.

Whether or not this utility becomes regulated, it is desirable to determine how to correct the technical issues. The Staff believes that it is difficult or perhaps impossible for the Commission to issue any order that would resolve this. Even disregarding the issue of regulation, a conference within this formal context may be beneficial to determine the direction of this utility by negotiation between the interested parties. One obvious issue is that of whether or not the owner of the sewer system will agree to fund corrections. It is also possible that the owner may be forced by DNR enforcement action to do so.

In summary, the Staff recommends that a prehearing conference be set in order to address the two fundamental issues; the first of which is that of regulation, and the second of which is the technical issues, which should be addressed in this context regardless of the regulation issue.