

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

Cathy J. Orler,)	
)	
Complainant,)	
)	
v.)	<u>Case No. WC-2006-0082, et al.</u>
)	
Folsom Ridge, LLC, Owning and Controlling)	
the Big Island Homeowners Association,)	
)	
Respondent.)	

RESPONSE TO ORDER DIRECTING FILING

COMES NOW the Staff of the Missouri Public Service Commission ("Staff"), by and through Counsel, and for its Response to Order Directing Filing ("Response") states the following to the Missouri Public Service Commission ("Commission"):

1. On October 18, 2005, the Commission issued its **Order Denying Motion to Dismiss, and Directing Staff to Investigate and Report** ("Order") in the instant case, wherein it directed the Staff to investigate the issues raised by the complaints that have been consolidated in this case, and to file a report regarding that investigation on or before February 9, 2006.

2. Included in the document that is attached hereto as Appendix A, and that is incorporated herein by reference, is the *Staff Report of Investigation*, which is being submitted in compliance with the above-referenced Order.

WHEREFORE, the Staff respectfully submits this Response for the Commission's information and consideration in this case.

Respectfully Submitted,

/s/ Marc D. Poston

Marc D. Poston
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CERTIFICATE OF SERVICE

I hereby certify that copies of this Response have been mailed with first class postage, hand-delivered, transmitted by facsimile or transmitted via e-mail to all counsel and/or parties of record this 9th day of February 2006.

/s/ Marc D. Poston

APPENDIX A

STAFF REPORT OF INVESTIGATION

CASE NO. WC-2006-0082 ET AL.

STAFF REPORT OF INVESTIGATION

Case No. WC-2006-0082 et al.

**Prepared By:
Jim Merciel & Martin Hummel
Water & Sewer Department**

February 9, 2006

BACKGROUND

On August 18, 2005, an individual person filed a formal complaint against Folsom Ridge, LLC (Folsom), owning and controlling the Big Island Homeowners Association (BIHOA). The BIHOA is purportedly an association of property owners, residents and utility customers that owns and operates a water and sewer system for the residents in the area. Within the next several weeks eight additional individual persons also filed formal complaints against Folsom.

The points raised in the various formal complaints are somewhat varied, and are summarized in Attachment 1. Some issues raised in these complaints are clearly matters over which the Commission has no jurisdiction. Common among all of the complaints are the claims that the BIHOA is not a legitimate association, but is controlled by the land developer in the area who constructed the water and sewer systems. A second common claim is that non-members of the BIHOA are essentially utility customers. As such, the BIHOA or perhaps the developer should be regulated as a water and sewer utility. Some complaints also allege that the water and sewer systems do not comply with the regulations of the Missouri Department of Natural Resources (DNR), and some allege improper or inconsistent rules and charges regarding service connections.

Among other activity in these complaint cases, all of which have been consolidated into this case, the Commission issued its Order Denying Motion to Dismiss, and Directing Staff to Investigate and Report on October 18, 2005, in which it directed the Staff to prepare a report. This report is intended to comply with that order.

OVERVIEW

The area known as Big Island is located north of Roach, MO in Camden County. The island is approximately 160 acres in size, with most of the present development along the lake shore. There have been individual property owners in the area for several decades, but now the Folsom developers are involved with structured land development. Additional development could be undertaken inland from lakefront lots, and also in an area that is located off of and adjacent to the island.

Folsom began constructing a wastewater treatment facility and a community water system in 1998, for use by both owners of newly developed lots and existing individual homeowners. Folsom had apparently planned to transfer ownership to some type of an association, although the BIHOA is an entity that is controlled not by the homeowners, but rather by the same people that control Folsom.

The existing customers consist of both full-time and part-time residents. There are currently approximately 50 customers. The water system is a single well system with a capacity to serve 65 residential customers, and the sewer system consists of a pressure collection system requiring pump units on customers' premises, and a recirculating sand filter treatment facility with capacity to serve 80 residential customers. Folsom's current plans are to provide capacity to serve a total of 230 customers.

One well-known deficiency of the utility system is that during construction, both the water pipelines and the sewer pipelines were placed in the same trench, contrary to plans submitted to and approved by the DNR, and in violation of the Missouri Clean Water Law and the Missouri Safe Drinking Water Law. Subsequently, per an April 2004 settlement agreement between Folsom and DNR (represented by the Office of the Attorney General), Folsom agreed to make corrections to the water distribution system. This construction error is being corrected at the cost of the developer.

RESOLUTION OF THE UTILITY-RELATED ISSUES

There is no question that central water and sewer facilities are desirable in this area. The Staff believes that among the problems associated with the water and sewer systems, one reason why these complaints were filed, and why the situation exists as it is, is that Folsom believed that it could create an association of utility customers, but retain for itself control of the association.

Based on its experiences with many types of small water and sewer utilities, both regulated and unregulated, the Staff firmly believes that a utility owned and controlled by an association should truly be controlled by the customers who get their utility service from their association. The Commission espoused three (3) criteria for such a "legitimate" association in Case No. WD-93-307, which involved utility assets that were previously owned by a regulated water utility, but were acquired by an association known as Rocky Ridge Ranch Property Owners Association. These three criteria, sometimes referred to by the Staff as the "Rocky Ridge Ranch Points," are as follows:

1. The association's membership must include all of its utility customers, and the association must operate the utility only for the benefit of its members;
2. The association must base the voting rights regarding utility matters on whether a person is a customer as opposed to allowing one (1) vote per lot, which would not be an equitable situation if a person or entity owned a majority of lots irrespective of whether each of those lots subscribed to the utility service; and
3. The association must own or lease the utility system so that it has complete control over it.

Based upon the above criteria, the Staff does not believe that the BIHOA is a "legitimate" homeowners association, since not all of its customers are members and, also since the developer has control of the association, not the customers. Also, as the Staff understands, the area in which utility service is being provided is not comprised of one subdivision with a single association of all lot owners. Rather, there are different platted areas within the overall service area with the provisions for separate associations of property owners. As a result, ownership of the utility systems by a single, normal homeowners association is not practical.

However, a type of utility that can be formed to operate sewer systems and water systems, and that is similar in nature to a subdivision association, is what is commonly called a "393 nonprofit utility." This type of utility is a not-for-profit corporation that is established, organized and operated in accordance with the provisions of Chapter 393, RSMo. Specifically, Sections 393.825 through 393.861 govern nonprofit sewer utilities and Sections 393.900 through 393.954 govern nonprofit water utilities. Generally, 393 nonprofit utilities are similar to homeowners associations in that the customers, and not a developer or other property owners, have control over the utility in that the utilities' customers are members of the utility corporation. One disadvantage of either a "legitimate" homeowners association or a 393 nonprofit utility, from a developer's point of view, might be that existing customers could assert some control over additional development. Another disadvantage, in this specific situation, is that there appears to be some disagreements between various people or groups of people that include the developers, some existing customers, and some residents who could become customers in the future. As a result, the level of cooperation needed to establish, organize and operate 393 nonprofit utilities may not exist.

Alternatively, Folsom, as the owner of the utility systems, could establish a regulated water and sewer company and obtain the necessary authority to operate such a company from the Commission, through the Commission's issuance of a certificate of convenience and necessity (CCN) for water and sewer service. Indeed, Folsom requested additional time after the prehearing conference held in this case on December 8, 2005, to consider this option and is still actively doing so. If Folsom or an affiliated utility company were to seek a CCN, they would need to show technical, managerial, and financial capacities. This means, among other points, that they would need to be able to show that they will continue into the future with proper construction, good day-to-day operations and management, prompt response to problems and issues, and adequate funding for needed improvements, expansions, and repairs. Specifically, Folsom would need to show how it will improve on these points as related to how these systems were constructed with the noted deficiencies. A strategy of utility management that is independent of the developers might be one answer to this issue. In a CCN case, the Staff would also need to obtain and study data on the utility systems that could include lengths and sizes of pipelines, capacities both existing and proposed, component costs, customer numbers, sources of capital, and proposed rules for such things as ownership and maintenance responsibility of sewer pump units on customers' premises. The source of capital for Folsom apparently includes capital contributions that have been paid by not only some existing customers but also some residents who are not yet connected.

Alternatives to 393 nonprofit utilities or certificates held by Folsom or an affiliate could include unrelated utility entities that would acquire the utility assets from Folsom, such as a public water/sewer district or another regulated utility. However, there are no such entities available at the present time.

CONCLUSIONS

The Staff believes that either Folsom needs to file an application for a CCN to provide water and sewer service under the Commission's jurisdiction, or that a group of customers needs to create appropriate 393 nonprofit water and sewer utility entities so that the utility systems may be operated in this manner. Although 393 nonprofit utilities are not regulated by the Commission, the Staff would be willing to assist the customers and Folsom regarding capital structure, rates and charges, and rules for pipeline extensions and system expansion for future development, as well as assisting as requested in the development of the 393 nonprofit utilities.

Regardless of the organizational structure that is established for these water and sewer utility systems, it is clear that the technical oversight and construction inspection needs to be improved over what has been done in the past. Additionally, the management of the utility needs to be independent of the developer, and neutral to issues regarding future land development, even if the developers are the owners of the utility.

Big Island/Folsom Ridge
Summary of Formal Complaints

WC-2006-0082 (Orler) – developer control, service to non-members, fees charged to non-customers

WC-2006-0090 (Pugh) – service to non-members, improper installation and permit compliance, improper real estate disclosure, developer control

WC-2006-0107 (Weir) – developer control, entity acts as a utility rather than an association, improper installation and permit compliance, DNR violations, county road violations, fees charged to non-customers

WC-2006-0120 (Temares) – improper real estate disclosure, developer control, entity acts as a utility rather than an association

WC-2006-0121 (Kentner) – entity acts as a utility rather than an association, utility charges, fees charged to non-customers, connection requirements

WC-2006-0122 (Schrader) – a promise to not charge fees to non-customers, improper real estate disclosure, improper installation and permit compliance, forfeit of the right to connect after a certain time, developer control, system capacity issues, threat and assault by utility/developer

WC-2006-0129 (Stoyer) – leaks from treatment plant, health hazard, improper installation and permit compliance, developer control, fees charged to non-customers, service to non-members

WC-2006-0138 (C. Fortney) – entity acts as a utility rather than an association, fees charged to non-customers, non-members forced to pay association fees, interference with real estate closure, developer control

WC-2006-0139 (D. Fortney) – non-members forced to pay association fees, a promise to not charge fees to non-customers, demand for past fees, interference with real estate closure, improper installation and permit compliance, forfeit of the right to connect after a certain time, service to non-members

AFFIDAVIT OF JAMES A. MERCIEL, JR.

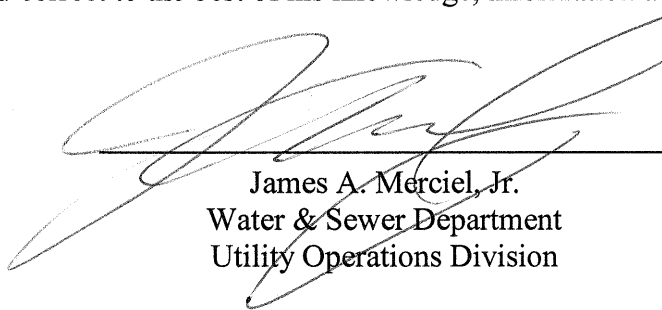
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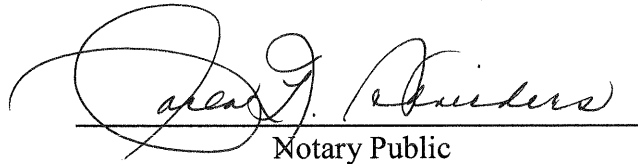
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COUNTY OF COLE)

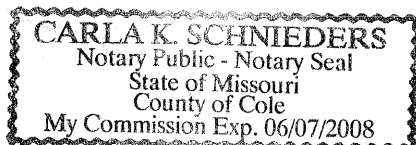
James A. Merciel, Jr., of lawful age, on his oath states: (1) that he is a member of the Staff of the Missouri Public Service Commission; (2) that he participated in the preparation of this Response to Order Directing Filing ("Response") and the *Staff Report of Investigation* ("Staff Report") included in the attached appendix; (3) that he has knowledge of the matters set forth in this Response and the Staff Report; and (4) that the matters set forth in this Response and the Staff Report are true and correct to the best of his knowledge, information and belief.


James A. Merciel, Jr.
Water & Sewer Department
Utility Operations Division

Subscribed and sworn to before me this 9th day of February 2006.


Notary Public

My Commission Expires: June 7, 2008



AFFIDAVIT OF MARTIN HUMMEL

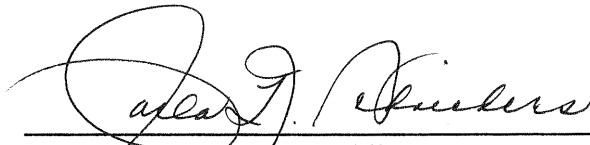
STATE OF MISSOURI)
) ss Case No. WC-2006-0082 et al.
COUNTY OF COLE)

Martin Hummel, of lawful age, on his oath states: (1) that he is a member of the Staff of the Missouri Public Service Commission; (2) that he participated in the preparation of this Response to Order Directing Filing ("Response") and the *Staff Report of Investigation* ("Staff Report") included in the attached appendix; (3) that he has knowledge of the matters set forth in this Response and the Staff Report; and (4) that the matters set forth in this Response and the Staff Report are true and correct to the best of his knowledge, information and belief.



Martin Hummel
Water & Sewer Department
Utility Operations Division

Subscribed and sworn to before me this 9th day of February 2006.



Notary Public

My Commission Expires: June 7, 2008

