

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

IN THE MATTER OF THE INVESTIGATION INTO)
THE UNAUTHORIZED ABANDONMENT OR DISCONTIN-)
UANCE OF WASTEWATER UTILITY SERVICES BY)
UTILITY SYSTEMS, INC., TO THE WOODS ON)
HERRING CREEK COMMUNITY AND THE ABILITY OF) PSC DOCKET NO. 05-58
UTILITY SYSTEMS, INC., TO OPERATE WASTE-)
WATER SYSTEMS SUBJECT TO THE JURISDICTION)
OF THE DELAWARE PUBLIC SERVICE COMMISSION)
(OPENED FEBRUARY 16, 2005))

IN THE MATTER OF THE INVESTIGATION INTO)
THE PROTEST OF THE WOODS ON HERRING CREEK)
HOMEOWNERS' ASSOCIATION REGARDING THE) PSC DOCKET NO. 04-WW-001
APPLICATION OF UTILITY SYSTEMS, INC., FOR)
A CERTIFICATE OF PUBLIC CONVENIENCE AND)
NECESSITY TO PROVIDE WASTEWATER SERVICES)
TO THE COMMUNITY (FILED OCTOBER 22, 2004))

FINDINGS, OPINION, AND ORDER NO. 6783

APPEARANCES:

On behalf of the Public Service Commission Staff:

Murphy, Spadaro & Landon, by
Francis J. Murphy, Esquire

On behalf of Utility Systems, Inc.:

Sergovic & Ellis, P.A., by
John A. Sergovic, Jr., Esquire

On behalf of the Woods on Herring Creek Homeowners' Association:

Wilson, Halbbrook & Bayard, P.A., by
Eric C. Howard, Esquire

This 22nd day of November, 2005, the Commission enters the following findings, determinations, and Order in these matters.

INTRODUCTION

1. These proceedings involve Utility Systems, Inc. ("USI"), a Delaware corporation that for many years has been in the business of providing wastewater services to several developments and communities in Delaware. These proceedings now play out before this Commission because in July 2004 the General Assembly and Governor decided to make certain private entities engaged in the operation of wastewater services, system plant, or equipment "public utilities" subject to the regulatory supervision of this Commission. 74 Del. Laws, ch. 317 § 1, amending 26 Del. C. § 102(2) (July 6, 2004) (adding "wastewater" to those services and systems that fall within the definition of "public utility").

2. The proceedings started from two prior Orders: first PSC Order No. 6506 (Nov. 9, 2004), and then PSC Order No. 6588 (Mar. 8, 2005). After proceedings conducted by a Hearing Examiner, and his submission of a 76-page Report with proposed findings and recommendations, the matters have now returned to the Commission for decision. While numerous "issues" are involved, at heart, the matters call upon the Commission to basically consider, and answer, four questions:

- (a) Did USI transgress a statutory obligation (26 Del. C. § 203C(c)(1)), and in turn PSC Order No. 6485 (Oct. 5, 2004), when it, in December 2004, withdrew from operating or maintaining its wastewater services and facilities in the "Woods on Herring Creek" service areas without first obtaining approval for such cessation from this Commission?¹

¹In Order No. 6485, this Commission ordered all "existing" wastewater utilities (which the Commission finds to include USI) to abide by all statutes and laws governing public wastewater utilities.

- (b) Did USI transgress a statutory obligation (26 Del. C. § 215(a)(1)), as enforced by PSC Order No. 6485 (Oct. 5, 2004), when it, in December 2004, sold three parcels of property held as plant in its "The Woods on Herring Creek" service area without first obtaining Commission approval?
- (c) Has USI fulfilled its statutory obligation (26 Del. C. § 308) to provide and maintain efficient, sufficient, and adequate public utility services and facilities at the "The Woods on Herring Creek" and "The Woodlands" communities?

and
- (d) Are sanctions, or remedial penalties, justified and appropriate for any of the above statutory or regulatory violations and defaults by USI and, if so, in what amount or form?

3. As noted above, the Hearing Examiner conducted an evidentiary hearing focusing on USI's operations and actions in its "The Woods on Herring Creek" ("WOHC") and "The Woodlands" ("Woodlands") service areas. In his Report, the Hearing Examiner, through a series of proposed findings of fact and conclusions of law, provides his recommended answers to each of the central questions. He also provides his recommendations for appropriate relief.²

4. The Commission adopts - as its own - almost all of the Hearing Examiner's Report, embracing both his factual findings and legal conclusions. Nothing presented in USI's exceptions, and nothing in the argument before the Commission, calls into question his determinations about the material facts in these matters. Similarly, after considering USI's lengthy exceptions, the Commission finds that

²See "Findings and Recommendations of the Hearing Examiner" at ¶ 158 (A)-(H) (Sept. 25, 2005) ("HE Rpt.").

the Hearing Examiner's legal rulings and legal conclusions are both appropriate and correct.

5. The Commission also adopts the Hearing Examiner's recommendations about appropriate responses and remedies but with a variation concerning the actual imposition, assessment, or collection of the monetary sanctions imposed under 26 Del. C. § 217 and the service quality penalties arising under 26 Del. C. § 308(a)(2). While the Commission agrees that such § 217 sanctions and § 308 penalties are appropriate and while the Commission also adopts the Examiner's assessment of the correct amounts of such sanctions and penalties, the Commission will not now assess and enforce those amounts to make them immediately due from USI. Instead, it defers assessment and collection of both the sanctions and the penalties for a six-month period. At that time, Staff shall report whether: (a) USI (as a public utility) is providing efficient, sufficient, and adequate wastewater services, products, and facilities in its Woodlands service territory; and (b) USI has cooperated with the Commission Staff, and the Woods on Herring Creek Homeowners' Association in restoring efficient, sufficient, and adequate wastewater service to the Woods on Herring Creek Community and defraying the costs involved in rectifying the inefficient, insufficient, and inadequate facilities and service that existed at the time USI unlawfully abandoned the Woods on Herring Creek wastewater system in December 2004. Based on the circumstances existing then, the Commission will revisit whether it might forgive, further defer, or (on the other hand) then assess all, or a portion of, the sanction and penalty amounts. If the Commission chooses to

further defer assessment and collection of any sanction or penalty amount, the Commission will then return for another reconsideration of those amounts one year from the date of this Order. In addition, the Commission will - relying on its determination that USI violated 26 Del. C. § 215(a)(1) by selling three lots in its WOHC utility plant without first obtaining Commission approval - direct USI to promptly take appropriate actions to return both title and possession of such parcels to USI.

6. The Commission emphasizes that its goal here is not to collect dollars but rather to ensure that consumers in these two communities have the benefit of efficient, sufficient, and adequate wastewater facilities and services. The § 217 sanctions stand as a reminder that statutory requirements dictated by the public utility regime serve important purposes and that a utility - even a "new" one - should not view compliance as merely optional.³ And the large § 308 penalties are intended to be coercive (and if unsuccessful remedial), not punitive. The Commission expects that the threat that these significant monetary sanctions and penalties might soon come to bear will induce USI to move with both effort and vigor to fully meet its public utility obligations.

³For example, here USI made the choice not to seek Commission approval prior to surrendering its wastewater operator's license for its WOHC system and leaving the operation of those facilities to others. That made USI, rather than the Commission, the final arbiter whether its exit would be "unduly disruptive to the present or future public convenience and necessity." 26 Del. C. § 203A(c)(3).

B. PROCEDURAL BACKGROUND

7. The Commission adopts the Hearing Examiner's summary of the prior "Procedural Background" in these two consolidated matters. HE Rpt. ¶¶ 1-11. To bring down the procedural chronology, the Commission notes that the Hearing Examiner filed his Report on September 25, 2005. USI filed lengthy exceptions, accompanied by a long affidavit from H. Clark Carbaugh, its President, on October 17, 2005. The Commission sat to consider the Examiner's Report and USI's exceptions at its public meeting on October 25, 2005. At that time, it heard argument, and rejoinder, from USI, The Woods on Herring Creek Homeowners' Association (an intervening party), and the Commission Staff. The Public Advocate also presented his view. This Order follows from the Commission's deliberations at such public meeting.

C. OPINION

(I) Findings and Conclusions

8. As noted before, the Commission adopts as its own almost all of the findings and conclusions proposed and recommended by the Hearing Examiner in his Report. Thus, for the purposes of the provisions called for by 29 Del. C. § 10128(b)(1), (2), and (3), the Commission adopts, and incorporates by reference into this Order, the following sections of the Hearing Examiner's Report: Section I, "Introduction;" Section II, "Jurisdiction;" Section III, "Evidentiary Motions and Due Process Objections;" Section IV, "Summary of the Evidence;" and Section VI, "Findings of Facts and Conclusions of Law."⁴

⁴Before the Hearing Examiner, USI challenged any consideration of "public comments" offered at a public comment session and later incorporated into a Staff witness's testimony. The Hearing Examiner recommended that the

9. In particular, the Commission finds that the Hearing Examiner correctly identified the central legal issues posed (HE Rpt. ¶¶ 12, 122), and the Commission adopts as its own the factual findings and reasoning he articulated to reach his legal determinations on each such central issue. See HE Rpt. ¶¶ 12-14 (jurisdiction); 123-35 (abandonment of WOHC service area without approval); 153-55 (conveyance of three parcels without approval); 141-42 (USI's financial capabilities); 143-47 (adequacy of facilities and services in the WOHC service area); 151-52 (adequacy of facilities and services in Woodlands service area).⁵

10. As to one particular issue that USI has raised, the Commission will offer some additional opinion. Repeatedly throughout these proceedings, USI has asserted a "no Certificate/no jurisdiction, no obligation" position: that USI was under no obligation to gain Commission approvals prior to ending its wastewater operations in the WOHC service area or prior to selling its three lots there because at the time of those actions it had not been awarded a Certificate of Public Convenience and Necessity ("CPCN") to provide its wastewater

Commission not rely on such incorporated comments in resolving "the facts." The Commission follows that course; the facts crucial to these matters do not turn on such "public comment" testimony. The Commission leaves for another day resolution of the question whether in a service quality investigation or proceeding it may "consider any service complaints by subscribers and the public" 26 Del. C. § 308(a)(2).

⁵In addition, the Commission adopts the Hearing Examiner's reasoning and rationale why he was not disqualified to hear the evidence and submit a Report in these matters. See HE Rulings dated June 2, 2005. The Commission also adopts the Hearing Examiner's reasoning and conclusions related to USI's evidentiary objections and its "due process" challenge that it was not accorded sufficient notice that it might face an investigation - and might be penalized under 26 Del. C. § 308 - due to the quality of its services and facilities in its WOHC and Woodlands service territories. HE Rpt. ¶¶ 15-25, 26-27, 28-30.

services to the WOHC area. According to USI, the Commission's regulatory authority over it - in the context of its wastewater services in the WOHC - could not accrue until it was awarded a CPCN to serve that area. Until that Certificate was issued by the Commission, it held no "public utility" status in its services and facilities in the WOHC. As such, it could not face any sanctions or penalties for its actions as a "non-public utility" serving a not-certificated service territory. The Hearing Examiner rejected that "jurisdictional" argument (HE Rpt. ¶¶ 12-14 and June 2, 2005 HE Ruling) and the Commission adopts his findings, rationale, and conclusions as to why USI did hold the status of a "public utility" in its facilities and services to the WOHC development. The Commission concludes that USI's argument runs counter to the generally accepted view that certification by a regulatory commission is not a condition precedent to an entity's classification as a "public utility." Status as a public utility (with its corresponding regulatory obligations) does not depend on the entity securing a certificate, but arises if the entity, in fact, is operating a business defined by the legislature as a public utility.⁶

11. In addition, as the Hearing Examiner determined (HE Rpt. ¶ 14), USI's "no-CPCN, no jurisdiction" construct is hard to square

⁶See 64 Am. Jur. 2d "Public Utilities" § 158 (Westlaw database updated Aug., 2005). Compare also J. M. Huber Corp. v. FPC, 236 F.2d 550, 556-57 (3d. Cir. 1956). ("The jurisdiction of the [Federal Power] Commission over a natural gas company conferred by Section 4(b) of the Act does not depend on whether that company fulfills its obligation under 7(c) to obtain a certificate.") and Sun Oil Co. v. FPC, 281 F.2d 275, 278 (5th Cir. 1960) ("The power of the Commission over [a company] and its sales and deliveries of gas is not dependent upon it having made an application for and the Commission having issued a Certificate of Public Convenience and Necessity.")

with the Public Utility Act in general and even more particularly the language and structure of the provisions that the General Assembly enacted in 2004 directed at subsuming existing "grandfathered" wastewater operations into the public utility regime. See 26 Del. C. §§ 203D(a)(2) (obligating each existing wastewater operation to file a descriptions of its facilities and existing service area and to obtain a certificate for existing service areas); § 301(c) (imposing rate regulation, under Commission supervision, on existing wastewater operations effective July 6, 2004).

(II) Sanctions, Penalties, and Other Remedies

12. The Hearing Examiner made recommendations that the Commission impose sanctions (under 26 Del. C. § 217) for USI's defaults in not seeking, and gaining, Commission approvals to abandon its services and facilities in the WOHC service area and to transfer the three lots held by it in that territory. HE Rpt. ¶¶ 136-39 (abandonment), 155 (transfer of three lots). He also recommended particular monetary amounts for those sanctions: (a) \$90,000 related to the abandonment (HE Rpt. ¶¶ 136-39); and (b) \$1,000 for the lot transfers (HE Rpt. ¶ 155). The Commission adopts the Hearing Examiner's findings and reasoning, both as to whether such sanctions are appropriate and the monetary amount of such sanctions for USI's failures to comply with its regulatory obligations. USI is found liable for those two amounts under § 217.

13. USI unlawfully abandoned the wastewater system at the WOHC at the end of December 2004. In addition, in December 2004, USI: (a) voluntarily relinquished the DNREC permits that authorized USI to

operate the WOHC wastewater system; and (b) informed the Commission that USI was withdrawing its application for a CPCN for the WOHC community wastewater system. Consequently, USI does not have any authority from DNREC to operate the WOHC wastewater system. And USI failed to comply with its obligation to seek and obtain a CPCN from the Commission, and therefore has no legal authority to operate the WOHC wastewater system as a public utility. In any event, the Commission did not institute Docket No. 05-58 with the intent of attempting to compel USI to resume operation of the wastewater system at the WOHC. USI's abandonment of the wastewater system at the WOHC was an accomplished fact when Docket No. 05-58 was opened, and the WOHC Homeowners' Association had already been forced to commence operating the wastewater system as a result of USI's unauthorized and unlawful conduct. Consequently, the Hearing Examiner was charged with determining the appropriate conditions to impose upon USI under 26 Del. C. § 203A(c)(4) in connection with USI's unauthorized and unlawful abandonment of the WOHC wastewater system. The Hearing Examiner recommended that the Commission impose a penalty, under 26 Del. C. § 308(a)(2), upon USI as a means to restore the wastewater facilities and service in the WOHC community, and as a condition of abandonment under § 203A(c)(4). In addition, the Hearing Examiner recommended that the Commission impose a penalty, under § 308(a)(2), upon USI as means to restore the wastewater facilities and service at the Woodlands Community to a state of efficiency, sufficiency, and adequacy. HE Rpt. ¶¶ 143-52.⁷ The Hearing Examiner recommended

⁷USI never received Commission approval to abandon services and

monetary amounts for those § 308 penalties. HE Rpt. ¶¶ 14 8-49 (\$250,000 for WOHC); 150-52 (\$150,000 for Woodlands). The Commission adopts the Hearing Examiner's conclusion (and findings) that § 308(a)(2) penalties are appropriate. The Commission also adopts the Hearing Examiner's findings and reasoning as to the appropriate amount of such § 308(a)(2) penalty for each of the two separate service territories.

14. The Commission will, however, direct something slightly different about how the § 308 penalties will be "assessed" or "imposed." In the past, the Commission has utilized rate-of-return or rate reductions as the form of "penalty" under § 308(a)(2) in order to induce a utility to bring its services and facilities up to the level of adequacy and sufficiency required under § 308. In this instance, the Commission will use monetary penalties under § 308(a)(2) but apply them with a similar goal and in a somewhat similar manner. The Commission expects that the presently inadequate services and facilities at the WOHC and Woodlands service territories can be made adequate, efficient, and sufficient within one year from the date of this Order. Based on that expectation, the Commission will defer

facilities in the WOHC community, and could be held responsible for restoring the wastewater services and facilities in the community as a condition of abandonment. Compare United Gas Pipe Line Co. v. FPC, 385 U.S. 83, 91 (1966) ("We hold only that United has abandoned facilities and services without the consent of the Commission and must reactivate those facilities and restore the service until and unless the statutory consent is obtained"). Compare also United Gas Pipe Line Co. v. McCombs, 442 U.S. 529, 543 (1979) ("[W]e hold that § 7(b) requires respondents to continue supplying in interstate commerce all gas produced from the leasehold until they properly obtain permission for abandonment"). USI thus has the continuing obligation (under § 308) to ensure that adequate utility services and facilities exist in the WOHC service area.

imposition and assessment (i.e., collection) of the § 308 monetary penalties at this time. Rather, six months from the date of this Order, Staff shall file a Report as to the then condition of the wastewater service and facilities in the WOHC and the Woodlands. At that time, the Commission will revisit the question of imposition of the § 308 penalties. At the end of six months, the Commission may reconsider whether collection of all, or a portion, of the § 308 penalties is still appropriate. In addition, the Commission may rethink the amount of the § 308 penalties and may choose to further defer whether to impose any remaining penalties until the end of the one-year period. But conversely, depending upon the circumstances that exist at the end of six months, the Commission might then determine to assess, and seek to collect, the § 308 monetary penalties, in full or in part.⁸ In like fashion, at the end of the one-year period, the Commission will again reconsider the assessment of the § 308 monetary penalty amounts after Staff submits another survey of the condition of the facilities and services at that time.

15. The Commission believes this approach has several advantages. First, the "hanging" nature of the significant § 308 penalty dollar amounts clearly provides USI with an incentive to cooperate with the Commission Staff, its former customers at the WOHC, and its current customers at the Woodlands to improve the wastewater facilities and services in these communities. Moreover, within the one-year window for improvement, USI can use its funds to improve the

⁸Of course, this process would not foreclose the Commission from then pursuing other remedies at these review times.

services and facilities rather than paying the penalty amounts. At the same time, if efficient, sufficient, and adequate services and facilities are not restored, then subsequent assessment and collection of the § 308 monetary amounts might provide a "pool" of funds that the Commission might consider returning to those really injured by the ongoing inadequate facilities - USI's customers in those areas. They are the ones who will have continued to pay "full" rates for continued inadequate services.

16. For the same reasons, the Commission will also forego seeking present enforcement and collection of the \$91,000 in § 217 sanctions. Such enforcement and collection will be deferred for reconsideration at the six-month and one-year intervals when the Commission will reconsider assessment and collection of the § 308(a)(2) penalties. Again, the monies that might be used to pay § 217 sanctions will surely be better now spent by USI to improve its facilities and services in the two service territories. If adequacy promptly comes to the services and facilities in those two service areas, the Commission can then determine whether to forgive enforcement of the § 217 sanctions or rescind the sanctions in their entirety.

17. The Commission will also impose one additional obligation on USI not specifically recommended by the Hearing Examiner. The Examiner determined that USI had violated 26 Del. C. § 215(a)(1) by transferring the three lots it held in its WOHC service territory without first seeking, and obtaining, Commission approval. HE Rpt. ¶¶ 153-55. As noted above, the Commission accepts and adopts the

Hearing Examiner's findings and conclusion that USI, without cause, failed to obtain the necessary § 215 approval. The Commission believes that, without such prior approval, such transfers were, and remain, in violation of the law. While the Commission may not generally have the authority to reform land transactions, the Commission believes that, in this context, it does hold the power to order USI to promptly take steps to restore the parcels to its utility plant until such time as it might later receive Commission approval for any such transfer.⁹ Here, the non-approved transfer of plant was made from USI to an entity controlled in major part by USI's President. This relationship suggests that USI holds the power to now undo these transactions. To give USI added incentive, the Commission will consider foregoing any enforcement and collection of the § 217 sanction imposed on USI related to these transfers if USI promptly restores legal title to these transferred properties to its utility plant.¹⁰

III. Other Objections and Exceptions

18. In this Order, the Commission has not explicitly spoken to a myriad of other objections and exceptions presented or renewed by

⁹Compare Public Water Service Co. v. Penna. PUC, 645 A.2d 423, 426-27, 429 (Pa. Commwlth. 1994) (upholding utility commission's directive that utility return assets and property that it had acquired from other utilities without having first obtained required commission approval).

¹⁰The Hearing Examiner recommended that several additional accounting and reporting requirements be imposed on USI. HE Rpt. ¶¶ 156-57. Given the past conduct of USI in this matter and the current status of its facilities and services in two of its service territories, the Commission adopts the Hearing Examiner's recommendations that USI be subject to five additional reporting, accounting, and escrow fund payment requirements. See 26 Del. C. §§ 205(a), 209(a).

USI. The Commission has considered them. To the extent those issues were litigated before the Hearing Examiner, the Commission adopts his resolution of the issues, including his findings and reasoning. To the extent USI has asserted other factual or legal challenges not heard by the Hearing Examiner, the Commission finds them insufficient to call into question either the Commission's resolution of the central issues in these matters or the relief the Commission now enters.

Now, therefore, **IT IS ORDERED THAT:**

1. To the extent described in the body of this Order, the Commission specifically adopts the summaries, findings of fact, conclusions of law, and reasoning and rationales set forth in the "Findings and Recommendations of the Hearing Examiner," dated September 26, 2005. Such "Findings and Recommendations," a copy of which is attached to the original of this Order as Exhibit "A," are incorporated into this Order.

2. Any exceptions filed by Utility Systems, Inc. related to the June 2, 2005 decision of Senior Hearing Examiner William O'Brien denying the Motion to Strike and Disqualify Hearing Officer are hereby rejected for the reasons articulated by the Hearing Examiner. The Commission adopts, as its own, the June 2, 2005 decision of the Hearing Examiner on those issues.

3. As more fully explained in the body of this Order, the Commission adopts as its determination and action on the case (as referred to in 29 Del. C. § 10128(b)(5)) Section VII, the "Summary of Recommendations" set forth in the Findings and Recommendations of the

Hearing Examiner dated September 26, 2005, as well as the recommendations incorporated into Section VII and set forth elsewhere in such September 26, 2005 Findings and Recommendations but with the following modifications (that are more fully explained in the body of this Order):

- (a) Pursuant to 26 Del. C. § 217, the Commission now finds Utility Systems, Inc., liable for the sanctions identified in the September 26, 2005 Findings and Recommendations of the Hearing Examiner at paragraph 158, Part D (\$90,000) and Part G (\$1,000). Pursuant to 26 Del. C. § 308(a)(2), the Commission now finds Utility Systems, Inc., liable for the penalties identified in the September 26, 2005 Findings and Recommendations of the Hearing Examiner at paragraph 158 Part E (\$250,000) and Part F (\$150,000). The enforcement and assessment of these sanctions and penalties are deferred for a period of six months from the date of this Order. At that time, the Commission will again consider the enforcement and assessment of such sanctions and penalties after determining whether Utility Systems, Inc., has taken appropriate steps toward restoring efficient, sufficient, and adequate wastewater facilities and services as required by 26 Del. C. § 308 in the "The Woods on Herring

Creek" and "The Woodlands" communities. As explained in the body of this Order, the Commission may also further defer its reconsideration of those sanctions and penalties until one year after the date of this Order.

- (b) The December 2004 transfer and sale of three parcels of land (described as lots 5, 6, and 7) located at "The Woods on Herring Creek" development from Utility Systems, Inc., to Carbaugh Property Management, LLC, having been done without Commission approval, is declared to be in violation of 26 Del. C. § 215(a)(1). Therefore the transaction conveying the three lots is found to have been illegal. Utility Systems, Inc., shall take appropriate actions to have the title and possession of such parcels returned to the utility plant of Utility Systems, Inc., within ninety days from the date of this Order. If Utility Systems, Inc., reverses those earlier sales and transfers within such time, the Commission will then reconsider whether to forego enforcing and whether to revoke the \$1,000 sanction set forth in paragraph 158 Part G of the Findings and Recommendations of the Hearing Examiner. On or before 90 days from the date of this Order, Utility Systems, Inc., shall file a

report with the Commission reporting whether, and when, the title and possession of such parcels have been returned to the utility plant of Utility Systems, Inc.

4. The Commission has taken notice of Section IV "Summary of Public Comment" in the Hearing Examiner's Findings and Recommendations, as well as the unsworn written and oral public comments received in these proceedings, but does not rely upon Section IV of the September 26, 2005 Findings and Recommendations, or any unsworn public comments, as a basis for the determinations made in these Findings, Opinion, and Order.

5. The exceptions filed by Utility Systems, Inc. to the September 26, 2005 Findings and Recommendations of the Hearing Examiner, including the Supplemental Exceptions set forth in the Affidavit of H. Clark Carbaugh, President of Utility Systems, Inc., are denied.

6. The Commission Staff shall promptly, at the end of six months from the date of this Order, submit to the Commission a Report concerning the then adequacy, sufficiency, and efficiency of the services and facilities of Utility Systems, Inc. in its "The Woods on Herring Creek" and "The Woodlands" service territories. The Report shall specifically note what, if any, improvements have been made to those services or facilities since the date of this Order. Staff shall serve the copy of such Report on Utility Systems, Inc.

7. That this Order, and the actions required under it, shall be effective as of the date of this Order.

8. The Commission retains jurisdiction in this matter, including the authority to enter such further Orders and conduct such further proceedings as it deems just, proper, or appropriate.

BY ORDER OF THE COMMISSION:

/s/ Arnetta McRae
Chair

/s/ Joann T. Conaway
Commissioner

/s/ Jaymes B. Lester
Commissioner

Commissioner

/s/ Dallas Winslow
Commissioner

ATTEST:

/s/ Karen J. Nickerson
Secretary

E X H I B I T "A"

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(FILED OCTOBER 22, 2004))

FINDINGS AND RECOMMENDATIONS OF THE HEARING EXAMINER

DATED: SEPTEMBER 26, 2005

WILLIAM F. O'BRIEN
HEARING EXAMINER

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FINDINGS AND RECOMMENDATIONS OF THE HEARING EXAMINER

William F. O'Brien, duly appointed Hearing Examiner in this Docket pursuant to 26 *Del. C.* § 502 and 29 *Del. C.* ch. 101, by Commission Orders Nos. 6506 (Nov. 9, 2004) and 6588 (Mar. 8, 2005) reports to the Commission as follows:

I. INTRODUCTION

A. Appearances

On behalf of the Public Service Commission Staff:

Murphy, Spadaro & Landon, by

Francis J. Murphy, Esquire.
On behalf of Utility Systems, Inc.:

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John A. Sergovic, Jr., Esquire.

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Eric C. Howard, Esquire.

B. Procedural Background

1. On July 6, 2004, the Delaware General Assembly enacted new legislation, found at 74 Delaware Laws, Chapter 317, which granted the Delaware Public Service Commission (the "Commission") jurisdiction to regulate certain wastewater utilities having more than fifty customers, including the jurisdiction to grant and revoke Certificates of Public Convenience and Necessity ("CPCNs"). Under the new law, any person or entity in the business of a Wastewater Utility as of June 7, 2004, and subject to the supervision and regulation of the Commission under the new legislation, was required to obtain from the Commission a CPCN for its existing service areas by December 3, 2004.

2. On July 12, 2004, Utility Systems, Inc. ("USI"), a community wastewater system management company, filed a Complaint in the Court of Chancery against The Woods on Herring Creek Homeowners' Association ("Association") seeking approximately \$360,000 in contract damages relating to its operation of the wastewater system at The Woods on Herring Creek Community ("Herring Creek" or "WOHC"), which is located near Millsboro, Delaware. On August 16, 2004, the Chancery Court entered a preliminary injunction order prohibiting the Association from interfering with the wastewater system and directing

the Association to pay USI's ongoing operating expenses out of approximately \$30,000 that it held in escrow, which it had collected from Herring Creek property owners for wastewater service.

3. On October 1, 2004, USI filed three separate applications with the Commission for CPCNs to continue to provide wastewater services to Herring Creek, Gull Point Condominiums ("Gull Point") and The Woodlands of Millsboro ("Woodlands"). Those applications were docketed as 04-WW-001, 04-WW-002, and 04-WW-003, respectively. On November 24, 2004, the Commission granted CPCNs to USI for its Gull Point and Woodlands wastewater systems. Regarding the Herring Creek application, however, the Commission received letters dated August 19, 2004, and October 21, 2004, from the Association requesting that the Commission deny a CPCN to USI and requesting a hearing on its complaints. On November 9, 2004, the Commission directed Staff to investigate the Association's complaints and referred USI's CPCN application for Herring Creek to a Hearing Examiner to conduct proceedings on the matter. (PSC Order No. 6506 (Oct. 1, 2004).)

4. On December 15, 2004, USI sent a letter to the Hearing Examiner advising that: (a) USI intended to relinquish its permits from DNREC to operate the wastewater system at Herring Creek as of December 20, 2004; and (b) concurrently, effective December 20, 2004, USI was withdrawing its application for a CPCN to serve Herring Creek. On December 31, 2004, USI ceased operating and maintaining the Herring Creek wastewater system, without filing an application with the Commission seeking approval to abandon or discontinue its operation of the system, under 26 Del. C. § 203A(c)(1).

5. On March 8, 2005, the Commission initiated the above-captioned complaint proceeding against USI for the purpose of investigating, among other things: (a) whether USI unlawfully abandoned or discontinued its operation of the Herring Creek wastewater system; and (b) whether USI has the financial capability to operate the Gull Point and the Woodlands wastewater systems. (PSC Order No. 6588.) In addition, the Commission consolidated the complaint proceeding (PSC Docket No. 05-58) with the CPCN proceeding (PSC Docket No. 04-WW-001), and referred the matter to a Hearing Examiner.

6. On March 9, 2005, the Association requested, and was subsequently granted, intervention in the consolidated proceeding as a party. The parties then established a procedural schedule, which included a public comment hearing, a discovery period, submission of pre-filed written testimony, and evidentiary hearings.

7. On the evening of May 17, 2005, I conducted a duly-noticed public comment hearing near Millsboro, Delaware. Approximately 100 members of the public appeared, with twenty-three offering oral comment, which is summarized below. In addition, approximately fifteen customers from Herring Creek submitted written comments by either e-mail or by regular mail.

8. On May 31, 2005, USI filed a "Motion to Strike & Disqualify the Hearing Officer" seeking to exclude from the record the statements made by customers at the public comment hearing as well as the pre-filed written testimony of Staff's witnesses. USI also sought to disqualify me as the Hearing Examiner alleging bias resulting from my

exposure to the customer statements and the pre-filed testimony. Also on May 31, 2005, USI filed a "Motion to Dismiss and Motion in Limine" seeking to dismiss the case for lack of jurisdiction (or, in the alternative requesting a stay until the Chancery Court completed its case involving USI and the Association) and seeking to preclude Staff from proposing statutory penalties (under 26 *Del. C.* § 308) for any conduct of USI that is unrelated to the question of whether USI unlawfully abandoned the Herring Creek system. On May 31, and June 1, 2005, Commission staff filed responses to USI's motions. By letter dated June 2, 2005, I denied each of the motions. Then, later on June 2, 2005, USI filed a "Motion for Reconsideration" regarding the earlier motions.

9. On June 6, 8, and 17, 2005, I conducted duly-noticed evidentiary hearings. Prior to commencing the hearings, I heard argument on USI's Motion for Reconsideration. I granted one portion of the motion, regarding whether USI received adequate notice in this proceeding of Staff's intention to seek penalties under 26 *Del. C.* § 308 for inadequate service, which is discussed below. In addition, just prior to the hearing, USI submitted a written "Motion to Strike Testimony" seeking to exclude numerous portions of Staff's pre-filed testimony, which I deferred until Staff had an opportunity to respond, and which is discussed below.

10. On June 21, 2005, Chancery Court conducted its hearing on USI's complaint. As of the date of this report, Chancery Court has yet to issue its decision in that case.

11. At the conclusion of the PSC hearing, the record in this case consisted of 53 exhibits and 867 pages of verbatim transcripts. In accordance with the post-hearing schedule, as modified after the hearing, Staff filed its opening brief on June 30, 2005, USI filed its answering brief on August 1, 2005, and Staff filed its reply brief on August 17, 2005.¹¹ I have considered all of the record evidence, as well as the post-hearing briefs and, based thereon, I submit for the Commission's consideration these findings and recommendations.

II. JURISDICTION

12. In its May 31, 2005 Motion to Dismiss, USI argued that the Commission lacks jurisdiction because: (a) jurisdiction hinges on a finding that USI held title to the Herring Creek wastewater system on July 6, 2004, the day the Commission was granted jurisdiction over wastewater utilities, and that such a finding can only be made by Chancery Court in its case now pending between USI and the Association; and (b) the Commission has not "perfected" its jurisdiction over USI because it has yet to grant it a CPCN for the Herring Creek system. In my June 2, 2005 letter, however, I agreed with Staff that Commission jurisdiction depends neither on a finding regarding ownership of the system nor on the granting of a CPCN and that, under 26 *Del. C.* §§ 102(2), 201(a) and 203D, the Commission has jurisdiction over USI because USI "operated" the Herring Creek wastewater system after July 6, 2004, with or without a CPCN.

¹¹ Staff's opening brief and reply brief will be cited as "Staff OB at ___" and "Staff RB at ___." USI's answering brief will be cited as "USI AB at ___."

13. In its post hearing brief, USI renewed its jurisdictional challenge arguing that without a CPCN, USI could not exercise legal control over the Herring Creek system and that the Commission has no authority to penalize USI when USI did not hold a CPCN for Herring Creek at any time. (USI AB at 12-18.) Again, because USI operated the Herring Creek wastewater system after July 6, 2004, when state law granted the Commission regulatory authority over wastewater systems, USI meets the definition of a "public utility" over which the Commission has jurisdiction. 26 Del. C. § 102(2). It is undisputed that USI operated the system under DNREC permits in the second half of 2004 (*i.e.*, USI ran the equipment, contracted for waste hauling, billed customers and received funds, etc.), as USI has admitted in numerous contexts.¹² (Staff RB at 3-6.) In fact, USI stipulated to a preliminary consent order from Chancery Court in August of 2004, whereby the Association would pay USI its expenses for operating the system.

14. Furthermore, if USI were correct that the Commission must grant a CPCN in order to perfect jurisdiction, then wastewater service providers existing in Delaware when the Commission obtained wastewater authority could avoid regulation simply by refusing to apply for a CPCN, which would thwart the purpose of the wastewater legislation and produce an absurd result. Moreover, the statutory sections defining

¹² See, for example, USI's December 17, 2004 letter to the Herring Creek property owners informing them that while it has continued to "take care of" the system facilities and waste hauling pending the Chancery Court decision, it would now cease to do so at noon on December 31, 2004. (St. Ex. 21.) See also, Tr. 666, where Clark Carbaugh, USI's majority owner, agrees that he admitted, in Chancery Court, that USI provided wastewater collection and treatment services to Herring Creek in December 2004.

the Commission's jurisdictional authority in no way limit jurisdiction to those public utilities that hold CPCNs. For these reasons, I recommend that the Commission conclude that it has jurisdiction over USI in this matter pursuant to 26 Del. C. §§ 102(2), 201(a) and 203D.

III. EVIDENTIARY MOTIONS AND DUE PROCESS OBJECTIONS

A. USI's Objection Regarding Staff Counsel's Involvement in Drafting Pre-filed Testimony

15. In its brief, USI objected to "the practice of PSC Counsel drafting, in part, pre-filed testimony" as a violation of due process. (USI AB at 19-20.) At the hearing, USI counsel asked Staff witness Neilson, regarding his pre-filed testimony, "[who] put the words in?" and Mr. Neilson answered "I did part of that." Mr. Neilson then stated that he had "help from my lawyer." (Tr. 292-3.) USI argues that if counsel drafted portions of Mr. Neilson's testimony, then there is no way of telling what testimony is premised on Mr. Neilson's first hand knowledge and what is not.

16. At the hearing, however, when the Hearing Examiner questioned the relevance of USI's inquiries, rather than express his concern regarding the source of any information contained in the testimony, USI counsel simply dropped his line of questioning. (Tr. 294.) Had counsel explained his concerns, someone could have questioned Mr. Neilson about the source of his knowledge for any particular statement in his testimony, if the source were unclear from the testimony. Without counsel indicating what testimony required

further exploration as to its source, we had no chance to determine whether USI's concerns were warranted.

17. More importantly, however, USI did have the opportunity to question Mr. Neilson as to his source for any part of his testimony, as is routinely done in cross-examination. Even with this opportunity, which encompassed sixty-seven pages of transcript, USI asserts no specific objections regarding the source of Mr. Neilson's knowledge for any particular statement contained in his testimony, other than the hearsay objections addressed below. In addition, Mr. Neilson adopted the pre-filed testimony as his own under oath and, therefore, swore to his belief in its accuracy, notwithstanding any drafting or editing assistance he received from his counsel. For these reasons, I recommend that the Commission deny USI's objection regarding any assistance Staff Counsel provided to Mr. Neilson in drafting his testimony.

B. USI's Motion to Strike Hearsay Testimony

18. At the hearing, USI submitted a written Motion to Strike Testimony ("Motion"), dated June 6, 2005, seeking to exclude numerous portions of Staff's pre-filed testimony, as well as documentary exhibits, alleging that the statements are hearsay. While USI acknowledges that hearsay evidence is generally admissible at administrative hearings, it argues that hearsay cannot be used to establish a pivotal issue or be the sole basis for a decision.¹³

¹³ Citing *Shirley Barbour v. Unemployment Insurance Appeals Board*, Del.Super., C.A. No. 89A-MR-4, Herlihy, J. (October 26, 1990); *Dobnack v. Colonial Sec. Service*, 2003 WL 168631, *3 (Del.Super., 2003) (holding "Under Delaware law, the Board may not base its decision solely on hearsay; hearsay evidence is

(Motion at 2-3.) According to USI, the excessive use of hearsay violates USI's due process rights. USI identifies fifteen portions of testimony it alleges as hearsay, which it asserts should not form the basis of a decision. (Motion at 3-8.) In addition, USI supplemented its Motion during the hearing with several other hearsay objections. (See, e.g., Tr. 159.)

19. Staff, on the other hand, argues that Delaware law does not prohibit the Commission from basing a finding on uncorroborated hearsay evidence. (St. OB at 46; RB at 23.)¹⁴ More importantly, however, Staff argues, and I agree, that in no instance does Staff ask the Commission to make a finding that would be based solely on hearsay evidence and nowhere does USI identify such an instance. (*Id.* at 23-24.) Even if USI is correct on the law, therefore, the hearsay in this case is admissible because, in all instances, it is accompanied by other probative evidence sufficient to support the findings and recommendations proposed by Staff.

20. Furthermore, as argued by Staff, much of the disputed evidence meets one of the exceptions to the hearsay rule, which apply to certain types of hearsay that carry heightened reliability. (Staff RB at 25-30.) For example, USI objects to many of the documents that Staff obtained from the files of the Department of Natural Resources and Control ("DNREC") and the Division of Public Health ("DPH"), which

permissible if it accompanies other probative evidence sufficient to support the finding").

¹⁴ *Citing*, among other Delaware cases, *Sirkin and Levine v. Timmons*, 652 A.2d 1079, 1084 (Del. Super. 1994); *Levine v. Timmons*, *supra*; *Ridings v. Unemployment Ins. Appeal Bd.*, 407 A.2d 238, 240 (1979) (holding that all evidence which could conceivably throw light on the controversy should be heard by an administrative agency).

meet the definition of hearsay yet fall squarely within the public records exception to the hearsay rule. (St. RB at 26, *citing* D.R.E. 803(8).)

21. In its reply brief, after arguing generally that the Commission may admit and consider all hearsay evidence, Staff specifically addressed each of USI's objections. (St. RB at 24-35.) For most of the objections, Staff cited either corroborating evidence (in many cases, USI's own testimony and exhibits), or exceptions to the hearsay rule, or both.¹⁵ For the reasons provided by Staff, I recommend that the Commission overrule USI's hearsay objections and admit the disputed testimony, other than that regarding public comment, as addressed below.

22. I recommend that the Commission grant USI's Motion as it relates to Staff witness Nielson's recitation of un-sworn public comment. My recommendation, however, relates to established Commission practice and maintaining clarity of the record, rather than on USI's assertion that it constitutes inadmissible hearsay evidence. In his supplemental pre-filed testimony, Staff witness Neilson repeated many of the statements made by customers at the May 17, 2005 public comment hearing. (St. Ex. 6 at 2 (line 8) - 6 (line 7); at 9 (line 3) - 10 (line 11).)

23. Certainly, Staff may use public comment to direct its investigation and it may provide the results of its investigation in testimony. If Staff's investigation leads it to conclude that

¹⁵ For one hearsay objection, however, Staff simply agreed to remove the disputed testimony from the record. I have stricken, therefore, the one full sentence found at lines 22-27 of page 8 of Staff Exhibit No. 32 (Ambrose).

complaining customers have accurately described utility action (or inaction) that relates to its recommendations, then Staff may describe in its testimony the utility action (or inaction) involved and may summarize the public comment that prompted that part of its investigation. After all, Staff's investigation would likely include follow-up (*i.e.*, clarifying) questions for customers in an interview setting, physical inspection of the facilities (when applicable), as well as possible corroboration with other customers or utility representatives; all of which enhances the reliability of the statements from customers. However, to simply repeat un-sworn, un-verified customer statements in its testimony, contradicts long-standing Commission practice of separating, for evidentiary purposes, public comment and sworn testimony.

24. Furthermore, public comment already has a place in the Hearing Examiner's report and the Commission, therefore, still has the opportunity to consider such comment when deliberating. As is the custom now, however, a summary of public comment is clearly delineated in the report and separated from the summary of evidence. In this way, the risk of confusion between witness testimony, which has been sworn to and tested by cross-examination, and public comment, which is un-sworn and un-tested by cross-examination, is minimized.

25. For these reasons, I recommend that the Commission grant only that portion of USI's motion to strike that relates to Staff witness Neilson's pre-filed supplemental testimony in which he repeats the oral statements made by customers at the public comment hearing (*i.e.*, St. Ex. 6 at 2 (line 8) - 6 (line 7); at 9

(line 3) - 10 (line 11). As noted above, however, these statements are summarized in this Report, under the "Summary of Public Comment" section.

C. USI's Motion to Strike Legal Conclusions in Lay Testimony

26. In its June 6, 2005 Motion to Strike Testimony, USI also seeks to exclude thirty-eight separate portions of Staff's pre-filed testimony that it believes constitute improper legal conclusions from non-lawyer witnesses. (Motion at 3-8.) In its reply brief, Staff argues that any such legal conclusions would, at most, constitute harmless error because there is no lay-jury in this case that may be improperly swayed by such testimony. (St. RB at 37.) Staff also argues that it did not rely on any of the disputed testimony in making its conclusions and that many of the legal statements were included in testimony only for the purpose of putting USI on notice of its positions and recommendations in this case so that USI would have sufficient opportunity to prepare its defense. In any event, Staff addresses each of the objections and argues that it relied on none of the identified legal conclusions for its case and agreed that many of such statements could be disregarded. (St. RB at 38-40.)

27. In this case, therefore, as in any case, I recommend that the Commission make no legal conclusions based on the testimony of lay witnesses but, instead, rely on its own counsel and on those Delaware attorneys appearing in this case on behalf of the parties. I will note, however, that members of Commission Staff must apply Commission regulations to fact situations daily in performing their duties and, in the context of litigation, must make recommendations based on those

opinions. As such, while the Commission should not make a decision regarding a disputed legal issue on the basis of a lay witness's testimony, it need not exclude those portions of testimony that necessarily include certain opinions regarding regulatory violations. In addition, as suggested by Staff, the disputed legal conclusions that Staff included as notice to USI may be disregarded for purposes of deciding the legal issues, without actually striking them from the record. For these reasons, I recommend that the Commission deny USI's Motion to Strike as it relates to legal conclusions by lay witnesses.

D. Motion in Limine Regarding Notice of the Possibility of § 308 Penalties

28. Staff's recommendations include substantial penalties for inadequate service or facilities under § 308(a)(2) of Title 26. USI argues that in setting up this investigation, the Commission did not include consideration of penalties under § 308 and that USI, therefore, did not receive adequate notice that it could be subject to such penalties in this case. After initially denying USI's motion, I granted reconsideration of the motion at the hearing so that the Commission would consider the issue. At the time, I believed that there was some merit to the argument that when a Commission order clearly specifies certain areas of investigation (not including § 308) and then adds a general catch-all provision permitting investigation of any other matter, adequate notice of the possibility of § 308 penalties has not been provided.

29. I recommend, however, that the Commission deny the motion, for the following reasons. First, in authorizing Staff to investigate "any other matter related to the issues presented in [PSC Docket 05-58] or PSC Docket No. 04-WW-001" and directing the Hearing Examiner to "address whether further relief is just and proper, including whether the imposition of any statutory penalties on [USI] is appropriate," the Commission explicitly provided Staff substantial leeway in shaping its investigation and recommending penalties. (Order No. 6588 at ordering paragraph No. 4.) In setting up Docket No. 04-WW-001, in fact, the Commission referenced the Association's complaints regarding the adequacy of USI's facilities and service. (Order No. 6506 at page 2.) Investigating § 308 service quality issues and recommending § 308 penalties, therefore, was not outside the scope of this proceeding.

30. Second, Staff provided sufficient notice to USI of its § 308 recommendations to enable USI to prepare a defense, which satisfies its due process obligation regarding notice. In fact, USI was aware as early as May 11, 2005, when staff served USI with Mr. Neilson's direct pre-filed testimony. (St. OB at 61.) At that time, USI could have sought a continuance if it believed it lacked time to defend the § 308 charge, but it did not. Rather, USI in fact prepared and presented a vigorous defense of its actions relating to the condition of its facilities and the quality of service it provided. For these reasons, therefore, the Commission should deny USI's Motion in Limine regarding § 308 penalties.

IV. SUMMARY OF PUBLIC COMMENT

31. Twenty-two residents of Herring Creek and one resident of Gull Point offered oral comments at the May 17, 2005 public comment hearing. (Tr. at 21-76.) Their comments included the following complaints or concerns:

After paying approximately \$3,000 in hook-up fees and quarterly fees escalating from \$96 in 1998 to \$268, the wastewater system still does not work, despite repeated promises from USI of a new, state-of-the-art system;

When USI left the system at the end of December 2004, the facilities were in poor or inoperable condition, the locks had been removed from the tanks, the drain fields were littered with debris, and the Association had difficulty getting the power and phone service turned back on;

When homeowners built or bought their homes, USI did not inform them that the wastewater system was failing;

Certain holding tanks, which are shared between two neighbors, have never been pumped, and one tank was improperly installed too low, which causes constant overflow;

Raw sewage can be seen bubbling up on the drain fields, which abut several properties in the community, and which attract mosquitoes;

At times, a sewage odor permeates the community;

According to a homeowner who is also a realtor, home values in the community run at least 10 percent below market, and other homeowners had heard stories that homebuyers are having problems getting mortgages on homes in the community;

DNREC should not have continued to grant permits to USI in the Herring Creek community and should have responded better to complaints from residents;

Two homeowners described problems with toilet back-ups, which caused property damage, and asserted that the response from USI was inadequate;

One homeowner leaves on holiday weekends because of the increase in backflow he experiences because of increased load on the system; and

A resident of Gull Point asserted that USI operates in Gull Point with excessive overhead expenditures, which he suspected was a result of Gull Point funds being used on the Herring Creek system.

32. Approximately fifteen property owners submitted written public comment. Most of the written comments received expressed concerns similar to those heard at the public comment hearing including offensive odors from the septic field, standing effluent, improper use of USI funds, improper maintenance, and lack of pumping of the septic tanks that collect the solid waste for each home. The complaints also include lack of upgrades to the system, and a general failure to provide safe, adequate, and reliable wastewater service at Herring Creek for eight years or more. One homeowner, William J. Capanaro, submitted a letter dated May 6, 2005, in which he supported USI's actions. Mr. Capanaro, however, testified at the hearing and his letter was entered into the record as Staff Exhibit No. 33. His letter, therefore, is summarized under the following section.

V. SUMMARY OF EVIDENCE

A. Commission Staff

33. Kevin Neilson, Regulatory Policy Administrator for the Commission, filed written direct testimony on May 11, 2005 (St. Ex. 5), written supplemental testimony on May 27, 2005 (St. Ex. 6), and

testified at the hearing (Tr. at 111-215; 284-371). Mr. Neilson testified that USI entered the private wastewater utility business in the 1980s and entered into an "Agreement For Sewage Disposal Services" with the developer of Herring Creek on April 24, 1985. The Herring Creek developer financed initial construction costs for the wastewater system. USI entered into a number of similar arrangements in Sussex County, whereby USI would design a system, the developer would construct it, and then USI would own and operate the system under a long-term contract. (Ex. 5 at 5-6.)

34. According to Mr. Neilson, USI described its Herring Creek system, in a response to a data request, as follows:

The community wastewater system includes large (1500 gallon) septic tanks which are positioned in easements on side property lines to typically serve two (2) adjacent homes. The pretreated wastewater is then conveyed in gravity lines in the streets to two (2) transmission pumping stations. The wastewater is pumped to a dosing complex which, after intermediate treatment and equalization, distributes the wastewater to subsurface disposal beds located along Road 279 (Camp Arrowhead Road).

The transmission and dosing systems include multi-pump alternating controls and remote alarm systems to monitor and report (over the telephone

system) the status of the pumping systems and alarm conditions. The dosing system additionally includes timer controls to achieve flow equalization, which is essential to protect the disposal beds from hydraulic overload. The flows to the disposal beds are metered and recorded by a datalogger.

The system must be monitored and inspected on at least a weekly schedule. Pumping operations and the remote alarm system must be checked and tested. The performance of the pumps and timers of the equalization system must be reviewed and, if necessary, adjusted to achieve the desired result. The datalogger must be downloaded to a personal computer and the results evaluated. The disposal areas must be inspected and dosing pump operations adjusted as required.

In addition to routine weekly operations, there are requirements for routine cleaning of the septic tanks, necessary repairs and emergency actions. USI must be ready to respond at any time and be capable of carrying out the necessary work to maintain adequate system performance.

(*Id.* at 6-7.)

35. Mr. Neilson testified that shortly after July 6, 2004, when the Commission was granted regulatory oversight of wastewater utilities, Staff started receiving calls from Herring Creek residents

complaining of surfacing wastewater at the infiltration beds of the system, which was later confirmed by Staff. Staff also reviewed DNREC records and conferred with DNREC representatives, who indicated that the Herring Creek system has been, and continues to be, in violation of DNREC requirements.

36. According to Mr. Neilson, DNREC records and DNREC personnel indicate that there have been repeated, persistent problems with contaminated wastewater rising to the surface of the infiltration beds at Herring Creek since 1995. (*Id.* at 8.) On October 7, 2002, USI obtained a permit from DNREC to replace and upgrade the system. (*Id.* at 15.) By 2003, the infiltration beds had failed and USI was paying a contractor to pump waste from the system so that the waste would not reach the infiltration beds and rise to the surface. Even with the pumping, however, some wastewater would still reach the failed infiltration beds and, shortly thereafter, would rise to the surface. In other words, pumping the waste may have reduced, but did not eliminate, the surfacing of contaminated waste. (*Id.* at 8-9.)

37. Mr. Neilson testified that DNREC has found multiple violations of its ground water discharge regulations and permitting requirements regarding the Herring Creek wastewater system. On June 30, 2003, Doris Hamilton of DNREC issued a Notice of Violation to USI relating to ground water discharge violations extending back to 1997. On June 15, 2004, DNREC issued an order citing multiple violations and stating that USI had maintained the Herring Creek wastewater system "in a manner which has created a public health hazard." (*Id.* at 9.)

38. Mr. Neilson also testified that DPH has inspected the Herring Creek site. (*Id.* at 10.) By letter dated December 6, 2004, to the Sussex County Administrator, DPH indicated that the Herring Creek treatment system had failed and that if a fix was not underway by December 17, 2004, DPH would require installation of an 8-foot chain link fence around the drain field and dosing tanks. The fence would be required to reduce and control the human exposure to the raw effluent surfacing at the infiltration beds.

39. Mr. Neilson testified that on or about December 31, 2004, USI ceased providing wastewater services to Herring Creek, without obtaining the required approval from the Commission, and that the Association thereafter took responsibility for operating the system. The Association hired one contractor for day-to-day services and hired another contractor to continue pumping and hauling the waste. (*Id.* at 11.)

40. Mr. Neilson asserted that USI's financial viability is questionable, based on: (a) statements from USI regarding its inability to continue operating the system because of insufficient funds; and (b) delinquent USI invoices from Roberts Septic Service, Inc., ("Roberts Septic") in the amount of \$22,100, for pumping the system. In addition, in a deed dated December 21, 2004, USI improperly transferred three lots at Herring Creek to Carbaugh Property Management, LLC, of which Clark Carbaugh (USI owner) is a principal. Mr. Neilson noted that USI has yet to account for the funds received for the properties but asserted that they were not used to pay Roberts Septic. (*Id.* at 13.) The three lots constituted all

of the property owned by USI at Herring Creek and were purchased by USI to be used for the rapid infiltration beds that USI was to build pursuant to the October 2002 permit from DNREC.

41. Regarding USI's abandonment of the system, Mr. Neilson testified that USI failed to properly notify its Herring Creek customers and noted that certain customers continued to pay USI directly, even after the Association started collecting the fees. (*Id.* at 14.) Furthermore, the abandonment was effected without the required approval from the Commission and USI failed to leave the system in working order, according to Mr. Neilson. (*Id.* at 17.)

42. Mr. Neilson responded to USI's claims that the Association "blocked" its efforts to obtain the low interest financing it needed to replace and upgrade the Herring Creek system and that the Association later "starved" USI of the funds needed to operate the current system. (*Id.* at 17.) Upon investigation, Mr. Neilson determined that the low interest loan program required that a certain number of homeowners provide income information. Not enough Herring Creek residents provided the information, however, so no determination could be made as to whether USI qualified for the low interest loan. (*Id.* at 18.) Mr. Neilson testified, however, that USI's assertions are irrelevant because the utility is obligated to obtain necessary financing, not the customers. Regarding USI's assertion that the Association "starved" it of necessary funds, Mr. Neilson testified that the Association complied with a Chancery Court order that required the Association to turn over funds collected from residents to finance operations.

43. In his supplemental pre-filed testimony, Mr. Neilson testified that the comments offered by Herring Creek residents at the May 17, 2005 public comment hearing corroborated the information from the DNREC and DPH records reviewed earlier by Staff concerning the condition of the wastewater system. (St. Ex. 6 at 9.) In addition, Mr. Neilson asserted that in 2003 the estimate for replacing the waste treatment system was approximately \$500,000 (as corrected at that hearing). (*Id.* at 8, Tr. 118-119.) According to Mr. Neilson, the Association recently has received estimates for replacement of the system as high as \$1,500,000.

44. Mr. Neilson also testified that, from USI's responses to data requests, he determined that about 32 customers continued to pay USI through the end of 2004. Mr. Neilson disagreed, therefore, with USI's assertions that it was permitted to abandon service to Herring Creek because of nonpayment of bills. Mr. Neilson explained that not only did certain customers continue to pay USI (and were still abandoned), but that a utility may discontinue "service" to customers for nonpayment, without Commission approval, but cannot abandon its "business" or "operations" "in whole or in part" under any circumstances without Commission approval. (*Id.* at 11.) In addition, Mr. Neilson testified that because the Association was turning over funds pursuant to a Chancery Court order (and some customers continued to pay USI directly), it is arguable that none of USI's customers were guilty of nonpayment. (*Id.* at 14-15.) Furthermore, Mr. Neilson asserted that when USI abandoned the system, it left the equipment and facilities in a dangerous state and inoperable. (*Id.* at 12-13.)

45. Mr. Neilson testified that Staff's investigation revealed that USI's wastewater system at the Woodlands development had also been the subject of multiple DNREC violations from 1998 to 2005, involving failing disposal beds and surfacing effluent. (*Id.* at 16-19.) At the Woodlands, DNREC first required USI to construct relief trenches and an advanced treatment system, which did not resolve the surfacing problems. DNREC then required pumping of the system. With respect to USI's system at Gull Point, Mr. Neilson testified that USI had experienced some problems but that there appeared to be no immediate concerns or ongoing environmental violations. (*Id.* at 20.) Mr. Neilson noted that USI, in its Answer to Staff's Complaint in this proceeding, stated that in March of 2005 it entered into a contract for the sale of the Gull Point and Woodlands systems, but that USI had yet to seek the required Commission approval of the transfer.

46. Mr. Neilson also testified that he does not believe that USI has any property rights in the Herring Creek system for the following reasons: (a) the 1985 Sewage Disposal Agreement expired in April 2005, (b) the agreement bestowed no property rights to USI; (c) USI has no financial interest in the system (*i.e.*, the system was contributed by the developer); and (d) by failing to operate the system, USI lost any right it had to the easement that it had received for the purpose of operating the system. (*Id.* at 24-25.) Mr. Neilson also asserted that it would be against public policy for any property rights in the system to extend beyond the term of the sewage agreement because then USI could demand any price for the system, and could

prevent another utility from taking over the system, even though USI was not providing service. (*Id.* at 23-24.)

47. At the hearing, Mr. Neilson responded to USI's assertion that its Herring Creek system failed as a result of inadequate DNREC regulations that were in place when USI designed the system. (Tr. at 126.) Mr. Neilson testified that there were other wastewater systems built in Delaware at about the same time that the Herring Creek system was constructed, under the same DNREC regulations, that have not failed. Regarding USI's challenge to Commission jurisdiction in this case, Mr. Neilson presented, among other documents, a September 29, 2004 letter from USI to the Commission (as part of its CPCN application), stating that its easement gives USI the exclusive right to provide wastewater services to Herring Creek. (Tr. 135, St. Ex. 14.)

48. Mr. Neilson also testified that if USI qualified for DNREC's low-interest loan program, then it could have financed about half of the \$500,000 required for system improvements through that program and that the other half of the necessary capital would require conventional financing. (Tr. 138-143, *citing* St. Exs. 15 and 26, consisting of USI letters to DNREC from May and June of 2003.) Mr. Neilson saw no evidence that USI had the \$250,000 that it needed in addition to the \$250,000 it hoped to get from the low interest loan program. He also noted that, from his review of DNREC's files, it appeared that Mr. Carbaugh submitted a loan application for \$700,000 in January 2004, but that the application was incomplete. (Tr. 150-151.) Then in May 2004, Mr. Carbaugh applied to DNREC for a \$500,000

loan, but he lacked security for the loan and he would not provide a personal guarantee. (Tr. 154-157.) Mr. Neilson also noted that the Association considered transferring land to USI to serve as security for the loan but decided against it.

49. Mr. Neilson also testified that USI has had cash flow and operational difficulties relating to its Woodlands wastewater system. (Tr. 178, 184.) From his review of DNREC's file on USI, Mr. Neilson learned that in 2003 USI needed financing assistance from DNREC for improvements to its Woodlands system but that DNREC rejected its request for such assistance. (St Ex. 24.) In addition, DNREC cited performance problems with USI's disposal system at the Woodlands, including failing septic beds, in 2000, 2002 and 2004. (Tr. 186, 188; St. Ex. 28.)

50. Mr. Neilson submitted four photographs of the treatment beds at Herring Creek, taken by Staff in the latter half of 2004, which show dark water in the middle of the beds. (Tr. 285; St. Ex. 30A-D.) Mr. Neilson testified that the photographs show surfacing of wastewater in the septic fields. In addition, Mr. Neilson testified that he obtained a Site Visit Report from the DPH, referencing a November 19, 2004 inspection, which reflects a failed treatment system, surfacing effluent, and potential health hazards. (St. Ex. 18; as excerpted below.)

51. Mr. Neilson also reviewed USI's financial records (St. Ex. 31) and noted Herring Creek receipts for connection charges ranging from \$11,500 in 1995, to a peak of \$40,000 in 2000, to a low of \$3,000 in 2004. (Tr. 288-291.) Under its permit, when USI adds homes, it

must continue to build out the system, including installing holding tanks and increasing the bed size. (Tr. 331.) Mr. Neilson also noted that USI's sewage agreement allows it to sue homeowners who fail to pay the sewage fees and, in addition, to assert a lien against their property. (Tr. 369.)

52. Robert Ambrose, a Commission Regulatory Policy Administrator, submitted pre-filed direct testimony. (St. Ex. 32.) Mr. Ambrose testified that the Herring Creek system assets were contributed to USI by the developer, at no cost to USI, and that USI therefore has no rate base. The value of the system, therefore, is zero to a purchaser regulated by the Commission. (*Id.* at 3-4.) While USI had capital expenditures in 2001 and 2002 of \$26,768 for the design of a new system, these expenditures would not be considered rate base because the associated asset was never constructed and, therefore, is not "used and useful," which is a prerequisite for rate base treatment.

53. Mr. Ambrose also testified that it was improper for USI to recover a 15 percent profit on utility plant that was contributed to the system. He could not say, however, whether the sewage agreement, which allows 15 percent of cost as profit, also allows 15 percent profit on contributed facilities. (Tr. 508.) According to Mr. Ambrose, USI's questionable financial practices have drained its cash resources. At the hearing, Mr. Ambrose testified that USI does not use a general ledger for accounting its costs, which is essential in a utility business. (Tr. 484.) Nor has USI filed a tariff of its rates and terms of service, which is required. He concluded that USI lacks

the managerial and financial resources necessary to operate the Herring Creek system and to provide the necessary improvements.

54. Mr. Ambrose also reviewed the financial records regarding the Woodlands and Gull Point and concluded that USI lacks the resources to meet the future needs at the Woodlands (especially in light of Staff's recent discovery that the system there is failing) and that its ability to meet the future needs of Gull Point is in doubt. (St. Ex. 32 at 10.)

55. Doris Hamilton, a compliance officer with DNREC, submitted pre-filed direct testimony on behalf of Staff. (St. Ex. 29.) Ms. Hamilton testified that she first became employed by DNREC in July 1989, and, since that time, has been responsible for the inspection and evaluation of wastewater systems for compliance purposes. Prior to her employment with DNREC, Ms. Hamilton was a licensed wastewater operator and had responsibility for a 1.5 million gallons per day wastewater facility. (Tr. 216-18.)

56. Ms. Hamilton testified that, in August 1995, she was assigned the responsibility of overseeing all of USI's wastewater treatment sites and she made her first inspection of USI's facilities at Herring Creek. She observed serious problems with the Herring Creek treatment beds, including wastewater effluent surfacing in the treatment beds and trees growing in them, reflecting a complete lack of maintenance predating August 1995. (Tr. 219-221.) She testified that the treatment bed failures continued on a persistent basis through her last visit to the site in March 2005. (St. Ex. 29 at 1-3.) In 1995, the Herring Creek community was not the only system where

USI was having problems with raw wastewater effluent surfacing in the treatment beds. Ms. Hamilton observed the same problems at Bay Colony, Hunters Point and the Woodlands. (*Id.*)

57. Ms. Hamilton also agreed with the descriptions of the Herring Creek treatment beds contained in a Site Visit Report prepared by DPH, following a November 19, 2004 inspection. Ms. Hamilton participated in the inspection, along with Ron Graeber of DNREC and Gerald Llewellyn, Ph.D., of DPH. (St. Ex. 18; Tr. 221-2.) The report states, in part:

This housing development has more than 100 homes in a residential area of Sussex County. The wastewater system is owned and operated by USI for the Home Owners Association ... The drainfield is in a clearing covering about two football fields in an area with a nearby drainfield dosing system (three tanks, pumps, valves). The system is near several homes in the development and across Camp Arrowhead Road from several unassociated barriers. ... At least two backyards adjoin the drainfield. During the visit, one break-through of effluent bubbled, rose up and flowed toward a yard approximately 10 feet away.

Findings indicate that the sewage treatment system has failed. There is raw (liquid) effluent visible on the drainfield and in the surface soil (soft, mucky, gray colored). There is a slight odor of sewage at times evident on the drainfield site... The break-through locations vary in size from 10 to 500 square feet. The nearby drainfield dosing system was odiferous and had a small effluent leak near the yard of an adjacent home and the roadside ditch. The dosing tank covers were not secured and some concrete plugs were lifted and cracked open. The non-secured plastic tank covers present a definitive safety concern.

This failed system needs action and should be fixed immediately... [T]he raw effluent at the break-through areas on the ground would be expected to contain human pathogenic organisms.

The effluent would be expected to test positive for fecal indicator organisms. The pathway for exposure is via trespassers (children, adults and pets) having direct contact or tracking this effluent into the several adjacent homes and other homes/situations where ingestion and/or other entrance into the body (eyes, nose, wounds...) could lead to illness and disease.

(St. Ex. 18.) Ms. Hamilton testified that she called Mr. Carbaugh to inform him in advance of the site visit by DPH and DNREC. (Tr. 251-4.) She stated that Mr. Carbaugh wanted to attend the inspection, but said he could not be there due to a medical reason. She did not know if USI ever received a copy of the DPH Report. (*Id.*)

58. On cross-examination, Ms. Hamilton addressed the June 30, 2003 Notice of Violation that DNREC issued to USI for Herring Creek that required USI to pump wastewater from the system on a continuous basis to prevent surfacing of waste effluent in the treatment beds. (Tr. 242-5.) While pumping, by itself, may not have prevented all wastewater from reaching the treatment beds, Ms. Hamilton stated that USI could have placed a free-standing container at the site and pumped the dosing tank on a continuous basis to the container. This would have prevented wastewater from reaching the beds and, in fact, was recommended in the Notice of Violation. She also noted that USI had used this method at its Bay Colony system, when the beds there had failed. (Tr. 245-8.)

59. Ronald Graeber, who is DNREC's program manager of the Large Systems Branch of the Ground Water Discharges Section of the Division of Water Resources, testified on behalf of Staff. (Tr. 526-541.) Mr. Graeber disagreed with Brian Carbaugh's assertion that fifteen of thirty-nine DNREC-regulated large community wastewater systems had

serious treatment bed failures. (Tr. 527-530, 533-535.) When asked about the actual number of large systems with treatment bed failures, out of the thirty-nine systems regulated by DNREC, he testified:

A. I know of only one that consistently has difficulties and consistently is failing, and is not under some state of repair or reconditioning at the current time.

Q. What's that?

A. That would be Woods on Herring Creek.

Q. How does the Woods on Herring Creek system over the past ten years compare with other systems that have been under DNREC's regulation in terms of the operational performance of a septic field?

A. I guess the best way I could answer that question is by saying that this facility has the dubious distinction of being in our non-compliance list for the longest period of any facility we've ever regulated, and it continues at this time, to be on our list of facilities out of compliance.

(Tr. 529.)

60. Mr. Graeber also testified that he disagreed with the assertion that USI promptly moved to correct problems with the WOHC system that were brought to USI's attention:

Q. And does your review of DNREC's file dealing with The Woods and USI indicate to you that problems brought to USI's attention, they promptly moved to correct them to the satisfaction of DNREC, with one exception, and that's getting the new replacement system built?

A. That's a big exception. No, not really, because, and I have to say this, because of the frequent break outs we had directed USI to focus on pumping the systems out. And as Mr. B. Carbaugh mentioned earlier, it's difficult to know how much to pump out. But

there was not enough wastewater pumped out to prevent surfacing. So, although some repairs were made expeditiously, at the same time, in my professional opinion, everything was not done to ... [effect] the repairs that could have been done.

(Tr. 541.)

61. Mr. Graeber agreed with Clark Carbaugh that the operating life span of a septic field, like the field at Herring Creek, would be about fifteen to twenty years. (Tr. 529.) He noted that there are many variables involved, but on average, fifteen to twenty years is a reasonable lifetime for a disposal field. He explained that after such a period of time, the wastewater disposal system would have to be replaced in phases and significant renovations would be needed. (Tr. 535.)

62. Mr. Graeber testified that the Delaware Code permits DNREC to grant variances from DNREC regulations. (Tr. 532.) He noted, however, that USI never came to DNREC to request a variance to allow it to take funds earned at one of its several wastewater systems and apply the funds to renovate the wastewater system at Herring Creek.

B. USI

63. H. Clark Carbaugh, USI's President and majority stockholder, submitted pre-filed testimony on behalf of USI. (USI Ex. 4.) Mr. Carbaugh testified that in the early 1980s USI entered into a sewage agreement with the Herring Creek developers to plan, develop, and manage a community wastewater system. DNREC issued the permit in November 1985.

64. Mr. Carbaugh testified that USI encountered problems with the subsurface disposal areas at Herring Creek in the late 1990s,

after ten to twelve years of satisfactory performance. (*Id.* at 2.) The types of problems encountered were not specific to Herring Creek and were a result of deficiencies in the DNREC regulations in place at the time the systems were constructed. DNREC recognized these deficiencies and made major changes in its regulations.

65. At Herring Creek, the first significant breakout, or surfacing problem, occurred in 1997. At that time, USI, working closely with DNREC, installed relief facilities to correct the problems. Similar problems, however, occurred in 1999, 2000 and 2003. DNREC issued repair permits in March 1998, March 1999 and August 2000, and it issued a major improvements permit in October 2002.

66. Mr. Carbaugh testified that DNREC scientists and USI consultants investigated the surfacing problems and determined that the percolations tests performed under previous DNREC regulations were inadequate. (*Id.* at 3.) As a result, the Herring Creek testing failed to reveal certain groundwater conditions and variations in permeability that were present at Herring Creek. The newer DNREC regulations now require detailed soil investigations by certified professionals.

67. Mr. Carbaugh testified that by early 1999, USI had established the basic concepts of the permanent improvements plan and was working with DNREC to solve, on a temporary basis, the surfacing problems. (*Id.* at 4.) In 2000, USI and Tidewater Utilities, Inc. ("Tidewater") entered into negotiations regarding a buy-out of the USI wastewater systems, which caused a nine to ten month delay regarding the permanent plan. However, once Tidewater notified USI that it

would not proceed with the acquisition, USI contacted the Association and arranged a meeting for October 2000 to discuss the permanent improvements plan. DNREC regulations required USI to involve the Association in the planning process.

68. Mr. Carbaugh testified that, at the October 2002 meeting, USI discussed low interest federal financing programs that involve the community as the borrower. In addition, in March 2002, DNREC recommended another federal loan program, under the U.S. Department of Agriculture. Mr. Carbaugh met with the program officials at the federal agency and then sent a letter, dated April 5, 2002, to the Association outlining the steps required to proceed with the loan application. After two follow-up letters from USI, the Association responded (through counsel) on May 14, 2002, and USI responded thereto, by letter dated May 23, 2002. Then, by letter dated June 3, 2002, the Association rejected the concept of community borrowing. By letter dated June 17, 2004, USI acknowledged the Association's decision, and indicated that it would proceed with other financing options. Mr. Carbaugh attached copies of all the referenced correspondence to his pre-filed testimony. (*Id.* at Exhibits L-R.)

69. Mr. Carbaugh testified that in October of 2002 DNREC issued the permit for the permanent improvements plan, which involved construction of a rapid infiltration system. (*Id.* at 8.) USI was unable to begin construction in the winter of 2002-2003 because of severe wet conditions but, in the spring of 2003, site preparation work was completed. USI expected to complete construction of the new system by February or March 2004. On June 13, 2003, USI applied for

financing assistance from DNREC, under the Septic System Rehabilitation Program. Also on that date, USI advised the Association of the DNREC requirements regarding the loan program, which included that the Association transfer, by deed, the disposal areas to USI and that residents provide financial information regarding income levels.

70. In August 2003, after substantial effort on USI's part to alert the Association and homeowners of the importance of meeting the loan requirements, the Association advised USI that it decided that the community should not respond to the DNREC requirements. (*Id.* at 9-10.) Then, in November of 2003, DNREC Secretary Hughes called a meeting to attempt to move the improvements project forward. In response, the Association sent a letter to the homeowners asking them to provide the required financial information. Also at that time, USI explored commercial financing options and, in January of 2004, applied to DNREC for revolving loan-financing assistance.

71. Mr. Carbaugh testified that, on January 22, 2004, he telephoned DNREC and learned that the Herring Creek property owners had not provided the necessary financial information. (*Id.* at 11.) USI then considered either obtaining high cost commercial financing for the project or selling the Herring Creek system to either Tidewater or Artesian Water Company. The Association, however, proposed to buy the system itself and, on February 24, 2004, USI met with the Association and DNREC to discuss the proposal.

72. Based on a \$350,000 discrepancy between USI and the Association regarding un-reimbursed project costs, however, the parties could not reach a purchase agreement. (*Id.* at 12-14.) Mr. Carbaugh testified that USI made its final offer on April 19, 2004. Rather than respond to the offer, however, the Association called for a special election of the homeowners regarding the community taking over the wastewater system, pursuant to the reversion clause in the sewage agreement. According to Mr. Carbaugh, it was apparent that the Association purposefully delayed the improvements project to position itself to take over the system at a lower cost. (*Id.* at 14.)

73. Mr. Carbaugh testified that USI continued to proceed with the project, despite its high cost. (*Id.*) The Association conducted its election on May 12, 2004, the property owners voted for reversion of the system, and the Association notified USI that it had taken over the system. USI, however, through counsel, rejected the Association's contention, by letter dated May 14, 2004. On May 19, 2004, DNREC conducted two separate meetings -- one with the Association and one with USI. Secretary Hughes decided to issue an Order directing USI to complete the system improvements project within 25 weeks or face financial penalties. (Tr. 624.)

74. Mr. Carbaugh testified that USI continued to meet with DNREC regarding financing options and construction details. (USI Ex. 4 at 15.) On June 8, 2004, the Association sent third quarter invoices to the Herring Creek property owners and gave notice of the creation of the Woods Community Wastewater System, Inc. ("WCWS"). On June 15, 2004, DNREC issued its Order, which ignored the takeover of the system

by the Association. (*Id.* at Exhibit JJJ.) Without clear ownership of the system, and unable to proceed with construction or seek financing, USI took no action on the DNREC Order.

75. Then, on July 12, 2004, USI filed a complaint in Chancery Court against the Association and DNREC. (*Id.* at 16-17.) After an August 9, 2004 hearing, the Court ruled that the Association must turn over to USI the funds it had collected from property owners so that USI could operate the system. Based on delays and lack of payments, USI filed contempt proceedings against the Association. In addition to the funds from the Association, USI continued to receive payments directly from certain property owners but the amounts dropped off considerably. The payments from the Association were difficult to get, were late, and did not cover all payments that were due. USI's November 2004 expenditures of \$16,415 were never paid because, according to the Association's attorney, the Association did not have any money left.

76. Mr. Carbaugh testified that in early December 2004 USI decided to cease operations and maintenance services to Herring Creek because the parties were making no progress toward resolution. (*Id.* at 18.) The parties last tried to reach an agreement on December 6, 2004, to no avail. The revenue stream necessary to cover the operations and maintenance costs had, according to Mr. Carbaugh, "dried up." In December 2004, USI notified the property owners that it would cease operations at the end of the month, advised the Association's attorney that his client should prepare to operate the

system, relinquished its permits to DNREC, and withdrew its CPCN application at the Commission.

77. Mr. Carbaugh rebutted many of the statements made by the Herring Creek residents at the May 2005 public comment session. (Ex. 4 at 21-24.) Mr. Carbaugh testified that the residents were incorrect that their tanks, or pretreatment units, had not been serviced, and he asserted that USI responded promptly to all backups that involved the USI system.

78. At the hearing, Mr. Carbaugh testified that a sink hole has recently developed at the Woodlands system, which has caused a pump station to malfunction. (Tr. 556.) He also asserted that in January and August 2003, he advanced \$90,000, followed by \$6,800, of his personal funds to USI for the Herring Creek project and his wife advanced \$150,000. (Tr. 848.) USI needed the funds to move forward with the improvements project. Mr. Carbaugh loaned USI the money at an interest rate of four percent over the prime interest rate and the loan is secured by all USI property and accounts receivable. (Tr. 861.) Mr. Carbaugh testified that when he made the loan, he expected to be paid back by whatever financing USI got for the Herring Creek project.

79. Mr. Carbaugh also testified that if the community had agreed to be the borrower for the project, then USI's 15 percent contract profit would not have applied to the borrowing costs. (Tr. 585.) If USI obtained the financing, however, then not only would the rate be higher, but USI would add the 15 percent. USI informed the Association of this difference. Mr. Carbaugh testified that the

commercial financing he investigated required him to put up his own personal property, likely his home, retirement and investments. (Tr. 611.) Banks do not consider a community wastewater system to have value as collateral. Furthermore, because the homeowners were not cooperative, there was added risk involved to any lender. Even with the Chancery Court Order, USI was not getting enough money to pay all of its ongoing day-to-day expenses, according to Mr. Carbaugh. (Tr. 625-6.)

80. Mr. Carbaugh also noted that, prior to when negotiations with the Association broke off on December 6, 2004, USI had agreed on a buyout arrangement with Delmarva Utilities, but the Association rejected the buyout. (Tr. 631.) Although USI and Delmarva Utilities had not resolved the issue of un-reimbursed costs, in the amount of \$160,000, USI was willing to further negotiate that figure with Delmarva Utilities.

81. On cross-examination, Mr. Carbaugh testified that USI needed \$500,000 in 2003 to make the planned capital improvements. (Tr. 633.) He planned to obtain \$250,000 from the DNREC loan and USI would provide the other \$250,000. The \$240,000 that he and his wife advanced USI, however, was spent on operating costs, such as waste hauling, as well as some capital costs associated with the improvements project. He agreed, however, that the expenditures do not appear on a summary analysis provided by USI for 2003 and 2004 costs. (Tr. 637.) Mr. Carbaugh asserted that, even though the \$240,000 personal advance was spent, USI still would have come up with the \$250,000 needed to complete the project. (Tr. 638.) USI's

balance of funds in the bank as of December 31, 2004, was over \$95,000. (Tr. at 859.)

82. Mr. Carbaugh testified that, on June 25, 2004, USI sent out invoices to all property owners for \$3,429, due by July 6, 2004. (Tr. at 652.) USI did not expect payment, however, because the Association had taken over the system by that time. USI sent the invoices in order to show Chancery Court that it had made every attempt to get payment from the customers before filing suit. Mr. Carbaugh asserted that the July 6 due date for customer payments had no relation to the July 7, 2004 date on which the Commission jurisdiction over wastewater utilities took effect.

83. Mr. Carbaugh testified that in December 2004, USI sold three Herring Creek lots to Carbaugh Property Management, a company owned by he and his wife. (Tr. 674.) Tidewater had purchased the three lots, in anticipation of acquiring the wastewater system, which they needed to control if they bought the system. When Tidewater decided against the acquisition in September 2000, it conveyed the lots to USI, for the same price that Tidewater had paid. The \$95,000 that USI had in the bank at the end of December 2004 reflected, in part, the sale of the three lots. (Tr. 859.)

84. Brian Carbaugh, a consulting wastewater engineer, testified on behalf of USI. (Tr. 378-476.) Mr. B. Carbaugh is the son of Clark Carbaugh; he holds a small stock ownership in USI; and he receives a quarterly fee as a member of the board of directors. Mr. B. Carbaugh testified that, in the 1970s, community wastewater systems consisted of a collection system, treatment plants, and discharge into a stream

or waterway. By the mid-1980s, however, DNREC stopped issuing stream water discharge permits and required, instead, land disposal. (Tr. 382.)

85. Mr. B. Carbaugh testified that in 1984 he started working for his father's firm, CABA Associates, as an engineering technician. (Tr. 383.) At that time, CABA was designing the Herring Creek system. Mr. B. Carbaugh collected soil samples and did percolation tests for the Herring Creek system. (Tr. 430.) Also at that time, DNREC was working on new regulations for community systems, which were issued in 1985.

86. Mr. B. Carbaugh testified that the matting that Ms. Hamilton referred to is called the biomat, which is a black layer of bacteria and is created on all septic system disposal beds. (Tr. 391.) In 2002, DNREC issued new regulations, which included two changes designed to reduce the biomat, because community systems were getting excessive biomat growth. (Tr. 395.) DNREC now requires larger beds and treatment systems on the larger projects, which eliminate the food for the biomat and which, therefore, virtually eliminates the biomat.

87. Mr. B. Carbaugh testified that, initially, the Herring Creek system operated well. (Tr. 399.) Mr. B. Carbaugh asserted, however, that when the Herring Creek system was constructed in the late eighties, the infiltration capacity of the soil was not investigated as intensely as it is today. (Tr. 403.) At that time, the only test for soil permeability was the standard "perc" test, where water is poured into a hole in the soil and the permeability is measured in minutes per inch, corresponding with how fast the water

goes down.

88. Mr. B. Carbaugh testified that in 1995, or thereafter, he evaluated the Herring Creek system pursuant to a DNREC Order. He found that although the beds had more than enough infiltration capacity for the number of units (per its design) and the flow per unit was less than expected, there was surfacing of effluent on the beds. (Tr. 406.) He determined, therefore, that the beds were not functioning as expected under the DNREC regulation. Because the beds were not working properly, USI decided not to construct more beds. Instead, to address the immediate surfacing problem, they decided to build relief trenches, which move the effluent over to an adjacent underground disposal area. Shortly, thereafter, they proposed a plan to construct a new treatment and rapid infiltrations system. The relief trenches, however, eliminated the surfacing for a period of time. Mr. B. Carbaugh designed the relief trenches and the proposed treatment and rapid infiltration system.

89. Mr. B. Carbaugh testified that he and USI worked with DNREC to determine what level of treatment would be required in a new system, in light of anticipated federal regulations dealing with total maximum daily load, or TMDL, which relates to the amount of pollutants allowed in a particular type of waterway. (Tr. 414.) At that time, USI was determining what land would be available for the new system and it used experienced private soil scientists to investigate the soils. USI also solicited community input, which consisted mainly of the community's desire to have the disposal areas as far away as possible, and designed a rapid infiltration system. The location

where USI originally wanted to place the infiltration system, however, was not permeable enough. USI then found an alternative location nearby that was suitable and secured title rights to three lots. (Tr. 419.) They submitted a permit application on August 30, 2002, and DNREC approved the permit on October 7, 2002.

90. Mr. B. Carbaugh asserted that from a DNREC staff member, he learned that of thirty-nine permitted community systems built under the 1985 regulations, fifteen (two of which were USI systems) had or were having operational problems. (Tr. 411.) Based on the significant failure rate, he concluded that the original design concepts did not serve the industry well.

91. On cross-examination, Mr. B. Carbaugh testified that, in addition to the Herring Creek system, he was involved in the design and construction of other USI systems with septic drain failures, such as Hunter's Point, Bay Colony, the Woodlands, and Hamilton Station. (Tr. 436.) After surfacing occurred at the Herring Creek system, construction of more beds would have helped the system in the short term but, rather than continue with a technique that was not performing well, USI decided to use relatively inexpensive relief trenches for the short term and then build a new system for the long term. (Tr. 447.) Mr. B. Carbaugh asserted that he does not believe that any trees on the Herring Creek drainage field had anything to do with the failure of the beds.

92. Mr. B. Carbaugh agreed that the January 7, 2004 memorandum from Scott Strohmeier to Hillary Moore indicates that the septic beds at the Woodlands were failing. (Tr. 455.) He asserted that the

Woodlands system continues to have operational difficulties and surfacing problems despite an upgrade that has been implemented. (Tr. 457.) He believes, though, that the septic beds are in an isolated area, closed to public access, and therefore pose no significant health hazard. He also believes that with the correction of certain minor mechanical problems, the system may start to perform well.

93. Mr. B. Carbaugh also testified that he always tries to avoid pumping because it is not cost effective. In addition, it is difficult to resolve surfacing by pumping because it is impossible to know exactly when to pump. Even with pumping, he noted, a portion of the wastewater still travels to the drain field.

94. William Capanaro, a Herring Creek homeowner since 1989, testified on behalf of USI. (Tr. 543-556.) Mr. Capanaro testified that he lives four lots from the drain field and cannot smell odors from his house. When he runs by the field, however, between seven and nine o'clock in the evening, there is an odor. Mr. Capanaro testified that his wife took photographs of the drainage field on June 4, 2005, which showed debris that had accumulated since January 2005. (USI Ex. 3.) Mr. Capanaro testified that after living there for 2.5 years, he wrote to USI, explained that he was handicapped, and asked to have his tank pumped. They came within an hour of getting the letter and pumped the tank. He called another time with a problem and they came out quickly to fix the problem.

95. Mr. Capanaro testified that a newsletter from the Association in July 2003 indicated that the Association was not going to help USI get financing. Mr. Capanaro, therefore, called the

Association and offered to call residents to solicit responses. In December 2004, he called 120 people, eighty-nine of which responded with the financial disclosure. The Association had told Mr. Capanaro to remind everyone to send first quarter payments to the Association rather than to USI.

96. Mr. Capanaro also submitted written comments, in a letter dated May 6, 2005. (St. Ex. 33.) Mr. Capanaro stated that USI continued to operate the Herring Creek wastewater system in the third and fourth quarters of 2004, even though the Association had depleted USI's resources by directing members to pay their fees to WCWS. The Association's goal was to cut off funds from USI, so that it could no longer operate the system, so that the Association could then exercise the reversion clause in the sewage agreement and take over the system, according to Mr. Capanaro. The Association's actions left USI no alternative but to withdraw from operating the system in December 2004. Mr. Capanaro also asserted that not all Herring Creek residents agree with the Board of the Association that USI has been treated fairly. USI has served the community "effectively, efficiently, and conscientiously for over 17 years, and any problems were handled and resolved immediately..."

C. The Association

97. Donna Brooks, a Herring Creek homeowner, testified on behalf of the Association. (Tr. 258-264.) Ms. Brooks testified that she and her spouse purchased their lot in 1998 and built their home near the end of 2001. In the early part of 2001, Mr. Carbaugh and his engineers held a meeting at the Herring Creek pavilion to inform the

lot owners that Herring Creek needed a new state-of-the-art system, designed by USI, which would require an increase in sewer fees. No one told her, however, that the new system was required because the current system failed; she understood that the new system was required because of the additional homes in the community. Mr. Carbaugh assured her that the new system would be complete prior to her finishing her house. USI increased the sewer fees but did not build the system. Ms. Brooks asserted that she paid her fees faithfully until 2004 when, on advice of counsel, she did not pay the \$124 fee for pumping of the system, which was charged on top of the regular sewer fee.

98. Chuck Davidson, a Herring Creek resident, and an employee of DPH, testified on behalf of the Association. (Tr. 265-272.) Mr. Davidson testified that he acquired his lot in 1994 and finished building his home in 1996. He paid an impact fee, a hook-up fee, and quarterly operation and maintenance fees. No one from USI told him when he was building his house, or paying the connection fee, that the septic system had any problems. Mr. Davidson paid USI faithfully until 2004. The quarterly charges went from \$96 to \$112 to \$140, for the express purpose of upgrading the system and eliminating the health hazard of surfacing raw sewage. Mr. Davidson noted that, soon after he moved in to the community in 1996, he noticed the strong odor and observed raw sewage floating on the drain field. The odor has never abated entirely. On cross-examination, Mr. Davidson agreed that DNREC issued certain repair permits to address the problems and that it was

possible that the rate increases correlated with the attempted repairs.

99. Irene Tillman, a Herring Creek resident since 1991, testified on behalf of the Association. (Tr. 272-283.) Ms. Tillman testified that she is a real estate agent, that she listed properties in Herring Creek in 2003 and 2004, and that she had to disclose the septic problems to potential buyers. Ms. Tillman asserted that the homes in Herring Creek sell for less than market value of comparable developments without septic problems and that she has had difficulty even getting offers on homes in Herring Creek. She also noted that if a buyer purchased a lot in Herring Creek, the buyer could not connect to the septic system, which affects the ability to sell the lot. Buyers could not connect because the Association has put a moratorium on connections.

100. Phyllis Kane, a Herring Creek resident since 2001 testified on behalf of the Association. (Tr. 691-752.) Ms. Kane is also the Corresponding Secretary on the Board of Directors for the Association. Ms. Kane testified that at the end of 2003 USI started pumping the system three times per week (pursuant to a DNREC Order) and in 2004 went to five times per week. When Ms. Kane learned that USI was trying to get a three percent loan from DNREC for system renovation she did not believe that Herring Creek would qualify for the loan because the homeowners' average income would be too high. She did, however, send a letter to the residents asking them to complete the necessary financial disclosure forms. Eighty-seven completed the forms. (Ms. Kane noted that, currently, Herring Creek has 162

property owners.) Someone then went door-to-door to the people who did not respond to try to persuade them to complete the form. Even though they did not get the 95 percent response, which was required by DNREC, their accounting firm calculated the average income, and the results indicated that they would not have qualified for the three percent loan. They would have qualified, however, for a six percent loan. Ms. Kane testified that she then researched the available commercial loans and sent Mr. Carbaugh the results, which suggested that a commercial loan would not cost any more than the six percent DNREC loan. (Tr. 698.)

101. Ms. Kane also testified that in June of 2002, when Mr. Carbaugh asked for the Association's assistance in getting a loan, the Association's attorney wrote Mr. Carbaugh's attorney a letter informing him that the Association was not interested in obtaining financing themselves but that he should get the financing and tell them how much they owed. This has always been the Association's position regarding financing. (Tr. 701.) In November of 2003, the Association and its attorney met with DNREC Secretary Hughes and Mr. Carbaugh. Secretary Hughes asked Mr. Carbaugh to get a commitment from a bank for a commercial loan and he asked the Association to try to get the required financial disclosures from the residents. In December of 2003, Ms. Kane contacted DNREC to see if Mr. Carbaugh had gotten a commercial loan and was informed that he had obtained information regarding two loans but that DNREC was concerned that Mr. Carbaugh would not be able to meet the balloon payment that would be due after five years. (Tr. 707.)

102. Ms. Kane testified that in February 2004, at DNREC's urging, the Association put together a proposal to acquire the system from USI. USI had also been meeting with Tidewater and Artesian but it was not certain that a sale would occur. (Tr. 713.) The Association, however, disagreed with the large amount of allocated overhead claimed by USI, which was much greater than direct expenses, and USI would not disclose any records related to the overhead. (Intervenor Exhibit No. 1 is a graphical presentation of operations expenses versus overhead and payroll for the years 1985 to 2003.)

103. Ms. Kane testified that to turn over the system to the Association, Mr. Carbaugh wanted \$233,000 in un-reimbursed costs, plus the value of the system, plus rent payments for the three lots USI had purchased from Tidewater, which Tidewater had purchased in anticipation of taking over the system. (Tr. 721.) The Association had hoped to purchase the lots from USI. The rent for the lots would be \$1,200 per month, with annual increases of \$100 per month. On May 12, 2004, the Herring Creek residents met for the purpose of voting on whether or not to exercise the reversion clause in their sewage agreement with USI. (Tr. 727.) At that point, USI had been pumping for six or seven months.

104. On cross-examination, Ms. Kane read from a February 26, 2004 letter from Secretary Hughes in which he noted that the Herring Creek property owners had "resisted" DNREC's attempts to secure funding for the upgrade in that only 57 percent responded with income information. (Tr. 730.) Ms. Kane disagreed that the owners had "resisted" but she did not notify the Secretary of her disagreement.

Ms. Kane also asserted that in exercising the reversion clause, it was the Association's intent to take control of the system but, judging from what happened in Chancery Court, control was not transferred at that time. (Tr. 742.)

105. Walter Lee Lindsay, a resident of Herring Creek since July 2000, testified on behalf of the Association. (Tr. 761-791.) When he hooked up to the system, he paid \$3,000, but USI did not tell him of any problems with the system. In fact, he considered the community wastewater system to be a selling point for the community.

106. Mr. Lindsay testified that USI has sued the homeowners for un-reimbursed costs but he asserted that he should not have to pay for USI's deficits from Herring Creek prior to when he became a resident. Since June of 2004, Mr. Lindsay has been the president of WCWS, which is a corporation formed by the Association after the homeowners exercised the reversion clause in the sewage agreement. In June 2004, the WCWS applied for a DNREC permit and sent out bills for the third quarter. They then received a letter from USI counsel disputing the reversion and asserting that any steps taken would be considered trespass. WCWS, therefore, did not do anything except call Roberts Septic about pumping the main tanks. DNREC then sent Mr. Lindsay a letter stating that WCWS could not do anything involving pumping because they do not have a permit. So he called back Roberts Septic to cancel his orders.

107. On cross-examination, Mr. Lindsay testified that about 70 percent of the homeowners sent their payments to the WCWS. WCWS used the money to pay invoices sent to them by USI, after the August 2004

court order. (Tr. 778.) If they weren't sure whether to pay a bill, under the Court order, then they contacted their attorney. The first bill was for \$48,000 but they only had about \$30,000 in escrow. Because the invoice covered June 2004, however, and WCWS had not billed for that month, they did not pay that portion of USI's bill. The Chancery Court later clarified its earlier order (in the WCWS's favor), since the parties did not agree as to its application. (Tr. 787.) The Court indicated that the Association was to pay expenses but not the 15 percent overhead, or profit, (other than \$2,000) charged by USI. (Tr. 789.)

108. Karen Gastel, a Herring Creek homeowner and Association Treasurer, testified on behalf of the Association. (Tr. 792-817.) Ms. Gastel purchased her lot in 1985, built her house in the mid-1990s, and moved in to the house in 1997. Under the Chancery Court order, the Association issued three checks to USI. The first was for \$9,322.68, for July direct expenditures, which she paid in accordance with her understanding of the Court order. The second check was for \$19,512.19, for October 2004 expenditures, which she paid even though the bill was not itemized. (Tr. 800.) The balance of the funds held by the Association, or \$25,950.38, was put into escrow with USI's attorney for disbursement to USI. In total, \$49,492.15 of the 54,785.25 collected by the Association was paid to USI. Approximately \$5,200 may have been returned to the Association after USI stopped operating the system at the end of 2004, even though USI had incurred \$2,000 per week in pumping costs in November and December 2004 that had not been paid. (Tr. 803, 815.)

109. William Cassot, a Herring Creek homeowner since 1999, testified on behalf of the Association. (Tr. 817-846.) Prior to retiring to Delaware, Mr. Cassot spent twenty-three years with the Air Force in facilities management, including management of wastewater systems. Mr. Cassot testified that he provided the financial disclosure that was necessary for the DNREC loan but he knew that Herring Creek would not qualify for the low-cost, need-based loan based on the level of the homeowners' incomes. In June of 2004, Mr. Cassot became involved in the Association with the maintenance issues and he researched the wastewater system. Then, after USI left the system at the end of 2004, Mr. Cassot inspected the facilities and the drain field, in early January 2005.

110. Mr. Cassot testified that he took thirty-two photographs (numbered 4 through 35) with his digital camera of the facilities. (Intervenor Ex. 2.) The condition of the pump house facilities was a "disgrace." There were multiple garden hoses, a burnt extension cord, loose wires, unmarked electrical boxes, rusty pumps and gauges, and missing insulation. There was also a lot of debris on the drain field, including seven dead oak trees, cinder blocks that had been placed in "blow holes," and deep tire tracks. He also took pictures of the individual tanks that Roberts Septic pumped, and the waste was so thick that they had to break it up with shovels and back flush the tank. From one 1,500-gallon tank, servicing a home that experienced repeated back flow problems, they pumped 3,700 gallons of waste, because it refilled several times after being emptied. (Photographs Nos. 31-35.)

VI. FINDINGS OF FACT AND CONCLUSIONS OF LAW

A. Factual Background

111. Because the Commission did not gain authority over wastewater utilities until July 6, 2004, the history in this case prior to that date has little import over whether USI has violated Commission regulations. The background does, however, provide context regarding the chain of events that led to the failure of the Herring Creek system and to the ongoing dispute between USI and its Herring Creek customers. What follows, therefore, is a summary narrative of events that is not intended to resolve any relevant factual disputes.

112. In the early 1980s, because of changing environmental regulations, the industry for community wastewater systems evolved from systems that discharged treated wastewater directly into waterways to large septic systems that utilized land disposal methods. State environmental agencies, including DNREC, issued standards to govern the design of such systems in the mid-1980s. By the mid to late 1990s, however, many of the systems performed below operational standards and, with the benefit of hindsight, the design standards initially developed were deemed inadequate in certain respects.¹⁶ In Delaware, DNREC revised its wastewater standards for community systems in 1992.

¹⁶ According to Brian Carbaugh, one reason that the initial standards proved inadequate is that they were based on existing, individual septic system standards and while an individual septic system undergoes periodic "resting" periods when the homeowner is away or is simply not using the system, a community system is always being used by someone. (Tr. 467.) The periodic resting periods, as it turns out, are important to the survival of the treatment beds.

113. In 1985, the Herring Creek developer paid USI to design a community wastewater system, paid for its construction, and then transferred the system to USI to own and operate under a sewage disposal agreement. USI designed the system in compliance with the untested DNREC regulations in place at the time. In addition, USI relied on soil samples and "perc" tests that later proved to be unrepresentative of the actual soil and ground water conditions in several locations used as treatment beds for the Herring Creek system.

114. According to USI, the combination of untested design standards and inadequate soil sampling proved fatal to several of its systems, including the one at Herring Creek. The first system failure at Herring Creek, as revealed by the surfacing of effluent on the treatment beds, occurred in 1995. According to Staff and DNREC, maintenance problems contributed substantially to USI's system failure, judging from the number of similar designs in Delaware that did not fail during that time period and based on USI's failure to take effective corrective measures. Staff also notes that by the end of the 1990s, the Herring Creek system was approaching the end of its 15 to 20-year design life, and replacement soon would have been necessary anyway.

115. In 2000, 2002, and 2004, DNREC issued Notices of Violation for system failures at Herring Creek, primarily involving the surfacing of effluent. In accordance with the Notices, USI built relief trenches as a temporary measure, which worked for a period of time, but then was directed to continuously pump the waste from the system. The violations, however, were never adequately corrected and

the surfacing problem continued. As a result, USI's Herring Creek system remained on DNREC's noncompliance list longer than any other wastewater system in Delaware. In addition, during the early 2000s, several homeowners complained of system back-ups, excessive back flow into their homes, and the odor of sewage in the neighborhood.

116. In the late 1990s and early 2000s, USI developed a long-term plan to install a new treatment and rapid infiltration system, for which DNREC granted a permit in October of 2002. To help finance the project, USI explored the possibility of a low-interest loan program, which is administered by DNREC, and which would have covered half of the \$500,000 required for the project. However, not enough homeowners completed the financial disclosure forms for Herring Creek to qualify for the loan. Some owners did not comply because of their belief that the average income level in the community was too high for them to qualify for the program, which was based on financial need. In the meantime, USI paid a waste hauler to pump the system on a regular basis, at substantial cost.

117. According to Staff, USI could have obtained private financing for the project but Mr. Carbaugh, as USI's principal owner, was unwilling to put up the required collateral for the loan. According to USI, commercial financing was unlikely because banks will not accept a wastewater system as collateral, and a personal guarantee from Mr. Carbaugh would be too risky in light of the customer revolt unfolding in the Herring Creek community.

118. In May of 2004, faced with surfacing effluent adjacent to its community, periodic back-ups for certain residents, escalating

sewage fees, depressed property values, and years of waiting for USI to construct the new system, the Association attempted to exercise a reversion clause in its sewage agreement with USI, for the purpose of taking over operation of the system. In furtherance of this effort, the Association formed the WCWS and directed the homeowners to start paying sewage fees to the Association or WCWS rather than to USI. Most residents complied with the Association's request while a minority (perhaps 30 percent) continued to pay USI directly.

119. On July 6, 2004, the Commission was granted jurisdiction over wastewater utilities. Later in July, USI filed a contract action in Chancery Court against the Association, claiming that it was owed approximately \$360,000 under the sewage agreement. In August 2004, in a preliminary ruling, the Chancery Court enjoined the Association from interfering with USI's operation of the system and directed the Association to pay USI's operating expenses (*i.e.*, mainly pumping costs) from the sewage fees it had collected from homeowners.

120. In October of 2004, USI applied to the Commission for a CPCN, the Association objected, and the case was sent to a Hearing Examiner. In November of 2004, DPH inspected the Herring Creek system and issued a report citing the failure of the system, in which it identified potential health hazards and recommended certain corrective action. In December of 2004, USI notified the Herring Creek homeowners that it would cease operations on December 31, 2004, it relinquished its permits to DNREC, it withdrew its CPCN application with the Commission, and it sold three parcels of land (that it was holding for the system upgrade) to Mr. and Mrs. Carbaugh's property

management company for \$120,000. On December 31, 2004, USI ceased operations at Herring Creek. Since then, the Association has been paying a waste hauler to pump waste from its system.

121. In June of 2005, the Commission's Hearing Examiner and the Chancery Court conducted separate hearings. Decisions from the Commission and the Chancery Court are pending. (See *Utility Systems, Inc. v. Woods on Herring Creek Homeowners Association*, C.A. No. 558-S.)

B. Issues for Resolution

122. In this case, the Commission directed me to address several issues, as follows:

Hearing Examiner O'Brien shall address whether Utility Systems, Inc., may abandon or discontinue the operation of the Woods on Herring Creek Community wastewater system without Commission approval. Hearing Examiner O'Brien shall also address, and the Commission Staff is authorized to investigate, whether Utility Systems, Inc., has the financial capability to operate the two wastewater systems for which it has received CPCNs from the Commission, whether Utility Systems, Inc., has been paying its vendors, and whether Utility Systems, Inc., has the financial resources to do so, and any other matter related to the issues presented in this docket or PSC Docket No. 04-WW-001. Hearing Examiner O'Brien shall also address whether further relief is just and proper, including whether the imposition of any statutory penalties on Utility Systems, Inc., is appropriate.

(PSC Order No. 6588 (March 8, 2005); at Ordering ¶ 4.) I will address, therefore: (a) USI's abandonment or discontinuance of the Herring Creek system; (b) USI's financial capability to operate the Woodlands and Gull Point systems; and (c) any other related matters. Other related matters include Staff's recommendations relating to

adequacy of service at Herring Creek and the Woodlands and USI's sale of three Herring Creek lots in December 2004, without Commission approval. In addition, I will address, as directed, the imposition of statutory penalties relating to these topics. Finally, I will consider Staff's additional recommendations for USI, which consist of several prospective reporting and accounting requirements.

C. USI's Abandonment or Discontinuance of the Herring Creek System

123. The Commission identified this issue as "whether [USI] may abandon or discontinue the operation of the [Herring Creek] wastewater system without Commission approval." Title 26, § 203A(c)(1) of the Delaware Code provides:

Subject to the provisions of Chapter 10 and § 706(d) of this title and excluding electric suppliers, no public utility shall abandon or discontinue, in whole or in part, any regulated public utility business, operations or services provided under a certificate of public convenience and necessity or otherwise which are subject to jurisdiction of the Commission without first having received Commission approval for such abandonment or discontinuance.

Section 203(A)(c)(6) provides:

Nothing contained in this section shall be construed to require formal application for approval of abandonment or discontinuance of service to any individual customer or customer class where the basis for such abandonment or discontinuance is nonpayment of bills or other violation of a utility's rules, regulations and tariffs.

124. In its brief, USI argues that Commission approval is not required because: (a) it did not abandon all of its Delaware operations; (b) its abandonment of the system was not voluntary; (c) it turned the system over to a licensed operator with no service

disruption; and (d) USI's actions constituted a termination of service to a distinct customer class due to nonpayment by customers, which is permitted under § 203A(c)(6). (USI AB at 47-59.) For the following reasons, however, I recommend that the Commission reject each of these arguments and find that USI cannot cease operations at Herring Creek without first obtaining Commission approval.

125. First, the fact that USI did not abandon all of its Delaware business operations does not eliminate the requirement for Commission approval. As noted by Staff (and as seen above), Section 203A(c) prohibits a public utility from abandoning or discontinuing its business, operations or services "in whole, or *in part*." (Emphasis added.) The very language of the statute, therefore, contradicts USI's argument. Furthermore, to interpret the statute to allow a utility to abandon nearly all of its operations, yet avoid Commission scrutiny by holding on to some small part, would render the statutory requirement for approval nearly useless. (St. RB at 45.)

126. Second, USI's assertion that its cessation of operations was involuntary is not supported by the record evidence. USI claims that it was the Association's "starvation of funds to USI, combined with the threat of massive DNREC penalties should it fail to continue to pay pumping charges, that led to USI relinquishing its DNREC permits." (USI AB at 49.) However, the Association transferred to USI the funds it collected in wastewater charges *under court order* and most of the homeowners who did not send their fees to the Association paid USI directly. If USI disagreed with the manner in which the Association transferred the funds that it had collected, or the amount

thereof, it could have sought clarification of the order from Chancery Court, *which it did*. In other words, Chancery Court was controlling the Association's reimbursement of USI's expenses while the parties litigated the contract dispute and it would not (and did not) provide the Association the ability to "starve" USI of funds.

127. Moreover, USI's success in actually collecting funds undermines any allegation of "starvation," even if most of the funds were collected late. (Staff RB at 46-47.) After all, by the end of 2004, when USI ceased operations, it had collected \$124,981 out of \$140,248 in total invoices in 2004 (USI Ex. 5 at NNN, QQQ), for an 89 percent collection rate. With this level of collection, USI was not forced to cease operations at the end of 2004 without first gaining Commission approval. In addition, if USI truly needed additional funds, it could have sought permission from DNREC to use funds collected from other systems (USI had \$95,000 in the bank when it abandoned the Herring Creek system, and its only unpaid expense at Herring Creek was a \$22,100 waste-hauling bill from one vender) or it could have sought a rate increase from the Commission. (St. RB at 46.)

128. As part of its argument that its cessation of operations was not voluntary, USI asserts that, under Section 203A(b)(2), it need not seek approval for abandonment because it did not have control of the system.¹⁷ (USI AB at 48-49.) USI did control the system, however, to at least the extent necessary to continue pumping the system, which

¹⁷ Section 203A(b)(2) provides: "Interruptions of service in such operations over which [a]... legal entity ... had no control shall not be considered in determining whether or not there has been an abandonment of any such operations."

was nearly the sum total of operations taking place at that time. In fact, Roberts Septic continued pumping waste from the system through the end of 2004 and into 2005, even after USI abandoned the system and despite delinquent payments from USI. Furthermore, USI not only held the necessary DNREC permits for operation of the system but also was the beneficiary of a Court Order enjoining the Association's interference of its operations. USI held, therefore, whatever control was necessary to continue operating the system at the end of 2004 and beyond. Rather than continuing with the operations, pending the outcome of its claim in Chancery Court, however, USI freely chose to cease operations.

129. USI also cites the "threat of massive DNREC penalties" to justify its cessation of operations without Commission approval. It is unlikely, however, that DNREC would impose "massive" penalties on USI once USI commenced proceedings at the Commission in an effort to resolve its problems at Herring Creek (or to abandon the system), especially when DNREC had yet to fine USI after ten years of operational violations under its DNREC permits. I agree with Staff, therefore, that the potential for DNREC penalties does not justify abandonment of the system without Commission approval. (St. RB at 48.)

130. Ultimately, USI's contention that the Association interfered with its financial ability to operate the system, if correct, simply provides grounds for USI to request abandonment of the system and for the Commission, if it sides with USI, to grant the request. This contention does not, however, excuse USI from the

requirement to obtain approval prior to abandoning the system. After all, judging from the breakdown in the relationship between USI and its Herring Creek customers, and on USI's operational failures with the system to date, the Commission likely would permit abandonment, once sought, under appropriate conditions.

131. Third, USI's assertion that abandonment was not improper because it turned over the Herring Creek system to a licensed operator, without disruption of service, has no bearing on whether Commission approval is required. Again, whether or not USI secures a suitable replacement utility would bear on the Commission's decision regarding whether or not to grant approval of the request for abandonment, but it in no way excuses USI from the requirement for approval. Indeed, one of the reasons that approval is required is so that the Commission can determine whether the proposed replacement utility possesses the necessary technical, managerial, and financial ability to operate the system. USI is not authorized to make that assessment unilaterally.

132. Lastly, USI argues that its actions constituted a termination of service to a distinct customer class due to nonpayment by customers, which is permitted without Commission approval, under § 203A(c)(6). First, in light of the fact that the Association paid USI under a court order and that USI collected 89 percent of customer invoices, there was not sufficient "nonpayment" in this case to justify termination of service. More importantly, however, even if there were sufficient "nonpayment," I agree with Staff that the

"nonpayment" exception to the requirement of Commission approval does not apply to USI in this case, for the following reasons.

133. Section 203A(c)(1) forbids a public utility from abandoning or discontinuing, in whole or in part, its "business, operations or services." Section 203A(c)(6) creates an exception to the requirement of Commission approval, but only for abandonment or discontinuance of "service." The exception in § 203A(c)(6) does not, therefore, allow a public utility to abandon or discontinue its "business or operations" for nonpayment. It may only use nonpayment as a basis to abandon or discontinue "service." (St. OB at 62-3.) Utilities routinely discontinue, or "terminate," service to customers for nonpayment, without Commission approval, in accordance with their tariff and Commission regulations. Utilities cannot, however, abandon operations to an entire community without first filing for approval with the Commission.

134. USI also argues that because the structural aspects of its wastewater system do not allow for termination of service to individual customers, § 203A(c)(6) must be read to allow USI to cease all operations for nonpayment, even if some customers have not failed to pay their quarterly fees. (USI AB at 58.) The statute, however, includes no exception for utilities that cannot terminate individual service and, therefore, USI is still required to obtain Commission approval prior to abandoning its operations in a community. Again, while the Commission may consider USI's inability to terminate individual service in its decision as to whether or not to approve

abandonment, it in no way excuses USI from the requirement for Commission approval.

135. For these reasons, I recommend that the Commission find that when USI ceased operations at Herring Creek on December 31, 2004, without Commission approval, it violated 26 *Del. C.* § 203A(c)(1). By violating this section, USI also failed to comply with PSC Order No. 6458 (Oct. 5, 2004), which required all wastewater utilities to abide by all statutes and laws of the State of Delaware governing such utilities.

136. Staff recommends a \$90,000 fine for USI's failure to comply with PSC Order No. 6458 when it abandoned the Herring Creek system without Commission approval. (St. OB at 70.) Under 26 *Del. C.* § 217, a public utility that is in "default of compliance with any order of the Commission ... shall be subject to a penalty of up to \$1,000 per day for every day during which such default continues..." For each day that USI is in default of compliance with section 203A(c)(1), therefore, it is subject to a penalty of \$1,000 per day. Despite a written request by Staff that USI file an application for abandonment, USI failed to do so, and remains in default of its obligation to obtain Commission approval.

137. While USI has been out of compliance since December 31, 2004, Staff recommends daily \$1,000 fines for the 90 days that passed between January 8, 2005, which is the day after USI notified the Hearing Examiner that USI would not seek to obtain Commission approval for its abandonment of the Herring Creek system, and April 4, 2005, which is the date that USI served its Answer in PSC Docket No. 05-58.

Staff recommends that USI be required to pay the penalty at the rate of \$5,000 per month over the next 18 months, unless USI receives a substantial damages award in the Court Of Chancery, in which case the award should be applied to satisfy the penalty.

138. As grounds for the large size of the penalty, Staff argues that USI's conduct is particularly unreasonable, for the following reasons:

For starters, when USI walked away, the WOHC system was more than fifteen years old, and based on observations by DNREC and DPH, was obviously beyond its useful life expectancy. USI had known for more than five years that the system was in dire need of major capital improvements that would cost a minimum of \$500,000. The treatment beds had completely failed, and were subject to persistent surfacing of foul, health-threatening, raw effluent, despite regular pumping of the system dosing tanks. The system had been on DNREC's list of noncompliant wastewater systems for years; and much longer than any other community wastewater system. USI had been cited numerous times for regulatory violations at WOHC. USI knew when it abandoned the system, that the deplorable condition of the treatment beds meant that the system remained in violation of DNREC laws and regulations and that, at a minimum, hundreds of thousands of dollars would have to be invested in the system to bring it back into compliance.

Staff submits that USI used its dispute with its customers to try and rid itself of a public health, environmental, and financial disaster of its own making. USI was hoping to trade away a liability that was known to exceed \$500,000, at the cost of a few thousand dollars that the customers supposedly owed USI for unpaid utility bills.

There are more reasons justifying a major penalty against USI. When USI abandoned the residents of the WOHC, the only thing keeping the system from complete meltdown was the regular pumping of waste from the dosing tanks by Roberts Septic. However, as Clark Carbaugh testified, pumping is

outrageously expensive, and is obviously the least economical method of operating a wastewater system. That is precisely what USI and Mr. Carbaugh bequeathed to their customers, all of whom had paid their bills faithfully for years - until May 2004 - and all the while living with failed treatment beds, foul-smelling wastewater surfacing near their homes, and wastewater actually backing up into their homes. In December 2004, the WOHC wastewater system was a completely failed system, which could only be maintained by the most expensive method available.

But there are more. On November 19, 2004, the Division of Public Health, DNREC and Sussex County inspected the WOHC system. In addition to describing a public health hazard and substandard maintenance, DPH cited the need for a) daily monitoring of the treatment beds, b) treatment of the effluent breakouts with lime, c) installation of additional and improved signage, d) significantly increased pumping of waste (already outrageously expensive), e) an increased septic tank clean-out schedule, and f) an eight-foot high chain link fence around the perimeter of both the treatment beds and the dosing tanks. Mr. Carbaugh was given advance notice of the DPH/DNREC inspection. Whether he cared enough to find out about the outcome, he did not say. Regardless, when USI abandoned the system, the residents of the WOHC were left to deal with the needs of the system identified by DPH.

And there are still more. Mr. Carbaugh, the President and controlling shareholder of USI, is a licensed engineer, and is experienced in the design and operation of wastewater systems. He knows full well that he could not have left the WOHC system in worse shape, if he deliberately set out to ruin it, and his customers along with it. Mr. Carbaugh himself described WOHC as a "failed system." He has several times referred to the treatment beds as an unacceptable environmental condition that is worsening.

And still more. The unrebutted testimony of William Cassot described the system that USI left behind. There was bare electrical wiring which presented a serious safety hazard, a pump that was rusting apart, and treatment beds littered with debris in violation of DNREC regulations that would cost thousands of dollars to remove.

There were septic tanks that had not been pumped in four to six years, tanks clogged with solid waste, tanks with openings that were three feet below the ground that took hours to locate, tanks without risers that were needed for service, tanks overloaded with solid waste and openings that were too small to allow the waste to be broken up, and a tank that was improperly installed, that for years had caused wastewater to back up into a customer's home from the central collection system, and had never been fixed by USI.

USI did not leave behind any operations or maintenance manuals for Mr. Cassot or anyone else to consult in order to determine how best to operate the system and its equipment. Mr. B. Carbaugh had testified that USI's problems at the Woodlands supposedly stemmed from operations issues. The same might be true, at least to some extent, at WOHC. USI did not offer to coordinate with Mr. Cassot, or with White Marsh, the contract operator hired by the Homeowners Association. Mr. Carbaugh and his operations and maintenance employees did not meet with Mr. Cassot or White Marsh at the WOHC system, show them the equipment, explain how it should be maintained and operated, and answer questions. USI left the residents of WOHC to fend for themselves.

(Staff OB at 65-67.)

139. USI, of course, disputes many of Staff's conclusions. However, even if the Commission relied solely on the undisputed facts, Staff's recommended fine would be warranted. First, USI's large-scale abandonment of its regulated operations is unprecedented in the history of PSC regulation (outside the context of resellers of telephone service, where customers can easily pick up affordable service elsewhere). (St. OB at 64.) USI, after all, did not abandon a viable wastewater system, or even a system that required a reasonable amount of work to make it operable, in which case substantial penalties may not have been warranted. USI abandoned an

admittedly failed system (requiring a \$500,000 to \$1.5 million upgrade as a long-term fix), with "outrageous" ongoing operating costs, with outstanding violations from both DNREC and DPH relating to adverse environmental and public health conditions, *after transferring to its principal owner the very property that was necessary for a system upgrade*. These undisputed facts alone justify the size of the penalty recommended by Staff and I recommend, therefore, that the Commission accept Staff's recommendations regarding this item.

140. As an alternative, if the Commission finds that mitigating circumstances exist in this case, such as USI's inexperience as a regulated utility and its long-standing dispute over finances with its Herring Creek customers, and if the Commission finds that USI believed in good faith that no Commission approval was required for the abandonment, then the Commission may wish to consider foregoing any fines for past non-compliance. Instead, the Commission could direct USI to file for abandonment approval by a date certain (or resume operations under Staff supervision) and then impose \$1,000 penalties for each day that it fails to comply with the Order. In this way, USI could still avoid penalties for its unlawful abandonment, as long as it meets the filing deadline. In order to avoid penalties thereafter, USI would have to work with Staff to meet all conditions of approval for abandonment placed on it, which would likely relate to such things as the condition of the facilities and drain fields at the time of transfer, the return of properties necessary for system upgrade, and the presence of a suitable replacement utility that has agreed to a transfer arrangement.

D. USI's Financial Capability to Operate The Woodlands and Gull Point Systems

141. The Commission identified this issue as "whether Utility Systems, Inc., has the financial capability to operate the two wastewater systems for which it has received CPCNs from the Commission." (Order 6588.) In its post-hearing briefs, Staff made no recommendations for Commission action on USI's CPCNs for its Woodlands or Gull Point systems pertaining to USI's financial capabilities to operate these systems. Staff did, however, make the following assertions:

Gull Point receipts for 2004 were \$99,176.04 versus expenditures of \$14,218.32, which means receipts exceeded expenditures by more than \$84,000. USI's 2004 receipts at the Woodlands were listed at \$22,926 against expenditures of \$11,991.41, which means receipts exceeded expenditures by more than \$10,000. Thus, for those two systems combined, 2004 receipts exceeded expenditures by about \$94,000.

(Staff OB at 20; *citing* Staff Ex. 45.)

142. Based on these numbers, which show that receipts exceed expenditures, and on the absence of any recommendations from Staff on this item, I recommend that the Commission take no action on USI's Woodlands and Gull Point CPCNs relating to USI's financial capabilities.

E. Adequacy of Services and Facilities at Herring Creek and The Woodlands

143. As noted above, Staff's investigation in this case included whether or not USI's facilities and services at Herring Creek and the Woodlands are inadequate, which would subject USI to penalties under § 308 of Title 26. Section 308(a)(2) provides:

If the Commission finds that the public utility's facilities, products or services are inefficient, insufficient or inadequate, it may impose such penalty upon the public utility as may be necessary to restore such facilities, products or services to a state of efficiency, sufficiency or adequacy. Upon significant improvement in such services, products or facilities, the Commission may, after hearing, remove or reduce the penalty imposed.

Staff concluded that USI has not provided adequate facilities or service at Herring Creek or the Woodlands and has recommended penalties in the amounts of \$250,000 and \$150,000, respectively, pursuant to § 308(a)(2).

144. As addressed above, USI argues that it was not properly noticed of the possibility of § 308 penalties -- an argument which I have recommended that the Commission reject. (*Supra*, ¶¶ 28-30.) In the alternative, USI argues: (a) that the Association's actions prevented it from obtaining financing for construction of the DNREC-approved system upgrade at Herring Creek, which would have corrected any system deficiencies; and (b) that Staff has not shown that USI is providing inadequate service at the Woodlands. For the following reasons, however, I recommend that the Commission adopt Staff's proposals regarding § 308 penalties.

145. First, a public utility's statutory obligation to provide adequate facilities and service is in no way conditioned on the assistance of ratepayers in obtaining financing for capital improvements. While it may be true that USI's business model for its community wastewater systems differs substantially from the traditional "rate base, rate of return" regulatory model, USI cannot escape the Delaware legislature's decision, effective July 6, 2004, to

subject USI's wastewater systems to existing Commission regulations governing public utilities in this state. Therefore, whether or not the customers fully cooperated with USI's efforts to obtain financing, USI must provide adequate facilities and service, or face the possibility of financial penalties under § 308(a)(2).

146. Furthermore, aside from the proposed system replacement, there were several measures that USI could have undertaken to improve its operation of the system in the latter half of 2004 but did not. As noted by Staff, USI could have placed a free-standing container at the site to enable continuous pumping, which would have prevented wastewater from reaching the failed treatment beds and surfacing, and which USI had done at another USI community system. (St. OB at 13, *citing* Tr. (Hamilton) 242-45.) In addition, USI could have placed lime on the treatment beds to control odor and reduce the risk to public health, and it could have erected a fence and posted better signage at the beds, which also would have reduced the health risks. In this vein, Staff is not seeking to penalize USI for a management decision not to move forward with the replacement system, as argued by USI (USI AB at 60-61), but is simply penalizing USI for failing to maintain adequate facilities and service, by whatever means.

147. Apparently, USI does not dispute the fact that its Herring Creek facilities and service were inadequate in the latter half of 2004, at a time when the PSC held wastewater jurisdiction. In his pre-filed testimony, Mr. Carbaugh refers to the Herring Creek system as having "ongoing unacceptable environmental conditions" in early 2004 and, in December 2004, as a "failed system" with "outrageous

costs" and "unacceptable environmental conditions worsening." (Ex. 4 at 11, 18.) Moreover, even if it were disputed, there is ample record evidence to support such a finding, including photographs of surfacing effluent, eyewitness testimony from homeowners and Ms. Hamilton, the outstanding DNREC violations, and customer complaints regarding repeated backups and odors in the community. And, of course, the DPH report from a November 2004 site visit, which includes the following observations:

This failed system needs action and should be fixed immediately. ... [T]he raw effluent at the break-through areas on the ground would be expected to contain human pathogenic organisms. The effluent would be expected to test positive for fecal indicator organisms. The pathway for exposure is via trespassers (children, adults and pets) having direct contact or tracking this effluent into the several adjacent homes and other homes/situations where ingestion and/or other entrance into the body (eyes, nose, wounds...) could lead to illness and disease.

(St. Ex. 18.)

148. Staff recommends that the Commission penalize USI \$250,000 for its inefficient and inadequate service and facilities at Herring Creek and that the Commission order USI to pay the penalty with whatever funds Chancery Court awards USI, although Staff doubts that USI will prevail in that action. (St. OB at 75-76.) If Chancery Court does not award USI sufficient funds to pay the penalty, Staff notes that USI may apply to the Commission to have the penalty reduced if USI reimburses the Association or the WCWS the costs reasonably incurred in 2005 to resolve the system deficiencies and pay for the cost of complying with the recommendations made by DPH in its Site Visit Report from November 2004.

149. Based on the fact that USI's wastewater system at Herring Creek has failed completely and, by abandoning the system, USI has shown no intention of fixing it, and because USI has not even taken relatively simple steps to improve service on a temporary basis, Staff's proposed fine for inadequate service and facilities is warranted. Indeed, because of USI's neglect, a substantial penalty "may be necessary to restore such facilities ... or services to a state of efficiency, sufficiency or adequacy," under § 308(a)(2). I also note, however, that § 308(a)(2) provides that "upon significant improvement in such services, products or facilities, the Commission may, after hearing, remove or reduce the penalty imposed," which the Commission should consider if significant improvement is made.

150. Regarding USI's wastewater operations at the Woodlands, Staff recommends the following:

- a) The Commission impose a \$150,000 penalty upon USI, under section 308, for its inadequate services and facilities at the Woodlands for the period after July 2004 through the date the hearings in this matter began, namely, June 6, 2005; and
- b) USI be compelled to satisfy the penalty from any award of damages it may receive in the Chancery Court action against the WOHC Homeowners Association. In the event the Chancery Court does not make an award of damages in USI's favor, then USI may apply to the Commission for the elimination of, or reduction of, the penalty under the following circumstances: 1) USI establishes that a) it is pumping waste from the Woodlands system on a schedule that will reduce or eliminate surfacing of effluent in the treatment beds; or b) that USI has taken other steps to eliminate the threat of effluent surfacing, such as installing new equipment or improving the operation of its current equipment; 2)

USI is completely up to date on the cleaning of septic tanks at the Woodlands, and that there are no problems with the septic tank system comparable to those that exist at the WOHC; 3) USI establishes that the wastewater treatment system at the Woodlands is capable of providing safe, reliable and efficient wastewater service to the residents of the Woodlands; 4) USI cooperates with Staff in identifying and correcting the problems with the wastewater system at the Woodlands; and 5) USI pays, in advance, the reasonable cost of an independent consultant, selected by the Commission Staff, to oversee USI's activities at the Woodlands and to verify that USI is meeting, and ultimately, that USI has met, the requirements of conditions 1, 2 and 3, set forth above.

151. USI argues that Staff has not proven that USI's facilities at the Woodlands are inadequate. Ms. Hamilton, however, offered uncontradicted testimony that USI's system at the Woodlands presently suffers from surfacing effluent on the treatment beds, as it has consistently for the last ten years. (St. OB at 45, *citing* St. Ex. 29 (Hamilton) at 4.) Brian Carbaugh also noted ongoing surfacing problems at the Woodlands. (Tr. 457.) Ms. Hamilton's testimony is consistent with DNREC Notices of Violation from November 2000, February 2002, and January 2004, citing the surfacing of effluent in amounts sufficient to create a public health hazard. (St. OB at 43-5; *citing* St. Ex. 24, 26.) While these Notices reflect environmental violations prior to the onset of Commission jurisdiction and therefore would not form the basis of a Commission violation, such records do support Ms. Hamilton's testimony regarding a long-standing surfacing problem at the Woodlands.

152. In addition, while perhaps not as serious as surfacing problems, Brian Carbaugh testified that USI has yet to work out certain mechanical problems associated with a recent system upgrade at the Woodlands and Mr. Carbaugh testified that a sink hole has recently developed there, which in turn has caused certain operational problems with a pump station. (Tr. 457.) For these reasons, I recommend that the Commission find that Staff has met its burden of proving that USI's wastewater services and facilities at the Woodlands are inadequate, and accept Staff's proposed penalty of \$150,000 as well as Staff's proposed requirements for lifting of said penalty. As noted by Staff, if it turns out that USI is correct that its facilities at the Woodlands are adequate, then USI should readily be able to meet the conditions set by Staff for elimination the penalty.

F. USI's Sale of Three Properties at Herring Creek in December of 2004

153. On December 21, 2004, USI sold lots 5, 6, and 7 at Herring Creek to Carbaugh Property Management, LLC for \$120,000, without requesting permission of the Commission. (St. OB at 79.) Clark Carbaugh and his wife, Elizabeth D. Carbaugh, are equal owners of Carbaugh Property Management. USI netted just over \$35,000 from the sale of the lots. USI did not use the net proceeds of the sale to pay obligations directly attributable to Herring Creek by paying, for example, the balance owed to Roberts Septic. Staff argues that USI's sale of the lots violates section 26 *Del. C.* § 215(a)(1). USI contends that it sold the lots because it no longer has a business reason to continue the costs of ownership of the lots, and USI's

expenses were reduced as a result of the sale because it did not have to pay the financing for the lots. (*Id.*)

154. Under 26 *Del. C.* § 215(a)(1):

- (a) No public utility, without first having obtained approval of the Commission, shall:
 - (1) Directly or indirectly ... sell ... any essential part of its franchises, plant, equipment, or other property, necessary or useful in the performance of its duty to the public...

I agree with Staff that lots 5, 6, and 7 were essential to the wastewater improvements project that DNREC permitted and approved for the WOHC in October 2002, as the lots were to serve as the area for additional treatment beds. (*Id.*) Accordingly, they were also either "necessary or useful in the performance of its duty" to the Herring Creek community, under § 215(a)(1).

155. By failing to obtain Commission approval, therefore, USI violated § 215(a)(1) and, of course, PSC Order No. Order 6485, which required USI to comply with the provisions of Title 26. Staff recommends that the Commission assess a penalty of \$1,000 against USI under 26 *Del. C.* § 217. I agree with Staff that a penalty is warranted, especially in light of the fact that: (a) USI sold the properties to a company owned by Mr. and Mrs. Carbaugh, which raises certain conflict of interest issues associated with affiliated transactions; and (b) the sale was made just prior to abandoning the system, leaving the new operator without properties that likely will be required for a system upgrade.

G. Staff's Additional Recommendations

156. Staff has the following additional recommendations:

1. Staff recommends that USI be ordered to provide an accounting to Staff, on a monthly basis, of all of its income, receipts and expenditures, and provide copies of all supporting documentation, such as invoices and canceled checks.
2. Staff also recommends that USI be ordered to give Staff written notice, at least five business days in advance of any effort to transfer USI property with a value greater than \$500, except in the ordinary course of business to meet current obligations.
3. Staff recommends that USI be required to make and keep written records of all customer complaints and maintain such records for at least three years.
4. Staff recommends that USI remain financially obligated to fund improvements to the WOHC system, until the problems with the treatment system have been corrected.
5. Staff recommends that USI be required to escrow in a separate and distinct bank account, which is subject to review and audit by the Commission Staff, all funds that USI receives for residual property rights that USI has in the Henlopen Acres system. Those funds shall be first applied to repair any defects in the central waste collection system at WOHC that existed as of December 31, 2004, including any septic tank that was improperly installed. The funds should next be applied to pay the outstanding debt of \$22,100 to Roberts Septic. Next, the funds shall be applied to pay any penalties assessed against USI by the Commission in these proceedings. If USI sells any of its assets, the proceeds of the sale shall be placed in the escrow as indicated above and applied as indicated above.
6. The Commission should keep these dockets open for the purpose of following up on all issues related to these dockets, and for a determination of whether USI's CPCNs for Gull Point and the Woodlands should be suspended or revoked, pursuant to 26 Del. C., section 203D(j).

(St. OB at 80-81.) Based on USI's status as a regulated public utility and its demonstrated inability or unwillingness to sustain a viable wastewater system at Herring Creek, these recommendations are reasonable and I recommend their adoption by the Commission.

157. Throughout this proceeding, USI has gone to great lengths to avoid Commission regulation altogether or, in the alternative, to somehow excuse its failure to comply with PSC, DNREC, and DPH regulations. In enacting the recent wastewater legislation, however, the General Assembly saw a public need for PSC regulation of wastewater utilities, and judging from the evidence in this case, the Herring Creek system is the "neediest" of Delaware's wastewater systems. Staff would be remiss, therefore, not to bring to bear the full extent of the Commission's enforcement authority in this case in an attempt to resolve the serious problems at the Woods on Herring Creek. As such, and for the reasons stated above, all of Staff's recommendations for penalties and for ongoing supervision of USI's activities are warranted.

VII. SUMMARY OF RECOMMENDATIONS

158. In summary, and for the reasons discussed above, I propose and recommend to the Commission the following:

- A) That the Commission deny, in total, USI's June 2, 2005 Motion for Reconsideration of its May 31, 2005 Motion to Dismiss and Motion in Limine, in which USI challenges the Commission's jurisdiction in this matter and objects, on due process grounds, to the consideration of penalties under 26 Del. C. § 308(a)(2) in this proceeding (¶¶ 28-30);
- B) That the Commission find that Staff Counsel's assistance in drafting or editing Staff witness Neilson's pre-filed testimony does not violate

USI's due process rights and that the Commission, therefore, overrule USI's objection to such assistance (¶¶ 15-17);

- C) That the Commission grant USI's June 6, 2005 Motion to Strike as it relates to Staff witness Neilson's pre-filed supplemental testimony in which he repeats certain oral statements made by customers at the May 17, 2005 public comment hearing (*i.e.*, Staff Exhibit No. 6 at page 2 (line 8) to page 6 (line 7); and page 9 (line 3) to page 10 (line 11)) and deny the rest of USI's Motion to Strike as it relates to hearsay evidence and to legal conclusions by lay witnesses (¶¶ 18 to 27);
- D) That the Commission find that on December 31, 2004, USI abandoned its operations at the Woods on Herring Creek without Commission approval, in violation of 26 *Del. C.* § 203A(c)(1) and PSC Order No. 6458 (Oct. 5, 2004), and that it accept Staff's recommendation to impose a penalty for such violation in the amount of \$90,000, pursuant to 26 *Del. C.* § 217 (¶¶ 123-140);
- E) That the Commission find that from July 6, 2004 (when USI was first subject to the Commission's jurisdiction), until December 31, 2004 (when USI ceased operations at Herring Creek), USI failed to provide adequate facilities and service at the Woods on Herring Creek, and that it accept Staff's recommendation to impose a penalty for such failure in the amount of \$250,000, pursuant to 26 *Del. C.* § 308(a)(2) (¶¶ 143-149);
- F) That the Commission find that USI currently is failing to provide adequate facilities and services at The Woodlands of Millsboro, and that it accept Staff's recommendation to impose a penalty for such failure in the amount of \$150,000, pursuant to 26 *Del. C.* § 308(a)(2), and that it accept Staff's proposed requirements for elimination of the penalty (¶¶ 150-152);
- G) That the Commission find that USI sold "necessary or useful" property in December 2004 without Commission approval in violation of 26 *Del. C.* § 215(a)(1) and accept Staff's recommendation to impose a \$1,000 penalty for such violation, pursuant to § 217 (¶¶ 153-155); and
- H) That the Commission adopt Staff's additional recommendations, as outlined above, at ¶ 156.

159. I note that the penalties under E and F above may be reduced or eliminated, after a hearing, if USI shows significant improvement in its services and facilities, pursuant to § 308(a)(2). I also note that I have provided the Commission with an alternative course of action to D, at ¶ 140 above, that calls for the imposition of § 217 penalties only if USI fails to satisfy certain Commission-established conditions for approval of its abandonment of the Herring Creek system by certain future deadlines.

Respectfully submitted,

/s/ William F. O'Brien
William F. O'Brien
Hearing Examiner

Dated: September 26, 2005