

ORIGINAL

EXCEPTION



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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

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COMMISSIONERS

2004 DEC 20 P 4: 29

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MARC SPITZER - Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
MIKE GLEASON
KRISTIN K. MAYES

AZ CORP COMMISSION
DOCUMENT CONTROL

DOCKETED BY

IN THE MATTER OF THE APPLICATION OF
UTILITY SOURCE, L.L.C. FOR A CERTIFICATE
OF CONVENIENCE AND NECESSITY TO
PROVIDE WATER SERVICE IN COCONINO
COUNTY, ARIZONA.

DOCKET NO. WS-04235A-04-0073

IN THE MATTER OF THE APPLICATION OF
UTILITY SOURCE, L.L.C. FOR AUTHORITY TO
ISSUE PROMISSORY NOTE(S) AND OTHER
EVIDENCES OF INDEBTEDNESS PAYABLE AT
PERIODS OF MORE THAN TWELVE MONTHS
AFTER THE DATE OF ISSUANCE.

DOCKET NO. WS-04235A-04-0074

STAFF'S EXCEPTIONS

I. Introduction.

Staff reviewed the well-reasoned and thoughtful Recommended Opinion and Order ("ROO") prepared by the Hearing Division in this matter. The ROO appropriately addresses Utility Source's illegal actions in building a water system, providing service and charging rates without a Certificate of Convenience and Necessity and without rates and tariffs approved by the Commission. These actions were in violation of Title 40 and the Commission's rules, and it is appropriate for the Commission to make it clear that such actions will not be tolerated. Although the ROO departs from Staff's recommendations in a number of regards, Staff does not object to the substance of the ROO. However, Staff does believe that certain technical modifications to the ROO should be made in order to accomplish the goals described in the ROO. Accordingly, Staff submits these Exceptions to the ROO.

II. The ROO should be modified to include a fair value finding.

The first and most fundamental rule of ratemaking in Arizona is that the Commission must find fair value in setting rates. *U.S. West Communications, Inc., v. Arizona Corp. Comm'n*, 201 Ariz. 242, 245-46 ¶¶ 10-21, 34 P.3d 351, 354-55 (2001). Accordingly, Staff believes that the ROO should be modified so that it makes an explicit fair value finding. The ROO provides, at Finding of Fact No.

1 29, that Staff determined Utility Source's water rate base to be \$ 2,768,846 and its wastewater rate
2 base to be \$1,499,224. The ROO also notes that Utility Source did not dispute Staff's figures. Thus,
3 the ROO should be amended so that the Commission expressly finds Utility Source's water rate base
4 to be \$ 2,768,846 and its wastewater rate base to be \$1,499,224.

5 The ROO also states that Utility Source did not provide its customers with notice that the
6 rates it proposed may increase. Of course, in any CC&N application, the proposed rates may be
7 increased or decreased. Thus, in a strict legal sense, the notice required by the Hearing Division's
8 Procedural Order may have been adequate. But Staff is always sensitive to ensuring that customers
9 receive appropriate notice. And in this case, the magnitude of this increase is troubling. For these
10 reasons, Staff expressly required Utility Source to notify its customers of the potential that the rates
11 may be substantially increased. Staff's letter dated September 15, 2004 (attached as Exhibit A)
12 provides that:

13 Staff's agreement is expressly conditioned on the agreement of the developers
14 in question to fully disclose the situation to all of their customers whose sales have
15 not yet closed. Such disclosure must include... that the rates currently charged are
16 not authorized by the Commission and may have to be substantially increased.
Staff's agreement is further condition[ed] on the agreement of the developers in
question to cancel any sales contract or other commitment if the customer so desires.

17 This letter was discussed at pages 87 to 89 of the hearing transcript, and a copy of the letter was
18 provided to the ALJ. The ROO should be modified so that it is clear that Staff required Utility Source
19 to make this disclosure.

20 The ROO also provides that the rates will be "interim". In ratemaking, the term interim
21 generally means that the rates are subject to true-up. In this case, that could mean that Utility Source
22 could assert a claim against its customers to make up for the lower rates recommended in the ROO.
23 Staff would strongly oppose such a claim. Staff believes that the word "interim" should be
24 eliminated so that this potential claim does not arise. Further, certain legal requirements must be met
25 in order to set interim rates. *See Residential Utility Consumer Office v. Arizona Corp. Comm'n*, 199
26 Ariz. 588, 592 ¶¶ 15-18, 20 P.3d 1169, 1173 (2001). Neither the ROO nor any party suggests that
27 these requirements have been met, and therefore the Commission should set permanent rather than
28 interim rates.

1 The ROO proposes that the Commission approve Utility Source's existing rates, until the
2 Commission sets rates as part of a rate case. In a CC&N case where the applicant has existing rates,
3 the Commission can require the applicant to continue charging its existing rates until the next rate
4 case. *See Id.* (discussing *Pueblo Del Sol Water Co. v. Arizona Corp. Comm'n*, 160 Ariz. 285, 772
5 P.2d 1138 (1988)). In this case, Utility Source and Staff analyzed the rates using the normal methods
6 for CC&N applications, which involve estimating figures for rate base and expenses for five years.
7 In CC&N cases, this is done because the utility normally does not have any plant "in the ground" or
8 ongoing operations. Here, Utility Source violated the law by putting plant in the ground and
9 conducting utility operations without Commission authorization. (See ROO, findings of fact No. 30
10 and 31). Accordingly, the ROO found that it would be more appropriate to set rates using traditional
11 rate case methods, and the ROO directs Utility Source to file a rate case. Staff recommends that the
12 ROO be amended to clarify the legal basis for approving the existing rates and the relationship
13 between the fair value finding and the rate approval.

14 Accordingly, Staff recommends that the ROO be amended to (1) make a fair value finding; (2)
15 clarify the facts regarding notice to customers; and (3) clarify the legal basis for approving the
16 existing rates of Utility Source. Proposed language for such an amendment has been filed as Staff
17 Proposed Amendment No. 1, a copy of which attached as Exhibit B.

18 **III. The bond requirement should be clarified.**

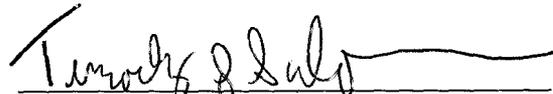
19 The ROO recommends that Utility Source be required to obtain a bond. Staff supports this
20 recommendation. But Staff is concerned about the language of the bond requirement. In particular,
21 although the requirement is termed a "performance bond", the ROO allows this requirement to be
22 satisfied by a "cash deposit" or a "certificate of deposit" or "similar alternative". These alternatives
23 to an actual bond do not provide for the same level of protection, and they impose practical problems.
24 For example, in a prior cases where this language has been approved, the Applicant (represented by
25 the same counsel as Utility Source) proposed submitting a CD payable to the Commission. Such a
26 CD, if ever cashed, would have to be deposited in the State General Fund, which would not benefit
27 the customers of the company at all. The Applicant eventually submitted a certificate of deposit
28 payable to itself. This is totally unsatisfactory, because the Applicant could cash out the CD at any

1 time. There would be no security for the customers and no notice to the Commission. For these
2 reasons, Staff believes that an actual surety bond should be required. Proposed language to amend
3 the ROO to require only an actual surety bond has been filed as Staff Proposed Amendment No. 2, a
4 copy of which attached as Exhibit C.

5 **IV. Conclusion.**

6 For these reasons, Staff requests that the Commission modify the ROO as discussed herein.

7 **RESPECTFULLY SUBMITTED** this 20th day of December 2004.

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11 
12 Timothy J. Sabo
13 Attorney, Legal Division
14 Arizona Corporation Commission
15 1200 West Washington Street
16 Phoenix, Arizona 85007
17 (602) 542-3402

15 The original and thirteen (15) copies
16 of the foregoing were filed this
17 20th day of December 2004 with:

18 Docket Control
19 Arizona Corporation Commission
20 1200 West Washington Street
21 Phoenix, Arizona 85007

22 Copies of the foregoing were mailed and faxed this
23 20th day of December 2004 to:

24 Richard L. Sallquist, Esq.
25 Sallquist & Drummond, P.C.
26 4500 S. Lakeshore Drive, Suite 339
27 Tempe, Arizona 85252

28

29 Deborah A. Amaral

EXHIBIT A

COMMISSIONERS
MARC SPITZER - Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
MIKE GLEASON
KRISTIN K. MAYES



BRIAN C. MCNEIL
Executive Secretary

ARIZONA CORPORATION COMMISSION

September 15, 2004

Via facsimile and first class mail

Richard L. Sallquist, Esq.
Sallquist & Drummond, P.C.
2525 E. Arizona Biltmore Circle, Suite 117
Phoenix, Arizona 85016

Re: Utility Source, L.L.C. (the "Company")
ACC Docket No. WS-04235A-04-0073

Dear Mr. Sallquist:

The purpose of this letter is to clarify who is an existing customer for the purposes of my letters dated March 22, 2004, April 9, 2004, and June 3, 2004. These letters directed the Company to continue serving existing customers but demanded that the Company cease serving any new customers until the Commission issues a Certificate of Convenience and Necessity. At our recent meeting, we agreed that the owners of certain lots would be considered an existing customer for the purposes of these letters. The criteria for these lots are that: (1) the developer requested service by March 22, 2004; and (2) a meter was in place to serve that lot by March 22, 2004. Your letter dated September 7, 2004, as amended by your letters of September 8, 2004 and September 9, 2004 represented that the lots on the attached list satisfy the criteria described above. Based on these representations, the Utilities Division ("Staff") will treat the lots described on the attached list as existing customers for the purposes of my letters described above.

The Company should retain all records relating to the two criteria stated above so that the data on the attached list can be verified.

Staff's agreement is expressly conditioned on the agreement of the developers in question to fully disclose the situation to all of their customers whose sales have not yet closed. Such disclosure must include (1) the fact that the Arizona Department of Water Resources has issued a letter of inadequacy for these subdivisions; and (2) that the rates currently charged are not authorized by the Commission and may have to be substantially increased. Staff's agreement is further condition on the agreement of the developers in question to cancel any sales contract or other commitment if the customer so desires.

EXHIBIT A

Richard L. Sallquist, Esq.
September 15, 2004
Page 2

Please call me at 602.542.6024 if you have any questions about this letter.

Very truly yours,

A handwritten signature in cursive script that reads "Timothy J. Sabo". The signature is written in black ink and has a long horizontal flourish extending to the right.

Timothy J. Sabo
Attorney, Legal Division

cc: Mr. Steve Olea
Mr. Jim Fisher
Mr. John Chelus

EXHIBIT A

Tim Sabo
September 9, 2004
Page 2

Utility Source. L.L.C. Customers as of March 22, 2004

Subdivision	Lot Numbers	Number
Flagstaff Meadows I	1-133	133
Flagstaff Meadows II	134,157,158,163,166,167,176,177,179,186,190,191,192,193, 196,198,200,201,202,203,204,211,210,212,213, 214 thru 220	32
Flagstaff Meadows Townhomes	13-48	36
Total		201

EXHIBIT B

THIS AMENDMENT:

Passed Passed as amended by _____
 Failed Not Offered Withdrawn

STAFF PROPOSED AMENDMENT # 1

DATE PREPARED December 20, 2004

COMPANY: UTILITY SOURCE, LLC.

DECISION NO. _____ DOCKET NOS. WS-04235A-04-0073 and WS-04235A-04-0074

OPEN MEETING DATE: DECEMBER 22, 2004 AGENDA ITEM NO. U-2

1. Page 15, line 20, INSERT at the end of Finding of Fact No. 29: Accordingly, we find Utility Source's water rate base to be \$ 2,768,846 and its wastewater rate base to be \$1,499,224.
2. Page 16, line 15, before "Given", INSERT in Finding of Fact No. 32: Staff's letter dated September 15, 2004 provides that:

Staff's agreement is expressly conditioned on the agreement of the developers in question to fully disclose the situation to all of their customers whose sales have not yet closed. Such disclosure must include... that the rates currently charged are not authorized by the Commission and may have to be substantially increased. Staff's agreement is further condition[ed] on the agreement of the developers in question to cancel any sales contract or other commitment if the customer so desires.

This requirement partially addresses our concern. But we note that it applies only to customers whose sales had not closed as of September 15, 2004. The remaining customers did not receive notice of the potentially increased rates.

3. Page 16, line 18, Finding of Fact No. 32: DELETE: "on an interim basis"
4. Page 16, line 20, INSERT after Finding of Fact No. 32, a new finding of fact as follows: In a CC&N cases where the applicant has existing rates, the Commission can require the applicant to continue charging its existing rates until the next rate case. *See Residential Utility Consumer Office v. Arizona Corp. Comm'n*, 199 Ariz. 588, 592 ¶¶ 15-18, 20 P.3d 1169, 1173 (2001)(discussing *Pueblo Del Sol Water Co. v. Arizona Corp. Comm'n*, 160 Ariz. 285, 772 P.2d 1138 (1988)). As we have noted, Utility Source and Staff analyzed the rates using the normal methods for CC&N applications, which involve estimating figures for rate base and expenses for five years. In CC&N cases, this is done because the utility normally does not have any plant "in the ground" or ongoing operations. Here, Utility Source violated the law by putting plant in the ground and conducting

utility operations without Commission authorization. Because Utility Source has plant in the ground and ongoing utility operations, we find that it not appropriate to set rates using 5 year projections. Instead, it is appropriate to set rates in this matter using traditional rate case methods, which look to the actual expenses and rate base of the Company. We do not have sufficient information in the record regarding the actual expenses and rate base of the Company to be able to set rates at this time. Because we lack sufficient information to change the Company's rates, we will direct the Company to use its existing rates until such time as the Company files a rate case, which it may do at any time.

EXHIBIT C

THIS AMENDMENT:

Passed Passed as amended by _____
 Failed Not Offered Withdrawn

STAFF PROPOSED AMENDMENT # 2

DATE PREPARED December 20, 2004

COMPANY: UTILITY SOURCE, LLC.

DECISION NO. _____ DOCKET NOS. WS-04235A-04-0073 and WS-04235A-04-0074

OPEN MEETING DATE: DECEMBER 22, 2004 AGENDA ITEM NO. U-2

1. Page 22, line 22, DELETE: "(cash deposit, surety bond, or similar alternative, i.e. certificate of deposit)"
2. Page 22, lines 23 to 25, DELETE: "that in the event Utility Source, LLC chooses to make a cash deposit, said amount shall be deposited with a federally insured financial institution and bear interest at a commercially acceptable rate;"