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2006 MAY 24 P 4: 54
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 6 and Southern Sunrise Water Company

7 **BEFORE THE ARIZONA CORPORATION COMMISSION**

8 IN THE MATTER OF THE APPLICATION OF
 9 NORTHERN SUNRISE WATER COMPANY FOR A
 CERTIFICATE OF CONVENIENCE AND
 10 NECESSITY TO PROVIDE WATER UTILITY
 SERVICE IN COCHISE COUNTY, ARIZONA.

DOCKET NO. W-20453A-06-0247

12 IN THE MATTER OF THE APPLICATION OF
 SOUTHERN SUNRISE WATER COMPANY FOR A
 13 CERTIFICATE OF CONVENIENCE AND
 NECESSITY TO PROVIDE WATER UTILITY
 14 SERVICE IN COCHISE COUNTY, ARIZONA.

DOCKET NO. W-20454A-06-0248

15 IN THE MATTER OF THE JOINT APPLICATION
 16 OF NORTHERN SUNRISE WATER COMPANY
 AND SOUTHERN SUNRISE WATER COMPANY
 17 FOR THE APPROVAL OF SALE AND TRANSFER
 OF WATER UTILITY ASSETS, AND
 18 CANCELLATION OF CERTIFICATES OF
 CONVENIENCE AND NECESSITY, FOR
 19 MIRACLE VALLEY WATER COMPANY,
 COCHISE WATER COMPANY, HORSESHOE
 20 RANCH WATER COMPANY, CRYSTAL WATER
 COMPANY, MUSTANG WATER COMPANY,
 21 CORONADO ESTATES WATER COMPANY, AND
 SIERRA SUNSET WATER COMPANY, LOCATED
 22 IN COCHISE COUNTY, ARIZONA.

DOCKET NOS. W-20453A-06-0251
 W-20454A-06-0251
 W-01646A-06-0251
 W-01868A-06-0251
 W-02235A-06-0251
 W-02316A-06-0251
 W-02230A-06-0251
 W-01629A-06-0251
 W-02240A-06-0251

**NORTHERN SUNRISE WATER
 COMPANY AND SOUTHERN
 SUNRISE WATER COMPANY'S
 RESPONSE TO STAFF REPORT**

23 Northern Sunrise Water Company ("Northern Sunrise") and Southern Sunrise Water
 24 Company ("Southern Sunrise") (collectively, "Applicants") hereby file this Joint Response to the
 25 Staff Report ("Staff Report") filed in this docket on May 17, 2006. Applicants appreciate Staff's
 26 timely recommendation for approval of the three applications filed in the above-captioned

1 dockets. However, the Staff Report also contains twenty-six (26) other recommendations, eleven
2 (11) of which are either: 1) unduly burdensome and must be removed, 2) problematic with respect
3 to timing concerns and must be modified, or 3) unclear and require modification to avoid
4 improper or unintended rate treatment of regulatory assets in future Arizona Corporation
5 Commission ("Commission") proceedings. Furthermore, the Staff Report does not adequately
6 address transition issues involving the current operator of the water systems, the Arizona Small
7 Utilities Association ("ASUA"), an area where the Commission and Staff can and should assist
8 Applicants, in contrast to many of Staff's recommended conditions which seek to place
9 unnecessary and burdensome restraints on Applicant's management and operations following
10 acquisition. Accordingly, and for the reasons discussed below, specific Staff recommendations
11 should be eliminated or modified.

12 **DISCUSSION**

13 The Staff Report organizes Staff's recommendations into the following category headings:
14 General, Babocomari, Accounting and Rates, Emergency Rate Case and Moratorium. To the
15 extent that Applicants provide comments on any specific Staff recommendation set forth in the
16 Staff Report, such Staff recommendation is referred to herein by category heading and number
17 (i.e., Accounting and Rates Recommendation No. 1). Additionally, those Staff recommendations
18 to which Applicants object in some fashion, as explained in this Response, are categorized in one
19 of the three general topics highlighted above, i.e., that they are unduly burdensome, that they
20 present timing problems or that they require clarification to avoid improper rate treatment in
21 future proceedings.

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1 **I. Accounting and Rates Recommendation Nos. 5 is Unduly Burdensome and Must be**
2 **Removed.**

3 **A. A Deferred Payment Plan Tariff is Unduly Burdensome, Confiscatory and**
4 **Signals Customers that Payment for Services is Not Mandatory.**

5 Accounting and Rates Recommendation No. 5 would require Applicants to file a Deferred
6 Payment Plan Tariff for the benefit of customers that might be unable to pay their bills under the
7 new rates. Staff Report at 9. Applicants sympathize with ratepayers who have been burdened by
8 the prior operator's unethical conduct. However, Applicants are a private investor-owned utility
9 dedicating its property to public use in exchange for assurance of just and reasonable rates. Every
10 customer must pay such rates or Applicants will be denied just and reasonable rates.
11 Furthermore, A.A.C. R14-2-409.G allows, but does not require, a water utility to offer to
12 qualifying residential customers a deferred payment plan prior to terminating service pursuant to
13 A.A.C. R14-2-410.C.1.a, which provides that "A utility may disconnect service to any customer
14 for any reason stated below provided the utility has met the notice requirements established by the
15 Commission: (b) failure of the customer to pay a delinquent bill for service." Therefore,
16 *requiring* Applicants to adopt a Deferred Payment Plan Tariff is also inconsistent with the
17 Commission's own rules.

18 That is not to say that Applicants do not have processes in place to address situations
19 where customers cannot pay all amounts due for utility service. Applicants, which will both be
20 operated by Algonquin Water Services ("AWS") in the same manner as other Algonquin-owned
21 water and sewer utilities operating in Arizona, will take steps to address situations where
22 customers have problems paying their bills. This occurs now with the other utilities operated by
23 AWS.¹ But every such situation is unique and the one-size fits all approach recommended by

24
25 ¹ The Staff Report incorrectly states that Applicants "will be operated and managed by the
26 employees of other water utilities owned by Algonquin in Arizona." Staff Report at 3. Applicants
will be operated and managed primarily by AWS under agreements with Applicants and such
costs have been included in Applicants' operating expenses.

1 Staff denies Applicants the flexibility to enter into separate deferred payment plans tailored to the
2 individual customer needs.

3 This problem is exacerbated by Staff's failure to clearly define the minimum
4 qualifications for Staff's recommended program. What qualifies as "struggling to pay bills"?
5 Will Applicants have to coordinate information sharing (another economic cost) with public and
6 private entities offering "bill assistance" to ensure these qualifications are being met? Again,
7 through AWS, Applicants have processes in place to address customer delinquencies, processes
8 that are consistent with the Commission's rules and regulations. Mandating means by which
9 customers can avoid paying fees when due is not only overkill, it is administratively burdensome
10 and deprives Applicants of just and reasonable rates.

11 **II. General Recommendation No. 3, Babocomari Recommendation Nos. 2, 3, and**
12 **Moratorium Recommendation No. 2 Should be Modified to Either Provide**
13 **Applicants Sufficient Time to Comply or to Streamline the Applicable Approval**
14 **Process.**

14 **A. General Recommendation No. 3 Should Be Modified to Require Applicants to**
15 **Complete the Requisite Projects Within One Year from the Date that the**
16 **Bankruptcy Sale Closes.**

16 General Recommendation No. 3 would require Applicants to complete the projects listed
17 in Exhibit 4 of the Staff Report, along with 30,000 gallons of storage for the Sierra Sunset system,
18 by June 30, 2007. Staff Report at 8. Staff's recommendation is predicated on Staff anticipation
19 that the asset transfer will close within 20 to 30 days after a Commission decision in this matter.
20 However, that date is uncertain and largely outside Applicants' control. When it does occur and
21 the sale closes, plant improvements are scheduled to be completed within 6-12 months. Staff
22 Report, Exhibit 4. Additionally these plant improvements as detailed on Exhibit 4 may be made
23 exactly as anticipated therein, but more realistically may be modified as is deemed appropriate
24 after the Applicants' close on the transaction and, together with their consultants, have the
25 opportunity to more thoroughly investigate the assets, evaluate alternatives and design the
26

1 potential solutions. As a consequence, General Recommendation No. 3 should be modified to
2 require Applicants to complete substantially all the capital improvement construction projects (or
3 equivalent) one full year after the close of the transaction by which title to the assets passes to
4 Applicants.

5 **B. Babocomari Recommendations Nos. 2 and 3 Should Be Modified to Require**
6 **Northern Sunrise to File Annual Reports on Development Activity in the**
7 **Babocomari Area.**

8 Babocomari Recommendations Nos. 2 and 3 would require Northern Sunrise to docket a
9 copy of the Approval to Construct, and developer's Letter of Assured Water Supply for the
10 Babocomari development within one year from the effective date of the decision in this
11 proceeding.² Staff Report at 9. If the developer's Letter of Assured Water Supply is not filed,
12 then, under the recommendation, the certificate of convenience and necessity ("CC&N") for the
13 Babocomari area will be considered null and void after due process. *Id.*

14 Northern Sunrise included the Babocomari development in its CC&N application in order
15 to conduct the advance planning necessary to integrate the new water distribution infrastructure
16 into the larger water system, and because the developer was willing to convey an ideal parcel of
17 land for off-site facilities. Staff Report at 4. Although this land parcel will be eventually useful
18 to the potential customers within the Babocomari area, it will be immediately useful to the
19 existing customers of several of the McLain systems. The Babocomari developers are offering
20 this parcel on the expectation that that they will be eligible for water service when needed. There
21 is no incentive for these developers to provide Northern Sunrise a site for off-site facilities only to
22 have the benefit to be received in exchange taken away based on an artificial timeline set by Staff.

23 Indeed, if Staff's timeline is imposed and the land parcel is not transferred to Northern
24 Sunrise as a result, existing customers will ultimately have to bear higher capital costs for

25 ² It is not clear whether a "Letter of Assured Water Supply" will be generated, or is a requirement
26 with respect to this project, and hence such may not be necessary.

1 alternative (and less ideal) locations for off-site facilities. In short, although timing of
2 development in the Babacomari area is uncertain and outside Northern Sunrise's control, the
3 public interest is well served by inclusion of this area in Northern Sunrise's CC&N without
4 artificial deadlines for development. Therefore, Staff's Babocomari Recommendations Nos. 2
5 and 3 should not be adopted. As an alternative, Northern Sunrise will agree to submit a status
6 report on development activity in the Babocomari development within 365 days of the decision in
7 this matter, and annually thereafter. Staff can then provide comments to the status report, and
8 make recommendations (if applicable) on whether a more thorough review is warranted.

9 **C. Moratorium Recommendation No. 2 Must Be Modified to Incorporate a**
10 **Timely Approval Process by Staff When Lifting the Moratorium for Each**
11 **Former McLain System.**

12 Moratorium Recommendation No. 2 requires Applicants to file a notice of completion
13 ("Notice") with Staff once the projects listed by system in Exhibit 4 of the Staff Report are
14 completed. Staff will then inspect the projects and file a memo in the Docket. Staff Report at 11.
15 If the Staff memo concurs that the projects have been completed, the moratorium will be
16 considered lifted for the applicable system or systems.³

17 Applicants do not oppose continuation of the moratorium issued in Commission Decision
18 No. 68272, and believe that imposing it was necessary given the state of the water systems being
19 acquired. However, Applicants are concerned that Moratorium Recommendation No. 2 is vague
20 concerning the process for Staff approval of the Notice. Applicants assert that Staff should file
21 any responsive memo to the docket within 10 days of receiving a Notice from either Northern
22 Sunrise or Southern Sunrise. Provided that General Recommendation No. 3 is modified to allow
23 Applicants flexibility in the design and construction of the projects listed in Exhibit 4 of the
24 Report, as already addressed herein, the Notice provided by either Northern Sunrise or Southern
25 Sunrise would include a list of new and replaced plant upgrades.

26 ³ The Report is unclear as to what a "system or systems" signifies. Applicants interpret this
phrase to apply to each of the seven individual McLain water systems, rather than the two
systems they are being reorganized into.

1 No action would mean approval and the moratorium lifted. If Staff files a memo opposing
2 lifting of the moratorium, a hearing should be scheduled within 20 days to address the dispute.
3 Absent this specific safeguard, or something similar, Applicants will face the risk of unreasonable
4 delay.

5 **III. Accounting and Rates Recommendation Nos. 1, 6 and 10, and Emergency Rate Case**
6 **Recommendation No. 2 Must Be Clarified to Avoid Improper or Unintended Rate**
7 **Treatment in Future Commission Proceedings.**

8 **A. Phased-in Rates are Improper.**

9 Staff agrees with Applicants' proposed rates and rate design. Staff Report at 9 and
10 Exhibit C at 6. Staff goes further, however, and provides an alternative rate schedule that utilizes
11 three phases for monthly usage charges, with each phase increase triggered by the amount of
12 Applicants' combined capital invested in infrastructure upgrades. Staff Report, Exhibit C at 7.
13 This proposed alternative must be rejected.

14 To begin with, Staff is concerned over "rate shock." It is true that in most instances,
15 Applicants' future customers have not experienced rate increases for more than 20 years. *Id.* at
16 6. This is hardly Applicants' fault, however, and the sooner customers begin paying just and
17 reasonable rates for water utility service, the sooner they can expect to receive service that is
18 adequate, safe and reliable. It is patently inequitable to penalize Applicants by imposing the
19 administrative burden of multiple notices of rate changes and filings with the Commission, as
20 well as, most importantly, by postponing recovery of just and reasonable rates.

21 This is especially true given the substantial risks Applicants and their shareholder are
22 taking in acquiring the McLain systems. Applicants do not own the systems at this time and have
23 no idea of the final cost to bring the systems into compliance. Applicants will also bear the
24 burden of customer frustration as service is brought up to standard after decades of inadequacy. It
25 is unfair, in the face of these risks and burdens, to also saddle Applicants with less than just and
26 reasonable rates as a gesture to ratepayers. Again, ratepayers may not be at fault, but neither are
Applicants, and they are entitled to the rates both Staff and Applicants agree are just and

1 reasonable. Accordingly, Staff's primary recommendation to adopt the proposed rates and
2 charges set forth in Schedule REL-5 should be accepted, and any alternative proposal be rejected.

3 **B. Accounting and Rates Recommendation No. 6 Must be Modified to Ensure**
4 **Proper Treatment of Acquisition Costs in Future Proceedings.**

5 Staff's recommended treatment of Applicants' respective acquisition or transaction costs
6 is confusing. On the one hand, Staff has adopted Applicants' respective deferred accounting
7 treatments of the transaction costs, which costs have been built into Northern Sunrise and
8 Southern Sunrise's initial rate structures. See Northern Sunrise Application, Exhibit 9; Southern
9 Sunrise Application, Exhibit 8. On the other hand, Accounting and Rates Recommendation No. 6
10 would authorize Applicants to defer acquisition related costs, with the appropriate accounting
11 treatment addressed in the next rate application filed by Northern Sunrise or Southern Sunrise,
12 respectively. Staff Report, Exhibit C at 3. This recommendation is unacceptable to Applicants.

13 Applicants' combined total transaction cost estimate is \$300,000. Applicants recognize
14 that a significant portion of these transaction costs must be estimated at this time, meaning some
15 later review is necessary. That review, however, should be limited to verification of cost and
16 assurance that such costs were incurred in connection with the transaction. In contrast, Staff's
17 recommendation appears intended to postpone a prudency-type review until the next rate
18 proceeding. Given that this transaction (and the hugely complicated process associated with
19 bringing it to a potential resolution) has consumed resources that the Applicants would never
20 incur in a typical acquisition transaction, the resulting risk Applicants' face in acquiring several
21 bankrupt and chronically non-compliant water systems should not also include future "second-
22 guessing" by Staff or a new Commission without some appreciation of the history. If the
23 Commission concludes that the applications are in the public interest, it will also be affirming that
24 the costs incurred to complete the reorganization of these systems to a new owner are in the
25 public interest. No further analysis of prudency is necessary or appropriate.

26

1 **C. Accounting and Rates Recommendation No. 10 Must be Modified to Reflect**
2 **Correct Individual Asset Values for Plant in Applicants' Rate Base Schedules.**

3 Accounting and Rates Recommendation No. 10 adopts Staff's recommended plant
4 balances as delineated in Schedule REL-1. Staff Report at 10. However, Applicants takes
5 exception to Staff's individual asset values as listed in Staff's rate base schedule. While the rate
6 bases between Staff and the Applicants are approximately the same, Staff has allocated
7 differences between the original cost of land and the fair market value of the land, or \$208,752,
8 per Decision 68412 (dated January 23, 2006), *over all assets*. The Company believes this
9 incorrectly states the individual asset values.

10 On page 8 of Decision 68412, the \$208,752 is specifically identified as relating to the real
11 property. Thus, the \$208,752 should not be spread over all assets and should stay with the land
12 values only. Staff's method effectively increases the other assets over the RCND values as stated
13 in the RCND schedules attached to the original order. Appropriate adjustments should therefore
14 be made before Schedule REL-1 can be adopted.

15 **D. Emergency Rate Case Recommendation No. 2 Must be Modified to Address**
16 **Other Transition Issues Between Applicants and ASUA.**

17 Emergency Rate Case Recommendation No. 2 would modify Decision No. 68667 to omit
18 requirements for a System Improvement Surcharge ("SIS") and a separate bank account for the
19 SIS. Staff Report at 11. This recommendation should also require that other transition issues be
20 addressed either by amending Decision No. 68667 where appropriate, or in the context of this
21 proceeding. The Staff Report does not address issues such as how customer deposits will be
22 transferred, or how billing information (i.e., payment history) will be transferred from the
23 Commission's current operator, ASUA, to Applicants. To the extent that Staff believes that these
24 transitional issues should be addressed directly between Applicants and ASUA, Applicants
25 request that Emergency Rate Case Recommendation No. 2 be modified accordingly.
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CONCLUSION

Applicants appreciate Staff's timely issuance of the Staff Report in this proceeding, and recognize the breadth and complexity of the issues surrounding the transfer of assets and implementation of new rates for customers of the former McLain water systems. Applicants assert that the modifications to Staff's recommendations proposed in this Response are directed at facilitating an intense and aggressive capital improvement construction schedule, increasing the quality of water service to customers and taking advantage of economies of scale to limit the impact of increased rates. Transforming the McLain water systems into two viable water companies is a Herculean task, but one that Applicants believe can be accomplished without the added regulatory burden of some of the Staff recommendations, as addressed herein.

RESPECTFULLY SUBMITTED this 24th day of May, 2006.

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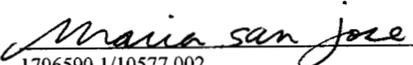
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