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BEFORE THE ARIZONA CORPORATION CC

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
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Arizona Corporation Commission

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IN THE MATTER OF THE APPLICATION OF PERKINS MOUNTAIN UTILITY COMPANY FOR A CERTIFICATE OF CONVENIENCE AND NECESSITY.

DOCKET NO. SW-20379A-05-0489

IN THE MATTER OF THE APPLICATION OF PERKINS MOUNTAIN WATER COMPANY FOR A CERTIFICATE OF CONVENIENCE AND NECESSITY.

DOCKET NO. W-20380A-05-0490

STAFF OPENING BRIEF

I. INTRODUCTION

On July 7, 2005, Perkins Mountain Utility Company ("Perkins Utility") filed with the Arizona Corporation Commission ("Commission") an application for a Certificate of Convenience and Necessity ("Certificate" or "CC&N") to provide wastewater service to a master-planned community in Mohave County, Arizona.

On July 7, 2005, Perkins Mountain Water Company ("Perkins Water") filed an application with the Commission for a Certificate to provide water service to a master-planned community in Mohave County, Arizona.

On September 19, 2005, the Commission's Utilities Division Staff ("Staff") filed its Sufficiency Letters indicating that Perkins Utility and Perkins Water (collectively, "the Companies") applications had met the sufficiency requirements of A.A.C. R14-2-402C. On February 10, 2006, the Companies filed an Analysis of Adequate Water Supply issued by the Arizona Department of Water Resources. The filing indicated that legal availability and continuous availability of the water supply for the entire development were not proven at the time the letter was issued on October 19, 2005.

At a procedural conference on July 31, 2006, the Administrative Law Judge ("ALJ") ordered that Staff and the Companies brief several issues related to the actions of the Companies and Rhodes Homes Arizona, LLC ("Rhodes Homes"). Rhodes Homes is the developer of Golden Valley South.

1 **II. DISCUSSION OF ISSUES**

2 A. Who is the Applicant in this case, Rhodes Homes or the Companies?

3 The Companies are the Applicant in this case. The Companies both filed applications in this
4 case for CC&N's. Although the Companies have transferred 100% of their stock to Rhodes Homes,
5 the Companies still exist as separate legal entities. If the Companies are granted CC&N's, the
6 Companies, not Rhodes Homes, will be responsible for providing water and wastewater services to
7 their certificated areas.

8 B. Is Rhodes Homes of Arizona acting as a public service corporation by constructing
9 water infrastructure to serve Golden Valley South? If yes, is Rhodes Homes of
10 Arizona violating A.R.S. § 40-281?

11 Public service corporations ("PSCs") are defined in the Arizona Constitution as "all
12 corporations other than municipal engaged in . . .furnishing water for irrigation, fire protection, or
13 other public purposes, . . .for profit. . .shall be deemed public service corporations." Ariz. Const. Art.
14 15 § 2. The Arizona Supreme Court created an eight-element test to determine whether a company is
15 a PSC. None of the elements is dispositive. However, several elements, in totality, may be sufficient
16 to define the company as a PSC:

- 17 (1) What the corporation actually does;
- 18 (2) A dedication to public use;
- 19 (3) Articles of incorporation, authorization and purpose;
- 20 (4) Dealing with the service of a commodity in which the
public has been generally held to have an interest;
- 21 (5) Monopolizing or intending to monopolize the territory
with a public service commodity;
- 22 (6) Acceptance of substantially all requests for service;
- 23 (7) Service under contracts and reserving the right to
discriminate is not always controlling;
- 24 (8) Actual or potential competition with other corporations
whose business is clothed with public interest.
Natural Gas Service v. Serv-Yu Coop., 70 Ariz. 235, 237-38, 219 P.2d 324, 325-
26 (1950).

25 In *Van Dyke v. Geary*, the U.S. Supreme Court affirmed that the Commission has the
26 authority to regulate all public service corporations, including a small water company owned by a
27 married couple that only serviced a local site. 244 U.S. 39 (1917). The water company's character,
28 not its ownership, determines whether it is a public service corporation. *Id.* at 43. Allowing a

1 privately owned company, which acts like a public service corporation, to escape regulation would
2 undermine a public service commission's purpose by allowing public utilities to hide behind private
3 ownership. *Id.* at 44.

4 In this case, Rhodes Homes is actively constructing water infrastructure to serve at least 350
5 lot reservations in Golden Valley South. (July 31, 2006 Public Comment Tr. at 52). In Phase I,
6 "approximately 1,000 of the lots are approximately 60 percent graded." *Id.* at 34. Rhodes Homes is
7 also building a golf course and "the grading for the back nine holes of that golf course is substantially
8 completed." *Id.* In addition, Rhodes Homes has put a well in close proximity to the golf course. *Id.*
9 at 47. Rhodes Homes has built three other wells. *Id.* at 35. Rhodes Homes has completed four
10 design homes and two more are currently under construction. *Id.* at 48. Water to the design homes is
11 from well GV-1. *Id.* at 48-49. The water is hauled from GV-1 to an onsite tank that serves the
12 design homes. *Id.* at 48. There are presently two sets of design homes that are each served by a
13 separate tank. *Id.* at 55. The water supplied to the design homes is used to water the plants around the
14 house and for the bathrooms. *Id.* at 48. Rhodes Homes also has constructed some earthen reservoirs
15 for grading purposes and dust suppression. *Id.* at 49. Rhodes Homes has built approximately five
16 miles of 24-inch ductile iron pipe north of the Golden Valley South development that is connected to
17 well GV-1. *Id.* at 36.

18 When the *Serv Yu* factors are applied to the facts and circumstances present here, it becomes
19 clear that Rhodes Homes is acting as a public service corporation. Rhodes Homes is building a golf
20 course and has built several wells. Also, Rhodes Homes has built and is serving design homes.
21 Rhodes has built storage tanks and a five mile transmission main. Clearly, Rhodes Homes is
22 presently furnishing water for public purposes with the infrastructure it has constructed. The public
23 certainly has an interest in receiving water service in and around the Golden Valley South
24 Development. In addition, Rhodes Homes is charging a \$2,000 lot reservation fee for future water
25 customers. *Id.* at 78.

26 In this case, there are several additional factors that show that Rhodes Homes is acting as a
27 public service corporation. Main extension agreements are typically set up and approved by the
28 Commission before a developer constructs and agrees to transfer utility infrastructure to a utility

1 provider. In this case, there is no main extension agreement in place. At this time, there is not even
2 an existing public service corporation to which to transfer infrastructure since the Companies are
3 brand new legal entities trying to get certificated at this time. Finally, Rhodes Homes has an atypical
4 relationship with the proposed utility providers in this case, the Companies. Rhodes Homes owns
5 100% of the stock of the Companies and the Companies and Rhodes Homes are operated from the
6 same address. *Id.* at 26. Although the Companies are the proposed utility providers in this case, the
7 character of Rhodes Homes' actions seems to indicate Rhodes Homes' intention to act as a public
8 service corporation at this time.

9 Under A.R.S. § 40-281, "[a] public service corporation . . . shall not begin construction of
10 a . . . line, plant, service, or system, or any extension thereof, without first having obtained from the
11 commission a certificate of public convenience and necessity." In this case, Rhodes Homes has
12 constructed wells, storage tanks, and a five mile transmission main without a CC&N. Thus, Rhodes
13 Homes is violating A.R.S. § 40-281 at this time.

14 C. Are the Companies acting as public service corporations? If yes, are the Companies
15 violating A.R.S. § 40-281?

16 The Companies are not acting as public service corporations at this time. The Companies
17 have not constructed any water infrastructure to serve Golden Valley South. At this point, the
18 Companies only actions have been to apply for CC&N's from the Commission.

19 D. Are either Rhodes Homes of Arizona or the Companies acting as public service
20 corporations by supplying water to the design homes discussed at the procedural
conference?

21 At this time, the Companies are not supplying water to the design homes discussed at the
22 procedural conference. Rhodes Homes is acting as a public service corporation by supplying water to
23 the design homes referenced above. Rhodes Homes has completed four design homes and two more
24 are currently under construction. (July 31, 2006 Public Comment Tr. at 48). Water to the design
25 homes is from well GV-1. *Id.* at 48-49. The water is hauled from GV-1 to an onsite tank that serves
26 the design homes. *Id.* at 48. There are presently two sets of design homes that are each served by a
27 separate tank. *Id.* at 55. The water supplied to the design homes is used to water the plants around the
28 house and for the bathrooms. *Id.* at 48. Since one tank is being used to supply two design homes,

1 Rhodes Homes is using the same infrastructure to serve multiple parcels. This water set-up for the
2 design homes is consistent with the other activities of Rhodes Homes described above. Taken as a
3 whole, these activities show that Rhodes Home is acting as a public service corporation.

4 E. Does the current setup for providing water to the design homes qualify as a water
5 utility system?

6 Under A.R.S. § 40-201, a “[w]ater system” includes “all property used in connection with the
7 diversion, development, storage, distribution and sale of water for beneficial uses for compensation.”
8 Although a “water utility system” is not defined, the plain meaning suggests some type of water
9 system owned and operated by a public service corporation. The current setup for providing water to
10 the design homes has one storage tank being used to supply two design homes. In other words, the
11 water utility system is serving more than one property. The source of the water for the storage tanks
12 is from well GV-1. The design homes are used to persuade prospective residents to pay lot
13 reservation fees. Thus, since Rhodes Homes is acting as a public service corporation in this case, the
14 current setup for providing water to the design homes qualifies as a water utility system.

15 F. Are there prior examples in Arizona where developers have constructed water
16 infrastructure for a development before a Certificate was issued?

17 Staff reviewed the original Anthem case (Decision No. 60975) from 1998 and was not able
18 find any reference to developers constructing water infrastructure prior to a CC&N being issued. In
19 Decision No. 60975, Anthem was referred to as the Villages at Desert Hills. Decision No. 60975
20 says that “as a proposed new community, the Project [the Villages at Desert Hills] has no existing
21 water and wastewater infrastructure.” (Decision No. 60975 at 4).

22 Staff found two prior examples where developers have constructed water infrastructure for a
23 development before a Certificate was issued. The first example was Commission Decision No.
24 67157. In that case, the Applicant was The Links at Coyote Wash Utilities, L.L.C. (“Coyote
25 Wash”). Coyote Wash sought to provide sewer service in Yuma County for a residential and golf
26 course development. The developer in this case formed Coyote Wash to provide wastewater
27 treatment service to the development. Coyote Wash constructed a sewage treatment facility and
28 began serving customers prior to receiving its CC&N. The Commission pointed out that

1 “Applicant’s actions of constructing its system and providing service prior to receiving its Certificate
2 are in violation of Arizona Law and the Commission’s rules.” (Decision No. 67157, Finding of Fact
3 13). Even though the Applicant in this case was not charging the customers it hooked up, the
4 Commission ordered as a condition of approval of the requested Certificate that Coyote Wash pay “as
5 a financial penalty, within 30 days of the effective date of this Decision, \$500 per active service
6 connection prior to the date of hearing.” (Decision No. 67157, Ordering Paragraphs).

7 The second example was Commission Decision No. 67446. In that case, the Applicant was
8 Utility Source, L.L.C. (“Utility Source”). Utility Source sought to provide water service in Coconino
9 County and obtain financing. The development in this case was called Flagstaff Meadows and 201
10 residential homes were built and provided water and wastewater service by Utility Source prior to
11 receiving its CC&N. The Commission pointed out that “Utility Source violated the law by putting
12 plant in the ground and conducting utility operations without Commission authorization.” (Decision
13 No. 67446, Finding of Fact 33). The Commission ordered Utility Source to pay a \$20,000 fine as a
14 condition of approval of the requested Certificate, based “on a penalty of \$100 for each of its
15 approximately 200 customers that were connected to the Company’s system prior to the issuance of a
16 CC&N.” (Decision No. 67446, Finding of Fact 41). The Commission determined that Utility
17 Source’s actions in this case of constructing a significant portion of its water and wastewater systems
18 and proceeding to connect customers before it had a CC&N constituted “one of the most egregious
19 examples of unauthorized preemptory operations ever confronted by the Commission.” (Decision
20 No. 67446, Finding of Fact 41).

21 G. Are there prior examples in Arizona where developers have constructed water
22 infrastructure for a development before a Certificate was issued and where there was a
23 pending Certificate for the development area?

24 The two prior examples Staff found are listed above in Staff’s answer to the previous
25 question.

26 H. What is the standard in Arizona for piercing the corporate veil?

27 In Arizona the courts will disregard an entity’s “corporateness” and pierce the corporate veil
28 when there is (1) unity of control and (2) observance of corporate form would sanction a fraud or

1 promote injustice. *Gatecliff v. Great Republic Life Insurance Co.*, 170 Ariz. 34, 37, 821 P.2d 725,
2 728 (1991); *Deutsche Credit Corporation v. Case Power & Equipment Co.*, 179 Ariz. 155, 160, 876
3 P.2d 1190, 1195 (App. 1994).

4 There is a unity of control when you have any of the following: when one corporation is in
5 control of another, its management functions, stock ownership; common officers or directors;
6 financing of subsidiary by the parent; payment of salaries and other expenses of subsidiary by the
7 parent; failure of subsidiary to maintain formalities of separate corporate existence. *Gatecliff*, 170
8 Ariz. at 37, 821 P.2d 725 at 728; *Deutsche Credit Corp.*, 179 Ariz. at 161, 876 P.2d at 1195; *Walker*
9 *v. Southwest Mines Development Co., et al.*, 52 Ariz. 403, 414-15, 81 P.2d 90, 95 (1938). If any of
10 the above examples are present, “the courts will look beyond the legal fiction of distinct corporate
11 existence, as the interests of justice require. . . .” *Walker*, 52 Ariz. at 414, 81 P.2d at 95.

12 The second standard to be met is whether the interplay between the two companies promotes
13 “fraud or injustice.” *Gatecliff*, 170 Ariz. at 38, 821 P.2d at 729; *Walker*, 52 Ariz. at 415, 81 P.2d at
14 95. For example, when one corporation forms a subsidiary in which control remains in the parent and
15 the parent is able to perpetrate a fraud through the subsidiary or subvert legislative policy. *Walker*,
16 52 Ariz. at 415, 81 P.2d at 95; *Micciche v. Billings*, 727 P.2d 367, 373 (Colo. 1986).

17 When there is such unity of interest and ownership that there is no variance in the identities of
18 the owner and the corporation, an “alter ego” is said to exist and, thus, an owner will be personally
19 liable. *Deutsche*, 179 Ariz. App. at 160, 876 P.2d at 1195. The “alter ego” doctrine . . . does not
20 create assets for or in the corporation. It simply fastens liability upon the individual who uses the
21 corporation merely as an instrumentality in the conduct of his own personal business. The liability
22 springs from fraud . . . perpetrated not on the corporation, but upon third persons dealing with the
23 corporation. *Garvin v. Matthews*, 193 Wash. 152, 156-57, 74 P.2d 990, 992 (1938).

24 Arizona courts will pierce the corporate veil and impose personal liability if a business is run
25 on a personal, not a corporate, basis and if the business was created without a foundation of financial
26 adequacy. *Keams v. Tempe Technical Institute, Inc.*, 993 F.Supp. 714, 723 (D. Ariz. 1997), *Chapman*
27 *v. Field*, 124 Ariz. 100, 602 P.2d 481, 483 (1996). The fact that normal corporate functions or failure
28 to file annual reports or keep proper records are not followed is not, alone, sufficient to justify

1 piercing the corporate veil under Arizona law; the evidence must show that there is an “intermingling
 2 of personal and corporate assets or disrespect of the corporate form.” *Keams*, 993 F.Supp. at 724.
 3 For example, a company that promises to perform an act in the future with the present intention to not
 4 perform that act, in Arizona, has committed an act of fraud and if coupled with an “alter ego” issue,
 5 the veil may be pierced. *Youngren v. Rezzonico*, 25 Ariz. App. 304, 306, , 543 P.2d 142, 144 (1976);
 6 *Waddell v. White*, 56 Ariz. 420, 108 P.2d 565 (1940); *Law v. Sidney*, 47 Ariz. 1, 53 P.2d 64 (1936).

7 A corporation’s financial situation is not necessarily the only factor relied upon by the courts
 8 to pierce the corporate veil. Although, under Arizona law, undercapitalization of a corporation is an
 9 “important factor” upon which the courts rely. *Keams*, 993 F.Supp. at 724, citing *Ize Nantan*
 10 *Bagowa, Ltd. v. Scalia*, 118 Ariz. 439, 443, 577 P.2d 725, 729 (App. 1978). “The capitalization of a
 11 corporation is evaluated at the time that it is established.” *Norris Chemical Co. v. Ingram*, 139 Ariz.
 12 544, 679 P.2d 567, 570 (App. 1984). The fact that a corporation is not profitable is not a determiner
 13 of undercapitalization, but it is a determiner when the amount of capital is “illusory or trifling.” *Id.*

14 In this case, it is not necessary to pierce the corporate veil. Rhodes Homes is acting as a
 15 public service corporation in this case. Rhodes Homes is violating A.R.S. § 40-281. The
 16 Commission can enforce its regulations against the corporation that is responsible for the violation.

- 17 I. If the Commission were to find that Rhodes Homes of Arizona was not acting as a
 18 public service corporation, is it appropriate for the Commission to implement A.R.S. §
 19 40-281 in such a way as to allow the public service corporation to set up an affiliate
 20 designed to bypass the statute?

21 No public service corporation should be allowed to bypass a statute. When enforcing a
 22 statute, the Commission should look at the language of the particular statute and how the
 23 Commission has enforced a particular statute in prior Commission decisions. That being said, each
 24 case that comes before the Commission may have its own unique set of circumstances which may
 lead to a unique result for that particular applicant.

25 III. CONCLUSION

26 Based on the facts in this case, Staff’s position is that Rhodes Homes is a public service
 27 corporation. Rhodes Homes has violated A.R.S. § 40-281 by installing infrastructure without a
 28 CC&N and serving design homes.

1 The current relationship between Rhodes Homes and the Companies is problematic and is
2 hindering the proceedings at this time. The appropriate remedy for Rhodes Homes and the
3 Companies is to have all the utility assets owned by the specific entity or entities requesting the
4 CC&N. Rhodes Homes needs to either apply for its own CC&N or convey all the utility assets to the
5 Companies. In addition, all construction of utility infrastructure (water or sewer) should cease
6 immediately. Once the appropriate applicant in this case has been determined, the issues facing Staff
7 and the applicant will be much more transparent. This transparency will make it easier for Staff to
8 review the merits of this particular application.

9 Lastly, there should be an appropriate remedy for Rhodes Homes' violations of A.R.S. § 40-
10 281. However, the best time to determine the remedy for the actions of Rhodes Homes is at the end
11 of this CC&N proceeding.

12 RESPECTFULLY SUBMITTED this 14th day of August, 2006.

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18 Original and fifteen (15) copies
19 of the foregoing were filed this
14th day of August, 2006 with:

20 Docket Control
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1200 West Washington Street
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22 Copy of the foregoing mailed this
23 14th day of August, 2006 to:

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