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Docket Control  
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Re: ACC Docket No. W-02860A-06-0002  
ACC Docket No. W-02860A-05-0727

This correspondence will serve to document the response of Naco Water Company, LLC (NWC) to Arizona Corporation Commission (ACC) staff surrebuttal testimony filed on 23 October 2006 regarding ACC Docket # W-02860A-06-0002 and Docket # W-02860A-05-0727.

Specifically, this correspondence will address testimony submitted by Ms. Dorothy Hains regarding the Southern Upper San Pedro River Hydrogeologic Assessment (SUSPRHA) required to begin negotiations with Phelps Dodge Corporation.

In summary, Ms. Hains has correctly identified the general scope a hydrogeologic assessment (page 1, lines 16-23), as well as the imperative need for completion of the SUSPRHA (page 2, lines 10-17). However, Ms. Hains has completely mis-stated facts used to justify her opinion that the ACC should not approve a rate increase sufficient to fund the SUSPRHA (page 2, lines 19-26).

Furthermore, as NWC has repeatedly stated before ACC staff, within its written testimony, and within its staff rebuttal written testimony, a rate increase which only authorizes a \$450,000 Water Infrastructure Finance Authority (WIFA) loan is completely insufficient to address the ongoing and worsening drinking water supply conditions within the NWC system.

Nonetheless, Ms Hains has for reasons of her own, apparently chosen to ignore these immediate and overwhelming water supply issues. Instead, Ms. Hains has chosen to focus all her efforts in this rate increase and financing approval application exclusively on resolving water loss issues; but she has chosen to do so in a manner which does not comprehensively address the water loss issues, and which completely ignores the overwhelming and immediate drinking water supply conditions within the NWC system.

Please understand it is certainly the position of NWC that system water loss issues are a pressing system operation issue, and one which should be addressed as soon as possible. But also please understand that if the water supply issues are not simultaneously addressed, there will be no water loss problems to address because: **THE SYSTEM WILL NOT HAVE WATER SUPPLIES TO DISTRIBUTE.**

Obviously this situation begs for a witty analogy like the chicken and egg concept, except for the fact that the issue at hand is far too serious: the viability of drinking water supplies for NWC system users. Frankly, the apparent lack of concern Ms. Hains has demonstrated for the health and welfare of NWC system users is staggering. Furthermore, it is somewhat appalling that our system of regulating and financing Arizona's most vital rural drinking water systems appears to be managed so cavalierly.

The rationale Ms. Hains has chosen to approve some water loss elimination projects, while excluding other water loss elimination projects from this WIFA financing package, appears to be a function of the final financing amount recommended by ACC staff. Generally speaking, NWC would agree with Ms. Hains in that the most significant water losses should be addressed first, and that less significant water losses addressed in a future rate increase application, or through improved system revenues.

However, nowhere in Ms. Hains' logic system does she account for the fact that the system will very soon run out of water supplies in the Bisbee Junction area. As Ms. Hains knows well, NWC has been forced to truck water into the Bisbee Junction area for each of the past two summers, and water supply issues are only getting worse.

Consequently, NWC cannot support Ms. Hains logic to completely exclude water supply issues from this financing application for the simple fact that if there are no water supplies to distribute, there will be no water losses to address. Obviously, water supply issues are more pressing than water loss issues.

Apparently, Ms. Hains is trying to justify her failure to address the water supply issues on the basis of:

- 1.) the water supply issues will all be resolved under a pending settlement with the Phelps Dodge Corporation;
- 2.) the proposed SUSPRHA "will be extremely expensive";
- 3.) there are other water providers within the SUSPRHA study area which should share in the cost of the SUSPRHA;
- 4.) the fact that Phelps Dodge Corporation should pay for the cost of the SUSPRHA;
- 5.) the SUSPRHA should be conducted after the water loss issues are addressed.



### **PHELPS DODGE FINANCIAL SETTLEMENT HAS NO CERTITUDE**

Within its direct and surrebuttal testimony, Ms. Hains assumes that Phelps Dodge Corporation will provide financial assistance to help NWC mitigate groundwater contamination impacts associated with Phelps Dodge mine tailing pile. ACC staff has made these assumptions despite the fact that Phelps Dodge has never at any time made a legally binding commitment to provide this financial assistance; and Phelps Dodge may possibly never contribute any financial assistance to NWC. Under such a scenario, water supply problems within the NWC system will continue to worsen to the point where some customers will be without drinking water in the very near future.

To assume that the already financially cash-strapped NWC system will be able finance a legally-binding financial settlement with a company the size of Phelps Dodge also assumes that Phelps Dodge will have no objections to the financial remedies sought by NWC. Even the slightest objections from Phelps Dodge will precipitate an expenditure of legal fees which the NWC simply cannot fund.

Therefore, assuming that any financial settlement with Phelps Dodge is imminent or pending may be a prerogative that Ms. Hains is willing to take. But it certainly not the type of cavalier water system management that NWC could ever provide to its system users. NWC simply cannot rely upon any financial settlement until such time as a legally-binding agreement is executed with Phelps Dodge Corporation.

Nonetheless, as NWC has repeatedly stated before ACC staff, within its written testimony, and within its staff rebuttal written testimony, if Phelps Dodge does indeed contribute financial assistance to replace or deepen contaminated supply wells, or to replace distribution lines required to relocate contaminated wells, NWC would in-turn not borrow funds from WIFA to replace threatened drinking water supply wells. Because WIFA only requires repayment of funds actually borrowed, and there would be no need for further rate increases to repay WIFA loans associated with relocating contaminated wells, those potential rate increases could then be forfeited.

### **SUSPRHA WILL NOT BE "EXTREMELY EXPENSIVE"**

Ms. Hains' testimony indicates that the SUSPRHA "will be extremely expensive", because it will cover approximately 1,225 square miles spread over two countries. Ms. Hains has provided this testimony despite the fact that she has never requested, or has she ever been provided, a scope of work for the proposed SUSPRHA.

If she had requested a copy of the SUSPRHA work scope, she would have seen that the proposed study covers 36 square miles within southern Cochise county only; and that the SUSPRHA does not cover 1,225 square miles spread over two countries. The 36 square mile SUSPRHA study area coincides with the same geographic area delineated by the NWC Certificate of Convenience & Necessity (CC&N) area approved by the ACC.



Obviously, it would not be cost effective or professionally responsible to study the 1,225 square mile area spread over two countries which Ms. Hains identifies - especially since NWC is only authorized to operate within approximately 18 square miles in southern Cochise County. The proposed SUSPRHA study area only includes those areas contained within the NWC CC&N, and those areas immediately adjacent to the NWC CC&N area.

Furthermore, it is inconceivable why Ms. Hains would testify that the SUSPRHA "will be extremely expensive", when she knows full well that the cost of the SUSPRHA was proposed at less than \$75,000 in the above referenced ACC finance approval application. While \$75,000 is certainly no small sum of money, it is important to note that this cost was proposed within the context of a \$2,457,118 preliminary cost estimate for all required system work. Obviously, asking the NWC system users to finance \$75,000 (3%) of a total \$2,457,118 in required system upgrade work, would not generally meet the definition of "extremely expensive".

#### **NWC IS THE ONLY IMPACTED WATER PROVIDER IN THE SUSPRHA**

Ms. Hains testified that "Naco Water Company is not the only water provider in the SUSPRHA study area." While it is correct that the Arizona Water Company (AWC) does operate a wellfield within the western portion of the SUSPRHA, AWC supply wells are not impacted by the Phelps Dodge groundwater contaminant plume.

In fact, AWC wells are located within the most likely area for new NWC supply wells to be installed. And since AWC and NWC will then ultimately be competing for the same groundwater resources, why would AWC have any incentive to assist NWC in preparing the SUSPRHA which will then be used to justify the installation of NWC supply wells?? And, even if we could look past the failed business logic of AWC paying for a portion of the SUSPRHA, there is no legal authority under which NWC could ever compel AWC to pay any portion of the SUSPRHA.

In summary, there are no other water providers within the SUSPRHA study area impacted by the Phelps Dodge groundwater contaminant plume, and there is no legal authority under which NWC could ever compel any other water provider to pay any portion of the SUSPRHA. In short, it appears as if Ms. Hains is trying to divert attention away from the absolutely pressing need for the SUSPRHA by asserting a series of non-sequiturs with respect to other water providers.

#### **WHEN SHOULD PHELPS DODGE PAY COST FOR SUSPRHA**

While NWC does not argue with Ms. Hains opinion that Phelps Dodge should pay for all of the SUSPRHA, there are obvious limitations relating to timing of any possible payment which apparently escapes Ms. Hains.



Firstly, what if Phelps Dodge never reaches agreement with NWC?? When and how would Phelps Dodge ever pay for the SUSPRHA??

Secondly, Ms. Hains appears to not understand the process involved in reaching a legal settlement between any two aggrieved parties. Before NWC can reach any legal settlement with Phelps Dodge, NWC must first determine what compensation it seeks from Phelps Dodge.

The SUSPRHA is that tool with which the NWC will determine where to place its new water supply wells so as to avoid future impacts from the Phelps Dodge groundwater contaminant plume (Ms. Hains testimony, page 1, lines 22-23). Consequently, the SUSPRHA will then be used by NWC to determine what compensation it seeks from Phelps Dodge. Ms. Hains correctly expects Phelps Dodge to pay for the SUSPRHA, but she ignores the fact that NWC must first complete the SUSPRHA so it can reach a legally binding settlement with Phelps Dodge, under which Phelps Dodge will then pay for the SUSPRHA.

The SUSPRHA is absolutely essential to NWC if it is ever going to enter into fair and equitable negotiations with Phelps Dodge. The SUSPRHA will provide the first comprehensive independent assessment NWC has ever made regarding the impacts of Phelps Dodge groundwater contamination; and the SUSPRHA is absolutely essential to determining if and where NWC might hope to relocate its impacted water supply wells.

Without the SUSPRHA, NWC cannot even begin to negotiate settlement with Phelps Dodge. This will in-turn cause more eventual cost increases to NWC and its system users; and will completely invalidate ACC staff assumptions regarding a Phelps Dodge financial settlement.

NWC must first pay to complete the SUSPRHA so that it has a valid technical basis upon which it can reach a legally-binding settlement with Phelps Dodge. NWC will then of course insist that Phelps Dodge reimburse the SUSPRHA cost as part of any final settlement.

Ms. Hains solution to financing the SUSPRHA would be akin to this scenario:

You are involved in a terrible automobile accident and severely injured when another motorist runs a red light and crashes into your vehicle. By running the red light, the other motorist is clearly at fault, and his automobile insurance company will ultimately be responsible to cover all your costs. But upon your arrival at the hospital, your health insurance company advises you that they won't pay for your health care today because ultimately the other driver's automobile insurance company will pay for you to go to the hospital at some date in the future. Even though the logic is flawed, you may still die waiting for the automobile insurance company to settle.



NWC is asking the ACC to step-up today, authorize a WIFA loan today which will pay for the work NWC needs today, so that NWC can ultimately reach a beneficial settlement with Phelps Dodge tomorrow. NWC urges the ACC to approve a rate increase order stating that costs associated with the SUSPRHA are to be included in the total WIFA funding package finally approved for NWC.

**SUSPRHA SHOULD NOT WAIT UNTIL WATER LOSS ISSUES ARE RESOLVED**

To reiterate the position of NWC with respect to Ms. Hains' recommendation of waiting until the water loss issues are resolved to begin work on the SUSPRHA; NWC cannot support Ms. Hains logic to exclude the SUSPRHA work from this financing application for the simple fact that if there are no water supplies to distribute, there will be no water losses to address. Obviously, water supply issues are more pressing than water loss issues.

In summary, ACC staff cannot base its rate increase recommendations upon the assumption that Phelps Dodge will reach a financial settlement with NWC, while at the same time denying NWC the very tools which it requires to reach that financial settlement. The SUSPRHA is absolutely essential to NWC if it is ever going to enter into fair and equitable negotiations with Phelps Dodge.

Likewise, ACC staff cannot blindly concentrate its regulatory efforts and approval on eliminating distribution system water losses, without first ensuring that the system will have water to distribute.

Thank you for your time and consideration in these matters. If you should have any questions, or require any additional information, please feel free to contact me at (602) 864-3887.

Sincerely,



J. Dan Kelley, P.E.  
on behalf of Naco Water Company

cc: Mr. Salim S. Dominguez, Jr. - NWC  
Ms. Bonnie O'Connor - SWUM

