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ARIZONA CORPORATION COMMISSION

September 28, 2007

Arizona Corporation Commission

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AZ CORP COMMISSION  
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Chairman Mike Gleason  
Commissioner William A. Mundell  
Commissioner Jeff Hatch-Miller  
Commissioner Gary Pierce

Re: Commission Policy on Prohibition of Groundwater for use on Golf Courses and Ornamental Water Features; Docket No. RW-00000B-07-0051

Dear Colleagues:

I write in response to Commissioner Hatch-Miller's September, 26, 2007 letter concerning the use of effluent and groundwater on golf courses and ornamental lakes. While I remain strongly supportive of the Commission's prohibition on the sale of groundwater for use on golf courses, if some Commissioners wish to revisit the issue, the best venue for such a discussion is in the CC&N generic docket.

As you know, to date, the Commission has adopted the prohibition on the sale of groundwater for use on golf courses and ornamental lakes in 16 cases.<sup>1</sup>

With regard to the Best Management Practices ("BMPs") that the Arizona Department of Water Resources ("ADWR") is considering as part of its Third Management Plan, I believe that the Commission should consider going beyond what DWR is proposing for Arizona's medium and large water companies by requiring larger water utilities to adopt a greater number of BMPs than are currently contemplated under the DWR BMP rulemaking.

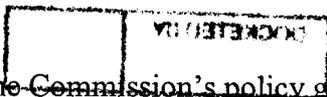
The Commission can, and I believe should, under appropriate circumstances, require more of regulated water and wastewater companies than the Arizona Department of Water Resources. The Commission should be leading the way in the arena of groundwater conservation, and

<sup>1</sup> Johnson Utils. Co., Decision No. 69414, Docket No. WS-02987A-06-0663; New River Utility Co., Decision No. 69576, Docket No. W-01737A-06-0171; Aizona Water Co., Decision No. 69732, Docket No. W-01445A-07-0018; Empirita Water Co., Decision No. 69399, Docket No. W-03948A-06-0490; Ariz. Water Co., Decision No. 69386, Docket No. W-01445A-06-0317; Lucky Hills Water Co., Decision No. 69381, Docket No. W-01961A-06-0037; Green Acres Water, L.L.C., Decision No. 69256, Docket No. W-20430A-05-0839; Beaver Dam Water Co., Decision No. 69243, Docket No. W-03067A-06-0117; Diablo Village Water Co., Decision No. 69206, Docket No. W-02309A-05-0501; Picacho Water Co., Decision No. 69174, Docket No. W-03528A-06-0313; Ariz. Water Co., Decision No. 69163, Docket No. W-01445A-06-0059; Willow Springs Utils., L.L.C., Decision No. 68963, Docket No. WS-20432A-05-0874; Johnson Utils. Co., Decision No. 68961, Docket No. WS-02987A-05-0695; Diversified Water Utils., Inc., Decision No. 68960, Docket No. W-02859A-04-0844; Ariz. Water Co., Decision No. 68919, Docket No. W-01445A-05-0701; Ariz. Water Co., Decision No. 69901, Docket No. W-01445A-06-0662.

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recently we have been at the forefront of implementing policies designed to wisely safeguard Arizona's precious groundwater supplies.

For your review, I am attaching a law review article to this letter which I wrote highlighting our policy of prohibiting groundwater use on golf courses, turf, and ornamental water features. This article was published in the 49<sup>th</sup> volume of the University of Arizona College of Law's Arizona Law Review.



I look forward to discussing the Commission's policy goals with regard to groundwater use and water conservation in the upcoming months.

Sincerely,

A handwritten signature in black ink, appearing to read "Kris Mayes".

Kris Mayes  
Commissioner

Cc: Dean Miller  
Ernest Johnson  
Chris Kempley  
Lyn Farmer  
Lace Collins  
Parties to the Docket

# ENCOURAGING CONSERVATION BY ARIZONA'S PRIVATE WATER COMPANIES: A NEW ERA OF REGULATION BY THE ARIZONA CORPORATION COMMISSION

Kris Mayes\*

## I. THE ARIZONA CORPORATION COMMISSION: AN INTRODUCTION

### A. *Private Water Companies and Growth: Managing Complexity*

The Arizona Corporation Commission ("Commission") has both constitutional and statutory authority to regulate Arizona's public service corporations, including the approximately 350 private water companies currently serving an estimated 400,000 customers in the state.<sup>1</sup> Article 15, section 2, of the Arizona Constitution specifically mandates that water companies are to be among those shepherded by the Commission.<sup>2</sup>

With as many as 12,000 people moving to Arizona each month—9,400 per month to Maricopa County alone—ensuring the long-term availability of water

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\* Arizona Corporation Commissioner. This Article is a revised version of a paper originally presented at the Water Law and Policy Conference hosted by the University of Arizona James E. Rogers College of Law in Tucson, Arizona, on October 6–7, 2006. Articles from the Conference are collected in this symposium issue, Volume 49 Number 2, of the *Arizona Law Review*.

1. Interview with Commission Staff, including Steve Olea, Assistant Dir., Utils. Div., Ariz. Corp. Comm'n, in Phoenix, Ariz. (Oct. 2005).

2. The Arizona Constitution defines "public service corporations" as follows:

All corporations other than municipal engaged in furnishing gas, oil or electricity for light fuel or power; or in furnishing water for irrigation, fire protection, or other public purposes; or in furnishing, for profit, hot or cold air or steam for heating or cooling purposes; or engaged in collecting transporting, treating, purifying and disposing of sewage through a system, for profit; or in transmitting messages or in furnishing public telegraph or telephone service, and all corporations other than municipal, operating as common carriers, shall be deemed public service corporations.

ARIZ. CONST. art. 15, § 2.

for all residents has become increasingly important.<sup>3</sup> The Commission uses a number of tools to encourage or mandate water conservation. These tools include the use of Orders Preliminary for water companies outside an Active Management Area to require that companies prove up adequate water supplies prior to receiving a Certificate of Convenience and Necessity ("CC&N"); a preference for integrated wastewater and water utilities in order to maximize the potential for the use of reclaimed water in common areas, golf courses, and ornamental water features; measures to encourage the consolidation of small water companies, particularly those in growing areas prone to shortages; curtailment tariffs, now required of all water companies; tiered water rates, which are also now established in rate cases; and the use, when necessary, of hook-up moratoriums.

However, as the state struggles to match water supplies with its booming population and ensure reliable water delivery to future generations, the Commission will need to expand its efforts at conservation into uncharted areas. This will likely include allowing for recovery in rates of the costs associated with specific conservation measures that are soon to be required by the Arizona Department of Water Resources ("ADWR"); pinpointing small distressed water companies that are suffering high water loss rates or otherwise providing substandard service and utilizing rate premiums or acquisition adjustments to encourage their consolidation into larger entities; and working more closely with executive branch agencies to facilitate the aggressive institution of conservation measures at all of the state's private water systems. The combination of a broad network of water companies under its watch and the growing demands on Arizona's water supplies requires creative oversight by the Commission. In the face of such complexity, the Commission should continue to use its plenary powers as the regulator of private water companies to mitigate the effects of growth on water supplies and to help ensure the long-term availability of Arizona's most precious resource.

#### *B. A Brief History of the Commission's Broad Mandate*

Established at statehood as a popularly elected branch of state government, the Commission was originally composed of three commissioners. It was expanded by popular vote to five commissioners in 2000. The Commission was intended by the state's founding fathers to be a bulwark for consumers against the power of the large corporations that dominated commerce at the turn of the century.<sup>4</sup>

In addressing various challenges to the Commission's authority, courts have largely upheld the Commission's jurisdiction over public service corporations. The courts most often note the Commission's broad powers as suggested by the language of the primary constitutional provision, article 15, section 3, of the Arizona Constitution:

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3. See Jon Kamman, *County Gained 313 People a Day Since 2000*, ARIZ. REPUBLIC, June 27, 2006, at B1.

4. See THE RECORDS OF THE CONSTITUTIONAL CONVENTION OF 1910, at 614, 970 (John S. Goff ed., 1991); *Ariz. Corp. Comm'n v. Woods*, 830 P.2d 807, 811-13 (Ariz. 1992) (detailing the constitutional origins of the Commission).

The Corporation Commission shall have full power to, and shall, prescribe . . . just and reasonable rates and charges to be made and collected, by public service corporations within the State for service rendered therein, and make reasonable rules, regulations, and orders, by which such corporations shall be governed in the transaction of business within the State, and may prescribe the forms and contracts and the systems of keeping accounts to be used by such corporations in transacting such business, and make and enforce reasonable rules, regulations, and orders for the convenience, comfort, and safety, and the preservation of the health, of the employees and patrons of such corporations . . . .<sup>5</sup>

Two years after enactment of the constitution, the Arizona Supreme Court distinguished the Commission from other commissions nationally: "Article 15 of our Constitution is unique in that no other state has given its Commission, by whatever name called, so extensive power and jurisdiction."<sup>6</sup> The court called the Commission's responsibility for supervising public service corporations "one of the most vexatious as well as vital questions of government" and noted that it was created by the state's founding fathers "primarily for the interest of the consumer."<sup>7</sup> In short, the court ruled that the Arizona Legislature could not infringe on the Commission's exclusive powers to regulate public service corporations; it could only legislate to broaden its powers.

A later line of cases, beginning with *Arizona Corp. Commission v. Pacific Greyhound Lines*,<sup>8</sup> questioned the breadth of the Commission's authority and "apparently established"<sup>9</sup> the doctrine that the Commission's exclusive constitutional authority is limited to ratemaking. However, the Arizona Supreme Court, in *Arizona Corp. Commission v. State ex rel. Woods*, criticized the *Greyhound* court's narrow construction of the Commission's authority to regulate public service corporations.<sup>10</sup> In this decision, the court noted that *Pacific Greyhound's* interpretation of article 15, section 3 was unreasonably narrow in light of "the framers' vision of the Commission's role" as well as earlier case law.<sup>11</sup> The court, however, declined to overrule *Pacific Greyhound*, noting that even a restrictive interpretation of article 15, section 3 extends the Commission's authority beyond simple ratemaking to actions that are required to complete its ratemaking responsibilities.<sup>12</sup> Constricting the scope of the Commission's authority, according to the *Woods* court, would frustrate the framers' intent in

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5. *E.g., Woods*, 830 P.2d at 812; *State v. Tucson Gas, Elec. Light & Power Co.*, 138 P. 781, 783-84 (Ariz. 1914).

6. *Tucson Gas*, 138 P. at 783.

7. *Id.* at 786.

8. 94 P.2d 443, 450 (Ariz. 1939); *see also Rural/Metro Corp. v. Ariz. Corp. Comm'n*, 629 P.2d 83, 85 (Ariz. 1981) (in banc) (finding that the legislature's ability to expand the Commission's authority is limited to the public service corporations delineated in article 15, section 2, of the Arizona Constitution).

9. *Woods*, 830 P.2d at 815 & n.8 (noting that the language in the *Greyhound* opinion is "less than clear").

10. *Woods*, 830 P.2d at 813-15, 818.

11. *Id.* at 813-15.

12. *Id.* at 815.

forming the Commission. Today, the Commission continues to issue decisions that are rooted in the broad language of the constitution and in the spirit of *Woods* and other early cases affirming its position as the exclusive regulator of public service corporations in Arizona.<sup>13</sup>

## II. ORDERS PRELIMINARY

### A. Recognizing the Problem

As existing private water companies seek to expand their boundaries to accommodate new customers and new water companies sprout up in rural Arizona and on the periphery of the state's urban centers, the Commission is facing new questions about how to license these companies. The Commission's practice of issuing conditional CC&Ns as the primary vehicle for approving new companies and expansions is evolving to meet the new challenges posed by growth, in particular its consequences for conservation and water supplies.<sup>14</sup>

For decades, the Commission issued conditional CC&Ns, granting the CC&N but imposing a series of requirements designed to be subsequently met by the water company.<sup>15</sup> Developers generally favor this form of CC&N because it allows them to proceed with construction and implementation of their project while the water company making the application for the CC&N works on fulfilling the conditions.<sup>16</sup> The fundamental difference between an Order Preliminary and a conditional CC&N is that under the conditional CC&N, developers may commence construction of homes and a water system designed to deliver services to residents, whereas under the Order Preliminary regime, a developer could not begin building either homes or the water system until he had met all of the conditions outlined in the Order Preliminary and then been granted a final CC&N by the Commission. As noted above, the Commission is beginning to question the usefulness of the conditional CC&N, at least in cases involving water companies

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13. Observers of the Commission have also argued for a continued expansive reading of the body's authority and reach. *E.g.*, Deborah Scott Engelby, Comment, *The Corporation Commission, Preserving Its Independence*, 20 ARIZ.S T. L.J. 241 (1988). Scott Engelby argues that *Rural/Metro* failed to take into account the constitution's framers' "intent to encompass the entire field of public utilities." *Id.* at 259. She contends that the Commission should be permitted to determine on a case-by-case basis which new technologies and forms of utilities should be brought under its regulatory umbrella. *Id.*

14. In the case of water companies, a CC&N is essentially a grant of authority by the Commission to do business as a monopoly water company. CC&Ns are provided for by statute. ARIZ. REV. STAT. ANN. § 40-281 (2006). Section 281 permits the Commission to issue a CC&N authorizing public service corporations to conduct business in Arizona; section 282(D) allows the Commission to issue Orders Preliminary authorizing public service corporations to conduct business in Arizona.

15. In some cases, water companies are given up to 24 months to fulfill the prescribed conditions.

16. Often the water company making the application for a new CC&N is owned by the developer of the subdivision or is affiliated with the developer. *See, e.g.*, Picacho Water Co., Decision No. 69174, Docket No. W-03528A-06-0313, at 3 n.2 (Ariz. Corp. Comm'n Dec. 5, 2006); Woodruff Water Co., Decision No. 68453, Docket No. W-01445A-04-0755, at 5 & n.1 (Ariz. Corp. Comm'n Feb. 2, 2006).

outside Active Management Areas ("AMAs").<sup>17</sup> To that end, Chairman Jeff Hatch-Miller issued a letter in February 2005 announcing that the Commission had opened a generic docket to consider replacing conditional CC&N's with Orders Preliminary.<sup>18</sup>

Orders Preliminary are a seldom-used form of CC&N authorized under statute:

If a public service corporation desires to exercise a right or privilege under a franchise or permit which it contemplates securing, but which has not yet been granted to it, the corporation may apply to the commission for an order preliminary to the issue of the certificate. The commission may make an order declaring that it will thereafter, upon application, under rules it prescribes, issue the desired certificate, upon terms and conditions it designates, after the corporation has obtained the contemplated franchise or permit or may make an order issuing a certificate on the condition that the contemplated franchise or permit is obtained and on other terms and conditions it designates. If the commission makes an order preliminary to the issuance of the certificate, upon presentation to the commission of evidence that the franchise or permit has been secured by the corporation, the commission shall issue the certificate.<sup>19</sup>

In moving toward the issuance of Orders Preliminary outside AMAs, the Commission is attempting to avoid situations where it grants a CC&N that allows a water company to begin serving customers, but later discovers that the company has failed to meet the CC&N conditions. Some of the developer's conditions are critical to a public interest standard, including obtaining a Letter of Adequate Water Supply from ADWR or an Approval to Construct from the Arizona Department of Environmental Quality ("ADEQ").<sup>20</sup> The Commission was clearly

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17. See generally Ariz. Dep't of Water Res., Assured/Adequate Water, [http://www.azwater.gov/WaterManagement\\_2005/Content/OAAWS/default.asp](http://www.azwater.gov/WaterManagement_2005/Content/OAAWS/default.asp) (last visited Mar. 9, 2007). The 1980 Groundwater Management Act created five Active Management Areas: Prescott, Pinal, Phoenix, Tucson and Santa Cruz. ARIZ. REV. STAT. ANN. § § 45-411, -411.03. Water conservation and recharge requirements are stricter within the state's AMAs; for example, inside an AMA, developers must comply with ADWR's Assured Water Program, which requires a demonstration that a water supply to the proposed development will be physically, legally, and continuously available for the next 100 years. This showing must be made before the developer records plats or sell parcels. Outside AMAs, developers must still determine whether there is a 100-year assured water supply, but may proceed with the sale of lots and the recording of plats as long as the developer has informed the buyer of the lack of an assured water supply.

18. See Letter from Jeff Hatch-Miller, Chairman, Ariz. Corp. Comm'n, to All Interested Parties (Feb. 14, 2005), available at <http://www.azcc.gov/divisions/admin/about/Hatch-Miller-02-14-05.pdf>.

19. ARIZ. REV. STAT. ANN. § 40-282(D).

20. Under normal circumstances, before any additions can be made to the infrastructure for a public water system, the company must first get an Approval to Construct from ADEQ. For a water company located inside an AMA, before the developer can get Department of Real Estate approval to sell lots, the developer must prove to ADWR

worried that with conditional CC&Ns, it could be conveying a property right, difficult to dislodge, before the water company and associated developers had achieved the necessary approvals from other state agencies.<sup>21</sup> Thus, in August 2006, after receiving only two comments during a year-long comment period,<sup>22</sup> the Commission directed Staff to begin using Orders Preliminary as a matter of standard practice when preparing recommendations on all new CC&N applications and CC&N extensions outside AMAs.

### B. Historical Context

The Commission has utilized the Order Preliminary sparingly over the past three decades. For example, Orders Preliminary were issued in cases involving the Morristown Water Company and Johnson Utilities (Decision Nos. 41802 and 67586, respectively). In the Johnson Utilities case, the Commission granted an Order Preliminary requested by Johnson Utilities which was to be used as a vehicle to assume control over the assets and service territory of the beleaguered Arizona Utility Supply and Services, L.L.C. ("AUSS").<sup>23</sup> In the end, Johnson Utilities had to fulfill a number of conditions before a final CC&N for the territory previously served by AUSS would be transferred to Johnson.<sup>24</sup>

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that it has a 100-year assured supply of water. For developments outside an AMA developers just need a letter of adequacy *or* inadequacy to get permission from the Department of Real Estate to sell lots.

21. See Letter from Hatch-Miller to All Interested Parties, *supra* note 18, stating:

In many instances, the utility will begin serving customers in the certificated area in question without meeting one or more of the conditions. As a result, the utility is serving customers without a valid CC&N, thereby operating without the necessary permits and possibly endangering the public. In other instances, the applicant will request several extensions of time to comply with the conditions, saddling both itself and Commission Staff with unnecessary work.

22. Constellation New Energy and Strategic Energy filed comments on March 30, 2005 and Arizona Water Company filed comments on May 18, 2005. The companies wrote in support of the Commission's continuing its practice of issuing conditional CC&Ns but preventing the applicant from serving customers within the CC&N until all conditions have been fulfilled and the applicants have received a confirmation letter from the Commission. Arizona Water Company filed comments on May 18, 2005, indicating support for the continued issuance of conditional CC&Ns, with the addition of language preventing the applicant from serving customers until all conditions have been fulfilled and the applicant has received a confirmation letter from the Commission.

23. Ariz. Util. Supply & Servs., L.L.C., Decision No. 67586, Docket No. SW-04002A-02-0837, at 13 (Ariz. Corp. Comm'n Feb. 15, 2005). AUSS was a wastewater utility that filed for bankruptcy protection and experienced difficulty operating two of its treatment plants; thus, this case essentially involved one utility coming to the rescue of another. See *id.* at 5-7.

24. *Id.* at 8-9. Among the conditions that had to be met by Johnson before a final CC&N would issue were the transfer of all AUSS's franchise rights with Pinal County to Johnson, the transfer of any governmental approvals needed by AUSS to Johnson Utilities, and a series of ADEQ requirements necessary to the operation of AUSS plants and transfer of the assets.

Conversely, in *Utility Source, L.L.C.*,<sup>25</sup> the Commission acknowledged the usefulness of Orders Preliminary but nonetheless denied the request.<sup>26</sup> In its application, the water company sought two concessions from the Commission: first, a conditional CC&N for a segment of homeowners that were already being served, but without a CC&N; and, second, an Order Preliminary for a future phase of the development.<sup>27</sup> The Commission ultimately granted a conditional CC&N for the portion of the development that was already being served, but it rejected the bid for an Order Preliminary because the water company had violated title 40, section 281 of the Arizona Revised Statutes by serving customers without a CC&N.<sup>28</sup> Consequently, the Commission ruled that the water company would have to apply separately for a CC&N extension for the future development.<sup>29</sup>

Perhaps the most compelling evidence of the need for Orders Preliminary comes from a case pending before the Commission out of Mohave County.<sup>30</sup> This application involves the effort of a Nevada developer to obtain a conditional CC&N for a 30,000 home development in an area outside Kingman, Arizona. The application was filed with the Commission on July 7, 2005, and subsequently received a hearing before an Administrative Law Judge. Four days prior to the Commission's scheduled vote on the Recommended Opinion and Order, the Company's attorneys filed a letter in the docket from the ADWR, which stated that the developer had not proven up adequate water supplies. Concerned about ADWR's findings and the prospect of voting on a CC&N application that had critical deficiencies, two Commissioners requested an additional evidentiary hearing as well as discovery. At the time of this writing, the Commission is conducting additional evidentiary hearings and discovery in the matter and has hosted one public comment session in Kingman to collect input from area residents. In this instance, the use of an Order Preliminary would allow the Commission to avoid a scenario in which it might approve a CC&N, only to discover later that the company failed to acquire adequate water supplies to serve the area.

While construction of a given subdivision may be delayed during the time it takes a water company to obtain the permits required by an Order Preliminary, the Commission will have upheld the public interest by ensuring that the water company in question actually has an adequate or assured water supply, an approval to construct, and the necessary county franchise permit prior to serving its customers, all factors that reduce the likelihood of forming a water company where none should be. The consequence of this policy for the internal operation of the Commission is that most, if not all, of the Recommended Opinion and Orders in cases involving new CC&N requests and CC&N extensions in areas outside AMAs will come to us in the form of an Order Preliminary. Thus, the

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25. Decision No. 67446, Docket No. WS-04235A-04-0073 (Ariz. Corp. Comm'n Jan. 4, 2005).

26. *Id.* at 10–11, 25.

27. *Id.* at 10.

28. *Id.* at 20, 23–25.

29. *Id.* at 25.

30. See Perkins Mountain Util. Co., Docket Nos. W-20380A-05-0490, SW-20379A-05-0489 (Ariz. Corp. Comm'n filed July 7, 2005).

recommended Order Preliminary would be approved or denied at a Commission Open Meeting, and, after the applicant water company meets all of the pre-conditions, it would return to the Commission for a final Order granting or denying a CC&N.

### III. REQUIRING WATER RE-USE AT ARIZONA'S PRIVATE WATER COMPANIES

#### *A. Toward a New Paradigm: Integrated Water and Wastewater Systems*

In recent months, the Commission has issued decisions indicating a preference that new subdivisions be served, where possible, by integrated water and wastewater companies. These integrated utilities help to achieve economies of scale, encourage conservation efforts, and facilitate the use of effluent for golf course irrigation, ornamental lakes, and other water features.<sup>31</sup> The concept of integrated wastewater and water companies was approved by the 1999 Commission Water Task Force, a working group comprised of Commission Staff, the Residential Utility Consumer Office ("RUCO"), ADEQ, ADWR, and water company stakeholders. Though the Task Force's policy proposals have never been formally adopted by the Commission, the integrated water and wastewater model has been explicitly favored in several recent decisions. One of these cases involved a clash between the Arizona Water Company ("AWC"), a stand-alone water utility, and a competing entity that proposed to serve the area in question with an integrated water and wastewater operation.<sup>32</sup>

In *Woodruff*, the Commission was presented with a choice between two water companies that wanted to serve the same 3,200 acre development (called Sandia) in a fast growing area of Pinal County.<sup>33</sup> The Commission's decision was heavily influenced by the question of whether the CC&N should be granted to an entity capable of utilizing effluent. Ultimately, the Commission awarded the CC&N to Woodruff Water and Sewer Companies over AWC. The Commission chose Woodruff despite the fact the AWC was a far more experienced water provider.<sup>34</sup> The Commission favored Woodruff's planned use of effluent from its

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31. The following companies are integrated water and wastewater providers: Ajo Improvement Co., Baca Float Water Co., Bachmann Springs Utility Co., Clear Springs Utility Co., Cloud Nine Water Co., Far West Water and Sewer, Fisher's Landing Water and Sewer Works, Francisco Grande Utility Co., Johnson Utilities Co., MHC Operating Limited Partnership, Oak Creek Utility Co., Pima Utility Co., Rainbow Parks, Red Rock Utilities, Rio Rico Utilities, Rio Verde Utilities, Sunrise Utilities, Sunrise Vistas Utilities, Utility Source, Willow Springs Utilities, Litchfield Park Service Co., Santa Cruz Water Co., Picacho Water Co., Palo Verde Utilities, Santa Rosa Utilities, and Arizona-American Water. Arizona-American is the oldest integrated water-wastewater company in Arizona.

32. Woodruff Water Co., Decision No. 68453, Docket No. W-01445A-04-0755, at 5-6 (Ariz. Corp. Comm'n Feb. 2, 2006), *appeal filed*, 1CA-CV 07-0167 (Ariz. Ct. App. Mar. 9, 2007).

33. At build-out the Sandia development will serve an estimated 25,000 to 30,000 people. *Id.* at 7.

34. *Id.* at 5, 31. AWC is a water company serving more than 80,000 customers in eight Arizona counties. Woodruff is a water company founded by a developer with no prior experience operating water companies in Arizona, though the Company did put on evidence

planned wastewater treatment facility to sustain the development's proposed golf course.<sup>35</sup> During the CC&N hearing, Woodruff testified that its integrated approach to wastewater and water was designed to facilitate a 20-year build-out of the development, and that it would allow it to implement a water reuse program that it called "essential" to the project.<sup>36</sup> Against this backdrop, the Commission concluded that "[t]he benefits of developing and operating integrated water and wastewater utilities in this instance outweigh the economies imputed to AWC's larger scale."<sup>37</sup>

Companies competing for the right to serve some of the state's fastest growing areas are advantaged when they present an integrated approach to the Commission, thus allowing Commissioners the opportunity to mandate the use of effluent from the moment the service area is created.

#### *B. Mandating Effluent for Use on Golf Courses and Ornamental Water Features*

In recent decisions, the Commission has begun prohibiting water companies from selling groundwater for use on new golf courses or ornamental water features.<sup>38</sup> This effectively means that developers hoping to construct golf courses and ornamental water features within the service territories of water companies subject to this provision will either have to find the effluent for use on their golf courses, or wait to build the golf course until the development is

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that it had hired an individual with significant experience running a separate water and wastewater company serving master planned developments in Arizona. *Id.* at 5.

35. *See id.* at 29.

36. *See id.* at 8. During the Commission's Open Meeting on the matter, the company's attorney told the Commissioners that the developer, which was owned by the same individual as the proposed water company, had agreed to voluntarily postpone construction of two golf courses until such time as effluent was made available from build-out of second phase of the development. The Author believes *Woodruff* to be a critical case in the evolution of the Commission's decision making in this area. Woodruff was the first company to concede that it was possible to defer the construction of a golf course until it had adequate build-out of homes to provide the effluent needed for the golf course. Additionally, the Author of this Article offered an amendment to the Administrative Law Judge's Recommended Opinion and Order, which was approved, requiring Woodruff to file with the Commission within a year a report detailing the company's progress in the utilization of effluent on ornamental lakes, golf courses and other aesthetic features.

37. *Id.* at 29.

38. Commission orders now routinely contain the following language:  
In recent months, the Commission has become increasingly concerned about the prolonged drought in Central Arizona. Therefore, we believe [the company] should be required to conserve groundwater and that [the company] should be prohibited from selling groundwater for the purpose of irrigating any future golf courses within the certificated expansion areas or any ornamental lakes or water features located in the common areas of the proposed new developments within the certificated expansion areas.

*E.g.*, Ariz. Water Co., Decision No. 69163, Docket No. W-01445A-06-0059, at 10 (Ariz. Corp. Comm'n Dec. 5, 2006).

sufficiently built out to provide the effluent.<sup>39</sup> Two water companies have objected to this provision, arguing that it veers into regulatory territory already occupied by ADWR. The opponents of the effluent provision assert that ADWR has promulgated rules under its Third Management Plan that allow the use of some groundwater on golf courses inside AMAs, and that therefore the Commission prohibition goes too far.<sup>40</sup> The Commission retained the language over the Company's objections in both instances.<sup>41</sup> The Commission should continue its recently established practice of prohibiting groundwater for use on golf courses and ornamental water features in order to achieve the state's conservation goals.

*C. Aggressive Water Reuse by Newly Formed Water Companies: The Global Water Resources Example*

While it has become commonplace for wastewater utilities to deliver effluent for use on golf courses, greenbelts, ornamental lakes, and other ornamental water features (and for the Commission to require these uses as a condition to a new CC&N) no Arizona water or wastewater company has yet provided effluent for outdoor or indoor residential use. One Arizona water company, however, has announced plans to begin the aggressive use of effluent at the home-site. Global Water Resources recently briefed Corporation Commissioners on the company's decision to take effluent to home-sites within the Belmont development in western Maricopa County, a 25,000 acre residential

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39. To date, the language prohibiting the use of groundwater on new golf courses has been adopted in twelve cases: Empirita Water Co., Decision No. 69399, Docket No. W-03948A-06-0490, at 13 (Ariz. Corp. Comm'n Mar. 29, 2007); Ariz. Water Co., Decision No. 69386, Docket No. W-01445A-06-0317, at 14 (Ariz. Corp. Comm'n Mar. 22, 2007); Lucky Hills Water Co., Decision No. 69381, Docket No. W-01961A-06-0037, at 8 (Ariz. Corp. Comm'n Mar. 22, 2007); Green Acres Water, L.L.C., Decision No. 69256, Docket No. W-20430A-05-0839, at 18 (Ariz. Corp. Comm'n Jan. 19, 2007); Beaver Dam Water Co., Decision No. 69243, Docket No. W-03067A-06-0117, at 7 (Ariz. Corp. Comm'n Jan. 19, 2007); Diablo Village Water Co., Decision No. 69206, Docket No. W-02309A-05-0501, at 11 (Ariz. Corp. Comm'n Dec. 21, 2006); Picacho Water Co., Decision No. 69174, Docket No. W-03528A-06-0313, at 7 (Ariz. Corp. Comm'n Dec. 5, 2006); Ariz. Water Co., Decision No. 69163, Docket No. W-01445A-06-0059, at 10 (Ariz. Corp. Comm'n Dec. 5, 2006); Willow Springs Utils., L.L.C., Decision No. 68963, Docket No. WS-20432A-05-0874, at 16 (Ariz. Corp. Comm'n Sept. 21, 2006); Johnson Utils. Co., Decision No. 68961, Docket No. WS-02987A-05-0695, at 7 (Ariz. Corp. Comm'n Sept. 21, 2006); Diversified Water Utils., Inc., Decision No. 68960, Docket No. W-02859A-04-0844, at 6 (Ariz. Corp. Comm'n Sept. 21, 2006); Ariz. Water Co., Decision No. 68919, Docket No. W-01445A-05-0701, at 7 (Ariz. Corp. Comm'n Aug. 29, 2006).

40. See Arizona Water Company's Exceptions to Administrative Law Judge's Recommended Order at 5, Ariz. Water Co., Decision No. 69163, Docket No. W-01445A-06-0059 (filed Oct. 12, 2006); Exceptions of Picacho Water Company to Administrative Law Judge's Recommended Opinion and Order, Picacho Water Co., Decision No. 69174, Docket No. W-03528A-06-0313 (filed Nov. 16, 2006).

41. See Picacho Water Co., Decision No. 69174, at 7; Ariz. Water Co., Decision No. 69163, at 10.

subdivision.<sup>42</sup> This subdivision will receive water from the Water Utility of Greater Tonopah and wastewater service from Hassayampa Utilities, both owned by Global.<sup>43</sup>

Global is proposing using reclaimed water for all outside uses at home sites within the Belmont community. Assuming the average home usage is 0.4 acre-feet ("AF") of water, 0.16 AF for outside uses and 0.24 AF for indoor uses, the home would send 0.16 AF of discharge to treatment.<sup>44</sup> Under Global's Belmont proposal, the 0.16 AF of discharge would go to treatment and then be used as treated effluent to supply the outside water needs for homes within the development.<sup>45</sup> Basic water reclamation would result in a decrease in annual water consumption by 30%, but with the aggressive use of water reclamation annual water consumption is reduced by 40% at Belmont.<sup>46</sup> The neighborhood would not discharge any water, compared with a typical neighborhood, which discharges 117,288,000 gallons of water a year.<sup>47</sup> When the plan is complete, it is estimated that Belmont will be the largest master planned community with fully integrated water reclamation planning in Arizona.<sup>48</sup> The Commission should begin a process designed to examine whether provisioning of effluent for use at home sites should eventually become a requirement in future CC&N approvals, particularly in cases involving large, well-capitalized utilities.

***D. Arizona Department of Water Resources' Modified Non-Per Capita Program: Expecting Conservation at all Water Companies***

The Commission is likely entering an era of mandating conservation measures at Arizona's regulated water companies. This is in part because ADWR is currently engaged in a stakeholder process that will culminate in the amendment of the agency's Third Management Plan, and with that amendment will come new conservation requirements for water companies.

The Third Management Plan is designed to implement the safe yield requirement established pursuant to the 1980 Groundwater Management Act. It is believed that the newly amended rules governing safe yield will require water systems, including the private water companies regulated by the Commission, to implement water conservation measures, called Best Management Practices ("BMPs"), geared toward achieving the state's safe yield target.<sup>49</sup> Larger water companies will likely be asked to implement more BMPs than smaller companies,

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42. See Briefing to Commissioners, Trevor T. Hill, Global Water Resources LLC, Minimizing Water Use/Maximizing Water Reuse in Development (Apr. 2, 2007) (on file with author).

43. *Id.*

44. *Id.*

45. *Id.*

46. *Id.* For a typical section of land with 2,250 units, the neighborhood that consumed 293,220,000 gallons of water before reclamation and reuse would now use 175,932,000 gallons of water per year.

47. *Id.*

48. *Id.*

49. See Ariz. Dep't of Water Res., Program Framework: Modified Non-Per Capita Conservation Program (Oct. 5, 2006) (on file with author).

but all companies will be permitted to choose from a list of approximately 25 BMPs.<sup>50</sup> Among the list of BMPs currently under discussion are the installation or promotion of low-flush toilets or low-pressure shower heads and conservation advertising.<sup>51</sup> In order to meet the requirements, companies will have to show that they have implemented the BMPs, but will not be required to show that the measures have resulted in a prescribed amount of conservation.<sup>52</sup>

Water companies have long argued that they cannot implement conservation programs because they are unable to obtain rate relief from the Commission for their conservation efforts.<sup>53</sup> This is a fundamental misperception on the part of the companies. The Commission has never been asked for rate recovery of these programs, and Commission Staff have made it clear that they would be receptive to filings from Companies seeking to recover (in rates) the costs of implementing conservation programs, particularly those designed to satisfy ADWR's new rulemaking.<sup>54</sup> The Commission should continue to make it clear that it is ready to facilitate conservation efforts by water companies, especially those programs that are necessary to meet ADWR's new rules, and that the Commission is prepared to do this even before ADWR finalizes its rulemaking. Moreover, the Commission should notify water companies that they can file tariff applications with the Commission that are designed to implement conservation programs. For example, these tariffs could be designed to allow water companies to carry out conservation measures in the same way municipalities do. Such water company tariffs could condition service on the installation of low-flow toilets, low-flow shower heads, or minimal or zero usage of groundwater for outdoor irrigation. The Commission could adopt these tariffs as part of rate cases, CC&N applications or CC&N extensions.

#### IV. ENCOURAGING CONSOLIDATION OF DISTRESSED WATER COMPANIES AS A MEANS OF ACHIEVING WATER CONSERVATION AND REUSE

Implementation of conservation programs is generally a low priority for the state's troubled water companies. Most of these utilities lack the resources and the management experience to make conservation a priority. The only long-term hope for the advancement of conservation measures at these companies is their consolidation into other larger utilities.

In the 1999 Water Task Force Report to the Commission, Commission Staff and industry stakeholders issued a number of recommendations aimed at

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50. *See id.* Under the Draft Program, water companies with up to 5,000 service connections would be required to implement a basic water conservation education program plus one other BMP; companies with between 5,001 and 30,000 service connections would be required to implement the education program plus five BMPs; and companies with more than 30,000 service connections would be required to implement the education program plus ten BMPs.

51. *See id.*

52. *See id.*

53. Interview with Commission Staff, *supra* note 1.

54. *Id.*

encouraging the consolidation of smaller water companies (Class D and E companies with Class A or B or C utilities).<sup>55</sup> Pursuant to section R14-2-103 of the Arizona Administrative Code, the Commission classifies public service corporations into five categories based upon the public service corporation's annual operating revenue. For water and sewer companies, the breakdown is as follows: Class A: Annual Operating Revenue exceeding \$5,000,000; Class B: Annual Operating Revenue from \$1,000,000 to \$5,000,000; Class C: Annual Operating Revenue from \$250,000 to \$999,999; Class D: Annual Operating Revenue from \$50,000 to \$249,999; Class E: Annual Operating Revenue less than \$50,000. Though each Task Force representative agreed that incentives should be used by the Commission to achieve the goal of consolidating distressed water companies, the group could not come to consensus on which incentives are best.<sup>56</sup> Among the consolidation incentives promoted by Staff as part of the Task Force report were rate premiums for larger water companies that acquire smaller companies, and the development of a policy or rule setting forth the Commission's parameters for acquisition adjustments—premiums on the purchase price of troubled water companies.<sup>57</sup> The use of an acquisition adjustment represents a fairly radical deviation from normal ratemaking processes, as it involves a decision by the Commission to allow rate base to reflect a purchase price for a company's assets that is higher than the book value of that company. Under ordinary circumstances, rates are set using the book value of a company's assets at the time they are placed in service.

Staff recommended that acquisition adjustments be used under a specific set of conditions, including where the acquisition would not be deleterious to the acquiring company; where it was in the public interest; where the purchase price was judged to be fair and reasonable; where the recovery period for the resulting acquisition adjustment was set for a definitive period of time; and where the acquisition would have a positive effect on the service of the acquired company.<sup>58</sup> RUCO opposed the idea of acquisition adjustments, and industry representatives argued for California's policy allowing the use of fair market value in setting acquisition adjustments.<sup>59</sup>

Alternatively, Staff and RUCO agreed that rate premiums on the Company's authorized rate of return could be a valuable tool in the effort to encourage consolidation. Under this proposal, acquisitions would be spurred when an acquiring company realized it would be able to recover the costs of folding in a troubled company, and could do so without the regulatory lag created by the normal ratemaking process at the Commission.<sup>60</sup> According to RUCO, rate premiums are preferable to acquisition adjustments because they permit the

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55. See WATER TASK FORCE, ARIZ. CORP. COMM'N, INTERIM REPORT OF THE ARIZONA CORPORATION COMMISSION'S WATER TASK FORCE 7-11 (1999) (Docket No. W-00000C-98-0153) (on file with author).

56. *Id.* at 8.

57. *Id.*

58. *Id.*

59. *Id.* at 8-9.

60. *Id.* at 9.

Commission to maintain control over the amount of the incentive allowed.<sup>61</sup> Rate premiums, unlike acquisition adjustments, can be limited to a set number of years, or a specific period of time, such as the length of time between rate cases.<sup>62</sup>

To date, rate premiums and acquisition adjustments have not been formally blessed by the Commission via either a rulemaking or policy statement. Since the Water Task Force report was issued, the Commission has only approved one acquisition adjustment, in a case involving the acquisition by a Class A utility of a small distressed company in southeastern Arizona.<sup>63</sup> In that case, which involved the Commission's approval of the purchase of the severely hobbled and disastrously managed McLain water systems in Cochise County, the Commission approved a \$696,000 purchase price<sup>64</sup> of the companies by Algonquin Water Resources of America, a multinational income fund that owns five water and wastewater companies in Arizona (excluding the McLain systems).<sup>65</sup> The price represented a significant inflation of the estimated book value of the companies,<sup>66</sup> which were believed to be in such poor shape that they represented a threat to the health and safety of the companies' customers.<sup>67</sup> The Commission did not refer to the purchase price as an acquisition adjustment, but that is essentially what it was, as the purchase price was substantially greater than the book value of the company. Moreover, the large purchase premium was being used by the Commission to establish a positive rate base and encourage the purchase by Algonquin.<sup>68</sup> The Commission acknowledged the extraordinary nature of the acquisition price and of the Commission's role in setting it, but felt it was the only hope for stimulating a purchase and rehabilitation of the companies.<sup>69</sup>

Acquisition adjustments and rate premiums hold promise for use when the Commission desires to encourage the consolidation of small, troubled water companies. Strengthening the two dozen or so small water companies that currently find themselves on the financial ropes would dramatically improve the opportunities for implementing water conservation measures at those companies. The Commission should first endeavor to identify those water companies it believes are the likeliest targets for consolidation. A model for this has been developed in California, where the California Public Utilities Commission ("CPUC") has identified in its 2005 Water Action Plan the goal of providing incentives for the acquisition and operation of small water companies by larger

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61. *Id.*

62. *Id.*

63. *See* Miracle Valley Water Co., Decision No. 68412, Docket No. W-01646A-05-0506, at 12 (Ariz. Corp. Comm'n Jan. 23, 2006).

64. *Id.* at 12.

65. *See* N. Sunrise Water Co., Decision No. 68826, Docket No. W-20453A-06-0247, at 4-5 (Ariz. Corp. Comm'n June 29, 2006).

66. *See* Minutes of the Commission Open Meeting (June 27, 2006) (on file with author). The meeting included a discussion by Commissioners regarding the dilapidated condition of the water systems; ultimately, the Commission established a purchase price that was tailored to covering the amount of taxes owed by the water companies to the State of Arizona and Cochise County, rather than to the actual value of the systems.

67. *Id.* at 8.

68. *Id.* at 9-10.

69. *Id.*

private or municipal water companies.<sup>70</sup> CPUC's Water Action Plan did not identify specific companies for acquisition; rather, the report identified the goal of providing incentives. CPUC Staff, working with other government agencies, has since identified thirty systems (serving 10,500 customers) that would be in a position to qualify for acquisition by larger systems.<sup>71</sup> The Arizona Commission should similarly establish a list of troubled water systems considered candidates for consolidation and then establish a policy statement informing the water company community that acquisition adjustments and rate premiums will be considered to encourage the consolidation of these identified systems where the conditions laid out by Staff in the 1999 Water Task Force are met.<sup>72</sup>

#### V. CORRALLING WATER LOSS: CONSERVING WATER BY KEEPING IT IN THE PIPELINE

An increasing number of Arizona's private water companies are suffering from water loss—losses that occur between the point of origin (i.e., either at a well site if groundwater is used, or the Central Arizona Canal if CAP water is used) and the point of use by customers. In determining the amount of acceptable water loss, the Commission generally follows the recommendation of the American Water Works Association that loss greater than 15% is per se unacceptable, and loss below 10% is acceptable. The Commission monitors and enforces this standard in two ways. First, each company must include as part of its annual report to the Commission an accounting of the number of gallons pumped and the number of gallons sold, which, when analyzed, offers a glimpse of the amount of water each company is losing during the distribution process. Second, each company's water loss is reviewed by Commission Staff when the company is before the Commission for a rate case or request for a CC&N extension. The Commission derives its authority to regulate water loss from its authority to establish rates that are just and reasonable.<sup>73</sup>

The Commission has routinely required companies that are experiencing higher than acceptable levels of water loss to report back to the Commission with a plan to reduce loss to below the 10% standard or to explain why doing so is not

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70. CAL. PUB. UTILS. COMM'N, WATER ACTION PLAN 7 (2005), available at [http://www.cpuc.ca.gov/static/hottopics/3water/water\\_action\\_plan\\_final\\_12\\_27\\_05.pdf](http://www.cpuc.ca.gov/static/hottopics/3water/water_action_plan_final_12_27_05.pdf).

71. Memorandum from Michael Miller, Utils. Eng'r, Cal. Pub. Utils. Comm'n, et al. to John Bohn, Comm'r, Cal. Pub. Utils. Comm'n 1 (Oct. 23, 2006) (on file with author).

72. See WATER TASK FORCE, *supra* note 55, at 8.

73. Specifically, title 40, section 250(C) of the 2006 Arizona Revised Statutes provides:

[T]he commission shall by order establish the rates, fares, tolls, rentals, charges, classifications, contracts, practices, rules or regulations proposed, in whole or in part, or establish others in lieu thereof, which it finds just and reasonable, and which, if not suspended, shall, on the expiration of thirty days from the time of filing the order, or in such lesser time as the commission grants, become effective and be established, subject to the power of the commission to alter or modify the order.

possible. For instance, in *Livco Water Co.*,<sup>74</sup> Livco Water was found to have a 17.2% water loss. The Commission required Livco to file a water loss mitigation report with the Commission within 15 months of the effective date of the decision. Furthermore, the Commission ruled that Livco's water loss could not exceed 15%.<sup>75</sup>

In the most recent rate case involving the Pine Water Company, a utility chronically beset by water shortages in the summertime, the Commission rejected a provision in the proposed Settlement Agreement that would have allowed the company to file a water loss plan designed to reduce its 12.6% water loss rate.<sup>76</sup> The Commission did not find the proposed water loss provision aggressive enough under the circumstances, stating:

Arizona is in a severe drought. Water is a precious resource and is in particularly limited supply in the Pine area. It is unacceptable that a utility would request that its customers pay the costs of a speculative chance for additional water but could determine that reducing existing water loss to within acceptable levels is not "practical." Pine Water's detailed water loss plan shall only address ways to reduce water loss to less than ten percent.<sup>77</sup>

In other words, the Commission was mandating that the Company find a way to get its water loss beneath the 10% standard. The Commission further ordered its Staff to return to it with recommended actions if not satisfied by the Company's plan for remediation of the water loss problem.<sup>78</sup> Subsequent to this decision, Pine Water filed a detailed report looking at water supplies not only for their certificated area, but for the entire Payson area.

The Commission has also determined that some companies simply cannot come into total compliance with the water loss standard without undertaking unreasonable capital expenditures. In Decision No. 66849, the Commission determined that it would not be reasonable to require the Arizona Water Company to improve its water loss rates to below 10% on its Superior water system. The Commission found that doing so would necessitate the replacement of an above-ground pipeline that traveled significant distances and experienced evaporative losses as a result of warm temperatures.<sup>79</sup>

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74. Decision No. 68751, Docket No. W-02121A-05-0820, at 6 (Ariz. Corp. Comm'n June 5, 2006).

75. See *id.* at 6, 17.

76. Pine Water Co., Decision No. 67166, Docket No. W-03512A-03-0279, at 5-6, 15-16 (Ariz. Corp. Comm'n Aug. 10, 2004). Pursuant to the Settlement Agreement, if the Company found that reducing the 12.6% rate was infeasible or impractical, it could present its arguments against further reductions to the Commission. The Settlement Agreement also required the Company to file quarterly reports describing in detail the sources of the Company's water, quantity of water, and gallons of water pumped, whether from the Company's wells or well water obtained via well-sharing agreements, from water hauling or through the pipeline known as Project Magnolia.

77. *Id.* at 11.

78. *Id.* at 15-16.

79. See Ariz. Water Co., Decision No. 66849, Docket No. W-01445A-02-0619, at 41 (Ariz. Corp. Comm'n Mar. 19, 2004).

The Commission's approach to addressing water loss suffers from its passivity. The Commission cannot know whether a company is posting high water losses unless the company comes forward and files for a rate increase or for an expansion of its territory. A random review of one water company's annual reports illustrates that there are companies that remain out of compliance with the water loss requirement in the intervening years between rate cases. For instance, Ehrenberg Water is experiencing an 11% water loss rate and has not been in for a rate case since November, 1996. Golden Shores Water is experiencing a 16% water loss rate and has not been before the Commission since August, 1999.

The Commission's method of addressing water loss also suffers from a lack of auditing of the water loss reports. For instance, the 2003 annual report of the Beardsley Water Company (serving portions of the West Valley) claimed that it had sold five million gallons more than it pumped in 2003, suggesting a next-to-impossible net water *gain*.<sup>80</sup> Yet in its 2004 rate case, the Beardsley Water Company was found to have a system-wide water loss of between 2% and 3%.<sup>81</sup>

Water losses are also tracked by ADWR through the agency's Annual Water Withdrawal and Use reports, required of all water companies serving within AMAs. But these reports also go largely without audit, and appear to be often unreliable. Using the West End Water Company as an example, the Company's ADWR Annual Water Withdrawal and Use Report for 2002 declared that the Company had withdrawn 137.07 acre-feet, and delivered 126.38 acre-feet to its users, or a water loss rate of 7.8%.<sup>82</sup> This contrasts with the 2002 Annual Report, filed with the Commission, in which West End Water stated that it sold 87.01 acre-feet of water, but pumped 136.18 acre-feet, for a loss rate of approximately 36%.<sup>83</sup>

Staunching water losses at Arizona's water companies will require a multi-pronged effort. First, the Commission should continue on its current course requiring companies to engage in water loss mitigation planning whenever those companies come in for rate cases or CC&N extensions. Second, the Commission should consider financial incentives for companies that engage in water loss mitigation, potentially including a surcharge mechanism designed to allow for more timely recovery of costs associated with infrastructure improvements that are aimed at preventing water loss. Such a surcharge has been advocated by a coalition

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80. BEARDSLEY WATER CO., ANNUAL REPORT 11 (2003), available at <http://www.azcc.gov/divisions/util/Annual%20Reports/2003/Beardsley%20Water%20Company.pdf>.

81. See ARIZ. CORP. COMM'N, STAFF REPORT: BEARDSLEY WATER COMPANY, DOCKET NO. W-02074A-04-0358: APPLICATION FOR A PERMANENT RATE INCREASE, at attachment A, at 6 (2004).

82. WEST END WATER CO., ANNUAL WATER WITHDRAWAL AND USE REPORT: PROVIDER SUMMARY 2002 (2003).

83. WEST END WATER CO., ANNUAL REPORT (2002), available at <http://www.azcc.gov/divisions/util/Annual%20Reports/2002/West%20End%20Water%20Company.pdf>.

of Arizona water companies<sup>84</sup> and has been implemented in other states, including Pennsylvania, Delaware, Ohio, and Illinois.<sup>85</sup>

#### VI. ENCOURAGING CONSERVATION THROUGH TIERED WATER RATES AND CURTAILMENT TARIFFS

Tiered water rates and curtailment tariffs have become the de facto norm for all new water company applications, rate cases, and CC&N extensions. Beginning in 2001, Commission Staff began recommending in each water utility rate case that the Commission adopt a tiered water rate structure in order to properly price water and encourage conservation. The tiered rates are tailored specifically to each water company.

Recent Commission decisions demonstrate the use of tiered rates. In *Chaparral City Water Co.*,<sup>86</sup> the Commission implemented the following rate schedule:<sup>87</sup>

Commodity Rates (per 1,000 Gallons), based upon the size of the meter going to the customer.

##### ¾" Residential Meter

|                      |        |
|----------------------|--------|
| 1,000–3,000 Gallons: | \$1.68 |
| 3,001–9,000 Gallons: | \$2.52 |
| Over 9,000 Gallons:  | \$3.03 |

##### ¾" Commercial & Industrial Meter

|                      |        |
|----------------------|--------|
| 1,000–9,000 Gallons: | \$2.52 |
| Over 9,000 Gallons:  | \$3.03 |

##### 2" Meter (Residential, Commercial & Industrial)

|                             |        |
|-----------------------------|--------|
| From 1,000–100,000 Gallons: | \$2.52 |
| Over 100,000 Gallons:       | \$3.03 |

The Commission decision in Arizona Water Company's Eastern Group System<sup>88</sup> adopted the following rates for the Company's Bisbee system:

84. See INVESTOR OWNED WATER UTILS. OF ARIZ., RECOMMENDATIONS TO THE ARIZONA CORPORATION COMMISSION'S WATER TASK FORCE 10 (2005) (on file with author). The IOWUA white paper called on the Commission to implement a number of reforms geared toward allowing companies greater financial recovery. Among those proposals was the DSIC surcharge mechanism to permit water companies to recover funds from ratepayers between rate cases for "qualifying system improvement projects," including expenditures made by the company for "projects that reduce water losses, enhance water quality,[and] improve fire protection and long-term system viability." *Id.* at 5.

85. *Id.* at 4–5.

86. Decision No. 68176, Docket No. W-02113A-04-0616 (Ariz. Corp. Comm'n Sept. 30, 2005).

87. *Id.* at 41–42.

88. Ariz. Water Co., Decision No. 66849, Docket No. W-01445A-02-0619 (Ariz. Corp. Comm'n Mar. 19, 2004)

|                          |                      |
|--------------------------|----------------------|
| 0 to 10,000 gallons      | \$2.594              |
| 10,001 to 25,000 gallons | \$3.242              |
| Over 25,000 gallons      | \$3.89 <sup>89</sup> |

The rates for the Company's Apache Junction System:

|                          |                        |
|--------------------------|------------------------|
| 0 to 10,000 gallons      | \$1.9688               |
| 10,001 to 25,000 gallons | \$2.4610               |
| Over 25,000 gallons      | \$2.9532 <sup>90</sup> |

Between 2001 and 2004, the Commission began implementing curtailment plans for water companies as they filed applications at the Commission for rate cases and CC&N extensions. In May 2004, the Commission took steps to encourage every water company in Arizona to adopt a water curtailment tariff, regardless of whether they intended to come in for a rate case or CC&N extension in the near future. Originally designed to address emergencies such as a lightning strike to a well, the Commission realized that curtailment tariffs could also be used by water companies to require customers to conserve during a water shortage or severe drought conditions. Today, each water company that comes before the Commission for a rate case or CC&N extension must propose a curtailment tariff as a part of its case. If it fails to do so, Commission Staff proposes the tariff.

The Pine and Bella Vista Water Companies, serving Pine and Sierra Vista respectively, have used curtailment tariffs with regularity to address seasonal water shortages.<sup>91</sup> At the Pine Water Company, customers have become accustomed to a curtailment regime that allows the Company to prohibit certain water uses at Stages 3, 4, and 5, dependent on water production and storage levels at the time.<sup>92</sup>

The Pine curtailment tariff operates as follows:

Stage 1 (green): Water storage level is at least 90% of total capacity; no curtailment or notice required.

Stage 2 (blue): Water storage level is less than 90%, but at least 75% of capacity for at least 48 consecutive hours. Voluntary conservation measures may be employed by customers to reduce water consumption by 10%. Outside watering on weekends and holidays is curtailed. The Company is required to notify customers by changing sign postings, emailing, and posting a sign in the Pine Post Office.

Stage 3 (yellow): Water storage level is less than 75%, but at least 65% of its capacity for 24 consecutive hours. Mandatory conservation measures must be employed by customers to reduce water consumption by 25%. Outdoor watering is

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89. *Id.* at 48.

90. *Id.*

91. *See, e.g.,* Teresa McQuerrey, *Water Saving Mandated by State*, PAYSON ROUNDUP, July 15, 2005, available at <http://www.paysonroundup.com/section/localnews/story/19739>; *see also* Bella Vista Water Co., Decision No. 67505, Docket No. W-02465A-04-0692 (Ariz. Corp. Comm'n Jan. 20, 2005).

92. *See* Pine Water Co., Decision No. 65914, Docket No. W-03512A-03-0104 (Ariz. Corp. Comm'n May 16, 2003).

completely curtailed, with the exception of livestock. The Company is required to notify customers by changing sign postings, emailing, and posting a sign in the Pine Post Office.

Stage 4 (orange): Water storage or production is less than 65%, but at least 55% of capacity for 24 consecutive hours. Mandatory water restrictions are put into place and customers can be disconnected for not complying.

Stage 5 (red): Water storage or production is less than 55% of capacity for 12 consecutive hours. Similar to Stage 4, mandatory water restrictions are put into place.<sup>93</sup>

Customers are notified of the Stages via a bill stuffer and the posting of the Stage colors on flags throughout the service territory.<sup>94</sup>

The Bella Vista Water Company implemented a similar curtailment tariff, but found that some customers violated the mandatory curtailment measures. Bella Vista claimed it had few ways to force customers to abide by the curtailment stages and wanted to impose a presumptive violation of the advanced stages of the tariff. Under the Company's proposal to amend the tariff on its Southern system, customers using more than 600 gallons per day or 18,000 gallons per month during Stages 4 and 5 (when outdoor uses were prohibited) were presumed to be using water for those prohibited purposes.<sup>95</sup> The curtailment tariff approved by the Commission in *Bella Vista Water Co.* permits the Company to shut customers off with prescribed notice requirements, if they are issued a presumptive violation.<sup>96</sup> However, concerned about the effect the presumptive violation and ensuing shut-offs would have on customers, the Commission required the Company to follow strict notification guidelines aimed at providing the maximum amount of notice to customers.<sup>97</sup> Specifically, the Commission altered Bella Vista's curtailment notice proposal to require the Company to give presumptive violators two business days' notification that they are believed to be in violation of the tariff prior to shutting the customer's water off.<sup>98</sup> Customers, during those two days, may present evidence to the Company that their water usage was higher than the allowed 600 gallons per day as a result of permitted water uses.<sup>99</sup> The customer, pursuant to normal Commission rules, could also lodge a complaint against the Company at the Commission, which would be addressed by the Commission's Consumer Services Section.<sup>100</sup> The Commission also mandated that when taking special meter readings designed to demonstrate whether the customer was in violation, the Company must notify the customer of the reading and not charge the customer for it.<sup>101</sup>

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93. *Id.*

94. *Id.*

95. *See* Bella Vista Water Co., Decision No. 67505, Docket No. W-02465A-04-0692, at 2.

96. *Id.* at exhibit A.

97. *See id.*

98. *Id.* at 4.

99. *Id.*

100. *Id.* at exhibit A.

101. *Id.* at 4.

## VII. FORCED CONSERVATION THROUGH HOOK-UP MORATORIUMS WHEN ALL ELSE HAS FAILED

In recent years, the Commission has been among the few Arizona governmental entities to implement a comprehensive hook-up moratorium on a water system, a draconian but sometimes necessary method of conserving water supplies and staunching a downward spiral by a water company. On two recent occasions the Commission imposed a comprehensive moratorium either to address chronic water shortages caused by drought conditions, or to prevent the exacerbation of problems caused by the failure of the water company to invest in the water system's infrastructure, which had led to repeated outages on the system. In these instances, the Commission took the extraordinary step of preventing further connections to the water system, a de facto prohibition on development in the area in one case, and a severe restriction on growth in the other.<sup>102</sup>

### A. Pine Water Company

Since 1989, the water-shortage-prone Pine Water Company has operated under some form of hook-up restriction.<sup>103</sup> In 1989, the Commission established a total moratorium on new hook-ups. It allowed 10 connections per month beginning in 1990, lowered the limitation to one per month in 1996, and raised it again to 25 hook-ups per month in December 2002.<sup>104</sup> The company was required in a subsequent decision to present the Commission with semi-annual reports on the status of its water supply, and Staff was directed to use that information in drafting a recommendation for the Commission regarding the need for continuation or alteration of the 25 per month hook-up restriction.<sup>105</sup> On November 19, 2004, Staff filed a compliance report recommending the Commission adopt a complete prohibition on new connections to the Pine Water Company, citing the Company's reliance on a pipeline importing water from the Strawberry Water Company into Pine, as well as summertime water hauling, to meet the summertime demands of

102. The Commission recently addressed a third proposed hook-up moratorium in *Desert Hills Water Co.*, Decision No. 68780, Docket No. W-02124A-06-0379 (Ariz. Corp. Comm'n June 19, 2006). In this case, the Commission was presented with a well-capitalized water company that had failed to invest in adequate water infrastructure to serve a growing population in north Phoenix, resulting in numerous outages and water quality complaints. Staff recommended the Order to Show Cause, which would require, among other remedies, a hook-up moratorium until the issues facing the company are resolved. During the pendency of the case, however, the Company was purchased by the nearby Town of Cave Creek. Both the proposed purchase and the Order to Show Cause are currently pending before the Commission.

103. Pine, Arizona sits atop fragmented rock formations that rely on rain and snow melt for groundwater collections. Groundwater is the main source of water for the Pine Water Company. See *Pine Water Co.*, Decision No. 67823, Docket No. W-03512A-03-0279, at 3 (Ariz. Corp. Comm'n May 5, 2005).

104. See MARLIN SCOTT, JR., ARIZ. CORP. COMM'N, COMPLIANCE STAFF REPORT FOR PINE WATER COMPANY PER DECISION NO. 67166, at 1 (2004) (Docket No. W-03512A-03-0279) (on file with author); see also *Pine Water Co.*, Decision No. 64400, Docket No. W-03512A-01-0764, at 8 (Ariz. Corp. Comm'n Jan. 31, 2002).

105. See *Pine Water Co.*, Decision No. 65435, Docket No. W-03512A-01-0764, at 2 (Ariz. Corp. Comm'n Dec. 9, 2002).

the existing water system, and the potential long-term detriments of the pipeline to the Strawberry system.<sup>106</sup> In its most recent action on the Pine Water Company, the Commission again lowered the allowable per month hook-ups for the company to two residential connections per month, imposed a complete moratorium on new commercial hook-ups, and prohibited any additional main extension agreements.<sup>107</sup> The Commission also imposed a May 2006 deadline for the parties to the case to arrive at a permanent solution to the company's water supply woes or face an automatic moratorium on all new residential hook-ups.<sup>108</sup> As of the writing of this Article, the Company has implemented the comprehensive moratorium.

### *B. McLain Water Companies*

In July 2005, the customers of the McLain water systems experienced one of the longest water outages in Arizona history. The outage left the 265 customers of the Horseshoe Ranch and Cochise Water Companies without water for 16 days and caused Commissioners to ask Governor Janet Napolitano to declare an unprecedented state of emergency in the water system's service territory in order to free up funds that are available to the Governor for natural disaster recovery and other emergencies.<sup>109</sup> Ultimately, the Governor tapped funding from her Health Crisis Fund to provide a \$12,500 loan for a new well pump that resolved the short-term crisis. The outage was the latest in a string of incidents involving the dilapidated water system, which two years before had been placed under interim management<sup>110</sup> by the Commission due to its previous owner's failure to make necessary improvements and repairs.<sup>111</sup> As a result of the recent outages and compliance problems on the McLain system, the Commission took the extraordinary step of imposing a total moratorium on new connections to the

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106. See SCOTT, *supra* note 104, at 3.

107. Pine Water Co., Decision No. 67823, at 13.

108. See *id.* at 3 (discussing the Pine hook-up moratorium history).

109. The Author contacted Governor Napolitano's staff to ask for the assistance midway through the event. At the time, the systems were under interim management and were embroiled in a bankruptcy action and had no funding available to enable them to resolve the problem in a timely fashion.

110. See McLain, Decision No. 66241, Docket No. W-0146A-03-0601, at 2, 10 (Ariz. Corp. Comm'n Sept. 16, 2003).

111. The McLain water systems have been under heightened Commission scrutiny for years. Commission Staff and ADEQ officials believe the systems never had a chance, as they were constructed using sub-standard materials, had insufficient storage capacity, and suffered many other deficiencies. The Company's founder, Johnny McLain, Sr., filed bankruptcy seven times in the history of the companies. Commission Staff believe that he did so in order to skirt Commission and ADEQ jurisdiction and oversight on numerous occasions. The Commission ultimately voted to approve a purchase price for the Companies and approve Algonquin Water Resources as the new owner. Judge Eileen Hollowell of the U.S. Bankruptcy Court for the District of Arizona gave Algonquin until September 18, 2006 to finalize the purchase, which included entering into a consent decree with ADEQ regarding a schedule for coming into ADEQ compliance. Judge Hollowell allowed for additional time for closure of the sale, and as of the writing of this Article, Algonquin was within days of closing on the purchase of the Companies, and had taken over as interim manager of the systems.

system.<sup>112</sup> In order for the moratorium to be lifted, the new owners must prove that a series of prescribed improvements be made at each water company. The improvements must be certified by the Commission Staff.<sup>113</sup>

### VIII. COMMENTS ON THE NEED FOR GREATER COORDINATION BETWEEN STATE AGENCIES, COUNTIES, AND THE COMMISSION

The Commission can do much to require conservation by Arizona's 350 private water utilities through its ratemaking process.<sup>114</sup> However, the discussion above regarding ADWR's ongoing rulemaking, and the Commission's role in ensuring that water companies carry out ADWR's requirements, highlights the need for heightened engagement between the executive branch and the Commission. In order to maximize the ability of each branch of government to effectuate conservation goals, the Commission, ADWR, and ADEQ should institute a process that will lead to greater information sharing regarding water company conservation efforts. This could include monthly meetings between high-level Staff at each agency and the Commission, and should include increased discussions with elected officials. It could also include increased sharing of regulatory compliance filings by water companies between executive branch agencies and the Commission. For instance, the Author recently requested that ADWR send copies to the Commission of all Letters of Adequacy that the agency issues to developers or other entities. Under normal Commission practice, developers seeking to form a water company within an AMA may file a Certificate of Assured Water Supply up to 24 months after a CC&N is issued, while those seeking to form a water company outside an AMA may file a Letter of Adequacy as late as the hearing process.<sup>115</sup> Receiving ADWR's determinations with regard to water adequacy directly from the agency and upon issuance, rather than on the developer's timetable, will give the Commission greater information, and perhaps most importantly, more time to incorporate ADWR's determinations into the Commission's analysis of whether to approve a proposed water company.

### IX. CONCLUSION

From the earliest days of statehood, the Commission has been called upon by virtue of its constitutionally-driven, exclusive jurisdiction over public service corporations to meet the evolving challenges faced by private water utilities. As Arizona's seemingly unbounded growth continues, the Commission will increasingly be faced with questions of how to encourage and require conservation

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112. Miracle Valley Water Co., Decision No. 68272, Docket No. W-01646A-05-0509, at 13 (Ariz. Corp. Comm'n Nov. 8, 2005).

113. See N. Sunrise Water Co., Decision No. 68826, Docket No. W-20453A-06-0247, at 24 (Ariz. Corp. Comm'n June 29, 2006).

114. See discussion *supra* Part I regarding the Commission's broad constitutional and statutory authority.

115. See the preceding discussion of the Commission's decision to begin utilizing the Order Preliminary for water company applications outside AMAs. While this would prevent a developer from filing a Letter of Adequacy after the CC&N is granted, it would still permit a developer to hold on to a Letter of Adequacy (or inadequacy) until the date of a Commission hearing.

by water companies. The Commission has already established a record of encouraging and mandating conservation by water companies through tiered water rates, mandated use of effluent, required water loss improvements and the use of Orders Preliminary outside AMAs. The Commission should build on these efforts by expanding its use of acquisition adjustments, as well as using rate premiums to encourage the consolidation of small water companies, thereby improving the opportunities for conservation at small water utilities. The Commission should also emphasize its receptiveness to rate recovery applications that include spending by companies on prudent and necessary conservation programs, and establish its willingness to consider tariff filings by companies that implement mandatory water conservation by consumers. Finally, the Commission should forge a more regularized relationship with executive branch agencies that will facilitate greater information sharing and maximize the effectiveness of conservation efforts of water companies.