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ARIZONA CORPORATION COMMISSION
DOCKET CONTROL

BEFORE THE ARIZONA CORPORATION COMMISSION

8
 9 IN THE MATTER OF THE APPLICATION
 10 OF PINE WATER COMPANY FOR
 11 APPROVAL TO (1) ENCUMBER A PART
 12 OF ITS PLANT AND SYSTEM
 13 PURSUANT TO A.R.S. § 40-285(A); AND
 14 (2) ISSUE EVIDENCE OF
 15 INDEBTEDNESS PURSUANT TO A.R.S.
 16 § 40-302(A).

DOCKET NO: W-03512A-07-0362

PINE WATER COMPANY'S
CLOSING BRIEF

Arizona Corporation Commission
DOCKETED

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INTRODUCTION—THE COMPANY’S APPLICATION

Pine Water Company (“PWCo” or the “Company”) seeks two narrow approvals. Under A.R.S. § 40-285(A), PWCo seeks approval to encumber a well and well site by executing a lien. The lien is to secure the interest of the Pine-Strawberry Domestic Water Improvement District (“PSWID” or the “District”) in the K2 well and well site under the parties’ May 1, 2007 Joint Well Development Agreement (“JDWA”). Under A.R.S. § 40-302(A), the Company also seeks approval to issue evidence of indebtedness. This contingent obligation involves the return of the District’s investment in the K2 well project. This is a financing application.

Admittedly, this is not a typical financing application. The K2 well site does not contain any necessary facilities and the K2 well does not exist. PWCo currently has no obligation to return any of the District’s investment in the K2 project, and it won’t until the Commission issues an order including the total costs of the project in rate base. This is an “abundance of caution” filing, being made before the requirements for approval are ripe. But the fundamental nature of the transaction and the Commission’s role remains unchanged. The Commission’s analysis should be (1) whether the encumbrance will impair the Company’s ability to serve; (2) whether the financing is for a lawful purpose; and (3) whether PWCo’s revenues will support its repayment obligation. Staff Report, Ex. S-1; Hearing Transcript (“TR”) at 281-82 (Olea).

Of course, the Commission must also ensure that issuing the requested approvals is in the public interest. That’s simple. What could be more in the public interest than more water in Pine, Arizona? The Commission ordered PWCo to work with the District to find more water for the Company’s ratepayers. *See* Decision No. 67823 at 12. PWCo did, and the JDWA is the result. Now it is time for the Commission to provide two narrow approvals and let the parties look for more water.

1 **I. THE COMPANY'S APPLICATION SHOULD BE GRANTED**

2 **A. The Encumbrance Will Not Impair PWCo's Ability To Serve.**

3 Under the JDWA, PWCo is specifically required to record with the Gila County
4 Recorder, a "Notice of Continuing Security Interest and Lien" in favor of PSWID.
5 Application, Ex. A-3 at Exhibit 1 (the "JDWA") at § 4.2.15. The lien is security for the
6 funds being invested by PSWID and grants PSWID all of the rights and remedies of a
7 secured party under the Arizona Uniform Commercial Code with respect to the K2 well
8 site and well. *Id.* A.R.S. § 40-285(A) provides in part that "[a] public service corporation
9 shall not . . . encumber the whole or any part of its . . . plant , or system necessary or
10 useful . . . without first having secured from the commission an order authorizing it so to
11 do." An encumbrance made in violation of § 40-285(A) is void.

12 There is no evidence that the lien on the K2 well site and well will impair the
13 Company's ability to serve its ratepayers. Staff found that no impairment would occur as
14 a result of the transaction. *See* Staff Report, Ex. S-1 at 4-5. The Interveners agreed that
15 approval of a lien on the well and well site would not impair the Company's ability to
16 serve. TR at 136 (Krafczyk); 155 (Greer). The approval under A.R.S. § 40-285(A)
17 should be granted.¹

18 **B. The Evidence Of Indebtedness Is Within The Company's Means.**

19 Under the JDWA, "PWCo shall return the capital provided by PSWID pursuant to
20 this Agreement [\$300,000], together with a return thereon of six percent (6%) per annum
21 from the date the funds are deposited in the Escrow." JDWA at §§ 2.2, 4.2.2. The
22 conditions precedent to the obligation to return the investment include the finding of a
23 sustainable yield of 150 gpm and rate base treatment of the costs of the K2 project,
24 including the costs of the test well being funded with PSWID's investment, and the

25 ¹ Alternatively, the Commission could rule that A.R.S. § 40-285(A) is inapplicable
26 because the K2 well and well site is not presently necessary or useful in the conduct of
PWCo's service to the public.

1 permanent well and additional storage to be funded by PWCo. *Id.* This evidence of
2 indebtedness is clearly being undertaken for a lawful purpose – finding more water. *E.g.*,
3 Staff Report, Ex. S-1; TR at 282.

4 Staff also analyzed whether the Company could meet this payment obligation
5 under its current revenues. TR at 161 (Chavez). Staff determined both a “Times Interest
6 Earned Ratio” and a “Debt Service Coverage Ratio” for the Company and concluded that
7 PWCo “will be able to meet all obligations with cash generated from operations.” Staff
8 Report, Ex. S-1, at 2-3. *See also* TR at 161 (Chavez). Presumably, the Commission will
9 further ensure that the Company still has adequate revenues to meet its repayment
10 obligation if it approves the necessary rate base treatment for the plant paid for by
11 PSWID, again, a condition precedent to PWCo’s payment of a return on and of PSWID’s
12 investment in the test well.

13 Intervener Krafczyk attempted to cast doubt on Staff’s conclusions claiming that
14 based on his evaluation of “available financial data,” he could not make the determination
15 that PWCo was “creditworthy”. Krafczyk Direct Testimony, Ex. I-1 at 5. Yet,
16 Mr. Krafczyk presented no financial analysis or supporting evidence, and admitted that he
17 made no effort to obtain additional financial information to support his challenge to
18 Staff’s conclusions. TR at 140 (Krafczyk). More importantly, while Mr. Krafczyk has a
19 right to his opinion of PWCo’s “creditworthiness”, he is not PWCo’s lender. And neither
20 is the PSWID.

21 The JDWA reflects a public-private partnership focused on finding long-term
22 solutions to a chronic, regional water supply problem. Under the JDWA, PSWID is
23 pursuing its primary public purpose by investing in a test well to further exploration for
24 new water resources in the recently discovered R-aquifer underlying Pine and Strawberry,
25 Arizona. *See* Hardcastle Rebuttal Testimony, Ex. A-2 at Hardcastle Rebuttal Exhibit 1.
26 *See also* TR at 59-61 (Hardcastle). PSWID’s duly elected board made the decision to

1 place up to \$300,000 of capital at risk to drill a test well at the K2 site. TR at 162-63
2 (Chaves), 147 (Krafczyk). If the K2 well is successful, PSWID will realize a return on
3 and of its investment and further its mission to find more water for its members. See
4 PSWID Mission Statement, Ex. A-6. Thus, approval of the requested evidence of
5 indebtedness is not only within the Company's means but entirely consistent with the
6 public interest, and such approval should be granted consistent with Staff's recommended
7 conditions. See Chavez Responsive Testimony, Ex. S-2, at 4.

8 **II. OTHER ISSUES**

9 **A. Constitutionality Of The JDWA.**

10 1. The Validity of the JDWA is Beyond the Commission's Jurisdiction.

11 The directive that PWCo brief whether PSWID ran afoul of the Arizona
12 Constitution places the Company in a difficult position. First, the Company does not
13 represent or speak for the District, a political subdivision of the State of Arizona,
14 exercising its authority, and represented by independent legal counsel. PSWID
15 represented and warranted to the Company that the District had the full legal power and
16 authority to enter into the JDWA. JDWA at 7.1 For PWCo, this representation was
17 sufficient to enter into an agreement. TR at 42-43 (Hardcastle) referring to JDWA at § 7.

18 Second, the Supreme Court of Arizona has explained that "[n]o judicial power is
19 vested in or can be exercised by the corporation commission unless that power is
20 expressly granted by the constitution." *Trico Elec. Co-op v. Ralston*, 67 Ariz. 358, 363,
21 196 P.2d 470, 473 (1948). Article 15 of the Arizona Constitution contains the provisions
22 laid out for the Commission and the extension of its powers. Sections 3, 4 and 6 of
23 Article 15 read, in relevant part, as follows:

24 Section 3: The corporation commission shall have full power
25 to, and shall, prescribe just and reasonable classifications to
26 be used and 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,

1 regulations, and orders, by which such corporations shall be
2 governed in the transaction of business within the state, and
3 may prescribe the forms of contracts and the systems of
4 keeping accounts to be used by such corporations in
5 transacting such business, and make and enforce reasonable
6 rules, regulations, and orders for the convenience, comfort,
7 and safety, and the preservation of the health, of the
8 employees and patrons of such corporations;

9 Section 4: The corporation commission, and the several
10 members thereof, shall have power to inspect and investigate
11 the property, books, papers, business, methods, and affairs . . .
12 of any public service corporation doing business within the
13 state;

14 Section 6: The law-making power may enlarge the powers
15 and extend the duties of the corporation commission, and may
16 prescribe rules and regulations to govern proceedings
17 instituted by and before it.

18 None of the constitutional provisions that vest powers in the Commission “confer upon
19 the commission the jurisdiction to pass upon the construction and validity of contracts.”
20 *Trico Elec. Co-op*, 67 Ariz. at 363, 196 P.2d at 473. The Commission may not determine
21 the validity of a contract or the parties’ rights in that contract. *Id.* As a consequence, the
22 Company respectfully suggests that the JDWA’s “validity” is not an issue to be addressed
23 by the Commission in this docket.

24 2. The JDWA is not Inconsistent with the Arizona Constitution.

25 If the Commission could determine the validity of the JDWA, it would conclude
26 that the agreement is consistent with the Arizona Constitution because it accomplishes the
public purpose of finding potential water sources to benefit the District’s members.

a. Article 9, Section 10 of the Arizona Constitution.

In the 1800s, states tried to attract private companies, particularly railroads, by
granting loans. *Indus. Dev. Auth. of Pinal County v. Nelson*, 109 Ariz. 368, 372, 509 P.2d
705, 709 (1973). When many of these companies defaulted, the states incurred large
amounts of debt and the municipalities were required to pay the obligations from public

1 treasuries. *Id.* In reaction to this problem, many states added or included provisions in
2 their constitutions prohibiting the state and its subdivisions from donating or lending
3 money or credit to private entities. *Id.*

4 In 1910, at the constitutional convention, Arizona delegates also included
5 provisions to protect the state from this predicament. The so-called “Gift Clause”, Article
6 9, section 7, states in relevant part: “Neither the state, nor any county, city, town,
7 municipality, or other subdivision of the state shall ever give or loan its credit in the aid
8 of, or make any donation or grant, by subsidy or otherwise, to any individual, association,
9 or corporation.” Ariz. Const. art. IX, § 7. The District is expressly exempt from the
10 prohibitions of the “gift clause” in section 7. *See* Ariz. Const. art. XIII, § 7. However,
11 PSWID is subject to Article 9, Section 10, which states: “No tax shall be laid or
12 appropriation of public money made in aid of any church, or private or sectarian school,
13 or any public service corporation.” Ariz. Const. art. IX, § 10.

14 There is little jurisprudence to help interpret Article 9, Section 10 of the Arizona
15 Constitution, and there are no cases dealing with this particular issue. But it is clear that
16 Article 9, Section 10 does not stand for the proposition that no public money may be
17 channeled to public service corporations. *See Cmty. Council v. Jordan*, 102 Ariz. 448,
18 452, 432 P.2d 460, 464 (1967). Cases interpreting the “Gift Clause” can also provide
19 some guidance. The purpose of Arizona’s gift clause “was to bar governmental bodies
20 from giving special advantages or increasing the public debt by engaging in non-public
21 enterprises.” *Pimalco, Inc. v. Maricopa County*, 188 Ariz. 550, 559, 937 P.2d 1198,
22 1207 (Ariz. Ct. App. 1997). “The evil to be avoided was the depletion of the public
23 treasury or inflation of public debt by engagement in non-public enterprises. But it was
24 never thought that the state and local governments should be prohibited from dealing with
25 private enterprises.” *State v. Nw. Mut. Ins. Co.*, 86 Ariz. 50, 53, 340 P.2d 200,
26 201 (1959).

1 This is especially true with respect to irrigation and other districts which originally
2 were not considered municipal corporations or political subdivisions of the state. See
3 *Porterfield v. Van Boening*, 154 Ariz. 556, 558-59, 744 P.2d 468, 470-71 (Ariz. Ct. App.
4 1987) (referring to *Day v. Buckeye Water Conservation & Drainage Dist.*, 28 Ariz. 466,
5 474, 237 P. 636, 639 (1925)). The special districts were recognized to have functions
6 purely commercial and economic in nature, performed only for the benefit of the district
7 property owners and more in the nature of a commercial enterprise. *Porterfield*, 154 Ariz.
8 at 558 744 P.2d 468, 470. The “primary business functions of water districts were not
9 changed by the constitutional amendment granting them governmental powers.” *Id.*

10 Against this backdrop, the Arizona Supreme Court established the rule “that a use
11 of public money or property will not violate the Gift Clause if, taking a ‘panoptic’ view of
12 the transaction in question, a court concludes that (1) the use is for a public purpose, and
13 (2) the value of the public money or property is not so much greater than the value of the
14 benefit received by the public that the exchange of the one for the other is
15 disproportionate.” *Maricopa County v. State*, 187 Ariz. 275, 279-80, 928 P.2d 699, 703-
16 04 (Ariz. Ct. App. 1996). “A use of public funds or property that meets both these criteria
17 will not contravene the Gift Clause even though particular persons or organizations
18 benefit specially from such use.” *Id.* at 280, 928 P.2d at 704.

19 b. The JDWA Passes Constitutional Muster.

20 As stated, the “Gift Clause” does not apply to PSWID or the JDWA, but the test
21 articulated by the Arizona Supreme Court can still provide guidance. Section 10 of
22 Article 9 can be seen, like the Gift Clause as a “reaction of public opinion to the orgies of
23 extravagant dissipation of public funds” prevalent in 1800’s as the American continent
24 expanded. *Nw. Mut. Ins. Co.*, 86 Ariz. at 53, 340 P.2d at 201. Likewise, the *Maricopa*
25 *County* court’s discussion of “public purpose” in the context of this article of the State
26 Constitution brings to mind the Commission’s power to ensure that its decisions serve the

1 “public interest”. Under any such test, PWCo is hardly a modern day robber baron
2 feeding at the trough of government extravagance. The JDWA is for a public purpose and
3 the benefit of the District’s expenditure is intended for the public.

4 The purpose of PSWID is to fund investigations for expanding present and
5 potential water sources for the Pine and Strawberry communities. *See* Ex. A-6. The
6 JDWA not only satisfies this purpose but also aids the District. PSWID was formed in
7 order to find water, and the contract encompasses an agreement to find water by investing
8 in a test well. However, PSWID is not a “domestic” water district and therefore is not in a
9 position to sell water to the residents within its boundaries. This hurdle has been
10 overcome through the aid provided by PWCo. PWCo has offered a well site, it has
11 capped the District’s risk at \$300,000, and if the project succeeds in developing “used and
12 useful” assets, the Company has agreed to return the money that the District will invest
13 with a return thereon – essentially allowing PSWID an opportunity to accomplish its
14 mission with no cost to itself. *See* Hardcastle Rebuttal Testimony, Ex. A-2, at Hardcastle
15 Rebuttal Exhibit 1. In addition, PWCo will proceed further and construct a larger,
16 production well and additional water storage to maximize the benefit from this new water
17 source, something that the District would have difficulty accomplishing on its own. *See,*
18 *generally,* JDWA; Staff Report, Ex. S-1. The District and the public benefit from an
19 agreement that accomplishes the goals of the public entity while using the assets of the
20 private organization to minimize cost and achieve success.

21 The District’s actions are authorized by statute in Arizona. A.R.S. § 48-909(A)(6)
22 authorizes the PSWID Board of Directors to acquire, construct, reconstruct, or repair a
23 well. Additionally, PSWID may acquire by “gift, purchase, condemnation or otherwise in
24 the name of the district and own, control, manage and dispose of any real or personal
25 property or interest in such property necessary or convenient for the construction,
26 operation and maintenance” of the well. A.R.S. § 48-909(B)(1). PSWID may also join

1 with any person in the construction, operation, or maintenance of a well. A.R.S. § 48-
2 909(B)(2). In addition, PSWID may “[s]ell, lease or otherwise dispose of any property of
3 the district or interest in such property when the property is no longer required for the
4 purposes of the district or the use of which may be permitted without interfering with the
5 use thereof by the district.” A.R.S. § 48-909(B)(4). PSWID’s actions are also entirely
6 consistent with previous acts taken by the District. Past PSWID Boards have authorized
7 expenditures on investigations and studies to enhance the potential for improving and
8 supplementing present water sources available to these communities. PSWID previously
9 invested capital when it commissioned the first comprehensive study of the R-aquifer
10 underlying Pine and Strawberry and jointly participated in developing and monitoring the
11 Strawberry Borehole.

12 In sum, PSWID is doing what it is supposed to be doing, looking for more water to
13 benefit its members. The purpose behind Article 9, Section 10 would be grossly
14 misappropriated if used to stop the progression of the JDWA.

15 **B. Impact Of K2 Well On Other Wells In Strawberry.**

16 1. Could the Commission Order the Company not to Drill One or More
17 Wells at the K2 Well Site?

18 The Commission should not prohibit PWCo from drilling wells at the K2 well site
19 because (A) the Arizona Department of Water Resources (“ADWR”) has the power to
20 regulate groundwater, and (B) the Arizona Constitution and the legislature have not
21 granted to the Commission the power to stop public service corporations from undertaking
22 lawful activities; ADWR, and not the Commission, regulates Arizona groundwater.
23 ADWR has the responsibility of regulating and protecting the state’s water resources.

24 Sustaining groundwater in Arizona is of the utmost importance. For this reason,
25 the legislature stated in its declaration of policy in the Groundwater Code that:

26 It is therefore declared to be the public policy of this state that

1 in the interest of protecting and stabilizing the general
2 economy and welfare of this state and its citizens it is
3 necessary to conserve, protect and allocate the use of
4 groundwater resources of the state and to provide a
framework for the comprehensive management and
regulation of the withdrawal, transportation, use, conservation
and conveyance of rights to use the groundwater in this state.

5 A.R.S. § 45-401(B). Various forms of management were considered to hold this power,
6 however, “virtually all power to administer the Act is vested in a state agency, the
7 Department of Water Resources.” Desmond D. Conall, Jr., *A History of the Arizona*
8 *Groundwater Management Act*, 1982 Ariz. St. L. J. 313, 333 (1982). The ADWR
9 Director “has general control and supervision . . . of groundwater.” A.R.S. § 45-103(B).

10 ADWR has the obligation to achieve the safe-yield groundwater management goal
11 under the Code in which a long term balance is attained. A.R.S. § 45-561(12). In order to
12 achieve this goal, the Director is responsible to develop a series of ten year plans. A.R.S.
13 § 45-563. Certain areas of the state have been designated as active management areas
14 (“AMA”). A private water company has the “right to pump and deliver water to [its]
15 customers, shareholders or landowners, and the users have the right to continue to use
16 groundwater received from their supplier.” *Id.* However, because PWCo’s CC&N is
17 outside of an AMA, no restrictions on well placement or groundwater pumping apply and
18 no violation of law arises if impacts occur to other wells.

19 2. There is no Evidence of Detrimental Impacts on Other Wells.

20 The good news is that there is no need for the Commission to exceed its authority
21 and issue directives regarding well placement and well impacts as part of this financing
22 application. All existing wells in the vicinity are drilled to shallow depths where water is
23 found, not in a distinct aquifer, but rather in pockets of fractured rock. TR at 45-46, 214-
24 15 (Hardcastle). In contrast, the K2 well will be drilled to an estimated depth of 1700
25 feet, where the Project Hydrologist has advised the Company that no impact on shallow
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DATED this 15th day of February, 2008.

FENNEMORE CRAIG, P.C.

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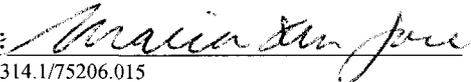
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