

ORIGINAL



0000081935

BEFORE THE ARIZONA CORPORATION COMMISSION

666 B

RECEIVED

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

COMMISSIONERS

MIKE GLEASON, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTIN K. MAYES
GARY PIERCE

2008 FEB 15 P 2: 46

AZ CORP COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF
PINE WATER COMPANY FOR APPROVAL TO
(1) ENCUMBER A PART OF ITS PLANT AND
SYSTEM PURSUANT TO A.R.S. §40-285(A);
AND (2) ISSUE EVIDENCE OF INDEBTEDNESS
PURSUANT TO A.R.S. §40-302(A).

DOCKET NO. W-03512A-07-0362

STAFF'S POST HEARING BRIEF

Hearing was held in this matter on December 12, 2007 presided over by Administrative Law Judge ("ALJ") Dwight D. Nodes. Arizona Corporation Commission ("ACC") Chairman Mike Gleason and Commissioner Kristin K. Mayes were in attendance. Mr. Robert Hardcastle provided testimony on behalf of Pine Water Company ("PWCo" or "Applicant"). Both Mr. Fred Krafczyk and Mr. Michael Greer requested and were granted intervention in this matter (collectively "Intervenors"). Each provided testimony on his own behalf. At the request of Judge Nodes, Staff of the ACC Utilities Division ("Staff") participated as well. Mr. Pedro Chaves and Mr. Steven Olea provided Staff's testimony. Mr. Olea adopted the pre-filed testimony of Mr. Marlin Scott.

At the conclusion of the hearing Judge Nodes ordered post-hearing briefs from all of the parties. The parties were to address any issues they felt were necessary to the determination of the Application. In addition, Commissioner Mayes directed the parties to brief two additional issues.

Commissioner Mayes requested that the parties respond to the following questions:

1. Does the proposed transaction between PWCo and the District violate the Arizona Constitution, Article 9 § 10?
2. If the Commission were to approve the Application, and if it were subsequently determined that the K-2 well was causing a reduction in the productivity of other wells in the Pine-Strawberry area, would the Commission have the authority to order PWCo to stop using the K-2 well?

DOCKETED

FEB 15 2008

DOCKETED BY	nr
-------------	----

1 **INTRODUCTION**

2 On June 11, 2007, Pine Water Company filed the instant application (“Application”) with the
3 Arizona Corporation Commission requesting permission to encumber assets it would obtain upon
4 consummation of a contract between itself and the Pine-Strawberry Water Improvement District
5 (“PSWID” or “District”). The Application also requests permission to issue evidence of indebtedness
6 pursuant to A.R.S. § 40-302, which would consist of a lien against the assets acquired under the
7 agreement.

8 The parties have proposed to enter into an agreement to explore the potential of a deep aquifer
9 water source beneath the Pine-Strawberry area. The exploration involves the drilling of a deep well,
10 which is forecast to cost approximately \$300,000. The agreed-upon well site is on a plot of land in
11 Strawberry, AZ which is currently owned by the Strawberry Water Company (“SWCo”). The
12 transaction begins once all Commission approvals are received. Thereafter, the District will place
13 \$300,000 into an escrow account with instructions that no money would be released from the account
14 until the well site lien has been recorded.¹ PWCo would have the authority to choose the company
15 that would do the actual drilling, but payment would be drawn directly from the escrow fund.² The
16 parties would then mutually agree on the remainder of the expenses.

17 Once the test well is completed, it would be pumped on a sustained basis in order to estimate
18 its eventual production capacity. If the District, PWCo, and the Arizona Department of Water
19 Resources all agree that the test well data shows the potential that a production well will result in a
20 long-term, sustainable water supply of at least 150 gallons per minute (“gpm”), then PWCo is
21 committed to providing an additional \$1 million to finish the outfitting of the deep well. If the
22 production well produces any volume less than 150 gallons per minute, PWCo would not be
23 obligated to complete the outfitting of the well, but could still do so if it felt the investment was
24 prudent. In the event PWCo chooses not to outfit the well, the District would retain ownership of the
25 land and the test well.

26
27
28 ¹ *Tr.* at 123 : 20-22.

² *Id.* at 123 : 23 – 124 : 3

1 Finally, if a “substantial portion” of the well and related infrastructure were to later be placed
2 into PWCo’s rate base, PWCo would then become obligated to reimburse the District its initial
3 investment of \$300,000 at a 6% interest rate.

4 **LAW AND ARGUMENT**

5 **I. SHOULD THE COMMISSION APPROVE THE FINANCING APPLICATION?**

6 A.R.S. § 40-302(A) requires that all public service corporations get approval from the ACC
7 before entering into debt. In relevant part, § 40-302(A) requires that:

8 “Before a public service corporation issues ... evidence of indebtedness, it
9 shall first secure from the commission an order authorizing such issue and
10 stating ... that, in the opinion of the commission, the issue is reasonably
11 necessary or appropriate for the purposes specified in the order, pursuant to §
12 40-301,”

11 A.R.S. § 40-301(C) further provides, in relevant part,

12 “The commission shall not make any order ... granting any application as
13 provided by this article unless it finds that such issue is for lawful purposes
14 which are within the corporate powers of the applicant, are compatible with
15 the public interest, with sound financial practices, and with the proper
16 performance by the applicant of service as a public service corporation and
17 will not impair its ability to perform that service.”

16 When the requirements of the two statutes are then combined, in order to approve this
17 application, the Commission must find that the issue is:

- 18 1. reasonably necessary for the purposes in the order,
- 19 2. for lawful purposes,
- 20 3. within the applicant’s corporate powers,
- 21 4. compatible with the public interest,
- 22 5. compatible with sound financial practices,
- 23 6. compatible with proper performance as a public service corporation, and
- 24 7. will not impair its ability to perform that service.

22 In making its recommendations in this matter, Staff analyzed the application within these
23 guidelines. Staff has recommended approval of the application.

24 The evidence shows no dispute in this matter that the Pine-Strawberry region suffers from
25 severe water shortages. According to Mr. Krafczyk, “everybody in the community wants water ...”³
26 Mr. Hardcastle, on behalf of PWCo, testified that “... it is abundantly clear Pine Water Company and
27

28 ³ *Id.* at 145 : 20-21.

1 Strawberry Water Company need more water.”⁴ There is likewise no dispute that PWCo itself has
2 suffered from chronic water shortages, to which Mr. Krafczyk himself has conceded.⁵ Mr. Hardcastle
3 summarized the effects of a successful K-2 well on the PWCo customer base, saying that “...
4 certainly some of the use restrictions and hopefully some of the regulatory limitations would go
5 away.”⁶ Mr. Hardcastle further stated that the K-2 well would benefit both the communities of Pine
6 and Strawberry.⁷ “[T]he primary use of the water will be directed to the customers of Pine Water
7 Company and that thereafter any excess water over and above that will be made available as needed
8 to the customers of Strawberry Water Company.”⁸

9 Neither party disputes that a deep well is a potential answer to the water crisis in the region.
10 Intervenors simply disagree with PWCo that the K-2 well site is the best location. Mr. Hardcastle, as
11 PWCo’s president, chose the K-2 well site because “I think that we have concluded that there is not
12 an equivalent alternative site in Pine to develop when you consider not only the geology but the
13 hydrology and the facility proximity to the infrastructure, the pumping system and the storage
14 capacity.”⁹ But according to Mr. Krafczyk, there exist “different and better locations for drilling for
15 water...”¹⁰ Mr. Hardcastle has testified that the total cost of the K-2 well project will reach
16 approximately \$1.3 million. With PWCo having slightly more than 2,000 customers, it could ill
17 afford to drill unsuccessfully. In order to undertake such a risk, PWCo sought out a very specific
18 confluence of factors.

19 During the evaluation period, PWCo was approached by the PSWID¹¹, which offered to
20 invest \$300,000 in a joint deep well project. PWCo was not certain it could afford to take the risk of
21 failure in drilling a deep well, and accepted the proposition because “the risk is high enough here that
22 I think it is reasonable and prudent that Pine Water Company mitigate its risk to the extent of this
23 agreement.”¹² In fact, even with the cost to PWCo being reduced to \$1 million, PWCo is not certain

24 ⁴ *Id.* at 50 : 1-3.

25 ⁵ *Id.* at 149 : 12-14.

26 ⁶ *Id.* at 114 : 17-19.

27 ⁷ *Id.* at 114 : 20-25.

28 ⁸ *Id.* at 44 : 4-8.

⁹ *Id.* at 115 : 5-9

¹⁰ *Id.* at 145 : 9-10.

¹¹ *Id.* at 208 : 21-23.

¹² *Id.* at 64 : 13-16.

1 it has the financial strength to complete the project as required.¹³ In order to do so, Mr. Hardcastle
2 admitted that PWCo may have to rely on funding from its parent company, Brooke Utilities, but
3 expressed his commitment that, although Brooke Utilities was not part of the agreement, it would
4 honor the debt of PWCo.¹⁴

5 Applying these facts to the statutory requirements, Staff believes this application meets all
6 criteria. Given the expensive and risky nature of deep well drilling, it is clear that PWCo reasonably
7 needs the approval of this financing to pursue its deep well option. It is likewise certain that drilling
8 of a deep well is a lawful purpose that is within the corporate powers of PWCo. Finding a new
9 source of water is certainly a proper function of a public service water company, and given that the
10 Commission has long ago directed PWCo to acquire new sources of water¹⁵, it appears that financing
11 this well is compatible with proper performance as a public service corporation. Even Mr. Krafczyk
12 agrees that entering into this arrangement will not impair PWCo's ability to serve its customers.¹⁶

13 Under the terms of the agreement, if the K-2 well is unsuccessful, as defined by its production
14 output, PWCo is obligated to do nothing. PWCo *ratepayers* do not lose a single penny because the
15 *company* does not lose a single penny. On the other hand, if the K-2 well produces 150 gpm or more,
16 then Pine Water will have significantly increased its overall capacity. According to ACC Utilities
17 Division Assistant Director Steven Olea, that volume of water may be enough to eliminate the water
18 hauling surcharges, which have been the root cause of complaints against PWCo.¹⁷ Given all of the
19 circumstances, the transaction is clearly in the public interest. PWCo has much to gain and nothing
20 to lose.

21 Staff witness Pedro Chaves testified regarding the financial ability of PWCo to reimburse the
22 District its \$300,000 investment, the final criterion under § 40-302(A). In his direct testimony, Mr.
23 Chaves indicated that PWCo pro forma debt service coverage ratio ("DSC") results showed that Pine
24 Water would be able to meet all obligations with cash generated from operations¹⁸ and that issuance

25
26 ¹³ *Id.* at 70 : 24 – 71 : 2.

27 ¹⁴ *Id.* at 121 : 1-5.

28 ¹⁵ *Id.* at 282 : 17-20.

¹⁶ *Id.* at 136 : 1-5.

¹⁷ *Id.* at 300 : 16 – 301 : 3.

¹⁸ (*Staff Report*, Ex. S-1, at 3.

1 of the proposed financing for the purposes stated in the application was consistent with sound
2 financial practices.¹⁹

3 It is Staff's position that the Application should be approved.

4 **II. DOES THE PROPOSED TRANSACTION BETWEEN PWCO AND THE DISTRICT**
5 **VIOLATE THE ARIZONA CONSTITUTION, ARTICLE 9 § 10?**

6 Article 9, Section 10 of the Arizona Constitution states "No tax shall be laid or appropriation
7 of public money made in aid of any ... public service corporation." In the instant transaction, the
8 Intervenors argue that the \$300,000 being spent by the District are in violation of this constitutional
9 provision. There is no dispute that PWCo is a public service corporation. And while there is no
10 allegation that the District has levied a tax in this matter, the District's funding has thus far been
11 *presumed* to have been raised through the District's power to tax. Therefore, the appropriate
12 questions are 1) Does the money being supplied by the District constitute an appropriation of "public
13 money", and 2) Does the manner in which the District's funds are to be used constitute "aid" to a
14 public service corporation?

15 **A. Does The Money Being Supplied By The District Constitute An Appropriation Of**
16 **"Public Money"?**

17 In 1999, the Supreme Court of Arizona had an occasion to consider the term "public money"
18 in deciding *Kotterman v. Killian*, 193 Ariz. 273, 972 P.2d 606 (1999). The Court noted that no
19 definition of the term appeared in the Constitution or the Arizona Revised Statutes. Having so noted,
20 the Court stated that "We must therefore look to their "natural, obvious and ordinary meaning." *Id.* at
21 617, 972 P.2d at 284, citing *County of Apache v. Southwest Lumber Mills*, 92 Ariz. 323, 327, 376
22 P.2d 854, 856 (1962).

23 The Court went on to cite Black's Law Dictionary for its definition of "public money", which
24 read "[r]evenue received from federal, state, and local governments from taxes ... etc." *Id.*, at 618,
25 972 P.2d at 285, citing *Black's Law Dictionary* 1005 (6th ed. 1990).

26
27
28 ¹⁹ *Id.*, Executive Summary.

1 Thus, if the money being provided by the District has in fact been raised through taxation,
2 then under the natural, obvious and ordinary meaning of the term, the money being invested by the
3 District does constitute an appropriation of "public money".

4 **B. Does The Manner In Which The District's Funds Are To Be Used Constitute**
5 **"Aid" To A Public Service Corporation?**

6 In 1967, the Supreme Court of Arizona, in deciding *Community Council v. Jordan*, 102 Ariz.
7 448, 432 P.2d 460 (1967), discussed the constitutional definition and application of the word "aid".
8 The Court defined "aid" as used in both Article 2, Section 12, and Article 9, Section 10, stating:

9 "The 'aid' prohibited in the constitution of the state is, in our opinion,
10 assistance in any form whatsoever which would encourage or tend to
11 encourage the preference of one religion over another, or religion per se over
12 no religion."

12 *Id.* at 454, 432 P.2d at 466.

13 In the instant case, "aid" to PWCo, as a public service corporation, would be any
14 advancement of funding which would encourage or tend to encourage the preference of PWCo over
15 other public service corporations.

16 In the instant matter, Mr. Hardcastle has testified that PWCo is not receiving any money from
17 the District. PWCo does not control the investment funds.²⁰ The money is being placed into an
18 escrow fund. The decisions on spending are to be agreed upon by PWCo and the District, and the
19 money is to be released from the fund according to specific escrow instructions.²¹ PWCo and the
20 District are simply partners in a business venture by which the District's monetary obligations arise
21 first, and PWCo's obligations come second, or possibly not at all.

22 Even assuming, arguendo, that the funds provided by the District were to be given directly to
23 PWCo, there still is no indication that this would constitute "aid". The Intervenors have not produced
24 any evidence which would show how such an arrangement provides an advantage to PWCo over any
25 other public service utility.

26
27
28 ²⁰ (*Tr.* at 60 : 8-9).

²¹ *Id.* at 60 : 10-15.

1 There are two scenarios possible for the money spent by the District. Either the test well
2 proves insufficient, in which case the District will own the test well. PWCo will not have any claim
3 of ownership, and the District will have expended the escrow funds for a well the District itself owns.
4 Under this scenario, there can be no argument that PWCo has received "aid" in any fashion.

5 Under the second scenario, the test well proves sufficient, and PWCo is then obligated to
6 finish drilling and then outfitting the production well, at which point PWCo is further obligated to file
7 for inclusion of the well into its rate base. Once the well, or even a substantial portion of the well, is
8 included in rate base, PWCo then must begin to pay the District for the cost of the test well, including
9 a 6% interest rate. Again, there is no compelling argument that this arrangement provides any
10 advantage to PWCo over any other public service corporation. The District has invested its money,
11 and is going to receive either a test well and the associated data, or it will have its initial investment
12 returned with interest. This transaction is simply an investment for the District.

13 The only argument to be made that this arrangement is advantageous to PWCo over another
14 public utility would suggest that the transaction was offered to PWCo, as opposed to some other
15 water provider. This argument, however, is flawed by the simple fact that most of the District's
16 members are located within PWCo's certificated area. PWCo has that exclusive right to serve them.
17 Even if the members desired service from some other water company, they could not receive it. They
18 must get their service from the District, or from PWCo. Since the District has no infrastructure with
19 which to provide service, PWCo is the natural choice.

20 In the absence of competition between water companies, it is difficult to argue that the
21 District's choice to transact with PWCo has provided PWCo with any preference.

22 **III. IF DATA WERE TO INDICATE THAT THE K-2 WELL WERE CAUSING**
23 **NEIGHBORING WELLS TO SUFFER A REDUCTION IN WATER PRODUCTION,**
24 **DOES THE COMMISSION HAVE THE AUTHORITY TO STOP PINE WATER**
25 **FROM USING THE WELL?**

26 Article 15, Section 3 of the Arizona Constitution provides that:

27 "The Corporation Commission shall have full power to, and shall ... make
28 and enforce reasonable rules, regulations, and orders for the convenience,
 comfort, and safety, and the preservation of health, of the employees and
 patrons of [public service] corporations;"

1 A.R.S. § 40-331(A) provides in relative part:

2 “When the commission finds that ... changes in the existing plant or physical
3 properties of a public service corporation ought reasonably to be made ... to
4 promote the security or *convenience* of ... the public, the commission *shall*
make and serve an order directing that such changes be made.” (emphasis
added)

5 If the K-2 test well produces the requisite 150 gpm, PWCo will be required to turn the test
6 well into a production well, costing PWCo approximately \$1 million. If PWCo wants the well to be
7 placed into its rate base, it must do so within the context of a rate case, which will provide the
8 Commission ample opportunity to examine both the transaction itself and the effect, if any, that K-2
9 is having on the Pine-Strawberry community. If the Commission concludes at any time that the net
10 effect of the K-2 well is negative, and that changes in PWCo’s existing plant ought reasonably to be
11 made to promote the convenience of the public, the Commission likely has the authority under
12 Article 15 § 3, and A.R.S. § 40-331 to direct PWCo to make reasonable and appropriate changes in
13 order to protect the public interest. Should the Commission decide to order PWCo to shut down K-2,
14 it is likely to have the authority to do so.

15 **CONCLUSION**

16 Staff believes that the application to encumber assets meets all of the criteria of the relevant
17 statutes. PWCo can afford to reimburse the District its investment up to and including the \$300,000
18 authorized. The application should be approved.

19 The money being invested by the District, if it indeed has been raised through the District’s
20 taxation authority, would constitute an appropriation of “public money” as the term has been defined
21 by the Arizona Supreme Court. However, the terms of the agreement between PWCo and the District
22 by which the money is to invested, distributed, and returned to the District clearly indicate that PWCo
23 will not receive any advantage over any other public service corporation, whether through the
24 District’s choice to contract with PWCo in the first place, or through the terms by which the
25 transaction could eventually unfold. Therefore, the transaction does not constitute an appropriation
26 of public funds for the aid of a public service corporation.

27
28

1 The Commission has the authority to order public service corporations to make modifications
2 to their infrastructure and for a variety of reasons. In the event the Commission finds that the use of
3 the K-2 well is against public interest or even the public convenience, the Commission would have
4 the authority to take whatever action it deems appropriate to remedy that situation.

5 RESPECTFULLY SUBMITTED this 15th day of February, 2008.

6
7 By: 

8 Kevin Torrey
9 Attorney, Legal Division
10 Arizona Corporation Commission
11 1200 West Washington Street
12 Phoenix, Arizona 85007

13 Original and 13 copies filed this
14 15th day of February, 2008 with:

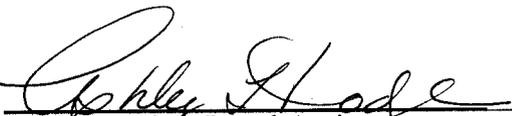
15 Docket Control
16 Arizona Corporation Commission
17 1200 West Washington Street
18 Phoenix, AZ 85007

19 Copies of the foregoing were mailed on the
20 15th day of February, 2008 to:

21 Jay L. Shapiro
22 Patrick J. Black
23 Fennemore Craig, PC
24 3003 North Central Avenue, Suite 2600
25 Phoenix, Arizona 85012

26 William P. Sullivan
27 Curtis, Goodwin, Sullivan,
28 Udall & Schwab, P.L.C.
501 East Thomas Road
Phoenix, Arizona 85012-3205
Attorneys for Pine-Strawberry Water Improvement District

John G. Gliege
Gliege Law Offices, PLLC
P.O. Box 1388
Flagstaff, Arizona 86002-1388
Attorneys for Intervenors

29 
30 Ashley Hodge, Legal Assistant