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ADMITTED TO PRACTICE IN:
ARIZONA, COLORADO, MONTANA,
NEVADA, TEXAS, WYOMING,
DISTRICT OF COLOMBIA

November 11, 2008

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Re: Ridgeline Water Company, L.L.C.
Docket No. W-20589A-08-0173

To Whom It May Concern:

Enclosed for filing in the above-referenced and above-docketed proceeding are the original and thirteen (13) copies of the Initial Brief on behalf of Ridgeline Water Company, L.L.C.

Thank you for your assistance with regard to this matter.

Sincerely,

Angela R. Trujillo
Secretary
Lawrence V. Robertson, Jr.

Arizona Corporation Commission
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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

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IN THE MATTER OF THE APPLICATION OF)
RIDGELINE WATER COMPANY, L.L.C. FOR) DOCKET NO. W-20589A-08-0173
A CERTIFICATE OF CONVENIENCE AND)
NECESSITY TO PROVIDE WATER SERVICE) APPLICANT'S INITIAL BRIEF
TO AND WITHIN AN UNINCORPORATED)
AREA IN PIMA COUNTY, ARIZONA.)

I.

INTRODUCTION

Pursuant to the October 7, 2008 Procedural Order issued by Administrative Law Judge
“(ALJ)” Belinda A. Martin in the above-captioned and above-docketed proceeding, Ridgeline
Water Company, L.L.C. (“Ridgeline”) hereby files its Initial Brief. The issues that are addressed
in this Initial Brief are as follows:

1. Is the Commission Staff's (“Staff”) recommendation that a Certificate of
Convenience and Necessity (“CC&N”) for Ridgeline be contingent upon
Ridgeline attaining a 70% (equity)/ 30% (AIAC/CAIC) capitalization by the end
of its fifth year of operations reasonable?
2. Is the issuance of an Order Preliminary, in advance of a CC&N in this proceeding,
necessary and/or appropriate under A.R.S. § 40-282?

II.

THE COMMISSION STAFF'S RECOMMENDATION THAT A
CERTIFICATE OF CONVENIENCE AND NECESSITY BE CONTINGENT
UPON THE COMPANY ATTAINING A 70% (EQUITY)/ 30% (AIAC/CAIC)

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1 **CAPITALIZATION BY THE END OF ITS FIFTH YEAR OF OPERATIONS IS**
2 **UNREASONABLE IN THE CIRCUMSTANCES OF THE INSTANT PROCEEDING**

3 **A. The Staff has Failed to Cite Any Applicable Commission Precedent to Support Its**
4 **Recommendation.**

5 During the course of her testimony in the October 2, 2008 evidentiary hearing, Staff
6 witness Crystal Brown referred to the Commission's Decision No. 70352¹ as precedent which
7 supported the Staff's recommendation that the continued validity of any CC&N granted to
8 Ridgeline should be contingent upon the company attaining a 70% (equity)/ 30% (AIAC/CAIC)
9 capitalization by the end of the fifth year of operation. However, upon careful examination, it is
10 readily apparent that Decision No. 70352 is not an applicable precedent for dispositive purposes
11 as to the instant proceeding.

12 More specifically, in the Double Diamond Utilities, Inc. ("DDU") proceeding, in which
13 Decision No. 70352 was issued, there is no evidence that the applicant took issue with the Staff's
14 70% (equity)/ 30% (AIAC/CAIC) capitalization recommendation. To the contrary, the decision
15 expressly states that

16 "In its Comments to Staff Report, DDU stated that it generally agreed with Staff's
17 recommendations..." [Decision No. 70352 (December 3, 2007) at page 11, lines
18 23-24] [emphasis added]

19 with the exception of a rate design recommendation which is not relevant to the instant
20 proceeding. Moreover, in adopting the Staff's recommendations in this regard, the Commission
21 offered no discussion as to why it believed that the capitalization ratio recommendation was
22 appropriate.

23 Conversely, in the instant proceeding, Ridgeline strongly opposed the Staff's 70%
24 (equity)/ 30% (AIAC/CAIC) capitalization recommendation. The first time Ridgeline expressed

25
26
27 ¹ Tr. 190, L. 1-Tr. 191, L. 3. In that regard, Staff counsel has not provided the undersigned with a list of any other
28 Commission decisions adopting the 70% (equity)/ 30% (AIAC/CAIC) capitalization ratio the Staff recommends, as
 the undersigned counsel requested during the October 2, 2008 evidentiary hearing, so the undersigned counsel has
 proceeded, for purposes of this Initial Brief, on the assumption no other Commission decisions on this issue exist.
 In that regard, see Tr. 190, L. 1-14; and, Tr. 195, L. 7-20.

1 its opposition was in its September 5, 2008 Supplement to CC&N Application, wherein it
2 observed as follows:

3
4 “Condition No. 7 [of the August 14, 2008 Staff Report] conditions the
5 effectiveness of such CC&N as might be granted upon Ridgeline attaining the
6 30% (AIAC/CAIC)/70% (equity) capital structure recommended by the
7 Commission’s Staff by the end of Ridgeline’s fifth year of operation. The 54%
8 (AIAC/CAIC)/46% (equity) capital structure at the end of the fifth year of
9 operation, which is reflected in the financial data filed by Ridgeline in support of
10 the Application, represents the actual allocation between on-site facilities and off-
11 site facilities for the water system infrastructure Ridgeline intends to install to
12 serve Ridgeline Estates. The former would be funded through advances-in-aid of
13 construction and contributions-in-aid of construction. Whereas, the latter would
14 be funded through common equity provided by the water company’s investors. In
15 order to achieve the capital structure recommended by the Commission’s Staff,
16 the water company would be required to fund water system infrastructure
17 normally funded by developers. Accordingly, against this background, Ridgeline
18 hereby requests that Condition No. 7 either be withdrawn or revised to reflect a
19 54% (AIAC/CAIC)/46% (equity) capital structure.” [Supplement to CC&N
20 Application, page 5, lines 9-21] [emphasis added]

21 The second time Ridgeline registered its opposition was during the October 2, 2008
22 evidentiary hearing through the testimony of Thomas J. Bourassa, its expert financial witness.
23 Therein, Mr. Bourassa reiterated the aforesaid rationale underlying Ridgeline’s opposition to the
24 Staff’s capitalization ratio recommendation, and discussed at length why he believed that the
25 Commission should not adopt the same. These reasons included (i) the fact that the Staff’s
26 recommended ratio is

27 “...contrary to the way that utilities typically fund their infrastructures,”
28 and would

“...require that the company fund what should be the responsibility of the
developer to put in the distribution mains within...”

Ridgeline Estates [Tr. 112, L. 1-2, and Tr. 112, L. 3-5, respectively]; and, (ii) the fact that
the Staff’s recommendation

“...in a sense, pigeonholes management to meet some artificial [capitalization
ratio] target...”

thereby leaving

“little flexibility for the company to use its expertise in balancing...”

1 its capitalization to adjust to events as they occur with the passage of time. [Tr. 112, L. 11-12,
2 and Tr. 112, L. 15-17, respectively] Stated differently, the Staff's capitalization recommendation
3 conditions the continued effectiveness of the CC&N upon Ridgeline attaining a hypothecated
4 capitalization that may or may not be appropriate after five (5) years of operation, at which time
5 Ridgeline will have been serving customers for several years.

6 **B. The Factual Circumstances of the Instant Proceeding Also Do Not Support**
7 **Adoption of the Staff's Capitalization Recommendation.**

8 The Staff has indicated that it believes that the owner(s) of a water company should have
9 enough investment at risk to motivate them to insure that the company is well managed and
10 providing reliable service to its customers. [See e.g. Tr. 186, L. 17-23; and, Tr. 194, L. 19-24];
11 and, Ridgeline agrees with that concept, provided that the end result is a "balanced
12 capitalization." In that regard, Mr. Bourassa defined that term as

13 "...a balance between providing the investor with a reasonable return, having him
14 have an investment at risk, and having rates kept in check by having some amount
15 of zero-cost capital on the books, because zero-cost capital has no rate of return"
[Tr. 115, L. 7-11]

16 However, the assignment of risk to the investor must have some rational basis in fact, such as the
17 traditional allocation of responsibility between the investor(s) and the developer(s) for funding
18 water system plant. The capitalization ratio reflected in Ridgeline's exhibits reflects a 54%
19 (equity)/ 46% (AIAC/CAIC) capitalization ratio based upon that traditional funding allocation,
20 when analyzed in the context of the actual water system plant contemplated by installation on
21 Ridgeline's system during the first five (5) years of operation. Whereas, the Staff's 70%
22 (equity)/ 30% (AIAC/CAIC) capitalization ratio bears no factual relationship to the
23 circumstances of the instant proceeding; and, the Staff has provided no independent rationale for
24 its 70% equity recommendation. Rather, the Staff's capitalization ratio recommendation is
25 predicated upon Commission action in another proceeding involving another CC&N applicant,
26 for which the Staff has yet to establish a relevant factual nexus.

27 Accordingly, for the reasons discussed above, Ridgeline submits that the Staff's
28 recommendation that a CC&N for Ridgeline be contingent upon the company attaining a 70%

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1 (equity)/ 30% (AIAC/CAIC) capitalization by the end of its fifth year of operations is
2 unreasonable in the circumstances of this instant proceeding, and should therefore be rejected.

3 III.

4 THE ISSUANCE OF AN ORDER PRELIMINARY IN ADVANCE OF A
5 CERTIFICATE OF CONVENIENCE AND NECESSITY IS NEITHER
6 NECESSARY NOR APPROPRIATE, WHEN EXAMINED IN THE
7 CIRCUMSTANCES OF THE INSTANT PROCEEDING
8 AND THE LANGUAGE OF A.R.S. § 40-282(D)

9 A. The Language of the Statute Does Not Require The Issuance of an Order
10 Preliminary In Advance of a CC&N.

11 A.R.S. § 40-282(D) addresses the situation where an applicant for a CC&N has requested
12 that the Commission first grant it an Order Preliminary, because the applicant has not as yet
13 obtained that “consent, franchise or permit” required by A.R.S. § 40-282(B) as a pre-requisite to
14 the granting of a CC&N by the Commission. However, neither A.R.S. § 40-282(B) or (D)
15 require that a CC&N applicant request an Order Preliminary as a first step in the CC&N process,
16 nor do they require that the Commission limit its exercise of jurisdiction under the circumstances
17 therein contemplated to only granting an Order Preliminary. To the contrary, A.R.S. § 40-
18 282(D) expressly provides that the Commission may either grant the requested Order
19 Preliminary, or the Commission

20 “... may make an order issuing a certificate [i.e. CC&N] on the condition that the
21 contemplated franchise or permit is obtained and on other terms and conditions it
22 designates.” [emphasis added]

23 In that regard, as ALJ Martin observed during the October 2, 2008 evidentiary hearing in
24 the instant proceeding,

25 “...order preliminaries are not used that frequently...”

26 by the Commission [Tr. 244, L. 10-11]. Supportive of this observation are the following
27 excerpts from Commission decisions issued in recent years.

1 “ Although the statute [i.e. A.R.S. § 40-282(D)] permits the issuance of an Order
2 Preliminary, the process apparently has not been used by the Commission for a
3 number of years. In recent years, the Commission has followed the practice of
4 granting so-called ‘Conditional CC&Ns whereby a company is granted a CC&N
5 for a given territory subject to compliance with certain conditions set forth in the
6 Order. Under the Conditional CC&N policy, no further action by the
7 Commission is necessary because the CC&N automatically becomes effective
8 upon satisfaction of the conditions, or becomes null and void if the conditions are
9 not met within the time period designated in the Order.” [Utility Source, L.L.C.;
10 Decision No. 67446 (January 4, 2008), page 10, lines 18-24] [emphasis added]²

7 * * *

8 “Recent Commission decisions have stated that although A.R.S. § 40-282(D)
9 allows for the issuance of an Order Preliminary, the process has not been used for
10 a number of years.” [Palo Verde Utilities Company; Decision No. 68498, page
11 11, lines 2-4, (February 23, 2008) citing Utility Source, L.L.C. Decision No.
12 67446]

13 In addition, the Commission’s Decision No. 70379 contains the above-quoted language from
14 Decision No. 68498, and cites to Decision Nos. 67446 and 68498. [Arizona Water Company
15 Decision No. 70379 (June 13, 2008) page 6, lines 14-18]

16 As indicated by the preceding discussion, the language of A.R.S. § 40-282(D) clearly
17 does not require that the Commission issue an Order Preliminary in advance of granting a CC&N
18 in the instant proceeding, assuming that the granting of a CC&N is otherwise warranted. To the
19 contrary, the granting of a “Conditional CC&N” to Ridgeline would be consistent with
20 Commission practice on a number of similar occasions over the years. The question then
21 becomes one of whether the circumstances of the instant case are such as to make the issuance of
22 an Order Preliminary either necessary or appropriate within the context of the Commission’s
23 exercise of its discretion under A.R.S. § 40-282(D). For the reasons discussed below, Ridgeline
24 submits the answer to that question is manifestly “NO.”

25 **B. The Issuance of an Order Preliminary In The Circumstances of the Instant Case is**
26 **Neither Necessary or Appropriate.**

27 ² The language underscored in this quotation derives directly from that language in A.R.S. § 40-282(D) which
28 authorizes the Commission, as an alternative to an Order Preliminary, to

“...make an order issuing a certificate [i.e. CC&N] on the condition that the contemplated
franchise or permit is obtained and on other terms and conditions it designates.”

1 A review and analysis of Commission decisions³ in recent years when an Order
2 Preliminary has been under consideration discloses that the same have been issued only in
3 unique circumstances or where there were a number of conditions yet to be satisfied which were
4 beyond the control of the applicant. That is not the situation in the instant proceeding, as ALJ
5 Martin observed during the October 2, 2008 evidentiary hearing:

6 “...I’m just saying that I’m not certain an order preliminary in this case is
7 proper...And the question that I would like addressed is whether or not an order
8 preliminary is proper in this matter where it seems as though the circumstances
9 sought to be remedied by Staff by use of the order preliminary are within the
10 company’s control.” [Tr. 225, L. 13-14, and Tr. 226, L. 14-18] [emphasis added]

11 More specifically, in its September 30, 2008 Supplemental Staff Report, the Staff has
12 recommended that the Commission issue an Order Preliminary to Ridgeline in advance of a
13 CC&N, subject to compliance with fourteen (14) conditions set forth at pages 2-4 of the
14 Supplemental Staff Report. However, and significantly, the Staff further recommends that a
15 CC&N be granted to Ridgeline “as soon as possible” after Ridgeline demonstrates compliance
16 with the following four (4) of the aforesaid fourteen (14) conditions:⁴

17 “1. That the Company files with Docket Control, a copy of the Approval To
18 Construct issued by Pima [County] Department of Environmental Quality for
19 water system facilities needed to serve the Ridgeline Estates development
20 within three years of the effective date of the decision granting the Order
21 Preliminary.”

22 “3. That the Company submit documentation demonstrating the transaction to
23 convert the debt to equity has taken place as discussed in item No. 1 under
24 STAFF’S RESPONSE above.”

25 “7. That the Company fill a revised curtailment tariff with Docket Control, as a
26 compliance item in this docket, within 3 years after the effective date of the
27 decision granting the Order Preliminary for the review and certification of the
28 Staff. Staff further recommends that this tariff includes a restriction for
operation of a standpipe in conformance with the sample tariff found on the
Commission’s web site at
www.azcc.gov/divisions/utilities/forms/CurtailmentTariffStandard.pdf.

³ The Commission decisions discussed in this Initial Brief are the same ones that ALJ Martin referred to during the October 2, 2008 evidentiary hearing in the instant proceeding. [Tr. 224, L. 12-20, and Tr. 226, L. 16-22] In the event that the Staff should identify and discuss any additional decisions involving an Order Preliminary in its Responsive Brief, Ridgeline will address those decisions as necessary or appropriate in its subsequent Reply Brief.

⁴ See Condition No. 14 on page 4 of September 30, 2008 Supplemental Staff Report.

1 “8. That the Company file a backflow prevention tariff with Docket Control, as a
2 compliance item in this same docket, within 3 years after the effective date of
3 the decision granting an Order Preliminary for the review and certification of
4 Staff. Staff further recommends that this tariff shall generally conform to the
5 sample tariff found posted on the Commission’s web site at
6 www.azcc.gov/divisions/utilities/forms/crossconnectbackflow.pdf. Staff
7 recognizes that the Company may need to make minor modifications to the
8 sample tariff according to its specific management, operational, and design
9 requirements as necessary and appropriate.

10 In connection with the above, it should be noted (i) that Condition Nos. 3, 7 and 8 are
11 entirely within the control of Ridgeline and its owners, and (ii) that these conditions could
12 probably be satisfied within a month or two following the issuance of a decision by the
13 Commission in the instant proceeding. In addition, it also should be noted that Condition No. 1
14 is neither unique nor controversial in nature. Rather, this type of condition is usually included
15 within the “Conditional CC&Ns” that the Commission has granted to water CC&N applicants in
16 recent years; and, there is nothing in the evidentiary record of the instant proceeding to suggest
17 that Ridgeline will not be able to readily satisfy this condition as well.

18 The aforementioned circumstances are to be contrasted with those in which an Order
19 Preliminary was issued by the Commission instead of a CC&N, or not issued at all. For
20 example, in Utility Source, L.L.C.,⁵ the applicant (i) was already providing water service to
21 customers without the requisite advance authorization from the Commission, (ii) was requesting
22 an Order Preliminary instead of a CC&N, and (iii) was proposing to provide service to an
23 additional geographic area for which it had been unable to demonstrate the existence of an
24 adequate and reliable water supply. Against this background, the Commission decided to deny
25 the applicant’s request for an Order Preliminary for the proposed new service area. As noted
26 above, these circumstances are in sharp contrast with those of the instant proceeding, where
27 Ridgeline (i) has not commenced the provision of water service to anyone in advance of
28 receiving the requisite Commission authorization, (ii) has applied for a CC&N instead of an
29 Order Preliminary, and (iii) has demonstrated the existence of the requisite 100-year water
30 supply for the water system demand it is proposing to serve at build-out.

⁵ See Decision No. 67446 in Docket No. WS-04235A-04-0073 et al.

1 Similarly, in Johnson Utilities, L.L.C., as the Commission noted,

2 “...given the number of unresolved issues, including acquisition of necessary
3 rights of way, compliance with ADEQ regulations, and final approval by the
4 Bankruptcy Court, the request for an Order Preliminary is appropriate under the
5 unique facts of this case.” [Decision No. 67585 at page 12, lines 18-20]
6 [emphasis added]⁶

7 Again, those circumstances are clearly distinguishable from the instant proceeding. More
8 specifically, in this case there are not numerous “unresolved issues” involving multiple third
9 parties, including a ruling from a Bankruptcy Court, and compliance with ADEQ regulations.
10 Nor, are there any circumstances surrounding the instant proceeding in the nature of those
11 “unique facts” which characterized the Johnson Utilities situation. Finally, and as previously
12 noted, Ridgeline has applied for a CC&N, not an Order Preliminary.

13 In Palo Verde Utilities Company, the Commission also concluded that the issuance of an
14 Order Preliminary was appropriate under the circumstances then present, as the Commission
15 therein noted by way of analogy:

16 “...we find the circumstances in the instant case similar to those in Johnson
17 Utilities, LLC Decision No. 67586 (February 15, 2005), where we found that an
18 Order Preliminary was appropriate until pending issues could be resolved.”⁷

19 More specifically, in Palo Verde Utilities Company the applicants had been requested to provide
20 water and wastewater service to 2,700 existing customers located within the boundaries of an
21 existing domestic water improvement district and an existing wastewater improvement district.
22 The aforesaid districts had contracted with a private party other than the applicants to operate the
23 water and wastewater systems owned by the districts, and that entity had proven incapable of
24 operating the systems in a competent and reliable manner. The ultimate goal of the applicants
25 was to extend their then existing CC&Ns into the districts’ service areas, and acquire the water
26 and wastewater systems of the districts. However, under the circumstances of the case, the
27 applicants proposed and the Staff recommended

28 ⁶ Decision No. 67585 was issued in Docket No. SW-04002A-02-0837 et al.

⁷ See Decision No. 68498 (February 23, 2006) at page 11, lines 19-21, which was issued in Docket No. SW-0375A-05-0470 et al.

1 “...that the Commission [first] issue, pursuant to A.R.S. § 40-282(D), an ‘Order
2 Preliminary’ to the issuance of the ultimate CC&Ns to Santa Cruz and Palo
Verde.” [Decision No. 68498 at page 9, lines 5-7]

3 In concluding that the issuance of an Order Preliminary was appropriate in these
4 circumstances, the Commission noted that Pinal County had requested that the Commission
5 condition approval of the CC&Ns on the districts first being dissolved (through the legal process
6 of deannexation) and certain management contracts being terminated prior to final Commission
7 approval.⁸ In addition, the Commission further stated that

8 “...We believe that the issuance of an Order Preliminary will allow the
9 Companies to move forward with development in the area while giving existing
10 and potential customers a sense of security that this matter will be resolved in a
11 favor of a final Order granting approval of the extension of the CC&Ns.
12 Additionally, an Order Preliminary gives the Companies a sense of security to
13 invest capital and make improvements to the infrastructure in the extension area.
14 Further, issuance of an Order Preliminary brings the extension areas under
15 Commission jurisdiction which will allow continued oversight by the
16 Commission that all requirements are met prior to the issuance of a final Order.”
17 [Decision No. 68498 at page 11, lines 21-28]

18 Clearly, these circumstances are distinguishable from those of the instant proceeding, where only
19 Condition No. 1 in the September 30, 2008 Supplemental Staff Report (issuance of an Approval
20 to Construct) requires an action by someone other than Ridgeline, in order to satisfy the Staff’s
21 four (4) prerequisites to the granting of the requested CC&N; and, Condition No. 1 is one which
22 is typically included within “Conditional CC&Ns” granted by the Commission.

23 The final Commission decision to be considered on the subject of an Order Preliminary is
24 Decision No. 70379, which was issued on June 13, 2008 in Docket No. W-01445A-07-0291. In
25 that proceeding, Arizona Water Company had filed an application to extend its existing CC&N
26 in Pinal County into five (5) additional geographic areas. One (1) of those areas was inside the
27 municipal boundaries of the City of Eloy, and the evidentiary record included a September 24,
28 2007 letter from the City of Eloy opposing the applicant’s CC&N request.⁹ In that regard, it is
worth noting that on a prior occasion the Commission had granted the applicant an Order
Preliminary, in order to give the applicant

⁸ See Decision No. 68498 at page 10, lines 15-25.

⁹ See Decision No. 70379 at page 5, lines 7-10.

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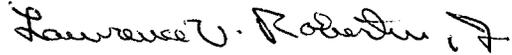
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end of its fifth year of operations is not reasonable in the circumstances of the instant proceeding, and therefore should not be adopted.

2. The issuance of an Order Preliminary, in advance of a CC&N in this proceeding, is neither necessary or appropriate under A.R.S. § 40-282.

Dated this 11th day of November 2008.

Respectfully submitted,



Lawrence V. Robertson, Jr.
Attorney for Ridgeline Water Company, L.L.C.

The original and thirteen (13) copies of the foregoing Initial Brief will be hand-delivered on the 12th of November 2008 to:

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1200 West Washington
Phoenix, Arizona 85007

A copy of the foregoing Initial Brief will be emailed or mailed on the 12th day of November 2008 to:

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