

OPEN MEETING AGENDA ITEM



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November 24, 2008

Arizona Corporation Commission
DOCKETED

NOV 24 2008

Chairman Mike Gleason
Arizona Corporation Commission
1200 W. Washington
Phoenix, AZ 85007

DOCKETED [Signature]

RE: *In the Matter of the Application of Pine Water Company for Approval to (1) Encumber a Part of Its Plant and System Pursuant to Ariz. Rev. Stat. § 40-285(A) and (2) Issue Evidence of Indebtedness Pursuant to Ariz. Rev. Stat. § 40-302(A); ACC Docket No. W-03512A-07-0362*

Dear Chairman Gleason:

On behalf of Pine Water Company ("PWCo"), we are providing this letter in response to your letter dated October 22, 2008. Before addressing the issues raised in your letter, however, we wanted to provide the Arizona Corporation Commission ("Commission") with an update on the status of the dealings between PWCo, Strawberry Water Company ("SWCo") and Brooke Utilities, Inc. ("BUI"), and the Pine Strawberry Water Improvement District ("District").

Status Update

On November 13, 2008, the District filed a condemnation complaint against PWCo, SWCo and BUI in Gila County Superior Court under Case No. CV-20080375. PWCo, SWCo and BUI will be contesting the District's condemnation filing, and we anticipate lengthy litigation relating to valuation of the companies and the District's hostile acquisition. As of today, the District still has not provided any concrete information relating to its financing for the proposed condemnation and acquisition. Prior to the condemnation filing, the District attempted to terminate the May 1, 2007 Joint Well Development Agreement ("JWDA") with PWCo. In turn, PWCo filed arbitration claims against the District for breach of the JWDA and unlawful, bad-faith termination of the JWDA. PWCo seeks damages and specific performance of the JWDA. Instead of performing its obligations under the JWDA, the District has refused to release

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the escrow funds for development of the K2 well. As a result, PWCo and the District have an arbitration hearing scheduled for February 2009 to resolve these issues relating to the JWDA.

Given that approval of the pending application in this docket is not necessary for performance of the JWDA, and because of the ongoing condemnation and arbitration proceedings between the parties, we also wanted to advise you that today PWCo filed a notice with the Commission withdrawing its application in this Docket No. W-03512A-07-0362. As PWCo has stated in prior filings, the relief sought in this docket was not necessary for PWCo to perform its obligations under the terms of the JWDA. Rather, approval of this application originally was required by the District as a pre-condition to deposit of the \$300,000 in escrow. After executing the JWDA, however, the District waived that requirement and deposited that money in escrow, which means that approval of the application is no longer needed per the JWDA.

Response to October 22, 2008 Letter

Although PWCo is withdrawing its application in this docket, we wanted to address the two questions raised in your October 22, 2008 letter as a matter of courtesy to you and the other Commissioners. Your two questions were:

- (1) Does the authority under which Pine Strawberry Improvement District was established allow it to own and operate a public water system?
- (2) If the Commission were to approve the Company's financing application, would the District be able to use the \$300,000 for purposes other than paying for the K2 test well?

We address these two issues below. PWCo also anticipates filing dispositive motions relating to the District's lack of authority to acquire, own and operate a public water utility system in the pending condemnation proceedings.

Generally speaking, it appears that the District does not have the authority to own and operate a public water utility system (i.e., PWCo and SWCo) under Arizona law and the District's formation petition, the District's By-Laws and the Gila County Board of Supervisor Resolution approving formation of the District. Unfortunately, in Mr. Gliege's November 4, 2008 letter filed with the Commission on behalf of the District, the District did not address all of the key underlying facts and circumstances relating to the District's powers and authority, which we briefly address and highlight below. Even the investigation conducted by Pamela Mason, as a private citizen and resident of Pine, raises substantial questions relating to the District's legal authority to acquire, own and operate PWCo and SWCo. See November 12, 2008 letter from Pamela Mason (with attachments) filed with Docket Control.

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Under Arizona law, the focus is whether the District has been formed as a “domestic water improvement district” under Title 48 of the Arizona statutes, thereby authorizing the District to provide public water utility service, or whether the District was formed as a “county water improvement district” without authority to be a purveyor of water utility services to the public. In its November 4, 2008 letter, the District answers that question by generically citing Ariz. Rev. Stat. § 48-909 and § 48-1014, and claiming that the District has statutory authority to own and operate a public utility under those statutes.

The District does not fully address the underlying legal issues or facts. The starting place for this inquiry is the District’s original formation petition. In November and December of 1995, property owners signed a petition to establish the “Pine Strawberry Water Improvement District.” That petition is unequivocal on two points. One, the District was **not** formed as a domestic water improvement district. Two, the District was **not** formed for the purpose of acquiring PWCo or SWCo or owning and operating a public utility.

To the contrary, the District was formed for the limited purpose of improving and developing water sources in Pine and Strawberry. The District’s stated purpose in the petition was “to improve the condition and maintenance of the water supply system” and the only improvement referenced was “the maintenance of the water supply system.” Without addressing its original purpose and intent, the District claims it is a fully empowered municipal corporation, including powers to condemn, own and operate a public utility.

Arizona courts, however, have held that “the general rule is that municipal corporations, as legislative creations, possess and exercise only such powers expressly granted, those necessarily or fairly implied by or incident to the powers expressly conferred, and those essential to the accomplishment of the corporation’s declared objectives and purposes.” *Maricopa Cty. v. Maricopa Cty. Municipal Water Cons. Dist. No. 1*, 171 Ariz. 325, 328, 830 P.2d 846, 849 (App. 1992), citing *City of Glendale v. White*, 67 Ariz. 231, 234, 194 P.2d 435, 437 (1948). Contrary to the District’s claims, “the scope of this power, however, is not unlimited. [Arizona courts] do not believe the legislature intended to grant special improvement districts unlimited use of municipal powers or place those districts on a par with other political subdivisions. ... The power to engage in the activities of a municipality generally is proper only when acting for a public purpose ... and when the activity is incidental to the primary purpose of the district.” *Id.* at 850, 830 P.2d at 329 (citations omitted).

Here, the District’s powers arguably do not include the legal authority to own and operate a public water system, because the District was not formed for the express purpose of purchasing and operating an existing domestic water delivery system. In Gila County Resolution 96-011954 approving formation of the District, the County expressly referenced the stated purposes of the District as contained in the original petition. See Gila County Resolution 96-011954 (“...the property included with the boundaries of the Pine-Strawberry Water Improvement District as

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those boundaries are described in the petition for the formation of the Pine-Strawberry Water Improvement District...”).

Incredibly, when the Gila County Board of Supervisors approved formation of the District at open meeting, the applicable meeting minutes *from July 2, 1996* establish that the District did **not** have the power to acquire, own and operate a public utility:

The purpose and function for the district will be outlined in the by-laws. As I understand, after conferring with the residents, they wanted to form this district, and this is the second time that this has been put before the people for their approval. The first time it was for the purchasing of water systems in the Pine area in 1988, or later than that. That failed simply because of the purposes in which they wanted to form it for, which was to purchase existing water companies that were there. There is no logic in doing that because the existing water companies, small ones and individual ones, put in by citizens over the years are deficient in providing water to the existing customers that are there. Those companies have allowed expansion to take place without production of new water. *The purpose of this district, as I understand it to be, is that it is for the purpose of acquiring rural development funds for the purposes of developing new water sources.* ... Well [lack of water] continues to happen and it will continue to happen until other sources of water are developed and found. *Water improvement district structure for that purpose is what this is all about.* There are hundreds of thousands of acres on public lands out there that have never been looked at for water, and have never been explored for water, and it is something that I would say that this district needs to be. They need to look at that very seriously, and *that is the purpose why we are here today. It's not for the purpose of purchasing the existing water system, which I don't know how that would solve the present water problem because I don't believe that it would, all you are doing is changing ownership again....It is being formed for the purpose of getting water and going out and finding water.*

July 2, 1996 Meeting Minutes from Gila County Board of Supervisors Meeting (comments of Supervisor Ronald Christensen) (emphasis added). Even further, the District's own Bylaws expressly state that the District's purpose is limited to developing water sources in Pine and Strawberry: “The purpose of the Board is to represent the interests of the Communities in securing long term and reliable sources of water for the Communities, and performing such other

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duties as required or provided by applicable state statute.” District Bylaws (amended March 11, 2000) at ¶ 1.

Under these facts, it is clear that the District was not formed “for the purpose of purchasing an existing or constructing a new domestic water delivery system” under Ariz. Rev. Stat. § 48-909(C). Nor was the District formed as a “domestic water improvement district” under Title 48, Article 4. A “domestic water improvement district” is defined expressly by statute to be “a county improvement district that is formed for the purpose of constructing or improving a domestic water delivery system or purchasing an existing domestic water delivery system and, if necessary, making improvements to the system or a district that is converted pursuant to section 48-1018.” Ariz. Rev. Stat. §48-1011(3) (emphasis added).

To that point, Gila County issued a letter on July 12, 2004 to various citizens, which reaffirmed the District’s status as a water improvement district, and not as a domestic water improvement district: “The PSWID is currently a Water Improvement District as defined in the Arizona Revised Statutes. However, it is subject to becoming a ‘domestic’ water improvement district if property owner approval and Board of Supervisor approval is obtained as required under A.R.S. 48-1018.” July 12, 2004 letter from Gila County at 1. In that letter, Gila County also reaffirmed that the “primary purpose” of the District “is water exploration.” *Id.*

Given the original purposes for which the District was formed, the efforts by the current board of the District to expand the District’s powers to include acquisition and operation of PWCo’s and SWCo’s domestic water systems appear to PWCo to violate controlling Arizona law, as well as principles of due process and fair notice. Put simply, property owners in the District were not advised that they might be subject to the substantial liabilities associated with ownership and operation of a public utility serving 3,200 customers. Due process suggests, if not requires, that persons affected by such potential liability receive adequate notice of the proposed improvement because “the cost of the completed project required by the district becomes a lien on the land of persons owning property in the district, and these lands are subject to foreclosure and loss for non-payment of assessments.” *Henningson, Durham & Richardson v. Prochnow*, 13 Ariz. App. 411, 416, 477 P.2d 285, 290 (App.Div.1 1970).

Current management of the District now proposes to dramatically alter the purpose of the District from developing additional water sources to acquiring, owning and operating a public water utility serving 3,200 connections. Because of situations like this, Arizona courts strictly construe the powers of improvement districts and “every reasonable doubt as to the extent or limitation of the power and authority should be resolved against the taxing power and in favor of the taxpayer.” *Phoenix Title & Trust Co. v. Burns*, 96 Ariz. 332, 335-36, 395 P.2d 532, 534 (Ariz. 1964). *See also, Braden v. Yuma County Board of Supervisors*, 161 Ariz. 199, 201, 777 P.2d 697, 699 (App.Div.1 1989) (“[T]here must be strict compliance with all statutes governing

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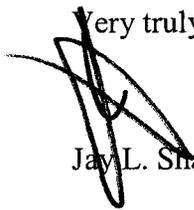
improvement districts.”). Even further, under Ariz. Rev. Stat. § 48-906(D), “alterations of an improvement district shall be made” in the manner provided for the establishment of the district.

For these reasons, PWCo believes the law and facts establish that the District does not have the authority to acquire, own and operate a public domestic water utility system. Again, as stated above, PWCo and SWCo anticipates pursuing dispositive motions on these issues in the condemnation proceedings, which would be resolved by the assigned Superior Court judge.

Finally, with respect to your second question relating to the District’s use of the \$300,000 in escrow, approval or disapproval of the pending application in this docket would not have impacted use or disbursement of the \$300,000 in escrow. Under ¶ 4.2.1.1 of the JWDA, the District was obligated to place the \$300,000 in escrow provided that “[t]he ACC has approved [the JWDA].” JWDA at ¶ 4.2.1.1. As discussed above, after execution of the JWDA, however, the District waived that condition and deposited the \$300,000 in escrow without such approval, which means that, even upon withdrawal of the application, PWCo would be entitled to disbursement of that money under the express terms of the JWDA and Escrow Instructions. As such, disbursement and use of the \$300,000 in escrow most likely will be decided in the pending arbitration between PWCo and the District.

We appreciate the opportunity to address the issues you have raised.

Very truly yours,



Jay L. Shapiro

cc: Commissioner William Mundell
Commissioner Jeff Hatch-Miller
Commissioner Kristin Mayes
Commissioner Gary Pierce
Docket Control (13 copies)
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