

ORIGINAL



0000100251

BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission

DOCKETED

JUL -2 2009

DOCKETED BY [Signature]

2 **COMMISSIONERS**
3 KRISTIN K. MAYES, Chairman
4 GARY PIERCE
5 PAUL NEWMAN
6 SANDRA D. KENNEDY
7 BOB STUMP

JUL -2 P 2:29

6 IN THE MATTER OF THE APPLICATION OF
7 FAR WEST WATER & SEWER COMPANY, AN
8 ARIZONA CORPORATION, FOR APPROVAL OF
9 INTERIM RATES AND CHARGES.

DOCKET NO. WS-03478A-08-0608

STAFF'S REPLY BRIEF

10 Arizona Corporation Commission ("ACC" or "Commission") Utilities Division Staff
11 ("Staff") hereby files its Reply to the Closing Briefs submitted by Far West Water and Sewer
12 Company ("FWWS" or the "Company") and the Residential Utility Consumer Office ("RUCO").
13 While Staff agrees with the Company's assertion that purpose of the instant hearing is to decide
14 "whether an emergency exists and if so, what remedy is appropriate", Staff continues to assert that
15 the circumstances of this case do not rise to the level of an emergency that would justify the
16 imposition of interim rates.

17 **I. THE COMPANY MISUSED THE PREVIOUS LOAN PROCEEDS.**

18 The central premise of the Company's application is that it is simply trying to carry out the
19 mandates of ADEQ, but has been unable to do so because the proceeds of the bond issue were not
20 sufficient to cover the total cost of all of the projects. Considering that the Commission granted
21 permission to take out \$25.2 million in loans for the projects based upon the Company's assertions
22 that such an amount would be sufficient, the question arises as to why the Company has run out of
23 money after *nearly* completing all, while *fully* completing none, of the projects. Why is the
24 Company now asking the Commission for an emergency rate increase?

25 The Company's explanation is that it "has been unable to raise the additional capital needed to
26 pay for cost overruns related to its sewer renovation project."¹ Unfortunately, this is an over-
27 simplification.

28

¹ Company's Closing Brief, pg 2:18-19.

1 The Company raised the \$25.2 million through IDA bonds approved in Decision No. 69950.
2 The Company acknowledges that “The Commission’s approval was premised on the Company’s
3 request for financing approval to pay off existing short- and long-term debt and to finance the costs of
4 wastewater system improvements necessary to comply with the Consent Order.”² If the money from
5 the bond issue had been spent on only the projects that were the subject of the Consent Decree, and
6 the total amount proved insufficient, those circumstances may warrant the Commission’s
7 consideration. However, the Company has admitted that it spent funds intended for the Consent
8 Order projects on non-Consent Order needs. The Company should not now come to the Commission
9 seeking assistance, especially when that assistance will come from the Company’s ratepayers.

10 **II. THE COMPANY HAS PROTECTED ITS OWN INTERESTS.**

11 The Company has placed its own needs above those of its ratepayers. The Company has
12 testified that in addition to the money it has spent on the ADEQ projects and non-ADEQ projects to
13 date, it has also accumulated funding needs totaling \$4,623,566. This amount reflects past due
14 balances for work already completed and amounts anticipated to cover the remaining work necessary
15 to complete the ADEQ projects. As the circumstances of this matter have evolved, at each step, the
16 Company has protected its own interests.

17 For example, H&S Developers (“H&S”), a FWWS affiliate company, loaned FWWS
18 \$330,000 to use as an advance payment to Coriolis, the firm responsible for the majority of the
19 engineering behind the ADEQ projects. When the loan came down, Far West reimbursed H&S for
20 the \$330,000 initial payment.”³

21 In addition, the Company’s balance sheet, hearing exhibit S-4, shows that “there was
22 \$920,000 and change owed [in accounts payable] to associated companies at the end of 2007.”⁴
23 According to the same balance sheet, however, “at the end of 2008, the indication is that that
24 \$920,000 was paid off.”⁵ Similarly, S-4 shows that FWWS owed an additional \$571,244 to
25
26

27 ² *Id.*, pg 12: 14-17.

³ *Transcript*, pg 550: 4-6.

28 ⁴ *Id.*, pg 560: 23-25.

⁵ *Id.*, pg 561: 1-4.

1 associated companies for long-term loans. As with the accounts payable to associated companies, as
2 of December 31st, 2008 the long term loans were also paid off.⁶

3 The Company was asked:

4 “Q: According to the amounts on Exhibit S-4, the total amounts paid to
5 associated companies is approximately a million and a half dollars over 2008, is
6 that correct?

7 A: That’s correct.”⁷

8 So, at the same time that FWWS was accumulating accounts payable to vendors, it was
9 actually able to pay down a million and a half dollars to its own affiliated company. Now, FWWS is
10 claiming financial hardship because it fears being forced into bankruptcy by these vendors if the
11 Commission does not grant interim rate relief. FWWS faces no such threat from H&S Developers.
12 H&S has been paid in full.

13 Further, according to hearing Exhibit S-3, the accounts receivable for associated companies
14 (which would be H&S Developers) actually *increased* by approximately \$200,000 in 2008, meaning
15 that FWWS did not collect these funds from H&S. Thus, the total effect of these activities between
16 FWWS and H&S in 2008 consumed approximately \$1.7 million of cash that could otherwise have
17 been used to satisfy the various outstanding vendor accounts, thus bringing FWWS closer to
18 compliance with the Consent Order.

19 As RUCO has pointed out in its initial closing brief, of the roughly \$4.6 million FWWS
20 claims to need, only \$1.2 million is needed to complete the projects. The remainder reflects existing
21 accounts payable. To put this into perspective, the amount the Company actually needs to *complete*
22 the projects and come into ADEQ compliance is actually \$500,000 *less* than the amount it has paid
23 to, or not collected from, its affiliated company, to which it now owes nothing. Throughout this
24 entire process, the only time FWWS showed sound financial planning was when it was looking after
25 its own interests.

26
27
28 ⁶ *Id.*, pg 561: 14-21.

⁷ *Id.*, 562: 11-15.

1 **III. SELF-INFLICTED DUPLICATIVE COSTS.**

2 At hearing, the Company complained of its extraordinary sludge removal costs, totaling
3 approximately \$500,000 per year. Ironically, it was the Company's failure to complete and attain
4 operational status of the Del Oro treatment plant that resulted in the need to haul the sludge in the
5 first place. It is important to note that the Company testified that the vendor associated with the Del
6 Oro situation, GE/Xenon, would be amenable to a payment arrangement, whereby GE/Xenon would
7 accept an initial payment of \$400,000 to initiate immediate operation, and thereafter would accept
8 periodic payments on the remaining outstanding balance. FWWS has been able to finance the
9 \$500,000 sludge removal but could not afford the \$400,000 initial payment that would have negated
10 the need for sludge removal in the first place. It should be noted that the initial payment could be
11 recovered in less than one year through operational savings.

12 Furthermore, these operational savings would augment the free cash flow of approximately
13 \$780,000 described in the Staff Report submitted in this matter, providing a total pro forma cash flow
14 of approximately \$1,280,000 annually.

15 Finally, through six days of hearing, the Company did not explain the reasons why cash flows
16 of this magnitude would be insufficient to support payment plans with its various vendors.

17 **IV. FAIRNESS TO RATEPAYERS.**

18 From the beginning of this process, Staff has maintained that the Company's current financial
19 stress is a direct result of the Company's mismanagement of the IDA bond funds. Had the Company
20 limited its spending to the projects strictly necessary to achieve ADEQ compliance, the
21 circumstances that led to the instant application would never have arisen. The Company admits that
22 it has made many mistakes in the way it disbursed the IDA funds, but the only "solution" the
23 Company will consider is an interim rate increase. This is no solution.

24 From the Company's perspective, if the Commission denies the interim rate increase, it will
25 be doing so as a punishment for having misspent the bond proceeds. But the Company's argument
26 misses an essential point. Throughout this entire process, no one has been looking after the interests
27 of the ratepayers. It is time to do so now.

1 It is important to remember that at no time thus far have the ratepayers had any input into the
2 decisions being made. Yet the ratepayers have a lot at stake in the outcome of this process. If the
3 interim rates are granted, the average ratepayer will see his or her utility bill double. Given the
4 current economic conditions throughout the State, this amount is significant. If the interim rates are
5 granted, the ratepayers will see even more of their paycheck given away for the same service they
6 already receive. Some of those ratepayers will belong to households which were previously two
7 income families. For them, the increase will hit twice as hard. But all of the Company's ratepayers,
8 regardless of their individual circumstances, will be forced to spend more on their essential utility
9 services, and will lose greater time value of that money. But the ratepayers have no one to whom
10 they can pass on the increase.

11 FWWS owes money to its engineering firm. FWWS owes money to various vendors.
12 FWWS owes money to lenders. The only entity to whom FWWS does not owe money as result of
13 this debacle is H&S Developers.

14 FWWS has stated repeatedly that it is out of options. It can not complete the ADEQ projects
15 without an interim rate increase to cover the financing. Its last hope falls squarely on its ratepayers.
16 The Commission should not let this happen.

17 As Staff testified, it is inappropriate for FWWS to pay for large capital projects, such as those
18 called for in the ADEQ Consent Order, using money collected monthly from ratepayers. Instead, the
19 Company proposes to use revenues generated by an interim rate increase to secure yet another loan.
20 The loan will pay for the projects, and the Company will be able to continue collecting rates and
21 gradually paying off its vendors. But the Company's financial health will be worse than ever. All of
22 its assets will be fully leveraged, and all of its cash streams will be allocated to existing debt. If the
23 Company were to face another emergency in the future, it will be unable to manage that emergency
24 without yet another emergency rate increase. And all of this assumes that the Company will actually
25 be able to secure a loan. To date, the Company has not found a lender who will make such a
26 commitment. So, a grant of interim rates may ultimately prove futile in any case. The only way to
27 stop this vicious circle is to use an alternative solution now.

1 FWWS needs a capital infusion. It makes no difference whether the infusion comes from
2 existing shareholders or from new investment. The Company claims that its owners can not
3 contribute funds of their own, but the evidence has shown that the owners were able to borrow on two
4 separate occasions by pledging their stock. Despite having previously pledged the owners' stock, the
5 Company asserts that it has no idea of the present value of the Company. Therefore, it further asserts
6 that borrowing against the owners' stock is not feasible under the current circumstances. It seems
7 highly unlikely that the Company is truly unable to calculate a dollar value of its current assets, but if
8 true, the Company's position only serves to underscore the depth of financial mismanagement that
9 has contributed to the current situation.

10 The only way to prevent a morbid sequel to the current crisis is to inject money into the
11 Company from a source other than its ratepayers. Any other "solution" is merely a temporary relief.
12 Absent an equity infusion, the current financial issue will return stronger than ever. But there are
13 limits to what ratepayers can afford, and if the Company continually relies on rate increases to remain
14 functional, there must come a time when there simply is no more revenue to be siphoned. The
15 Company needs to raise its investment and relieve the burden on its ratepayers. It is the only true
16 solution.

17 RESPECTFULLY SUBMITTED this 2nd day of July, 2009.

18
19
20 
21 Kevin O. Torrey, Attorney
22 Robin R. Mitchell, Attorney
23 Legal Division
24 Arizona Corporation Commission
25 1200 West Washington Street
26 Phoenix, Arizona 85007
27 (602) 542-3402

25 Original and thirteen (13) copies
26 of the foregoing were filed this
27 2nd day of July, 2009 with:

27 Docket Control
28 Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

1 Copies of the foregoing were mailed
2 this 2nd day of July, 2009 to:

3 Norman D. James
4 Jay L. Shapiro
5 FENNEMORE CRAIG, PC
6 3003 North Central Avenue, Suite 2600
7 Phoenix, Arizona 85012-2913

8 Michelle Wood
9 RESIDENTIAL UTILITY CONSUMER OFFICE
10 1110 West Washington Street, Suite 220
11 Phoenix, Arizona 85007-2958

12 Seth and Barbara Davis
13 2006 S. Arboleda Dr.
14 Merced, CA 95341

15
16
17
18
19
20
21
22
23
24
25
26
27
28

