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BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION  
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8 IN THE MATTER OF THE APPLICATION OF  
 9 CHAPARRAL CITY WATER COMPANY,  
 10 INC., AN ARIZONA CORPORATION, FOR A  
 11 DETERMINATION OF THE FAIR VALUE OF  
 12 ITS UTILITY PLANT AND PROPERTY AND  
 13 FOR INCREASES IN ITS RATES AND  
 14 CHARGES FOR UTILITY SERVICE BASED  
 15 THEREON.

Docket No. W-02113A-07-0551

Arizona Corporation Commission

**DOCKETED**

MAY 24 2010

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**RUCO'S REHEARING CLOSING BRIEF**

14 The Residential Utility Consumer Office ("RUCO") offers this Initial Closing Brief on  
 15 the matters raised at Chaparral Water Company's ("Chaparral's") recent rehearing, and  
 16 requests that the Commission reaffirm its prior Decision and deny the relief requested by  
 17 the Company.

- 18 1. Shareholders are not entitled to a 700% return on investment.

19 The Company entered into a settlement agreement with Fountain Hills Sanitation  
 20 District ("FHSD") regarding the contamination of Wells Nos. 8 and 9. Pursuant to the  
 21 settlement agreement, the Company recovered \$1.52 million ("Settlement Proceeds"). The  
 22 Company claims to have spent \$30,000 in attorneys' fees and costs in negotiating the  
 23 agreement. RUCO asserts that the Settlement Proceeds for the contamination of Wells  
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1 Nos. 8 and 9 be allocated 100% to the ratepayers minus the \$30,000 in attorneys' fees and  
2 costs incurred in resolving the matter. The Company argues that RUCO's position is based  
3 on a mistaken belief that ratepayers own the Company's assets.<sup>1</sup> RUCO is not asserting  
4 that the ratepayers own Wells Nos. 8 and 9. RUCO's position is that the Company has  
5 already received all recovery to which it is entitled, and granting further relief would result in  
6 excessive returns, creating a windfall for investors at the expense of ratepayers.

7 In the Bluefield and Hope decisions, the Supreme Court held a public utility that is  
8 efficiently and economically managed is entitled to recover the cost of its investment and  
9 the opportunity to earn a reasonable return thereon.<sup>2</sup> Robert Hanford, the Company's  
10 district manager, admitted that Well No. 8 went into service in 1971 and had an original  
11 cost of \$49,329.<sup>3</sup> He also admitted that the Well No. 9 went into service in 1972 at an  
12 original cost of \$54,139.<sup>4</sup> The Company's total investment in Wells Nos. 8 and 9 is  
13 \$103,468.00. Of that amount, Mr. Hanford testified 100% has already been recovered from  
14 ratepayers. He testified:

15 *...both wells were constructed over 36 years ago and have been fully*  
16 *depreciated and have no impact on rate base in the instant case.*<sup>5</sup>

17 By its own admission, the Company has fully recovered the cost of Wells Nos. 8 and 9 and  
18 received a reasonable return thereon. By law, the Company is entitled to no more.

19 The Company contends that the Commission should ignore the fact that it has  
20 already recovered 100 percent of its investment and a reasonable return thereon and grant

21 <sup>1</sup> Company's Original Closing Brief at 9.

22 <sup>2</sup> Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia, 262 U.S.  
679(1923) and Federal Power Commission v. Hope Natural Gas Company 320 U.S. 391(1944).

23 <sup>3</sup> See Rehearing Exhibit R-3 Company's Response to Staff DR MEM 7.3.

24 <sup>4</sup> Id.

<sup>5</sup> Original Transcript ("OT"): 255-278, 416-417. See also Rehearing Exhibit R-1 Direct Testimony of William Rigsby which includes Attachment A, a copy of Exhibit S-2 to the Original Proceeding, Millsap's Direct Testimony at 13 and Rehearing Exhibit R-3 Company's response to Staff DR MEM DR 7.3.

1 it 50 percent of the settlement proceeds or \$760,000. RUCO disagrees and asserts that the  
2 Company's request would result in excessive and impermissible returns.

3 The Supreme Court has held that a rate of return adopted for a utility should also be  
4 comparable to a return that investors would expect to receive from investments with similar  
5 risk.<sup>6</sup> Here, the Company seeks recovery of \$760,000 on its \$103,000 investment. The  
6 Company's request is tantamount to a request for a 700 percent return investment.  
7 Ratepayers are required to pay a "reasonable" return on investment.<sup>7</sup> A 700+ percent  
8 return on investment is not reasonable; it's absurd. There is no evidence on the record to  
9 support such a return. The Company has already received a fair return to compensate it  
10 for its risk. The Company does not face additional risk. Allowing the Company an  
11 additional return of the magnitude it proposes is unreasonable. RUCO respectfully  
12 requests that the Commission reaffirm its prior decision and deny the Company's ludicrous  
13 request for a 700 percent return on investment.

14 The Company complains that Well No. 8 was not used for potable water and  
15 therefore the ratepayers should not be able to recover the portion of the settlement  
16 associated with Well 8.<sup>8</sup> The Company's argument is disingenuous. First, as William  
17 Rigsby, RUCO's witness testified, Well No. 8 was an irrigation well.<sup>9</sup> It was used to supply  
18 water to the well-known fountain in Fountain Hill's park. Before entering into the agreement  
19 with the Fountain Hills Sanitation District ("FHSD"), the Company generated revenues from  
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21 <sup>6</sup> Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia, 262 U.S.  
22 679(1923) and Federal Power Commission v. Hope Natural Gas Company 320 U.S. 391(1944).

23 <sup>7</sup> Id.

24 <sup>8</sup> See Rehearing Transcript ("RT"):28 and 29. See Company's Original Closing Brief at 9 in which the  
Company argues alternatively that Well No. 8 was never in service. Whether Well No. 8 never went in service  
or whether it was used for irrigation, but taken out of service in the 1980's, the Company continued to recover  
costs via rates from that time until the present on plant it now asserts was not used and useful to ratepayers.

<sup>9</sup> RT:8-9.

1 irrigation water it sold to Fountain Hills, which allowed the Company to charge lower rates  
2 to its residential customers.<sup>10</sup> After the construction of the FHSD, the park secured its  
3 irrigation water from effluent produced by FHSD. This resulted in a loss of revenues to the  
4 Company which was used to offset residential rates. Because the ratepayers will be paying  
5 higher rates as a result in the loss of Well No. 8 revenues and the Company continues to  
6 receive the same revenue albeit from a different source, the Settlement Proceeds should  
7 be distributed 100 percent to ratepayers.

8 Second, Mr. Hanford testified that the purpose of the settlement was to replace  
9 water that Well No. 9 would produce over the remainder of its useful life.<sup>11</sup> Given that  
10 ratepayers will have to pay 100% of the cost of replacement water from Well No. 9, they  
11 should be able to apply 100% of the settlement proceeds to mitigate the expense of  
12 replacement water. Ratepayers have been paying for more expensive CAP water since the  
13 1990's when the Company turned from well water to CAP surface water. In addition, in this  
14 rate case, the Commission has authorized recovery of the cost of an additional CAP water  
15 allocation from ratepayers.<sup>12</sup> The cost of the additional CAP allocation, in this case, is  
16 \$1.28 million dollars. The entire amount has been placed in rate base as a deferred  
17 regulatory asset. Ratepayers will pay more than 100% of the cost of the additional CAP  
18 allocation because the current order treats the allocation as a deferred regulatory asset and  
19 allows the Company a return on the deferred regulatory asset in perpetuity. Because the  
20 Company asserts that the Settlement Proceeds were for replacement water, the settlement

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22 <sup>10</sup> Id.

23 <sup>11</sup> OT: 100, 416-417. See also Exhibit A-1 to the Original Hearing, Hanford's Direct Testimony at 10, ll. 11-  
13, and Rehearing Exhibit R-1 Direct Testimony of William Rigsby which includes Attachment A, a copy of  
Exhibit S-2, Millsap's Direct Testimony at 13.

24 <sup>12</sup> In the Matter of Chaparral City Water Co., Docket No. W-02113A-07-0551, Decision No. 71308.

1 proceeds should be used to mitigate the cost of replacement water. The ratepayers have  
2 lost the use of the potable water in Well No. 9 and have been paying for more expensive  
3 CAP water. For the foregoing reasons and because in this case ratepayers are paying  
4 100+ percent of the cost of an additional CAP water allocation, ratepayers' cost burden  
5 should be mitigated by a distribution of 100 percent of the Settlement Proceeds.

6 The Company complains that the settlement proceeds should be distributed 50/50  
7 consistent with Decision No. 66849.<sup>13</sup> The facts of this case are distinguishable from  
8 Decision No. 66849. First, in Decision No. 66849, Arizona Water received replacement  
9 water and wells. The FHSD did not provide replacement water to Chaparral. Second,  
10 there is no evidence in Decision No. 66849 that the Company fully recuperated its  
11 investment of and on all of the contaminated wells. Here, the Company admits Wells 8 and  
12 9 are fully depreciated and that the Company received its return of and on its investment.  
13 In fact, the Company continued to collect a return on and of its investment in Well No. 8 for  
14 two decades after which the well was no longer used and useful to ratepayers. Because  
15 this case is easily distinguishable from Decision No. 66849, the Company's argument has  
16 no merit and should be rejected.

17 The Company argues that a failure to provide it with 50 percent of the proceeds will  
18 serve as a disincentive for utilities to spend legal fees to pursue legal remedies if they are  
19 not allowed to share in the recovery. The Company's argument is without merit. The  
20 Company may be able to share in the recovery in some instances.<sup>14</sup> The Company claimed  
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23 <sup>13</sup> See Rehearing Exhibit R-2, Decision No. 66849, Arizona Water Eastern Group dated March 19, 2004,  
Docket No. W-01445A-02-0619.

24 <sup>14</sup> *Id.*

1 a legal expense of \$30,000 dollars to resolve the FHSD dispute.<sup>15</sup> RUCO did not object to  
2 the Company recovering the legal expense associated therewith, and the current order  
3 reimburses the Company 100 percent for the attorney's fees and costs associated with the  
4 negotiation of the settlement agreement. RUCO disagrees that the Company is entitled to  
5 anything more in light of the fact that the Company has fully recovered its investment in the  
6 wells and a reasonable return thereon. RUCO respectfully requests that the Commission  
7 reaffirm its prior decision distributing the \$1.52 million settlement to ratepayers minus the  
8 legal fees associated therewith.

9 The Company asserts that Staff changed its position and that RUCO stands alone in  
10 its position.<sup>16</sup> Simply stated, even if true, who cares? In the original hearing, Staff  
11 proffered one expert witness on the issue of the FHSD settlement proceeds, Marvin  
12 Millsap, a certified public accountant.<sup>17</sup> Mr. Millsap testified in direct and surrebuttal that the  
13 compensation for Wells Nos. 8 and 9 should not be shared 50/50 between shareholders  
14 and ratepayers.<sup>18</sup> He correctly pointed out that the assets are fully depreciated; the  
15 shareholders have already recovered the full cost of their investment through depreciation  
16 expense and received a full return on their investment.<sup>19</sup> He testified that shareholders are  
17 entitled to no more under the law.

18 During the course of testifying, Mr. Millsap indicated that Staff's utility division  
19 wanted to withdraw its objection to the Company's treatment of the settlement proceeds.  
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21 <sup>15</sup> OT: 141

22 <sup>16</sup> See Company's Original Closing Brief at 8.

23 <sup>17</sup> See Rehearing Exhibit R-1 Direct Testimony of William Rigsby, Attachment A at 5-6 and 11-15. See  
also Exhibit S-3 to the Original Proceeding, Surrebuttal Testimony of Marvin Millsap at 3-4.

24 <sup>18</sup> Id.

<sup>19</sup> OT: 416-417. See also Rehearing Exhibit R-1 which includes as Attachment A, Exhibit S-2 to the  
Original Proceeding, Millsap Direct Testimony at 13. See also, Rehearing Exhibit R-3 Company response  
to MEM DR 7.3.

1 However, neither Mr. Millsap nor the Utilities Division offered any rationale at that time for  
2 its position that the Company should receive 50 percent of the proceeds. Staff's sole  
3 witness in the original hearing, Mr. Millsap, testified that the settlement proceeds should be  
4 distributed 100% to the ratepayers and he refused to change his expert opinion or  
5 testimony.<sup>20</sup> He further testified that he did not analyze the need for the change of position  
6 and that no one on Staff provided him with information to support the change in position.<sup>21</sup>  
7 On rehearing, Staff witness, Elijah Abinah provided additional testimony. Mr. Abinah  
8 admitted that there was nothing wrong with the testimony offered by Mr. Millsap and that it  
9 was factually accurate. Staff offered as an option, the possibility of splitting the settlement  
10 proceeds if the Company would agree to split the proceeds from any future sale of Wells  
11 Nos. 8 and 9. The Company has agreed to do so.

12 RUCO respectfully disagrees with Staff's current position. First, Staff has given no  
13 rationale to support a 700 percent return on investment. Second, the Commission cannot  
14 prejudge the allocation of sale proceeds in this case based on an unknown and  
15 unmeasurable return in a future case. Third, the Company's agreement to share the  
16 proceeds from the sale of the Wells is a red herring. The Company testified that the Wells  
17 have no or nominal value.<sup>22</sup> In fact, both Company and Staff witnesses admit that the  
18 Company's current agreement with FHSD requires the Company to sell Well No. 8 to  
19 FHSD at no further cost. The Company's agreement to Staff's proposal that it split  
20 unknown and unmeasurable proceeds from Well No. 9 which is nominally valued and Well  
21 No. 8, which has no value for a 50 percent of share of \$1.52 million is not compelling. It is

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23 <sup>20</sup> OT: 416-417,

24 <sup>21</sup> *Id.*

<sup>22</sup> See Exhibit A-2 to the Original Proceeding, Hanford Rebuttal Testimony at 3-4.

1 unfair to expect ratepayers to forego \$760,000 of the Settlement Proceeds meant to  
2 mitigate the cost of replacement water in exchange for 50 percent of a nominal or \$0  
3 payment in the future. Last, the Commission must determine rates based on a finding of the  
4 fair value of the Company's assets.<sup>23</sup> A water utility is entitled a fair return on fair value of  
5 its properties devoted to public use, no more and no less.<sup>24</sup> The Company has already  
6 received full recovery of its investment long after the time at which, according to their  
7 witnesses, the property was no longer devoted to public use. A 700% return is not  
8 reasonable, particularly when one considers the Company has already received a full  
9 recovery of its investment. Considering these facts and that the future sales of Wells Nos. 8  
10 and 9 would provide no or nominal recovery to mitigate the cost of replacement water,  
11 fairness and the law necessitate rejection of the Staff's and the Company's proposal.

12 **2. The Commission should not compel ratepayers to pay for the**  
13 **shareholders' appeal and subsequent remand proceeding.**

14 The Company seeks \$100,000 in compensation for attorney's fees and costs for  
15 both the appellate and remand proceedings. RUCO respectfully disagrees with any award  
16 of fees as compensation for the appellate court action Chaparral City Water v. ACC, et al.,  
17 Case No. CC-CA 05-0002 or the subsequent remand because it would undermine good  
18 public policy and is patently unfair to ratepayers. The shareholders' pursuit of the appeal  
19 was discretionary. The Company's goal is to increase shareholder returns. Ratepayers  
20 should not also have to pay for the Company's pursuit of greater shareholder returns. This  
21 goal is contrary to ratepayers' interests. RUCO objects to legal expense associated with  
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24 <sup>23</sup> Arizona Constitution, Article 15 §§ 3 and 14.

<sup>24</sup> Arizona Corp. Commission v. Arizona Water Co. 85 Ariz. 198, 335 P.2d 412 (1959).

1 appeal actions or subsequent remand proceedings when the sole function of the action was  
2 the pursuit of additional returns for shareholders.

3 The Company purports to have spent \$500,000 to pursue the appeal and remand.  
4 RUCO recognizes that the utility has the right to appeal. However that right should not be  
5 likened to a guaranteed ability recover fees and costs associated with the decision to  
6 appeal. The Company's decision to appeal should have been prudent and included the  
7 proper weighing and balancing of the costs and benefits. It did not.

8 The Company sought the appeal on multiple grounds. The cumulative intent of the  
9 litigation was to achieve a greater rate of return for shareholders. The Court of Appeals  
10 denied relief on all grounds and did not issue a final judgment based on a full adjudication  
11 on the merits. Instead, the Court remanded the matter to the Commission for  
12 redetermination of the fair value rate of return. After remand proceedings concluded, the  
13 Company's shareholders derived an additional \$12,000 in required revenue. Clearly the  
14 expenditure of \$500,000 plus to recover \$12,000 was an imprudent decision.

15 Permitting a utility to recover its rate case expense for an appeal intended solely to  
16 benefit shareholders leaves utilities with the expectation that they can pursue any lawsuit  
17 with no worry of the costs associated therewith because captive ratepayers will pick up the  
18 tab. A policy which compensates utilities for the pursuit of shareholder lawsuits encourages  
19 a lack of restraint, and prudence. Such a policy undermines the appropriate cost benefit  
20 analysis of the risks and benefits of litigation which should be undertaken by all litigants  
21 regardless of their monopoly status and particularly when the litigant is a monopoly. To  
22 grant the Company's its fees and costs, here, would signal to all utilities that they get a free  
23 bite at the apple, without the required cost/benefit analysis, on the ratepayers' dime. The

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1 fact that the Company spent \$500,000 to recover an additional \$12,000 in required revenue  
2 could not be clearer proof of RUCO's concerns. RUCO believes that, consistent with good  
3 public policy, the Company should pay the costs for its business decision to pursue an  
4 appeal for its shareholders and therefore, its request for rate case expense associated with  
5 the appeal and subsequent remand should be denied.

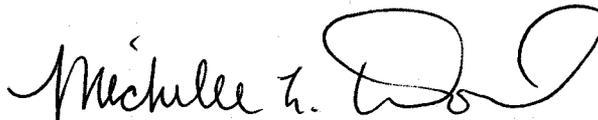
6 The Company asserts that the ratepayers should nonetheless share the  
7 shareholder's costs of appeal and remand. RUCO disagrees. The Company requested  
8 \$280,000 in rate case expense for the underlying rate case and received 100 percent of its  
9 request. The Company claimed to have spent \$30,000 in attorney's fees and costs in  
10 negotiating the FHSD Settlement Agreement. The Company received 100 percent of the  
11 amount it claimed to have spent. The Company did not propose the notion of sharing these  
12 expenses. RUCO is not opposed to the sharing of rate case expense and is likely to  
13 propose the sharing of rate case expense in future cases. However, it would be unfair and  
14 inconsistent to propose the notion of sharing rate case expense here, given that the  
15 Company's shareholders did not share in the rate case expenses associated with this case,  
16 Case no. 07-0551 or the negotiation of the FHSD settlement. Based on the foregoing,  
17 RUCO respectfully requests that the Commission reaffirm its prior decision and deny the  
18 Company's request for an additional \$100,000 for rate case expense.

19 **C. CONCLUSION**

20 RUCO disagrees that the FHSD settlement proceeds should be divided equally  
21 between shareholders and ratepayers. Shareholders have received recovery of and on  
22 their investment in Wells Nos. 8 and 9 and are legally entitled to no more. RUCO asserts  
23 that the Company's request for legal fees for the appeal and remand be denied as a matter  
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1 of fairness and public policy. Accordingly, RUCO respectfully requests that the  
2 Commission reaffirm its prior decision and deny the Company all requested relief.

3  
4 RESPECTFULLY SUBMITTED this 24<sup>th</sup> day of May 2010.

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7 Michelle L. Wood, Counsel  
8 Residential Utility Consumer Office

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10 AN ORIGINAL AND THIRTEEN COPIES  
11 of the foregoing filed this 24<sup>th</sup> day  
12 of May 2010 with:

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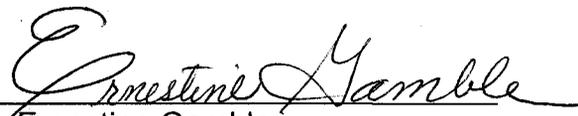
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