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AZ CORP COMMISSION
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DOCKET NO. W-02886A-10-0369

IN THE MATTER OF THE
APPLICATION OF KOHL'S RANCH
WATER COMPANY FOR AN
EMERGENCY RATE INCREASE.

Arizona Corporation Commission

DOCKETED

OCT 20 2010

MEMORANDUM IN SUPPORT
OF MOTION TO INTERVENE
AND STATEMENT OF
POSITION BY KOHL'S RANCH
HOMEOWNERS ASSOCIATION

DOCKETED BY

I. The "Emergency" Is Only the Result of Past Mismanagement of the Water Company.

In the entire history of the Kohl's Ranch Water Company ("KRWC"), it has never functioned as a "real" utility. Rather, water service has consistently been treated as an incidental service of whoever happened to own the Kohl's Ranch Resort. Since 1955, water service has always been owned by the Resort and has always been treated as an inseparable function of that ownership. As a result, the homeowner/customers ("homeowners") have never had a full understanding of the operations of the water company or even of what assets the water company controls. While the water company has been a separate corporation and has been a regulated utility of the ACC, its ownership, actions, rates, and behavior have been completely opaque to its customers.

In 1995, the Resort realized that the water company had even legally ceased to exist. At that time, because the Resort was being sold to ILX, the KRHOA wrote the ACC expressing concern about the separation between the water company and the Resort. A copy of this letter is attached. This letter did not object to the recreation of the water company as a regulated utility holding these assets but rather expressed concern long-term about the potential separation of the water company from the Resort.

As we come to the matter now before the ACC, it is exactly what the homeowners have feared since 1995. Suddenly in the context of an emergency hearing the fact that the KRWC has never been operated as a genuine utility business is coming home to roost. But because of the lack of separate identity of the water company, and the complete confusion of what the water company actually owns and what the cost of operating the water company actually is, the homeowners suddenly find themselves before the ACC facing a **rate increase of nearly 800%**.

The KRHOA is not opposed to some kind of reasonable rate increase. The Association realizes that the rates have been kept artificially low for a long period of time because of

the failure to operate this as a true utility business. However, the KRHOA has two overriding points in its intervention:

First, no rate increase should be granted until many questions about the water company have been answered more clearly. Second, the rate increase request before the Commission at this time does not appear to be reasonable.

II. No Rate Increase Should be Granted Until Many More Questions are Answered about KRWC.

This rate increase request really represents the first time the KRWC has ever attempted to account for its actions as an independent regulated utility. This is the first time that the KRWC has provided to its customers even the slightest degree of transparency in its operations.

For example, over the years various capital improvements have been made without any understanding by the homeowners of whether these improvements were made by the Resort or by the water company. There is, for example, a large storage tank used primarily for fire suppression which the homeowners were told was built by the Resort as a requirement of its fire insurance. Whether that tank is owned by the Resort or by the water company has never been clear.

There were storage tanks located next to the old Arizona Highway 87, which were demolished by ADOT and some kind of condemnation compensation was made either to the Resort or the water company but the homeowners have never known which. For years the homeowners were told those tanks would be replaced but they never were.

The homeowners have understood that there are two sources of water to the small Kohl's Ranch community. One is a spring at Indian Gardens and the second is a well. At various times in the history of KRWC homeowners have been told that the spring is part of the water company but the well is owned separately and independently by the Resort. More recently, in the filings made in this case, the well is identified as part of the KRWC assets.

It is imperative that the KRWC clearly specify all of its assets, so that going forward any potential buyer and the customers are aware of exactly what the water company owns. At a minimum, this must include the spring, the well, all of the storage tanks, the pipes for both water delivery and the fire suppression system.

The Indian Garden Spring is utilized by the water company under a permit from the Forest Service. That permit specifies that it is issued specifically to ILX and is not transferrable to a new entity. **It is imperative that the position of the Forest Service with regard to the permit for the Indian Garden Spring be clarified in connection with listing the spring as an asset.**

If KRWC proposes to use some portion of this massive increase for maintenance and capital improvements (which would be desirable) we believe they should present at least some plan for anticipated improvements before the increase is granted.

The final question which must be answered before any rate increase can be reasonably considered is what the actual cost of operating the water company has been. This is virtually impossible to tell from the filings. The filing shows operating income in 2009

as \$10,011. This is not broken out as to source. If \$10,011 were divided by the approximately 120 residential meters and then divided by 12 months it would represent only \$6.95 per month per resident. This would mean the Resort has paid nothing. Yet in another part of the filing (final page table), the Resort is said to have been charged a minimum of \$65 per month in 2009. Why are these payments not shown as operating income?

The filing shows operating expenses paid directly by ILX of \$51,953. Is this how the Resort has "paid" for its water? Has the Resort been paying nothing for its utility service, but simply been covering some operating expenses of the water company? If this is the case, the fact that the water company showed a 2009 total loss of \$58,627 is largely meaningless.

The emergency rate filing is designed to produce an "extra" \$80,000 in annual revenue. But the documentation provided by KRWC is so sketchy, and the past practices so lax, that this number is not justifiable. KRWC should be required to provide a clearer explanation of its past practices.

III. The Requested Rate Increase is Excessive, and based on a Highly Speculative Budget.

While it is extremely difficult to figure out exactly what the justification is for the rate increase because there is no history of utility operations to rely on, it is clear that as requested the rate increase is excessive. As mentioned previously the rate since at least the early 1970's has been \$5.75 for 5,000 gallons per month plus .50 cents for each 1,000 gallons thereafter. The proposed rate increase is a flat monthly surcharge of \$36.00 to all residents on top of the existing \$5.75 plus .50 cents per 1,000 over 5,000. At a minimum, therefore, the rate increase for individual homeowners would go from \$5.75 per month to \$41.75 per month, a **rate increase of 726%**. On a percentage basis this is surely one of the largest rate increases in the history of the Arizona Corporation Commission. The filings made to date offer insufficient support to justify this massive increase.

A. KRWC has not met the burden of justifying its request for increased revenue.

The rate increase is predicated on KRWC's stated "need" to produce approximately \$80,000 in additional annual revenue. This is beyond the \$10,000 in operating income for 2009. This need for an additional \$80,000 in revenue is based on estimated expenses provided by the KRWC in its rate filing. The KRHOA believes that many of these expenses are excessive. They are certainly difficult to understand and represent only very vague estimates. Examples of unclear and potentially excessive expenses include:

1. Salaries and wages of \$355/month. In the past, meters have been read and repairs have been made by employees of the Resort. KRHOA does not understand if KRWC proposes to contract with the Resort, obtain part-time other employees, or what basis there is for a \$400/month salary and wage charge.
2. Power costs. We believe the power costs are related to the operation of the pump at the well site. In the past, the homeowners have been told that the well is the property of the Resort and not of the water company. We believe the well is and should be property of the water company. No

explanation is made if this power cost is directly related to the well and is the full cost of operating the pump.

3. Repairs and maintenance. The proposed budget shows repairs and maintenance of \$600 per month. The KRHOA is very concerned that the system has not been well maintained in the past and above all else we want it to be safe, maintained, and reliable. But we see no justification offered for this \$600 per month expense.

4. Outside services. The outside service budget is particularly troubling. It is shown as being nearly \$50,000 in 2009 or \$4,000 per month. This is apparently on top of the \$400 per month wages for an employee. Reading all of the meters of the water company is approximately a six hour task (based on talking to the current meter reader). In the winter months most of the meters do not even need to be read. We cannot, therefore, understand how these expenses could be so high. In addition, it appears that the budget proposed has an additional \$1,700 a month for a daily operator, \$3,000 a month for a billing person, and \$500 a month in legal expenses.

In summary, the KRHOA understands that there is a need for the water company to be more businesslike and to take in more revenue. Based on the existing filings, however, we do not believe that the target of an additional \$80,000 in annual revenue has been justified.

B. The proposed rate places too much burden on the homeowners relative to the Resort.

Perhaps the thorniest question raised by this request is how to apportion the cost of the water company between the Resort on the homeowners. Because the Resort has apparently never been charged for water this issue has never previously been faced. The filing states that the Resort has been paying an average of \$65 for approximately 125,000 gallons per month. But as previously noted the overall operations of the utility company have not made clear if this \$65 has actually been credited to the operational accounts of the utility. In any event, the Resort has certainly been underpaying for water for its entire history. The Resort is a commercial operation which runs year round. In the last few years under ILX's ownership, the Resort has added acres and acres of grass lawn and extensive planting areas far beyond what any of the homeowners have done—probably far beyond what all the homeowners put together have done in terms of landscaping. The Resort uses high amounts of water to amenitize its commercial operations as an attraction. It has the only swimming pool in the area and has a restaurant which operates daily year round.

The principal proposed change in rates is a flat surcharge--\$36 per month for homeowners, \$2,160 per month for the Resort. This means the total homeowner surcharge is \$4,464 per month while the total resort surcharge is \$2,160. In other words, the KRWC plan is to load 2/3 of the "emergency" onto the homeowners, and 1/3 onto the Resort.

This proposal is upside down. The KRHOA suggests a more equitable allocation of any surcharge is 1/3 on the homeowners, and 2/3 on the Resort. The Resort, after all, operates year round and draws far more water than all the homeowners put together.

This is particularly appropriate in light of the fact that it is the decision of the buyer of the Resort from ILX to “cut loose” the water company. Had the buyer decided to acquire the water company it could have chosen to continue the internal subsidy that ILX and the other owners have done in the past. If it is not doing so however, and if the water company must now stand on its own, that is the decision of the buyer of the Resort which has resulted in this “emergency need.”

The proposed rate does project a higher monthly charge to the Resort for water in the future. However, on a per gallon basis the Resort winds up paying, by KRWC’s own estimates (final page of KRWC filing), \$17.87 per 1,000 gallons versus each homeowner paying \$17.48 per 1,000 gallons. This gallonage charge is the result of a nearly equivalent cost per gallon applied to the homeowners (\$.0175 per gallon) and the Resort (\$.0179). This is a meaningless incremental difference. The Resort should pay a significantly higher charge per gallon. Progressive block prices should also be considered for both types of users.

C. The homeowner rate should have a lower base charge, more like other comparable utilities.

The proposed emergency rate increase simply slaps a \$36.00 per month surcharge on every customer year round. The KRHOA believes this is an unfair and inappropriate way to begin the transition to the KRWC being managed as a true utility. There are several reasons for the KRHOA’s position that this is an inappropriate tool.

There are only about 10 full-time residents at Kohl’s Ranch. Most of the summer home residents shut off their water system for most winter months, drain their pipes, and use no water at all. Under the proposal, however, their charges would go from the existing \$5.75 a month for month’s in which they use no water to \$41.75 for months in which they use no water. This is in contrast to other utilities in the immediate area which serve summer home communities which have a lower monthly base rate:

Community	Location	Base Rate
Tonto Village Water Company	Approximately 3 miles from Kohl’s Ranch	\$10/month
Tonto Creek Water Company	Directly across Highway 260 from Kohl’s Ranch	\$24/month
Utility System LLC/Christopher Creek	Approximately 6 miles from Kohl’s Ranch	\$18.80/month
Brook Utilities/Tonto Basin	Tonto Basin (+/- 45 miles)	\$16/month
Gardner Water Company	Colcord Area (+/- 10 miles)	\$18.80/month

Given these comparisons and the seasonal nature of usage, the KRHOA believes that a lower base rate should be established for the KRWC.

An additional monthly surcharge to the homeowners of \$10.00 per month would take the monthly base rate from \$5.75 to \$15.75. This is still a 300% increase for most of the homeowners. But it is much more in line with other utilities in the area and represents a more equitable split between the Resort and the

homeowners. In the sound operation of a utility business the homeowners also believe that it may be more appropriate to create a more steeply progressive rate structure for water used in excess of 5,000 gallons. This more progressive structure would be appropriate both at the Resort and for those homeowners who choose to add significant landscaping to their properties.

IV. Conclusion

Since the early 1950's when the Kohl's Ranch subdivision began the homeowners have been served by the water system built by the Kohl's Ranch Resort and Lodge. The service has had problems over the years. There have been interruptions, low water pressure, quality problems, and inconsistent maintenance. But year in and year out service has been maintained and has been extremely inexpensive. This is the result of the recognition by the Kohl's Ranch Resort that water service is so critical to its year round operation that it needed to heavily subsidize the water company. Now the KRWC proposes to embark on a new era where it is a separate stand alone utility. That represents a dramatic change.

It is of paramount importance to the KRHOA that the system be reliable, safe, and well maintained. The homeowners recognize, therefore, that rates will need to increase. But the "emergency" which brings this issue before the Commission is the result of the decision by the potential buyer of the Resort not to purchase the water company coupled with the extremely lax management practices of the water company for the last 60 years. Neither of those issues is the doing of the homeowners. It is not appropriate to penalize the homeowners by increasing rates by a factor of 750%. Rather, the Commission should order:

1. That before any rate increase is granted the KRWC must provide a clearer accounting of its assets.
2. Before any rate increase is granted the KRWC must more clearly justify its proposed budget in light of past expenses.
3. Before any rate increase is granted the KRWC should provide a list of proposed maintenance and capital improvement items.
4. The need for additional revenue should be much more heavily placed on the Resort since it is the primary user of the water system, since it operates year round, and since its use is much more extensively for landscaping. KRHOA suggests any surcharge proposed be split 2/3's to the Resort and 1/3 to the homeowners rather than the other way around as is proposed by KRWC.
5. The homeowner rate should not be allowed to increase dramatically beyond that of other small summer home utility in the area. That standard suggests the base rate for homeowners should be approximately \$15.00 per month.
6. The KRWC should establish more progressive per gallon charges over the base minimum amount. Separate progressive rates should be applied to the Resort and to the homeowners.

GAMMAGE & BURNHAM P.L.C.

By 
Grady Gammage, Jr., AZ Bar #4552
Two North Central Avenue, 15th Floor
Phoenix, Arizona 85004
Attorneys for Interveners
Tele: (602) 256-4469
Fax: (602) 256-4475
Email: ggammage@gblaw.com

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ARIZONA CORPORATION COMMISSION
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1200 West Washington Street
Phoenix, AZ 85007

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Arizona Reporting Service, Inc.
2200 N. Central Avenue, 502
Phoenix, SAX 85004-1481

Margaret B. LaBianca
Malbeth M. Klein
POLSINELLI SHUGHART PC
One East Washington, Suite 1200
Phoenix, AZ 85004

Nancy J. Stone, President
KOHL'S RANCH WATER COMPANY
c/o ILX Resorts Incorporated
2111 E. Highland Avenue, Suite 200
Phoenix, AZ 85016

Steve Olea, Director
Utilities Division
ARIZONA CORPORATION
COMMISSION
1200 West Washington Street
Phoenix, AZ 85007

Janice Alward, Chief Counsel
Bridget Humphrey, Staff Attorney
Legal Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street

Lynn Farmer
ARIZONA CORPORATION
COMMISSION
1200 West Washington Street
Phoenix, AZ 85007

KRHOA Memorandum
Docket No. W-02886A-10-0369
Phoenix, AZ 85007

Signed Terri J. McEuan

Jerry Rudibaugh
Chief Hearing Officer
Arizona Corporation Commission
April 27, 1995
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The Association does not object to the transfer of the assets of the Water Company into a corporation, which is the narrow request before the Commission in the application filed on April 7, 1995. The Water Company has been a separate corporation throughout most of its life and apparently ceased being a corporation only by operation of a 25-year expiration period in its original articles. Transferring the Water Company back into a corporation from Mr. and Mrs. Griffiths is acceptable to the Association. The Association is concerned about the ultimate disposition of the Water Company as part of the pending sale of Kohl's Ranch Resort to ILX, Inc., as has been reported in the newspapers. The Association's purpose in writing the Commission is to express opposition only to any potential separation of the assets of the Water Company from the Resort operation.

The primary water system for the homeowners is a spring-fed system from the Indian Gardens spring. During times of moderate drought that system has, in the past, proved seriously inadequate to supply the water demands of all of the homeowners. As a result, in the mid-70's, early 1980's and in 1986 there were pressure inadequacies and water shortages. This situation was exacerbated when State Route 260 was widened next to Kohl's Ranch Resort. As a result of that project, ADOT removed two auxiliary tanks and connecting lines from across the highway from the water system. We understand that the current owner of the Water Company has had a claim against ADOT to replace these tanks and connecting water lines, but that to date no resolution has occurred. If the Water Company were to be left with only the spring-fed system, particularly without the auxiliary tanks which had once existed, the situation would be intolerable for the homeowners.

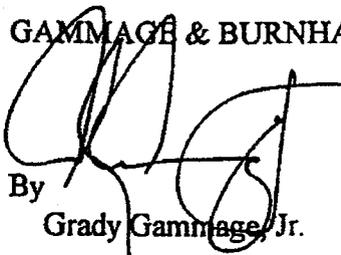
For the last several years (we believe since approximately 1986) the original spring-fed water system has been directly tied into a well, and a 200,000 gallon storage tank and booster pump located on the Resort property and constructed primarily to directly serve the Resort. The Association believes that it has been the position of past owners of the Resort that the well, storage tank and booster pump are the property of the Resort and not of the Water Company. Because of the inter-tie and the critical nature of these facilities as a past and current part of the overall operating water system, the Association is concerned regarding any potential separation of these elements from the assets of the Water Company. In the event these assets were sold with the Resort and the Water Company were to be owned separately, we believe that continuing reliable service to the homeowners would be severely jeopardized.

Jerry Rudibaugh
Chief Hearing Officer
Arizona Corporation Commission
April 27, 1995
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The Association does not object to the sale of all of the assets of the Water Company with the resort to a third party. Indeed, we are supportive of ILX's proposal to upgrade and renovate the existing resort operation. We do believe, however, that the assets of the Water Company should be clearly set forth and should include all critical elements of the water system.

Sincerely,

GAMMAGE & BURNHAM P.L.C.



By
Grady Gammage, Jr.

GG/mj

cc: Renz Jennings
Marcia Weeks
Carl Kunasek
Gary Yaquinto, Director Utilities Division
Skip Wallach, ILX, Inc.
Ray Heyman