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OPEN MEETING AGENDA ITEM



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BEFORE THE ARIZONA CORPORATION COMMISSION

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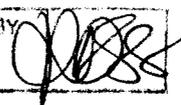
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Arizona Corporation Commission

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AZ CORP COMMISSION  
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FEB 22 2011

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IN THE MATTER OF THE APPLICATION OF  
CHAPARRAL CITY WATER COMPANY,  
INC., AN ARIZONA CORPORATION, FOR A  
DETERMINATION OF THE FAIR VALUE OF  
ITS UTILITY PLANT AND PROPERTY AND  
FOR INCREASES IN ITS RATES AND  
CHARGES FOR UTILITY SERVICE BASED  
THEREON.

Docket No. W-02113A-07-0551

**RUCO'S EXCEPTIONS**

The Residential Utility Consumer Office ("RUCO") offers these Exceptions and requests that the Commission reaffirm its prior Decision and deny the relief requested by the Company.

**A. Background**

The Chaparral City Water Company, Inc. ("Company") entered into a settlement agreement with Fountain Hills Sanitation District ("FHSD") regarding the contamination of Wells Nos. 8 and 9. Pursuant to the FHSD settlement agreement, ("settlement" or "agreement"), the Company received \$1.52 million ("Settlement Proceeds"), agreed to give a 15-year option to purchase Well No. 8 for no additional compensation and gave up the use of Well No. 9. By the settlement, the residential ratepayers lost a source of irrigation revenues previously generated

1 from Well No. 8 which mitigated residential rates. Moreover, the settlement provides no  
2 replacement water or wells to compensate for the loss of use of Wells Nos. 8 and 9.

3 **1. The Company's failure to provide notice to customers precludes**  
4 **modification of rates.**

5 The Company requested rehearing, but failed to meet notice provisions which would  
6 permit a modification of the existing decision.<sup>1</sup> Commission rule R14-2-105 requires "every  
7 public service corporation **shall** give notice to customers.<sup>2</sup> affected of **any** hearing at which the  
8 fair value of that corporation's property is to be determined and just and reasonable rates and  
9 charges are to be established." This rehearing involved the determination of the fair value of  
10 the Company's property, just and reasonable rates and will affect the interests of the  
11 Company's customers. Because the Company did not provide notice of the rehearing, the  
12 ROO should be rejected and the Commission should reaffirm its prior Decision.

13 **2. Approval of the ROO sets bad Commission precedent.**

14 The Company requested rehearing. The Company had the burden of presenting its  
15 case. The Company failed to present any witnesses or testimony on direct. Instead, RUCO  
16 was directed to show why the Company's application should be denied, essentially shifting the  
17 burden of proof before the Company had met its initial burden. The rehearing was procedurally  
18 flawed and it would set bad Commission precedent going forward.

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21 <sup>1</sup> Rehearing Transcript at 7, ll. 4.

22 <sup>2</sup> Customer is defined as "the person or entity in whose name service is rendered, as evidenced by the signature  
23 on the application or contract for that service, or by the receipt and/or payment of bills regularly issued in his  
24 name regardless of the identity of the actual user of the service." The definition of customer includes those  
specific persons or entities that had contracts for service at the time of rehearing. Notice to customers who  
existed at the time of the original hearing does not satisfy the requirements of R14-2-105. To satisfy the  
requirement, the Company should have noticed the specific customers who existed at the time of rehearing and  
did not.

1           **3. The ROO affords American States' shareholders an unreasonable and**  
2           **excessive return.**

3           Adopting the ROO would result in an excessive return for Chaparral's shareholders. In  
4 the Bluefield and Hope decisions, the Supreme Court held a public utility that is efficiently and  
5 economically managed is entitled to recover the cost of its investment and the opportunity to  
6 earn a reasonable return thereon.<sup>3</sup> Arizona courts have held similarly, finding that a water utility  
7 is entitled a fair return on fair value of its properties devoted to public use, no more and no  
8 less.<sup>4</sup> Robert Hanford, the Company's district manager, admitted that Well No. 8 went into  
9 service in 1971 and had an original cost of \$49,329.<sup>5</sup> He also admitted that Well No. 9 went  
10 into service in 1972 at an original cost of \$54,139.<sup>6</sup> The Company's total investment in Wells  
11 Nos. 8 and 9 is \$103,468.00. Of that amount, Mr. Hanford testified 100% has already been  
12 recovered from ratepayers. He testified:

13           *...both wells were constructed over 36 years ago and have been fully depreciated*  
14           *and have no impact on rate base in the instant case.*<sup>7</sup>

15           By its own admission, the Company has fully recovered the cost of Wells Nos. 8 and 9  
16 and received a reasonable return thereon. The Company asks the Commission to ignore that  
17 it has already recovered 100 percent of its investment and a reasonable return thereon and  
18 grant it 50 percent of the Settlement Proceeds or \$760,000. The ROO adopts the Company's  
19 position and recommends the Company recover \$760,000 on its \$103,000 investment which is  
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21 <sup>3</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).

22 <sup>4</sup> Arizona Corp. Commission v. Arizona Water Co. 85 Ariz. 198, 335 P.2d 412 (1959).

23 <sup>5</sup> See Rehearing Exhibit R-3 Company's Response to Staff DR MEM 7.3.

24 <sup>6</sup> Id.

<sup>7</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 tantamount to a 700 percent return. Ratepayers are required to pay a “reasonable” return on  
2 investment.<sup>8</sup> Allowing the Company a return of this magnitude is unreasonable and results in a  
3 windfall to the shareholders. RUCO respectfully requests that the Commission reject the ROO  
4 and reaffirm its prior decision.

5 Allowing this type of return is particularly egregious given what has transpired since the  
6 Commission issued its original Decision. Chaparral is currently owned by American States.  
7 However, American States recently sold Chaparral to Epcor for \$35 million or about \$9 million  
8 above book value. Although the sale is subject to the Commission’s approval, a hearing has  
9 been held in which both RUCO and Staff supported the sale subject to a few conditions. If the  
10 sale is approved, American States’ shareholders stand to gain \$9 million dollars from the sale  
11 of the Company. Allowing American States’ shareholders to share 50/50 in the Settlement  
12 Proceeds is unfair and unreasonable given that the shareholders will earn a \$9 million profit or  
13 25% from the sale of Chaparral, if the sale is approved by the Commission.

14 **4. Adopting the ROO would be unfair and unreasonable because**  
15 **ratepayers did not receive replacement water and infrastructure.**

16 Mr. Hanford testified that the purpose of the settlement was to replace water that Well  
17 No. 9 would produce over the remainder of its useful life.<sup>9</sup> The Company claimed that  
18 consistent with Decision No. 66849, the Commission should allocate 50% of the Settlement  
19 Proceeds to the shareholders.<sup>10</sup> The ROO adopts the position, ignoring important factual  
20 distinctions.

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<sup>8</sup> Id.

23 <sup>9</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>7</sup> In the Matter of Arizona Water, Docket No. W-01445A-02-0619, Decision No. 66849.

1 Although both cases involve distribution of settlement proceeds to compensate for the  
2 contamination of wells, in Decision No. 66849, Arizona Water received replacement wells which  
3 produced water equal to or above the amount of wells it lost to contamination. In that case, the  
4 ratepayers did not have to pay additional rates to secure an alternative water source or build  
5 new infrastructure.

6 In Chaparral, the Company did not get a replacement water supply. In fact, in Chaparral,  
7 the Commission has authorized recovery of \$1.28 million for the cost of an additional CAP  
8 water allocation from its ratepayers.<sup>11</sup> The entire amount has been placed in rate base as a  
9 deferred regulatory asset. Id. Ratepayers will pay more than 100% of the cost of the additional  
10 CAP allocation because the current order treats the allocation as a deferred regulatory asset  
11 and allows the Company a return on the deferred regulatory asset in perpetuity. Id. Because  
12 the Company admits that the Settlement Proceeds were for replacement water, the settlement  
13 proceeds should be used to mitigate the \$1.28 million cost of replacement water. The  
14 Commission should reject the ROO and reaffirm its prior decision which recognizes that  
15 ratepayers' additional burdens should be mitigated by a distribution of 100 percent of the  
16 Settlement Proceeds.

17 **5. The ROO's allocation of 50 percent of the future sale proceeds from Well**  
18 **No. 8 is misleading and unfair.**

19 The ROO justifies a 50/50 split of settlement proceeds by arguing that ratepayers will be  
20 able to recover 50 percent of the future sales proceeds of Wells No. 8 and 9 ignoring the actual  
21 expected value from future sales. The FHSD settlement agreement allows the FHSD a 15-year  
22 option to purchase Well No. 8 for no additional sums. Therefore, ratepayers will not recover

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24 <sup>11</sup> In the Matter of Chaparral City Water Co., Docket No. W-02113A-07-0551, Decision No. 71308.

1 anything in the future from the sale of Well No. 8. At the same time, the Company has given up  
2 a source of irrigation revenues which mitigated residential ratepayers' rates. As William Rigsby,  
3 RUCO's witness testified, Well No. 8 was an irrigation well used to supply water to the well-  
4 known fountain in Fountain Hill's park.<sup>12</sup> The revenues the Company generated from irrigation  
5 water sales to Fountain Hills, allowed the Company to charge lower rates to its residential  
6 customers.<sup>13</sup> Because the sale of Well No. 8 will generate no additional revenues and the  
7 ratepayers will be paying higher rates as a result in the loss of Well No. 8 revenues, the ROO is  
8 simply unfair.

9 **6. The ROO ignores the fact that the Company has already recovered 100**  
10 **percent of its fees and costs associated with the settlement .**

11 The Company argued that a failure to provide it with 50 percent of the proceeds will  
12 serve as a disincentive for utilities to spend legal fees to pursue legal remedies if they are not  
13 allowed to share in the recovery.<sup>14</sup> The ROO accepts that position and ignores that the existing  
14 decision already allows full recovery of legal fees. The Company sought and received 100  
15 percent recovery of the \$30,000 in attorneys' fees and costs incurred in negotiating the  
16 agreement in the existing order. RUCO did not object to the expense. The ROO ignores that  
17 fact. Because the Company has recovered 100 percent of its legal expense, the Commission  
18 should reject the ROO and reaffirm its current decision.

19 **B. The Commission should not compel ratepayers to pay for the shareholders'**  
20 **appeal and subsequent remand proceeding.**

21 The Company seeks \$100,000 in compensation for attorney's fees and costs for  
22 both the appellate and remand proceedings. RUCO respectfully disagrees with any award of

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23 <sup>12</sup> RT: 8-9.

24 <sup>13</sup> Id.

<sup>14</sup> OT: 141

1 fees as compensation for the appellate court action Chaparral City Water v. ACC, et al., Case  
2 No. CC-CA 05-0002, or the subsequent remand because it would undermine good public policy  
3 and is patently unfair to ratepayers. The shareholders pursued the discretionary appeal to  
4 increase shareholder returns. Ratepayers should not have to pay for the Company's pursuit of  
5 greater shareholder returns. This goal is contrary to ratepayers' interests. RUCO objects to  
6 legal expense associated with appeal actions or subsequent remand proceedings when the  
7 sole function of the action was the pursuit of additional returns for shareholders.

8 **C. CONCLUSION**

9 RUCO disagrees that the FHSD settlement proceeds should be divided equally  
10 between shareholders and ratepayers. Shareholders have received recovery of and on their  
11 investment in Wells Nos. 8 and 9 and are legally entitled to no more. RUCO asserts that the  
12 Company's request for legal fees for the appeal and remand be denied as a matter of fairness  
13 and public policy. The Company failed to properly notice the rehearing in compliance with R14-  
14 2-105 and therefore is precluded from obtaining a modification of the ROO. Accordingly,  
15 RUCO respectfully requests that the Commission reaffirm its prior decision and reject the ROO.

16 RESPECTFULLY SUBMITTED this 22<sup>nd</sup> day of February 2011.  
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20 Michelle L. Wood, Counsel  
21 Residential Utility Consumer Office  
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1 AN ORIGINAL AND THIRTEEN COPIES  
2 of the foregoing filed this 22<sup>nd</sup> day  
3 of February, 2011 with:

3 Docket Control  
4 Arizona Corporation Commission  
5 1200 West Washington  
6 Phoenix, Arizona 85007

6 COPIES of the foregoing hand delivered/  
7 mailed this 22<sup>nd</sup> day  
8 of February, 2011 to:

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