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MEMORANDUM

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TO: Docket Control
FROM: Ernest G. Johnson *EGJ*
Director
Utilities Division

Date: February 1, 2007

RE: STAFF REPORT FOR THE APPLICATION OF DESERT HILLS WATER COMPANY TO TRANSFER ASSETS TO THE TOWN OF CAVE CREEK AND CANCEL ITS CERTIFICATE OF CONVENIENCE AND NECESSITY.
DOCKET NO: W-02124A-06-0717

Attached is the Staff Report for the transfer of Desert Hills Water Company to the Town of Cave Creek and cancellation of its certificate of convenience and necessity. Staff recommends approval.

EGJ:LAJ:tdp

Originator: Linda A. Jaress

Arizona Corporation Commission
DOCKETED

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DOCKET NO. W-02124A-06-0717

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STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

DESERT HILLS WATER COMPANY
DOCKET NO. W-02124A-06-0717

TRANSFER OF DESERT HILLS WATER COMPANY TO
THE TOWN OF CAVE CREEK

FEBRUARY 1, 2007

STAFF ACKNOWLEDGMENT

The Staff Report for Desert Hills Water Company, Docket No. W-02124A-06-0717 was prepared by the Staff members shown below.



Linda A. Jaress
Executive Consultant III



Dorothy Hains
Utilities Engineer

**EXECUTIVE SUMMARY
DESERT HILLS WATER COMPANY
DOCKET NO. W-02124A-06-0717**

On May 17, 2005, the Town of Cave Creek (“Cave Creek” or “the Town”) held a special election which authorized up to \$50,000,000 of water and sewer bonds or loans from the Water Infrastructure Finance Authority of Arizona to provide funds to expand, extend and enlarge the Town’s sewer system and acquire, expand, extend and enlarge a water system. On September 12, 2006, the Town Council approved a resolution which authorized the Town to purchase Desert Hills Water Company (“Desert Hills” or “the Company”) and on that day, the Town acquired the stock of Desert Hills and began operating the Desert Hills system.

On November 8, 2006, Desert Hills (under the Town’s ownership) filed an application with the Arizona Corporation Commission (“the Commission”) for approval to transfer the ownership of the assets from Desert Hills to the Town and to cancel the Certificate of Convenience and Necessity (“CC&N”) of Desert Hills.

The Town has experience working with a contractor to operate a wastewater company. This experience will be relevant to the operation of the water company. The Town has the ability to make loans to acquire water companies through its voters’ approval. The stock of Desert Hills already belongs to the Town and the Town has owned the Company since September, 2006. The only immediate impact approval of this application will have is to cancel the stock and CC&N of Desert Hills and transfer the assets to the Town.

The Town has shown its intentions to maintain Desert Hills’ current rates for at least one year and to credit 189 customers for basic service charges paid during a period of outages. The Town also expects to contract with an affiliate of a large water company with several years of experience operating and maintaining water companies in Arizona. The Town has also described a system for responding to customer complaints or inquiries. Staff believes the Town is a fit and proper entity to receive and operate the assets of Desert Hills.

Staff recommends approval of the transfer of the assets of Desert Hills to the Town.

Staff further recommends the Commission cancel the CC&N of Desert Hills thereby extinguishing any compliance matters. However, Staff notes that if the assets are transferred and the CC&N cancelled, there will not be a holder of the CC&N against which the Commission could enforce the pending Order to Show Cause in Docket No. W-02124A-06-0379.

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
BACKGROUND	1
THE TRANSFER AGREEMENT	1
THE DESERT HILLS WATER SYSTEM	2
RATES AND CUSTOMER SERVICE	2
COMPLIANCE	3
SEWER SERVICE	4
CONCLUSIONS AND RECOMMENDATIONS	4

EXHIBITS

ENGINEERING REPORT	1
ENGINEERING MAP	2

INTRODUCTION

On May 17, 2005, the Town of Cave Creek (“the Town”) held a special election which ultimately authorized up to \$50,000,000 of water and sewer bonds or loans from the Water Infrastructure Finance Authority of Arizona to provide funds to expand, extend and enlarge the Town’s sewer system and acquire, expand, extend and enlarge a water system. On September 12, 2006, the Town Council approved a resolution which authorized the Town to purchase all of the common stock of Desert Hills Water Company (“Desert Hills” or “the Company”) for \$2.5 million and on that day, the Town acquired and began operating the Desert Hills system.

On November 8, 2006, Desert Hills (under the Town’s ownership) filed an application with the Arizona Corporation Commission (“the Commission”) for approval to transfer the ownership of the assets from Desert Hills to the Town and to cancel the Certificate of Convenience and Necessity (“CC&N”) of Desert Hills. On December 4, 2006, the Town authorized Mr. Abujbarah, the President of Desert Hills and the Town Manager, to transfer all of the assets of Desert Hills to the Town. Section 2 of the December 4th resolution gives the Town the right to terminate the Transfer Agreement “in the event that the Town, in its sole discretion, determines that unacceptable conditions might be or have been imposed on the transfer by any regulatory agency.”

If the application for approval to transfer the Desert Hills assets to the Town is approved, Desert Hills will no longer be regulated by the Commission.

BACKGROUND

The recent history of Desert Hills is fraught with water shortages, outages, poor customer service and customer complaints resulting in expensive, prolonged reviews, status updates, negotiations, and hearings involving the Commission, Global Water Resources (“Cave Creek Water Company”) and Arizona American Water Company (“Arizona-American”). Docket No. W-02124A-06-058 et al. addressed an interconnection with Cave Creek Water Company and Arizona-American Water Company. Docket No. W-02124A-06-0379 is an Order to Show Cause proceeding regarding Desert Hills’ failure to comply with Commission rules and regulations.

THE TRANSFER AGREEMENT

The November 7, 2006 Transfer Agreement between Desert Hills and the Town, would change the Company from a public service corporation into a municipal utility. In Section 3.5 of the Agreement, the Town agrees to fulfill several “obligations” including the following:

1. Provide 189 customers credit for monthly minimum charges for water service paid from June through September, 2006 due to service interruptions during that time.
2. Charge Desert Hills’ current rates and charges for a period of one year from closing.

3. Continue efforts to bring the water distribution system into compliance with Maricopa County Environmental Services Department and Arizona Department of Environmental Quality rules and regulations.
4. Continue efforts to address long-term water supply needs for customers previously served by Desert Hills.
5. Ensure that the Town's website will give water customers access to important information in the provision of water service.

Although the Town's agreement to fulfill the obligations listed may be reassuring, it should be noted that the agreement is between the Town and itself, and will be self-enforced.

THE DESERT HILLS WATER SYSTEM

The Desert Hills water system is comprised of three wells having a combined production rate of 640 gallons per minute, five storage tanks having a combined capacity of 1.01 million gallons and a distribution system serving approximately 1,630 customers. According to the Staff Engineering Report attached as Exhibit 1, the Desert Hills' wells do not produce enough water to serve existing customers. To supplement its well production, Desert Hills has interconnected with the Anthem District system of Arizona-American and also has an emergency interconnection with neighboring Cave Creek Water Company. The connection to Arizona-American is not currently provided for in a contract. However, Desert Hills has represented that it is in the final stages of negotiating a long term water acquisition agreement with Arizona-American. At December 11, 2006, the Town was also in the final stages of negotiating an Operations and Maintenance Agreement with American Water Operations and Maintenance, Inc., an affiliate of Arizona-American Water Company, to operate the Desert Hills system.

The Town is also finalizing an agreement to settle a condemnation proceeding against Cave Creek Water Company (owned by Global Water Resources) and to acquire it. According to the Town, the acquisition of Cave Creek Water Company will drive the Town's long-term plans to provide water to all customers with one integrated system.

A map of the Desert Hills service territory is attached as Exhibit 2. It can be seen that the Cave Creek Water Company service territory is contiguous to the Desert Hills service territory. Thus, if the Town acquires Cave Creek Water Company, and ultimately integrates the systems, it would likely experience economies of scale.

RATES AND CUSTOMER SERVICE

According to the testimony of Town Manager Usama Abujbarah, filed on January 5, 2007, "For now, the Town has no plans to increase the rates in the DHWC service area." He also commits to providing notice to customers, holding public meetings and allowing the customers an opportunity to be heard before changing the rates charged to customers. In addition, as

previously mentioned, the Transfer Agreement includes a section whereby the Town agrees to charge current rates for a period of one year from the date of the transfer.

Staff asked the Town to describe the customer complaint resolution process it will use after the transfer. The Town responded that:

“Any complaints regarding the quality of water service to customers currently connected to the DHWC system will first be addressed by the system operator, American Water Operations and Maintenance, Inc. The Town Manager and Administrative office will be notified of all complaints, and if not resolved to a customers satisfaction by the system operator, any complaint shall be processed via the Town’s administrative resolution process, including ultimate resolution by the Town Council, if necessary.”

The Town has retained two of the former Desert Hills’ employees and is able to provide its own billing and collection services.

The Commission’s Consumer Services Section reports that 7 customer complaints, inquiries and opinions were logged regarding Desert Hills in 2004; 16 in 2005; 150 from January 1, 2006 to September 11, 2006; and 12 since the acquisition of Desert Hills by the Town on September 12, 2006.

COMPLIANCE

On September 11, 2006, Maricopa County Environmental Services Department (“MCESD”) issued a Notice of Violation and Demand for Compliance to Ms. Mary Beth Rowland, then owner of Desert Hills, demanding the water system be brought into compliance with the Maricopa County Environmental Health Code and the Arizona Administrative Code. Upon acquisition of Desert Hills, the Town took responsibility for all open enforcement actions. Without admitting to any of the allegations, the Town expressed its desire to MCESD to settle all matters without further enforcement action. On November 27, 2006, the Town and MCESD signed a Stipulated Settlement Agreement whereby the Town would pay a penalty of \$12,000. The Town also agreed to submit an engineering report demonstrating adequate pressure, storage and water supply within 30 days of the agreement.

On December 4, 2006, MCESD stated that Desert Hills was delivering water that met water quality standards required by Arizona Administrative Code, Title 18, Chapter 4. MCESD also determined that a pressure problem had been rectified, after the new Cloud Road booster station was placed in service and the Company was able to purchase water from Arizona-American.

The Company is located in the Phoenix Active Management Area. The Arizona Department of Water Resources has indicated that the Company is in compliance with its reporting requirements.

The U.S. Environmental Protection Agency reduced the arsenic maximum contaminant level ("MCL") in drinking water from 50 parts per billion ("ppb") to 10 ppb. Arsenic levels in one of the Company's existing wells exceed the new MCL. The Company must comply with the new arsenic standard no later than December 31, 2007. The Town intends to develop a long-range plan for arsenic treatment once the operating agreement is finalized with Arizona-American Water Company.

SEWER SERVICE

Cave Creek has been providing sewer service to its businesses and residents since 1999. According to the Town, the monthly rate for residential sewer service is \$35. It has never raised the sewer rates. An affiliate of Arizona-American operates the sewer system. Cave Creek Water Company provides billing and collection services for the sewer operations.

CONCLUSIONS AND RECOMMENDATIONS

The Town has experience owning a public utility and working with a contractor to operate it. The Town has the ability to make loans to acquire water companies through its voters' approval. The stock of Desert Hills already belongs to the Town and the Town has owned the Company since September, 2006. The only immediate impact approval of this application will have is to cancel the stock and CC&N of Desert Hills and transfer the assets to the Town.

The Town has shown its intentions to maintain Desert Hills' current rates for at least one year and to credit 189 customers for basic service charges paid during a period of outages. The Town also expects to contract with an affiliate of a large water company with several years of experience operating and maintaining water companies in Arizona. The Town has also described a system for responding to customer complaints or inquiries. Staff believes the Town is a fit and proper entity to receive and operate the assets of Desert Hills.

Staff recommends approval of the transfer of the assets of Desert Hills to the Town.

Staff recommends the Commission cancel the CC&N of Desert Hills thereby extinguishing any compliance matters. However, Staff notes that if the assets are transferred and the CC&N cancelled, there will not be a holder of the CC&N against which the Commission could enforce the pending Order to Show Cause in Docket No. W-02124A-06-0379.

MEMORANDUM

DATE January 22, 2007

TO: Linda Jaress
Executive Consultant III

FROM: Dorothy Hains, P. E. *DH*
Utilities Engineer

RE: **Application For Approval of Desert Hills Water Transfer of Utility Assets To Town of Cave Creek, Pursuant To A.R.S. 40-285 Docket No. W-02124A-06-0717**

I. Introduction

Desert Hills Water Co. ("Desert Hills" or "the Company"), has submitted to the Arizona Corporation Commission ("ACC") an application for Approval of Transfer of Utility Assets to Town of Cave Creek ("the Town"), Pursuant to ARS 40-285. Desert Hills also requested the Commission cancel its existing Certificate of Convenience and Necessity (CC&N). At present the Company serves approximately 1,630 metered customers who live within the nine and half square mile Desert Hills' CC&N area. The CC&N area, bound by Rockway Hills Road, 19th Ave., Dove Valley Road and 24th Street, is located in an unincorporated area north of the City of Phoenix and west of the Town of Cave Creek in Maricopa County.

II. Desert Hills Water System

Desert Hills operates a water system that consists of three drinking water wells (having a combined production rate of 640 gallons per minute) and five storage tanks (having a combined capacity of 1.01 million gallons). Desert Hills has a temporary interconnection with the Anthem District system of Arizona American Water Company ("Arizona American") and also has an emergency interconnection with Cave Creek Water Company ("Cave Creek"). If the Company had to depend only on its existing three wells, then it would not have adequate water production to serve existing customers; however, the Company does have the option of providing water from other sources, such as, purchasing water from another water company. The Company is in the final stages of negotiating a long term water acquisition agreement with Arizona American.¹

¹ See Company's December 11 response to Staff's Data Request.

III. Town of Cave Creek Water System prior to the Desert Hills acquisition

The Town has never owned or operated a water system prior to its November 2006 Desert Hills asset purchase. After Desert Hills entered into an Asset Transfer Agreement with the Town, the Town contracted with Arizona American to operate the Desert Hills water system.

IV. Maricopa County Environmental Services Department (“MCESD”) Compliance Status

Staff received a compliance status report for Desert Hills from MCESD in which MCESD stated that it has determined that Desert Hills is currently delivering water that meets water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.²

MCESD also determined that a pressure problem had been rectified, after the Cloud Road booster station was placed in service and the Company was able to purchase water from Arizona American. However, the interconnection between Arizona American and the Company is a temporary, above ground connection; MCESD has cited this violation. A Stipulated Settlement Agreement between the Company and MCESD was signed on November 27, 2006.

V. Arizona Department of Water Resources (“ADWR”) Compliance Status

The Company is located in the Phoenix Active Management Area (“AMA”), as designated by ADWR. ADWR has indicated that the Company is in compliance with its reporting requirements.

VI. ACC Compliance Status

There is a pending Order To Show Cause in Docket No. W-02124A-06-0379.

VII. Arsenic

The U.S. Environmental Protection Agency (“EPA”) has reduced the arsenic maximum contaminant level (“MCL”) in drinking water from 50 micrograms per liter (“µg/l”) or parts per billion (“ppb”) to 10 µg/l. Arsenic levels in one of the Company’s existing wells exceed the new MCL. The Company must comply with the new arsenic standard no later than December 31, 2007.

² Staff received the compliance status report from MCESD on December 5, 2006.

The Town intends to develop a long-range plan for arsenic treatment once the operating agreement is finalized with Arizona American.³

VIII. Curtailment Tariff

The Company has an approved curtailment tariff on file with the Commission.

XI. Summary

1. Staff concludes that Desert Hills does not have adequate production to serve its customers in its service area without the interconnection with the Anthem District system of Arizona American.
2. Desert Hills is currently delivering water that meets the water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.
3. ADWR has determined that Desert Hills is in compliance with its monitoring and reporting requirements.
4. There is a pending Order To Show Cause in Docket No. W-02124A-06-0379.

³ See Company's December 11 response to Staff's Data Request.

MEMORANDUM

TO: Linda Jaress
Executive Consultant III
Utilities Division

FROM: Barb Wells 
Information Technology Specialist
Utilities Division

THRU: Del Smith 
Engineering Supervisor
Utilities Division

DATE: January 31, 2007

RE: **DESERT HILLS WATER COMPANY (DOCKET NO. W-02124A-06-0717)**
TOWN OF CAVE CREEK

Desert Hills has filed an application to transfer its CC&N to the Town of Cave Creek.

Attached are copies of the maps for your files.

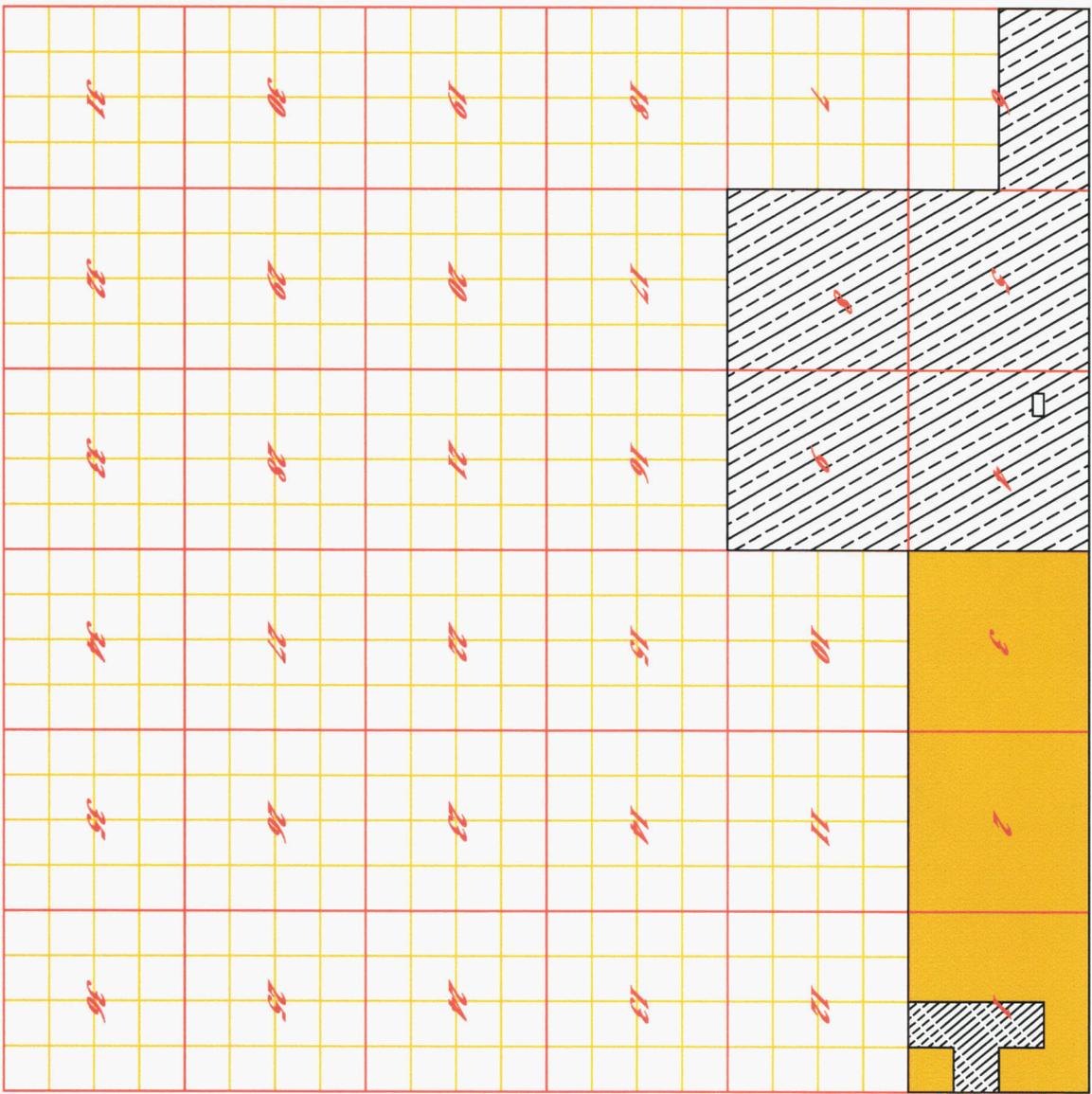
:bsw

Attachment

cc: Mr. Jay Shapiro
Ms. Deb Person (Hand Carried)
File

COUNTY: Maricopa

RANGE 3 East

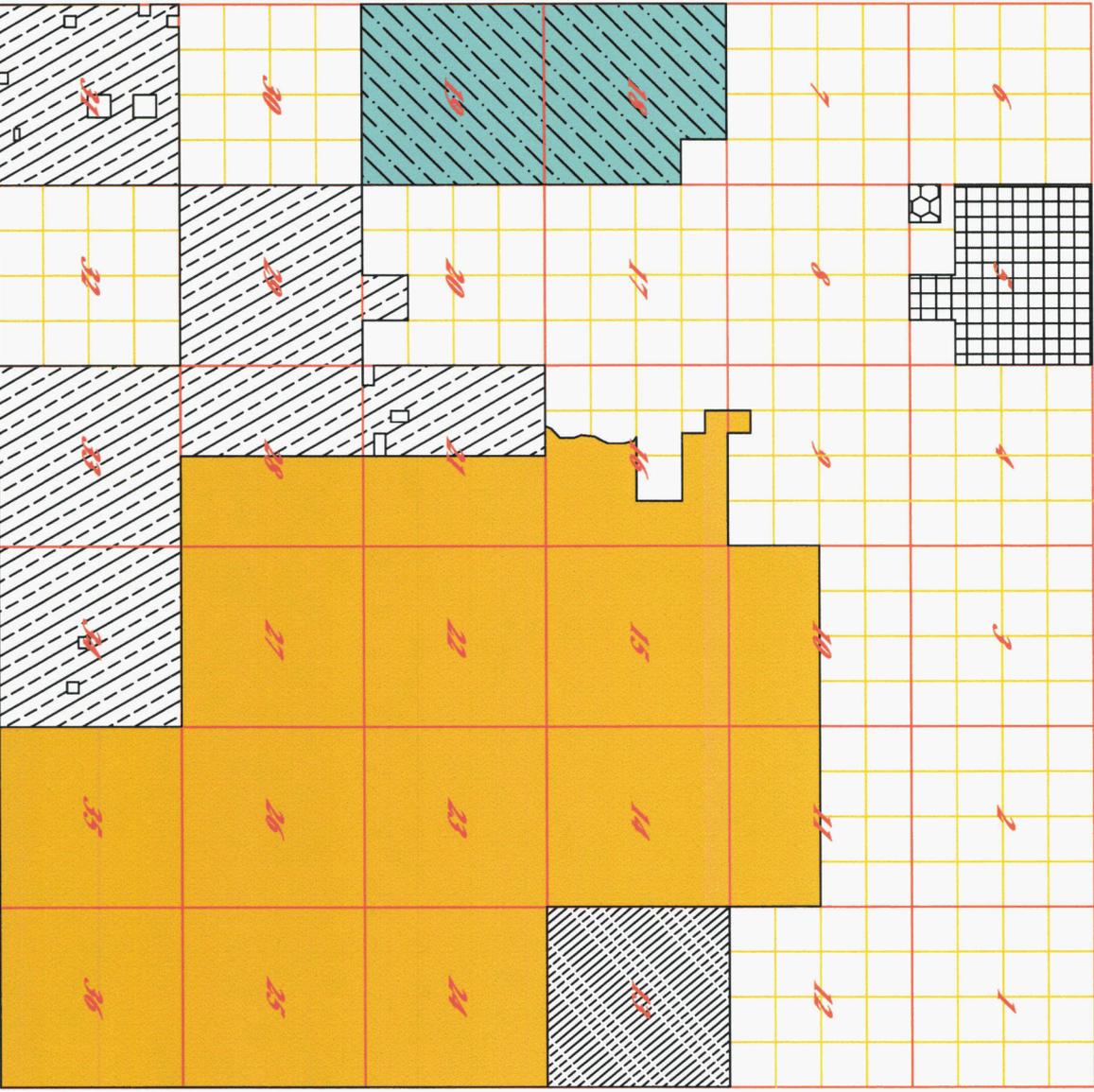


TOWNSHIP 5 North

-  W-1452 (4)
Cave Creek Water Company
-  W-2124 (2)
Desert Hills Water Company, Inc.
- 
Cave Creek Water Company
Docket No. W-01452A-06-0449
Application for Extension
- 
Desert Hills Water Company, Inc.
Docket No. W-02124A-06-0717
Application for Cancellation
(To Town of Cave Creek)

COOUNTY: Maricopa

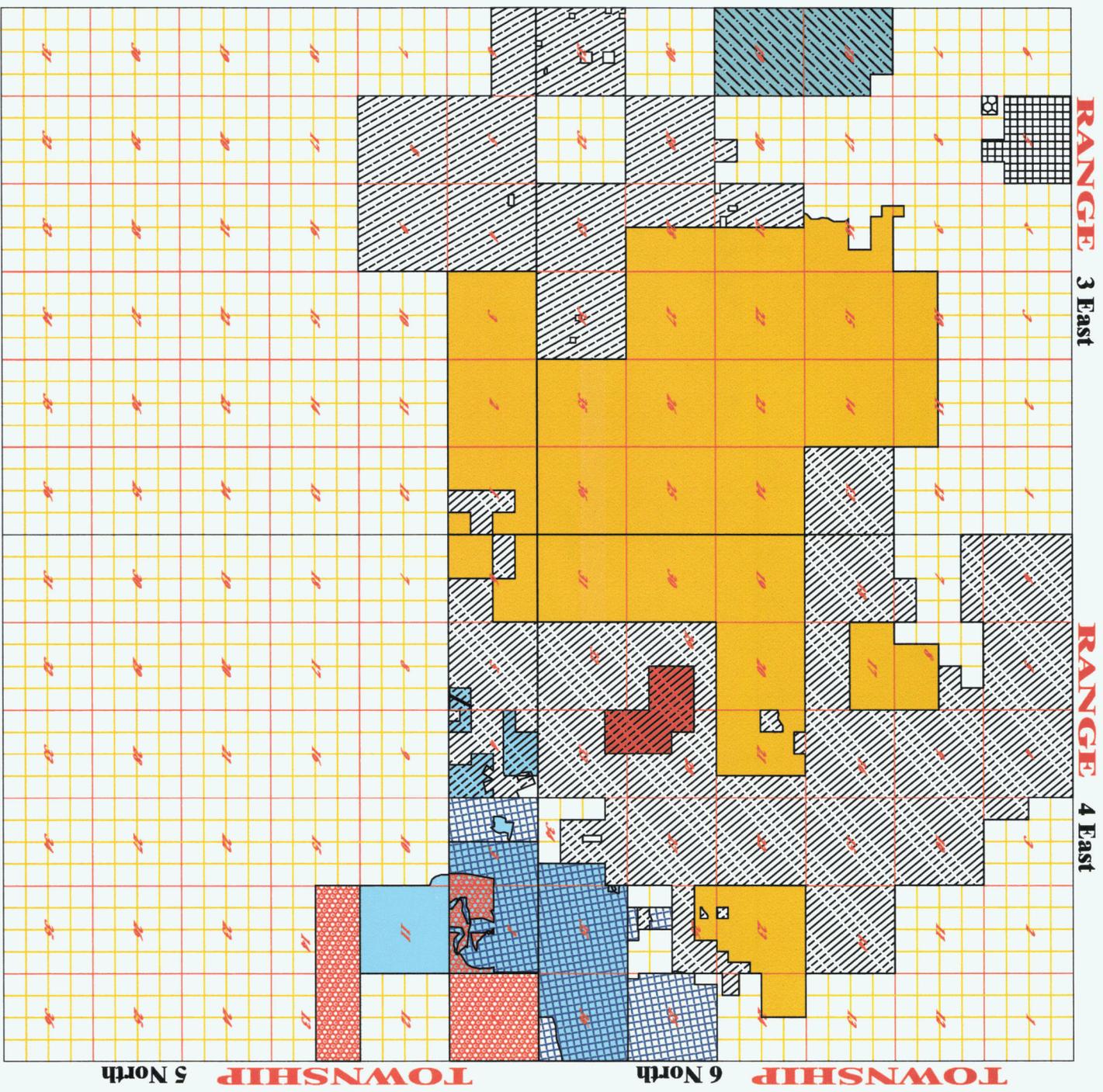
RANGE 3 East



TOWNSHIP 6 North

-  WS-1303 (14)
-  Arizona-American Water Company (Anthem)
-  W-1452 (4)
-  Cave Creek Water Company
-  W-2124 (2)
-  Desert Hills Water Company, Inc.
-  W-2111 (1)
-  Sabrosa Water Company
-  W-2474 (1)
-  Shangri-La Associates, Inc.
-  Cave Creek Water Company
Docket No. W-01452A-06-0449
Application for Extension
-  Desert Hills Water Company, Inc.
Docket No. W-02124A-06-0717
Application for Cancellation
(To Town of Cave Creek)

COUNTY: Maricopa



RANGE 3 East

RANGE 4 East

TOWNSHIP 6 North **TOWNSHIP 5 North**

-  WS-1303  Sewer
-  Arizona-American Water Company
-  W-1452
-  Cave Creek Water Company
-  W-2124
-  Desert Hills Water Company, Inc.
-  W-2111
-  Sabrosa Water Company
-  W-2474
-  Shangri-La Associates, Inc.
-  Sewer SW-2361
-  Black Mountain Sewer Corporation
-  City of Scottsdale (Nonjurisdictional)
-  Town of Carefree (Nonjurisdictional)
-  Town of Cave Creek (Sewer Only)
-  Cave Creek Water Company
Docket No. W-01452A-d6-0449
Application for Extension