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BEFORE THE CORPORATION COMMISSION

Arizona Corporation Commission

Commissioners

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ARIZONA CORP. COMM
400 W CONGRESS STE 218 TUCSON AZ 85709

IN THE MATTER OF THE APPLICATION OF
MONTEZUMA RIMROCK WATER COMPANY
LLC FOR AN EMERGENCY RATE INCREASE

DOCKET NO. W-04254A-11-0296

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Intervener's Response to Staff
Report and Company's Request
For Emergency Rate Increase

Motion to Amend Staff Report

Motion to Continue Emergency
Rate Increase Hearing

Intervener agrees with Staff's recommendation that the Company's request for an emergency rate increase should be denied.

Background

The Company is requesting an emergency rate increase because it chose not to conduct an Environmental Impact Statement that was required by the Arizona Water Infrastructure Financing Authority to obtain a \$165,000, low-interest loan for an arsenic treatment facility.

Rather than conducting the EIS, which is designed to protect Montezuma Well National Monument and Wet Beaver Creek from serious damage from operation of the Company's proposed Well No. 4 that is integral to the arsenic treatment facility, the Company *voluntarily* withdrew its WIFA loan application in January 2011 and instead sought financing from private lenders.

Borrowing from private sources would eliminate the need to obtain an EIS. Private financial institutions, however, have refused to loan money to the Company because of its weak financial condition. Faced with no other option, the Company filed for an Emergency Rate Increase request on July 25, 2011.

In essence, the Company is seeking the emergency rate increase to make an end run around environmental laws designed to protect important national resources, forcing it to obtain a more expensive private loan that will only increase costs to ratepayers.

At the same time, the Company is attempting to fold in generic operating losses into the emergency rate increase that have nothing to do with financing for the arsenic treatment facility. Staff has remained silent on this dubious maneuver.

The Company's fancy footwork underlying its request demonstrates the Company is attempting to use interim rate relief for purposes not contemplated nor allowed for regulated utilities.

Obtaining a loan from a private institution does not constitute an emergency. Seeking to bypass a full rate hearing to address generic operating losses is not a legitimate reason for an emergency rate increase.

Regulatory bodies, including this Commission, "utilize interim rates as an emergency measure when a sudden change brings hardship to the company, when the company is insolvent, or when the condition of the company is such that its ability to maintain service pending a formal rate determination is in serious doubt. (Arizona Attorney General Opinion, 71-17).

The Company has failed to meet any of the three standards for interim rate adjustment.

Sudden Change that Brought on Hardship

The Company may claim that it is facing a hardship because it has an April 7, 2012 deadline to install the arsenic treatment system in order to comply with an Arizona Department of Environmental Quality Consent Order DW-36-10. Indeed, the company attached a copy of the Consent Order to its initial filing for an emergency rate increase.

The Company's requirement to treat its water for arsenic is not new. The standards have been in effect since January 2006 and neighboring Arizona Water Company has been in compliance since 2006.

The Company signed the Consent Order in June 2010 requiring it to have the arsenic treatment facility in place by June 7, 2011. When the Company failed to meet the date, ADEQ and the Company signed the First Amendment to the Consent Order extending the deadline to April 7, 2012.

The fact that the Company finds itself facing an April 2012 deadline is not the result of a "sudden change", but instead, is the result of bad management decisions over many years that has culminated in an ADEQ Consent Order.

Any suggestion that WIFA's November 2010 decision to require an EIS constitutes a "sudden change" falls woefully short as well. WIFA made the decision only after the Company submitted less than candid responses on its November 2009 loan application in connection with obtaining a "categorical exemption" from National Environmental Policy Act provisions.

After reviewing the Company's Environmental Information Document, WIFA decided, with the support of US EPA and an independent engineering firm, that a full-blown EIS was needed prior to funding.

Thus the change in status of the WIFA loan to require an EIS was the direct result of poor management of the Company and does not constitute a "sudden change" from an outside force resulting in hardship.

Company Insolvency

The Company may claim it is facing insolvency. To date, the Company has not submitted a shred of financial evidence to support such an assertion. And even if the Company produces records attesting to insolvency, there are compelling reasons for the Commission to refuse to take such evidence on face value.

Intervener has submitted exhibits in the Formal Complaint docket (W-04254A-11-0323) that raise substantial doubt about the veracity of the Company's financial statements for the last five years, including the Company's failure to report a \$32,000 long-term debt that was entered into in 2005.

Intervener has also submitted evidence to strongly suggest that the Company has diverted excessive funds to its owner, Patricia Olsen, including inappropriate mileage reimbursements, excessive salaries and excessive rents for office space located in a residential property owned by Ms. Olsen and her husband. The Company's financial problems appear to be largely rooted in inappropriate diversions of Company resources to Ms. Olsen and her family.

Further complicating matters, the Company disclosed for the first time during a September 13 procedural conference, that its offices have been repeatedly burglarized since October 2009 and that company financial records have been tampered with and stolen.

The Company also claims that its computer had been hacked on several occasions and that unauthorized emails had been sent to customers. Inexplicably, the Company stated that the burglaries were not reported to police.

The Commission learned of the alleged burglaries only after Intervener filed a motion to deny the Company's motion to suppress Intervener's discovery. In the Company's motion to suppress, the Company claimed the cost and time was too great to produce requested records. Suddenly, that story changed on September 13 when Counsel

for the Company indicated the Company records are contained in a couple of boxes and are incomplete because of the alleged burglaries.

Intervener will have the first opportunity to review records on Monday, Sept. 19, just three days before the pending Hearing in this case. The limited amount of time to review, analyze and determine what records are missing raises serious doubt of whether due process is being afforded to the Intervener for Discovery prior to the hearing.

Intervener will utilize all options available to it during Discovery, including seeking a telephonic procedural conference with the Commission to discuss issues that may arise during the initial review of the Company's records.

By the Company's own statements, its financial records are now incomplete. Any assertion by the Company that it is facing insolvency cannot be accepted as legitimate without a complete, independent, forensic audit of the Company.

Ability to Maintain Service

Interim rate relief is not intended to be a bailout mechanism for a company that has driven itself to the brink of failure.

The 1971 Attorney General's Opinion that has guided Emergency Rate Increases for decades states:

"Perhaps the only valid generalization on this subject is that interim rate relief is not proper merely because a company's rate of return has, over a period of time, deteriorated to the point it is unreasonably low. In other words, interim rate relieve should not be made available to allow a public service corporation to ignore its obligations to be aware of its earnings position at all times and to make timely application for rate relief, thus preserving its ability to render adequate service and to pay a reasonable return to its investors."

The Company has not sought a rate increase through a non-emergency process to address any systemic financial problems facing the company, including ongoing operating losses, since the last rate hearing in 2009.

The Company's transparent attempt to fold operating losses into the emergency rate increase that is dressed as vehicle to obtain financing for the arsenic treatment facility is typical of its sleight-of-hand operation and a clear attempt to avoid the scrutiny that would come with a full rate case.

Approving Emergency Rate Increase is Premature

The Staff report states:

“MRWC currently only has Commission approval for a loan from WIFA and providing emergency rates in order for the Company to attempt to secure debt financing from a private institution when the Commission has yet to address the issue would be inappropriate.”

Intervener agrees.

Intervener recommends that an emergency rate increase, if approved, will not be implemented until the Commission has approved the loan modification request pending in W-04254A-08-0361/0362 *and* the Company has fully responded to the Formal Complaint in W-04254A-11-0323.

Failure of Staff to Conduct Financial Analysis on Company's Request

Intervener not only contends the Company does not meet the minimum standards for an emergency rate increase, Intervener strongly objects that Staff has failed to conduct even a rudimentary review of the Company's financial condition prior to the emergency rate hearing.

To date, there is no evidence Staff has conducted any financial analysis for Company's application whatsoever, a point that the Commission raised in the September 13 procedural conference.

Analysis of the Company's operating losses is crucial because the Company's emergency rate increase application includes funding to cover ongoing operating losses as well as principle and interest for the proposed \$165,000 loan from Sunwest Bank.

In addition, the WIFA loan approved in Decision 71317 was designed to be revenue neutral for the Company. Based on the Company's submission from Sunwest Bank, the \$165,000 loan would require \$23,503 a year for principle and interest.

Yet the emergency rate increase requests an additional \$14,000 a year for unspecified purposes. Staff has made no recommendation or analysis on whether this \$14,000 a year is justified and should be included in the emergency rate increase. Nor has Staff raised the fact that the WIFA loan was to be revenue neutral.

These are crucial points that Staff should have addressed in its report.

Intervener recommends that an emergency rate increase, if approved, be revenue neutral for the Company so that generic operating losses are not included in an arsenic surcharge.

Intervener acknowledges that the emergency rate increase is based on a limited review of the Company's financial condition. But this isn't the same as NO financial analysis. In other recent emergency rate increases considered by the Commission, Staff has conducted a formal review of basic financial reports, which is entirely lacking in this instance.

For example, on December 19, 2008, Far West Water and Sewer Company filed an application for an emergency rate increase with the Arizona Corporation. According to the Staff report:

“Staff obtained the unaudited financial statements from Far West for each of its Divisions for the period ending December 31, 2008. Staff compiled this information on the attached Schedule GWB-1. Due to the emergency nature of the application, Staff considered other income, i.e., non-operating and expenses in its analysis. Further, Staff adjusted these results as shown to remove interest and dividend income that is not expected to continue because the associated principal has been used for capital expenditures.”

Whereas Staff took the initiative to conduct extensive financial analysis in the Far West case, it has done nothing in this case.

Intervener also contends Staff should be required to provide a reasonable degree of independent analysis of whether the Company's financial reporting is in fact accurate and truly reflective of its current condition prior to holding a hearing on an emergency rate increase.

At this point, Staff has done nothing even though it is well aware of the Formal Complaint that provides evidence of significant material omissions from the Company's annual reports from 2006 through 2010 and examples of what appears to be unjust enrichment.

The public is certainly entitled to such protection in a full rate hearing.

*“A public utility is entitled to due process when a ratemaking body undertakes to calculate a reasonable return for the use of its property and services by the public. See Simms, 80 Ariz. at 149, 294 P.2d at 380 (citing Smyth v. Ames, 169 U.S. 466, 18 S.Ct. 418, 42 L.Ed. 819 (1898)). **Conversely, the public is entitled to the same level of protection when the government seeks to increase the utility rates that the public is obligated to pay.**” (RESIDENTIAL UTILITY CONSUMER OFFICE, an agency of the State of Arizona, Appellant, v. The ARIZONA CORPORATION COMMISSION, an agency of the State of Arizona, Appellee, Rio Verde Utilities, Inc., Appellee-Intervenor. No. 1 CA-CC 99-0008)*

The absence of *any* financial analysis by Staff, once again raises due process concerns in this case in that Ratepayers and the Public have not been afforded a fair and competent analysis of the Company's basic financial condition prior to an emergency rate hearing.

Intervener moves the Commission to direct Staff to provide a financial analysis of the Company's emergency rate increase including a review of generic operating losses included in the Emergency Rate application prior to the Sept. 22 hearing. If it is not possible to prepare and docket the report by 4 p.m, Sept. 21, Intervener moves that the emergency rate hearing be continued until after such report is prepared and posted in this Docket.

Staff's Failure to Include Formal Complaint in Staff Report

Under the Consumer Services section of the Staff Report, Staff stated the following:

"A review of the Consumer Services Section database from January 1, 2008 to August 23, 2011, revealed that there have been three complaints and ten opinions filed on MRWC. There were two opinions' against rate case items and eight in favor of the emergency rate case. All complaints have been resolved and closed."

This is a materially misleading assessment of complaints filed against the company. ACC records show there have been at least seven complaints filed against the company that have been recorded on "Utility Complaint" forms since January 1, 2008.

Intervener is deeply troubled over Staff's decision to review complaints filed "to August 23, 2011", rather than much closer to the date the Staff report was published on Sept. 12. The brevity of the Staff report certainly did not require Staff to terminate evaluation of Consumer Services complaints more than three weeks before the report was released.

In a glaring omission, the Staff report fails to include reference to the Formal Complaint filed on August 23, 2011 against Montezuma Rimrock in Docket No. W-04254A-11-0323. This complaint obviously has not been closed and contains material information relevant to the emergency rate increase request.

Staff's failure to include the Formal Complaint in the Staff report does not provide the public with an accurate assessment of the serious issues facing Montezuma Rimrock and casts doubt on Staff's objectivity and on whether Staff is even reviewing the issues raised in the Formal Complaint.

Intervener moves the Commission to direct Staff to amend the Sept. 12 Staff report under the Consumer Services Section to include notice that a Formal Complaint has been filed under Docket W-04254A-11-0323 and that the case remains open and to include an accurate accounting of the number of complaints concerning Montezuma Rimrock filed with the Commission since January 1, 2008 through the date staff amends the report.

If an Emergency is Established

“Interim rate-making authority is limited to circumstances in which (1) an emergency exists; (2) a bond is posted by the utility guaranteeing a refund to customers if the interim rates paid are higher than the final rates determined by the Commission; and (3) the Commission undertakes to determine final rates after a valuation of the utility's property. (118 Ariz. at 535, 578 P.2d at 616 (following the conclusion drawn in Op. Att'y Gen 71-17)).

Staff, perhaps confident that an emergency rate increase will not be granted, has once again ignored a crucial issue on the value of the bond to be required if the Commission determines an emergency exists.

Intervener, while strongly opposed to an emergency rate increase, recommends that a minimum \$28,000 bond be posted if the Commission grants the emergency request.

This amount is equal to two years of the Company's operating losses based on the Sunwest Bank analysis attached to the Company's emergency rate application. As pointed out above, Sunwest Bank has provided the only financial analysis conducted to date on the Company's emergency rate increase.

Ratepayers should be protected if in the course of a full rate hearing to follow an interim increase it is determined the \$14,000 a year annual operating losses should not have been included in the emergency increase.

Conclusion

Intervener recommends the Emergency Rate increase be denied. Intervener agrees with Staff's conclusion:

“Granting an emergency rate increase could result in the Company receiving additional revenues that would serve no purpose beyond enriching the Company's owner at the expense of Company's customers.”

However, Intervener is deeply troubled by Staff's failure to conduct anything more than a cursory review of the Company's request. The Staff report fails to address key aspects of the pending hearing including providing any financial analysis.

The report ignores the existence of the Formal Complaint and provides no recommendations on what to do if an emergency is determined to exist, particularly on the appropriate amount for the bond.

Montezuma Rimrock may be a Class D utility and a relatively low priority for Staff, but an emergency rate increase would have a major financial impact on Ratepayers and should be afforded competent and thorough analysis by Commission Staff.

At this point, such an analysis has not been completed and is a glaring omission in the days leading up to the emergency rate hearing.

Dated this 16th Day of September, 2011


John E. Dougherty
Intervener

Copies of the foregoing mailed
This 16th day of September, 2011 to:

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