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BEFORE THE CORPORATION COMMISSION

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Arizona Corporation Commission

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Commissioners

GARY PIERCE – Chairman
BOB STUMP
SANDRA D. KENNEDY
PAUL NEWMAN
BRENDA BURNS

DOCKETED BY	M/7
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IN THE MATTER OF THE APPLICATION OF
MONTEZUMA RIMROCK WATER
COMPANY, LLC FOR APPROVAL OF A
RATE INCREASE

DOCKET NO. W-04254A-08-0361

IN THE MATTER OF THE APPLICATION OF
MONTEZUMA RIMROCK WATER COMPANY,
LLC FOR APPROVAL OF A FINANCING
APPLICATION

DOCKET NO. W-04254A-08-0362

**Response to
Procedural Order**

By the Intervener:

Preface: Montezuma Rimrock is attempting to sidestep Commission approval of its latest financing scheme for the Arsenic Treatment Facility by attempting to make it appear that the Company is not entering into a capital lease agreement to pay for the ATF, when, in fact, it is.

The only conceivable reason for the Company to resort to such complicated maneuvers is because Montezuma Rimrock cannot qualify for a loan or a capital lease. This fact was proved during the Company's short-lived Emergency Rate Increase proceeding last year.

In a desperate attempt to obtain financing, the Company is now relying on Ms. Patricia Olsen as a private party to sign lease agreements and a purchase agreement and then have Ms. Olsen turn around and sublease the equipment to her financially crippled water company.

The Company wants to avoid Commission scrutiny by declaring the capital lease between Ms. Olsen and Montezuma Rimrock to be merely an "operational agreement". The Commission should reject the Company's characterization of the financial

agreements to build the ATF, keep this docket open and schedule an evidentiary hearing, either in this docket or in the Formal Complaint under Docket No. W-04254A-11-0323.

Procedural Order: The Commission's April 9, 2012 Procedural Order directed staff, Montezuma Rimrock and Intervener to provide analysis on three points related to the Company's submission of a purchase agreement, lease and sub-lease (Water Service Agreement).

1. For each document:
 - a. Regardless of its title, whether it is a lease agreement and why or why not;
 - b. If it is a lease agreement, whether it is a capital lease or an operating lease and why; and
 - c. Whether Commission approval is required for the document and why or why not;
2. Whether this docket should remain open for consideration of whether to modify Decision No. 71317 under A.R.S. 40-252 concerning financing approval and related provisions; and
3. If the docket should remain open, whether an evidentiary hearing should be held for such consideration.

Question 1: As of this date, the Company has submitted insufficient information to definitively answer this question.

Staff's Third Data Request submitted to Montezuma Rimrock on April 25, 2012 supports Intervener's position that more information is needed to make a full assessment of the nature of the lease agreements, their relationship to a purchase agreement, the characterization of the Water Services Agreement and whether Commission approval is required. (Exhibit 1)

Intervener supports Staff's position in seeking additional information and hereby requests that Staff provide Intervener with the Company's responses to the Third Data Request when, and if, they become available.

Notwithstanding the production of this additional information, Intervener will provide answers to Question 1 based on information available at this time.

a. The contractual language in the two agreements between Nile River Leasing, LLC, and Ms. Olsen plainly state both agreements are leases.

Montezuma Rimrock stated the Water Services Agreement is a lease in a March 20, 2012 filing in this docket:

“Under that Water Services Agreement, Ms. Olsen proposes to lease the arsenic treatment facilities to MRWC.”(Emphasis added.)

b. There is insufficient information to determine whether the lease agreements between Nile River Leasing and Ms. Olsen are capital or operating leases until the Company responds to Staff’s Third Data Request. There is uncertainty of the relationship between the purchase agreement between Ms. Olsen and Kevlor Design and the lease agreement between Ms. Olsen and Nile River Leasing for arsenic equipment. These issues could have a profound impact on ratepayers, depending on the overall cost of the ATF (which, has been noted in previous filings, excludes significant costs of the project including land acquisition, construction of a pipeline, construction of Well #4 and related costs.)

The water services lease agreement, however, is properly classified as a capital lease.

According to the Financial Accounting Standards Board Statement No. 13—Accounting for Leases, a proposed lease must meet four tests to be considered an “operating lease”.

A lease must be treated as a capital lease if it meets **any one** of the following four conditions:

- a. If the lease life exceeds 75 percent of the life of the asset.
- b. If there is a transfer of ownership to the lessee at the end of the lease term.
- c. If there is an option to purchase the asset at a “bargain price” at the end of the lease term.
- d. If the present value of the lease payments, discounted at an appropriate discount rate, exceeds 90% of the fair market value of the asset.

The Water Services Agreement lease calls for the transfer of ownership at the end of the lease term and for that transfer to occur at a “bargain price” of \$1. Therefore, the

lease meets FASB 13 (B, C) standards as a capital lease (Paragraph 15, Water Services Agreement).

As a capital lease, Ms. Olsen is required to classify the expenses covered by Montezuma Rimrock's lease payments called for in the Water Services Agreement. According to Commission Decision No. 66400, all potential Lessors of arsenic treatment facilities must break out lease payments into the following three separate components:

1. The Lessor's equipment construction costs.
2. Recoverable Operating & Maintenance Costs.
3. Other O&M Costs.

Decision No. 66400 also requires potential Lessors of arsenic treatment facilities to identify the interest rate embedded in the lease payment.

Montezuma Rimrock has not disclosed Ms. Olsen's equipment construction costs, recoverable operating and maintenance costs, and other O&M costs. Nor has the Company disclosed the embedded interest rate in water services lease agreement, which is among the items sought in Staff's Third Data Request.

c. Full Commission is required to approve all capital leases. (A.R.S. 40-301 and 302)

Question 2: On April 27, 2011, in response to a request filed by Montezuma Rimrock, the Commission voted at the Commission's Staff Open Meeting to reopen Decision No. 71317 pursuant to A.R.S. 40-252 to determine **whether to modify** the decision concerning financing approval and related provisions. (Emphasis added.)

Montezuma Rimrock has failed to present sufficient information to allow the Commission to determine "whether to modify" Decision 71317. The fact that Staff is seeking through its Third Data Request additional information on the Company's latest financing proposal supports the need to keep this docket open.

Furthermore, the Water Services Agreement is a capital lease and therefore this docket must remain open to allow for full Commission approval.

In addition, Decision No. 71317 was a rate case and financing of the ATF was an integral part of the case. Decision No. 71317 includes a repayment mechanism for the ATF. Nowhere has Montezuma Rimrock addressed how its complicated and expensive lease arrangements (this would cost far more than what Decision No. 71317 anticipated

with the WIFA loan) will impact the arsenic financing mechanism approved in Decision No. 71317.

Until these issues are addressed, it is in the best interest of the public, ratepayers and the Company to keep this docket open.

Question: 3: Montezuma Well National Monument, which is managed by the U.S. Department of Interior, and Commissioner Paul Newman, have requested that an evidentiary hearing be held in this docket. The Monument expressed its concern over the potential of Well #4, which is an integral part of the ATF, having a negative impact on the national monument. Mr. Newman expressed concerns that Well #4 could have a negative impact on a significant Native American cultural resource.

Intervener also believes an evidentiary hearing should be held in this docket. Montezuma Rimrock's mismanagement and flagrant spending has created a crisis for the community it serves. The Company overextended water service in the mid-2000s, despite knowing that it had an inadequate water supply. The Company has also failed to provide the Commission truthful and accurate information concerning its operations.

These deceptive practices include failing to disclose to the Commission prior to Decision 71317 that it did not have commercial zoning in place for Well #4. The Company also failed to disclose a \$32,000 long-term debt to purchase the residential land for Well #4.

The Company also is in violation of two orders in Decision No. 71317 for failure to obtain ADEQ permits for Well #4 and the ATF.

In the last month, the crisis facing the Company and its customers, who have had to make an appointment to obtain bottled water from MRWC for nearly two years, has gone from bad to worse. As a result, Intervener filed a Motion to Stay in this docket based on recent actions by Yavapai County to revoke the Commercial Use Permit for Montezuma Rimrock to use Well #4; the issuance of a Notice of Violation by the Arizona Department of Environmental Quality for violating a 2010 Consent Order to install the ATF by April 7, 2012; and pending litigation in Yavapai County Superior Court that will determine whether Well #4 will ever be used.

Intervener is also seeking an evidentiary hearing in a Formal Complaint under Docket No. W-04254A-11-0323 in which Intervener has requested the Commission to revoke Montezuma Rimrock's Certificate of Convenience and Necessity.

Intervener believes an evidentiary hearing is necessary before Decision 71317 is modified in any way and before approval of any alternative financing plan for the ATF.

Dated this 27th Day of April, 2012

A handwritten signature in black ink, appearing to read "John E. Dougherty". The signature is stylized with large, flowing loops and a long horizontal stroke extending to the right.

John E. Dougherty
Intervener

Copies of the foregoing mailed
This 27th Day of April, 2012 to:

Todd C. Wiley
Fennemore Craig, PC
3003 N. Central Ave.
Suite 2600
Phoenix, AZ 85012

Patricia D. Olsen, Manager
MONTEZUMA RIMROCK WATER COMPANY, LLC
P.O. Box 10
Rimrock, AZ 86335

Exhibit 1

COMMISSIONERS
GARY PIERCE - Chairman
BOB STUMP
SANDRA D. KENNEDY
PAUL NEWMAN
BRENDA BURNS



ERNEST G. JOHNSON
Executive Director

ARIZONA CORPORATION COMMISSION

April 25, 2012

Todd C. Wiley
FENNEMORE CRAIG, P.C.
3003 North Central Avenue, Suite 2600
Phoenix, Arizona 85012

Sent via U.S. Mail & E-mail to:
patsy@montezumawater.com
twiley@fclaw.com

Patricia D. Olsen, Manager
MONTEZUMA RIMROCK WATER
COMPANY, L.L.C.
Post Office Box 10
Rimrock, Arizona 86335

Re: Staff's **Third** Set of Data Requests to Montezuma Rimrock Water Company, LLC
Docket No. W-04254A-08-0361 et al.

Dear Mr. Wiley and Ms. Olsen:

Please treat this as Staff's **Third** Set of Data Requests to Montezuma Rimrock Water Company, in the above-referenced matter. For purposes of this data request set, the words "Company," "you," and "your" refer to Montezuma Rimrock Water Company, and any representative, including every person and/or entity acting with, under the control of, or on behalf of Montezuma Rimrock Water Company. For each answer, please identify by name, title, and address each person providing information that forms the basis for the response provided.

These data requests are continuing, and your answers or any documents supplied in response to these data requests should be supplemented with any additional information or documents that come to your attention after you have provided your initial responses. Please respond within **ten (10)** calendar days of your receipt of the copy of this letter. However, if you require additional time, please let us know.

Please provide one hard copy as well as searchable PDF, DOC or EXCEL files (via email or electronic media) of the requested data directly to each of the following addressees via overnight delivery services to:

- (1) Jeffery Michlik, Utilities Division, Arizona Corporation Commission, 1200 West Washington Street, Phoenix, Arizona 85007. jmichlik@azcc.gov
- (2) Charles H. Hains, Attorney, Arizona Corporation Commission, 1200 West Washington Street, Phoenix, Arizona 85007. chains@azcc.gov

Sincerely,

A handwritten signature in black ink, appearing to read "Charles H. Hains", written over a horizontal line.

Charles H. Hains, Attorney
Legal Division
(602) 542-3402

CHH:rbo
Enclosures
cc: Jeffery Michlik

**ARIZONA CORPORATION COMMISSION
STAFF'S THIRD SET OF DATA REQUESTS
REGARDING THE PROCEDURAL ORDER OF
MONTEZUMA RIMROCK WATER COMPANY
DOCKET NOS. W-04254A-08-0361 AND W-04254A-08-0362
APRIL 25, 2012**

Subject: All information responses should ONLY be provided in searchable PDF, DOC or EXCEL files via email or electronic media.

Accounting Data Requests

- JMM 3.1** Total Contract Price – Please provide the total contract price to Ms. Olsen for the Arsenic Treatment Facility, including all design, permitting, construction and acquisition costs.
- JMM 3.2** Nile River Lease Agreements – Do the Terms and Conditions that were provided comprise the entirety of the lease agreements for the Arsenic Building Plant (“Building”) and the Arsenic Removal Water Treatment System (“Treatment System”)? If not, please provide copies of the entire lease agreements.
- JMM 3.3** Nile River Lease Agreements – State whether Ms. Olsen considers the lease agreements to be operating leases or capital leases. Are either or both of the agreements considered to be “lease to own” agreements?
- JMM 3.4** Nile River Lease Agreements – Does title to the respective leased property transfer to Ms. Olsen after the term of the lease expires (36 months for the Building and 60 months for the Treatment System)?
- JMM 3.5** Nile River Building Lease Agreement – Please confirm that the total cost of the Building is \$12,315.24 (i.e., \$342.09 x 36). Otherwise, state the actual total cost of the Building and describe how that amount was determined. Please explain how this piece fits into the total contract price from JMM 3-1 above.
- JMM 3.6** Nile River Treatment System Lease Agreement – Please confirm that the total cost of the Treatment System is \$63,490.80 (i.e., \$1,058.18 x 60). Otherwise, state the actual total cost of the Treatment System and describe how that amount was determined. Please explain how this piece fits into the total contract price from JMM 3-1 above.

**ARIZONA CORPORATION COMMISSION
STAFF'S THIRD SET OF DATA REQUESTS
REGARDING THE PROCEDURAL ORDER OF
MONTEZUMA RIMROCK WATER COMPANY
DOCKET NOS. W-04254A-08-0361 AND W-04254A-08-0362
APRIL 25, 2012**

Subject: All information responses should ONLY be provided in searchable PDF, DOC or EXCEL files via email or electronic media.

JMM 3.7 Kevlor Design Group – Please explain how the project costs of \$46,000.00 from the Kevlor Design Group relate to the Nile River Lease Agreements? If the \$46,000 is separate from the lease agreements, please explain how this piece fits into the total contract price from JMM 3-1 above.

JMM 3.8 Water Services Agreement – Please confirm that the total cost for the monthly standby fee is \$360,000 (i.e., \$1,500 x 240). Otherwise, state the actual total monthly standby fee to be collected over the term of the lease and describe how this amount was determined.

JMM 3.9 Water Services Agreement – Please answer the following:

- a. Is the monthly standby fee structured as an ordinary annuity or an annuity due; i.e., are payments due at the end or the beginning of each month?
- b. What is the incremental borrowing rate of the lessee (the rate that would have been incurred to borrow the funds necessary to purchase the assets with a secured loan with payment terms similar to the payment schedule in the lease) or the percentage return on investment assumed by Ms. Olsen?
- c. What is the amount of executory costs (e.g., insurance, maintenance, and taxes) included in the monthly payments?
- d. Are the executory costs paid by Ms. Olsen or by Montezuma Rimrock Water Company?
- e. What are the residual values of the Building and Treatment System at the end of each lease?
- f. If there are residual values, are the values guaranteed or not guaranteed?