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BEFORE THE ARIZONA CORPORATION CO.

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Arizona Corporation Commission

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COMMISSIONERS

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CORP COMMISSION
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IN THE MATTER OF THE COMMISSION ON
ITS OWN MOTION INVESTIGATING THE
FAILURE OF TRUXTON CANYON WATER
COMPANY TO COMPLY WITH
COMMISSION RULES AND REGULATIONS.

DOCKET NO. W-02168A-10-0247

STAFF'S REPLY BRIEF

I. INTRODUCTION

Staff intended its closing brief to be comprehensive of its position in this matter. In light of Truxton Canyon Water Company's ("Truxton" or "Company") response, Staff believes that it would be helpful to clarify certain matters addressed by the Company, as well as respond to misplaced arguments raised by Truxton. Staff's silence on any issue raised in the Company's Response Brief is not agreement with the Company. Rather, where Staff has not chosen to clarify an issue in this brief, Staff relies on the arguments presented in its Opening Brief.

II. DISCUSSION

A. Non-Violations

As noted by the Company in its Response Brief, Staff did not cite to a number of statutes and rules as sources of violations in the Staff Closing Brief. Rather than leave the Administrative Law Judge in the position of having to determine from Staff's silence whether Staff has ceased to press certain violations, Staff hereby states which violations that were asserted in the Complaint that Staff no longer believes were violated. Staff does not believe that the Company has violated Arizona Administrative Code Rule R14-2-407(E) because Staff has confirmed that the instance of low water pressure was nonetheless compliant with the rule requirements of 20 pounds per square inch gauge at the meter. Staff no longer believes that the Company has violated A.A.C. R14-2-406(G), (M) and - 409(D)(1) in relation to the Bacus Main Line Extension Agreement ("MXA") because the rules

1 require a refund in the event that Staff does not approve the MXA and it is Staff's understanding that
2 refunds are underway.

3 Staff does not contend that the Company violated A.R.S. § 40-321(A) and Ariz. Const. Art.
4 XV § 3. Staff notes that these provisions articulate sources of authority for the Commission to issue
5 orders relating to the conduct of public service corporations. These provisions supply sufficient
6 power for the Commission, in the event that it is determined that the Company's performance has
7 been inadequate by violating the many other counts of the Staff Complaint, to require the Company
8 to make improvements to the Company's facilities as well as whatever additional requirements that
9 the Commission determines are appropriate under the circumstances. With respect to Staff's
10 concerns with the inadequate water service provided to customers, Staff believes that A.R.S. § 40-
11 321(A) permits the Commission to order the Company to improve its equipment as necessary to
12 remedy the inadequate service. Regarding Staff's concerns with the Company's history of
13 commingling funds, inadequate record keeping and financial violations which all serve to hinder the
14 Commission's ability to set appropriate rates for Truxton, Staff contends that Ariz. Const. Art. XV §
15 3 gives the Commission the ability to specify suitable remedies that will correct the issues, including
16 the appointment of an interim manager.

17 **B. Responses to Company Assertions**

18 In all other respects, Staff continues to assert that the Company is in violation of the matters
19 discussed within the Staff Complaint.

20 **1. Health and Safety Violations**

21 The Company maintains the untenable view that the water it serves customers is potable
22 merely because the Arizona Department of Environmental Quality ("ADEQ") has not stopped them
23 from serving water to their customers. The novel contention is meritless. The record is replete with
24 instances where ADEQ has observed and cited Truxton for violations of drinking water standards.
25 Exhibit S-4, Attachment DMH-1 at 4-6; Attachment DMH-1 attachment 3; Attachment DMH-1
26 attachment 5; Attachment DMH-1 attachment 7. Moreover, as demonstrated by Staff, the most
27 recent ADEQ drinking water compliance report issued by ADEQ for Truxton indicates that it is not
28 possible to determine whether the Company is providing safe water at this point. Exhibit S-11,

1 Attachment A, February 1, 2012 ADEQ Drinking Water Compliance Status Report. Staff would note
2 that utilities have been required to provide bottled water service under circumstances of contaminant
3 levels exceeding ADEQ requirements and it was Staff that requested the switch to bottled water and
4 not ADEQ. *See* Decision No. 69723 (July 30, 2007) at 5:20-23. However, under those
5 circumstances, it was not a prerequisite to a finding that the utility was not providing potable water so
6 much as a practical response to a persisting contamination issue. Here, the Company has avoided the
7 issue because its water testing is suspect by ADEQ. February 29, 2012 Hearing Transcript at 108:6-
8 21.

9 A.A.C. R14-2-407(A) places an affirmative obligation on a public service company to provide
10 potable water to its customers. Truxton cannot demonstrate to ADEQ that the water it provides is
11 actually potable at this time. Because Truxton must be able to show that it is providing potable water
12 to the customer and presently cannot make such a showing, the Company is in violation of A.A.C.
13 R14-2-407(A).

14 **2. Record Keeping Violations**

15 **a. NARUC and GAAP**

16 The Company contends that it is not in violation of A.R.S. § 40-221, -221(A), -221(B), and -
17 221(C). With respect to A.R.S. § 40-221, -221(A) and -221(B), the Company's argument is that
18 these provisions confer authority on the Commission rather than set out requirements on the utility.
19 Staff would point out that it did not cite A.R.S. § 40-221(A) or (B) within its Complaint. Rather,
20 Staff contends that Truxton violated A.R.S. § 40-221 and -221 (C). Staff acknowledges that the
21 Company is correct that A.R.S. § 40-221 only contains provisions within the subparts. As such, Staff
22 would clarify that the Company did not violate A.R.S. § 40-221 although Staff continues to assert
23 that Truxton is in violation of A.R.S. § 40-221(C). To the extent that the Company's bookkeeping is
24 noncompliant with Commission requirements that have been established pursuant to the
25 Commission's authority under A.R.S. § 40-221(A) and (B), these are violations of A.R.S. § 40-
26 202(L) which is discussed separately below.

27 The evidence in the record amply demonstrates that the Company has failed to maintain its
28 books in a National Association of Regulatory Utility Commissioners ("NARUC") and Generally

1 Accepted Accounting Practices (“GAAP”) compliant manner. These are required by A.A.C. R14-2-
2 411(D)(1) and (D)(2). Staff’s examination of the Company’s books revealed that Truxton was not
3 complying with NARUC Uniform System of Accounts or GAAP. Exhibit S-2 at 13:17-24; February
4 29, 2012 Hearing Transcript at 179:1-4. Additionally, Company witness Chris Hopper conceded in
5 prefiled testimony that the Company’s records did not conform to NARUC requirements. Exhibit A-
6 3, Post-Hearing Testimony of Chris Hopper, Exhibit 1; January 18, 2011 Hearing Transcript at 87:5-
7 8; February 28, 2011 Hearing Transcript at 188:14-15. On Brief, the Company likewise admits that it
8 was not keeping its books in a NARUC compliant manner. Truxton Response Br. at 6:19.5-20.5.
9 However, the Company suggests that the responsibility falls to Staff to explain to the Company how
10 to come into compliance with NARUC and GAAP. *Id.* at 6:26.5-7:4.5.

11 The responsibility for maintaining the utility’s books is on the utility, not Staff. The
12 Company’s contentions are nonresponsive to the allegation that Truxton has not maintained its books
13 in a compliant manner. Copies of the NARUC Uniform System of Accounts are readily available for
14 a nominal fee. See <http://www.naruc.org/Store/>. More to the point, neither Staff nor the Commission
15 micromanage utilities and it is not the responsibility of Staff to observe a utility’s obligations on the
16 utility’s behalf. The rule places the onus for maintaining records properly on the utility and the
17 Company has failed and continues to fail to meet its requirements. Because Truxton’s books are non-
18 NARUC or GAAP compliant, they are accounts other than those prescribed by the Commission and
19 the Company is therefore in violation of A.R.S. § 40-221(C) in addition to violating A.A.C. R14-2-
20 411(D)(1) and (2).

21 **b. Commingling of Funds and Inaccurate Water Loss Reporting**

22 The Company asserts that it has not violated any Commission requirement regarding the
23 commingling of funds because A.R.S. § 40-204(A) does not specifically state a prohibition on the
24 commingling of funds. Additionally, Truxton states that it has “never failed to furnish the
25 Commission with any Company documents.” Truxton Response Br. at 10:19.5-20.5. The Company’s
26 contention fails to address that documentation provided to the Commission stating the earnings and
27 expenses of a utility must be accurate or the filing fails to answer the inquiry posed by the
28 Commission requirement that such information be reported. The requirement of A.R.S. § 40-204(A)

1 is not to provide documents but to answer the Commission's questions in a form and level of detail
2 specified by the Commission. A.R.S. § 40-204(A).

3 As Staff explained in its Opening Brief, the commingling of funds produces records that do
4 not accurately reflect the state of the utility's finances. This is detrimental to both the Company and
5 its ratepayers. February 29, 2012 Hearing Transcript at 180-81. As well as creating a problem by
6 way of introducing concerns of subsidization between regulated and unregulated activities by
7 ratepayers, the commingling of funds obscures cash flow problems to the utility that further imperil
8 utility service to the ratepayer. *Id.* at 181. As was illustrated during the hearing, even the Company
9 does not know the Claude K. Neal Family Trust's ("Trust") or the Company's financial states due to
10 the commingling of funds. March 1, 2012 Hearing Transcript at 335-339.

11 For the same reasons, the Company's casual dismissal of the inaccurate water loss reporting
12 in its annual reports is nonresponsive to the allegation. Truxton Response Br. at 10:23-28. As
13 explained in Staff's Opening Brief, high water loss is a ratemaking concern as it means a utility is not
14 efficiently controlling its expenses. These inefficiencies give rise to cash flow concerns which can
15 lead to operational problems that harm the ratepayer, notwithstanding the fact that the entity
16 supplying water to the Company is not regulated.

17 The Company states, with respect to alleged violations of A.R.S. § 40-204(B), that it has
18 provided Staff with every document Staff has requested and has thus not violated the statute. Truxton
19 Response Br. at 11:5-9.5. Staff contends that, as with A.R.S. § 40-204(A), providing documents that
20 do not accurately present the information that is requested by the Commission is a violation of the
21 statute. A.R.S. § 40-204(B) requires a public service corporation to provide documents and records
22 in its possession, "or in any way relating to its property or affecting its business, and also a complete
23 inventory of all its property in the form the commission desires." As explained in the Staff Opening
24 Brief, the prior commingling of funds impairs the Commission's ability to determine what the
25 complete property of the Company is and therefore constitutes a violation of A.R.S. § 40-204(B).

26 **c. Main Extension Agreements**

27 Staff continues to assert that the Northern Arizona Consolidated Fire District ("NACFD")
28 Agreement is a Main Extension Agreement ("MXA") for which Commission approval would be

1 necessary. The NACFD Agreement is an MXA because it involves the contribution of funds from an
2 entity other than the Company for the construction of facilities to be used by the Company to provide
3 service within its service territory. The NACFD Agreement provides for the fire district to supply
4 Truxton with \$17,420 in order to have four fire hydrants emplaced. See Exhibit A-5, Rebuttal
5 Testimony of Rick Neal, Attachment 4, Hydrant Installation and Maintenance Agreement Between
6 Northern Arizona Consolidated Fire District #1 and Cerbat and Truxton Canyon Water Companies at
7 1. The Commission will ultimately have to determine the appropriate regulatory treatment for these
8 funds, and the failure to provide the NACFD Agreement for approval, as with any other MXA,
9 therefore constitutes a violation of A.A.C. R14-2-406(M).

10 **3. Financial Violations**

11 Concerning the alleged violations of A.R.S. § 40-301(B) and -302(A), the Company contends
12 that the approximately \$400,000 in long term debt listed by the Company in its annual report is
13 “simply an accountant reclassification from accounts payable to long term debt.” Truxton Response
14 Br. at 4:20.5-21.5. By way of explanation for the situation, the Company points to its inability to pay
15 its mounting bills to the Trust for money that the Trust has given to Truxton. *Id.* at 4:23-28. In
16 addition to reinforcing Staff’s concerns about the precarious financial situation the commingling of
17 funds has placed the Company in, the Company’s explanation fails to dispute that the Company has
18 violated either A.R.S. § 40-301(B) or -302(A). Rather than refute the allegation, the Company
19 complains of Staff’s recommendation that the \$400,000 debt to the Trust be treated as paid in capital
20 within the Company’s rate case and that the violation, in conjunction with the multitude of other
21 violations Staff alleges, should serve as the basis of potential fines or other remedies. Truxton
22 Response Br. at 5:5-13.5.

23 Staff continues to believe that the \$400,000 debt is long term debt that was incurred without
24 Commission authorization for all the reasons provided in Staff’s Opening Brief. In addition, Staff
25 would observe that treating unauthorized debt between a regulated utility and its parent (or in this
26 case a trust that shares the same principals as the ownership of the utility) is ratemaking treatment
27 that is well within the Commission’s constitutionally plenary ratemaking authority. See e.g. Ariz.
28 Const. Art. XV § 3. That said, Staff concedes that the treatment of the long term debt as paid in

1 capital will necessarily have to be resolved within a rate case such as Truxton's current rate case
2 application in Docket No. W-02168A-11-0363.

3 **4. Consumer Service Violations**

4 In its Response Brief, the Company acknowledges its prior poor customer service. Truxton
5 Response Br. at 7:22-23. However, the Company explains that there were extenuating circumstances
6 and that in any event, the level of customer service has improved and consequently no penalty should
7 result. *Id.* at 7 – 8. Staff agrees that the level of customer service has improved. February 29, 2012
8 Hearing Transcript at 162:5-163:12. However, Staff would observe that a prior violation is sufficient
9 basis for a penalty in the event that the Commission determines that one is appropriate, contrary to
10 the contentions of the Company. Truxton Response Br. at 8:6-7, 8:14.5 – 15.5. Consequently, Staff
11 maintains that the Commission should find that the Company has previously violated A.A.C. R14-2-
12 411(A)(1) and (2) and require that the Company remain in compliance with A.A.C. R14-2-411(A)(1)
13 and (2).

14 **5. Violation of Commission Rules, Regulations and Orders**

15 With respect to Staff's assertion that the Company has violated A.R.S. § 40-202(L), Truxton
16 states that the Commission cannot compel the transfer of the Trust's wells to the Company, and that
17 the Company has suggested multiple means by which Truxton could purchase the Trust's wells and
18 equipment. Truxton Response Br. at 9:28-10:6. The Company's responses deflect, but fail to rebut
19 the violation asserted by Staff. The Company is presently in violation of a Commission order
20 requiring the transfer of the Trust's wells. Decision No. 72386 (May 27, 2011) Exhibit C,
21 Attachment 1, Recommendation 4. As noted in the Staff Opening Brief, the Commission has not
22 granted a stay from the operation of Decision No. 72386. Decision No. 72548 at 2:23-24. Moreover,
23 simply requesting rehearing pursuant to A.R.S. § 40-253 does not stay the order that is being reheard.
24 A.R.S. § 40-253(D). Because Decision No. 72386 remains in effect, its compliance requirements are
25 likewise still in effect and the Company has failed to comply with one of its requirements. Truxton's
26 failure to comply with the order represents a violation of A.R.S. § 40-202(L).

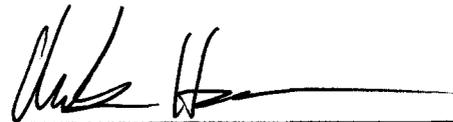
27 The Company further suggests that this is the first time that Staff has asserted a basis for
28 Truxton's violation of A.R.S. § 40-202(L). Staff would point out that A.R.S. § 40-202(L) requires a

1 public service corporation to “comply with every order, decision, rule or regulation made by the
2 commission...” Consequently, A.R.S. § 40-202(L) applies to every rule violation described within
3 the Staff Complaint and as stated within the Staff Opening Brief. Staff Opening Br at 13:5-7. Staff’s
4 observation with regard to the violation of A.R.S. § 40-202(L) for failure to comply with the
5 requirements of Decision No. 72386 was, as explained within the Staff Opening Brief, to illustrate
6 that the Company remains in violation of *and* has committed a new violation of Commission
7 regulations and orders since the initiation of the Order to Show Cause. Staff Opening Br. at 13:7-9.
8 Staff recognizes that the Company had not violated Decision No. 72386 at the time that the Staff
9 Complaint was filed because Decision No. 72386 had not issued at that point and that Staff would
10 have to pursue compliance with Decision No. 72386 in a separate complaint.

11 **III. CONCLUSION**

12 For all the reasons stated above and in the Staff Opening Brief, Staff believes that the
13 Commission should find the Company in violation of A.R.S. §§ 40-202(L), -204(A), -204(B), -
14 221(C), -301(B), and -302(A), as well as A.A.C. R14-2-406(M), -407(A), -407(C), -411(A)(1), -
15 411(A)(2), -411(D)(1), and -411(D)(2).

16 RESPECTFULLY SUBMITTED this 1st day of June, 2012.

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