

**ORIGINAL**

**OPEN MEETING**

**MEMORANDUM**



0000138218

TO: THE COMMISSION

**RECEIVED**

FROM: Utilities Division

2012 JUL 21 P 2: 13

DATE: July 27, 2012

RE: IN THE MATTER OF THE APPLICATION OF LITCHFIELD PARK SERVICE COMPANY FOR A WAIVER UNDER A.A.C. R14-2-806 OR, IN THE ALTERNATIVE, NOTICE OF INTENT TO REORGANIZE UNDER A.A.C. R14-2-803 (DOCKET NOS. W-01427A-11-0419 AND SW-01428A-11-0420).

**Introduction**

On November 22, 2011, Litchfield Park Service Company ("LPSCO" or "Company") filed applications ("Applications") with the Arizona Corporation Commission ("Commission") for both its water and wastewater operations, requesting an order from the Commission that either (i) declares that the affiliated interests rules (Arizona Administrative Code ("A.A.C.") R14-2-801, et seq.) do not apply to a transaction (the purchase of all outstanding shares of Entrada Del Oro Sewer Company, Inc. ("EDO") by Liberty Water Company ("Liberty Water")) or (ii) grants a waiver under A.A.C. R14-2-806 with respect to that transaction. Alternatively, LPSCO requests that the Commission approve the transaction under A.A.C. R14-2-803, a notice of intent to reorganize an existing public utility holding company. On December 22, 2011, Docket Nos. W-01427A-11-0419 and SW-01428A-11-0420 were consolidated by the Hearing Division.

**Background**

Litchfield Park Service Company ("LPSCO or Company"), a wholly-owned subsidiary of Liberty Water Company ("Liberty Water"), is a public service corporation engaged in providing water and wastewater utility services in Maricopa County, Arizona. Its principal place of business is 12725 W. Indian School Road, Suite D-101, Avondale, Arizona.

At the present time, LPSCO provides water service to approximately 16,500 water customers and 18,500 wastewater customers. LPSCO's current rates and charges were authorized in Decision No. 72026 (December 10, 2010).

Entrada Del Oro Sewer Company, Inc. ("EDO") at the present time provides wastewater services to approximately 324 wastewater customers in Pinal County, Arizona. EDO's current rates and charges were authorized in Decision No. 68306 (November 14, 2005).

LPSCO's application presents the following description of the transaction and its relationship with EDO:

Arizona Corporation Commission

On August 26, 2008, Liberty Water entered into a Stock Purchase Agreement with Sellers for the purchase of all outstanding shares of

JUL 27 2012

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EDO's common stock (the "Stock Purchase Agreement"). A copy of the Stock Purchase Agreement will be provided subject to an appropriate confidentiality agreement. Liberty Water paid \$635,000 cash to Sellers for EDO's common stock. The stock shares are escrowed and will be transferred once the Commission grants a waiver or, in the alternative, approves the Transaction. Liberty Water has also paid growth premiums totaling \$279,000. To date the purchase price is \$914,000. That amount will increase based on customer growth expected through 2018.

Also on August 26, 2008, Liberty Water and EDO entered into an Agreement for Labor Services (the "Management Agreement"). A copy of the Management Agreement will be provided subject to an appropriate confidentiality agreement. By way of the Management Agreement, Liberty Water maintains and operates EDO's wastewater treatment plant.

The Transaction does not involve the sale, lease, assignment, encumbrance or transfer or conveyance of any of EDO's utility plant, assets, revenue or property. The only change to EDO as a result of the Transaction is that EDO, which elected S-Corporation tax status, will revert back to a C-Corporation, as EDO will become a subsidiary of Liberty Water which is a C-Corporation.<sup>1</sup> Nevertheless, the Transaction will be transparent to EDO customers, as well as to LPSCO customers.

The Transaction between Liberty Water and EDO will not alter the utility service provided by LPSCO. LPSCO has provided and will continue to provide safe and reliable utility service to customers in its service territory. Moreover, LPSCO has operated and will continue to operate as a public service corporation and be subject to the Commission's authority and jurisdiction.

LPSCO has asked for a waiver to the above transaction. If the Commission is inclined to grant a waiver, it should only apply to this transaction.

### **Explanation of the Affiliate Interest Rules**

The Rules cover the Commission's review of transactions between public utilities and affiliates. In general, A.A.C. R14-2-804 states that, in order to transact business with an affiliate, the utility must agree to provide the Commission with access to the books and records of the affiliate to investigate transactions between the two. The utility is also obligated to maintain necessary accounting records regarding transactions with each affiliate. The Rules were created so that the Commission could be made aware of transactions and other occurrences at the holding company level that may affect the regulated utility's operations or financial well-being – even if

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<sup>1</sup> EDO's 2008, 2009, and 2010 Utility Reports on file with the Commission incorrectly reflect that EDO is a C-Corporation.

indirectly. In the past, when dealing with certain other utilities with corporate parents, Staff has sometimes experienced difficulties obtaining information at the parent level that Staff believed was necessary for a complete analysis. Staff notes this concern now in hopes of avoiding any such delays or lack of cooperation in this and any future proceedings the Commission may have with the Company, although Staff has not experienced problems obtaining requested information from LPSCO in the past.

Staff concludes that the Commission or other parties might have questions about the proposed transaction; therefore, it is not in the public interest to either declare that the Rules do not apply or to grant a waiver.

### **Company's alternative if its waiver is denied**

LPSCO requests that, in the event that its request for a waiver is denied, the Commission approve the transaction under A.A.C. R14-2-803 ("Rule 803"), a notice of intent to reorganize an existing public utility holding company. LPSCO provided in its Application all eleven components required in a notice of intent to reorganize as a public utility company pursuant to Rule 803.

The reorganization involves only the purchase and sale of common stock. The transaction does not involve the sale, lease, assignment, encumbrance or transfer or conveyance of any of EDO's utility plant, assets, revenue or property. The only change to EDO as a result of the transaction is that EDO, which elected S-Corporation tax status, will revert back to a C-Corporation. The transaction will also not alter the capital structure of LPSCO.

Staff recommends that this transaction, and only this transaction, should be approved under Rule 803, and agrees with the Company that a hearing is not necessary. Staff further concludes that this transaction should benefit rate payers, by permanently unifying the owner and operator of EDO; provide EDO with access to greater managerial, financial and technical expertise; and provide EDO with access to the equity capital markets.

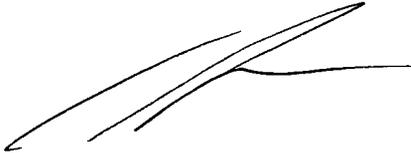
### **Recommendations**

1. Denial of the request for a waiver.
2. Approval of the reorganization subject to the following conditions:
  - a. LPSCO fully complies with any Staff inquiries or requests for information and/or documents regarding any transactions that Staff determines might have some effect, direct or indirect, on the Company's operational or financial health.
  - b. EDO is ordered to refrain from seeking an acquisition adjustment due to this transaction in any future rate case.
  - c. EDO is ordered to maintain its quality of service, including, but not limited to: that the number of service complaints should not increase; that the response

time to service complaints should not increase; and that service interruptions should not increase as a result of the reorganization.

- d. EDO and LPSCO are directed to maintain an equity position that represents no less than 35 percent of its total capitalization (aggregate of common equity, long-term debt and short-term debt).

Staff's recommendations are made to ensure that the Company's ratepayers are unharmed by the reorganization and that the transaction is in the public interest.



Steven M. Olea  
Director  
Utilities Division

SMO:JMM:sms\RRM

ORIGINATOR: Jeffrey M. Michlik

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BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF THE APPLICATION OF  
LITCHFIELD PARK SERVICE COMPANY  
FOR A WAIVER UNDER A.A.C. R14-2-806  
OR, IN THE ALTERNATIVE, NOTICE OF  
INTENT TO REORGANIZE UNDER A.A.C.  
R14-2-803.

DOCKET NOS. W-01427A-11-0419  
AND SW-01428A-11-0420  
DECISION NO. \_\_\_\_\_  
ORDER

Open Meeting  
August 14-15, 2012  
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

**A. Introduction**

1. On November 22, 2011, Litchfield Park Service Company ("LPSCO" or "Company") filed applications ("Applications") with the Arizona Corporation Commission ("Commission") for both its water and wastewater operations, requesting an order from the Commission that either (i) declares that the affiliated interests rules (Arizona Administrative Code ("A.A.C.") R14-2-801, et seq.) do not apply to a transaction (the purchase of all outstanding shares of Entrada Del Oro Sewer Company, Inc. ("EDO") by Liberty Water Company ("Liberty Water")) or (ii) grants a waiver under A.A.C. R14-2-806 with respect to that transaction. Alternatively, LPSCO requests that the Commission approve the transaction under A.A.C. R14-2-803, a notice of intent to reorganize an existing public utility holding company.

1           2.     On December 22, 2011, Docket Nos. W-01427A-11-0419 and SW-01428A-11-  
2 0420 were consolidated by the Hearing Division.

3 **B.     Background**

4           3.     Litchfield Park Service Company (“LPSCO or Company”), a wholly-owned  
5 subsidiary of Liberty Water Company (“Liberty Water”), is a public service corporation engaged  
6 in providing water and wastewater utility services in Maricopa County, Arizona. Its principal  
7 place of business is 12725 W. Indian School Road, Suite D-101, Avondale, Arizona.

8           4.     At the present time, LPSCO provides water service to approximately 16,500 water  
9 customers and 18,500 wastewater customers. LPSCO’s current rates and charges were authorized  
10 in Decision No. 72026 (December 10, 2010).

11           5.     Entrada Del Oro Sewer Company, Inc. (“EDO”) at the present time provides  
12 wastewater services to approximately 324 wastewater customers in Pinal County, Arizona. EDO’s  
13 current rates and charges were authorized in Decision No. 68306 (November 14, 2005).

14           6.     LPSCO’s application presents the following description of the transaction and its  
15 relationship with EDO:

16                   On August 26, 2008, Liberty Water entered into a Stock Purchase  
17 Agreement with Sellers for the purchase of all outstanding shares of EDO’s  
18 common stock (the “Stock Purchase Agreement”). A copy of the Stock  
19 Purchase Agreement will be provided subject to an appropriate  
20 confidentiality agreement. Liberty Water paid \$635,000 cash to Sellers for  
21 EDO’s common stock. The stock shares are escrowed and will be  
22 transferred once the Commission grants a waiver or, in the alternative,  
23 approves the Transaction. Liberty Water has also paid growth premiums  
24 totaling \$279,000. To date the purchase price is \$914,000. That amount  
25 will increase based on customer growth expected through 2018.

26                   Also on August 26, 2008, Liberty Water and EDO entered into an  
27 Agreement for Labor Services (the “Management Agreement”). A copy of  
28 the Management Agreement will be provided subject to an appropriate  
confidentiality agreement. By way of the Management Agreement, Liberty  
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or transfer or conveyance of any of EDO’s utility plant, assets, revenue or  
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EDO, which elected S-Corporation tax status, will revert back to a C-  
Corporation, as EDO will become a subsidiary of Liberty Water which is a

1 C-Corporation.<sup>1</sup> Nevertheless, the Transaction will be transparent to EDO  
2 customers, as well as to LPSCO customers.

3 The Transaction between Liberty Water and EDO will not alter the utility  
4 service provided by LPSCO. LPSCO has provided and will continue to  
5 provide safe and reliable utility service to customers in its service territory.  
6 Moreover, LPSCO has operated and will continue to operate as a public  
7 service corporation and be subject to the Commission's authority and  
8 jurisdiction.

9 7. LPSCO has asked for a waiver to the above transaction. Staff recommends that if  
10 the Commission is inclined to grant a waiver, it should only apply to this transaction.

11 **C. Explanation of Affiliate Interest Rules**

12 8. The Rules cover the Commission's review of transactions between public utilities  
13 and affiliates. In general, A.A.C. R14-2-804 states that, in order to transact business with an  
14 affiliate, the utility must agree to provide the Commission with access to the books and records of  
15 the affiliate to investigate transactions between the two. The utility is also obligated to maintain  
16 necessary accounting records regarding transactions with each affiliate. The Rules were created so  
17 that the Commission could be made aware of transactions and other occurrences at the holding  
18 company level that may affect the regulated utility's operations or financial well-being--even if  
19 indirectly.

20 9. In the past, when dealing with certain other utilities with corporate parents, Staff  
21 has sometimes experienced difficulties obtaining information at the parent level that Staff believed  
22 was necessary for a complete analysis. Staff notes this concern now in hopes of avoiding any such  
23 delays or lack of cooperation in this and any future proceedings the Commission may have with  
24 the Company. Although Staff has not experienced problems obtaining requested information from  
25 LPSCO in the past.

26 10. Staff concludes that the Commission or other parties might have questions about the  
27 proposed transaction; therefore, it is not in the public interest to either declare that the Rules do not  
28 apply or to grant a waiver.

<sup>1</sup> EDO's 2008, 2009, and 2010 Utility Reports on file with the Commission incorrectly reflect that EDO is a C-Corporation.

**D. Company's Alternative if its Waiver is denied**

11. LPSCO requests that, in the event that its request for a waiver is denied, the Commission approve the transaction under A.A.C. R14-2-803 ("Rule 803"), a notice of intent to reorganize an existing public utility holding company. LPSCO provided in its Application all eleven components required in a notice of intent to reorganize as a public utility company pursuant to Rule 803.

12. The reorganization involves only the purchase and sale of common stock. The transaction does not involve the sale, lease, assignment, encumbrance or transfer or conveyance of any of EDO's utility plant, assets, revenue or property. The only change to EDO as a result of the transaction is that EDO, which elected S-Corporation tax status, will revert back to a C-Corporation. The transaction will also not alter the capital structure of LPSCO.

13. Staff recommends that this transaction, and only this transaction, should be approved under Rule 803, and agrees with the Company that a hearing is not necessary. Staff further concludes that this transaction should benefit rate payers, by permanently unifying the owner and operator of EDO; provide EDO with access to greater managerial, financial and technical expertise; and provide EDO with access to the equity capital markets.

**14. Staff Recommendations:**

Denial of the request for a waiver.

Approval of the reorganization subject to the following conditions:

- a. LPSCO fully complies with any Staff inquiries or requests for information and/or documents regarding any transactions that Staff determines might have some effect, direct or indirect, on the Company's operational or financial health.
- b. EDO is ordered to refrain from seeking an acquisition adjustment due to this transaction in any future rate case.
- c. EDO is ordered to maintain its quality of service, including, but not limited to: that the number of service complaints should not increase, that the response time to service complaints should not increase, and that service interruptions should not increase as a result of the reorganization.
- d. EDO and LPSCO are directed to maintain an equity position that represents no less than 35 percent of its total capitalization (aggregate of common equity, long-term debt and short-term debt).

15. Staff's recommendations are reasonable, and should be adopted.

CONCLUSIONS OF LAW

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1. The Company is a public water service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. 40-250 and 40-252 and the Commission's Affiliated Interest Rules, A.A.C R14-2-801-806.

2. The Commission has jurisdiction over the Company and the subject matter of the application.

3. The public interest requires that the Commission apply the Affiliated Interests Rules in a manner that will maximize protection to ratepayers.

4. Approval of the transaction proposed in the Application would serve the public interest only if conditions are imposed to provide adequate protection to ratepayers.

5. The public interest requires that the transaction proposed in the Application be approved subject to the conditions recommended by Staff.

6. The transaction proposed in the Application, with the conditions set forth and discussed herein, is reasonable and in the public interest and should be approved.

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ORDER

IT IS THEREFORE ORDERED that Litchfield Park Service Company's request for a waiver from Commission review of the transaction proposed in the Application pursuant to A.A.C. R14-2-806, is hereby denied.

IT IS FURTHER ORDERED that the transaction proposed in the Application and Notice is hereby approved, as a reorganization of a holding company pursuant to A.A.C. R14-2-803, subject to the conditions set forth in Findings of Facts Nos. 13 and 14.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

**BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION**

CHAIRMAN

COMMISSIONER

COMMISSIONER

COMMISSIONER

COMMISSIONER

IN WITNESS WHEREOF, I, ERNEST G. JOHNSON, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this \_\_\_\_\_ day of \_\_\_\_\_, 2012.

\_\_\_\_\_  
ERNEST G. JOHNSON  
EXECUTIVE DIRECTOR

DISSENT: \_\_\_\_\_

DISSENT: \_\_\_\_\_

SMO:JMM:sms\RMM

1 SERVICE LIST FOR: Litchfield Park Service Company  
2 DOCKET NO. W-01427A-11-0419 ET AL

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4 Vice President & General Manager  
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