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BEFORE THE ARIZONA CORPORATION CC

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Arizona Corporation Commission
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AZ CORP COMMISSION
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BOB STUMP - Chairman
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH

IN THE MATTER OF THE APPLICATION OF
TRUXTON CANYON WATER COMPANY, INC.
FOR APPROVAL OF A RATE INCREASE.

DOCKET NO. W-02168A-11-0363

IN THE MATTER OF THE APPLICATION OF
TRUXTON CANYON WATER COMPANY, INC.
FOR APPROVAL OF A REVISION OF THE
COMPANY'S EXISTING TERMS AND
CONDITIONS OF WATER SERVICE.

DOCKET NO. W-02168A-13-0309

ORIGINAL

IN THE MATTER OF THE APPLICATION OF
TRUXTON CANYON WATER COMPANY, INC.
FOR AUTHORITY TO INCUR LONG-TERM
DEBT.

DOCKET NO. W-02168A-13-0332

**STAFF'S INITIAL CLOSING
BRIEF**

The Utilities Division ("Staff") of the Arizona Corporation Commission ("Commission") hereby files its opening brief in the above captioned matter. This brief addresses the disputed issues between Staff, Truxton Canyon Water Company, Inc. ("the Company" or "Truxton") and the Intervener, Valle Vista Property Owners Association, Inc. ("Valle Vista" or "VVPOA") (together "Parties") and the issues resolved subsequent to pre-filed testimony. Staff maintains its position as presented in its pre-filed testimony on any issue not specifically addressed here.

I. INTRODUCTION.

Truxton is an Arizona public service corporation engaged in providing water utility services in portions of Mohave County, Arizona, pursuant to Decision No. 41781, issued December 15, 1971. Truxton filed an application for a rate increase in the above captioned matter on September 30, 2011, using a test year ending June 30, 2011, pursuant to the order of the Commission contained in its Decision No. 72386 (May 27, 2011). That test year was subsequently updated to a test year ending December 31, 2012.¹ During the 2012 Test Year, Truxton served approximately 924 metered

¹ Updated Rate Case Data, Ex. A-2, Attachment 1 at 6.

1 connections.² Truxton is solely owned by the Claude K. Neal Family Trust (“the Trust”), which
2 also owns Cerbat Water Company (“Cerbat”), another regulated water utility in Mohave County.³

3 The Company’s present rates and charges for utility service were approved by the
4 Commission on June 6, 2001, in Decision No. 63713, using a 1999 test year.⁴ In its Updated Rate
5 Case Data, the Company requests a revenue increase of \$300,000, or 53.96 percent, from \$555,924
6 to \$855,924. The Company proposes an original cost rate base (“OCRB”) of a negative \$185,698.
7 Due to its negative rate base, the Company proposes using an operating margin and requests that it
8 be set at 11.10 percent.⁵ Staff recommends a \$66,818 or 12.02 percent revenue decrease from
9 \$555,924 to \$489,106. Staff proposes an operating margin of 10.22 percent.

10 **II. DISCUSSION.**

11 **A. Ownership of Plant Assets by the Trust.**

12 One single fact is the basis for virtually all the disputed issues in this case: the continuing
13 ownership of water plant assets by the Claude K. Neal Family Trust (“the Trust”). It is blamed for
14 preventing the Company from being able to support its claimed expenses, and thus to recover the
15 same in rates. And it raises concerns, which Staff believes to be supported by the evidence, that the
16 Company seeks to recover the same expenses, some of which are not allowable in any event,
17 multiple times under multiple accounts. Because it agreed to do so, and the Commission ordered the
18 Company to acquire the plant assets from the Trust thereby resolve the myriad problems that result
19 from the Trust’s ownership of the plant, Staff has opted to treat the Company as if it had acquired
20 the plant assets.⁶

21 **1. Ownership of Plant.**

22 Substantially all of the plant necessary to provide water to Truxton’s customers other than its
23 distribution system is owned by the Claude K. Neal Family Trust. According to Company witness
24 Matthew Rowell, the Trust owns three active wells, three inactive wells, a 500,000 gallon
25 underground concrete storage tank, a 40,000 gallon above ground storage tank, a booster pump

26 ² *Id.*

27 ³ Ex. A-2, Attachment 1 at 7; Tr. Vol. II at 222-23.

28 ⁴ Sonn Rowell Dir. Test., Ex. A-1 at 2.

⁵ Crystal Brown Dir. Test., Ex. S-3 at 3-4.

⁶ *Id.* at 7.

1 station, a pressure tank and approximately fifteen miles of 14 to 16 inch pipeline.⁷ In addition, Mr.
2 Neal disclosed at hearing that virtually all assets needed to operate the water company are owned by
3 the Trust, stating:

4 ... the Trust, they own everything that goes along with this water company. They
5 own backhoes, they own Ditch Witches, they own vehicles, they own trailers, they
6 own welders, they own pumps, they own shops, they own yards. They own
7 everything that it takes to run a water company. They don't just own a pipeline that's
8 70 years old and five wells. That's not what the Trust owns. And you can't run a
9 water company with a pipeline and five wells. It doesn't work that way. You need a
10 whole bunch of things to go along with that, including employees. And the Trust
11 owns all of that stuff.⁸

12 In Decision No. 72386, the Commission ordered the Company to acquire all water system
13 assets required for the provision of water service by June 30, 2011. In that 2010 case, Staff had filed
14 a Complaint and a Petition for Order to Show Cause ("OSC") against Truxton, alleging numerous
15 violations of Arizona law and the Commission's rules and regulations.⁹ Staff, Valle Vista and the
16 Company entered into a Stipulation Agreement in which Truxton agreed to perform various actions,
17 including the acquisition of "all water system assets necessary to provide service."¹⁰

18 Although Truxton sought and was granted a re-hearing, the Decision in that case has not
19 been stayed and remains in full force and effect.¹¹ Yet at this time, more than three years after its
20 agreement to do so, and nearly three years past its deadline for doing so, Truxton has not acquired
21 the water plant assets. Truxton now asserts that it must pay the Trust \$1.4 million to acquire those
22 assets.¹²

23 2. Affiliate Transactions Between Truxton and the Trust.

24 The Trust is a family trust creased by Claude K. Neal, now deceased, who is the father of B.
25 Marc Neal, the trustee and manager of the Trust, and the grandfather of Rick Neal, the current
26 manager of Truxton and Cerbat. The Trust is the sole shareholder of Truxton¹³ and it is undisputed

27 ⁷ Matthew Rowell Reb. Test., Ex. A-5, at 2; Tr. Vol. II at 259-60.

28 ⁸ Tr. Vol. II at 241.

⁹ Complaint and Petition for Order to Show Cause, Docket No. W-02168A-10-0247.

¹⁰ Decision No. 72386 at 11 and Attachment C at 11.

¹¹ Tr. April 11, 2011 Procedural Conference at 29.

¹² Matthew Rowell Reb. Test. at 3; Neal Reb. Test. at 2-3; Tr. Vol. II at 256, 260.

¹³ Tr. Vol. II at 274.

1 that Truxton and the Trust are affiliates.¹⁴ Affiliate transactions are problematic in that they raise the
2 concern of self-dealing where prices are not driven by market forces and where utilities have an
3 incentive to shift costs from non-regulated operations to regulated monopoly operations.¹⁵ The
4 National Association of Regulatory Utility Commissioners (“NARUC”) specifically addresses those
5 concerns in its Accounting Guidelines for Cost Allocations and Affiliate Transactions (“NARUC
6 Guidelines” or “Guidelines”).¹⁶ While the Commission has not officially adopted those Guidelines,
7 it consistently follows them, as Company witness Mr. Rowell, a former Commission employee,
8 acknowledges.¹⁷

9 The Guidelines define affiliates as “companies that are related to each other due to common
10 ownership or control.”¹⁸ Truxton and the Trust, then, are affiliates under the Guidelines.¹⁹ Prior to
11 the creation of either Truxton or the Trust, the Neal family had significant land holdings in Mohave
12 County, Arizona, which had access to water. The family traded, and may have sold, water to the
13 railroad and the U.S. Army. In this manner, the family acquired both land and plant assets, including
14 the fifteen mile transmission line at issue.²⁰

15 It is unknown when the Trust was created, but it appears to have been done before the water
16 company was created.²¹ According to Mr. Neal, when the water company was created in 1971 or
17 1972, the Hualapai well field, the Hackberry well field and the storage tanks were intentionally
18 retained by the Trust and not transferred to the water company because the ‘the Truxton/Claude K.
19 Neal entity’²² wanted to avoid being regulated by the Commission.²³ This case involves two types of
20 affiliate transactions, both of which are addressed by the NARUC Guidelines. These include both
21 the provision of products, services and assets and the transfer of assets between affiliates. As to the
22 transfer of assets, the Guidelines state:

23
24 ¹⁴ Tr. Vol. II at 296.

25 ¹⁵ NARUC Guidelines for Cost Allocations and Affiliate Transactions, Ex. S-8 at D.

26 ¹⁶ *Id.* at A.1.

27 ¹⁷ Tr. Vol. I at 136.

28 ¹⁸ *Id.*

¹⁹ *Id.* at 296.

²⁰ Tr. Vol. II at 228-31.

²¹ *Id.* at 269.

²² *Id.*

²³ *Id.* at 270.

1 Generally, transfer of assets from an affiliate to the utility should be at the lower of
2 prevailing market price or net book value, except as otherwise required by law or
3 regulation. To determine prevailing market value, an appraisal should be required at
4 certain value thresholds as determined by regulators.²⁴

5 The Guidelines also provide that “the burden of proof for any exception from the general rules
6 rests with the proponent of the exception.”²⁵

7 **3. Acquisition of Plant Assets by the Trust.**

8 Truxton contends that it is appropriate to incur WIFA financed debt in order to pay the Trust
9 \$1.4 million to acquire the water plant assets. The Company asserts that this is significantly lower
10 than the market value.²⁶ Staff’s position is that, under the NARUC Guidelines, the correct price must
11 be the *lower* of the net book value or prevailing market value. Staff believes the net book value
12 should be set at zero.

13 Truxton has not demonstrated why the general rule should not be applied or established the
14 actual market value for the plant in question. Nor was the requisite appraisal performed.²⁷ Moreover,
15 if the net book value is zero as Staff contends, then that is the lower value.

16 Net book value is the original cost of the asset, plus any additions, less retirements, and the
17 accumulated depreciation on that plant.²⁸ It is clear that, based on the age of the assets, without
18 more, those assets must be fully depreciated.

19 Staff engineer Dorothy Hains provided an itemized list of those assets, showing the year that
20 plant was placed in service and its estimated original cost.²⁹ Company witness Matthew Rowell
21 acknowledged that those dates were accurate, but neither he nor the Company has any knowledge as
22 to their actual cost of acquisition.³⁰ Company manager Rick Neal acknowledged that there had been
23 no cost for some items, such as the transmission line.³¹

24 Even without knowledge of the actual cost, it is evident that these assets have no net book
25 value. The wells in question were placed in service in 1943, 1962 and 1964.³² The useful life of a

26 ²⁴ Ex. S-8 at D.4.

27 ²⁵ *Id.*

28 ²⁶ Neal Reb. Test., Ex. A-5, at 3.

29 ²⁷ Tr. Vol. I at 291-92.

30 ²⁸ *Id.* at 58, 175-76; Vol. III at 550.

31 ²⁹ Hains Test. Summary, Ex. S-2 at 4.

32 ³⁰ Tr. Vol. II at 127-28, 272, 274.

33 ³¹ *Id.* at 272.

34 ³² Hains Test. Summary, Ex. S-2 at 4.

1 well is 30 years,³³ so those wells would have been fully depreciated in 1973, 1992 and 1994,
2 respectively. The storage tanks were placed into service in approximately 1944 and 1964. The useful
3 life of a storage tank is 45 years³⁴ so those tanks were fully depreciated in 1989 and 2009,
4 respectively. Likewise, the transmission and distribution lines were placed in service in
5 approximately 1943. Their useful life is 50 years³⁵ so they were fully depreciated in 1993.

6 In pre-filed testimony, Mr. Rowell asserted that improvements could have been made that
7 would extend the depreciable life of the plant.³⁶ Had the Company produced any details or
8 documentation of such, they would have been considered. However, neither Mr. Rowell nor Mr.
9 Neal nor any other witness was able to identify or provide any documentation of the occurrence or
10 cost of any system improvements or upgrades.³⁷ Indeed, when asked if the Company could document
11 any repair costs or other improvements so the Commission could determine what had been put into
12 the wells, Mr. Neal answered:

13 One of my biggest challenges, and it was what made this first rate case so extremely
14 difficult when I stepped into this, was the lack of documentation to support money.
15 And I don't care if it was expenses, income, it was just -- and, and I don't know who to
16 blame; I don't know why. I don't know if they do. I don't know if they did where it
17 would be. I just know that every time I have tried to find something, it has been very
18 difficult for me to do, and once I do, it's piecemeal at best.³⁸

18 Truxton further asserts, through its expert witness, Mr. Rowell, that even if the subject assets
19 are fully depreciated to zero, it does not mean that the assets have no value. However, when asked by
20 the Administrative Law Judge at hearing what would make an asset with zero net book value have
21 value in a ratemaking scenario, the only thing he could come up with is that the Company needs
22 sufficient revenue to be an ongoing concern. In other words, he could not provide an answer.³⁹

25 _____
26 ³³ Brown Dir. Test., Ex. S-3 at 4.

³⁴ NARUC depreciation rates.

³⁵ Brown Dir. Test., Ex. S-3 at 4.

³⁶ Matthew Rowell Reb. Test., Ex. A-5 at 3.

³⁷ Tr. Vol. I at 130-31.

³⁸ Tr. Vol. II at 274.

³⁹ Tr. Vol. I at 202-003.

1 The NARUC Guidelines provide that the transfer must be at the lower of market value or net
2 book value. As the net book value is zero, then, by definition, it is the lower and proper value of the
3 transfer. Therefore, based on the NARUC Guidelines, it is the net book value of \$0 that must be used.

4 **B. Revenue Requirement, Rate Base, and Cost of Capital.**

5 **1. Rate Base Adjustments.**

6 Truxton and Staff agree that Truxton has a negative rate base. Truxton states the rate base as
7 (\$185,698) and Staff recommends that the rate base be set at (\$249,270).⁴⁰ The difference is the
8 primarily the result of Staff's adjustment to contributions in aid of construction ("CIAC").⁴¹

9 **a. Adjustment to AIAC, CIAC and Amortization of CIAC.**

10 Truxton's Updated Rate Case Data⁴² reflects \$815,260 in advances in aid of construction
11 ("AIAC") which Staff treats as contributions in aid of construction ("CIAC"). Staff was able to
12 determine, and the Company confirmed that the \$815,260 recorded in Truxton's books as AIAC was
13 related to line extension agreements.⁴³ However, the Company was able to provide line extension
14 agreements for only \$314,160 of the \$815,260, leaving \$501,100 unsupported. Moreover, although
15 the Commission, in Decision No. 72386, had ordered the Company to file its line extension
16 agreements for approval by the Commission, the Company does not appear to have done so.⁴⁴

17 Staff treats the entire \$815,260 in AIAC as CIAC.⁴⁵ Staff's adjustments to CIAC and AIAC
18 result in an increase to the amortization of CIAC by \$13,533.⁴⁶ While Truxton did not expressly
19 agree with Staff's adjustment, neither did it present any testimony or other evidence to refute Staff's
20 recommendation.

21
22
23
24 ⁴⁰ Brown Surrebuttal Test., Ex. S-4, Schedule CSB-4.

25 ⁴¹ The VVPOA does not take a position on rate base, operating income and expenses, or cost of capital.

26 ⁴² Updated Rate Case Data, Ex. A-2.

27 ⁴³ Tr. Vol. II at 258.

28 ⁴⁴ Brown Dir. Test., Ex. S-3 at 11; *see also* Tr. Vol. II at 359. Staff reviewed its files and records and was unable to find any evidence that the contracts were filed with or approved by the Commission. Mr. Neal indicated at hearing that the Company had "list[ed] everything....we've done all that." However, Mr. Neal was unable to provide any specifics regarding such a filing, indicating that he could not remember.

⁴⁵ Brown Dir. Test., Ex S-3 at 10-12.

⁴⁶ Brown Surrebuttal Test., Ex. S-4, Schedule CSB-3.

1 **b. Customer Deposits.**

2 Truxton did not capture customer deposits in the calculation of rate base. As customer
3 deposits are a reduction to rate base, Staff decreased rate base by \$5,618 to reflect the same.⁴⁷ Here,
4 too, Truxton did not expressly agree with Staff's adjustment, but neither did it present any testimony
5 or other evidence to refute Staff's recommendation.

6 **c. Cash Working Capital Allowance ("CWC").**

7 Truxton's Updated Rate Case Data reflects cash working capital ("CWC") in the amount of
8 \$71,487.⁴⁸ However, the Company did not conduct a lead-lag study, so no customer-provided capital
9 is reflected in the working capital requirement.⁴⁹ Instead, the Company includes only prepayments in
10 its working capital allowance. Staff asserts that it is inequitable for a utility the size of Truxton to
11 calculate its working capital allowance by ignoring its CWC; this approach guarantees a positive
12 working capital result for Truxton. Had a lead-lag study been conducted, it might have shown that the
13 Company's total net working capital allowance was actually negative, which would have resulted in a
14 reduction to rate base. Staff recommends removing \$71,487 from working capital.⁵⁰ Once again,
15 Truxton did not expressly agree with Staff's adjustment, nor did it present any testimony or other
16 evidence to refute Staff's recommendation.

17 **2. Operating Income & Expense Adjustments.**

18 With regard to operating income expenses, Staff is placed in an unusual situation. Staff made
19 numerous adjustments to the Company's stated income and expenses in its direct testimony.⁵¹ In its
20 rebuttal testimony, the Company notes that the two most significant adjustments are to purchased
21 water and outside services.⁵² It further states: "Due to the fact that Staff's recommendations are so
22 far out of the realm of reasonableness, the Company has elected not to alter its position."⁵³ No
23 additional schedules have been presented, nor has any other evidence been presented in response to
24 Staff's adjustments.

25 _____
⁴⁷ Brown Dir. Test., Ex. S-3 at 13-14.

26 ⁴⁸ *Id.* at 14-15 and Schedule CSB-4 and CSB-9.

27 ⁴⁹ *Id.* at 14.

⁵⁰ *Id.* at 14-15.

⁵¹ *See generally*, Brown Dir. Test., Ex. S-3.

28 ⁵² Sonn Rowell Reb. Testimony, Ex. A-5 at 2.

⁵³ Sonn Rowell Reb. Testimony, Ex. A-5 at 2.

1 The two categories of purchased water and outside services expenses are based on
2 transactions between Truxton and the Trust, as are some of Staff's other adjustments. Such
3 transactions are also the subject of the NARUC Guidelines, which, as to services, products and assets,
4 state:

5 Generally, the price for services, products and the use of assets provided by a non-
6 regulated affiliate to a regulated affiliate should be at the lower of the fully allocated
7 cost or prevailing market prices.

8 Here, too, Truxton has not introduced any evidence as to either the actual market value of
9 these expenses or their cost. In evaluating Truxton's application, Staff determined it would be most
10 appropriate to treat the plant assets as if they had been acquired by Truxton for ratemaking purposes.
11 Staff did so for several reasons, including that the Commission had ordered the acquisition in
12 Decision No. 72386 and, in doing so, had found a transfer of assets to be in the public interest. In
13 addition, such treatment would benefit ratepayers by eliminating the need to pay the cost of
14 purchased water.⁵⁴

15 An additional issue regarding the Company's expenses is the general lack of documentary
16 support to establish the level of expenses actually incurred and whether the expenses were for the
17 Company or for the Trust. Staff has attempted to include any actual expenses where they appeared
18 reasonable, but was hampered by the dearth of documentation as discussed by Mr. Neal. The
19 Company's testimony at hearing did raise concerns about the reliability of the Company's expense
20 information. It was quite clear that none of the Company's witness could make any distinction
21 between expenses incurred by Truxton and expenses incurred by the Trust and passed on to Truxton.
22 Ms. Rowell testified that the only documentation she was given consisted of spreadsheets prepared by
23 "Rick Neal's wife and some woman named Tammy."⁵⁵ She just accepted that the expenses were
24 exclusively those of Truxton. Likewise, Mr. Neal conceded that the Trust has provided Truxton no
25 documentation of the cost of providing water.⁵⁶

27 ⁵⁴ Brown Dir. Test., Ex. S-3 at 7-8.

28 ⁵⁵ Tr. Vol. I at 65.

⁵⁶ Tr. Vol. II at 278-79.

1 **a. Purchased Water Expense.**

2 The Company includes an expense of \$147,409 for purchased water during the 2012 test
3 year.⁵⁷ Truxton has no operational wells and purchases the majority, if not all, of its water from the
4 Trust.⁵⁸ Clearly, if Truxton owned the Trust's wells and other plant assets, it would not pay for
5 purchased water; it would instead recover its cost of service and earn a return on its rate base. Thus
6 Staff adjusts the expense to \$0.⁵⁹

7 But even if Truxton never acquires the plant assets, Staff's recommendation would be fair to
8 ratepayers and the Company. Truxton purchases water from the Trust pursuant to a Water Supply
9 Agreement ("WSA").⁶⁰ The current WSA was entered into on September 1, 2010, though a virtually
10 identical version of that agreement has been in effect since at least 1991.⁶¹ According to the WSA,
11 Truxton pays the Trust on a commodity basis in 1,000 gallon increments. The rate may be adjusted
12 annually.⁶² The agreement sets the basis for determining the rate charged to Truxton as follows:

13 Said price will be based upon the market value of the water considering the operation,
14 maintenance and capital cost to Trust, **plus a return on the value of the equipment**
15 **and facilities necessary to provide service under this agreement.**⁶³ (Emphasis
added.)

16 This provision not only provides for full recovery of the Trust's costs, it also allows the Trust
17 a return on investment, or a profit, from its subsidiary. As previously discussed, this is contrary to the
18 NARUC Guidelines and even the Company acknowledges that the Commission generally does not
19 allow profit on affiliate transactions.⁶⁴

20 Including the purchased water expense in rates is also problematic because it potentially
21 duplicates at least some of the Trust's cost of providing water which the Company includes as
22

23 ⁵⁷ Updated Rate Case Data, Ex. A-2 at 19.

24 ⁵⁸ Hains Dir. Test., Ex. S-1, Engineering Report at 3. For purposes of this discussion, Staff refers to assets as owned by
25 the Trust and owned by Truxton. This terminology reflects the position of the Company that the Trust and the Company
are two separate entities. As discussed elsewhere, Staff contends that the Trust and the Company, may, in fact, be one and
the same under Arizona law. The references to ownership in this discussion are not intended to concede that the two are
distinct entities.

26 ⁵⁹ Brown Dir. Test., Ex. S-3 at 16.

27 ⁶⁰ Water Supply Agreement, Ex. S-6.

28 ⁶¹ Tr. Vol. II at 336-37.

⁶² Water Supply Agreement, Ex. S-6 at 3.

⁶³ *Id.*

⁶⁴ Tr. Vol. I at 136.

1 allocated costs in other operating expense accounts, including repair & maintenance, outside services
2 and transportation expenses.⁶⁵ The WSA itself makes it clear that the price of water sold includes all
3 of the Trust's costs of providing service.

4 Not only does the clause cited above so state, but that is affirmed by the following clause
5 which appears elsewhere in the WSA, *to wit*:

6 In the event treatment of the water is required, Trust may, at its option, undertake such
7 treatment and make such capital investments as is necessary to comply with the water
8 quality requirements of the appropriate regulatory agency(s). In that event, Trust shall
9 own and operate or cause to be operated, the necessary treatment facilities. The
10 capital, operating and maintenance cost associated with said treatment will be
11 recovered by adjustments in the water purchase price as set forth in Paragraph 8
12 below.⁶⁶

13 Paragraph 8 contains the provision for the annual review of the water rates which may be adjusted
14 based on the market value of water considering the operation, maintenance and capital costs to the
15 Trust plus a return on the plant and services necessary to provide services. This establishes that
16 changes in expenses will be addressed through the annual water rate rather than by allocation of costs
17 to Truxton.

18 The Company's Updated Rate Case Supporting Documents⁶⁷ include invoices which support
19 the operating expenses listed in the 2012 test year filing.⁶⁸ A review of the invoices reveals that
20 many represent, not the costs incurred by the Company, but those incurred by the Trust.⁶⁹ For
21 instance, several invoices from Mohave Electric Cooperative for electric service are billed to the
22 Trust in care of Truxton Water Company. Invoices from the Arizona Department of Environmental
23 Quality for sampling fees are billed to B. Marc Neal, the trustee of the Trust. The invoices from the
24 Trust to Truxton for "Management Agreement," which Rick Neal says were incorrectly categorized
25 as "Management Agreement,"⁷⁰ represent the Trust's cost of equipment and other ancillary services
26 required to operate the water Company.⁷¹ However, the Company concedes that it is unable to

26 ⁶⁵ Updated Rate Case Data, Ex. A-2 at 19.

27 ⁶⁶ Water Supply Agreement, Ex S-6 at 3.

28 ⁶⁷ Updated Rate Case Supporting Documents, Ex. A-3.

⁶⁸ Updated Rate Case Data, Ex. A-2.

⁶⁹ Updated Rate Case Supporting Documents, Ex. A-3.

⁷⁰ Tr. Vol. II at 347.

⁷¹ *Id.*

1 determine which expenses contained in its 2012 test year filing reflect Company expenses and which
2 are Trust expenses.⁷²

3 Staff would also point out that even the purchased water charges reflected in the invoices do
4 not match the \$147,000 expense stated by the Company. Those invoices include monthly charges for
5 purchased water exceeding \$200,000.

6 Given the combination of facts – the inclusion of a profit for an affiliate, the Company’s own
7 failure to abide by the terms of the WSA, the significant concern of over-charging and the absence of
8 documentation no expense should be allowed for purchased water, regardless of the ownership of
9 plant assets.

10 **b. Repair and maintenance expense.**

11 The Company seeks \$37,480 for repair and maintenance expense. Staff recommends \$35,872.
12 Staff only disallowed two items of Truxton’s expenses, that related to the cost of Sirius radio at \$175,
13 which Staff does not deem necessary to the provision of water services,⁷³ and an item in the amount
14 of \$1,433, which was not incurred in the test year.⁷⁴ Nor did the Company have any explanation for
15 an increase of \$15,570 in repair and maintenance from 2011 to 2012.⁷⁵

16 The only supporting documents that were provided by the Company were those included as
17 Updated Rate Case Supporting Documents and the Company’s general ledger, provided in response
18 to Staff’s data requests.⁷⁶ Based on its review of the general ledger and the invoices, Staff determined
19 that the general ledger supported \$14,565 for repairs and maintenance during 2012.⁷⁷ Nonetheless,
20 Staff allowed the \$35,872 explained above, a difference of \$21,307, which Staff understood to be
21 related to the Trust’s expenses allocated to the Truxton and which appeared reasonable.⁷⁸ Despite the
22 concerns raised at hearing, Staff has not changed its recommendation. It is likely that some expenses
23 exist and, if the purchased water expense is not allowed, the expenses could be. The amount of the
24 expenses appears reasonable and not inconsistent with other companies of similar size.

25 _____
26 ⁷² Tr. Vol. II at 278-79.

27 ⁷³ Brown Dit. Test., Ex. S-3 at 18.

28 ⁷⁴ Brown Surrebuttal Test., Ex. S-4 at 7.

⁷⁵ Brown Dir. Test., Ex. S-3 at 17.

⁷⁶ *Id.*

⁷⁷ Brown Surebuttal Test., Ex. S-4 at 6.

⁷⁸ *Id.* at 6-7.

1 **3. Outside Services Expense.**

2 Truxton seeks to recover \$266,283 in outside services.⁷⁹ The expenses in question are
3 primarily related to what have been referred to as management services or a management agreement.
4 Based on the representation of the Company in its application that the management agreement
5 between Truxton and the Trust had been cancelled,⁸⁰ Staff determined that the \$202,891 in actual
6 payments to the Trust as reflected in the Company's general ledger should be removed.⁸¹ Staff's
7 adjustment results in an outside services expense of \$63,392.⁸²

8 **a. Staff's analysis.**

9 The documentation of the outside services expense consisted only of the invoices from the
10 Trust contained in the Company's Updated Rate Case Documents and the Company's general
11 ledger,⁸³ provided in response to Staff's data request.⁸⁴ In an attempt to reconcile and verify these
12 expenses, Staff compared the entries in Truxton's general ledger to those itemized on the invoices
13 from the Trust. The general ledger reflects contractual or outside services in the following amounts:

14 Account No. 630 \$209,778.00
15 Account No. 631 \$31,325.56
16 Account No. 635 \$4,846.00
17 Account No. 636 \$ 2,558.12
 Total \$248,507.68

18 These payments were understood to have been incorporated into the Company's Updated
19 Rate Case Data in Account No. 630. However, the total of these accounts is \$17,775.32 less than the
20 \$266,283 reported in Account No. 630.⁸⁵ Thus the numbers could not be reconciled or verified.

21 Although Staff calculated the total of the payments to the trust at \$202,891.⁸⁶ Staff has
22 determined, in reviewing these documents following the hearing, that both Direct and Surrebuttal
23 Schedules CSB-14 contain a typographical error. At line 22, the entry dated 5/31/2012 paid to the
24

25 ⁷⁹ Updated Rate Case Data, Ex. A-2 at 19.
26 ⁸⁰ Sonn Rowell Dir. Test., Ex. A-1 at 3.
27 ⁸¹ Brown Dir. Test., Ex. S-3 at 26.
28 ⁸² *Id.* at 18-20.
⁸³ Tr. Vol. II at 348, 349.
⁸⁴ Tr. Vol. III at 563.
⁸⁵ Tr. Vol. III at 563-64.
⁸⁶ Brown Surrebuttal Test., Ex. S-4, Schedule CSB-14.

1 Claude K. Neal Family Trust in the amount of \$2,572, should read \$3,572 according to the
2 Company's General Ledger⁸⁷ so that the actual total should have been \$203,891. Staff notes that this
3 error is in the Company's favor and that the amount is *di minimus* and does not require the
4 preparation and submission of new schedules. It also shows that Ms. Brown misspoke at hearing⁸⁸
5 when she stated that the total billed from the Trust to Truxton is \$209,778. In fact, she was referring
6 to the general ledger⁸⁹ which shows a total of the account in question at \$209,778 but that includes
7 other payees than the Trust and reflects payments to the Trust rather than the Trust's billing to the
8 Company. In any event, neither of the items billed, purchased water or management agreement can
9 be reconciled with Staff's calculation.⁹⁰ Therefore, Staff adjusted outside services by removing the
10 \$202,891 which appeared to reflect payments to the Trust for undocumented management expenses.⁹¹

11 Further comparisons reveal more inconsistencies. The invoices from the Trust to Truxton⁹²
12 reflect only two types of monthly charges, "Management Agreement" and "Purchase of Water."
13 According to the general ledger, the total charges for Management Agreement in 2012 were
14 \$146,205.74. The total charges for purchase of water were \$210,349.67. Yet in the Company's
15 Updated Rate Case Data, purchased water is listed at \$147,409 and outside services at \$266,283. As
16 a result, the actual expenses of the Company in these categories simply cannot be determined. Mr.
17 Neal confirmed their unreliability when he testified at hearing, stating that that the 2011 test year data
18 was correctly prepared by Ms. Rowell, but that the 2012 test year data was not correctly prepared.⁹³

19 That fact becomes more significant when comparing the 2011 and 2012 expenses for outside
20 services. In 2012 the outside services expense increased by \$251,801 over the prior test year expense
21 of \$14,482. In its application, the Company listed its 2011 test year outside services expense at
22 \$140,589, but made a pro forma adjustment in the amount of \$126,107,⁹⁴ to reflect the cancellation
23 of the management agreement.⁹⁵ The Company reclassified that \$126,107 amount as salaries &

24 _____
25 ⁸⁷ *Id.*, Attach. A at 51.

⁸⁸ Tr. Vol. III at 562.

⁸⁹ *Id.* at 563.

⁹⁰ Updated Rate Case Supporting Documents Ex. A-3; Brown Surrebuttal Test., Ex. S-4, Schedule CSB-14.

⁹¹ Tr. Vol. III at 564; Brown Surrebuttal Test., Ex. S-4, Schedule CSB-14.

⁹² Updated Rate Case Supporting Documents, Ex. A-3.

⁹³ Tr. Vol. II at 350-351.

⁹⁴ Rate Application Ex. A-1, Schedule C-1.

⁹⁵ *Id.* Sonn Rowell Dir. Test., Ex. A-1 at 3; Tr. Vol. I at 91-93.

1 wages, for a total expense in that account of \$128,952, again to reflect that the management
2 agreement had been cancelled and an employee hired. That left \$14,482 remaining in outside
3 services.

4 The Company's Updated Rate Case Data for the 2012 test year reflects that salaries & wages
5 account declined only slightly, from \$128,952 to \$104,118.⁹⁶ The employee hired in the 2011 test
6 year continued that employment during the 2012 test year and remains employed to this date.⁹⁷
7 However, the outside services expense jumped from \$14,482 to \$266,283.⁹⁸ There was no evidence
8 presented of a corresponding or similar adjustment to any other category to indicate this was a re-
9 classification,⁹⁹ and it appears to be a new and unexplained expense.

10 The magnitude of this increase can be seen by comparing the 2011 and 2012 data in the
11 Company's Updated Rate Case Data.¹⁰⁰ The Company's total operating expenses increased from
12 \$491,394 in 2011 to \$803,125 in 2012, an increase of \$311,731, (63 percent). Of that increase,
13 \$251,801 (80.1) percent, is related to outside services. The Company's explanation for the increase
14 was "we were required to produce invoices for that, and so it was, it was all of the equipment
15 expenses and those types of expenses that were put into there. What they were, I don't know. I would
16 have to go back through it and figure it out."¹⁰¹ It would ordinarily be expected that such a large
17 increase be identified and documented.

18 **b. Management Agreement.**

19 In this case, the inconsistencies are not limited to numbers that cannot be reconciled. Here the
20 Company has also been unable to even indicate what services or goods were provided, let alone
21 establish the reasonableness or even the actual costs thereof. The evidence presented by the Company
22 to support these expenses is unclear and inconsistent at best.

23 The Company has been unable to establish whether a management agreement even exists. In
24 its application the Company stated that the management agreement had been cancelled. Staff, in its
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26 ⁹⁶ Updated Rate Case Data, Ex. A-2 at 19.

⁹⁷ Tr. Vol. II at 234.

27 ⁹⁸ Updated Rate Case Data, Ex. A-2 at 19.

⁹⁹ Tr. Vol. II at 346.

28 ¹⁰⁰ Updated Rate Case Data, Ex. A-2 at 19.

¹⁰¹ Tr. Vol. II at 345.

1 direct testimony, removed the more than \$202,000 the Company had paid in management expenses
2 based on there being no management agreement. Yet in none of the subsequent pre-filed testimony
3 did the Company correct Staff's understanding or indicate that the agreement had been reinstated or
4 that a new agreement entered into. In fact, at hearing, Ms. Rowell confirmed her pre-filed testimony
5 that the agreement had been cancelled. Even Mr. Neal testified inconsistently as to the status of any
6 agreement:

7 Q. [By Ms. Humphrey] You mentioned the management agreement. Is
8 there currently a management agreement in place?

9 A. [By Mr. Neal] There is.

10 Q. You heard Ms. Rowell's testimony yesterday where she indicated in
11 the management contract, or management agreement between the Trust
12 and Truxton or, between the Trust and Truxton had been cancelled.
Was that correct?

13 A. Yes.

14 Q. And has it been reinstated?

15 A. No.

16 Q. So is that agreement now considered cancelled?

17 A. According to the Commission, yes.

18 Q. According to the, Truxton, is that agreement still in effect?

19 A. No. And this is, this is so confusing, and --

20 Q. Tell me about it.

21 A. Because -- here's what happened, when I came into the picture.
22 There was allocations of commingling of funds between the Trust and
23 Truxton. Imagine that....

24 there were several things that came out of that. One is the Trust
25 cancelled their contract with VVPOA and put everything under the
26 water company and, and -- so how it stands today is there are not, there
27 is not enough revenue to pay the real bills; meaning, meaning utilities,
28 gasoline, diesel fuel, repairs supplies, much less cover the inter-
agreements between, the in-house agreements, if you will, between
Truxton and the Trust, those are -- or lease payments on the building.
So it's the immediate needs of the water company that are met first. So,

1 so when you say are they in place, well, if you can't pay them, then are
2 they in place or not. Yeah, I guess you can keep racking up the bills
3 and just not get paid for them. So I really don't know how to answer
4 that question.

5 Q. Let me see if I can clarify it. Ms. Rowell testified that the
6 management agreement was cancelled, and you agreed with her
7 statement that it was cancelled, correct?

8 A. But it was of my opinion that it was, we were directed to cancel that
9 agreement.

10 Q. And is it your position today that there – what is your position today
11 as to whether there is a current agreement between the Trust and
12 Truxton whereby management services will be provided to the Trust, to
13 Truxton, and Truxton will pay a fee for those services?

14 A. My position today is that we are not allowed to do that, the Trust is
15 not allowed to do that.

16 Q. That doesn't answer my question. Whether it's allowed to or not, is
17 there one in place?

18 A. Yes.

19 Q. There is a management contract?

20 A. Yes.

21 Q. When Ms. Rowell filed her pre-filed testimony, she also indicated
22 that the contract was cancelled. Did any of your subsequently filed
23 testimony refute that?

24 A. I don't know that it does.¹⁰²

25 Q. And Ms. Rowell testified that when she prepared the 2011 test year
26 schedules, she moved approximately \$126,000 from the category of
27 outside services to the category of salaries and wages, because of the
28 cancellation of that management contract.

A. Okay.

Q. One, you heard her testify to that, correct?

A. Correct.

Q. Two, was that an accurate statement?

¹⁰² Tr. Vol. II at 340-44.

1 A. She did do that. So, yes, that would be accurate.

2 Q. And is it true that subsequent to the management contract being
3 cancelled, the water company hired an employee to perform the
4 services that had been provided by the management contract?

5 A. One of the services, correct.¹⁰³

6 Nonetheless, the Company insists that the Trust provides goods, services and the use of assets
7 to Truxton. Mr. Neal's comments as to the management agreement are telling. When his counsel
8 asked why Truxton still used the Trust to help 'fix problems,' Mr. Neal responded:

9 A: Well, the thing that nobody understands is that the Trust, they own
10 everything that goes along with this water company. They own
11 backhoes, they own Ditch Witches, they own vehicles, they own
12 trailers, they own welders, they own pumps, they own shops, they own
13 yards. They own everything that it takes to run a water company. They
14 don't just own a pipeline that's 70 years old and five wells. That's not
15 what the Trust owns. And you can't run a water company with a
16 pipeline and five wells. It doesn't work that way. You need a whole
17 bunch of things to go along with that, including employees. And the
18 Trust owns all of that stuff. The Trust doesn't get paid for all of that
19 stuff. Should they? Absolutely. So should the Trust let the water
20 company use their backhoes and their Ditch Witches and all their
21 equipment, their graders and their welders? I wouldn't, but they do.
22 Shame on them.

23 Q. [By Mr. Wene] And that's where a lot of that cost that seems to be
24 this mysterious cost that doesn't get transferred over is in, it's the cost of
25 all the equipment, the labor --

26 A. Right.

27 Q. -- everything that is done, that's --

28 A. Correct.

Q. So, essentially, what you tried to do with the invoices in this case is
to, is to reflect that there's additional costs out there that need to be in
rates to produce revenue, fair?

A. Fair.¹⁰⁴

¹⁰³ *Id.* at 340-43.

¹⁰⁴ *Id.* at 241-42.

1 The invoices to which Mr. Neal refers are unreliable for several reasons. First, is Mr. Neal's
2 explanation of how they were created: "we were required to produce invoices for that, and so it was,
3 it was all of the equipment expenses and those types of expenses that were put into there. What they
4 were, I don't know. I would have to go back through it and figure it out."¹⁰⁵ This suggests that the
5 invoices were created to support the claimed expenses after the fact, rather than relied up for the
6 determination of what those expenses were.

7 Second, the invoices do not indicate what services were provided; they merely cite
8 "Management Agreement."¹⁰⁶ Mr. Neal states that referring to the expense as "management
9 agreement" was incorrect, but he insists that whatever the expenses reflected, it was money owed to
10 the Trust for services provided to Truxton.¹⁰⁷

11 Third, the invoices indicate that the costs are related, not to the services provided, but to a
12 monthly charge per connection. The invoices not only contain no details, they also indicate that the
13 price of services and products is not based on actual services or products. This would be consistent
14 with the Company's previous management agreement which constituted a monthly service fee,
15 whereby a specific amount was charged by the Trust to Truxton for each connection. The Company
16 conceded that no study had been done to determine the actual cost of services performed by the
17 Trust.¹⁰⁸ In this instance, the invoices indicate a 'price each' charge on every invoice of \$13.18,
18 which appears to coincide with the monthly fee per connection.

19 To the extent that such an agreement does exist, or goods, services or use of assets provided,
20 this, too, is an affiliate transaction and subject to the NARUC Guidelines. Because the Company
21 introduced no evidence as to the market value of these services, only the allocated costs would be
22 allowed. Again, the lack of detail means those costs simply cannot be determined. Given that the
23 WSA allows the Trust to earn a profit on its sales of water to Truxton and the fact that the
24 management fees are not cost-based, but represent an undefined monthly charge, there are concerns
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27 ¹⁰⁵ *Id.* at 345.

¹⁰⁶ Updated Rate Case Supporting Documents, Ex. A-3.

28 ¹⁰⁷ Tr. Vol. II at 347-48.

¹⁰⁸ Tr. Vol. II at 278-79.

1 that those fees exceed the actual allocable costs of service and are contrary to the NARUC Guidelines
2 and the practices of this Commission.

3 Finally, the description of the nature of the services by Mr. Neal suggests that that there is
4 some large, nebulous cloud of services which the Trust provides which cannot be itemized other than
5 as ‘everything it takes’ to run a water Company. In fact, Truxton’s counsel may have been the most
6 accurate of all in referring to the outside services expense as ‘this mysterious cost,’ for mysterious it
7 is. The failure of Truxton to clearly state what is provided by the Trust also raises the spectre of
8 redundant charges for the same services in various categories. If Mr. Neal is unable to identify all of
9 those “ancillary expenses to run the water Company”¹⁰⁹ which appear as purchased water expense,
10 again in repair & maintenance costs, again in outside services and again in transportation, it cannot
11 be determined that each account includes costs distinct from the others.

12 .. **d. Water Testing Expense**

13 The Company sought \$4,846 for water testing expense.¹¹⁰ Staff witness Dorothy Hains
14 recalculated the minimum annual expense at \$5,215,¹¹¹ an upward adjustment of \$369. The
15 Company has not commented on or submitted evidence to controvert Staff’s adjustment.

16 **e. Rents Expense**

17 The Company states its rent expense at \$6,600.¹¹² This amount appears to correlate to the
18 \$6,600 in shared office space shown in the Company’s original application.¹¹³ That office space is
19 shared with Cerbat. Schedule C-2e of that application reflects a 25 percent reduction for the portion
20 of the office space used by Cerbat. Particularly given Mr. Neal’s admission that the 2011 test year
21 data was correctly prepared and the 2013 not. Staff’s adjusted rent expense by \$1,650 to \$4,950¹¹⁴
22 should be adopted here.

26 ¹⁰⁹ *Id.* at 348.

27 ¹¹⁰ Updated Rate Case Data, Ex. A-2 at 10.

27 ¹¹¹ *Id.* at 19.

28 ¹¹² Hains Dir. Test., Ex. S-1, Engineering Report at 7.

28 ¹¹³ Updated Rate Case Data, Ex. A-2 at 19.

28 ¹¹⁴ Rate Application, Ex. A-1, Schedule C-20.

1 **f. Transportation Expense**

2 The Company states its transportation expense at \$42,123 in its Updated Rate Case Data, but
3 submits no details or documentation to support that expense. Staff evaluated the information provided
4 by Truxton's expert witness, Sonn Rowell, in the Company's original application which reflected an
5 actual expense of \$13,168 with a pro forma adjustment of \$22,506.¹¹⁵ In response to a Staff DR, the
6 Company indicated that it leased three trucks, two of which still had balances owing and associated
7 payments. A third, a 2005 Chevrolet Silverado, was fully paid for.¹¹⁶ According to Truxton, it bears
8 all the repair and maintenance related to those trucks, which Staff did not contest. However, because
9 the charge for the 2005 Silverado did not represent either a purchase price or repair and maintenance
10 expense, the rent or lease of that truck appeared to be made up of profit only. Staff therefore made an
11 adjustment of \$2,700 to remove profit on the 2005 Silverado, resulting in a total transportation
12 expense of \$39,423. Truxton did not dispute this adjustment or present controverting evidence.

13 **g. Depreciation Expense**

14 The Company, in its Updated Rate Case Data, appears to have simply imported the
15 depreciation expenses stated in the Company's application prepared by Ms. Rowell, in the amount of
16 \$34,471. Staff made adjustments to plant balances and CIAC balances, which impact the depreciation
17 expense. Staff calculated the depreciation expense to be \$38,734, and adjusted that balance by
18 deducting the amortization of CIAC in the amount of \$29,155, for a balance of depreciation expense
19 of \$9,579. This necessitates a \$24,892 reduction to the Company's stated expense to result in the
20 correct depreciation expense of \$9,579.¹¹⁷ Again, Truxton did not dispute this adjustment or present
21 controverting evidence.

22 **h. Property Taxes**

23 Truxton proposes \$16,240 for its property tax expense.¹¹⁸ Staff recalculated property taxes
24 based on Staff's recommended revenues utilizing the modified Arizona Department of Revenue
25
26

27 ¹¹⁵ Brown Surrebuttal Test., Ex. S-4, Schedule S CSB-10, CSB-16.

¹¹⁶ Updated Rate Case Data, Ex. A-2 at 19.

28 ¹¹⁷ Rate Application, Ex. A-1, Schedules C-1 and C-2-f.

¹¹⁸ Brown Surrebuttal Test., Ex. S-4, Schedule CSB-18.

1 Methodology. This results in an adjustment of \$2,563 and an annual expense of 16,803.¹¹⁹ Again,
2 Truxton did not dispute this adjustment or present controverting evidence.

3 **i. Interest Expense on Customer Deposits**

4 The Company does not include any expense for interest on customer deposits.¹²⁰ The Arizona
5 Administrative Code requires regulated water companies to pay interest expense on customer
6 deposits.¹²¹ Staff calculates that interest to be \$337.¹²² Again, Truxton did not dispute this adjustment
7 or present controverting evidence.

8 **3. REVENUE REQUIREMENT**

9 Because the Company has a negative rate base, Staff the rate of return method for determining
10 rates is not helpful. Instead, Staff uses the cash flow methodology.¹²³ Staff's recommended OCRB is
11 a negative \$249,270, and Staff recommends a \$66,818 (12.02 percent) revenue decrease from
12 \$555,924 to \$489,106. This decrease would produce an operating income of \$50,000. Staff's
13 operating income is derived from the cash flow methodology which would result in an operating
14 margin of 10.22 percent.¹²⁴

15 Although a revenue decrease is unusual, it is not unexpected or unwarranted in this case. Part
16 of the Settlement Agreement and Decision in the 2010 OSC case was the requirement that Truxton
17 file a rate case no later than September 30, 2011. The evidence in that case established that there had
18 been commingling of funds and cross-subsidization among the Trust, Truxton and Cerbat.¹²⁵ In the
19 present case, nearly \$400,000 of the Company's operating expenses are paid to or on behalf of the
20 Trust, including: \$340,614 paid directly to the Trust for purchased water and the purported
21 management agreement; \$45,268 paid to Mohave Electric Cooperative for the Trust's monthly
22 electricity charges; \$3,763 in ADEQ fees; and approximately \$2,954 for repairs to Trust assets. The
23 vast majority of these costs is unsupported by any documentation and, as discussed elsewhere within
24 this brief, some of these expenses appear to be duplicated.

25 _____
¹¹⁹ Rate Application, Ex. A-2 at 19.

26 ¹²⁰ Brown Surrebuttal Tes., Ex. S-4, Schedules CSB-11 and CSB-19.

27 ¹²¹ Brown Surrebuttal Test., Ex. S-4, Schedule CSB-18.

28 ¹²² A.A.C. R14-2-403(B).

¹²³ Brown Surrebuttal Test., Ex. S-4, Schedule CSB-11, CSB-21.

¹²⁴ Brown Dir. Test., Ex. S-3 at 28.

¹²⁵ Brown Surrebuttal Test., Ex. S-4 at 2; Decision No. 72386.

1 **C. FINANCING APPLICATION**

2 In addition to requesting a general rate increase, Truxton filed a financing application that was
3 consolidated with the rate case. The Company filed a request for authorization to incur \$1,819,208 in
4 debt from the Water Infrastructure Financing Authority of Arizona (“WIFA”). The stated reason for
5 the request was to finance equipment improvements toward installing arsenic treatment.¹²⁶ Exhibit 2
6 attached to the financing application notes only \$419,208 in total costs for the improvements,
7 however. Additionally, Exhibit 2 includes a plan by Fann Environmental, for the construction of the
8 arsenic treatment facilities and indicates a bid estimate of \$177,800 to construct the arsenic treatment
9 facility.¹²⁷

10 The Company further breaks out the allocation of the \$419,208 between (1) arsenic treatment
11 plant, (2) electrical controls and instrumentation changeover, and (3) replacing transmission line.
12 \$193,652 is applied toward constructing the treatment plant.¹²⁸ \$127,000 is applied toward the
13 electrical improvements.¹²⁹ \$98,556 is for replacing transmission line.¹³⁰

14 Truxton further explained that in addition to the \$419,208 for the improvements, the WIFA
15 financing amount includes approximately \$1.4 million for the acquisition of plant used in the delivery
16 of water service by Truxton that is currently owned by the Trust.¹³¹ The Company’s application to
17 WIFA requests \$431,208 in loans to be used to fund improvements in three categories. The first is
18 construction of an arsenic treatment plant.¹³² The second involves replacement of a mile of the main
19 transmission line owned by the Trust.¹³³ The third and final type of improvement discussed in the
20 WIFA application is to bring electric service to the Hualapai 1 Well as part of a plan to convert it
21 from natural gas to electric driven pumps.¹³⁴ The financing application also provides for \$1.4 million
22
23

24
25 ¹²⁶ *Id.*

¹²⁷ Financing Application filed Sept. 30, 2013, Ex. A-4 at 1-2.

¹²⁸ *Id.* at Ex. 2.

¹²⁹ *Id.*

¹³⁰ *Id.*

¹³¹ *Id.*

¹³² Matthew Rowell Reb. Test., Ex. A-5 at 3; Neal Reb. Test., Ex. A-5 at 2-3.

¹³³ Finance Application, Ex. A-4 at 1.

¹³⁴ *Id.*

1 toward the acquisition of the Trust's wells and pipeline used for delivering water utility service to
2 Truxton.¹³⁵

3 Based on Staff's review of the financing application made to WIFA and application filed in
4 this matter, Staff recommends the Company be authorized to incur \$259,800 in new debt related to
5 the construction of arsenic treatment improvements.¹³⁶ Due to Staff's position regarding the value of
6 the Trust assets to be transferred to Truxton, Staff recommends against approving the \$1.4 million of
7 financing relating to a purchase of the Trust's assets.

8 Staff's recommendation includes an itemized recommendation of estimated costs of \$156,500
9 for constructing the arsenic treatment plant.¹³⁷ Additionally, the Staff recommendation provides
10 \$60,000 for the extension of power to the building that will house the arsenic treatment plant.¹³⁸
11 Staff's recommendation disallows any costs related to the transmission line as the application does
12 not provide sufficient information for Staff to evaluate the location or the need to perform the
13 requested improvements.¹³⁹ Finally, Staff's recommendation includes \$43,300 for administration and
14 contingencies.¹⁴⁰

15 The Company disagrees with Staff's recommendations regarding the financing. At hearing,
16 Mr. Neal testified as to his belief that the amounts Staff recommends are insufficient to construct the
17 arsenic treatment plant.¹⁴¹ Likewise, Truxton has expressed disagreement with Staff's
18 recommendation regarding the extension of electrical service to the Hualapai 1 Well or for the
19 replacement of a mile of transmission main pipe.¹⁴²

20 With respect to the transmission main replacement, the Company did not provide supporting
21 information to explain the request. Staff cannot tell from the application where along the pipe the
22 replacement is to occur, nor why the portion in question is more appropriately replaced than any other
23 portion.¹⁴³

24
25 ¹³⁵ *Id.*

¹³⁶ *Id.* at 3.

¹³⁷ Hains Dir. Test., Ex. S-1, Engineering Report at 8-9.

¹³⁸ *Id.*

¹³⁹ *Id.*; Tr. Vol. III at 461-62.

¹⁴⁰ Hains Dir. Test., Ex. S-1 Engineering Report at 8-9; Tr. Vol. III at 460-61, 463-65.

¹⁴¹ Hains Dir. Test., Ex. S-1, Engineering Report at 8-9.

¹⁴² Tr. Vol. I at 251.

¹⁴³ *Id.* at 249-50, 258.

1 Staff recommends against providing any financing toward the extension of power to the
2 Hualapai 1 Well. Staff recognizes the potential for efficiencies that may be realized by converting
3 the well to electric pumps rather than relying on the natural gas driven pumps currently used at the
4 well.¹⁴⁴ However, the financing application does not provide for the installation of the electric
5 pumps. In light of the Company's asserted lack of funds, Staff concluded that the Company does not
6 have the wherewithal to complete the conversion of the well to electric using the application currently
7 before WIFA. Staff estimates that the electric pumps will incur a substantial cost to acquire and
8 install.¹⁴⁵ Consequently, the absence of an amendment to the financing application to cover the
9 purchase and installation of electric pumps presents an incomplete plan to accomplish the desired
10 well conversion. Staff recommends against granting the requested financing approval related the
11 Hualapai 1 well conversion until the Company comes forward with a more complete plan to
12 implement the electric conversion.

13 Regarding the construction of the arsenic treatment plant, Staff would begin by pointing out
14 that its recommendation regarding the extension of electrical service to the building that will house
15 the treatment plant is part of the total recommendation regarding the treatment plant.¹⁴⁶ Additionally,
16 because Staff recommends against the financing of the power line to the Hualapai 1 Well as well as
17 the replacement of an unspecified mile of transmission main, the contingency and administration
18 costs are also part of the Staff recommendation toward the construction of the arsenic treatment plant.
19 Consequently, Staff's total recommendation for the treatment plant is the sum of the \$156,500, the
20 \$60,000 for bringing power to the building and the \$43,300 in contingency and administration costs
21 or \$259,800. Therefore, Staff is recommending more be approved toward the construction of the
22 arsenic treatment plant than the \$193,652 out of the \$419,208 in the Company's application that is
23 allotted toward arsenic treatment.

24 Staff notes that Mr. Neal asserted that the building that will house the arsenic treatment
25 already has power. Therefore the \$60,000 associated with Staff's recommendation to bring power to
26

27 _____
¹⁴⁴ Hains Dir. Test., Ex. S-1, Engineering Report at 8-9; Tr. Vol. III at 464.

28 ¹⁴⁵ Tr. Vol. III at 481.

¹⁴⁶ *Id.* at 461.

1 the building is apparently either wholly, or in part, unnecessary.¹⁴⁷ Even if the entire \$60,000 Staff
2 recommended for the extension of three-phase power and installation of electrical control equipment
3 is no longer necessary and were removed, thereby reducing Staff's total recommendation to
4 \$199,800, Staff's recommendation is still reasonable in light of the Company's \$193,625 estimate for
5 the construction of arsenic related plant.

6 **D. RATE DESIGN**

7 The Company requests and Staff recommends use of an inverted three-tier rate design. A
8 residential customer on a 3/4 inch meter with the median usage of 3,754 gallons per month will
9 experience a 61.94 percent, or \$15.45 increase under Truxton's proposed rates. Using Staff's
10 recommendation, the same customer will receive a 22.79 percent or \$5.68 reduction in their monthly
11 bill.¹⁴⁸

12 With respect to the 5/8 and 3/4 inch meter customers, Staff and the Company agree as to the
13 commodity use break points for the tiers.¹⁴⁹ For every larger meter size, the Company and Staff
14 diverge on the appropriate break point to use for their respective rate designs with Staff's break point
15 set substantially lower than the Company's proposal.¹⁵⁰ Additionally, for meters 1 inch and larger, the
16 Company proposes and Staff recommends transitioning from three-tier inverted rates to two-tier
17 inverted rates.¹⁵¹

18
19 The Company also proposes a two-tier rate design for water sales to VVPOA whereas Staff
20 recommends adoption of a flat rate design.¹⁵² Significantly, Staff's proposed commodity rate for
21 VVPOA sales is lower than what was established on an interim basis in Decision No. 72724 (January
22 6, 2012). Pursuant to Decision No. 72724, approval of the Staff recommended rate design will
23 produce a refund to VVPOA because it is lower than the interim rate established in Decision No.

24
25
26 ¹⁴⁷ *Id.*

¹⁴⁸ *Id.* at 615.

¹⁴⁹ Brown Dir. Test., Ex. S-3 at 29.

¹⁵⁰ Brown Surrebuttal Test., Ex. S-4, Schedule CSB-22.

¹⁵¹ *Id.*

¹⁵² *Id.*

1 72724, a circumstance that representatives of both Truxton and VVPOA acknowledged in their
2 testimony at hearing.¹⁵³

3 The Company likewise proposes, and Staff recommends approving, changes to its meter and
4 service line charges. The proposed changes are illustrated on Exhibit S-4, attached schedule CSB-22
5 page 3 of 3.

6 **1. Allocation of Cost of Arsenic Treatment**

7 The Company and Staff also agree that to the extent customers are using arsenic treated water,
8 they should be required to pay for the costs of treatment. VVPOA has taken the position that it
9 should not contribute toward the cost of arsenic treatment.¹⁵⁴ However, not all water that VVPOA
10 receives is for irrigation purposes. Additionally, much of the water used for irrigation is also treated
11 for arsenic because some wells used for supplying irrigation water are also backup water sources for
12 drinking water and are treated for arsenic as a consequence.

13
14 Upon questioning, VVPOA witness Wes Stewart asserted that substantially all of the VVPOA
15 members are also residential customers of Truxton.¹⁵⁵ Mr. Stewart acknowledged that any revenue
16 shortfall due to rate design choices that take the burden away from VVPOA will necessitate greater
17 impacts on other customer classes, including the residential customers who make up the membership
18 of VVPOA.¹⁵⁶

19 Staff believes that customers should pay for costs that serving them incurred on the utility.
20 Rates that are set so as to allocate the reasonable cost of service to cost causers is generally a goal
21 that should be aspired to in appropriate rate design methodology. Serving VVPOA's needs
22 necessarily involves incurring arsenic treatment related costs due to the configuration of Truxton's
23 system and the dual irrigation and drinking water source duties served by the Company's wells. Thus
24 it is reasonable that VVPOA should bear its portion of arsenic treatment that was involved in
25 producing water to serve its needs.
26

27 ¹⁵³ *Id.*

¹⁵⁴ Tr. Vol. III at 424-25.

¹⁵⁵ Stewart Rebuttal Test., Ex. I-5 at 4.

¹⁵⁶ Tr. Vol. III at 424.

1 Moreover, if Staff's commodity rate for VVPOA is adopted, VVPOA will likely be due a
2 refund as was acknowledged by Mr. Stewart.¹⁵⁷ A refund would serve to moderate the impact of
3 having to shoulder arsenic treatment costs as well.

4 2. Service Charges

5 The Company also proposes a number of changes to its service charges. The Company seeks
6 to increase the Establishment charge from \$45.00 to \$50.00; eliminate the Establishment (After
7 Hours) charge; increase the Reconnection (Delinquent) charge from \$65.00 to \$70.00; eliminate the
8 Reconnection (Delinquent/After Hours) charge; increase the Meter Test (If Correct) charge from
9 \$35.00 to \$40.00; eliminate the Re-establishment (Delinquent/After Hours) charge; increase the NSF
10 Check charge from \$15.00 to \$25.00; increase the Meter Re-Read (If Correct) charge from \$15.00 to
11 \$25.00; increase the Call Out charge from \$25.00 to \$35.00; add an After Hours Service Charge of
12 \$25.00; and to eliminate its fire sprinkler service charges.

14 Staff agrees with the Company's proposal to eliminate the Establishment (After Hours),
15 Reconnection (Delinquent/After Hours) and Re-establishment (Delinquent/After Hours) charges.¹⁵⁸
16 Likewise, Staff agrees that it is appropriate to add an After-Hours charge although Staff recommends
17 that it be set at \$30 rather than the Company's proposed \$25.¹⁵⁹ Staff further believes that it would
18 be appropriate to apply the After Hours charge cumulatively with the underlying service charge that
19 is being performed after business hours.¹⁶⁰

21 Staff disagrees with the Company's request to increase the Call Out service charge. Staff
22 recommends eliminating the charge as it will be duplicative of the new After Hours service charge.¹⁶¹

23 Additionally, Staff recommends lower charges that are closer to the range of established
24 charges for similar water utilities than the Company proposes for several existing service charges.
25 For the Meter Test (If Correct) charge, Staff recommends a \$25 charge as opposed to the \$40

26 ¹⁵⁷ *Id.* at 426.

27 ¹⁵⁸ *Id.* at 425.

28 ¹⁵⁹ Brown Dir. Test., Ex. S-3 at 30.

¹⁶⁰ *Id.*

¹⁶¹ *Id.*

1 requested by the Company.¹⁶² With regard to Truxton's request for a \$25 Meter Re-read (If Correct),
2 Staff recommends that the charge be set at \$20.¹⁶³ The Company also requests the Reconnection
3 (Delinquent) charge be \$70 whereas Staff recommends that the charge be set at \$45.¹⁶⁴ Regarding
4 the Establishment charge, Staff recommends maintaining the charge at the current \$45 as opposed to
5 the Company request to increase the charge to \$50.¹⁶⁵ Finally, the Company requests to set the NSF
6 charge at \$25 whereas Staff recommends continuing the present charge of \$15 because the Company
7 has provided no documentation from its bank to support the increase.¹⁶⁶

8 The last change to service charges that Truxton proposes is the elimination of its fire sprinkler
9 charge. Staff disagrees with this proposal because providing fire sprinkler service is in the public
10 interest and recommends continuation of the tariff for fire sprinklers so that the Company may
11 recover the cost associated with providing fire sprinkler service.¹⁶⁷ Staff recommends the fire
12 sprinkler rate be set at two percent of the monthly minimum for comparably sized meters but not less
13 than \$10.00 per month.¹⁶⁸

14 **E. Additional Issues**

15 **1. Interim Manager**

16 The Commission, in Decision No. 72386 ordered that:

17 Staff may appoint an Interim Manager for Truxton, without further
18 action by the Commission, if Truxton is not fully in compliance with
19 all Commission and ADEQ rules and regulations by September 30,
20 2011, or the compliance deadlines established in the ADEQ Consent
Order, whichever comes later.¹⁶⁹

21 In that case, a number of concerns were raised regarding Truxton's failure to comply with
22 ADEQ requirements and Commission rules.¹⁷⁰ Staff indicated in that case that it believed that
23 Truxton, through its new management, is committed to ensuring that Truxton is properly managed on

24 _____
25 ¹⁶² *Id.*

¹⁶³ *Id.* at 31.

26 ¹⁶⁴ *Id.*

¹⁶⁵ *Id.*

¹⁶⁶ *Id.*

27 ¹⁶⁷ *Id.*

¹⁶⁸ *Id.* at 32.

28 ¹⁶⁹ Decision No. 72386.

¹⁷⁰ *See, generally,* Decision No. 72386 at 5-9.

1 a going-forward basis.¹⁷¹ Public comment given in this case would support this assessment.¹⁷²
2 Truxton has made efforts to come into compliance, but it remains out of compliance in several
3 respects, and its failure to comply with the Stipulation Agreement and orders of the Commission
4 which are part of Decision No. 72386 is particularly troubling.

5 Staff witness Dorothy Hains noted on-going non-compliance issues in her engineering report
6 of November 1, 2013.¹⁷³ These include the failure to monitor chlorine residual in the water, arsenic
7 levels which exceed ADEQ's standards, the lack of an ADEQ arsenic reduction plan, the failure to
8 install an approved arsenic removal plant, and the failure to monitor nitrate levels. Truxton has also
9 not complied with the Commission's orders to acquire all water system assets necessary to provide
10 water from the Trust by June 30, 2011, or to grant Staff access to the Trust's accounting books and
11 records, for Staff's regulatory audit during Truxton's rate case proceeding.

12 As is discussed more thoroughly below, Mr. Neal has disclosed that an offer to purchase the
13 well was received but was declined. In addition counsel for the Company has advised Staff that the
14 Trust will terminate automatically upon the death of B. Marc Neal's mother. Due to her age and
15 health, this could occur at any time. Both of these facts raise concerns that, absent the ability to
16 appoint an interim manager, there is a risk that service to the customers of Truxton could be
17 interrupted.

18 Ongoing concerns remain regarding commingling of funds, and failure to maintain proper
19 records. Although Mr. Neal explained that there were virtually no records when he began managing
20 the Company,¹⁷⁴ he has now been managing the Company for at least three years¹⁷⁵ yet for 2011 and
21 2012 records still have not been kept. Similarly, in Decision No. 72386, Truxton was to provide Staff
22 access to the books and records of the Trust. Mr. Neal has not done so.

24 ¹⁷¹ Decision No. 72386, at 19.

25 ¹⁷² Victoria Hoag stated that "We do have to give credit to Mr. Neal, Rick Neal, who has worked very hard to bring the
26 leaks and the repairs under control in a timely manner during his tenure." Tr. Vol. I at 7. Mr. William Meehan stated
27 "The third point that I want to make is the need for an interim manager still exists. Since the order to show cause and the
stipulation agreement in 2010, improvements in relationships and management have experienced between VVPOA and
Truxton, and I cite Rick Neal for that improvement. I would say that we need his expertise, or equivalent, to continue to
manage the water company. *Id.* at 13.

28 ¹⁷³ Hains Dir. Test., Ex. S-1, Engineering Report at 6.

¹⁷⁴ Tr. Vol. II, at 274.

¹⁷⁵ Tr. Vol. II, at 220; Decision No. 72386, Ex. C, Stipulation Agreement.

1 In light of the continuing nature of these concerns, Staff recommends that the Commission
2 maintain the authorization for Staff to pursue an interim manager should circumstances warrant
3 appointing one.

4 2. The Trust As A Public Service Corporation

5 At hearing, Parties were instructed to brief the issue of whether the Trust is a public service
6 corporation. Staff believes that pursuant to the analysis set out by caselaw on the subject that the
7 Trust could be a public service corporation.

8 Determining whether an entity is a public service corporation requires a two-step analysis.
9 First, one must consider whether the entity satisfies the literal and textual definition of a public
10 service corporation under Article 15, Section 2, of the Arizona Constitution.¹⁷⁶ Second, one must
11 evaluate whether the entity's business and activity are such as to makes its rates, charges and methods
12 of operation a matter of public concern by considering the facts presented by the case in light of the
13 eight factors discussed by the Arizona Supreme Court in *Natural Gas Serv. Co. v. Serv-Yu Co-op.*, 70
14 Ariz. 235, 219 P.2d 324 (1950).¹⁷⁷ Finally, other Arizona cases such as *Nicholson* provide additional
15 important guidance.

16 a. The Trust is a Public Service Corporation under the Plain 17 Language of Article XV, Section 2 of the Arizona Constitution.

18 Any discussion of whether an entity is a public service corporation must start with the words
19 of the Arizona Constitution. The Arizona Constitution defines the term "public service corporation"
20 as:

21 [a]ll corporations other than municipal engaged in furnishing gas, oil, or electricity for
22 light, fuel, or power; or in **furnishing water for irrigation, fire protection, or other**
23 **public purposes**; or in furnishing, for profit, hot or cold air or steam for heating or
cooling purposes; or engaged in collecting, transporting, treating, purifying and
disposing of sewage through a system, for profit; or in transmitting messages or
furnishing public telegraph or telephone service, and all corporations other than
municipal, operating as common carriers, shall be deemed public service corporations.

24 Ariz. Const. Art. XV, § 2 (emphasis added). By owning and operating wells, pumps and other plant
25 assets necessary to providing water service and by selling the water to its wholly owned subsidiary
26

27
28 ¹⁷⁶ *Southwest Transmission Cooperative v. Ariz. Corp. Comm'n*, 213 Ariz. 427, 430, 142 P.3d 1240, 1243 (App. 2007).

¹⁷⁷ *Id.*

1 for sale to the public, and, until recently, to the VVPOA, qualifies the Trust as a public service
2 corporation under the plain language of the Arizona Constitution.

3 The Trust sells water to Truxton pursuant to the WSA on a per 1,000 gallon basis. Until
4 ordered to cease doing so in Decision Nos. 72386 and 72739, the Trust also sold water to VVPOA
5 and to Cerbat Water Company. In years past, the owner of these wells, whether the Trustor or the
6 Trust, also furnished water service to the United States Military and to the railroad, for which
7 consideration was received.¹⁷⁸ That the Trust furnishes water is undisputed. The question then
8 becomes whether it furnishes water for public purposes. Also undisputed is that the Trust sells water
9 to the water company, Truxton, for the purpose of providing that water to its nearly 1,000 customers.
10 Not only does the Trust own the wells and the transmission mains but as Mr. Neal testified, the Trust
11 owns and operates for the benefit of Truxton all the equipment necessary to maintain Truxton as a
12 water utility.¹⁷⁹

13 That the Trust does not sell directly to the end user does not change the fact that the water is
14 sold for public purposes. Arizona's Court of Appeals addressed and rejected an argument to the
15 contrary in *Southwest Transmission Cooperative v. Ariz. Corp. Comm'n.* There Southwest
16 Transmission Cooperative, Inc. argued that it sells electricity to distributors that convert it for retail
17 use, and that it is not a public service corporation because it does not furnish electricity to the end
18 user. The Court rejected that argument on the basis that the electricity would ultimately be used for
19 light, fuel or power and that the Constitution does not exclude a seller that does not provide service to
20 the ultimate end user. Thus, under that case, the Trust is a public service corporation as defined in
21 Article XV, Section 2 of the Arizona Constitution.

22 **b. The *Serv-Yu* Factor Analysis Also Supports a Finding That the**
23 **Trust Is A Public Service Corporation.**

24 Merely meeting the textual definition of Article 15, § 2 does not establish an entity as a public
25 service corporation.¹⁸⁰ To be a public service corporation, a company's business and activities must
26

27
28 ¹⁷⁸ Tr. Vol. II at 229-230.

¹⁷⁹ Tr. Vol. II at 241.

¹⁸⁰ *Southwest Transmission*, 213 Ariz. at 432, 142 P.3d at 1244 (citing *Southwest Gas*, 169 Ariz. at 286, 818 P.2d at 721).

1 implicate the public interest.¹⁸¹ In *Serv-Yu*, the Arizona Supreme Court set out eight factors to
2 consider in determining whether a corporation is “clothed with a public interest.”

3 Before undertaking a discussion of the various *Serv-Yu* factors, it is appropriate to review the
4 posture of the *Serv-Yu* case, because its history influenced the development of the factors. The
5 purpose of this oft-cited case was to clarify a previously issued opinion. While *Serv-Yu* provides
6 helpful suggestions for determining whether a company is a public service corporation, the *Serv-Yu*
7 Court did not intend for these factors to be used as a rigid test. The case merely lists these factors as
8 facts from the original case “that should have been pointed out.”¹⁸² In other words, *Serv-Yu* creates a
9 list of subjects to explore; it does not create a rigid checklist.

10 Moreover, the eight *Serv-Yu* factors are merely guides for analysis and they need not all be
11 found to exist before the company in question may be deemed a public service corporation.¹⁸³
12 Finally, it is important to note that the various factors tend to overlap, as will become apparent in
13 subsequent sections of this brief.

14 The *Serv-Yu* factors include the following:

- 15 (1) What the corporation actually does
- 16 (2) A dedication to public use
- 17 (3) Articles of incorporation, authorization, and purposes
- 18 (4) Dealing with the service of a commodity in which the public has been generally held to have
19 an interest
- 20 (5) Monopolizing or intending to monopolize the territory with a public service commodity
- 21 (6) Acceptance substantially of all requests for service
- 22 (7) Service under contracts and reserving the right to discriminate is not always controlling
- 23 (8) Actual or potential competition with other corporations whose business is clothed with public
24 interest.

26 ¹⁸¹ *Southwest Transmission*, 213 Ariz. at 432, 142 P.3d at 1245.

¹⁸² *Serv-Yu*, 70 Ariz. at 237, 219 P.2d at 325.

27 ¹⁸³ See *Petrolane-Arizona Gas Serv. v. Ariz. Corp. Comm'n*, 119 Ariz. 257, 259, 580 P.2d 718, 720 (1978). See also,
28 *Southwest Transmission*, 213 Ariz. at 427; 142 P. 3d at 1240 (affirming the lower court which applied the eight-factor test
found in *Serv-Yu* and concluded that, although four factors might favor the position that entity was not a public service
corporation, the balance of factors weighed in favor of finding that entity was a public service corporation).

1 Each of these factors is discussed in turn below with respect to the Trust's operations.

2 **i. What the Trust actually does.**

3 The Trust is a family trust created for the purpose of transferring assets held by Claude Neal
4 to his heirs in a manner which would minimize tax consequences.¹⁸⁴ The Trust is the sole
5 shareholder in two certificated water utilities, Truxton and Cerbat, both of which are regulated by the
6 Commission.¹⁸⁵ It is unknown whether the Trust was created first, and then the water company
7 followed, or whether they were created simultaneously. However, Mr. Neal testified that it was his
8 understanding that when the water company was created, the Trust retained virtually all of the water
9 plant assets for the purpose of avoiding regulation.¹⁸⁶

10 Until Staff brought OSC actions against Truxton and Cerbat in 2009, all three entities shared a
11 single bank account into which all funds, including those of both water companies, were deposited.¹⁸⁷
12 No attempt was made to retain the separate identity of the funds. B. Marc Neal, the Trustee of the
13 Trust, managed both water companies, as well.¹⁸⁸ At present, and as a result of the two OSC actions,
14 efforts have been made to separate the companies.¹⁸⁹ B. Marc Neal no longer manages either
15 company and separate financial accounts are maintained.¹⁹⁰ Nonetheless, the Trust remains active in
16 the operations of the water companies.

17 The evidence in this case clearly shows that, while the Trust was created for financial
18 purposes, what it actually does is own and run water companies which furnish water to the public and
19 provides water as well. In addition to owning all of the water plant assets, the Trust is required by the
20 WSA to maintain a continuous water supply to Truxton, to install and maintain water meters at
21 delivery points, and to test and treat all water in accordance with ADEQ standards.¹⁹¹ And, while the
22 status of a management agreement between the Trust and Truxton is in dispute, Mr. Neal asserts, and
23 the invoices from the Trust confirm, that the Trust provides management services to Truxton.¹⁹²

24 _____
184 Tr. Vol. I at 17.

25 185 Tr. Vol. II. at 223, 274.

26 186 *Id.* at 269-70.

27 187 Tr. Vol. II at 340-41.

188 *Id.* at 222-25.

27 189 *Id.* at 340-41.

190 *Id.* at 340-50.

28 191 Water Supply Agreement, Ex. S-7.

192 Tr. Vol. II at 340-50.

1 into contracts with customers would control the determination of whether an entity is a public service
2 corporation that would be an easy way of evading the law.²⁰⁶

3 **viii. Actual or potential competition with other corporations**
4 **whose business is clothed in the public interest.**

5 A corporation, calculated to compete with public utilities and take business away from them,
6 should be under like regulatory restriction if effective governmental supervision is to be
7 maintained.²⁰⁷ Actual or potential competition with other corporations whose business is clothed
8 with a public interest is a factor that must be considered; otherwise, corporations could be organized
9 to operate in competition with bona fide utilities, thereby isolating portions of the public network
10 from public regulation and oversight.²⁰⁸ Until the Trust stopped providing water service to VVPOA,
11 its provision of that water was in direct competition with the incumbent water utilities, its subsidiary,
12 Truxton.

13 **c. Other Considerations**

14 Representatives of the Trust may argue that it is not a public service corporation because
15 providing water utility service is incidental to its true purpose. The Arizona Supreme Court has
16 indicated that under certain limited circumstances, an entity that is otherwise providing utility service
17 may not in fact be a public service corporation when the provision of said utility service is incidental
18 to its primary purpose.²⁰⁹ In this case, the Trust's water selling activities would not qualify as
19 incidental to its purpose. Rather, as testified to by Mr. Neal, the reason that the water utility assets
20 are in the Trust's direct ownership is to avoid regulation.²¹⁰ The sale of water from the Trust to
21 Truxton is an integral part of the overall scheme to place all the regulatory consequences of providing
22 water utility service on Truxton while minimizing the exposure of the assets used in the delivery of
23 said service by keeping it in the hands of the Trust. Selling water to Truxton is therefore not
24 incidental, but is rather essential to the arrangement to posture Truxton as the entity directly offering
25 the public water service. Consequently, the Trust's activities are not incidental to its purpose.

26 ²⁰⁶ 70 Ariz. at 240, 219 P.2d at 327.

27 ²⁰⁷ 70 Ariz. at 241, 219 P. 2d at 328.

28 ²⁰⁸ *Id.*

²⁰⁹ *Arizona Corp. Comm'n v. Nicholson*, 108 Ariz. 317, 497 P.2d 815 (1972).

²¹⁰ Tr. Vol. I at 17; Tr., Vol. II at 269-70.

1 **d. Staff's Recommendations**

2 Staff believes that under the prescribed analysis that it is possible to reach the conclusion that
3 the Trust is public service corporation. However, Staff is not recommending that the Commission
4 determine that the Trust is a public service corporation as part of this proceeding. Staff notes that the
5 Trust is not a party to this proceeding.

6 **3. Letter Regarding Potential Sale of Utility Assets**

7 The continuing uncertainty as to when the Company and the Trust will complete the transfer
8 of the Trust's water assets to Truxton has given rise to concerns other than proper recovery of the
9 expenses necessary to operate the system. On March 26, 2014, VVPOA docketed a letter discussing
10 the possibility that the Trust had either transferred the water utility assets in its possession to a
11 developer, or was in negotiations to do so.²¹¹ Owing to a lack of response from Truxton to confirm or
12 deny the assertion, VVPOA requested a procedural conference to discuss the matter. Staff joined the
13 request. Before the matter could be heard at a procedural conference, the Commission heard the
14 matter in an Open Meeting on April 8, 2014.

15 During the Open Meeting, VVPOA explained the origin of the concern by citing several
16 conversations, including one with the developer purported to be seeking to acquire the property from
17 the Trust. In response, Mr. Neal indicated that he first heard of the possibility of a transaction
18 between the Trust and a developer was when he saw the letter filed by VVPOA.²¹² Upon prompting
19 from Staff, Mr. Neal agreed to work with the Trust to obtain a letter certifying that the Trust has not
20 sold and is not planning to sell the Hualapai 1 Well.

21 On April 10, 2014, the Company filed a letter signed by Trust representative, Mr. B. Marc
22 Neal. On April 11, 2014, parties met before the Administrative Law Judge in a procedural
23 conference to discuss the issue and the letter from the Trust. VVPOA raised various concerns
24 relating to the Trust's letter. In response, Mr. Rick Neal reiterated his position that the Hualapai 1
25 Well will not be sold without Commission approval.²¹³ Further, he suggested that parties work on
26 mutually agreed language for a further letter that would resolve the concerns regarding the potential

27 _____
28 ²¹¹ Letter Addressed to Steve Wene from Todd Wiley filed March 26, 2014 in Docket No. W-02168A-11-0363 *et al.*

²¹² Recording of April 8, 2014 Open Meeting at 2:00:17.

²¹³ April 11, 2014 Procedural Conference Tr. at 24.

1 sale of Hualapai 1 Well. Parties agreed and mutually acceptable language was developed during a
2 break in the procedural conference.

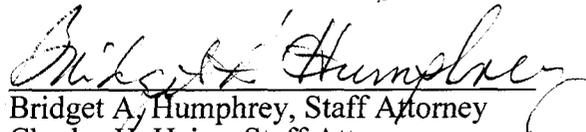
3 On April 21, 2014, Truxton docketed a letter using the agreed upon language and signed by
4 Mr. B. Marc Neal on behalf of the Trust. Based upon this commitment by the Trust not to sell the
5 Hualapai 1 Well without prior Commission approval, Staff's concerns regarding this issue have been
6 resolved.

7 **III. CONCLUSION**

8 For all the above stated reasons, Staff's recommended rates are reasonable and should be
9 adopted. With regard to the other issues, principally the interim manager and the acquisition of the
10 Trust's water assets, the continued ownership by the Trust of assets used to supply water service to
11 Truxton gives rise to manifold concerns for Staff. Staff would further observe that transfer of the
12 assets from the Trust to the Company would appear to resolve so many of the difficult ambiguities
13 presented by this case and would be in the best interests of both the Company and the Trust.

14 Because the Trust is not a party to the proceeding, Staff does not recommend reaching a
15 conclusion as to whether the Trust is a public service corporation at this time. However, Staff
16 recognizes that due to the significance of these issues to Truxton's ability to provide continued water
17 service to its ratepayers that further clarification may be beneficial and in the public interest. Staff
18 recommends that the Company provide a definitive statement as to whether the relevant assets will be
19 transferred to Truxton, as provided in Decision No. 72386. In the absence of such clarification, Staff
20 believes that an order to show cause may be appropriate to clarify the Trust's status as a public
21 service corporation.

22 RESPECTFULLY SUBMITTED this 25th day of April, 2014.

23
24 
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4 Docket Control
5 Arizona Corporation Commission
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8 Copy of the foregoing mailed and/or emailed
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