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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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AZ CORP COMMISSION
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IN THE MATTER OF THE APPLICATION OF
GRANITE MOUNTAIN WATER COMPANY,
INC. FOR APPROVAL OF A RATE INCREASE.

DOCKET NO. W-02467A-14-0230

IN THE MATTER OF THE APPLICATION OF
CHINO MEADOWS II WATER COMPANY,
INC. FOR APPROVAL OF A RATE INCREASE.

DOCKET NO. W-02370A-14-0231

STAFF'S JOINT REPLY BRIEF

The Utilities Division of the Arizona Corporation Commission ("Staff") hereby files its Reply Brief in the above-captioned matter. In this brief, Staff will respond to the disputed issues addressed by Granite Mountain Water Company, Inc. ("Granite Mountain") and Chino Meadows II Water Company, Inc. ("Chino Meadows") (jointly referred to as "Companies"). On any issue not specifically addressed in this brief, Staff maintains its position as presented in its Opening Briefs for Granite Mountain and Chino Meadows and its testimony in these dockets.

I. COMMON ISSUES.

Staff has fully set forth its position on the following issues in its Opening Briefs and will not readdress them here.

- Mr. Levie's Salary
- Disallowance of 10% of Unsupported Plant
- Income Tax Expenses
- Working Capital

Arizona Corporation Commission

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A. Allocation of Common Costs.

The Companies contend that Staff's four-factor allocation method is inappropriate and, if adopted, will result in their inability to recover their common costs. While Staff initially used a four-factor allocation method, which methodology it continues to support in general, Staff revised its

1 recommendation in response to the Companies' concerns. Staff initially recommended an allocation
2 of 70.12% to Chino Meadows, 26.93% to Granite Mountain, and 2.95% to their affiliate, Antelope
3 Lakes Water Company, Inc. ("Antelope Lakes"), based on the four factor method.¹ However, Staff
4 tested its method by conducting many, many calculations using a variety of factors, including using
5 gross plant, as advocated by the Companies.² Staff then revised its recommendation to 74 % to
6 Chino Meadows and 25% to Chino Meadows, with 1% allocated to their affiliate, Antelope Lakes.³
7 Staff deemed this allocation to be fairly representative of the range of allocation results in its
8 calculations.

9 There is little to no evidence to support the Companies' concern that Staff's recommended
10 allocation will impair their ability to recover costs. Both the Companies and Staff have produced
11 schedules to support their recommendations. Moreover, both Staff and the Companies have adjusted
12 their allocations so that, at this point, the difference between them is fairly small: for Chino
13 Meadows, 80.5% to 74% and for Granite Mountain, 19.5% to 25%.

14 **B. Code of Affiliate Conduct.**

15 The Companies agree to develop a Code of Affiliate Conduct as recommended by Staff.
16 Staff acknowledges that, absent the Companies' agreement, the non-regulated affiliates cannot be
17 compelled to enter into such a Code. However, the regulated utilities must comply with the Code in
18 their dealings with both regulated and unregulated affiliates.

19 **C. Annual Report of Corporate Cost Allegations.**

20 When Staff originally recommended that the Companies file annual reports concerning cost
21 allocations, it was anticipated that the percentage numbers, and thus the allocations, would vary over
22 time. That will not be the case if Staff's recommended allocation is adopted. Staff also recommends
23 that the Companies' officers and employees maintain time records as to the time spent on each
24 Company in order to more accurately allocate direct costs. Doing so would reduce the controversy
25 in allocating costs and render rates more accurately cost-based. Nor would this impose a significant
26 burden on the Companies. Only two persons would be required to maintain records, the Company

27 _____
28 ¹ Granite Mountain ("GM") Exhibit S-3 at 8-11, Chino Meadows ("CM") Exhibit S-1 at 9-13.

² GM Exhibit S-4 at 3-4, CM Exhibit S-2 at 4.

³ GM Exhibit S-4 at 3-4, CM Exhibit S-2 at 4, CM TR at 123-124.

1 president and its operations manager. A minimum amount of detail would be required and it could
2 be recorded in a rather informal manner. A small effort would result in significant savings in time,
3 effort and expenditures in the next rate case. If the Company were to keep such records, and the
4 same allocation percentage remain in place until the next rate case, the need for annual reports could
5 be eliminated.

6 **D. Affiliate Transactions (Receivable and Payables).**

7 The Companies characterize Staff's recommendations regarding affiliate payables and
8 receivables as four distinct items, which Staff will similarly address.⁴

- 9 1. The Companies should collect all receivables from affiliates within one year from
10 the Decision in this case.
- 11 2. The Companies should cease making any further personal loans or advances with
12 Company funds.
- 13 3. The Companies should pay all payables to affiliates within 24 months of the
14 Decision in this case.
- 15 4. The Companies should obtain specific authorization by the Commission for
16 indebtedness payable, including amounts appearing in affiliate payable accounts.

17 Staff and the Companies are in agreement as to No. 1. The Companies oppose No. 2 to the
18 extent that it applies to anyone other than affiliates. If the Companies' position were to be adopted,
19 Staff's concerns with the Companies' conduct would not be addressed. As discussed in Staff's
20 Opening Brief, the Companies' records show that both Granite Mountain⁵ and Chino Meadows⁶
21 have loaned or advanced funds to the regulated affiliates, and, directly or indirectly, to Mr. Levie's
22 other businesses, to Mr. Levie himself and to Mr. Levie's family members. Such loans or advances
23 are not for the Companies' business purposes and represent improper use of funds recovered through

24 ⁴ Companies' Joint Opening Brief at 8, GM Exhibit A-1 at 24-25.

25 ⁵ GM Exhibit S-3, Attachment G (Response to Staff DR GM TBH 1.31), which states:

26 146.08- Due GFL CMI Tract B Water Line - This account represent funds advanced to Desert Snow Construction on
27 behalf of Mr. Levie. The funds paid for a waterline serving property owned by Mr. Levie. The property is within the
28 Town of Chino Valley water service area and is not associated with any of the water utilities owned by Mr. Levie. The
balance is due and payable upon demand by Granite Mountain. The balance at the end of the test year was 15,195.58.

146.10- Due from PDL trust - This account represent funds advanced to or on behalf of Mr. Levie. The funds were
for personal use. The balance is due and payable upon demand by Granite Mountain. The balance at the end of the test
year was 15,000.00.

146.11- Due from Zooki - This account represent funds advanced on behalf of Mr. Levie's son, Daniel P. Levie. The
funds covered expenses for office support provided to Mr. Levie by an outside contractor that were billed to Granite
Mountain in error. The balance is due and payable upon demand by Granite Mountain. The balance at the end of the test
year was 260.00.

⁶ CM Exhibit S-1, Attachments E and F (Response to Staff DR CM TBH 1.31).

1 rates. The Companies' example of an employee advance is within the scope of a business purpose
2 and would be allowed, unless that employee is a relative or an affiliate.

3 The Companies also oppose Nos. 3 and 4. The Companies assert that using excess funds
4 from one utility to meet the cash needs of another utility is necessary to their operation and, as long
5 as there is no interest charged and no obligation to repay the funds, there is no debt which requires
6 approval pursuant to A.R.S. §40-301. Staff does not agree. A.R.S. §40-301 provides:

7 40-301. Issuance of stocks and bonds; authorized purposes

8 A. The power of public service corporations to issue stocks and stock certificates,
9 bonds, notes and other evidences of indebtedness, and to create liens on their property
10 located within this state is a special privilege, the right of supervision, restriction and
11 control of which is vested in the state, and such power shall be exercised as provided by
12 law and under rules, regulations and orders of the commission.

13 B. A public service corporation may issue stocks and stock certificates, bonds, notes
14 and other evidences of indebtedness payable at periods of more than twelve months after
15 the date thereof, only when authorized by an order of the commission.

16 C. The commission shall not make any order or supplemental order granting any
17 application as provided by this article unless it finds that such issue is for lawful purposes
18 which are within the corporate powers of the applicant, are compatible with the public
19 interest, with sound financial practices, and with the proper performance by the applicant
20 of service as a public service corporation and will not impair its ability to perform that
21 service.

22 It is Staff's position that A.R.S. §40-301 restricts the utilization of one utility's excess funds
23 to pay the costs of another: if repayment does not occur within twelve months, Commission approval
24 of the transaction is required and, in order to obtain approval, a transaction must be for lawful
25 purposes which are within the corporate powers of the applicant; be compatible with the public
26 interest, with sound financial practices, and with the proper performance by the applicant of service
27 as a public service corporation; and not impair its ability to perform that service.

28 When such transactions have occurred between Granite Mountain and Chino Meadows, the
lending or donor utility either pays expenses of the other or infuses cash to the other, recording it on
the Companies' books as a payable or receivable. This constitutes evidence of indebtedness as
described in A.R.S. §40-301. This makes the transactions subject to A.R.S. §40-301.

Yet, even if the Companies had sought Commission approval, it would be unlikely to be
granted. When the two companies were created, they were established as separate entities, operating

1 independently of one another. That they share costs does not alter the separate status of each. The
2 rates have been set by the Commission to enable the Companies to meet their costs and expenses and
3 earn a return on and of their investment. To allow utilities to loan or advance funds back and forth is
4 inconsistent with principles of rate design.

5 Moreover, using funds recovered from the customers of one company to support another
6 company provides no benefits to the ratepayers of the lending or advancing company and, in fact, is
7 contrary to their interest and to that of the public. By depleting the resources of one company to pay
8 the other's costs, the first company's ability to meet its on-going and any unexpected expenses, as
9 well as its duty to maintain and upgrade its infrastructure may be significantly impaired.

10 The Companies complain that requiring compliance with A.R.S. §40-301 would force the
11 Companies to "adopt burdensome, formalized policies and potentially obtain approvals prior to
12 transferring funds."⁷ Indeed, it would, and that is precisely what is required by law for the protection
13 of the Companies' customers and the public generally. For many years, these Companies have
14 engaged in practices which are self-preferential, as noted in Staff's Granite Mountain Opening
15 Brief.⁸ They have engaged in financial transactions in which the shareholders and their relatives
16 received monies or services, and have previously been ordered not to do so.⁹ Giving money to
17 another utility is no different than giving free water to the Levie family members. It is taking money
18 from the utility and using it for a non-business purpose of that Company and impairing its ability to
19 provide service as required by law. The Companies complain that, if ordered to comply with Staff's
20 recommendation, the only solution to meeting the utilities' needs would be for the company to issue
21 a distribution to Mr. Levie who could then provide an influx of cash to the other Company.¹⁰ Such a
22 transaction would, in fact, comply with the law and would be supported by Staff. What the
23 Companies seek is the Commission's approval of a practice that could allow the Companies to
24 operate outside the law. Clearly, this should be denied.

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27 ⁷ Companies' Opening Brief at 9.

⁸ Granite Mountain Opening Brief at 7-8.

28 ⁹ Decision No. 74384 at 21, 38-39.

¹⁰ Joint Opening Brief at 9.

1 **E. Interim Manager.**

2 The Companies argue that appointment of an interim manager in this case violates their due
3 process rights in that, by delegating the appointment of an interim manager to Staff by and thereby
4 not providing the Companies notice and a fair hearing.¹¹ This is inaccurate. Staff has sought the
5 authority to appoint an interim manager in this proceeding. The Companies were notified of the
6 same in Staff's Direct Testimony and a hearing was held at which evidence was presented and the
7 issue addressed. The Decision will be the Commission's but will not be implemented unless certain
8 specified actions are taken by the Company or Companies. Thus the Companies' due process rights
9 have been met.

10 The Companies further argue that insufficient evidence of a risk to the public health and
11 safety exists to warrant appointment of an interim manager. Once again, Staff disagrees. For more
12 than seven years, Staff and the Commission have expressed concerns over the financial management
13 of the Companies and, in multiple orders, the Commission has ordered the Companies to cease its
14 practices of inter-company loans and payment of the personal expenses of Mr. Levie and his family
15 members. Yet the practice continued up until the time these rate cases were filed. These were more
16 fully discussed in Staff's Opening Briefs, and include providing free water to Daniel Levie's four
17 accounts, giving funds to PDL Trust and PDL Zookie (Mr. Levie's companies), paying Mr. Levie's
18 personal expenses, failing to set aside monies for payment of a WIFA loan as ordered and violating
19 A.R.S. §40-301 by lending (or equally improperly giving away) cash from one regulated utility to
20 the other.

21 Although the Companies have come into compliance during the pendency of these rate cases
22 and have been openly communicative with Staff, their long-term history raises concerns that, once
23 the cases are over, they will return to their former behavior. This is particularly so given the
24 Companies' refusal to abide by Staff's recommendations Nos. 3 and 4 regarding affiliate
25 transactions where, once again, the Companies seek to sidestep the statutory requirements. Nor is it
26 true that the Companies' financial actions do not harm the public. By spending company assets in
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¹¹ *Id.* at 10-12.

1 the manner they do, the Companies continually put the Companies at financial risk which would
2 them make then unable to provide the requisite services to their customers.

3 **II. GRANITE MOUNTAIN ISSUES.**

4 Staff has fully set forth its position on the following issues in its Opening Brief and will not
5 readdress them here.

- 6 • Storage Tank No. 3
- 7 • WIFA Payments
- 8 • Rate Design
- 9 • Penalties

10 **A. Well No. 6 Purchase and Easement.**

11 As anticipated, Granite Mountain attempts to persuade the Commission that the \$75,000
12 investment the Company made in purchasing the well and easement was a good business decision,
13 certainly as compared to the cost of drilling a new well. Based on the evidence presented, the
14 acquisition of the property may have been a better resolution of the issue. However, that does not
15 mean that the value assigned was appropriate or that the entirety of the easement was necessary or
16 used and useful or that the cost should be passed on to the ratepayers.

17 Again, the specter of self-preferential dealing manifests itself. The property consists of a
18 residence, a guest house, three storage sheds, a well house, a well and 61,034 square feet of land.
19 The residence is rented to tenants who also are using the guest house and the three sheds. The only
20 portion of the property currently being used by Granite Mountain consists of the well, the well house
21 and transmission lines. The Company *may* drill another well at some time in the future but currently
22 has no plans to do so. The portion being used by the Company consists of only 12,200 square feet.
23 The Company's own appraisal values the well, pump and slab at \$16,000 and the well house at
24 \$1,232, for a total of \$17,232. The 12,200 acres were valued at \$1.15 per acre, for a total of \$14,030
25 per the Company's appraisal, and were valued at \$1.00 per acre, for a total of \$12,200 per the
26 Yavapai County Public Works Department, when it acquired part of the property in February 2012.
27 Staff uses the lower estimated value, making the value of the used and useful part of the easement
28 \$29,432.

1 **B. Accumulated Depreciation and Depreciation Expense.**

2 Granite Mountain deducted \$4,680 from accumulated depreciation and the depreciable plant
3 balance to reflect post-year retirement. Staff inadvertently failed to make this deduction; the
4 Company is correct.

5 **C. Income Tax Expense.**

6 Staff agrees with the Granite Mountain's assertion that the parties largely agree on how to
7 calculate income-tax expense. Staff incorrectly used the corporate tax rate in Direct Testimony. In
8 Surrebuttal Testimony, Staff made the corrections and used the individual tax rates as well as
9 synchronizing the interest expense. Granite Mountain did not synchronize the interest expense.
10 Given that Granite Mountain and Staff disagree on their revenue and expense recommendations, the
11 recommended income taxes at the proposed rates will continue to be different.

12 **III. CHINO MEADOWS ISSUES.**

13 **A. Operating Margin.**

14 Staff has not based its rate recommendation on achieving any particular operating margin.
15 Staff's analysis determined that the current rates produce revenue in excess of either traditional rate
16 of return ratemaking or the 15% operating margin initially proposed by Chino Meadows. Therefore
17 Staff recommended no change in rates.

18 Staff has never recommended any specific operating margin. When adjustments requested
19 by Chino Meadows were made by Staff in Staff's Surrebuttal Testimony, under existing rates, the
20 resulting operating margin also changed. Staff deems the resulting 13.38 operating margin sufficient
21 and Staff continues to recommend no change in rates.

22 **B. CIAC Amortization.**

23 Staff agrees with Chino Meadows' determination that Staff erred in the calculation of the off-
24 setting CIAC amortization by using the wrong amortization period (0.5 years instead of 1 .5 years).
25 The differences between Staff and Chino Meadows are minor, and Staff accepts Chino Meadows'
26 Rebuttal CIAC amortization adjustment supported by Schedule RLJ-2 Rebuttal, Pages 5.1 and 5.2.

1 **IV. SUMMARY AND CONCLUSION.**

2 Staff's recommendations in this matter are summarized as follows:

3 For Granite Mountain Staff recommends:

4 1. The Commission approve the Staff-recommended rates and charges as shown on
5 Schedule TBH GM-26, attached to Exhibit 9, Response Testimony of Teresa Hunsaker.

6 2. The Company be ordered to file with Docket Control, a tariff schedule of its new
7 rates and charges within 30 days after the effective date of the Decision in this proceeding.

8 3. The Company be ordered to repay outstanding notes payable involving affiliates
9 within one year. Further, Staff recommends the Company discontinue the practice of recording
10 notes receivable involving affiliates for a period that exceeds one year without prior Commission
11 approval. Further, Staff recommends that the Company refrain from making personal loans or
12 advances with Company funds.

13 4. The Company provide an annual report of the accounting of all Corporate Cost
14 Allocations. The reports should be reconciled to the amounts billed and paid by each regulated and
15 unregulated affiliate company. This annual report should be filed in this docket by April 15th for the
16 previous calendar year. Such filing requirement would cease with the filing of the Company's next
17 rate case.

18 5. The Commission order the Company to use an allocation of 74% to Chino Meadows
19 and 25% to Granite Mountain for indirect expenses between regulated affiliated companies in its
20 next rate case, and Company employees be required to utilize detailed time sheets to trace and
21 allocate payroll cost to each regulated and unregulated affiliate.

22 6. The Company be ordered to cease providing discounted water to owners, owner
23 family members or employees and to appropriately collect revenues from every recipient of water
24 service as previously ordered in Decision No. 71869.

25 7. A penalty be assessed to the Company pursuant to A.R.S. §§ 40-424 and 40-425 for
26 the Company's failure to appropriately collect revenues as ordered in Decision No. 71869.

27 8. The Company develop and submit a Code of Affiliate Conduct related to affiliate
28 activities and transactions, as discussed in Staff's Testimony within 90 days of an order approving

1 new rates in this docket. Such Code of Affiliate Conduct would be applicable to Granite Mountain
2 and all regulated and unregulated affiliates.

3 9. The Commission provide the authority for Staff to immediately install an interim
4 manager if the Company violates any part of the Code of Affiliate Conduct.

5 10. The Company file all documentation related to the WIFA Loan.

6 For Chino Meadows Staff recommends:

7 1. The Commission approve the Staff-recommended rates and charges as shown on
8 Schedule TBH CM-24A attached to Exhibit S-1 Direct Testimony of Teresa Hunsaker.

9 2. The Company be ordered to file with Docket Control, a tariff schedule of its new
10 rates and charges within 30 days after the effective date of the Decision in this proceeding.

11 3. The Company be ordered to repay outstanding notes payable involving affiliates
12 within one year. Further, Staff recommends the Company discontinue the practice of recording
13 notes receivable involving affiliates for a period that exceeds one year without prior Commission
14 approval. Further, Staff recommends that the Company refrain from making personal loans or
15 advances with Company funds.

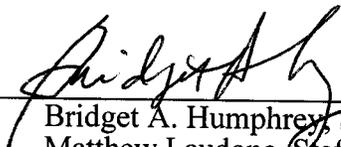
16 4. The Company provide an annual report of the accounting of all Corporate Cost
17 Allocations. The reports should be reconciled to the amounts billed and paid by each regulated and
18 unregulated affiliate company. This annual report should be filed in this docket by April 15th for the
19 previous calendar year. Such filing requirement would cease with the filing of the Company's next
20 rate case.

21 5. The Commission order the Company to use an allocation of 74% to Chino Meadows
22 and 25% to Granite Mountain for indirect expenses between regulated affiliated companies in its
23 next rate case, and the regulated water company employees be required to utilize detailed time sheets
24 to trace and allocate payroll cost to each regulated and unregulated affiliate.

25 6. The Company develop and submit a Code of Affiliate Conduct related to affiliate
26 activities and transactions, as discussed in Staff's Testimony within 90 days of an order approving
27 new rates in this docket. Such Code of Affiliate Conduct would be applicable to Chino Meadows
28 and all regulated and unregulated affiliates.

1 7. The Commission provide the authority for Staff to immediately install an interim
2 manager if the Company violates any part of the Code of Affiliate Conduct.

3 RESPECTFULLY SUBMITTED this 5th day of May, 2015.

4
5 By 

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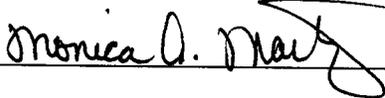
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13
14 Original and thirteen (13) copies of the foregoing
15 filed this 5th day of May, 2015, with:

16 Docket Control
17 Arizona Corporation Commission
18 1200 West Washington Street
19 Phoenix, Arizona 85007

20 Copy of the foregoing mailed and/or emailed
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