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# MEMORANDUM

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Date: December 26, 2018

To: The Honorable Chairman and Members  
Pima County Board of Supervisors

From: C.H. Huckelberry  
County Administrator

A handwritten signature in black ink, appearing to read "CHH", is written over the printed name "C.H. Huckelberry".

Re: **Pima County's Objection to the Ajo Improvement Company Proposed Utility Rate Increases in the Unincorporated Area of Pima County**

Enclosed, please find the County's filing of objection to the Ajo Improvement Company (AIC) rate increases proposed to recover significant capital investments that have not been approved or authorized by the Arizona Corporation Commission (ACC).

It appears the AIC made a unilateral decision to spend \$47.8 million on improvements to various utility assets without ACC approval, nor with any expectation that the expenditure would be recovered. Now, apparently, the parent company of the AIC, Freeport McMoran is seeking to recover these unauthorized expenditures. To do so, will cause a significant utility rate increase for Ajo residents as well as County service centers located in Ajo.

In summary, we conclude that the rate increases at the magnitude contemplated did not meet the Constitutional requirement for just and reasonable rates and should be rejected.

CHH/anc

Attachment

c: The Honorable John Peck, Presiding Justice of the Peace, Ajo Justice Court  
Andrew Flagg, Chief Civil Deputy County Attorney  
Charles Wesselhoft, Deputy County Attorney  
Diana Durazo, Special Projects Manager, Pima County Administrator's Office

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10 *Attorney for Pima County*

11 **BEFORE THE ARIZONA COPORATION COMMISSION**

12 COMMISSIONERS

13 TOM FORESE - Chairman.  
14 BOB BURNS  
15 ANDY TOBIN  
16 BOYD W. DUNN  
17 JUSTIN OLSON

18 IN THE MATTER OF THE APPLICATION OF AJO  
19 IMPROVEMENT COMPANY – WASTEWATER  
20 DIVISION FOR AN INCREASE TO ITS  
21 AUTHORIZED RATES AND CHARGES, FOR A  
22 DETERMINATION OF THE FAIR VALUE OF ITS  
23 PROPERTY DEVOTED TO WASTEWATER  
24 UTILITY SERVICE IN THE STATE OF ARIZONA,  
25 AND FOR OTHER RELATED APPROVALS.

Docket No. WS-01025A-17-0361

26 IN THE MATTER OF THE APPLICATION OF AJO  
IMPROVEMENT COMPANY – ELECTRIC  
DIVISION FOR AN INCREASE TO ITS  
AUTHORIZED RATES AND CHARGES, FOR A  
DETERMINATION OF THE FAIR VALUE OF ITS  
PROPERTY DEVOTED TO ELECTRIC UTILITY  
SERVICE IN THE STATE OF ARIZONA, AND FOR  
OTHER RELATED APPROVALS.

Docket No. E-01025A-17-0362

IN THE MATTER OF THE APPLICATION OF AJO  
IMPROVEMENT COMPANY – WATER DIVISION  
FOR AN INCREASE TO ITS AUTHORIZED RATES  
AND CHARGES, FOR A DETERMINATION OF THE  
FAIR VALUE OF ITS PROPERTY DEVOTED TO  
WATER UTILITY SERVICE IN THE STATE OF  
ARIZONA, AND FOR OTHER RELATED  
APPROVALS.

Docket No. WS-01025A-17-0363

**INTERVENOR PIMA COUNTY'S  
OPENING BRIEF**

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1 Pima County operates a number of facilities in the Ajo area served by Ajo  
2 Improvement Company (AIC). A summary of those is attached hereto as Attachment A.  
3 All of the County's facilities are operated on fixed budgets and, while small increases in  
4 utility costs can be absorbed, large increases have the potential of impacting the degree of  
5 services provided.

6 AIC proposed substantial rate increases for its customers and has agreed to the  
7 ACC Staff recommended increases for: water customers of 236.37% increase phased in  
8 over five years (Hearing Exhibit A-17 at page 4, line 12); wastewater customers of 384%  
9 phased in over seven years (*Id.* at page 13, line 21), and electricity customers of 108.8%  
10 phased in over five years (*Id.* at page 14, line 18; Hearing Exhibit S-7 at page 3, line 5),  
11 including Pima County. Even though the increases will be phased in, the rate increases  
12 proposed for the first year are enormous. These increases will negatively impact the  
13 County as well as all other customer, especially those with a limited budget.

14 Arizona's Constitution requires the Arizona Corporation Commission (ACC) to  
15 "prescribe . . . just and reasonable rates and charges to be made and collected, by public  
16 service corporations." Ariz. Const. art. 15, §3. Much of the case law construing this  
17 provision centers on ensuring that public service corporations earn a return on their  
18 investment and how those returns are calculated. *See Residential Utility Consumer Office*  
19 *v. Arizona Corporation Commission*, 240 Ariz. 108 (2016). However, it is clear from  
20 Arizona's early history, the provision also requires equal consideration of the rights of the  
21 public.

22 The Supreme Court of the Territory of Arizona, in *Salt River Valley Canal Co. v.*  
23 *Nelssen*, 10 Ariz. 9 (1906), considered the matter of a farmer (Nelssen) seeking delivery  
24 from a canal company, Salt River Valley Canal Co. (SRV) of Nelssen's Salt River water  
25 appropriation. SRV refused to deliver Nelssen's water unless Nelssen either purchased  
26 water rights in SRV or paid exorbitantly higher water rates than those with water rights or

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1 holding SRV stock. *Id.* at 10. SRV, a public utility<sup>1</sup>, was unable to show any basis for  
2 the rate differential other than the lack of a lease or purchased water right. *Id.* at 14.

3 The court's decision centered on the reasonableness of the rate charged. In  
4 determining reasonableness, it looked, not only at what was good for SRV, but also at  
5 what was good for the served public. In finding for Nelssen, it stated:

6 [a] reasonable rate is not one ascertained solely from considering the bearing of  
7 the facts upon the profits of the corporation. The effect of the rate upon persons to  
8 whom services are rendered is as deep a concern in the fixing thereof as is the  
9 effect upon the stockholders or bondholders. A reasonable rate is one which is as  
fair as possible to all whose interests are involved.

10 *Id.* at 13.

11 In support of its decision, the *Salt River* court quoted liberally from a case,  
12 *Covington & L. Turnpike Company v. Sanford*, 164 U.S. 578 (1896), involving a turnpike  
13 company charging unjust and unreasonable tolls for use of a roadway. The *Covington*  
14 court stated: “[t]he public cannot properly be subjected to unreasonable rates in order  
15 simply that stockholders may earn dividends”; and “[i]f a corporation cannot maintain  
16 such a highway and earn dividends for stockholders, it is a misfortune for it and them  
17 which the Constitution does not require to be remedied by imposing unjust burdens on  
18 the public.” *Salt River* at 14, citing to *Covington & L. Turnpike Company v. Sanford*, 164  
19 U.S. 578, 596 (1896).

20 The clear message from the *Salt River* and *Covington* courts is that the interest of  
21 both the utility and the public must be balanced but the utility's right to a profit carries  
22 substantially less weight than the public's right to rates that do not create an undue  
23 burden. Both AIC's proposed rates and the ACC Staff's recommendations fail to fit  
24 within that model and should be rejected. In addition, AIC's rate proposal is problematic

25  
26 <sup>1</sup> The Court, in a prior decision, *Slosser v Salt River Valley Canal Co.*, 7 Ariz. 376, 391 (1901), determined SRV to be a public accequia and, therefore, essentially a public agency due to SRV's practice of supplying water to consumers other than its shareholders.

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1 for a number of reasons.

2 **I. AIC Failed to Seek ACC Oversight and Ratepayer Input Prior to Expending**  
3 **Funds**

4 Arizona law requires public utilities to seek ACC approval prior to raising capital  
5 by issuing stock or borrowing money. A.R.S. § 40-301(B) prohibits public service  
6 corporation issuance of “stocks and stock certificates, bonds, notes and other evidences of  
7 indebtedness payable at periods of more than twelve months after the date thereof”,  
8 unless the ACC issues an authorizing order. The purpose of this oversight is explained in  
9 A.R.S. § 40-301(C) which provides criteria for decisions:

10 [t]he commission shall not make any order or supplemental order granting any  
11 application as provided by this article unless it finds that such issue is for lawful  
12 purposes which are within the corporate powers of the applicant, are compatible  
13 with the public interest, with sound financial practices, and with the proper  
14 performance by the applicant of service as a public service corporation and will  
15 not impair its ability to perform that service.

16 Key among those criteria is the requirement that the issue is “compatible with the public  
17 interest.” *Id.* An issue that unduly burdens the public is plainly not compatible.

18 AIC characterizes the \$47.8 million spent on improvements as “paid in capital”  
19 from its parent company (*See, for example*, Hearing Exhibit A-4, Sched. A-5, line 37) or  
20 a “capital infusion”. Hearing Exhibit A-14 at page 5, line 8. While a capital infusion by a  
21 parent company may technically not meet the § 40-301(B) standard of incurred debt, it  
22 nonetheless results in an unregulated imposition of a repayment burden on the rate  
23 payers. In the instant case, the capital is returned to AIC and, ultimately its parent  
24 company, Freeport Minerals Corporation, through the depreciation component of the  
25 proposed rates.<sup>2</sup>

26 <sup>2</sup> In Commissioner Tobin’s October 29, 2018 letter, AIC was asked whether it is “seeking to have the Ajo  
community pay the full value of the capital investments?” AIC’s response did not answer the question but, instead,  
repeated the company’s misleading litany that “AIC is not seeking a return on rate base funded by the capital  
investments.” Hearing Exhibit A-14 at page 11, line 15. Not only is AIC seeking return of the investment, it is also  
seeking a return on that investment because the marginal rate base includes depreciation.

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1 Depreciation expense is a major component of the rates sought. For the test year,  
2 depreciation for the Water Division was \$629,760, representing 46.3% of the total  
3 expenses of \$1,339,936. Hearing Exhibit A-4, Schedule C-1 at page 1. Similarly,  
4 Electrical Division depreciation for the test year was \$206,732, representing 18.6% of the  
5 total expenses (Hearing Exhibit A-5, Schedule C-1 at page 2.2) and, for the Wastewater  
6 Division, depreciation was \$473,834, representing 68.8% of the \$688,444 total test year  
7 expenses. Hearing Exhibit A-6, Schedule C-1 at page 1. Addition of these expenses to  
8 the rate base without any ACC input, while maybe not a true violation of § 40-301(B),  
9 obviously flies in the face of the statute's intent.

10 What is more troubling is AIC's failure to consult with its ratepayers. When asked  
11 whether ratepayers were given an opportunity to provide input concerning the  
12 improvements<sup>3</sup>, AIC suggested this was accomplished through the "significant notice"  
13 provided to residents prior to tearing up the streets and the County permitting process.  
14 Hearing Exhibit A-14 at page 10, line 15. Neither of these actions even remotely put  
15 ratepayers on notice of the cost of the improvements or that they would be paying for  
16 those improvements.

17 This not the first time AIC spent money on improvements without seeking ACC or  
18 ratepayer input. In May, 1984, AIC sought rate increases for its water, electric, and gas  
19 divisions based, in part, on debt incurred through cash advances from its parent company,  
20 Phelps Dodge. Docket E-1025-84-126. The rate application was followed by a  
21 November, 1984, application requesting authorization to issue common stock and  
22 evidence of long term indebtedness. Docket E-1025-84-282. The proceeds from re-  
23 financing proposed in authorization application would have been used to re-pay AIC's  
24 parent company, Phelps Dodge, for a number of unauthorized cash advances made for  
25 unknown purposes in the years prior. Decision No. 54709 at page 5, line 14. The re-

26 \_\_\_\_\_  
<sup>3</sup> Commissioner Olson letter of October 17, 2018.

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1 financing was also intended to re-pay Phelps Dodge for Phelps Dodge assets transferred  
2 to AIC. *Id.* at page 4, line 7.

3 In refusing to authorize AIC's financing package as proposed, the ACC stated:  
4 "[a]pplicant could have and should have sought Commission authorization to issue  
5 evidence of indebtedness for the precise amounts borrowed at the time the loans were  
6 made." *Id.* at page 5, line 3 (emphasis in original). The ACC substantially wrote down  
7 the amount of debt it would authorize and appropriately adjusted the rate increase  
8 downward. *Id.* at page 17, line 10.

9 What is apparent from the 1984 rate case is that AIC was willing to operate at a  
10 loss and borrow capital and operating funds from its parent company until someone in the  
11 company changed the paradigm. That "oops" moment seems to have recurred in the  
12 instant matter. AIC, without consulting anyone at the ACC or within its customer base,  
13 initially sought and received substantial funding from its parent company with minimal  
14 concern about whether it could recoup the money. In the explanation accompanying its  
15 2012 Appropriation Request for the "Area 2 Street Paving Project," AIC stated:

16 [n]o appreciable amount of capital investment can be recovered through utility rate  
17 increases due to the large expenditure relative to the number of AIC customers  
18 (and related unreasonable high rate and substantial rate shock), customer  
19 demographics (low income) and ACC decisions, policies and practices for  
comparable utilities in Arizona.

20 Hearing Exhibit RS-7 at page AIC003276.

21 However, AIC, consistent with its course reversal in 1984, wanting its money back  
22 and is now obviously concerned only with whatever internal reasons it has to create a  
23 substantial fair value rate base and the appearance of a return. The impact of the decision  
24 on its ratepayers is unimportant.

25 Because it does not have to borrow money on the open market, AIC is operating in  
26 a grey area allowing it to expend substantial amounts of money without consulting the

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1 ACC or its rate base. The ACC should fulfill its mission of providing oversight of the  
2 company's "debt" management by limiting AIC's ability to pass the cost of its internal  
3 decisions on to its ratepayers.

4 **II. AIC's Failure to Properly Maintain Company Assets Resulted in Undue**  
5 **Deterioration of the Physical Plants**

6 AIC seems to believe it is acceptable to operate without regard to impact on its  
7 customer base and has a long history of mismanaging company assets. In the instant  
8 matter, the mismanagement is evident from the poor condition of the physical plant and  
9 conveyance/distribution assets in each of the three company divisions which necessitated  
10 the substantial cost for improvements. For example, in one of its internal funding  
11 requests of Area 3 & 4 Water Distribution Improvements, AIC stated: "As a result of  
12 deferred maintenance and equipment wear and obsolescence, the water distribution  
13 infrastructure that serves the Ajo town site is generally very old and in increasingly  
14 deteriorating condition." Hearing Exhibit P.C. #1 at page AIC003315. This theme was  
15 repeated in other water and wastewater system funding requests. *Id.* at AIC003323,  
16 AIC003330, and AIC003361.

17 Had AIC properly maintained its infrastructure, the maintenance expenses would  
18 have been incurred at a measured and tolerable rate and it is also probable the amount of  
19 money AIC spent on the recent improvements would have been much smaller. The  
20 ratepayers should not be penalized for the company's poor maintenance record.

21 **III. AIC Appears to be Double-Expensing Assets Used to Support the Rate**  
22 **Increases.**

23 AIC's Schedules for the Water, Wastewater, and Electric Divisions show Plant in  
24 Service values at the end of the test year of \$22,618,820, \$21,241,998, and \$7,264,120,  
25 respectively. Hearing Exhibits A-4, A-5, and A-6, Schedules B-2. These schedules also  
26 show that, since 2006, AIC made Adjusted Plant Additions totaling \$22,609,883,

1 \$21,346,758, and \$5,799,116 to the Water, Wastewater, and Electric Divisions,  
2 respectively. *Id.* These totals roughly approximate the amounts AIC states it spent on  
3 improvements over the last ten years. Hearing Exhibit A-12 at page 6, line 1. The B-2  
4 schedules also clearly show AIC is depreciating these assets (Hearing Exhibits A-4, A-5,  
5 and A-6, Schedules B-2) and adding the depreciation expenses to the operating expenses  
6 used as the bases for its proposed rate increases. *See* Hearing Exhibits Hearing Exhibits  
7 A-4, A-5, and A-6, Schedules E-2.

8 Exhibit PC-1, however, suggests that at least four significant expenditures were  
9 previously expensed by the company. A 2011 Authorization for Expenditure (AR-1)  
10 form for “Area 3 & 4 Water Distribution Improvements” (Hearing Exhibit PC-1 at page  
11 AIC003315) requests \$7.4 million for work beginning that year. Similarly, another 2011  
12 AR-1 form for “Area 2 Sewer and Area 4 Lift station Construction” requests \$5 million  
13 (*Id.* at page AIC003323); an AR-1 form for 2007 related to “AIC Water & Sewer Utility  
14 System” work requested \$3.5 million (*Id.* at page AIC003330); and a 2012 AR-1  
15 requested \$14.1 million for “Area 3 & 4 Sewer System Improvements”. *Id.* at page  
16 AIC003361. All four AR-1 forms indicate the funding would be counted as an expense,  
17 rather than capital. The reason for expensing the expenditures is explained by the  
18 company in AIC003330:

19 [t]his project will not provide a direct economic benefit. No appreciable amount  
20 of the investment is expected to be recoverable through utility rate increases due to  
21 customer demographics and ACC policies and practices (see Utility Rate History  
22 and recovery of Investment sections of the project write-up. As such, this  
23 spending authorization request has classified the AIC project spending as  
24 expense.”

25 *Id.* at page AIC003330.

26 The \$30 million requested in these four AR-1 forms is an estimate of the  
improvement costs and something more or less may have been spent. However, if the  
amounts spent were expensed in the years accrued, AIC should not be including them in

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1 the depreciation expenses used to calculate the marginal rate base.

2 It is clear from the above, AIC had no intention or expectation of recovering its  
3 capital when the money was initially spent. This, more than AIC's current explanation:  
4 "it was best to wait until the infrastructure projects were completed" (Hearing Exhibit A-  
5 14 at page 4, line 22), explains why AIC failed to file a rate case sooner.

6 There is an informational gap concerning what portion of the \$47.8 million was  
7 previously expensed by AIC. While the four projects cited above suggest the funds spent  
8 were expensed earlier, there is nothing in the record explaining how AIC accounted for  
9 the other contemporaneous projects. The ACC should request additional information on  
10 the expensing issue from AIC and adjust AIC's test year expenses appropriately before it  
11 renders a rate decision.

12 **IV. Conclusions**

13 AIC's unilateral decision to expend \$47.8 million on improvements to its assets,  
14 followed by its decision to recover that money from its ratepayers, will result in an unjust  
15 and unreasonable burden on its ratepayers. Rate increases of the magnitude contemplated  
16 do not meet the Constitutional requirement for just and reasonable rates and should be  
17 rejected.

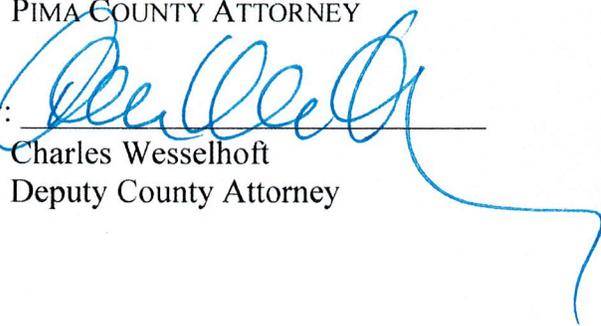
18 AIC's failure to consult with the ACC and AIC's rate payers prior to expending  
19 \$47.8 million on infrastructure improvements, followed by its attempt to recover those  
20 expenditures through exorbitant rate increases, displays the company's disdain for  
21 anything but its bottom line. Further, some undefined portion of the infrastructure repairs  
22 appears to have resulted from AIC's failure to properly maintain its infrastructure. The  
23 ratepayers should not suffer inordinate burdens to serve AIC's needs.

24 Finally, AIC must supplement the record to explain how the costs of the  
25 infrastructure improvements can be recovered through addition of depreciation expense  
26 to its operating expense when the costs of at least some of those improvements were

1 apparently expensed when the costs were accrued. If the costs were previously expensed,  
2 they should not re-appear as depreciation expenses.

3  
4 RESPECTFULLY SUBMITTED December 21, 2018.

5  
6 BARBARA LAWALL  
7 PIMA COUNTY ATTORNEY

8  
9 By:   
10 Charles Wesselhoft  
11 Deputy County Attorney

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**CERTIFICATE OF SERVICE**

The Original and thirteen copies of the foregoing were mailed this day to:

Docket Control  
ARIZONA CORPORATION COMMISSION  
1200 West Washington  
Phoenix, AZ 85007

I further hereby certify that I have on this day served the foregoing documents on all parties of record in this proceeding by either emailing a copy to those who have consented to email service, or by mailing a copy thereof, properly addressed with first class postage prepaid to:

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*Attorneys for Arizona Water Company*

Dated at Tucson, Arizona, this 21st day of December, 2018.

By: Marilee Weston

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**County Owned Properties - Ajo Improvement Company**

Address	Electric	Water	Department	Property Use	Notes
111 La Mina Ave	Yes	Yes	Justice Courts	Courthouse	
625 N. Ajo Well #1 Road	No	No	NRPR	Palo Verde II Park	School may pay for electric
1131 N. Ajo Well #1 Road	Yes	Yes	Department of Transportation	DOT Shop	Includes Fleet Services Fuel Island
1133 N. Ajo Well #1 Road	Yes	Yes	Facilities Management	FM Shop	
1211 N. Ajo Well #1 Road	Unknown	No	ITD	Tower	May use power from jail or State.
1249 N. Ajo Well #1 Road	Yes	Yes	Sheriff's Department	Jail/Housing	Multiple Buildings
1259 N. Ajo Well #1 Road	Yes	Yes	Animal Control	Animal Control	
2000 N. Ajo Well #1 Road	No	Yes	Environmental Quality	Landfill	Generator is used for electric
77 W. Mead Road	APS	No	Attractions & Tourism	Golf Course	Land is leased so tenant may pay for the water
77 W. Mead Road	APS	No	Transportation	Airport Hanger	
120 W. Estrella	Yes	Yes	Facilities Management	Healthcare Center	
290 W. 5th Street	Yes	Yes	NRPR	Community Center/Pool	
341 W. Esperanza Ave	No	No	Sustainability & Conservation	Curley Gym	Vacant
411 W. Esperanza Ave	Yes	Yes	NRPR	Food Bank	
421 W. Esperanza Ave	Yes	Yes	NRPR	Community Art	
500 W. Lomita Ave	No	Yes	Flood Control	Meter Only	Meter only with private residence address
1330 W. Childs Street	No	Yes	NRPR	Forrest Park	AZ Water Company
5075 N. Ajo Gila Bend Hwy	APS	No	ITD	Tower	
41 W. Plaza Street	Yes	No	Department of Transportation	Traffic Light	
15 W. Plaza Street	Yes	Yes	County Free Library	Ajo Library	Leased Building
532 W. Hospital Road	Included	Included	Facilities Management	County Atty House	Leased Building

\*APS electric provider is not affected by the lawsuit.