COUNTY ADMINISTRATOR'S OFFICE
PIMA COUNTY GOVERNMENTAL CENTER
130 W. CONGRESS, FLOOR 10, TUCSON, AZ 85701-1317
(520) 724-8661 FAX (520) 724-8171

C.H. HUCKELBERRY
County Administrator

December 26, 2018

Roy Archer, President
Ajo Improvement Company
P.O. Drawer 9
Ajo, Arizona 85321

Re: **Your December 19, 2018 Letter Regarding the Ajo Improvement Company Rate Case**

Dear Mr. Archer:

I appreciate your December 19, 2018 letter regarding the Ajo Improvement Company rate case with the Arizona Corporation Commission.

As a courtesy, I am enclosing Pima County's December 21, 2018 filing, objecting to the proposed rate increases as an Intervenor.

Sincerely,

C.H. Huckelberry
County Administrator

CHH/anc

Enclosures

c: The Honorable Chairman and Members, Pima County Board of Supervisors
Richard Bark, Director of Government Relations & Environmental Counsel, Freeport McMoRan Copper and Gold

AJO IMPROVEMENT COMPANY
P O DRAWER 9
AJO, ARIZONA 85321

TELEPHONE: 520-387-2001 FAX: 520-387-7627

December 19, 2018

Dear Administrator Huckleberry,

During the past year, the Ajo Improvement Company has been working on a rate case with the Arizona Corporation Commission. AIC's last rate increase was in 2004, and we have not been covering our basic operating expenses for many years. Our current rates are much lower than the rates paid by Arizona Public Service and Arizona Water customers who in many cases are just across the street from the AIC service area.

While these rate increases will bring more parity between AIC and APS customers and allow AIC eventually to cover its operating expenses, we understand they will have a negative impact on AIC's low-income customers.

As one of several measures to help offset this impact, AIC is pleased to create a fund to provide bill-pay assistance to low-income Ajo residents who need it, similar to those offered by APS and Tucson Electric Power. Qualified Ajo residents can ask for assistance from a pool of $20,000 per year the first two years of new rates and $25,000 per year thereafter. AIC understands that this fund will be administered by Arizona Community Action Association in conjunction with the same local nonprofit that administers similar programs offered by other utility companies in Ajo.

AIC has been serving Ajo since shortly after Arizona statehood in 1912 and provides utilities to about 1,000 customers in the original township area of about 1 square mile.

During the past decade, AIC has completed $60 million in infrastructure improvements, including building a new water treatment plant to meet recent federal treatment requirements, fully replacing much of the original water and sewer facilities, and upgrading the substation to handle the increased demand as more people in Ajo installed air conditioning.

AIC is not seeking a rate of return on this $60 million in infrastructure improvements, and instead only is seeking to cover operating costs with this rate increase.

In addition to the bill-pay assistance fund, AIC is taking the following steps to mitigate or ease the effect the proposed rates may have:

- Waiving revenues of approximately $7.5 million by phasing in electric and water rates over a five-year period and wastewater rates over seven years.

- Applying a monthly credit of approximately $5 to the average customer bill for the first three years of the rate increase using approximately $200,000 of unused funds collected through two surcharges paid by customers.

These mitigation efforts mean AIC will not break even on operating costs for at least four years after the new rates go into effect.

AJO IMPROVEMENT COMPANY
P O DRAWER 9
AJO, ARIZONA 85321

TELEPHONE: 520-387-2001 *FAX: 520-387-7627*

My family has deep roots in Ajo, having arrived there in the early 1920s. My 88-year-old aunt still lives in Ajo, and I have fond childhood memories of visiting my grandmother there. I have served the residents of Ajo in the utility business for more than 20 years, and I am pleased AIC will provide this new fund to help our low-income residents manage the hardship this rate increase may cause.

Sincerely,

Roy Archer
President
Ajo Improvement Company

BARBARA LAWALL
PIMA COUNTY ATTORNEY
CIVIL DIVISION
Charles Wesselhoft, SBN 023856
Deputy County Attorney
32 North Stone Avenue, Suite 2100
Tucson, Arizona 85701
Telephone: 520-724-5700
Charles.Wesselhoft@pcao.pima.gov
Attorney for Pima County

BEFORE THE ARIZONA COPORATION COMMISSION

COMMISSIONERS
TOM FORESE - Chairman
BOB BURNS
ANDY TOBIN
BOYD W. DUNN
JUSTIN OLSON

IN THE MATTER OF THE APPLICATION OF AJO IMPROVEMENT COMPANY – WASTEWATER DIVISION FOR AN INCREASE TO ITS AUTHORIZED RATES AND CHARGES, FOR A DETERMINATION OF THE FAIR VALUE OF ITS PROPERTY DEVOTED TO WASTEWATER UTILITY SERVICE IN THE STATE OF ARIZONA, AND FOR OTHER RELATED APPROVALS.	Docket No. WS-01025A-17-0361
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

BARBARA LAWALL
PIMA COUNTY ATTORNEY
CIVIL DIVISION

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

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

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

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

BARBARA LAWALL
PIMA COUNTY ATTORNEY
CIVIL DIVISION

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

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

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

Id at 13.

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

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

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

BARBARA LAWALL
PIMA COUNTY ATTORNEY
CIVIL DIVISION

for a number of reasons.

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

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

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

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

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

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

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

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

[3] Commissioner Olson letter of October 17, 2018.

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

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

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

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

Hearing Exhibit RS-7 at page AIC003276.

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

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

BARBARA LAWALL
PIMA COUNTY ATTORNEY
CIVIL DIVISION

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

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

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

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

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

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

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PIMA COUNTY ATTORNEY
CIVIL DIVISION

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PIMA COUNTY ATTORNEY
CIVIL DIVISION

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

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

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

Id. at page AIC003330.

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

BARBARA LAWALL
PIMA COUNTY ATTORNEY
CIVIL DIVISION

the depreciation expenses used to calculate the marginal rate base.

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

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

IV. Conclusions

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

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

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

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

RESPECTFULLY SUBMITTED December 21, 2018.

BARBARA LAWALL
PIMA COUNTY ATTORNEY

By: _____
Charles Wesselhoft
Deputy County Attorney

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PIMA COUNTY ATTORNEY
CIVIL DIVISION

BARBARA LAWALL
PIMA COUNTY ATTORNEY
CIVIL DIVISION

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:

Robert Sorrels
301 E. 2nd Ave.
Ajo AZ 85321
rs@rsorrels.com
tedemore@aol.com

Michael W. Patten
SNELL & WILMER, LLP
One Arizona Center
400 East Van Buren Street
Phoenix AZ 85004
mpatten@swlaw.com
jthomes@swlaw.com
docket@swlaw.com

Andy Kvesic, Director
Legal Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix AZ 85007
LegalDiv@azcc.gov
UtilDivServicebyEmail@azcc.gov

Elijah Abinah, Director
Utilities Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix AZ 85007

E. Robert Spear, General Counsel
ARIZONA WATER COMPANY
P.O. Box 29006
Phoenix AZ 85038

Meghan H. Grabel
Kimberly A. Ruht
OSBORN MALEDON, PA
2929 North Central Avenue, Ste 2100
Phoenix AZ 85012
Attorneys for Arizona Water Company

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

By: Marilee Weston

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.

ATTACHMENT A