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See Ariz. R. Supreme Court 111(c); ARCAP 28(c);  
Ariz. R. Crim. P. 31.24



DIVISION ONE  
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IN THE COURT OF APPEALS  
STATE OF ARIZONA  
DIVISION ONE

TOWN OF YOUNGTOWN, a municipal ) No. 1 CA-CC 08-0001  
corporation of the State of )  
Arizona, ) DEPARTMENT A  
)  
Appellant, ) **MEMORANDUM DECISION**  
)  
v. ) (Not for Publication -  
) Rule 28, Arizona Rules of  
ARIZONA CORPORATION COMMISSION, ) Civil Appellate Procedure)  
an agency of the State of )  
Arizona, )  
)  
Appellee, )  
)  
)  
RESIDENTIAL UTILITY CONSUMER )  
OFFICE, )  
)  
Intervenor/Appellee. )

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Arizona Corporation Commission  
Docket No. W-01303A-07-0209

**AFFIRMED**

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**B A R K E R**, Judge

¶1 On May 16, 2008, the Arizona Corporation Commission ("Commission") issued Decision No. 70351, which established rates and charges for Arizona-American Water Company's ("AAW's") Sun City Water District. The Town of Youngtown, which intervened in the proceedings before the Commission, appeals. Youngtown challenges the Commission's decision not to approve a fire flow cost recovery mechanism ("FCRM") to allow AAW to recover the cost and expenses of a capital improvement plan intended to provide improved water distribution for fire protection. Youngtown further challenges the Commission's decision not to order AAW to implement the capital improvement plan even without the FCRM. For the following reasons, we affirm.

***Facts and Procedural History***

¶2 AAW is the largest investor-owned water utility in Arizona. Its Sun City Water District serves approximately 23,000 customers and includes all of Sun City and Youngtown, and parts of Peoria and Surprise. In a prior rate case for the Sun

City Water District, the Commission ordered AAW to form a Fire Flow Task Force to determine if the water production capacity, storage capacity, water lines, water pressure, and fire hydrants of Youngtown and Sun City were sufficient to provide the fire protection capacity each community wanted. The Task Force included representatives from the Sun City Fire Department, the Surprise Fire Department, as well as the Town of Youngtown.

¶3 The Task Force report, filed in May 2005, recognized that AAW had no regulatory mandate to provide fire flow to the community but that fire flow was an important public safety issue that should be timely addressed. The report recommended a minimum standard fire flow of 1000 gallons per minute ("gpm") for single-family residential areas and 1500 gpm for commercial and multi-family areas, which was consistent with the standards of the Uniform Fire Code and the International Fire Code. The report further recommended fire hydrant spacing every 660 feet. It found that most of the Sun City Water District met the fire flow recommendations but that some areas required larger pipelines and more hydrants to satisfy the local fire departments' recommendations. The Task Force recommended a four-year capital improvement plan to upgrade the fire flow capabilities in the water district. The Task Force estimated the total four-year cost at \$3,080,102.

¶14 In April 2007, AAW filed an application for a rate increase for the Sun City Water District. In addition to a rate increase, the application sought a rate surcharge for the fire flow improvement projects identified by the Task Force. The FCRM would be similar to the arsenic cost recovery mechanism ("ACRM"), a mechanism employed to allow recovery of costs associated with complying with new federally mandated levels of arsenic. Under the FCRM, a surcharge would be set to recover the authorized rate of return associated with the completed fire flow projects, would be increased upon Commission order as projects were completed and reviewed, and would terminate when new permanent rates were established in the next AAW Sun City Water District rate case. The step increases would occur over four years and when such a step increase was requested, the company would provide updated earnings information. Only if the adjusted return on equity were equal or below what the Commission approved would the step increase be authorized for the fire flow. AAW explained that it was not in a financial position to advance the capital investments for the improvements without immediate rate recovery and that Youngtown had indicated that it lacked available funds to contribute to the project. AAW stated that if the Commission did not approve the FCRM, AAW would be unable to move forward on the fire flow improvements for many years.

¶15 The Residential Utility Consumer Office ("RUCO")<sup>1</sup> and the Town of Youngtown intervened in the proceeding. Youngtown supported the recommendations of the Task Force and the approval of the FCRM, explaining that it was concerned that the water system serving the town did not uniformly meet the minimum requirements of the International Fire Code ("IFC"), in that it did not everywhere provide the required level of fire flow and/or have properly spaced fire hydrants, although most of the Sun City Water District customers had access to the minimum level of fire flow and fire hydrants required by the IFC. Youngtown asserted that the improvements posed life and safety issues and should not be deemed discretionary unless they created an unreasonable cost burden on AAW or its customers. It argued that the failure to provide sufficient fire flows and fire hydrants violated Arizona Revised Statutes ("A.R.S.") sections 40-361(B) and -334(A) and (B), which Youngtown argued placed an affirmative duty on the Commission to protect the public safety and prevent disparate treatment of utility customers. Youngtown contended that it did not have the financial means to make the improvements and that, even if it did, it would be legally precluded from doing so by Article 9,

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<sup>1</sup> RUCO is a statutorily created entity charged with representing the interests of residential utility consumers in regulatory proceedings before the Corporation Commission involving public service corporations. Ariz. Rev. Stat. ("A.R.S.") § 40-462 (2001).

Section 7, of the Arizona Constitution, which prohibits governmental bodies from making a donation or grant to a corporation. Ariz. Const. art. 9, § 7. Youngtown also argued that the individual customers should not have to bear the cost of improvements because they already pay a pro rata share for providing minimum fire flows to customers in the Sun City Water District that already have access to adequate service. Youngtown asked the Commission to order AAW to make the proposed fire flow improvements and authorize the FCRM or any cost recovery mechanism that would be fair to both AAW and the consumers.

¶16 RUCO objected to the imposition of the FCRM. It asserted that whether to order the construction of the improvements was discretionary, noting that the Arizona Administrative Code required water utilities to deliver potable water at a minimum pressure but did not require a particular level for fire flow. RUCO claimed that improving the water utilities to meet the recommended fire flow would be cost-prohibitive and result in state-wide rate shock. RUCO pointed out that the price of water and wastewater service had escalated because of federal and state mandates and opined that to burden public utility rates with a discretionary expenditure that could jeopardize the affordability of water service in Arizona would be very bad public policy. RUCO noted that the Commission had

previously granted a rate increase for fire flow construction in Paradise Valley on the grounds that it was necessary for public safety and the ratepayers supported the project and were willing to pay for it. However, once the rates went into effect, the ratepayers objected on the grounds that the surcharge was unfair, and Paradise Valley was seeking a modification of the rates. RUCO further objected on the grounds that implementing such a rate surcharge would deviate from the normal rate-making practices, when a company's plant additions are reviewed in a rate case and examined in the context of an historical test year, and that although the Commission does sometimes depart from the standard rate-making practices, it does so only under unique circumstances. RUCO took the position that if Youngtown wanted the improvements, Youngtown should pay for them.

¶17 The Staff of the Corporation Commission argued that adequate fire flow was a matter of public health and safety and that the FCRM was a preferable method to pay for the improvements. Staff asserted that the fire flow improvements were necessary to provide the same level of service to all ratepayers.

¶18 On January 7, 2008, a hearing began before Administrative Law Judge ("ALJ") Jane Rodda. In opening statements, counsel for Youngtown argued that it supported applying the FCRM but that it also believed that the Commission

should exercise its authority to order the fire flow improvements regardless of how AAW was permitted to recover the cost. RUCO argued that the Commission was not responsible for providing a public benefit through a fire flow project, asserting that fire flow was unrelated to what was necessary to provide water service at reasonable rates. RUCO claimed that approving the fire flow projects jeopardized the affordability of water service and was contrary to the public interest.

¶19 An AAW engineer testified that the standard for water service providers was to provide water pressure of twenty pounds per square inch ("psi") at the customer's point of delivery and that the Sun City Water District system met that requirement. See Ariz. Admin. Code ("A.A.C.") R14-2-407(E). He also testified that some areas of the water district did not meet the minimum standards for fire flow recommended by the task force and that AAW was not required to provide fire flow.

¶10 Thomas Broderick, the manager of rates for AAW, testified that the surcharge would be based on actual cost data for the improvements and would not be in the form of a prepayment. He noted that, of the responses received from a company survey of water district customers, fifty-nine percent supported improving the fire flows, and fifty-one percent said they would pay the cost in their water bill. He testified that AAW was not required to implement the fire flow projects in

order to provide basic water service in the district and therefore the project was unquestionably discretionary. He testified that the step increases of the surcharge would be requested over four years and so would be considered potentially four years beyond the fair value determination in the rate case. Broderick further explained that AAW could not proceed with the project if the FCRM were not approved. He testified AAW had had negative income for a number of years and was being "kept afloat" by its parent company American Water. The company had invested \$335 million but had a rate base of only \$149 million. It further had multiple projects in progress for which cost recovery had been deferred. Broderick testified that the parent company would find proceeding with the fire flow project an unacceptable risk if cost recovery had to be deferred.

¶11 The battalion chief for the Sun City Fire Department testified that residents in the fire district paid the same fire tax rate, but some areas did not meet the recommended fire flow standards. He explained that the lack of fire hydrants created a situation where backup trucks had to find a water source instead of helping with the fire or rescue. Although the fire department had maps of hydrant locations, because hydrants were lacking in certain areas, time was lost having to make a logistic decision regarding the best route to convey water to the fire scene. He acknowledged that the problems have existed

since he arrived in 1989, when Youngtown owned the system. Youngtown sold the system in 1995.

¶12 The mayor of Youngtown testified that the water system and the structures had been built approximately fifty years before and that the population was elderly, making escape from fire more difficult. He testified that Youngtown could not pay for the improvements, stating that Youngtown had no bonding authority because it had no primary property tax and owned no utility that could create a stream of income that would support a bond. He also expressed the opinion that Article 9, Section 7, of the Arizona Constitution precluded Youngtown from making improvements on a system it did not own and therefore Youngtown could not pay for the improvements. He agreed that the inadequacies in the system had existed for more than forty years and that Youngtown owned the system until 1995.

¶13 Marylee Diaz Cortez, RUCO's chief of accounting and rates, testified that AAW was in compliance with all Commission rules and was not required to do any of the proposed upgrades for the fire flow project. She asserted that the projects and associated rate surcharge were being proposed at the request of Youngtown, not because the Commission required it, making the improvements discretionary. She explained that RUCO did not contest that citizens should have fire safety or that the fire flow projects would improve public safety. RUCO's position was

that public safety issues were the responsibility of the legislature and municipal bodies. Diaz Cortez asserted that the public safety issue involved should not burden utility rates for water service. She explained that RUCO objected to jeopardizing the affordability of a basic necessity like water service by spending money on discretionary projects that were not the responsibility of the Commission under existing rules and regulations. She testified that the Commission's responsibility for public safety must relate to the service the Commission requires, which would be basic water service, and that with respect to that service, the company was providing equivalent service to customers in the Sun City Water District. She expressed the opinion that because all customers were receiving the service required by the Commission rules, differences in fire flow service, which was not required by the Commission rules, could not be unreasonable under A.R.S. § 40-334(B), which prohibits a public service corporation from establishing any "unreasonable difference" as to rates or services between localities or classes of service. Diaz Cortez suggested that Youngtown could put forth an initiative to create a funding source to support a bond if it wanted the fire flow project to be performed. RUCO also objected to the FCRM as the mechanism to fund the projects, noting that building infrastructure could create cost savings that would not be considered with the step

increases but would be considered in a standard rate case. She also testified that the rate increase for the fire flow would be thirty cents per month in addition to a twenty-five percent rate increase for basic water service and a proposed thirty-five percent increase in sewer rates. She noted that the general public had approved the Paradise Valley fire flow project until customers began to see the rate increases.

¶14 On April 17, 2008, the ALJ issued a Recommended Opinion and Order ("ROO"), approving the requested FCRM. The ROO found that the fire flow improvement project was important to promote and protect the health and safety of AAW's customers and authorized AAW to begin construction.

¶15 On May 16, 2008, the Commission issued its order, rejecting the recommendation of the ALJ and denying the request to implement the FCRM. The Commission order stated:

Our experience with considering major construction projects outside the context of a rate case teaches us that often substantial unintended adverse consequences can result from implementing surcharges such as the FCRM. Cost recovery mechanisms such as the FCRM should only be implemented in extraordinary circumstances. We do not find that the proposed fire flow improvement project warrants the extraordinary rate making treatment being proposed by the Company, Staff and Youngtown. Consequently, we deny the request to implement the FCRM. Our finding on the merits of the FCRM, however, does not affect how the Commission would treat the capital improvements if the Company constructed them voluntarily and

seeks their inclusion in rate base in a rate case.

¶16 Youngtown filed an application for rehearing pursuant to A.R.S. § 40-253, which was deemed denied by operation of law when the Commission failed to grant it within twenty days. A.R.S. § 40-253(A) (2001). Youngtown filed a timely notice of appeal.

### ***Discussion***

#### ***1. Jurisdiction***

¶17 The Arizona Constitution gives the Corporation Commission

full power to . . . prescribe just and reasonable classifications to be used and just and reasonable rates and charges to be made and collected, by public service corporations within the State for service rendered therein, and make reasonable rules, regulations, and orders, by which such corporations shall be governed in the transaction of business within the State . . . .

Ariz. Const. art. 15, § 3. A party dissatisfied with an order of the Commission involving a public service corporation and related to rate making or rate design may appeal directly to this court to vacate, set aside, affirm in part, reverse in part, or remand the Commission's order. A.R.S. § 40-254.01(A) (2001). Appeals of Commission decisions not involving rate making or rate design must be brought in superior court. A.R.S. § 40-254 (2001).

¶18 Youngtown appeals from both the Commission's decision not to authorize the FCRM and its failure to order AAW to implement the fire flow improvements without the FCRM. RUCO argues that this court lacks jurisdiction over a direct appeal of the latter issue because whether the Commission properly refused to order the improvements is unrelated to rate making or rate design under A.R.S. § 40-254.01(A). RUCO argues that an appeal from that order must first be brought before the Commission for initial determination.

¶19 We have previously determined that the legislature's purpose in authorizing a direct appeal of a rate case to this court was "to reduce the time and expense of appealing a rate case in superior court." *Ariz.-Am. Water Co. v. Ariz. Corp. Comm'n*, 209 Ariz. 189, 191, ¶ 12, 98 P.3d 624, 626 (App. 2004). An order that merely affects rates is not directly appealable. *Id.* at 192, ¶ 12, 98 P.3d at 627. To be directly appealable, the order must arise from the rate-making process, that is, from a rate case. *Id.* at 193, ¶ 19, 98 P.3d at 628.

¶20 Here, the order arises from a rate case, and the Commission's decision denying the FCRM clearly falls within our jurisdiction of a direct appeal. The Commission's failure to order the fire flow project, however, although arising from a rate case, is unrelated to rate making. Nevertheless, we agree with Youngtown that to require Youngtown to bring both an appeal

in this court of the FCRM portion of the order and an appeal in superior court would defeat the legislature's purpose of reducing the time and expense of appealing a rate case and would certainly constitute an inefficient use of judicial resources. This is particularly true when, as we describe *infra*, the Commission did not reach the issue of inadequate, unequal, or unsafe provision of services. Under these circumstances, we find that we have jurisdiction to consider both issues raised by Youngtown from this rate case.

**2. Inadequate, Unequal, and/or Unsafe Services Are Not at Issue**

¶21 Having indicated that we have jurisdiction to consider the issue of inadequate, unequal, or unsafe services asserted by Youngtown, we do not address that issue in this appeal. We do not do so because the Commission did not take up the issue even though evidence was presented to it on that point. *Stewart v. Mut. of Omaha Ins. Co.*, 169 Ariz. 99, 108, 817 P.2d 44, 53 (App. 1991) (finding it inappropriate to address the issues raised by the cross-appellant when the "trial court did not rule on the merits of these issues"); see also *Chalpin v. Snyder*, \_\_\_ Ariz. \_\_\_, \_\_\_ n.4, ¶ 16, 207 P.3d 666, 671 n.4 (App. 2008) (declining to consider the appellee's argument because the trial court had not ruled on the issue).

¶122 As set forth earlier, the Commission's order was very narrow. The ruling is expressly limited to the FCRM. The Commission prefaced its order by indicating that "often substantial unintended adverse consequences can result from implementing surcharges such as the FCRM." (Emphasis added.) The issue the Commission decided was whether it should "implement[] surcharges," not whether there was a violation of the statutory mandates in the services presently provided. The Commission's sole finding was not whether the services provided by AAW were inadequate, unsafe, or unequal, but rather only that "the extraordinary rate making treatment being proposed by the Company [AAW], Staff and Youngtown" was not warranted. (Emphasis added.) Accordingly, the Commission ruled: "Consequently, we deny the request to implement the FCRM." There are no findings, and no ruling, with regard to the alleged inadequate, unequal or unsafe services related to fire flow. Thus, we decline to address that issue. See *Stewart*, 169 Ariz. at 108, 817 P.2d at 53. As the Commission and RUCO agreed at oral argument, because there was no complaint filed against AAW as part of these proceedings, and the issue of inadequate, unequal, and/or unsafe services was not reached by the Commission, Youngtown is free to file a complaint with the Commission against AAW without prejudice to the proceedings (including any rulings) in this rate case.

### **3. Was the Commission's Order Denying the FCRM Unlawful?**

¶23 On appeal, the party challenging the Commission's decision related to rate making must make a "clear and satisfactory showing that the order is unlawful or unreasonable." A.R.S. § 40-254.01(E). A "clear and satisfactory" showing is the same as a "clear and convincing" showing. *Consol. Water Utils., Ltd. v. Ariz. Corp. Comm'n*, 178 Ariz. 478, 481, 875 P.2d 137, 140 (App. 1993). This court's review is therefore "limited to whether the findings and conclusion of the Commission are supported by substantial evidence and are not arbitrary or otherwise unlawful." *Ariz. Corp. Comm'n v. Superior Court*, 107 Ariz. 24, 26, 480 P.2d 988, 990 (1971). We may not reweigh the evidence or substitute our judgment for that of the Commission. *Tucson Elec. Power Co. v. Ariz. Corp. Comm'n*, 132 Ariz. 240, 243, 645 P.2d 231, 234 (1982).

¶24 Because the Commission narrowed the issue solely to the question of the denial of the FCRM, our treatment of this issue need not be lengthy, nor will it, as indicted above, address the issue of whether the services provided by AAW are inadequate, unequal, or unsafe. One of the factors that the Commission was entitled to rely upon in considering whether the "extraordinary rate making treatment" of an FCRM should be applied is the length of time the circumstances at issue had

been in existence. At the hearing, Hank Oleson, the battalion chief for the Sun City Fire Department, testified as follows:

Q. So, you've been there since 1989; correct?

A. Yes.

Q. So you're familiar with these inadequacies that you have been describing. Have these inadequacies been around since 1989 since you have been there?

A. Yes.

Q. Were these same inadequacies there before you were there? If you know.

A. I would assume.

Q. Okay. And during the time that you have been there, did you ever speak to your superiors or to the Town about these inadequacies?

A. *We've been addressing these and talking about these and planning around these ever since I started, yes.*

(Emphasis added.) Youngtown's mayor, Michael Levault, gave similar testimony, indicating that the situation creating the inadequacies the Town asserts had been in place for "between 40 and 50 years". He testified that the water system, with the inadequacies of which Youngtown complained, was owned by Youngtown until sold in 1995. Accordingly, the circumstances in issue have been in existence for decades. This fact alone supports the Commission's decision not to consider this matter as qualifying for "extraordinary rate making treatment." As

noted, our decision is without prejudice to whether the services provided by AAW (1) are inadequate, unsafe, or unequal and (2) provide the basis for a complaint against AAW pursuant to A.R.S. § 40-246 or any other pertinent statutory provision.

***Conclusion***

¶25 For the foregoing reasons, we affirm.

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DANIEL A. BARKER, Judge

CONCURRING:

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PHILIP HALL, Presiding Judge

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JON W. THOMPSON, Judge