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MEMORANDUM

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2004 MAR -4 P 1: 27

AZ CORP COMMISSION
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TO: Docket Control

FROM: Ernest G. Johnson
Director
Utilities Division

DATE: March 4, 2004

RE: STAFF REPORT FOR MOUNTAIN GLEN WATER SERVICES, INC. RATE INCREASE APPLICATION (DOCKET NO. W-03875A-03-0737) AND MOUNTAIN GLEN WATER SERVICES, INC. FINANCING APPLICATION (DOCKET NO.W-03875A-03-0870)

Attached is the Staff Report for Mountain Glen Water Services, Inc. applications for a permanent rate increase and financing. Staff recommends approval of the rate application using Staff's recommended rates and charges and the financing application as modified by Staff.

EGJ:ENZ:red

Originator: Elena Zestrijan

Attachment: original and sixteen copies

Arizona Corporation Commission
DOCKETED

MAR - 4 2004

DOCKETED BY

Service List for: Mountain Glen Water Services, Inc.
Docket No. W-03875A-03-0737
Docket No.W-03875A-03-0870

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STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

MOUNTAIN GLEN WATER SERVICES, INC.

DOCKET NO. W-03875A-03-0737
AND
DOCKET NO. W-03875A-03-0870

APPLICATIONS FOR A
PERMANENT RATE INCREASE
AND
FINANCING

MARCH 4, 2004

STAFF ACKNOWLEDGMENT

The Staff Report for Mountain Glen Water Services, Inc., Docket No. W-03875A-03-0737 was the responsibility of the Staff members listed below. Elena Zestrijan was responsible for the review and analysis of the Company's application, revenue requirements, rate base and rate design. Marlin Scott, Jr. was responsible for the engineering and technical analysis. Deborah Reagan was responsible for reviewing the Commission's records on the Company, determining compliance with Commission policies/rules and reviewing customer complaints filed with the Commission.

Alejandro Ramirez was responsible for the review and analysis on the Company's financing application Docket No. W-03875A-03-0870. Marlin Scott, Jr. was responsible for the engineering and technical analysis.

Elena Zestrijan
Public Utility Rate Analyst III

Alejandro Ramirez
Public Utility Rate Analyst I

Marlin Scott, Jr.
Utilities Engineer

Deborah Reagan
Public Utilities Consumer Analyst I

EXECUTIVE SUMMARY
MOUNTAIN GLEN WATER SERVICES, INC.
DOCKET NO. W-03875A-03-0737
AND
DOCKET NO. W-03875A-03-0870

Mountain Glen Water Services, Inc. ("Company") is engaged in the business of providing utility water service exclusively to Arizona customers in Navajo County. The Company is located northwest of Show Low along State Highway 260, and it provides service to approximately 269 customers in three communities; Linden, Pinedale and Clay Springs. The Company's existing rates were approved by this Commission in Decision No. 62905 dated September 18, 2000.

The Company's rate application requested an increase in revenues of $37,500 or a 29.30 percent increase over adjusted test year revenues of $128,006. The Company proposed rates will produce revenues of $165,506 and an operating income of $33,625, for a 22.76 percent rate of return on an Original Cost Rate Base ("OCRB") of $147,739. The Company's proposed rates would increase the typical residential bill with a median usage of 5,277 gallons by $6.90 or 21.50 percent.

Without consideration of a surcharge, Staff is recommending a revenue level of $146,853 for an increase in revenues of $18,847 or 14.72 percent over adjusted test year revenues of $128,006. Staff recommended revenues result in a 9.88 percent rate of return on an OCRB of $137,834. Staff's recommended rates would increase the typical residential bill with a median usage of 5,277 gallons from $32.06 to $34.67 for an increase of $2.61 or 8.10 percent excluding any surcharge.

With the arsenic surcharge, Staff is recommending a revenue level of $220,016, for an increase in revenues of $92,010 or 71.88 percent over adjusted test year revenues of $128,006. Staff recommended revenues result in a 58.94 percent rate of return on an OCRB of $137,834. Staff's recommended rates would increase the typical residential bill with a median usage of 5,277 gallons from $32.06 to $57.33 for an increase of $25.27 or 78.80 percent including a surcharge of $22.66 per customer per month to service the loan to be issued by the Water Infrastructure Finance Authority ("WIFA") for the arsenic modification and reduction as required by the Arizona Department of Environmental Quality ("ADEQ").

On December 4, 2003, the Company filed a financing application with the Arizona Corporation Commission ("Commission") requesting authorization to borrow $640,710 from WIFA to purchase or construct the necessary arsenic removal equipment to comply with the federal arsenic rule.

The applicant obtained information from the ADEQ website regarding cost estimates for equipment necessary to remove arsenic. Based on ADEQ's Arsenic Master Plan, Staff estimated the arsenic treatment capital cost at $786,392, including engineering fees.

The financial analysis is based on Staff's proposed rates. Schedule AXR-1, attached, presents selected financial information reflecting Staff's recommended rates and pro forma information reflecting the inclusion of the estimated $786,392 WIFA loan at 6.00 percent per annum.

Staff recommends approval of its recommended rates and charges as presented on Schedule 4 of this report and the financing as altered by Staff.

TABLE OF CONTENTS

PAGE

FACT SHEET 1

Rates: *1*
Customers: *1*
Complaints: *2*
Notification: *2*

SUMMARY OF FILING 3

BACKGROUND 3

CONSUMER SERVICES 4

FINANCIAL ANALYSIS 4

ENGINEERING ANALYSIS 4

COMPLIANCE 5

RATE BASE 6

OPERATING REVENUES 6

OPERATING EXPENSES 6

RATE OF RETURN 7

REVENUE REQUIREMENTS 8

RATE DESIGN 8

STAFF RECOMMENDATIONS 9

SCHEDULES

SUMMARY OF FILING ..... Schedule 1

RATE BASE ..... Schedule 2

STATEMENT OF OPERATING INCOME ..... Schedule 3

RATE DESIGN ..... Schedule 4

TYPICAL BILL ANALYSIS ..... Schedule 5

ACTUAL BILL ANALYSIS ..... Schedule 5A

Attachments

Financing Report 1
- Income Statement – Excluding Surcharge AXR-1
- Calculation of Incremental Revenue Required AXR-2
- Income Statement – Including Surcharge AXR-3
- Table A AXR-4

Engineering Report 2
- Engineering Financing Report ..... MSJ-A
- Curtailment Tariff ..... MSJ-B

FACT SHEET

Current rates: Decision No. 62905, dated September 18, 2000.

Type of ownership: Arizona "C" Corporation

Location: The Company is located northwest of Show Low along State Highway 260. The Company provides service to approximately 269 customers in three communities; Linden, Pinedale and Clay Springs totaling 1.50 square miles in a certificated area within Navajo County.

The Company is not located in an Active Management Area ("AMA"). The Company is subject to mandatory participation in the Monitoring Assistance Program ("MAP").

Rates:

Permanent rate increase application filed: October 6, 2003
Current Test year Ended: December 31, 2002
Current Rates: Effective September 18, 2000
Financing Application filed: December 4, 2003

	Company		Staff Recommended	
	Current Rates	Proposed Rates	Excluding Surcharge Rates	Including Surcharge Rates
Monthly Minimum Charge				
Based on 5/8 X 3/4 - inch meter	18.60	24.50	20.25	42.91 *
Gallons in Minimum	0	0	0	0
Commodity Charge				
From 0 to 5,000 gallons	2.55	2.70	2.70	2.70
From 5,001 to 10,000 gallons	2.55	3.45	3.30	3.30
From 5,001 to 20,000 gallons	2.55	N/A	3.30	3.30
In excess of 10,000 gallons	2.55	3.95	N/A	N/A
In excess of 20,000 gallons	2.55	3.95	3.80	3.80
Arsenic removal surcharge	0	0	0	22.66 *
Typical residential bill				
(Based on median usage of 5,277 gallons)	32.06	38.96	34.67	57.33

* Monthly minimum charge includes arsenic removal surcharge.
Surcharge will not go into effect until four months after the loan with WIFA has closed.

Customers:

Average number of customers in current test year: 269

Current test year customers by meter size:

5/8 X3/4 - inch 269

1-inch metered 0

Complaints:

Numbers of customers concerns since rate application filed: 30

Percentage of complaints to customer base: 11.15 percent

Notification:

Customer notification was mailed by the Company on November 14, 2003.

Summary of Filing

Summary of Filing

Based on test year results as adjusted by Utilities Division Staff ("Staff"), Mountain Glen Water Services, Inc. ("Company") suffered an operating loss of $1,667 on an Original Cost Rate Base ("OCRB") of $137,834 for no rate of return as shown on Schedule 1.

Staff used Company's actual test year results rather than the Company adjusted test year results, because adjusted test year reflects future rates included in revenue.

The Company's proposed rates would produce operating revenues of $165,506 and operating income of $33,625 for a 22.76 percent rate of return on an OCRB of $147,739. The Company's proposed rates would increase the typical residential bill with a median usage of 5,277 gallons from $32.06 to $38.96, for an increase of $6.90 or 21.50 percent. The Company had not submitted a financing application at the time the rate increase was requested, therefore, revenues to cover debt to be incurred by the arsenic removal or modification and reduction were not taken into account by the Company until approximately one month later at which time the financing application was submitted requesting authorization to borrow $640,710 from the Water Infrastructure Finance Authority ("WIFA").

Without consideration of a surcharge, Staff's recommended rates would produce a revenue level of $146,853 and an operating income of $13,625, for a 9.88 percent rate of return on an OCRB of $137,834. Staff's recommended rates would increase the typical residential bill with a median usage of 5,277 gallons from $32.06 to $34.67, for an increase of $2.61 or 8.10 percent.

With the arsenic surcharge, Staff's recommended surcharge of $22.66 per customer per month will provide the Company with revenues to service the WIFA debt for the arsenic removal and produce a revenue level of $220,016 for an operating income of $81,233, a 58.94 percent rate of return on an OCRB of $137,834. Staff's recommended rates would increase the typical residential bill with a median usage of 5,277 gallons from $32.06 to $57.33, for an increase of $25.27 or 78.80 percent.

Background

On October 6, 2003, the Company filed an application for a permanent rate increase and a financing application was filed on December 4, 2003, with the Arizona Corporation Commission ("Commission"). The rate increase application was made sufficient on November 5, 2003. The Company used a test year ending December 31, 2002. The Company served approximately 269 customers in the test year.

On December 4, 2003, the Company filed an application requesting authorization to borrow $640,710 from WIFA to purchase and/or construct arsenic removal equipment for wells owned by the Company.

The Company indicated that a rate increase is necessary due to increases in operating expenses and for projected construction needs.

Consumers Services

A review of the Commission's records found that the Company has a backflow/cross connection tariff on file, but no curtailment tariff. Its customer bill is in compliance with the Arizona Administrative Code R14-2-409 B.2. There were three inquiries filed in 2002 requesting explanations of rules and tariffs, and one complaint was filed in 2003 regarding disconnect, prior to receiving disconnect notice. Disconnect notice was dated incorrectly. Company reconnected customer's service on same day complaint was received. There have been two inquiries in 2003. One resulted in a meter check by staff. Meter check showed results within Commission Rules and customer agreed to payment arrangements with the Company. The other inquiry was referred to the Company for a response to a question from a title company. Eight opinions in opposition to the proposed rate increase have been received. On December 11, 2003, the Commission received a petition signed by 22 customers of the Company stating their opposition to the proposed rate increase.

Financial Analysis

On December 4, 2003, the Company filed a financing application with the Commission requesting authorization to borrow $640,710 from WIFA to purchase and/or construct the necessary arsenic removal equipment to comply with the new federal arsenic rule.

The Company obtained information from the ADEQ website regarding cost estimates for equipment necessary to remove arsenic. Based on ADEQ's Arsenic Master Plan, Staff estimated the arsenic treatment capital cost at $786,392, including engineering fees. (See Attachment MSJ-A). WIFA has confirmed its ability to be flexible on funding the total necessary costs related to arsenic treatment.

The financial analysis is based on Staff's proposed rates. Schedule AXR-1, attached, presents selected financial information reflecting Staff's recommended rates and pro forma information reflecting the inclusion of the estimated $786,392 WIFA loan at 6.00 percent per annum.

Engineering Analysis

The water systems were field inspected on November 7, 2003, by Marlin Scott, Jr., Staff Utilities Engineer, in the accompaniment of Mr. William Parker, owner of the Company. The Company operates four independent water systems. A complete discussion of Staff Engineering's findings, recommendations, and description of the water system is provided in the attached Engineering Report (Attachment 2).

The Company is subject to mandatory participation in the Monitoring Assistance Program ("MAP"). Starting January 2002, water companies paid a fixed $250 per year fee, plus an additional fee of $2.06 per service connection, regardless of meter size for participation in MAP. Participation in the MAP program is mandatory for water systems which serve less than 10,000 persons (approximately 3,300 service connections).

The Company reported its water testing expense as $3,201 during the test year. Engineering Report's Table A shows Staff's annual monitoring expense estimated at $3,102 with participation in the MAP. Staff and Company's expense reflect a difference of $99. Since the difference is not material, Staff will accept the Company's annual water testing expense of $3,201.

Staff calculated a 12.9 percent non-account water loss for the Linden West System. Staff recommends that the Company file a report within six months after an order is issued in this proceeding with the Director of the Utilities Division, indicating the quantity of water pumped, gallons sold, water loss percentage and actions taken by the Company to reduce water loss to 10 percent or less. If the reported water loss for the period is greater than 10 percent, the Company shall prepare a report containing a detailed analysis and explanation demonstrating why a water loss reduction to 10 percent or less is not feasible or cost effective.

Staff recommends that the Company use the depreciation rates delineated in Engineering Report's Table B on a going forward basis.

Staff recommends the acceptance of the Company's proposed Service Line and Meter Installation Charges as delineated in Engineering Report's Table C.

Staff recommends approval of the Company's Curtailment Plan Tariff (see Attachment MSJ-B). This curtailment tariff should be filed with the Company's tariff schedule after an order is issued in this proceeding.

Compliance

The Company is current on its property and sales tax payments. The Company is in good standing with the Commission's Corporations Division, and has no outstanding Commission compliance issues.

The Company is not located in any Active Management Area ("AMA") and is not subject to any AMA's reporting and conservation requirements.

The ADEQ has determined that all four of the Company's systems are currently delivering water that meets the water quality standards required by Arizona Administrative Code, Title 18, Chapter, 4.

The U.S. Environmental Protection Agency has reduced the arsenic maximum contaminant level ("MCL") in drinking water from 50 parts per billion ("ppb") to 10 ppb. The effective date for compliance with the new MCL is January 23, 2006.

The Company's arsenic concentrations range from 6.9 ppb to 16 ppb. Based on these concentrations, the Company has submitted a financing application, Docket No. W-03875-03-0870, to address its arsenic issue. The financing application is requesting funding authorization from WIFA for arsenic removal treatment. The Company is asking for arsenic removal cost funding approval in this proceeding. For the financing conclusions and recommendations, see Attachment MSJ-A.

Rate Base

As shown on Schedule 2, page 1, Staff recommends a rate base of $137,834. This rate base represents a decrease of $9,905 from the Company's proposed $147,739 rate base, due to Staff's adjustments.

The Company's prior rate case included a Reconstruction Cost New ("RCN") study. There was no RCN study submitted in the instant application. Therefore, Staff's recommended plant values were determined by adding and subtracting original cost of additions and retirements to the original cost ending balances approved in Decision No.62905, dated September 18, 2000.

Accumulated depreciation was calculated by adding depreciation expense at the approved rates for the intervening years to the approved original cost balance in Decision No. 62905 of $182,250. This account was also decreased for plant retirements to arrive at the accumulated depreciation balance of $212,514 resulting in a decrease of $111,888 as shown in schedule 2, page 3.

Adjustment C as shown in Schedule 2, page 1, increases operating and maintenance working capital by $1,266, due to Staff's adjustment to operating expense.

Operating Revenues

Staff made no adjustment to the Company's test year Operating Revenue of $128,006.

Operating Expenses

Staff adjustments to operating expenses resulted in an increase of $6,295 from $123,378 to $129,673, as shown on Schedule 3, page 1. The adjustments are discussed below.

Adjustment A increases Salaries and Wages by $1,240 as a result of Staff's audit findings. The Company's general ledger entries were greater than Company's rate increase application.

Adjustment B increases Repairs and Maintenance by $1,678. Staff made an adjustment to record additional expense discovered on the Company's books.

Adjustment C increases Office Supplies and Expense by $189 which resulted from Staff's audit findings; additional expenses incurred by the Company, but not included in the rate application

Adjustment D increases Outside Services by $5,000, to reflect the additional duties in accounting services.

Adjustment E increases Rate Case Expense by $2,000, to reflect rate case expense not included in the instant application of Rate Case Expense. Staff made an adjustment accordingly.

Adjustment F increases Miscellaneous Expense, by $19 to record additional expense incurred, but not included in the Company's test year.

Adjustment G decreases Depreciation Expense by $3,303. Staff's adjustments reflect Staff Engineers recommended going forward depreciation rates, in which some categories are lower than Company's previously approved rates used to calculate depreciation expense.

Adjustment H increases Taxes Other Than Income Expense by $574 to reflect the appropriate expense level consistent with Staff's audit findings.

Adjustment I decreases Income Tax expense by $1,102 to reflect the appropriate expense level consistent with Staff's adjustments.

Rate of Return

Without consideration of a surcharge, Staff's proposed permanent rates and charges result in a 9.88 percent rate of return on rate base. This rate of return would provide a positive cash flow of approximately $33,072 and a 9.28 percent operating margin.

With the arsenic surcharge, Staff's proposed rates and charges including the arsenic surcharge, result in a 58.94 percent rate of return on rate base. This rate of return would provide a positive cash flow of approximately $100,680 and a 36.92 percent operating margin. Cash flow of $100,680 should be reduced by the arsenic removal WIFA loan annual debt service in the amount of $67,608 providing the Company with $33,072 net cash flow and a 36.92 percent operating margin.

Revenue Requirements

The Company is requesting an increase in revenues of $37,500 or 29.30 percent over adjusted test year revenues of $128,006. This increase would result in a rate of return of 22.76 percent and an operating margin of 20.32 percent.

Without consideration of a surcharge, Staff recommended rates would result in operating revenues of $146,853 for an increase of $18,847 or 14.72 percent. Staff proposed revenues would result in a rate of return of 9.88 percent and an operating margin of 9.28 percent. In Staff's opinion its recommended revenues would allow the Company to meet its obligations and provide for a cushion for contingencies.

With the arsenic surcharge, Staff recommended rates including the arsenic surcharge would result in operating revenues of $220,016 for an increase of $92,010 or 71.88 percent. Staff proposed revenues would result in a rate of return of 58.94 percent and an operating margin of 36.92 percent. In Staff's opinion its recommended revenues would allow the Company to meet its obligations and provide for repayment of debt and a cushion for contingencies. The Company is having issues with high levels of arsenic. The financing application was submitted and is requesting funding authorization from WIFA for arsenic removal treatment. The Company is asking for arsenic removal cost funding approval in this proceeding.

Rate Design

The Company's current rate structure consists of one tier and includes zero gallons in the monthly minimum charge. The Company proposed and Staff recommended rate design consists of three tiers and no gallons included in the monthly minimum charge. The difference between the Company and Staff proposed rate designs other than the commodity rates is the tier breaks. Company and Staff concur on the first tier break at 5,000 gallons. The Company requested the second tier break at 10,000 gallons with the third tier applicable to consumption in excess of 10,000 gallons. Staff recommends a second tier break at 20,000 gallons so that the third tier applies to consumption over 20,000 gallons.

The Company consists of four separate, not physically connected water systems. However, the Company currently has one set of tariffs for all four systems, i.e., the Company has one consolidated rate design.

Staff's proposed rate design set the first tier break at 5,000 gallons. This tier would apply to 47.96 percent of the residential bills that produced 22.15 percent of the revenue from water sold. The second tier at the 20,000 gallon range would apply to 43.59 percent of the bills which produced 23.56 percent of the revenue from water sold. The third tier in excess of 20,000 gallons would apply to 8.45 percent of the bills that produced 8.89 percent of the revenue from water sold in the residential customer class. The remaining 45.40 percent of the revenue is generated by the monthly minimum charge.

Staff Recommendations

Staff recommends approval of its recommended rates and charges as presented on Schedule 4 of this report.

Staff further recommends that the Company be ordered to adopt the depreciation rates shown on Table B in the Engineering Report. The use of a composite rate is not authorized.

Staff further recommends the acceptance of the Company's proposed Service Line and Meter Installation Charges as delineated in Table C Engineering Report.

Staff further recommends approval of the Company's Curtailment Plan Tariff (see Engineering Report). The curtailment tariff should be docketed as part of the Company's Tariff Schedule within 30 days of the Decision in this matter.

Staff further recommends that the Commission authorize a surcharge tariff for the purpose of funding principal, interest and income taxes thereon on a closed loan obtained to plan and construct arsenic treatment facilities. The arsenic surcharge filing would have to be docketed within 30 days of WIFA loan closing. In the present rate case procedure Staff has estimated the amount of the surcharge based on the currently available information to be $22.66 per customer per month. There are two components in the surcharge, the debt service component and the income tax component. Staff recommends that the Company be ordered to submit a surcharge tariff calculated using the same methodology as Staff used to determine the estimated surcharge amount in this case using the principal and interest rate from the actual loan.

Staff further recommends the surcharge be shown on the customers monthly bill as a line item labeled as "arsenic surcharge".

Similar to the 30-day new tariff procedure, Staff will review the tariff and the surcharge calculation and make a recommendation for consideration by the Commission.

Staff further recommends that the arsenic surcharge would become effective with the Company's first billing cycle four months following the closing of the loan. The first loan payment to WIFA is due six months after the closing of the loan. The surcharge is temporary and will automatically cease when new rates become effective in the Company's next rate case and the arsenic plant has been evaluated for recovery in rate base.

Staff further recommends that the debt service component portion of the surcharge collections should be deposited in a separate interest-bearing account. The only authorized disbursements from this account will be for servicing the WIFA debt incurred for the arsenic treatment equipment capital expenditures that are the subject of this case. The purpose of the

surcharge is to aid the Company in financing arsenic treatment plant and equipment expenditures required by the new MCL for arsenic.

Staff further recommends, the Company should be ordered to file a report on the arsenic account, with the Director of the Utilities Division, by August 31 each year for the most recent twelve month period beginning July 1 and ending June 30 showing the beginning and ending balances, earned interest, total deposits, and total expenditures as long as the arsenic account exists.

Staff further recommends that the Company should be ordered to file a new rate case within 48 months of the effective date of rates established in this case so that permanent rates can be established with consideration of the arsenic treatment equipment. If the Company fails to file a rate case within 48 months of the effective date of rates established in this case, the Staff is ordered to file an Order to Show Cause ("OSC") proceeding against the Company to cause it to file a rate case.

Staff further recommends that if the Company fails to file a rate case within 60 months of the effective date of rates established in this case, the surcharge will automatically cease.

Staff further recommends that the method of disposition of any excess funds in the arsenic fund account over debt service obligations measured at the date rates become effective in the Company's next rate case or 60 months following the effective date of rates established in this rate case, whichever comes first, shall be determined by the Commission in a future order. Disposition may include refunding to customers, accounting for the funds as a contribution in-aid-of-construction ("CIAC") or any other method determined by the Commission to be in the public interest.

Staff further recommends the approval of the Company's request for authorization to obtain financing on the terms and conditions described in the application consistent with Staff's recommendation that the Commission approve an arsenic removal surcharge mechanism to enable the Company to meet both principal and interest payments on the proposed WIFA loan.

Staff concludes that the purchase and/or construction of arsenic removal equipment would allow the Company to comply with the federal rule that requires reducing the arsenic level in the drinking water to a maximum of 10 ppb by January 23, 2006.

Staff further recommends that the Company file data on the Linden West System within six months after an order is issued in this proceeding with the Director of the Utilities Division, indicating the quantity of water pumped, gallons sold and water loss percentage for the last 12 month period and actions taken by the Company to reduce water loss to 10 percent or less. If the reported water loss for the last 12 month period is greater than 10 percent, the Company shall prepare a report containing a detailed analysis and explanation demonstrating why water loss

reduction to 10 percent or less is not feasible or cost effective. The Company's Linden West System non-account water was calculated to be 12.9 percent water loss.

Staff further recommends authorizing the Company to execute any documents necessary to effectuate the authorizations granted.

Staff further recommends that the Company be ordered to provide the Utilities Division Director with copies of all executed financial documents within 60 days after the loan agreement is signed.

Staff further recommends that, in addition to the collection of the Company's regular rates and charges, Mountain Glen Water Services Inc., shall collect from its customers their proportionate share of any privilege, sales or use tax as provided for in A.A.C. R14-2- 409(D).

Mountain Glen Water Service, Inc.
Docket No. W-03875A-03-0737
Test Year Ended December 31, 2002

Schedule 1

SUMMARY OF FILING

	-- Present Rates --		-- Proposed Rates --			
	Company as Filed	Staff as Adjusted	Company as Filed	Staff excluding Surcharge	Staff including Surcharge	
Revenues:						
Metered Water Revenue	$125,126	$125,126	$162,626	$143,973	$143,973	
Surcharge - Arsenic (Temporary)	-	-	-	-	73,163	*
Other Water Revenues	2,880	2,880	2,880	2,880	2,880	
Total Operating Revenue	$128,006	**$128,006**	$165,506	**$146,853**	**$220,016**	
Operating Expenses:						
Operation and Maintenance	$88,061	$98,187	$88,061	$98,187	$98,187	
Depreciation	22,750	19,447	25,546	19,447	19,447	
Property & Other Taxes	11,415	11,989	11,415	11,989	11,989	
Income Tax	1,152	50	6,859	3,605	9,160	*
Total Operating Expense	$123,378	**$129,673**	$131,881	**$133,228**	**$138,783**	
Operating Income/(Loss)	$4,628	**($1,667)**	$33,625	**$13,625**	**$81,233**	
Rate Base O.C.L.D.	$147,739	$137,834	$147,739	$137,834	$137,834	
Rate of Return - O.C.L.D.	3.13%	-1.21%	22.76%	9.88%	58.94%	
Times Interest Earned Ratio (Pre-Tax)	N/A	N/A	N/A	N/A	1.94	
Debt Service Coverage Ratio (Pre-Tax)	N/A	N/A	N/A	N/A	1.62	
Operating Margin	3.62%	-1.30%	20.32%	9.28%	36.92%	

* The surcharge revenue includes a provision for incremental income tax on the surcharge.

Mountain Glen Water Service, Inc.
Docket No. W-03875A-03-0737
Test Year Ended December 31, 2002

RATE BASE

	Original Cost			
	Company	Adjustment		Staff
Plant in Service	$481,779	($123,059)	(A)	$358,720
Less:				
Accum. Depreciation	324,402	(111,888)	(B)	212,514
Net Plant	$157,377	($11,171)		**$146,206**
Less:				
Advances in Aid of Construction	$14,755	$0		$14,755
Meter Deposits (Meter & Service Line)	3,419	0		3,419
Total Advances	$18,174	$0		$18,174
Contributions Gross	$2,000	$0		$2,000
Less:				
Amortization of CIAC	150	0		150
Net CIAC	$1,850	$0		$1,850
Total Deductions	$20,024	$0		**$20,024**
Plus:				
1/24 Power	$311	$0		$311
1/8 Operation & Maint.	10,075	1,266	(C)	11,341
Inventory	0	0		0
Prepayments	0	0		0
Total Additions	$10,386	$1,266		**$11,652**
Rate Base	**$147,739**	**($9,905)**		**$137,834**

Explanation of Adjustment:

A - Based on Staff adjustment to reflect Original Cost, Decision No. 62905, dated Sep 18, 2000.
B - See Schedule 2, page 3
C - Based on Staff adjustments to operating expenses.

Mountain Glen Water Service, Inc.
Docket No. W-03875A-03-0737
Test Year Ended December 31, 2002

PLANT ADJUSTMENT

	Company Exhibit	Adjustment	Staff Adjusted
301 Organization	$8,500	$0	$8,500
302 Franchises	0	0	0
303 Land & Land Rights	9,460	0	9,460
304 Structures & Improvements	21,884	(2,575)	19,309
307 Wells & Springs	57,920	(18,855)	39,065
311 Pumping Equipment	48,785	2,898	51,683
320 Water Treatment Equipment	0	0	0
330 Distribution Reservoirs & Standpipes	35,552	3,700	39,252
331 Transmission & Distribution Mains	198,885	(68,176)	130,709
333 Services	52,419	(35,486)	16,933
334 Meters & Meter Installations	29,297	(4,565)	24,732
335 Hydrants	0	0	0
336 Backflow Prevention Devices	0	0	0
339 Other Plant and Misc. Equipment	0	0	0
340 Office Furniture & Equipment	7,349	0	7,349
341 Transportation Equipment	11,728	0	11,728
343 Tools Shop & Garage Equipment	0	0	0
344 Laboratory Equipment	0	0	0
345 Power Operated Equipment	0	0	0
346 Communication Equipment	0	0	0
347 Miscellaneous Equipment	0	0	0
348 Other Tangible Plant	0	0	0
105 C.W.I.P.	0	0	0
TOTALS	$481,779	($123,059)	**$358,720**

Plant Adjustments - Staff developed plant value by using original cost from Decision No. 62905, dated September 18, 2000, plus additions minus retirements.

Mountain Glen Water Service, Inc.
Docket No. W-03875A-03-0737
Test Year Ended December 31, 2002

ACCUMULATED DEPRECIATION ADJUSTMENT

		Amount
Accumulated Depreciation - Per Company	$	324,402
Accumulated Depreciation - Per Staff		212,514
Total Adjustment	**$**	**(111,888)**

Explanation of Adjustment:

A -	Accumulated Depreciation - Original Cost balance per Decision No. 62905	$	182,250
	Plus:		
	Depreciation Expense 2000		13,713
	Depreciation Expense 2001		14,985
	Depreciation Expense 2002		16,697
	Less:		
	Retirements		(15,131)
	Staff Balance as of December 31, 2002		212,514

Mountain Glen Water Service, Inc.
Docket No. W-03875A-03-0737
Test Year Ended December 31, 2002

STATEMENT OF OPERATING INCOME

	Company Exhibit	Staff Adjustments		Staff Adjusted
Revenues:				
461 Metered Water Revenue	$125,126	$0		$125,126
460 Unmetered Water Revenue	0	0		0
474 Other Water Revenues	2,880	0		2,880
Total Operating Revenue	$128,006	$0		**$128,006**
Operating Expenses:				
601 Salaries and Wages	$53,741	$1,240	(A)	$54,981
610 Purchased Water	0	0		0
615 Purchased Power	7,462	0		7,462
618 Chemicals	0	0		0
620 Repairs and Maintenance	8,715	1,678	(B)	10,393
621 Office Supplies & Expense	4,428	189	(C)	4,617
630 Outside Services	2,392	5,000	(D)	7,392
635 Water Testing	3,201	0		3,201
641 Rents	1,278	0		1,278
650 Transportation Expenses	2,662	0		2,662
657 Insurance - General Liability	1,678	0		1,678
659 Insurance - Health and Life	0	0		0
666 Regulatory Commisssion Expense - Rate Case	0	2,000	(E)	2,000
675 Miscellaneous Expense	2,504	19	(F)	2,523
403 Depreciation Expense	22,750	(3,303)	(G)	19,447
408 Taxes Other Than Income	4,020	574	(H)	4,594
408.11 Property Taxes	7,395	0		7,395
409 Income Tax	1,152	(1,102)	(I)	50
Total Operating Expenses	$123,378	$6,295		**$129,673**
OPERATING INCOME/(LOSS)	**$4,628**	**($6,295)**		**($1,667)**
Other Income/(Expense):				
419 Interest and Dividend Income	$0	$0		$0
421 Non-Utility Income	0	0		0
427 Interest Expense	276	0		276
426 Miscellaneous Non-Utility Expense	0	0		0
Total Other Income/(Expense)	($276)	($0)		($276)
NET INCOME/(LOSS)	**$4,352**	**($6,295)**		**($1,943)**

STAFF ADJUSTMENTS

(A)	-	SALARIES and WAGES	$53,741	
		Per Staff	54,981	$1,240
		To record audit results.		
(B)	-	REPAIRS and MAINTENANCE	$8,715	
		Per Staff	10,393	$1,678
		To record additional repairs expense as a result of Staff's audit.		
(C)	-	OFFICE SUPPLIES and EXPENSE	$4,428	
		Per Staff	4,617	$189
		To record Staff's audit results.		
(D)	-	OUTSIDE SERVICES	$2,392	
		Per Staff	7,392	$5,000
		To Record increase in Outside Services Expense.		
(E)	-	REGULATORY COMMISSION EXPENSE - Rate Case	$0	
		Per Staff	2,000	$2,000
		To record Company pro-forma and Staff's recommended expense level.		
(F)	-	MISCELLANEOUS EXPENSE - Per Company	2,504	
		Per Staff	2,523	19
		To reflect increase in expense.		

STAFF ADJUSTMENTS (Cont.)

(G)	-	DEPRECIATION - Per Company	$22,750	
		Per Staff	19,447	($3,303)

To adjust depreciation expense to Staff's calculation.

Pro Forma Annual Depreciation Expense:

Plant in Service	$358,720	
Less: Non Depreciable Plant	17,960	
Fully Depreciated Plant	0	
Depreciable Plant	$340,760	
Times: Staff Proposed Depreciation Rate	5.71%	
Credit to Accumulated Depreciation	$19,447	
Less: Amort. of CIAC* @ 5.00%	0	5.71%
Pro Forma Annual Depreciation Expense	**$19,447**	

(H)	-	TAXES OTHER THAN INCOME - Per Company	4,020	
		Per Staff	4,594	574

To record Staff's audit results.

(I)	-	INCOME TAX - Per Company	1,152	
		Per Staff	50	($1,102)

To record Staff's allocation of Corporate Income Tax Expense.

Mountain Glen Water Service, Inc.
Docket No. W-03875A-03-0737
Test Year Ended December 31, 2002

Schedule 4

RATE DESIGN

Monthly Usage Charge	Present Rates	Proposed Company	Staff Recommended Rates Excl.Surcharge	Staff Recommended Rates Incl.Surcharge	
5/8" x 3/4" Meter	$ 18.60	$ 24.50	$ 20.25	$ 42.91	a
3/4" Meter	27.90	36.75	30.38	53.04	a
1" Meter	53.10	61.25	50.63	73.29	a
1½" Meter	75.60	122.50	101.25	123.91	a
2" Meter	89.10	196.00	162.00	184.66	a
3" Meter	188.10	392.00	303.75	326.41	a
4" Meter	278.10	612.50	506.25	528.91	a
6" Meter	368.10	1,225.00	1,012.50	1,035.16	a
Commodity Rates:					
Gallons Included in Minimum	0	0	0	0	
Excess of Minimum - per 1,000 Gallons	$ 2.55	N/A	N/A	N/A	
Excess of Minimum - per 1,000 Gallons (0-5,000 Gallons)	$ 2.55	$ 2.70	$ 2.70	$ 2.70	
Excess of Minimum - per 1,000 Gallons (5,001-10,000 Gallons)	2.55	3.45	N/A	N/A	
Excess of Minimum - per 1,000 Gallons (5,001-20,000 Gallons)	$ 2.55	N/A	3.30	3.30	
Excess of Minimum - per 1,000 Gallons (Over 10,000 Gallons)	2.55	3.95	N/A	N/A	
Excess of Minimum - per 1,000 Gallons (Over 20,000 Gallons)	$ 2.55	N/A	3.80	3.80	
Arsenic removal monthly surcharge	-	-	-	22.66	a
Service Line and Meter Installation Charges					
5/8" x 3/4" Meter	$ 410.00	$ 550.00	$550.00	$550.00	
3/4" Meter	440.00	580.00	580.00	580.00	
1" Meter	535.00	675.00	675.00	675.00	
1½" Meter	570.00	710.00	710.00	710.00	
2" Meter	970.00	1,110.00	1,110.00	1,110.00	
3" Meter	1,350.00	1,490.00	1,490.00	1,490.00	
4" Meter	2,155.00	2,295.00	2,295.00	2,295.00	
6" Meter	4,165.00	4,305.00	4,305.00	4,305.00	
Service Charges					
Establishment	$30.00	$40.00	$30.00	$30.00	
Establishment (After Hours)	40.00	50.00	45.00	45.00	
Reconnection (Delinquent)	35.00	35.00	35.00	35.00	
Reconnection (Delinquent) after hours	35.00	45.00	45.00	45.00	
Meter Test (If Correct)	40.00	40.00	40.00	40.00	
Deposit	*	*	*	*	
Deposit Interest	*	0.00%	*	*	
Re-Establishment (Within 12 Months)	**	**	**	**	
NSF Check	15.00	25.00	15.00	15.00	
Deferred Payment	1.50%	1.50%	1.50%	1.50%	
Meter Re-Read (If Correct)	10.00	15.00	15.00	15.00	
Late Payment Penalty (per month)	N/A	N/A	N/A	N/A	
Main Extension	Cost	Cost	Cost	Cost	

* Per Commission Rules (R14-2-403.B)
** Months off system times the minimum (R14-2-403.D)

a) Monthly minimum charge includes arsenic removal surcharge.

Mountian Glen Water Services, Inc.
Docket No. W-03875A-03-0737
Test Year Ended December 31, 2002

TYPICAL BILL ANALYSIS

General Service 5/8 X 3/4 - Inch Meter

Average Number of Customers: 269

Company Proposed	Gallons	Present Rates	Proposed Rates	Dollar Increase	Percent Increase
Average Usage	7,886	$38.71	$47.96	$9.25	23.9%
Median Usage	5,277	$32.06	$38.96	$6.90	21.5%
Staff Proposed - Excluding Surcharge					
Average Usage	7,886	$38.71	$43.28	$4.57	11.8%
Median Usage	5,277	$32.06	$34.67	$2.61	8.1%
Staff Proposed - Including Surcharge					
Average Usage	7,886	$38.71	65.94	27.23	70.3%
Median Usage	5,277	$32.06	57.33	25.27	78.8%

Present & Proposed Rates (Without Taxes)
General Service 5/8 X 3/4 - Inch Meter

				Excluding Surcharge		Including Surcharge	
Gallons Consumption	Present Rates	Company Proposed Rates	% Increase	Staff Proposed Rates	% Increase	Staff Proposed Rates	% Increase
0	$18.60	$24.50	31.7%	$20.25	8.9%	42.91	130.7%
1,000	21.15	27.20	28.6%	22.95	8.5%	45.61	115.7%
2,000	23.70	29.90	26.2%	25.65	8.2%	48.31	103.8%
3,000	26.25	32.60	24.2%	28.35	8.0%	51.01	94.3%
4,000	28.80	35.30	22.6%	31.05	7.8%	53.71	86.5%
5,000	31.35	38.00	21.2%	33.75	7.7%	56.41	79.9%
6,000	33.90	41.45	22.3%	37.05	9.3%	59.71	76.1%
7,000	36.45	44.90	23.2%	40.35	10.7%	63.01	72.9%
8,000	39.00	48.35	24.0%	43.65	11.9%	66.31	70.0%
9,000	41.55	51.80	24.7%	46.95	13.0%	69.61	67.5%
10,000	44.10	55.25	25.3%	50.25	13.9%	72.91	65.3%
15,000	56.85	75.00	31.9%	66.75	17.4%	89.41	57.3%
20,000	69.60	94.75	36.1%	83.25	19.6%	105.91	52.2%
25,000	82.35	114.50	39.0%	102.25	24.2%	124.91	51.7%
50,000	146.10	213.25	46.0%	197.25	35.0%	219.91	50.5%
75,000	209.85	312.00	48.7%	292.25	39.3%	314.91	50.1%
100,000	273.60	410.75	50.1%	387.25	41.5%	409.91	49.8%
125,000	337.35	509.50	51.0%	482.25	43.0%	504.91	49.7%
150,000	401.10	608.25	51.6%	577.25	43.9%	599.91	49.6%
175,000	464.85	707.00	52.1%	672.25	44.6%	694.91	49.5%
200,000	528.60	805.75	52.4%	767.25	45.1%	789.91	49.4%

Mountian Glen Water Services, Inc.
Docket No. W-03875A-03-0737
Test Year Ended December 31, 2002

ACTUAL BILL ANALYSIS

General Service 5/8 X 3/4 - Inch Meter

Actual Usage Customer Bills randomly picked by the Company.
12 Months usage for 2002

High Consumer

	Actual Gallons	Present Rates	Company Proposed Rates	% Increase	Staff Proposed Rates Excluding Surcharge	% Increase	Including Surcharge	% Increase
January	9,302	$ 42.32	$ 49.39	16.7%	$ 44.65	5.5%	$ 67.31	59.0%
February	9,530	42.90	53.63	25.0%	48.70	13.5%	71.36	66.3%
March	8,370	39.94	49.63	24.2%	44.87	12.3%	67.53	69.1%
April	25,390	83.34	116.04	39.2%	103.73	24.5%	126.39	51.7%
May	38,970	117.97	169.68	43.8%	155.34	31.7%	178.00	50.9%
June	62,840	178.84	263.97	47.6%	246.04	37.6%	268.70	50.2%
July	27,040	87.55	122.56	40.0%	110.00	25.6%	132.66	51.5%
August	21,140	72.51	98.86	36.3%	87.20	20.3%	109.86	51.5%
September	28,610	91.56	128.36	40.2%	115.59	26.2%	138.25	51.0%
October	37,480	114.17	163.80	43.5%	149.67	31.1%	172.33	50.9%
November	5,980	33.85	41.38	22.3%	36.98	9.3%	59.64	76.2%
December	5,940	33.75	41.24	22.2%	36.85	9.2%	59.51	76.3%
Total	280,592	$ 938.71	$ 1,298.54	38.3%	$ 1,179.63	25.7%	$ 1,451.55	54.6%
Average Usage	23,383	$ 78.23	$ 108.21	38.3%	$ 98.30	25.7%	$ 120.96	54.6%

Low Consumer

	Actual Gallons	Present Rates	Company Proposed Rates	% Increase	Staff Proposed Rates Excluding Surcharge	% Increase	Including Surcharge	% Increase
January	7,349	$ 37.34	$ 46.10	23.5%	$ 41.50	11.1%	$ 64.16	71.8%
February	5,840	33.49	40.90	22.1%	36.52	9.0%	59.18	76.7%
March	6,931	36.27	44.66	23.1%	40.12	10.6%	62.78	73.1%
April	12,269	49.89	64.21	28.7%	57.74	15.7%	80.40	61.2%
May	17,390	62.94	84.44	34.2%	74.64	18.6%	97.30	54.6%
June	35,800	109.89	157.16	43.0%	143.29	30.4%	165.95	51.0%
July	16,050	59.53	79.15	33.0%	70.22	18.0%	92.88	56.0%
August	17,980	64.45	86.77	34.6%	76.58	18.8%	99.24	54.0%
September	19,510	68.35	92.81	35.8%	81.63	19.4%	104.29	52.6%
October	9,290	42.29	52.80	24.9%	47.91	13.3%	70.57	66.9%
November	5,490	32.60	39.69	21.8%	35.37	8.5%	58.03	78.0%
December	5,190	31.83	38.66	21.4%	34.38	8.0%	57.04	79.2%
Total	159,089	$ 628.88	$ 827.36	31.6%	$ 739.89	17.7%	$ 1,011.81	60.9%
Average Usage	13,257	$ 52.41	$ 68.95	31.6%	$ 61.66	17.7%	$ 84.32	60.9%

MEMORANDUM

TO: Elena Zestrijan
Auditor III
Utilities Division

FROM: Alejandro Ramirez
Public Utilities Analyst I
Utilities Division

DATE: January 22, 2004

RE: MOUNTAIN GLEN WATER SERVICE
DOCKET No. W-03875A-03-0870 (Financing Application)

Introduction

On December 4, 2003, Mountain Glen Water Service, Inc. ("Mountain Glen" or "Applicant") filed an application with the Arizona Corporation Commission ("Commission") requesting authorization to borrow $640,710 from the Water Infrastructure Finance Authority of Arizona ("WIFA") to purchase and/or construct arsenic removal equipment.

Notice

Mountain Glen notified its customers by mailing to each customer a notification on December 13, 2003. A copy of this notice is attached.

Background

On January 23, 2001, the Environmental Protection Agency ("EPA") reduced the drinking water maximum contaminant level of arsenic from 50 parts per billion ("ppb") to 10 ppb. All community water systems and non-transient non-community water systems need to comply with the new federal rule by the January 23, 2006 deadline.

Purpose of the Financing

The purpose of the $640,710 loan from WIFA is to provide Mountain Glen with sufficient funds to purchase/construct the necessary arsenic removal equipment to comply with the federal arsenic rule.

The Applicant obtained information from the Arizona Department of Environmental Quality ("ADEQ") website regarding cost estimates to equip Mountain Glen's Systems with the equipment necessary to remove arsenic. The cost estimates can be found in the Arsenic Master Plan developed by ADEQ in early 2002 and are based on Arizona cost models developed for

different options and media type. The actual amount to purchase and/or construct arsenic removal equipment may be higher or lower than the amount that the Applicant is seeking to finance.

Engineering Analysis

Mountain Glen operates four independent water systems northwest of Show Low in Navajo County: Clay Springs, Pinedale, Linden West and Linden East. The Clay Springs and Pinedale systems have arsenic levels at 6.9 ppb and 7.3 ppb, respectively, and may not need arsenic treatment. If arsenic treatment is required, these systems should consider a point-of-use ("POU") treatment option. Staff updated plant information for both the Linden West system and the Linden East system. Staff adjusted the treatment options to reflect the storage tanks that currently operate in the two systems.

Based on ADEQ's Arsenic Master Plan, Staff estimated the arsenic treatment capital cost at $786,392 (this amount includes engineering fees) for two systems having three point-of-entries ("POEs"). Staff analysis will rely in the updated estimated funds that Mountain Glen needs to purchase and/or construct arsenic removal equipment.

Description of the Proposed Financing

The term of the proposed $640,710 WIFA loans is 20 years. The maximum interest rate chargeable is the prime rate plus 200 basis points. WIFA will require the assets of Mountain Glen to serve as collateral for the loan. WIFA sets the interest rate the Wednesday before a loan closing. Debt service coverage ("DSC") of at least 1.2 is required for a loan. Payments on the loan begin six months after WIFA provides the monies to the Applicant. Monthly payments on the loan comprise both principal and interest. WIFA initially calculates the monthly payment based on the maximum amount of the loan independently of the amount of the first draw down. WIFA may adjust the monthly payment amounts if the borrower ends up requiring a total amount different from the maximum amount of the loan.

Financial Analysis

The financial analysis is based on Staff's proposed rates. Schedule AXR-1, attached, presents selected financial information reflecting Staff's recommended rates and pro forma information reflecting the inclusion of the estimated $786,392 WIFA loans at 6 percent per annum. Mountain Glen's capital structure before the WIFA loans is composed of 100.0 percent equity. The Applicant's capital structure after the WIFA loans would be composed of 2.4 percent short-term debt, 85.8 percent long-term debt, and 11.9 percent equity.

The debt service coverage ratio represents the number of times internally generated cash will cover required principal and interest payments on long-term debt. A DSC greater than 1.0 indicates that operating cash flow is sufficient to cover debt obligations.

The times interest earned ratio ("TIER") represents the number of times earnings will cover interest expense on a long-term debt. A TIER greater than 1.0 means that operating income is greater than interest expense.

Schedule AXR-1, column B, shows that the pro forma effect on Mountain Glen's financial ratios of obtaining a $786,392 WIFA loan at an interest rate of 6.0 percent and implementation of Staff's recommended permanent rates is to produce a TIER of 0.37 and a DSC of 0.54. These ratios indicate that the Applicant would lack sufficient earnings and operating cash flow to meet WIFA obligations.

Given that the Applicant must comply with the federal rule that requires reducing arsenic levels in water by January 2006, Schedule AXR-2 calculates the additional annual revenue that Mountain Glen would require to meet its obligations, including an estimated $786,392 WIFA loan, and provide the Applicant with the same amount of cash flow it had before the loan. The Applicant would need an additional $46,612 for interest expense, $20,995 for principal and $5,555 for income taxes on the incremental revenue for a total of $73,163.

Schedule AXR-3, attached, presents selected financial information reflecting Staff's recommended permanent rates and pro forma information reflecting an additional $73,163 in annual surcharge revenue and issuance of an estimated $786,392 WIFA loan at a 6 percent per annum. Mountain Glen's capital structure before the WIFA loan is composed of 100.0 percent equity. The Applicant's capital structure after the proposed surcharge and the proposed WIFA loan would be composed of 2.3 percent short-term debt, 83.0 percent long-term debt, and 14.7 percent equity. The Applicant's proposed loans would result in a capital structure that is more leveraged than preferable. However, there are no other known options for Mountain Glen to finance the purchase/construction of the arsenic removal equipment required to comply with the EPA's maximum contaminant level. Non-compliance may result in delivery of unsafe water and other consequences that may have detrimental operational and financial impacts on the Applicant.

Schedule AXR-3, column B, shows that the pro forma effect on Mountain Glen's financial ratios of an additional $73,163 in annual surcharge revenue and of an estimated $786,392 WIFA loan at an interest rate of 6.0 percent is to produce a TIER of 1.94, and a DSC of 1.62. These pro forma ratios indicate that Mountain Glen would have adequate earnings and cash flows to meet all obligations.

Compliance

There were no compliance issues at the Commission with the Applicant as of December 15, 2003.

Conclusion and Recommendations

Staff concludes that the purchase and/or construction of arsenic removal equipment is necessary for Mountain Glen to comply with the federal rule that requires reducing the arsenic level in the drinking water to a maximum of 10 ppb by January 23, 2006.

Staff concludes that its recommended permanent rates are insufficient to meet debt service obligations of the proposed WIFA debt.

Staff concludes that the issuance of an estimated $786,392 debt on the terms described in the filing would result in the Applicant having a higher than normal leveraged capital structure. However, Staff also recognizes that there are no other known options for Mountain Glen to finance the purchase/construction of the necessary arsenic removal equipment to deliver safe drinking water. Not complying with the federal arsenic rule may have detrimental operational and financial impacts on the Applicant.

Staff recommends that Mountain Glen file before the Commission an arsenic removal surcharge tariff application that would enable the Applicant to meet its principal and interest obligations on the proposed WIFA loan and income taxes on the surcharge.

Staff recommends that the Applicant follow the same methodology presented on Schedule AXR-4 to calculate the incremental revenue needed to meet its interest, principal and incremental income tax obligations on the WIFA loan using actual loan amounts and use the result to develop its arsenic removal surcharge tariff application. The increase in revenue calculation should be included in the arsenic removal surcharge tariff application.

Staff recommends approval of Mountain Glen's request for authorization to obtain financing on the terms and conditions described in the application with the understanding that the Commission will subsequently also consider an arsenic removal surcharge to enable the Applicant to meet its principal and interest obligations on the proposed WIFA loan, and incremental income taxes on the surcharge.

Staff further recommends ordering Mountain Glen to provide to the Utilities Division Director copies of its calculation of revenue requirement for principal and interest obligations on the WIFA loan and incremental income taxes on the surcharge within 60 days after the loan agreement is signed by both WIFA and the Applicant.

Staff further recommends authorizing the Applicant to execute any documents necessary to effectuate the authorizations granted.

Staff further recommends ordering Mountain Glen to provide to the Utilities Division Director copies of all executed financing documents within 60 days after the loan agreement is signed.

PUBLIC NOTICE
OF
AN APPLICATION FOR AN ORDER
AUTHORIZAING THE ISSUANCE OF DEBT
BY MOUNTAIN GLEN WATER SERVICE, INC.

Mountain Glen Water Services, Inc. ("Mountain Glen" or "Company") filed an Application with the Arizona Corporation Commission ("Commission") for an order authorizing Applicant to Issue $640,710.00 of debt. The application is available for inspection during regular business hours at the office of the Commission in Phoenix, Arizona, and the Company's offices in Clay Springs, Arizona.

Intervention in the Commission's proceedings on the application shall be permitted to any person entitled by law to intervene and having a direct substantial interest in this matter. Persons desiring to intervene must file a Motion to Intervene with the Commission which must be served upon applicant and which, at a minimum, shall contain the following information:

1. The name, address and telephone number of the proposed intervenor and of any person upon whom service of documents is to be made if different than the intervenor.

2. A short statement of the proposed intervenor's interest in the proceeding.

3. Whether the proposed intervenor desires a formal evidentiary hearing on the application and the reasons for such a hearing.

4. A statement certifying that a copy of the Motion to Intervene has been mailed to Applicant.

The granting of Motions to Intervene shall be governed by A.A.C. R14-3-105, except that all Motions to Intervene must be filed on, or before, the 15th day after this notice.

FINANCIAL ANALYSIS

Selected Financial Data
Including Immediate Effects of the Proposed Debt

INCOME STATEMENT	Rate Case [A]	Pro Forma [B]
Metered Water Revenue	$ 143,973	$ 143,973
Unmetered Water Revenue	$ -	$ -
Other Water Revenues	$ 2,880	$ 2,880
Operating Revenue:	$ 146,853	$ 146,853
Operating Expenses:		
Purchased Water/Pumping Power	$ 7,462	$ 7,462
Admin. & General	$ 74,469	$ 74,469
Maintenance & Testing	$ 16,256	$ 16,256
Depreciation [4]	$ 19,447	$ 19,447
Property Taxes	$ 7,395	$ 7,395
Other taxes	$ 4,594	$ 4,594
Income Tax [2]	$ 3,605	$ -
Total Operating Expense	$ 133,228	$ 129,623
Operating Income [1]	$ 13,625	$ 17,230
Interest Income	$ -	$ -
Interest Expense [3]	$ -	$ 46,612
Interest-Customer Deposits	$ 276	$ 276
Net Income	$ 13,625	$ (29,382)
Principal Repayment [5]	$ -	$ 20,995
TIER (Interest Coverage)		
[1 + 2] ÷ 3	N/A	0.37
DSC		
[1 + 2 + 4] ÷ [3 + 5]	N/A	0.54

Capital Structure

Short-term Debt	$ -	0%	$ 20,995	2.4%
Long-term Debt	$ -	0%	$ 765,397	85.8%
Common Equity	$ 135,577	100%	$ 106,195	11.9%
Total Capital	$ 135,577	100%	$ 892,587	100%

[A] Staff's recommended permanent rates without WIFA loan
[B] Staff's recommended permanent rates including WIFA loan

CALCULATION OF INCREMENTAL REVENUE REQUIRED FOR WIFA LOAN
TO PRESERVE CASH FLOW

Line No.			
1	Annual Principal Payment on the Loan	$	20,995
2	Gross Revenue Conversion Factor		1.2646
3	Increase in Revenue Due to Principal Payment [L1 X L2]	$	26,550
4	Annual Principal Payment on the Loan [L1]	$	20,995
5	Incremental Income Taxes [L3 - L4]	$	5,555
6	Annual Interest Payment on the Loan	$	46,612
7	Debt Service Component of Incremental Revenue [L1+L6]	$	67,607
8	Total Incremental Revenue Requirement [L5 + L7]	$	73,163

FINANCIAL ANALYSIS

Selected Financial Data
Including Immediate Effects of the Proposed Debt

INCOME STATEMENT	Rate Case [A]	Change	Pro Forma [B]
Metered Water Revenue	$ 143,973		$ 143,973
Surcharge	$ -	$ 73,163	$ 73,163
Other Water Revenues	$ 2,880	$ -	$ 2,880
Operating Revenue:	$ 146,853	$ 73,163	$ 220,016
Operating Expenses:			
Purchased Water/Pumping Power	$ 7,462	$ -	$ 7,462
Admin. & General	$ 74,469	$ -	$ 74,469
Maintenance & Testing	$ 16,256	$ -	$ 16,256
Depreciation [4]	$ 19,447	$ -	$ 19,447
Property Taxes	$ 7,395	$ -	$ 7,395
Other taxes	$ 4,594	$ -	$ 4,594
Income Tax [2]	$ 3,605	$ 5,555	$ 9,160
Total Operating Expense	$ 133,228	$ 5,555	$ 138,783
Operating Income [1]	$ 13,625	$ 67,607	$ 81,232
Interest Income	$ -	$ -	$ -
Interest Expense [3]		$ 46,612	$ 46,612
Interest-Customer Deposits	$ 276	$ -	$ 276
Net Income	$ 13,625	$ 20,995	$ 34,620
Principal Repayment [5]	$ -	$ 20,995	$ 20,995
TIER (Interest Coverage)			
[1 + 2] ÷ 3	N/A		1.94
DSC			
[1 + 2 + 4] ÷ [3 + 5]	N/A		1.62

Capital Structure

Short-term Debt	$ -	0%	$ 20,995	2.3%
Long-term Debt	$ -	0%	$ 765,397	83.0%
Common Equity	$ 135,577	100%	$ 135,577	14.7%
Total Capital	$ 135,577	100%	$ 921,969	100.0%

[A] Staff's recommended permanent rates without WIFA loan
[B] Staff's recommended permanent rates and surcharge with a WIFA loan

TABLE A

Conversion Factor Table (Based on a 20-year Loan)

Line No.	Column A Annual Interest	Column B Annual Payment Conversion Factor	Column C Annual Interest Payment Conversion Factor	Column D Annual Principal Payment Conversion Factor
1	3.50%	0.0696	0.0344	0.0352
2	3.75%	0.0711	0.0369	0.0342
3	4.00%	0.0727	0.0394	0.0333
4	4.25%	0.0743	0.0419	0.0324
5	4.50%	0.0759	0.0444	0.0316
6	4.75%	0.0775	0.0468	0.0307
7	5.00%	0.0792	0.0493	0.0299
8	5.25%	0.0809	0.0518	0.0291
9	5.50%	0.0825	0.0543	0.0283
10	5.75%	0.0843	0.0568	0.0275
11	6.00%	0.0860	0.0593	0.0267
12	6.25%	0.0877	0.0618	0.0259
13	6.50%	0.0895	0.0643	0.0252
14	6.75%	0.0912	0.0668	0.0245
15	7.00%	0.0930	0.0692	0.0238
16	7.25%	0.0948	0.0717	0.0231
17	7.50%	0.0967	0.0742	0.0224
18	7.75%	0.0985	0.0767	0.0218
19	8.00%	0.1004	0.0792	0.0211

Instructions to Calculate the Annual Surcharge Revenue Requirement on the Loan

Step 1. Find the Annual Payment on the Loan
Refer to Table A, the Conversion Factor Table. Reading the table from top to bottom, find the interest rate in column A that is equal to the stated annual interest rate of the loan. Reading across the table, find the Annual Payment Conversion Factor in Column B that corresponds with the loan interest rate (in the event that the loan interest rate is different from the interest rates in Table A, use the next higher interest rate that can be found in Table A). Multiply that annual payment conversion factor by the total amount of the loan to calculate the annual debt service on the loan.

Annual payment conversion factor
(*) Times total amount of the loan
(=) Equals annual debt service on the loan

Step 2. Find the Annual Interest Payment on the Loan
Refer to Table A and find the annual interest payment conversion factor in Column C that corresponds with the stated annual interest rate of the loan. Multiply the annual interest payment conversion factor by the total amount of the loan to calculate the annual interest expense on the loan.

Annual interest payment conversion factor
(*) Times total amount of the loan
(=) Equals annual interest expense on the loan

Step 3. Find the Annual Principal Payment on the Loan
Refer to Table A and find the annual principal payment conversion factor in Column D that corresponds with the stated annual interest rate of the loan. Multiply the annual principal payment conversion factor by the total amount of the loan to calculate the annual principal payment on the loan.

Annual principal payment conversion factor
(*) Times total amount of the loan
(=) Equals annual principal payment on the loan

Step 4. Find the *Gross Revenue Conversion Factor*[1] (GRCF)
The GRCF calculated below is used in step 5.

$$\text{GRCF} = \frac{1}{1 - \text{Effective incremental income tax rate}^{2}}$$

[1] The gross revenue conversion factor indicates the incremental revenue required to increase operating income by one dollar.
[2] The effective income tax rate represents the effective tax rate on the incremental income. Use the effective incremental income tax rate of 20.9228%.

$$\text{GRCF} = \frac{1}{1 - 0.2092} = \frac{1}{0.7907} = 1.2646$$

Step 5. Find the Incremental Income Tax Factor
The incremental income tax factor is calculated below:

Incremental Income Tax Factor = GRCF - 1

= 1.2646 - 1

= 0.2646

Step 6. Find the Annual Income Tax Component of the Surcharge Revenue
Multiply the incremental income tax factor by the annual principal payment on the loan determined in step 3 to calculate the income tax component of the annual surcharge revenue.

Incremental income tax conversion factor
(*) Times the annual principal payment on the loan
(=) Equals the annual income tax component of the annual surcharge revenue

Step 7. Find the Debt Service Component of the Annual Surcharge Revenue
Add the annual interest expense on the loan determined in step 2 to the annual principal payment determined in step 3. The sum is the debt service component of the annual surcharge revenue.

Annual interest payment on the loan
(+) Plus annual principal payment
(=) Equals the debt service component of the annual surcharge revenue

Step 8. Find the Total Annual Surcharge Revenue Requirement Needed for the Loan.
Add the annual income tax component determined in step 6 to the annual debt service component determined in step 7. The sum equals the annual surcharge revenue requirement for the loan.

Annual income tax component of the surcharge revenue
(+) Plus annual debt service component of the surcharge revenue
(=) Equals the total annual surcharge revenue requirement for the loan

Step 9. Find the monthly surcharge per customer.
Divide the Result obtained in step 8 by the number of months in a year (12). Divide this result by the number of customers at filing time to obtain the monthly surcharge per customer.

Total annual surcharge revenue requirement needed for the loan
(/) Divided by 12
(=) Total monthly surcharge revenue requirement needed for the loan
(/) Divided number of customers at filing time
(=) Equals the monthly surcharge per customer

Example

Loan amount: 786,392
Term: 20 years
Stated Annual Interest Rate: 6%

Instruction
Step 1. Find the Annual Payment on the Loan
Refer to Table A, the Conversion Factor Table. Reading the table from top to bottom, find the interest rate in column A that is equal to the stated annual interest rate of the loan. Reading across the table, find the Annual Payment Conversion Factor in Column B that corresponds with the loan interest rate (in the event that the loan interest rate is different from the interest rates in Table A, use the next higher interest rate that can be found in Table A). Multiply that annual payment conversion factor by the total amount of the loan to calculate the annual debt service on the loan.

Result

0.0860	Annual Payment Conv. Factor (Table A, Ln 11, Column B)
(*) $786,392	Total loan amount
(=) $67,607.48	Annual loan payment

Instruction
Step 2. Find the Annual Interest Payment on the Loan
Refer to Table A and find the annual interest payment conversion factor in Column C that corresponds with the stated annual interest rate of the loan. Multiply the annual interest payment conversion factor by the total amount of the loan to calculate the annual interest expense on the loan.

Result

0.0593	Table A, Line 11, Column C
(*) $786,392	Total loan amount
(=) $46,612.39	Annual interest expense

Instruction
Step 3. Find the Annual Principal Payment on the Loan
Refer to Table A and find the annual principal payment conversion factor in Column D that corresponds with the stated annual interest rate of the loan. Multiply the annual principal payment conversion factor by the total amount of the loan to calculate the annual principal payment on the loan.

Result

0.0267	Table A, Line 11, Column D
(*) $786,392	Total loan amount
(=) $20,995.08	Annual principal payment

Instruction

Step 4. Find the *Gross Revenue Conversion Factor* (GRCF)
The GRCF calculated below is used in step 5.

Result

$$\text{GRCF} = \frac{1}{1 - \text{Effective incremental income tax rate}}$$

$$\text{GRCF} = \frac{1}{1 - 0.2092} = \frac{1}{0.7907} = 1.2646$$

Instruction

Step 5. Find the Incremental Income Tax Factor
The incremental income tax factor is calculated below:

Result

$$\text{Incremental Income Tax Factor} = \text{GRCF} - 1$$

$$= 1.2646 - 1$$

$$= 0.2646$$

Instruction

Step 6. Find the Annual Income Tax Component of the Surcharge Revenue
Multiply the incremental income tax factor by the annual principal payment on the loan determined in step 3 to calculate the income tax component of the annual surcharge revenue.

Result

0.2646	Incremental income tax factor (Step 5)
(*) $20,995.08	Annual principal payment (Step 3)
(=) $5,555.03	Annual income tax component of the annual surcharge revenue

Instruction

Step 7. Find the Debt Service Component of the Annual Surcharge Revenue

Add the annual interest expense on the loan determined in step 2 to the annual principal payment determined in step 3. The sum is the debt service component of the annual surcharge revenue.

Result

$46,612.39	Annual interest expense (Step 2)
(+) $20,995.08	Annual principal payment (Step 3)
(=) $67,607.48	Debt service component of the annual surcharge revenue

Instruction

Step 8. Find the Total Annual Surcharge Revenue Requirement Needed for the Loan.

Add the annual income tax component determined in step 6 to the annual debt service component determined in step 7. The sum equals the annual surcharge revenue requirement for the loan.

Result

$5,555.03	Annual income tax component (Step 6)
(+) $67,607.48	Debt service component (Step 7)
(=) $73,162.50	Total annual surcharge revenue requirement for the loan

Instruction

Step 9. Find the monthly surcharge per customer.

Divide the Result obtained in step 8 by the number of months in a year (12). Divide this result by the number of customers at filing time (currently the number of customers is 269) to obtain the monthly surcharge per customer.

Result

$73,162.50	Total annual surcharge revenue requirement for the loan (Step 8)
(/) 12	Number of months in a year
(=) $6,096.88	Total monthly surcharge revenue requirement needed for the loan
(/) 269	Number of customers at filing time
(=) $22.66	Monthly surcharge per customer

Engineering Report for Mountain Glen Water Services, Inc.

Docket No. W-03875A-03-0737 (Rates) and Docket No. W-03875A-03-0870 (Financing)

By: Marlin Scott, Jr.
Utilities Engineer

February 2, 2004

CONCLUSIONS

A. Mountain Glen Water Services, Inc. ("Company") operates four independent water systems. The Linden East, Linden West, Pinedale, and Clay Springs systems have non-account water losses of 6.5%, 12.9%, 5.2%, and 2.6%, respectively. These percentages are within acceptable limits, except for the Linden West system of 12.9%. (For the Linden West system's recommendation, see RECOMMENDATIONS below.

B. Staff concludes that the Clay Springs and Pinedale systems appear to be operating adequately at this time due to the fact that approximately half the customers are part-time residents. However, the Company should take notice with reference to additional storage capacities needed for these systems.

The Linden West system needs an additional 40,000 gallons of storage capacity and one option that could be considered is an interconnection with the Linden East system. Multiple well sources from both Linden systems would satisfy the storage capacity deficiency. (For the Linden West system's recommendation, see RECOMMENDATIONS below.

C. The Arizona Department of Environmental Quality ("ADEQ") has determined that all four of the Company's systems are currently delivering water that meets the water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.

D. The Company's arsenic concentrations range from 6.9 ppb and 16 ppb. Based on these concentrations, the Company has submitted a financing application, Docket No. W-03875A-03-0870, to address its arsenic issue. The financing application is requesting funding authorization from the Water Infrastructure Finance Authority for arsenic removal treatment. The Company is asking for arsenic removal cost recovery in this proceeding. For the financing conclusions and recommendations, see Attachment 3 - Engineering Financing Report.

E. The Company is not located in any Active Management Area ("AMA") and is not subject to any AMA's reporting and conservation requirements.

F. The Company has no outstanding Arizona Corporation Commission compliance issues.

RECOMMENDATIONS

1. Staff calculated a 12.9% non-account water loss for the Linden West System. Staff recommends that the Company file a report within six months after an order is issued in this proceeding with the Director of the Utilities Division, indicating the quantity of water pumped, gallons sold, water loss percentage and actions taken by the Company to reduce water loss to 10% or less. If the reported water loss for the period is greater than 10%, the Company shall prepare a report containing a detail analysis and explanation demonstrating why a water loss reduction to 10% or less is not feasible or cost effective.

2. The Company should address the storage capacity deficiency for the Linden West system during the evaluation of the arsenic issue. Staff recommends that this storage capacity deficiency be corrected when the arsenic treatment facilities are placed into service for the Linden West and East systems. (See Attachment 3 – Engineering Financing Report.)

3. Staff recommends the adoption of the Company's annual water testing cost of $3,201.

4. Staff recommends that the Company use the depreciation rates delineated in Table B on a going forward bases.

5. Staff recommends the acceptance of the Company's proposed Service Line and Meter Installation Charges as delineated in Table C.

6. Staff recommends approval of the Company's Curtailment Plan Tariff (see Attachment 4 – Curtailment Tariff). This curtailment tariff should be filed with the Company's Tariff Schedule after an order is issued in this proceeding.

TABLE OF CONTENTS

PAGE

ENGINEERING REPORT FOR MOUNTAIN GLEN WATER SERVICES, INC. 1

CONCLUSIONS 1
RECOMMENDATIONS 2

A. LOCATION OF COMPANY 4

B. DESCRIPTION OF THE WATER SYSTEMS 4

FIGURE 1. NAVAJO COUNTY MAP 7
FIGURE 2. CERTIFICATED AREAS 8
FIGURE 3. CLAY SPRINGS SYSTEM SCHEMATIC 9
FIGURE 4. PINEDALE SYSTEM SCHEMATIC 10
FIGURE 5. LINDEN WEST SYSTEM SCHEMATIC 11
FIGURE 6. LINDEN EAST SYSTEM SCHEMATIC 12

C. WATER USE 13

WATER SOLD 13
FIGURE 7. WATER USE 13
NON-ACCOUNT WATER 13
SYSTEM ANALYSIS 14

D. GROWTH 15

FIGURE 8. GROWTH PROJECTION 15

E. ARIZONA DEPARTMENT OF ENVIRONMENTAL QUALITY (ADEQ) COMPLIANCE 16

COMPLIANCE 16
WATER TESTING EXPENSE 16
TABLE A. WATER TESTING COST 16
ARSENIC 17

F. ARIZONA DEPARTMENT OF WATER RESOURCES COMPLIANCE 17

G. ARIZONA CORPORATION COMMISSION COMPLIANCE 17

H. DEPRECIATION RATES 18

TABLE B. DEPRECIATION RATES 18

I. OTHER ISSUES 19

1. SERVICE LINE AND METER INSTALLATION CHARGES 19
TABLE C. SERVICE LINE AND METER INSTALLATION CHARGES 19
2. CURTAILMENT PLAN TARIFF 20

ATTACHMENTS

ATTACHMENT 3 – ENGINEERING FINANCING REPORT
ATTACHMENT 4 – CURTAILMENT TARIFF

A. LOCATION OF COMPANY

Mountain Glen Water Services, Inc. ("Company") serves three communities; Linden, Pinedale, and Clay Springs, all northwest of Show Low along State Highway 260. Figure 1 shows the location of the Company within Navajo County and Figure 2 shows the three certificated areas totaling 1-1/2 square-miles.

B. DESCRIPTION OF THE WATER SYSTEMS

The water systems were field inspected on November 7, 2003, by Marlin Scott, Jr., Staff Utilities Engineer, in the accompaniment of Mr. William Parker, Owner of the Company. The Company operates four independent water systems with brief descriptions as follows:

1. Clay Springs, PWS #09-081: This system is located approximately 19 miles from Show Low and consists of a well (equipped with a 5 horsepower ("Hp") submersible pump producing 22 gallons per minute ("gpm")) that pumps into a 5,000 gallon storage tank, through a 3-Hp booster pump, a 1-inch meter, and two 85 gallon bladder tanks before distribution into the system to serve 20 service connections.

2. Pinedale, PWS #09-054: This system is located approximately 11 miles from Show Low and consists of a new well (3-Hp submersible pump at 11 gpm) that pumps into a 2,500 gallon storage tank, through a 3-Hp booster pump, a 1-inch meter, and two 85 gallon bladder tanks before distribution into the system to serve 17 service connections.

3. Linden West, PWS #09-070: This system is located approximately four miles from Show Low and consists of a well (7-1/2-Hp submersible pump at 40 gpm) that pumps into a 12,000 gallon storage tank, through a 5-Hp booster pump, a 1-1/2-inch meter, and four 85 gallon bladder tanks before distribution into the system to serve 90 service connections.

4. Linden East, PWS #09-025: This system is located approximately 3-1/2 miles from Show Low and has two well sites. Well Site #1 has a well (20-Hp submersible pump at 150 gpm) that pumps into a 15,000 gallon storage tank, through two 5-Hp booster pumps, a 2-inch meter, and three 85 gallon bladder tanks before distribution into the system. Well Site #2 has a well (7-1/2-Hp submersible pump at 60 gpm) that pumps into a 12,000 gallon storage tank, through a 5-Hp booster pump, a 2-inch meter, and four 85 gallon bladder tanks before distribution into the system. This system serves 145 service connections. The Linden East and West systems are approximately 1,500 feet apart.

System schematics for all four systems are shown as Figures 3, 4, 5, and 6. Combined detailed plant facility listings are as follows:

Table 1. Well Data

Location/No.	ADWR ID #	Pump Hp	Pump GPM	Casing Size	Casing Depth (Feet)	Meter Size
Clay Springs	55-087029	5	22	6"	550	1"
Pinedale	* 55-501550	3	11	6"	503	1"
Linden West	55-629079	7.5	40	6"	180	1.5"
Linden East #1	55-629078	20	150	12"	285	2"
Linden East #2	55-629080	7.5	60	6"	190	2"
Old Pinedale Well	55-584187					

* Note: New well drilled in 2000 for Pinedale.

Table 2. Storage Tanks

Capacity (Gallons)	Quantity (Each)	Location
5,000	1	Clay Springs
2,500	1	Pinedale
15,000	1	Linden East #1
12,000	2	Linden West, Linden East #2
(10,000)	1	(Old tank @ Clay Springs)

Table 3. Booster Systems

Booster Pumps	Bladder Tanks	Location
3-Hp	Two 85 gallon	Clay Springs
3-Hp	Two 85 gallon	Pinedale
5-Hp	Four 85 gallon	Linden West
Two 5-Hp	Three 85 gallon	Linden East #1
5-Hp	Four 85 gallon	Linden East #2

Table 4. Water Mains

Diameter	Material	Length
2-inch	PVC	1,150 ft.
3-inch	PVC	7,850 ft.
4-inch	PVC	25,750 ft.
6-inch	PVC	7,795 ft.
3-inch	ACP	1,625 ft.
6-inch	ACP	3,000 ft.
	Total:	47,170 ft.

Table 5. Customer Meters

Size	Quantity
5/8 x 3/4-inch	275
3/4-inch	-
1- inch	-
1-1/2-inch	-
2-inch	-
Total:	275

Table 6. Fire Hydrants

Size	Quantity
Standard	none

Table 7. Structures

Structures
Clay Spring Pump House – 10' x 12' CMU building
Pinedale Pump House – 12' x 15' wooden building
Linden West Pump House – 10' x 10' CMU building
Linden East #1 – 8' x 10' wooden building
Linden East #2 – 6' x 8' plywood (temporary)

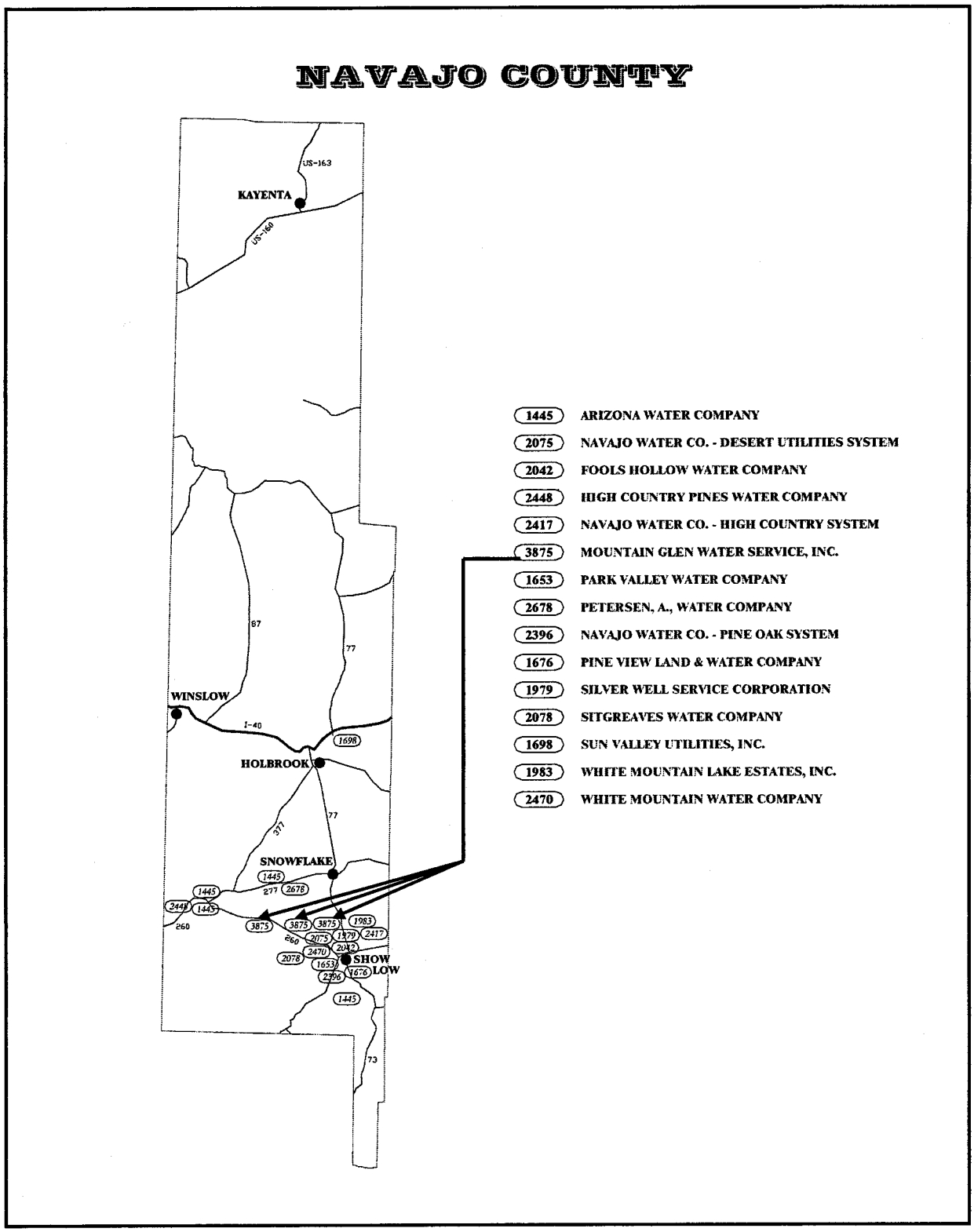

Figure 1. Navajo County Map

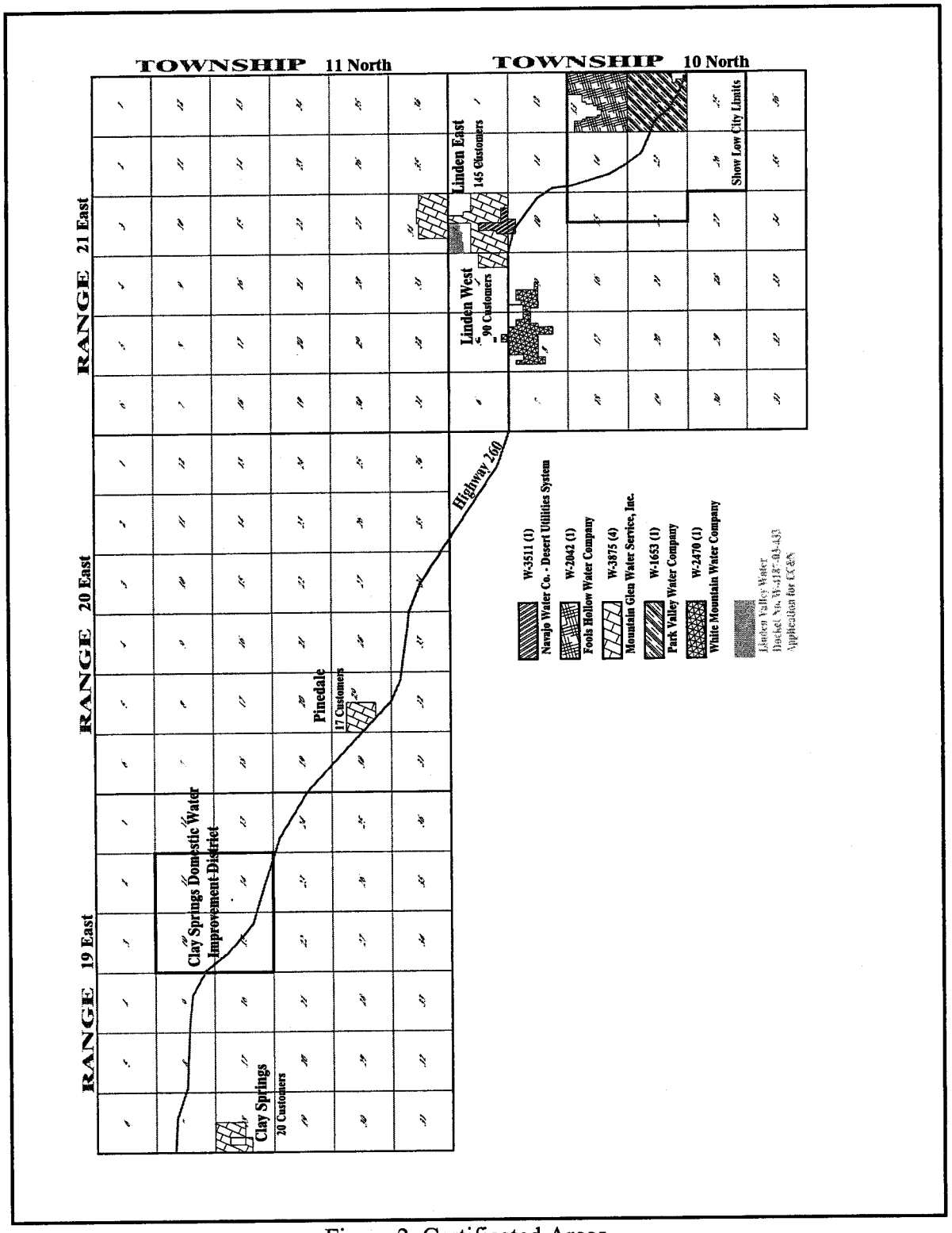

Figure 2. Certificated Areas

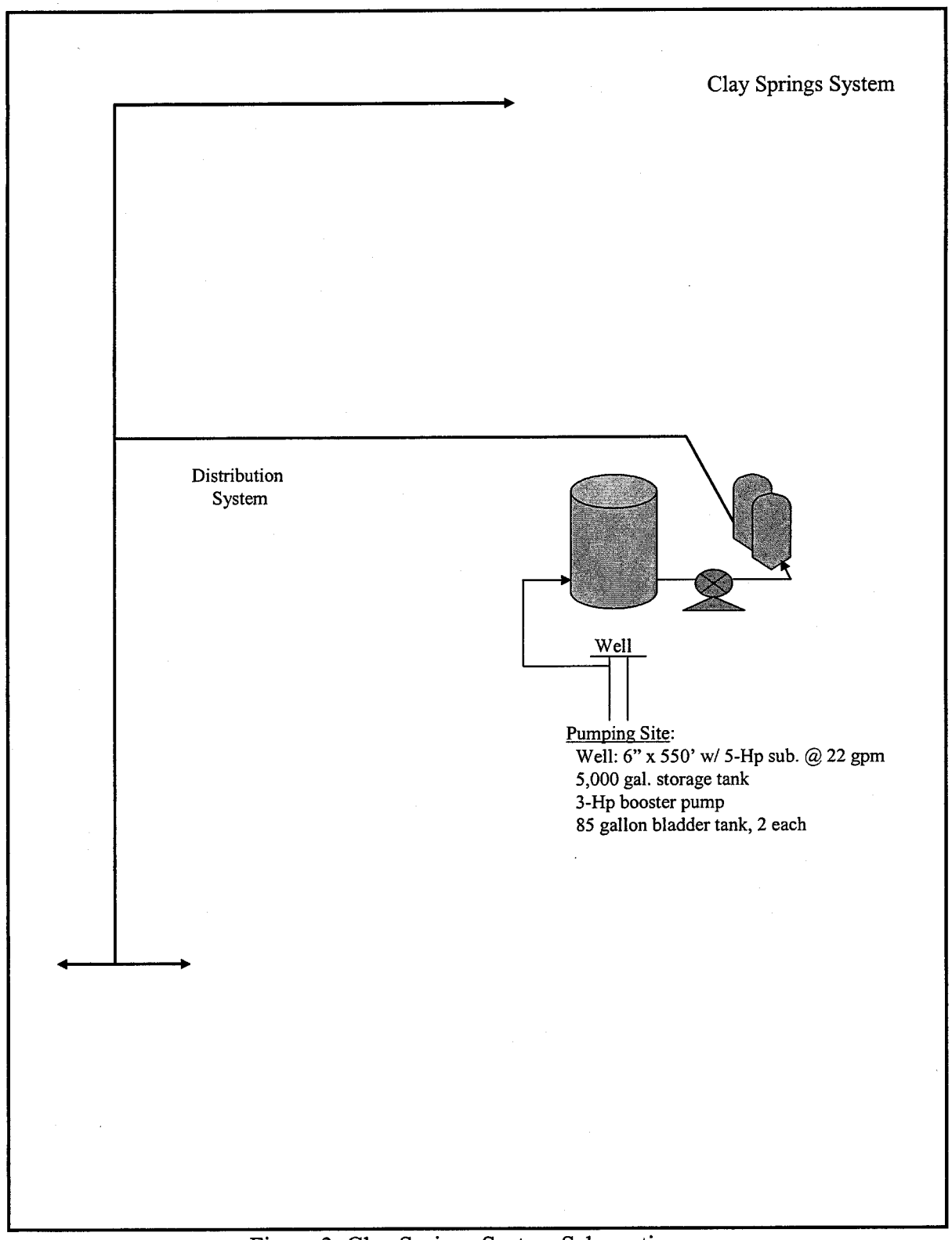

Figure 3. Clay Springs System Schematic

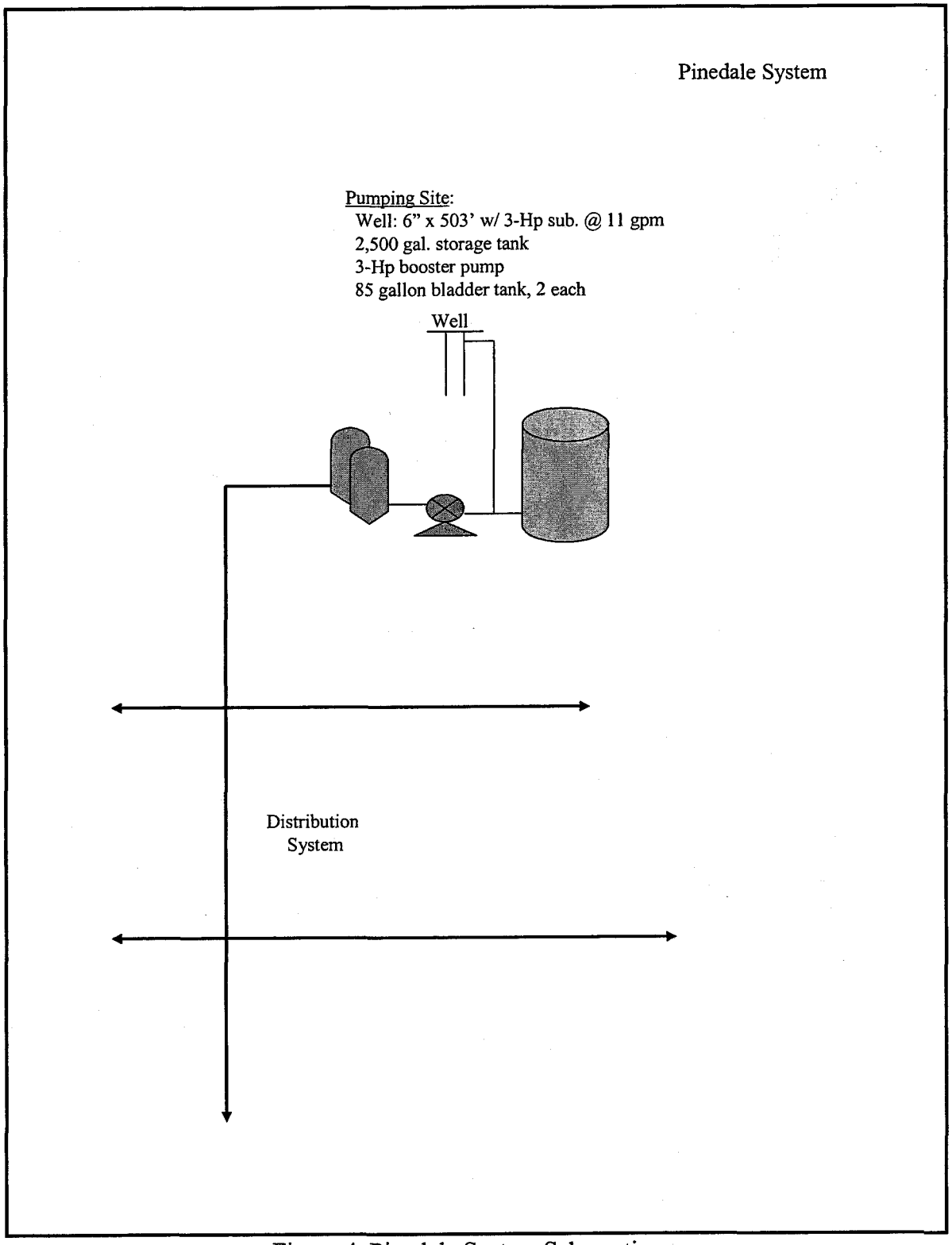

Figure 4. Pinedale System Schematic

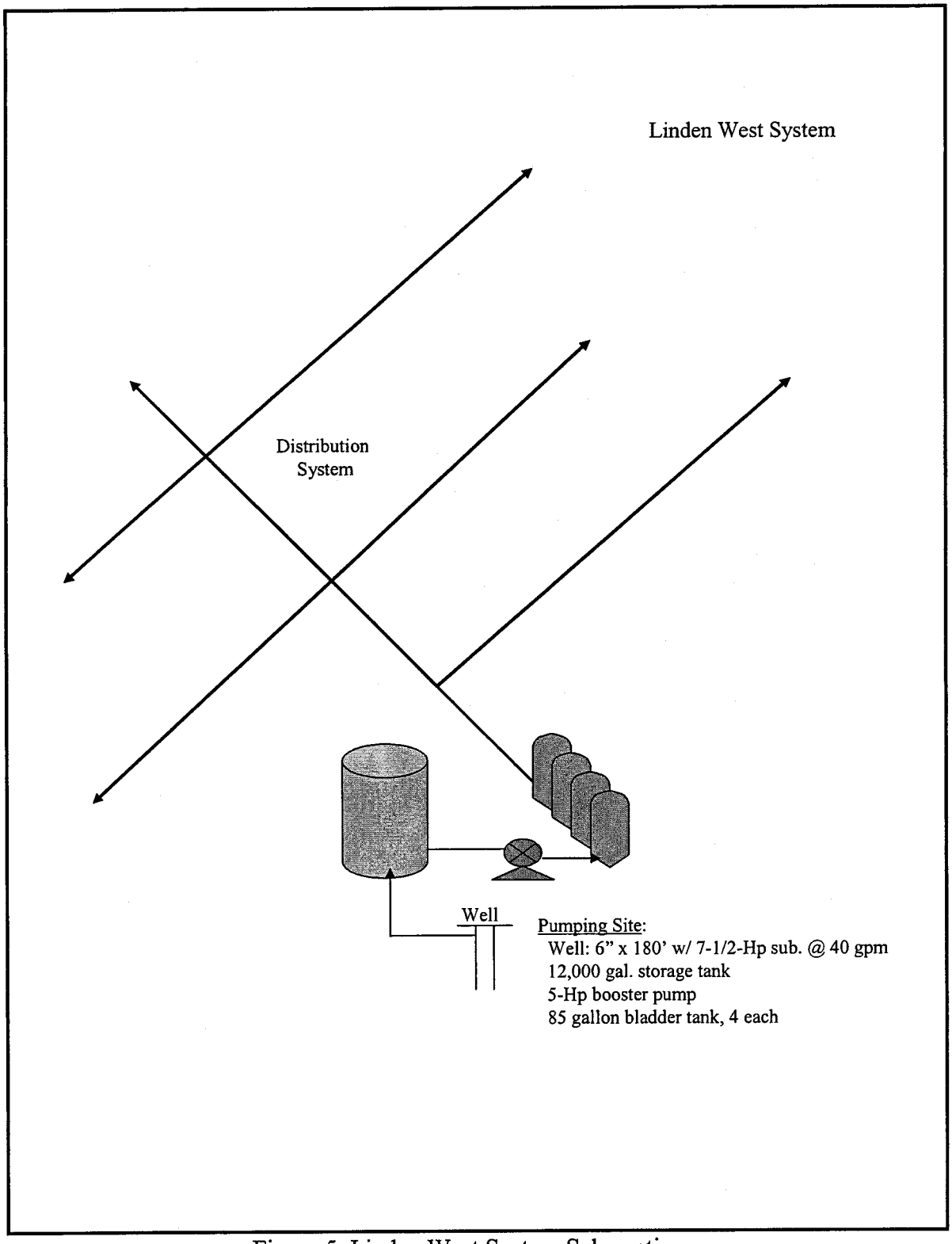

Figure 5. Linden West System Schematic

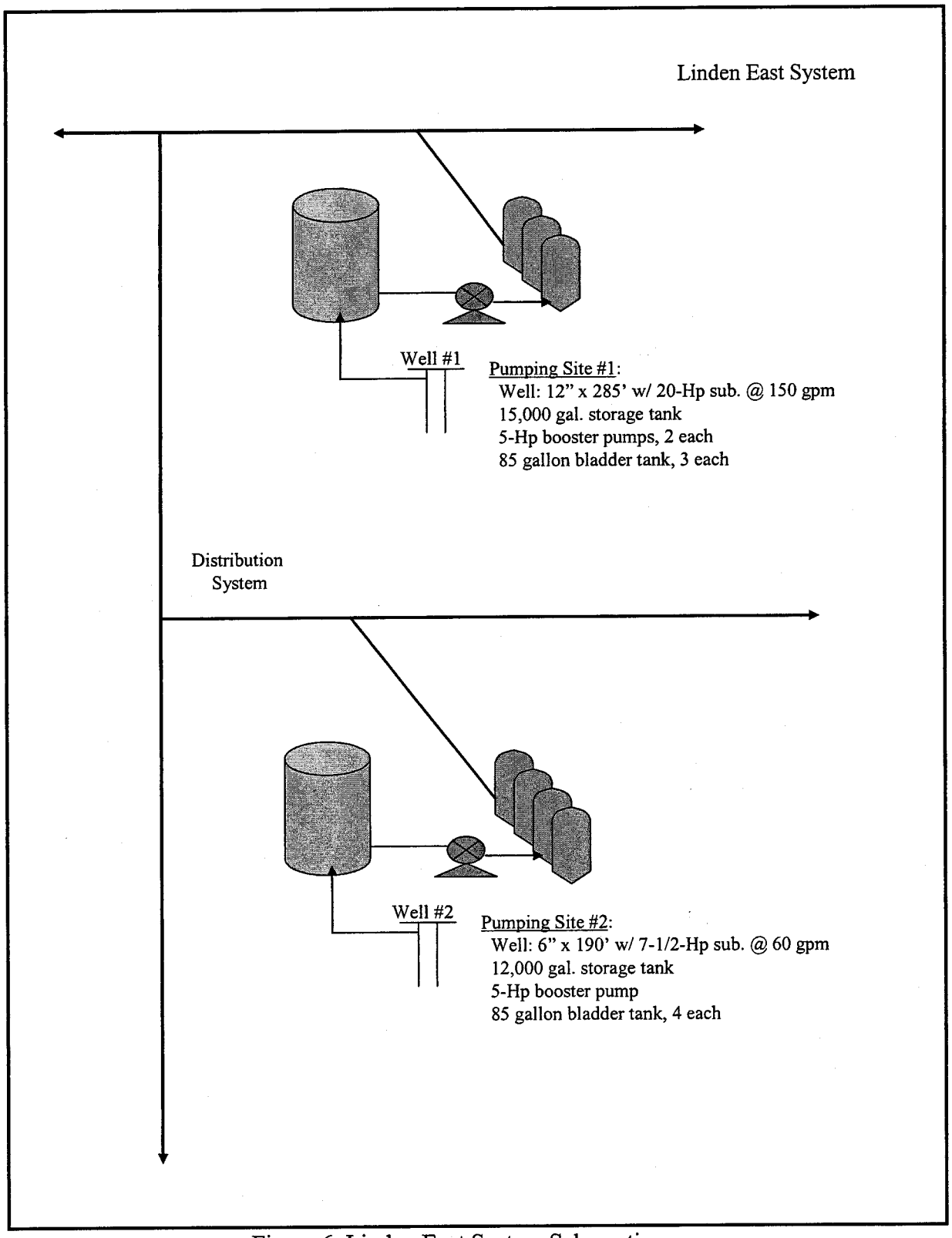

Figure 6. Linden East System Schematic

C. WATER USE

Water Sold

Based on the information provided by the Company on its Water Use Data Sheets, water use for the year 2002 is presented below for each system.

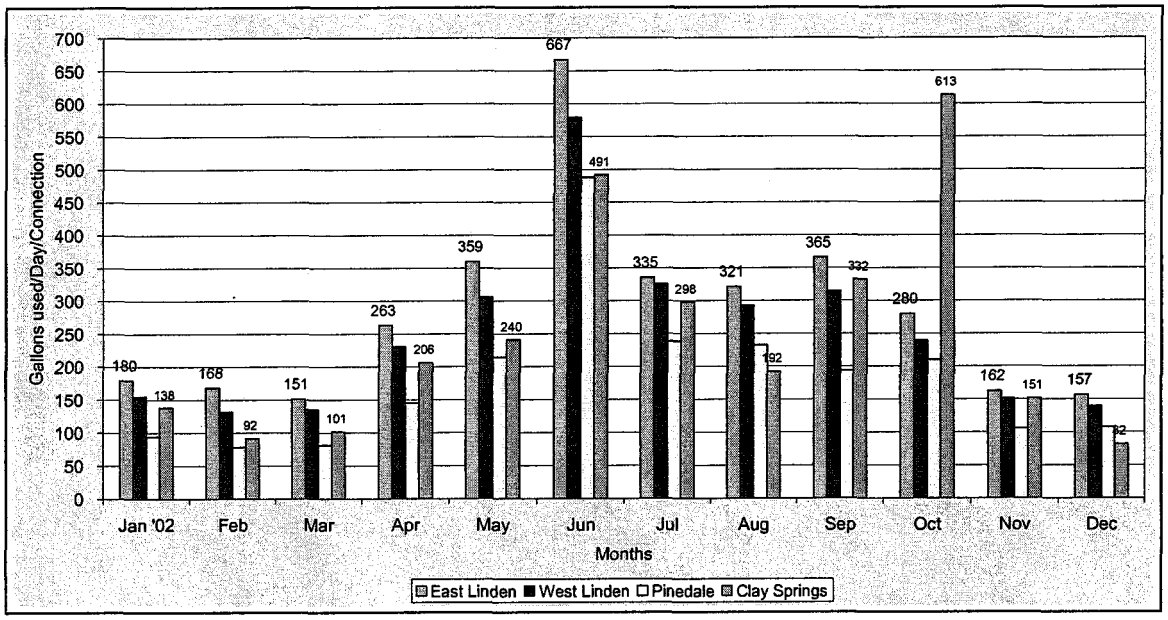

Figure 7. Water Use

Monthly customer consumption for each system was calculated and presented above to show the following usages:

System	Water Use, gallons per day ("GPD") per connection High/Mo.	Low/Mo.	Average
Linden East	667 in June	151 in Mar.	284
Linden West	579 in June	132 in Feb.	250
Pinedale	487 in June	78 in Feb.	182
Clay Springs	♣ 613 in Oct.	82 in Dec.	245

♣ Note: This high usage was contributed by a customer whose meter malfunctioned and/or had a leak. The Company is currently investigating this consumption.

Non-Account Water

For each water system, the Company reported the following gallons pumped and gallons sold, which Staff used to determine the water loss per system:

Table 8. Water Loss

Water System	Gallons Pumped	Gallons Sold	Water loss, %
Linden East	16,001,000	14,967,890	6.5%
Linden West	9,049,600	7,883,290	♦ 12.9%
Pinedale	1,176,080	1,115,270	5.2%
Clay Springs	1,671,660	1,628,090	2.6%

♦ Note: The Company is aware of this percent and is currently monitoring this system.

Non-account water should be 10% or less. Staff will accept the above percentages at this time, but will recommend that the Company continue to monitor the Linden West system. For this Linden West system, Staff will further recommend that the Company file a report within six months after an order is issued in this proceeding with the Director of the Utilities Division, indicating the quantity of water pumped, gallons sold, water loss percentage, and actions taken by the Company to reduce water loss to 10% or less. If the reported water loss for the period is greater than 10%, the Company shall prepare a report containing a detail analysis and explanation demonstrating why a water loss reduction to 10% or less is not feasible or cost effective.

System Analysis

The Clay Springs system's current well capacity of 22 gpm and storage capacity of 5,000 gallons could adequately serve up to 10 connections. This system has 18 connections. This system could use an additional 5,000 gallons of storage capacity.

The Pinedale system's current well capacity of 11 gpm and storage capacity of 2,500 gallons could adequately serve up to 5 connections. This system has 17 connections. This system could use an additional 6,000 gallons of storage capacity.

The Linden West system's current well capacity of 40 gpm and storage capacity of 12,000 gallons could adequately serve up to 20 connections. This system has 87 connections. This system could use an additional 40,000 gallons of storage capacity.

The Linden East system's current well capacity of 210 gpm and storage capacity of 27,000 gallons could adequately serve up to 170 connections. This system has 148 connections.

The Clay Springs and Pinedale systems appear to be operating adequately at this time due to the fact that approximately half the customers are part-time residents. However, the Company should take notice with reference to additional storage capacities needed for these systems.

The Linden West system needs an additional 40,000 gallons of storage capacity and one option that could be considered is an interconnection with the Linden East system. Multiple well sources from both Linden systems would satisfy the storage capacity deficiency. The Company should address the storage capacity deficiency for the Linden West system during the evaluation of the arsenic issue. Staff recommends that this storage capacity deficiency be corrected when the arsenic treatment facilities are placed into service for the Linden West and East systems. (Also see Attachment 3 – Engineering Financing Report.)

D. GROWTH

Figure 8 depicts actual growth during the past nine years and projects an estimated growth for the next five years using linear regression analysis. Based on customer data obtained from the submitted Annual Reports, it is projected that the Company could have approximately 325 customers by 2007.

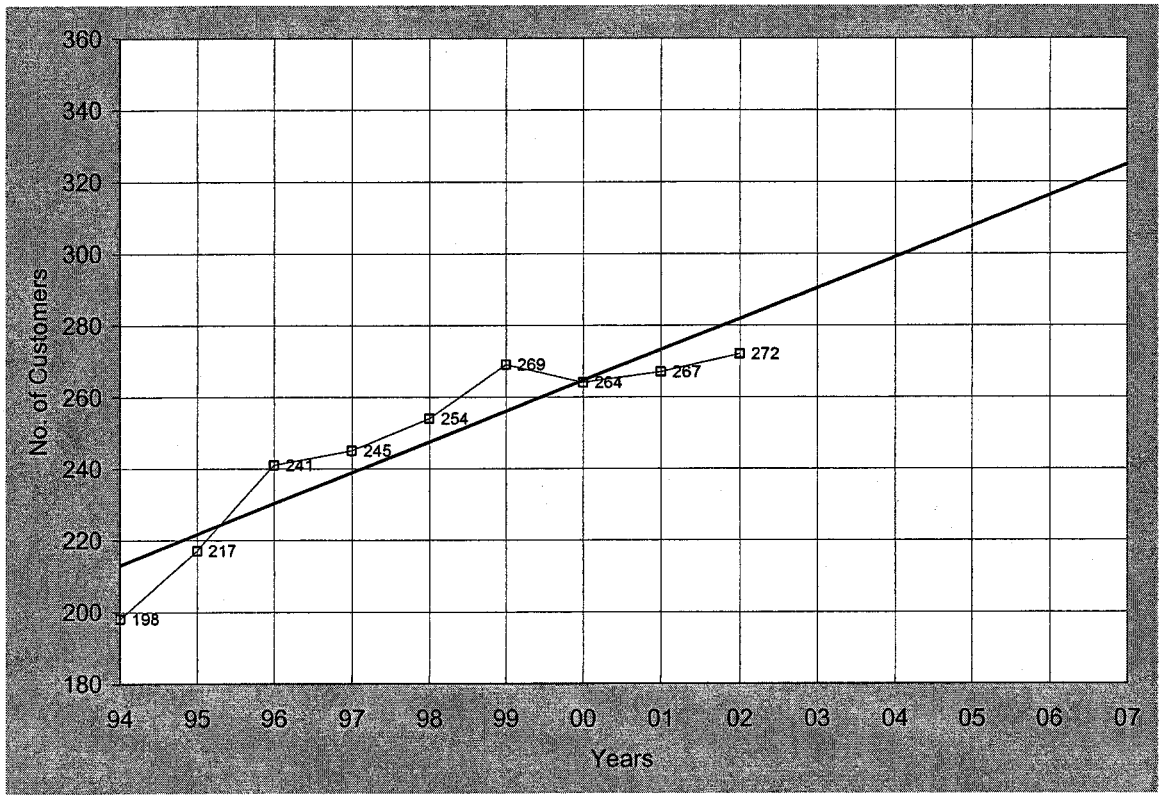

Figure 8. Growth Projection

E. ARIZONA DEPARTMENT OF ENVIRONMENTAL QUALITY (ADEQ) COMPLIANCE

Compliance

ADEQ has determined that all four of the Company's systems are currently delivering water that meets the water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.

Water Testing Expense

The Company is subject to mandatory participation in the Monitoring Assistance Program ("MAP"). Starting January 1, 2002, water companies paid a fixed $250 per year fee, plus an additional fee of $2.07 per service connection, regardless of meter size for participation in MAP. Participation in the MAP program is mandatory for water systems, which serve less than 10,000 persons (approximately 3,300 service connections).

The Company reported its water testing expense at $3,201 during the test year. Table A shows Staff's annual monitoring expense estimated at $3,102 with participation in the MAP. Staff and Company's expense has a difference of $99. Therefore, Staff will accept the Company's annual water testing expense of $3,201.

Table A. Water Testing Cost

Monitoring (Tests per 3 years, unless noted.)	Cost per test	No. of tests per 3 years	Total 3 year cost	Annual Cost
Total coliform – monthly				
East Linden		36	$612	$204
West Linden	$17	36	$612	$204
Pinedale		36	$612	$204
Clay Springs		36	$612	$204
Inorganics – Priority Pollutants	MAP	MAP	MAP	MAP
Radiochemical – per 4 years	MAP	MAP	MAP	MAP
Phase II and V:				
Nitrate – annual				
East Linden – 2 POEs		6	$120	$40
West Linden	$20	3	$60	$20
Pinedale		3	$60	$20
Clay Springs		3	$60	$20
Nitrite – once per period	MAP	MAP	MAP	MAP
Asbestos – per 9 years	MAP	MAP	MAP	MAP
MAP – IOCs, SOCs, & VOCs	MAP	MAP	MAP	

East Linden				558
West Linden				432
Pinedale				269
Clay Springs				287
Lead & Copper – per year				
East Linden		15	$480	$160
West Linden	$32	15	$480	$160
Pinedale		15	$480	$160
Clay Springs		15	$480	$160
Total				$3,102

Note: ADEQ - MAP invoices were for the 2003 Calendar Year.

Arsenic

The U.S. Environmental Protection Agency has reduced the arsenic maximum contaminant level ("MCL") in drinking water from 50 parts per billion ("ppb") to 10 ppb. The date for compliance with the new MCL is January 23, 2006.

The Company indicated its arsenic concentrations for the Clay Springs well at 6.9 ppb, Pinedale well at 7.3 ppb, Linden West well at 9.9 ppb, and Linden East Well #1 at 16 ppb. Based on these arsenic concentrations, the Company has submitted a financing application, Docket No. W-03875A-03-0870, to address its arsenic issue. The financing application is requesting funding authorization from the Water Infrastructure Finance Authority for arsenic removal treatment. The Company is asking for arsenic removal cost recovery in this proceeding. Staff has produced a separate engineering report as Attachment 3 – Engineering Financing Report to address this arsenic issue.

F. ARIZONA DEPARTMENT OF WATER RESOURCES COMPLIANCE

The Company is not located in any Active Management Area ("AMA") and is not subject to any AMA reporting and conservation requirements.

G. ARIZONA CORPORATION COMMISSION COMPLIANCE

According to the Utilities Division Compliance Unit, the Company has no outstanding Commission compliance issues.

H. DEPRECIATION RATES

The Company has been using a depreciation rate of 5.00% in every National Association of Regulatory Utility Commissioners ("NARUC") plant category. In recent orders, the Commission has been shifting away from the use of composite rates in favor of individual depreciation rates by NARUC category. (For example, a uniform 5% composite rate would not really be appropriate for either vehicles or transmission mains and instead, different specific retirement rates should be used.)

Staff has developed typical and customary depreciation rates within a range of anticipated equipment life. These rates are presented in Table B, and were used to re-calculate the annual depreciation expense for the Company. It is recommended that the Company use depreciation rates by individual NARUC category, as delineated in Table B.

Table B. Depreciation Rates

NARUC Acct. No.	Depreciable Plant	Average Service Life (Years)	Annual Accrual Rate (%)
304	Structures & Improvements	30	3.33
305	Collecting & Impounding Reservoirs	40	2.50
306	Lake, River, Canal Intakes	40	2.50
307	Wells & Springs	30	3.33
308	Infiltration Galleries	15	6.67
309	Raw Water Supply Mains	50	2.00
310	Power Generation Equipment	20	5.00
311	Pumping Equipment	8	12.5
320	Water Treatment Equipment		
320.1	Water Treatment Plants	30	3.33
320.2	Solution Chemical Feeders	5	20.0
330	Distribution Reservoirs & Standpipes		
330.1	Storage Tanks	45	2.22
330.2	Pressure Tanks	20	5.00
331	Transmission & Distribution Mains	50	2.00
333	Services	30	3.33
334	Meters	12	8.33
335	Hydrants	50	2.00
336	Backflow Prevention Devices	15	6.67
339	Other Plant & Misc Equipment	15	6.67
340	Office Furniture & Equipment	15	6.67
340.1	Computers & Software	3	33.33
341	Transportation Equipment	5	20.00

342	Stores Equipment	25	4.00
343	Tools, Shop & Garage Equipment	20	5.00
344	Laboratory Equipment	10	10.00
345	Power Operated Equipment	20	5.00
346	Communication Equipment	10	10.00
347	Miscellaneous Equipment	10	10.00
348	Other Tangible Plant	----	----

NOTES:

1. These depreciation rates represent average expected rates. Water companies may experience different rates due to variations in construction, environment, or the physical and chemical characteristics of the water.

2. Acct. 348, Other Tangible Plant may vary from 5% to 50%. The depreciation rate would be set in accordance with the specific capital items in this account.

I. OTHER ISSUES

1. Service Line and Meter Installation Charges

The Company has requested to change its service line and meter installation charges. These charges are refundable advances and the Company's proposed charges are within Staff's customary range of charges. Therefore, Staff accepts the Company's proposed service line and meter installation charges as shown in Table C below.

Table C. Service Line and Meter Installation Charges

Meter Size	Current Charges	Proposed Charges
5/8 x3/4-inch	$410	$550
3/4-inch	$440	$580
1-inch	$535	$675
1-1/2-inch	$570	$710
2-inch	$970	$1,110
3-inch	$1,350	$1,490
4-inch	$2,155	$2,295
6-inch	$4,165	$4,305

2. Curtailment Plan Tariff

A Curtailment Plan Tariff ("CPT") is an effective tool to allow a water company to manage its resources during periods of shortages due to pump breakdowns, droughts, or other unforeseeable events. Since the Company does not have this type of tariff, this rate proceeding provides an opportune time to prepare and file such a tariff. Staff and the Company have jointly reviewed the CPT and have agreed to the attached CPT, Attachment 4 – Curtailment Tariff. Therefore, Staff recommends approval of the attached Company's Curtailment Plan Tariff and that this curtailment tariff be filed with the Company's Tariff Schedule after an order is issued in this proceeding.

MEMORANDUM

DATE: February 10, 2004

TO: Alejandro Ramirez, Public Utilities Analyst I
Elena Zestrijan, Public Utilities Analyst III

FROM: Marlin Scott, Jr.
Utilities Engineer

RE: Mountain Glen Water Services, Inc.
Docket No. W-03875A-03-0870 (Financing)

Introduction

Mountain Glen Water Services, Inc. ("Company") has submitted a financing application for arsenic treatment. The Company operates four independent water systems northwest of Show Low in Navajo County.

Existing Water Systems

A brief description of each water system and arsenic concentration is as follows:

1. Clay Springs, PWS #09-081: This system is located approximately 19 miles from Show Low and consists of a well (equipped with a 5 horsepower ("Hp") submersible pump producing 22 gallons per minute ("gpm")) that pumps into a 5,000 gallon storage tank, through a 3-Hp booster pump, a 1-inch meter, and two 85 gallon bladder tanks before distribution into the system to serve 20 service connections. The arsenic concentration from the well is 6.9 ppb.

2. Pinedale, PWS #09-054: This system is located approximately 11 miles from Show Low and consists of a new well (3-Hp submersible pump at 11 gpm) that pumps into a 2,500 gallon storage tank, through a 3-Hp booster pump, a 1-inch meter, and two 85 gallon bladder tanks before distribution into the system to serve 17 service connections. The arsenic concentration from the well is 7.3 ppb.

3. Linden West, PWS #09-070: This system is located approximately four miles from Show Low and consists of a well (7-1/2-Hp submersible pump at 40 gpm) that pumps into a 12,000 gallon storage tank, through a 5-Hp booster pump, a 1-1/2-inch meter, and four 85 gallon bladder tanks before distribution into the system to serve 90 service connections. The arsenic concentration from the well is 9.9 ppb.

4. Linden East, PWS #09-025: This system is located approximately 3-1/2 miles from Show Low and has two well sites. Well Site #1 has a well (20-Hp submersible pump at 150 gpm) that pumps into a 15,000 gallon storage tank, through two 5-Hp booster pumps, a 2-inch meter, and three 85 gallon bladder tanks before distribution into the system. Well Site #2 has a well (7-1/2-Hp submersible pump at 60 gpm) that pumps into a 12,000 gallon storage tank, through a 5-Hp booster pump, a 2-inch meter, and four 85 gallon bladder tanks before distribution into the system. This system serves 145 service connections. The arsenic concentration from Well #1 and Well #2 (composited) is 16 ppb. The Linden East and West systems are approximately 1,500 feet apart.

Financing Application

The Company is requesting financing approval for a $640,710 loan from the Water Infrastructure Finance Authority ("WIFA"). This loan is needed to finance the purchase and/or construction of arsenic removal equipment. The cost estimates in the financing request were obtained from the ADEQ Arsenic Master Plan.

ADEQ Arsenic Master Plan

ADEQ initiated the Arsenic Master Plan ("AMP") in early 2002 to assist water systems in Arizona that are affected by the new arsenic rule. To assist these affected small water systems, compliance options were developed to categorize systems serving less than 10,000 persons and develop costs for funding arsenic mitigation projects for the systems. The focus of the AMP is on small groundwater systems serving fewer than 10,000 persons, although the report should also prove useful for larger groundwater systems.

Treatment Alternatives and Cost Models

The report provides detailed discussion of the potential arsenic removal technologies for small water systems and the associated costs. Iron-modified activated alumina (Fe-AA), granular iron media such as granular ferric hydroxide (GFH) or Sorb-33, coagulation with granular media filtration and point-of-use ("POU") devices (reverse osmosis and adsorption media) were determined as the feasible treatment options. Detailed information on site plans and schematics, and design criteria for each treatment alternative, were presented in the report. Cost models were developed for varying configuration options and media types, using Arizona specific cost factor models. Based on the cost models, capital and operation & maintenance ("O&M") costs were estimated for each category of system based on its size.

Cost Evaluation

Capital and O&M costs were developed on a statewide basis for each of the feasible alternatives. From the feasible alternatives, the two lowest cost options, from an annualized treatment cost perspective were selected (annualized cost = capital cost amortized over 20 years at a 6% interest rate + annual O&M cost). A list of the two

lowest cost options for each of the 473 impacted point-of-entries ("POEs") was presented in the report. The AMP recommends the use of these two lowest cost options as arsenic mitigation strategies.

The cost estimates do not include the engineering fees for design for these facilities. According to the AMP, a 30% factor should be used to estimate the engineering fees.

Point-of-Use

Systems serving fewer than 300 persons should consider the possibility of using POU treatment significant capital cost savings, ranging from 5 to 20 percent of centralized treatment costs, may be realized. Based on a comparison between centralized and POU treatment costs, it was observed that POU costs were significantly lower than centralized treatment cost for systems serving fewer than 30 connections. Based on a statewide POU evaluation, it was observed that approximately 64 POEs with average population less than 300 persons had annualized POU costs lower than the lowest central annualized treatment costs. These POEs should be further evaluated on a site-specific basis for POU feasibility, taking into consideration political and logistic issues associated with POU treatment.

Proposed Treatment Facilities

The Company has selected a treatment alternative and cost model from the AMP. The selected treatment method (AMP alternative) capital and O&M costs are shown below:

System No.	System Name	* Selected AMP Alternative	Capital Cost	Annual O&M Cost	Estimated Monthly Cost Increase
09-081	Clay Springs	1a	• $160,000	N/A	N/A
09-054	Pinedale	1a	$136,150	$5,597	$58.19
09-070	Linden West	4a	$168,193	$11,726	$23.04
09-025	Linden East 1	4a	$176,367	$17,777	$21.57
		Total:	$640,710		

* Note 1: Treatment "1a" is the iron modified activated alumina media. Treatment "4a" is the granular iron media. Both treatment methods, "1a and 4a", are for systems without storage tanks.

• Note 2: AMP did not provide cost estimates for this system; however, the Company estimated this amount for submittal.

Staff Analysis

To address the arsenic issue using the AMP, Staff must begin with the understanding of the system operations; i.e., well's gpm, arsenic level, existing storage tank, and number of service connections for each water system, in order to determine the estimated capital and O&M costs. This plant information is shown below:

System No.	System Name and/or Well #	Wells (GPM)	Arsenic Level	Storage Capacity	No. of Service Connections
09-081	Clay Springs	22	6.9 ppb	5,000 gal.	20
09-054	Pinedale	11	7.3 ppb	2,500 gal.	17
09-070	Linden West	40	9.9 ppb	12,000 gal.	90
09-025	Linden East #1	150	16 ppb	15,000 gal.	145
	Linden East #2	60	16 ppb	12,000 gal.	

As shown above, the Clay Springs and Pinedale Systems show arsenic levels at 6.9 ppb and 7.3 ppb, respectively, and may not need arsenic treatment. The Company will need to monitor and compile historical arsenic concentrations to determine if arsenic treatment is actually required. Since these systems only serve 20 and 17 service connections, respectively, and if arsenic treatment is to be required, then these systems should consider the POU treatment option.

The Linden West System and the Linden East System appear to have the need for arsenic treatment. Staff used updated plant information to evaluate and determine if the submitted loan amounts were reasonable. The Company now operates with storage tanks at each system, resulting in the AMP treatment method "a" option (selected by the Company) being replaced with a treatment method "b" option which should be used when storage exists. Applying its updated system plant information to the AMP, Staff determined the treatment cost to be as follows:

System No.	System Name and/or Well #	Selected Treatment	Capital Cost	Annual O&M Cost	Estimated Monthly Cost Increase
09-081	Clay Springs	None	0	0	0
09-054	Pinedale	None	0	0	0
09-070	Linden West	3b	$174,803	$9,918	$23.29
09-025	Linden East #1	3b	$309,043	$38,710	$37.73
	Linden East #2	3b	$199,973	$19,809	$21.40
		Totals:	$683,819	$68,437	
	Engineering at 15%:		$102,573	(Staff believes 15% is reasonable.)	
		Staff Total:	$786,392		

Based on the AMP, Staff estimated the arsenic treatment capital cost at $786,392 for two systems having three POEs.

Consideration of System Interconnection

When the Company retains a consulting firm to address the arsenic issue, consideration should be given to evaluate an interconnection of the Linden West and East systems in order to:

1. Address the storage capacity deficiency for the Linden West System.
2. Determine if both Linden East wells (arsenic at 16 ppb) are needed for system sufficiency.
3. Determine if one Linden East well and the Linden West well (at 9.9 ppb) are sufficient to serve the two system customer base.

Conclusion and Recommendation

The Company requested a WIFA loan in the amount of $640,710 for arsenic treatment for all four of its water systems. Using the AMP with updated plant information, Staff estimated the arsenic treatment facilities at $786,392 for two of the four water systems, Linden West and Linden East. The two other systems, Clay Springs and Pinedale, may not require arsenic treatment. Staff concludes that the arsenic treatment facilities are appropriate for the Linden West and East Systems and recommends that Staff's estimated amount of $786,392 be used for the financing request.

Utility: Mountain Glen Water Services, Inc.
Docket No.: W-03875A-03-0737
Phone No.: 928-739-4479

Tariff Sheet No.: 1 of 3
Decision No.: _____
Effective: _____

CURTAILMENT PLAN FOR MOUNTAIN GLEN WATER SERVICES, INC.

(Template 091802)

ADEQ Public Water System Nos.: Clay Springs (09-081), Pinedale (09-054), Linden West (09-070), and Linden East (09-025)

Mountain Glen Water Services, Inc. ("Company") is authorized to curtail water service to all customers within its certificated area under the terms and conditions listed in this tariff.

This curtailment plan shall become part of the Arizona Department of Environmental Quality Emergency Operations Plan for the Company.

The Company shall notify its customers of this new tariff as part of its next regularly scheduled billing after the effective date of the tariff or no later than sixty (60) days after the effective date of the tariff.

The Company shall provide a copy of the curtailment tariff to any customer, upon request.

Stage 1 Exists When:

Company is able to maintain water storage in the system at 100 percent of capacity and there are no known problems with its well production or water storage in the system.

Restrictions: Under Stage 1, Company is deemed to be operating normally and no curtailment is necessary.

Notice Requirements: Under Stage 1, no notice is necessary.

Stage 2 Exists When:

a. Company's water storage or well production has been less than 80 percent of capacity for at least 48 consecutive hours, and

b. Company has identified issues such as a steadily declining water table, increased draw down threatening pump operations, or poor water production, creating a reasonable belief the Company will be unable to meet anticipated water demand on a sustained basis.

Restrictions: Under Stage 2, the Company may request the customers to voluntarily employ water conservation measures to reduce water consumption by approximately 50 percent. Outside watering should be limited to essential water, dividing outside watering on some uniform basis (such as even and odd days) and eliminating outside watering on weekends and holidays.

Notice Requirements: Under Stage 2, the Company is required to notify customers by delivering written notice door to door at each service address, or by United States first class mail to the billing address or, at the Company's option, both. Such notice shall notify the customers of the general nature of the problem and the need to conserve water.

Stage 3 Exists When:

a. Company's total water storage or well production has been less than 50 percent of capacity for at least 24 consecutive hours, and

b. Company has identified issues such as a steadily declining water table, increased draw down threatening pump operations, or poor water production, creating a reasonable belief the Company will be unable to meet anticipated water demand on a sustained basis.

Restrictions: Under Stage 3, Company shall request the customers to voluntarily employ water conservation measures to reduce daily consumption by approximately 50 percent. All outside watering should be eliminated, except livestock, and indoor water conservation techniques should be employed whenever possible.

Notice Requirements:

1. Company is required to notify customers by delivering written notice to each service address, or by United States first class mail to the billing address or, at the Company's option, both. Such Notice shall notify the customers of the general nature of the problem and the need to conserve water.

2. Beginning with Stage 3, Company shall post at least one sign per system showing the curtailment stage. Signs shall be posted at noticeable locations, like at the well sites and at the entrance to major subdivisions served by the Company.

3. Company shall notify the Consumer Services Section of the Utilities Division of the Corporation Commission at least 12 hours prior to entering Stage 3.

Once Stage 3 has been reached, the Company must begin to augment the supply of water by either hauling or through an emergency interconnect with an approved water supply in an attempt to maintain the curtailment at a level no higher than Stage 3 until a permanent solution has been implemented.

Stage 4 Exists When:

a. Company's total water storage or well production has been less than 25 percent of capacity for at least 12 consecutive hours, and

b. Company has identified issues such as a steadily declining water table, increased draw down threatening pump operations, or poor water production, creating a reasonable belief the Company will be unable to meet anticipated water demand on a sustained basis.

Restrictions: Under Stage 4, Company shall inform the customers of a **mandatory** restriction to employ water conservation measures to reduce daily consumption. Failure to comply will result in customer disconnection. The following uses of water shall be prohibited:

- Irrigation of outdoor lawns, trees, shrubs, or any plant life is prohibited
- Washing of any vehicle is prohibited
- The use of water for dust control or any outdoor cleaning uses is prohibited
- The use of drip or misting systems of any kind is prohibited
- The filling of any swimming pool, spas, fountains or ornamental pools is prohibited
- Restaurant patrons shall be served water only upon request
- Any other water intensive activity is prohibited

Notice Requirements:

1. Company is required to notify customers by delivering written notice to each service address, or by United States first class mail to the billing address or, at the Company's option, both. Such notice shall notify the customers of the general nature of the problem and the need to conserve water.

2. Company shall post at least one sign per system showing curtailment stage. Signs shall be posted at noticeable locations, like at the well sites and at the entrance to major subdivisions served by the Company.

3. Company shall notify the Consumer Services Section of the Utilities Division of the Corporation Commission at least 12 hours prior to entering Stage 4.

Customers who fail to comply with the above restrictions will be given a written notice to end all outdoor use. Failure to comply within two (2) working days of receipt of the notice will result in temporary loss of service until an agreement can be made to end unauthorized use of outdoor water. To restore service, the customer shall be required to pay all authorized reconnection fees. If a customer believes he/she has been disconnected in error, the customer may contact the Commission's Consumer Services Section at 1-800-222-7000 to initiate an investigation.

Once Stage 4 has been reached, the Company must augment the supply of water by hauling or through an emergency interconnect from an approved supply or must otherwise provide emergency drinking water for its customers until a permanent solution has been implemented.