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MEMORANDUM

TO: Docket Control

FROM: Ernest G. Johnson
for Director
Utilities Division

Date: June 24 2004

RE: MONTEZUMA ESTATES PROPERTY OWNERS ASSOCIATION-
APPLICATION FOR APPROVAL OF THE SALE OF ASSETS AND TRANSFER
OF ITS CERTIFICATE OF CONVENIENCE AND NECESSITY (DOCKET NOS.
W-02064A-04-0270 AND W-04254A-04-0270)

Attached is the Staff Report for Montezuma Estates Property Owners Association, application for the Sale of Assets and Transfer of its Certificate of Convenience and Necessity. Staff recommends denial of the sale of assets and transfer of the Certificate of Convenience and Necessity.

EGJ:JEF:lmh

Originator: Jim Fisher

Arizona Corporation Commission

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JUN 24 2004

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Service List for: Montezuma Estates Property Owners Association
Docket Nos. W-02064A-04-0270 and W-04254A-04-0270

Mr. Peter O. Sanchez
President
Montezuma Estates POA
Post Office Box 592
Rimrock, Arizona 86335

Ms. Patricia D. Arias
Montezuma Rimrock Water Company, LLC
Post Office Box 10
Rimrock, Arizona 86335

Mr. Christopher C. Kempley
Chief, Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Mr. Ernest G. Johnson
Director, Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Ms. Lyn Farmer
Chief, Hearing Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

MONTEZUMA ESTATES PROPERTY
OWNERS ASSOCIATION

APPLICATION FOR APPROVAL OF THE SALE
OF ASSETS AND TRANSFER OF ITS
CERTIFICATE OF CONVENIENCE AND NECESSITY

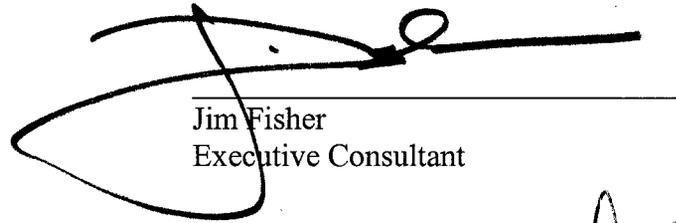
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AND
W-04254A-04-0270

June 2004

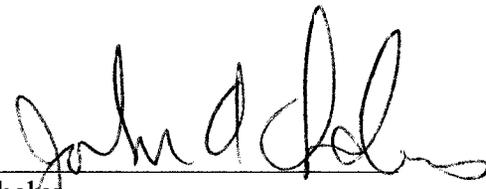
STAFF ACKNOWLEDGEMENT

The Staff Report for Montezuma Estates Property Owners Association (Docket Nos. W-02064A-04-0270 and W-04254A-04-0270) was the responsibility of the Staff members listed below. Jim Fisher was responsible for the review and analysis of the Company's application. John Chelus was responsible for the engineering and technical analysis.

Contributing Staff:



Jim Fisher
Executive Consultant



John Chelus
Utilities Engineer

**EXECUTIVE SUMMARY
MONTEZUMA ESTATES PROPERTY
OWNERS ASSOCIATION
DOCKET NOS W-02064A-04-0270
AND W-04254A-04-0270**

On April 9, 2004, Montezuma Estates Property Owners Association (“Montezuma” or “Association”) filed an application with the Arizona Corporation Commission (“ACC”) requesting approval of the sale of assets and transfer of its Certificate of Convenience and Necessity (“CC&N”) to Montezuma Rimrock Water Company, L.L.C. (“MRWC”).

Montezuma is a non profit association authorized to provide water service to certain portions of Yavapai County. Montezuma is currently serving approximately 117 customers, approximately 49 miles south of Flagstaff. Montezuma is a small water system with a history of inadequate plant, and limited cash flow. Montezuma has a need for significant capital improvements with increased rates to fund the system operations.

By this application, MRWC is seeking Commission approval to purchase the system with \$100,000 in debt financed proceeds. The Association’s annual reports to the Commission demonstrate that inadequate cash flow will be available to service the expected terms of the required debt. In addition, the Arizona Department of Environmental Quality Arsenic Master Plan estimates the Montezuma system will require \$256,538 in capital additions and \$32,150 in ongoing operational and maintenance costs for the arsenic treatment.

MRWC has not demonstrated financial capabilities to acquire, improve and operate the system so that the customers are assured of service that is equal to or better than the service currently provided.

Staff recommends that until such time as MRWC is able to demonstrate the financial capability to acquire, improve and operate the system so that service is equal to or better than the service currently provided, the Commission deny Montezuma Estates Property Owners’ Association’s Application for the Sale of Assets and Transfer of CC&N to Montezuma Rimrock Water Company, LLC.

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Introduction

On April 9, 2004, Montezuma Estates Property Owners Association (“Montezuma” or “Association”) filed an application with the Arizona Corporation Commission (“ACC”) requesting approval of the sale of assets and transfer of its Certificate of Convenience and Necessity (“CC&N”) to Montezuma Rimrock Water Company, L.L.C. (“MRWC”).

Background

Montezuma is a non profit association authorized to provide water service to certain portions of Yavapai County pursuant to authority granted by the ACC in Decision No. 52468 (September 18, 1981).

Montezuma is currently serving approximately 117 customers, approximately 49 miles south of Flagstaff. The Association’s current rates and charges were authorized in Decision No. 64665 (March 25, 2002). In Decision No. 65199 (September 20, 2002), the Commission authorized the Association to obtain a \$10,000 line of credit.

In Decision No. 64665, the Commission authorized rates based on a 2000 test year, designed to produce revenue of \$31,662 with operating income of \$4,355. According to the Association’s last annual report, 2002 revenue was \$47,429 and operating income was \$940. The same report shows 2003 revenue of \$95,740 and operating income of \$373. The Association’s last annual report to the Commission lists total assets of \$246,713 and no long-term debt.

According to Decision No. 65199, the Association’s distribution system is in need of repair and the cash required for capital additions and improvements exceeded the cash generated by hook-up fees for 1999, 2000, and 2001 by \$5,500, \$819 and \$10,000, respectively. The Commission found that, based on the Association’s financial future, its maintenance history and Staff’s recommendations, a \$10,000 line of credit was warranted. The Association had an estimated average monthly net income of \$363 which would be sufficient to meet the debt requirements.

The Water System

According to its 2003 Annual Report, the Association’s water system consists of two (2) wells which produce sixty (60) gallons-per-minute (“GPM”), two (2) ten thousand (10,000) gallon storage tanks, two (2) 2,000 gallon pressure tanks and the associated distribution lines serving approximately 117 connections. According to Staff’s analysis, the water system has adequate well production and storage tank capacity to serve the existing customer base.

Arsenic

The U. S. Environmental Protection Agency (“EPA”) has reduced the arsenic maximum contaminant level (“MCL”) in drinking water from 50 micrograms per liter ($\mu\text{g/l}$) to $10 \mu\text{g/l}$. The date for compliance with the new MCL is January 23rd, 2006. According to the Association’s last annual report to the Commission, its arsenic level at its two points-of-entry is $35 \mu\text{g}$.

The Arizona Department of Environmental Quality (“ADEQ”) has compiled an arsenic master plan for all water systems in the state. ADEQ has reviewed which systems will require treatment and estimated the capital and ongoing maintenance costs of treatment programs.

The Association has been identified by ADEQ as requiring arsenic treatment. According to Table 5.4 of the ADEQ Arsenic Master Plan, the Association is estimated to require \$256,538 in capital additions and \$32,150 in ongoing operational and maintenance costs for the arsenic treatment.

Staff’s analysis of the combined capital and operational costs for the arsenic facilities indicates existing customer rates may need to be increased an estimated \$40 per month to fund arsenic compliance measures.

The Company was ordered in Decision No. 64665 to submit a report to the Commission’s Utilities Division Director describing what steps the Company is planning to take in order to reduce the level in their water to a concentrate of 10 ppb by March 25, 2005.

MRWC

MRWC is an Arizona limited liability company formed July 14, 2003, whose sole member is Patricia Arias. Ms. Arias is currently the water system operator.

According to the application, all customer security deposits will be refunded at the time of closing the acquisition by MRWC. The application also provides that there are no refunds due on main extension agreements. However, there are currently refunds due on the meter and service line installations which will continue to be refunded under the same terms by MRWC. According to the last annual report, the meter deposit balance is \$37,742.

The Transaction

On June 10, 2004, Montezuma provided a copy of the Escrow Instructions agreement with MRWC. According to the agreement, MRWC is to pay \$100,000 for the water utility. No earnest money is required to be placed with the escrow agent or with any other agent. MRWC is to obtain the full purchase price of \$100,000 in loan proceeds.

ACC Compliance

A check with the Utilities Division Compliance Section showed no outstanding compliance issues for the Association. Staff notes that the Association has an approved Backflow Prevention Tariff and a Curtailment Tariff on file.

In addition, as discussed above, Montezuma is in need of an arsenic treatment plan.

Arizona Department of Environmental Quality Compliance

ADEQ regulates the Montezuma system under ADEQ Public Water System ("PWS") I.D. # 13-071. ADEQ has determined that the system does not meet water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.

Staff was informed that the Association is out of compliance for an unresolved action level exceedance for lead in 2001 and an unresolved Maximum Contaminant Level exceedance for arsenic at Point of Entry 2.

Summary

Montezuma is a small water system with a history of inadequate plant and limited cash flow. Montezuma has a need for significant capital improvements with increased rates to fund the system operations. The water system is currently out of compliance with ADEQ.

By this application, MRWC is seeking Commission approval to purchase the system with 100 percent debt. MRWC is owned by the current water system operator. MRWC intends to purchase the water system with \$100,000 in debt financed proceeds. Staff estimates debt service on a 10 year loan for that amount would require approximate monthly payments of \$1,161. The Association's annual reports to the Commission demonstrate that inadequate cash flow will be available to service the expected terms of the required debt.

As of January 2006, the Association will be required to ensure its arsenic level does not exceed 10 µg/l. The Association is currently delivering water that is 35 µg/l. In fact, ADEQ found the system exceeded at one point the current allowable arsenic level of 50 µg/l. The ADEQ Arsenic Master Plan the current Montezuma system will require significant capital additions and ongoing operational and maintenance costs for the arsenic treatment.

MRWC is a small entity, with limited capital, seeking to acquire the system with 100 percent debt. MRWC has not provided a financial plan to demonstrate its financial capabilities to acquire, improve and operate the system so that the customers are assured of service that is equal to or better than the service currently provided.

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Staff recommends that until such time as MRWC is able to demonstrate the financial capability to acquire, improve and operate the system so that service is equal to or better than the service currently provided, the Commission deny the application.

Recommendations

Staff recommends that the Commission deny Montezuma Estates Property Owners Association's Application for the Sale of Assets and Transfer of CC&N to Montezuma Rimrock Water Company, LLC.