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**Cotton, Norton, Stevens
Consulting, Inc.**

2004 JUL 21 A 8:29

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AZ CORP. COMMISSION
DOCUMENT CONTROL

June 18, 2004

W-02064A-04-0270

Arizona Corporation Commission W-04264A-04-0270

Mr. Marc Spitzer, Chairman
ARIZONA CORPORATION COMMISSION
1200 West Washington
Phoenix, AZ 85007-2966

DOCKETED

JUL 21 2004

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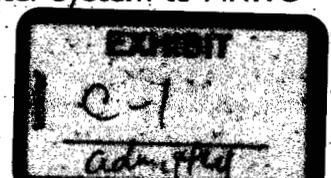
RE: Montezuma Estates Property Owners' Association (MEPOA) July 8, 2004 ACC Hearing To Sell its Assets and Transfer Its Certificate of Convenience and Necessity to Montezuma Rimrock Water Company (MRWC).

Dear Mr. Spitzer:

My partner, Bruce B. Schell and I, and our jointly owned LLC, Schelcot Enterprises, own property that is located within the service area of MEPOA, thus we are directly affected by the above proposed sale of MEPOA's water company to MRWC. That contiguous property consists of 3 commercial lots and two residential lots at the corner of Beaver Creek Highway and Thunder Ridge Road in Rimrock, AZ. We began acquiring this land, in three separate transactions with out of state owners, in November, 2001. We completed the construction of a 3200 SF triplex rental in January, 2003 on one of the commercial lots, and a 1600 SF spec house located on a residential lot will be completed before the end of the month. Our cost basis on this combined investment is in the neighborhood of \$475,000. The Rimrock area has experienced significant development and building activity over the past three years. Our property is located at the entrance to the Thunder Ridge Master Planned Community which is an area of 2500 to 4000 SF homes located on 2 to 6.5 acre sites. In general that community is the most upscale one in the Rimrock area. It is my understanding that the sites in the Thunder Ridge community (220 lots on 685 acres) are or will be served by individual water wells. The water service for our property is provided by MEPOA and the two structures we have built are connected to MEPOA's system.

In view of the extent of our investment in the MEPOA service area and the concerns discussed below I am asking that Owen L. Cotton, as a member of Schelcot Enterprises, LLC, be designated as a Formal Party to the above proceedings:

Our concerns and related background concerning the sale of MEPOA's water system to MRWC are as follows:



- The financial stability/capacity of the buyer, MRWC, and the related ability to adequately serve the water users in MEPOA's service area is OUR MAJOR CONCERN. I understand MEPOA serves approximately 110 connections and there are 400 plus (minus) lots in MEPOA's current service area. Our experience has been that service is generally reliable, but there are occasional outages and the mineral content of the water is high. On our triplex property we recently decided to install a filter system to cope with the mineral content of the water. In the MEPOA Special Membership meeting of January 9, 2004, that Mr. Schell & I attended, an operating problem with one of the two wells that would possibly require significant expenditures was discussed by the manager. The distribution system has experienced some serious leakage and could need major repairs. Also we have been informed that there is impending legislation that takes effect in 2006 on allowable arsenic levels that would require significant compliance costs. In short, whoever is approved as a purchaser of MEPOA's system must have substantial financial and technical resources to adequately deal with the challenges. With the area's development getting into high gear we need a water company that has the resources to provide an adequate level of service. If the Commission approves an undercapitalized purchaser of the system, and the new owner fails because of lack of capital and technical resources, it will be a major setback for the community.
- The "Arms Length" nature of the sale can be questioned. In the January 9th meeting it was discussed, after the question was raised, that Patricia Arias, the Statutory Agent, Manager, and apparent sole Officer and Director of MRWC is the daughter of the President of the MEPOA Board, Peter O. Sanchez and his wife Jennie Sanchez who holds the office of Treasurer of the MEPOA Board. In the latter part of December, 2003 the attached letter & ballot was sent to all MEPOA property owners concerning the sale of the Water Company assets of MEPOA. Note the family relationships between the buyer and seller were not disclosed in this letter. Many of the property owners live out of state and are not that aware of local relationships and happenings. It is possible if those out of state owners had been aware of the family relationships between the buyer and seller that they would have questioned the proposed transaction and not voted in favor of it. The letter also references a Board Resolution as being attached but in at least some cases it was not (none was in the packages Mr. Schell or I received). I requested a copy of the Board of Resolution and was told none was available at the meeting. I then asked that a copy of the resolution be sent to me and I received it about 5 days later. As I remember it was a short two or three sentence document dated during the summer of 2003 approving the sale. Unfortunately, my car was broken into a couple of weeks later and my briefcase stolen. Among other things my meeting notes and the copy of that resolution were in that briefcase.

- MEPOA's legal counsel was not present at the January 9, 2004 meeting, with the meeting being conducted by Mr. Sanchez, who indicated MEPOA did not want to spend the money on a fee for their attorney to attend the meeting. No current financial report was offered or available when requested by the membership. I suspect the mailing to property owners was fairly haphazard as there was several local customers present who had not received a meeting notice and attended as a result of being informed by a neighbor. The proposed buyer, who was then serving as the Manager of the Water Company, gave a short verbal presentation of her background and a brief "power point" presentation concerning the water company's sale volumes for the calendar years 2000, 2001, & 2002, while indicating revenue volumes for 2003 were not available. She briefly discussed the shape of the system, generally indicating the need for renewals and repairs. The primary focus of the power point presentation appeared to be that the average annual revenue for MEPOA was approximately \$45,000, thus a sales price of \$100,000 for the water company assets was fair. In response to the question as to why a \$100,000 sales price was fair the buyer indicated that an ACC staff member had told her approximately two times annual revenues was a good "rule of thumb" for a fair acquisition price. Various members of the audience then questioned the fairness of basing the selling price on past revenues in view of the significant amount of development and new homes in the service area. Per my memory, no hard copy handouts of an informative nature as to MEPOA's operations or the financial status of MRWC were available at the meeting.
- During the January 9th meeting I asked the question if any effort had been made to market the water company to one of the established water companies in the area. Mr. Sanchez indicated efforts had been made but no one was interested. I asked if there was any documentation available of those efforts and he indicated there was not. Several of the other property owners asked questions about the sales transaction and Sanchez became somewhat defensive and said " Our lawyer said we had to have this meeting and all I had to do was convene and adjourn the meeting, so I am going to adjourn it "
- In mid January I pulled the filed ACC reports for MEPOA for recent years and noted the Fixed Asset water system original cost in the 12/31/2001 report was approximately \$283,000 (see attached analysis on Exhibit I). I am not knowledgeable about purchase prices for utility companies, but have a basic understanding of how to develop an acquisition cost of a business operation. The original asset cost of \$283,000 raises some questions in my mind about the fairness of the proposed purchase price of \$100,000. It is certainly possible that functional obsolescence or deferred repairs could justify a discount from the original fixed asset cost, but the amount of the discount appears to

be possibly out on line for a system that is presently functioning. Perhaps the review of any recent appraisals of the fair market value of MEPOA's water company operations would be helpful in justifying the \$100,000 purchase price. This being said, in my opinion, the issue of the purchase price received by MEPOA is a smaller issue than the issue of having a buyer with the financial and technical strength necessary to insure future deliveries of quality water to the service area.

- It appears efforts to find an alternative buyer were not handled effectively by MEPOA's Board. During the latter part of January I contacted Lee Hetrick, Superintendent of the Sedona office of Arizona Water Company (AWC) and asked if AWC had ever been contacted about their interest in acquiring MEPOA's water system. He said they had preliminary talks about two years ago about acquiring MEPOA's system and had asked for certain information and never received it. He indicated AWC would be open to evaluating how MEPOA water operations could be combined with AWC's adjacent operations, but they would need information to evaluate MEPOA's operation in order to enter into negotiations to acquire the system. Unfortunately, I had other priorities in January, had heard the MEPOA vote was positive for the sale, and did not follow up on the possibility of AWC acquiring the system. This week, I again contacted Mr. Hetrick and he indicated they AWC was still open to evaluating if MEPOA's water company could be combined into their existing operations, and based on the results of that evaluation entering into negotiations to acquire the MEPOA's system. While I am not fully knowledgeable about AWC's financial standing I have done enough checking to know they have a good reputation in the Arizona business community. I also own property in the Munds Park development south of Flagstaff, which is serviced by Arizona Water Company. In doing the due diligence review on acquiring that property I learned that AWC did a good job of acquiring the system from a previous owner and taking the steps necessary to improve the system. The Munds Park system now has a good local reputation for service and water quality.
- In reviewing the three most recent ACC reports filed by MEPOA (see attached analysis at Exhibit I) there appears to be differences in presentation as well as some unusual account variations. Two of the more noticeable items include the significant increase in equity from a deficit of \$5K at 12/31/01 to a positive number of \$102K at 12/31/02. Also the 12/31/03 Accounts Receivable amount of \$94K seems large. Both amounts seem out of line for an operation that is represented to have annual revenues of approximately \$ 45K.
- A smaller issue is the refund of initial meter fees (\$500 to \$800 depending on installation location) payable to users over a ten-year period. From reviewing the Application For Approval of the Sale of Assets and/or transfer of Certificate of

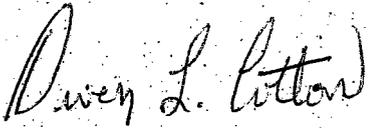
Convenience and Necessity filed with the Commission it appears that obligation will be funded by MEPOA. If that is the case it appears there is in effect a reduction of the purchase price received by MEPOA.

Besides the attached Exhibit I, the following copies of related items are enclosed:

- Public Notice of the July 8, 2004 ACC hearing.
- Notice dated 12/15/03 from MEPOA concerning the sale of the system.
- Copy of the 12/22/03 postmark on Schelcot and Owen L. Cotton Sale Notice packages.
- MEPOA's Ballot for Sale of Water Company.
- Proxy Copy.
- Notice of the 1/9/2004 Special Membership meeting of MEPOA.

I will be in New Mexico during the week of June 21st, returning to my Phoenix office on Tuesday, June 9th. During that time if any of the ACC staff need to contact me I can be reached at my cell, which is (602) 980-1644. After I return I can be contacted at my office number, which is indicated above.

Very truly yours,



Owen L. Cotton

cc: Jim Fisher – ACC Staff

MEPOA - PROPERTY AND BALANCE SHEET INFORMATION FROM ACC ANNUAL REPORTS

(2001 report obtained from ACC Web Site was poor print copy, thus difficult to read so could be minor differences between this analysis and report. Both 2001 and 2002 year end reports were made in the name of Montezuma Estates Property Owners' Association but the Balance Sheet in the year end 2001 report was entitled Montezuma Estates Water Company)

COMPARISON OF BALANCE SHEET FOR YEARS ENDED

Year Ended	12/31/03	12/31/02	12/31/01
Date ACC Report Filed	4/1/04	12/15/03	2/19/02
<u>Assets:</u>			
Cash	-	15,882	12,523
Accounts Receivable-Customers	94,492	34,687	224
Merchandise	500		
Supplies	500		
Accrued Receivables			1,814
Fixtures	25,906	25,906	
Vehicles	300		
Equipment	62,000	62,245	
Land	33,200	750	
Building	17,694		
Fixed Asset Cost - Amount required to come up with Total Assets (See below detail of Fixed Assets of \$283,295)			282,894
Accumulated Depreciation			(82,360)
Deferred Rate Case Expense			1,660
Total Assets per Report	234,592	139,470	216,757
<u>Liabilities & Equity:</u>			
Accounts Payable	88,694	7,456	2,006
Taxes Payable	6,509	10,000	340
Other Payables	33,772	20,231	1,478
Long Term Liabilities			217,681
Total Liabilities	128,975	37,687	221,506
Equity (Deficit) - Note Change 2001 to 2002	105,617	101,783	(4,749)
Total Liabilities and Equity Per Report	234,592	139,470	216,757

Property Related Detail Accounts Per December 31, 2001 Report Filed 2/19/02

<u>Fixed Asset Detail:</u>	Cost	Accumulated Depreciation	NBV
Distribution Reservoirs	25,906	(4,537)	21,369
Land & Land Rights	750		750
Meters	25,043	(1,778)	23,265
Plant Structure & Improvements	8,428	(1,262)	7,166
Pumping Equipment	31,063	(3,750)	27,313
Services	2,934	(1,448)	1,486
Transportation & Distribution Mains	177,805	(65,727)	112,078
Water Treatment Equipment	2,957	(191)	2,766
Wells & Springs	8,409	(3,648)	4,761
Totals	283,295	(82,341)	200,954
<u>Long Term Liabilities:</u>			
Advance in Aid Const.-Meter Fees			(23,592)
Advance in Aid Const.-Original Owners			(750)
Advance in Aid Const.- Prepaid Meters			(16,500)
Advance in Aid Const.-Hook up Fees			(106,800)
Accum. Amort.Const. In Aid			4,710
Utility Plant Acquisition Adj.			(83,704)
Accum. Amort. Acquisition Adj.			8,955
Totals - Long Term Liabilities			(217,681)
Report - Net Equipment after LTLiabilities - 12/31/2001?			(16,727)

1 Phoenix, Arizona 85007 or call 1-800-222-7000 or appear at the hearing and make
2 comment.

3 The Commission does not discriminate on the basis of disability in admission to
4 its public meetings. Persons with a disability may request a reasonable accommodation
5 such as a sign language interpreter, as well as request this document in an alternative
format, by contacting Yvonne McFarland, ADA Coordinator, voice phone number
602/542-3931, E-mail *YMcFarlin@cc.state.az.us*. Requests should be made as early as
possible to allow time to arrange the accommodation.

MEPOA

Lake Montezuma Estates Units 1 and 2
P.O. Box 592, Rimrock, AZ 86335

To all members of the Montezuma Estates Property Owners Association:

Enclosed please find a copy of a Board Resolution to sell the Montezuma Estates Water Company (which supplies water to your property) Notice of a public meeting to vote on the sale, a proxy form, and a ballot.

This matter has been under discussion by the board of directors for the past 5 years - with extensive research and investigation of all the options and the consequences of each. The fact is that we have outgrown the ability to effectively maintain the water system by ourselves, with volunteer manpower. State regulations have become stricter and more complex because of the increase in the demand for water over the past two years, and it is obvious that operations cannot continue as they have been.

Since our current water manager (as Montezuma Rimrock Water Company LLC) has stepped forward with an offer to purchase and run the water company, the board feels this is an opportune time to turn the system over to a professional, who also has our best interests in mind. The transition would be easy and trouble-free for us all, since operations and billing can continue without interruption.

The monies from the sale will be disbursed between all Montezuma Estates property owners.

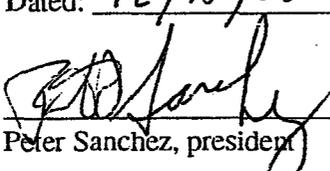
If you are a member in good standing (meaning you have paid your annual \$25 membership dues for 2003) you are entitled to vote on this proposed sale. You can cast one vote for every lot you currently own in Montezuma Estates. To vote you have 3 options:

1. You can send the enclosed ballot to MEPOA at the address above.
2. You can send in the proxy form directing the board to vote for you.
3. You can attend the meeting and cast your vote there.

The governing documents of the association limit voting rights to members who are current in the payment of their assessments (\$25 annual membership dues). If you are delinquent, you may forfeit your right to vote, or you can send in your \$25 with your vote - your voting rights will be reinstated and your vote will be counted.

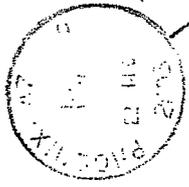
The board of directors urges you to take advantage of this opportunity to vote on the sale of the water company. The outcome of this process affects all of us, and the well-being of our community.

Dated: 12/15/03


Peter Sanchez, president

All mail-in votes must be postmarked before the date of the public meeting (see enclosed notice for date).
Both OLC to Shelcot's packages were postmarked 12/22/03

MONTEZUMA ESTATES
WATER COMPANY
PO BOX 592
RIMROCK ARIZONA 86335



*Mailed
12/22/03
From Phoenix*



405-25-094, 405-25-095
SHELCOE ENTERPRISES LLC
PO BOX 44015
PHOENIX AZ 85064-4015

*Not #1's
Not same as
what I show*

405-25-094, 405-25-095

MONTEZUMA ESTATES
WATER COMPANY
PO BOX 592
RIMROCK ARIZONA 86335



*Pls call in the mail of
Derrick + Darne
Package - No
Resolution
Included*

405-25-106
OWEN L
COTTON
3200 E CAMELBACK RD STE 389
PHOENIX AZ 85018-2328

405-25-094, 405-25-095

405-25-094, 405-25-095

MEPOA

Lake Montezuma Estates Units 1 and 2
P.O. Box 592, Rimrock, AZ 86335

Ballot for Sale of Water Company

I (We), _____, do hereby vote TO SELL the
Montezuma Estates Water Company to Montezuma Rimrock Water Company LLC for \$100,000.

dated: _____

_____ signed

Lot # _____

I (We), _____, do hereby vote NOT TO SELL
the Montezuma Estates Water Company.

dated: _____

_____ signed

Lot # _____

Please send in your vote before the meeting mentioned on the enclosed notice. If you are a member in good standing, simply send this form to the address above. If you want to reinstate your good standing by paying your \$25 membership dues now, please enclose your check (made payable to MEPOA) with this form.

**Notice of Special Membership Meeting of the
Montezuma Estates Property Owners Association**

YOU ARE HEREBY NOTIFIED that a special meeting of the members will be held on the 9th day of JANUARY, 2004 *[the meeting must be held more than ten days but not less than fifty days after mailing of the notice]* to consider the sale of the association's water company. Such meeting will convene at 7 o'clock P.M. at BEAVER CREEK SCHOOL *[location]*. A copy of the board's resolution to sell the water company is enclosed.

DATED: 12-15-03



authorized signature

LEGAL

MEMORANDUM

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2004 JUN 24 P 12:05

TO: Docket Control
FROM: Ernest G. Johnson
for Director
Utilities Division

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DOCUMENT CONTROL

JUN 24 2004

LEGAL DIV.
ARIZ CORPORATION COMMISSION

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:lhmm

Originator: Jim Fisher

AZ CORP COMMISSION
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EXHIBIT
S-1
Admitted

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

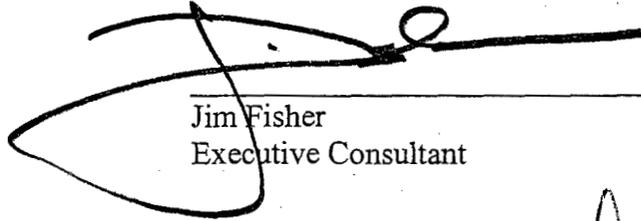
DOCKET NOS W-02064A-04-0270
AND
W-04254A-04-0270

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 μg .

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.

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.