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MEMORANDUM

Arizona Corporation Commission

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DOCKETED

TO: THE COMMISSION

APR 26 2005

FROM: Ernest G. Johnson
Director
Utilities Division

for

DOCKETED BY	<i>EW</i>
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DATE: April 26, 2005

RE: THE FILING OF NACO WATER COMPANY, LLC FOR AN EMERGENCY RATE INCREASE IN DOCKET NO. W-02860A-05-0184

RECEIVED
 2005 APR 26 P 1:04
 AZ CORPORATION COMMISSION
 DOCUMENT CONTROL

Introduction

Naco Water Company, LLC ("Naco" or "Company") serves approximately 321 customers and is located in Naco, Arizona. On March 14, 2005, Naco filed a request for an emergency rate increase.

Summary of Company's Justification for Emergency Rate Relief

Naco's application asserts that its rates are inadequate resulting in a shortage of cash flow. The Company claims its cash is insufficient to maintain operations, to make debt service payments and to attract capital for investment in infrastructure improvements necessary to meet peak demand.

The Company claims its accounts payable has grown to \$40,843 which primarily represents arrears for management and accounting fees owed to its utility management company. The Company used \$43,000 from its Water Infrastructure Finance Authority ("WIFA") reserve fund to relocate a portion of its system to accommodate a Cochise County road-widening project and to drill a replacement well when Well No. 3 went dry. WIFA requires the Company to replenish the reserve fund with a \$1,218 monthly payment. The Company needs additional capital improvements to increase water storage capacity, to reduce excess water loss, and to drill a new well. The Company estimates that it will need to borrow an additional \$600,000 to \$700,000 for the necessary improvements. The Company feels compelled to meet its WIFA debt service obligations to be eligible for additional loans to finance its capital improvement needs.

The Company's emergency rate request would provide \$44,682 of additional annual revenue, a 27.3 percent increase over current revenues of \$163,893.

Conditions Necessary for Emergency Rate Relief

General conditions necessary for interim emergency rates¹ include:

1. A sudden change that causes hardship to a company;
2. A company is insolvent, and
3. A company's ability to maintain service (pending a formal rate determination) is in serious doubt.

Staff's Analysis

The Company's application states that Cochise County required it to complete a road widening project. WIFA allowed the Company to use \$43,000 from its reserve fund to help finance the road widening project that cost approximately \$60,000. At the same time, a well went dry requiring a new well to be drilled that cost approximately \$30,000.

The Company's cash and reserves were insufficient to fund these capital improvements. In order to complete funding for these projects, the Company had to defer payment on other obligations. The Company chose to make payment on its WIFA loan obligations a priority because it anticipated a need to borrow an additional \$600,000 to \$700,000 to satisfy other capital improvement requirements. Therefore, the capital improvements were financed by deferring payment of operating expenses the bulk of which are utility management and accounting fees.

The Company's expeditious solution for funding the road widening project and the new well has contributed to its on-going cash flow deficit. WIFA is now requiring the Company to replenish its reserve fund and to contribute to a sinking fund for future repairs and maintenance.² These supplemental cash flow requirements are contributing to a growing, delinquent accounts payable balance. The Company has amassed an accounts payable exceeding \$43,000.

The Company's application shows that it is currently operating at a loss. The Company is in a perilous position. It is dependent upon its management company and other vendors continuing to provide service while the Company's debt to them grows and payments become more delinquent. Moreover, the Company is in no financial condition to incur the additional debt it deems necessary to make other capital improvements needed to reduce excess water loss and meet peak demand.

Staff's analysis, based on unaudited information provided by the Company, shows that the Company is running an annualized cash flow deficit exceeding \$25,000 as shown

¹ According to Attorney General Opinion No. 71-17, interim or emergency rates are proper when either all or any of the following conditions occur: when sudden change brings hardship to a Company; when the Company is insolvent; or when the condition of the Company is such that its ability to maintain service pending a formal rate determination is in serious doubt. Those criteria have been affirmed in *Scates v. Arizona Corporation Comm'n*, 118 Ariz. 531 (CT. App. 1978) and in *Residential Utility Consumer Office v. Arizona Corporation Comm'n*, 199 Ariz. 588 (2001) ("Rio Verde").

² The Company states that it is approximately three months delinquent in making its required WIFA repair and maintenance payment.

on Schedule 1. In other words, the Company needs a minimum revenue increase of \$25,973 to meet its continuing cash flow obligations. A nominal cushion to enhance the probability that the Company will have sufficient revenue to satisfy modest increases in costs is also provided. Staff's recommended increase does not provide for any meaningful reduction of existing accounts payable. However, it should halt growth in unpaid balances.

Conclusion

Staff concludes, based on review of the Company's unaudited application, that Naco's condition satisfies the criteria to qualify for emergency rates. Naco's ability to sustain service under existing rates until a permanent rate increase can be authorized is in serious doubt. The adequacy of the service the Company can provide is also in question. The Company's minimum immediate revenue requirement includes the ability to pay all of its on-going obligations. This minimum revenue is necessary to maintain the Company's standing with WIFA and provide necessary supplies and services. Additionally, the ability to retain the services of the utility management company is essential.

Proposed Interim Emergency Rates

The Company's present, proposed and Staff's recommended interim rates for a 5/8 x 3/4-inch meter are shown on Schedule 2. Staff recommends a \$6.50 per month surcharge for each 5/8 x 3/4-inch meter. Staff's recommended surcharge for other meter sizes is based on meter capacity flow multiples as follows: 3/4-inch, \$9.75; 1-inch, \$16.25; 1.5-inch, \$32.50; 2-inch, \$52.00; 3-inch \$97.50; 4-inch, 162.50; and 6-inch, \$325.00. Staff recommends no changes to the other existing rates.

Staff's Recommendations

Staff recommends adoption of the Staff proposed interim rates that include the surcharges presented on Schedule 2. The surcharges would provide annualized revenue of \$30,225, or \$14,457 less than the \$44,682 increase requested by the Company. Staff further recommends that the Company file a permanent rate increase application no later than March 31, 2006, based on the test year ended December 31, 2005. Staff further recommends that the interim rates be subject to refund pending the decision resulting from the permanent rate increase proceeding. Staff further recommends that the Company docket proof of a bond in the amount of \$10 prior to implementing the emergency rate increase authorized in this proceeding.

Ernest G. Johnson
Director
Utilities Division

EGJ:CSB:red
Originator: Crystal S. Brown

CASH FLOW ANALYSIS

As of 12/31/2004

Line No.		
1	Operating Revenue:	\$ 163,893
2	Operating Expenses:	
3	All Other Operating Expenses	\$ 103,198
4	Depreciation (d)	45,857
5	Property Taxes	9,762
6	Other taxes	0
7	Total Operating Expense	\$ 158,817
8	Operating Income (Line 1 - Line 7)	\$5,076
9	Add back Depreciation Expense	\$45,857
10	Total Cash Available	\$50,933
11	Less:	
12	Annual Principal and Interest Payment (\$3,973.05 x 12)	\$47,677
13	Annual Debt Service Reserve Payment (\$423.18 x 12)	\$5,077
14	Annual Reserve Fund "Catch-Up" Payment (\$1,218.08 x 12)	\$14,617
15	Subtotal	\$67,371
16	Annual Repair and Maintenance Payment (\$794.61 x 12)	\$9,535
17	Total WIFA Debt Service & Repair Cash Requirement	\$76,906
18	Cash Needed to Break Even (Line 10 - Line 17)	\$25,973
19	Cash - Undesignated	\$4,252
20	Cash Provided by Surcharges	\$30,225
21	Cash Provided by Surcharges	\$30,225
22	Divided by: 4,650 5/8" meter equivalents	4,650
23	Amount needed per 5/8" customer	\$6.50

RATE DESIGN

	Present	Company	Staff
	Rates	Proposed	Recommended
Monthly Customer Charge:			
5/8" x 3/4" Meter	\$16.43	\$24.00	16.43
3/4" Meter	16.43	24.00	16.43
1" Meter	31.48	35.00	31.48
1½" Meter	41.43	45.00	41.43
2" Meter	48.43	54.00	48.43
3" Meter	160.00	330.00	160.00
4" Meter	260.00	425.00	260.00
6" Meter	510.00	725.00	510.00

Monthly Customer Surcharge:			
5/8" x 3/4" Meter	N/A	N/A	\$6.50
3/4" Meter	N/A	N/A	\$9.75
1" Meter	N/A	N/A	\$16.25
1½" Meter	N/A	N/A	\$32.50
2" Meter	N/A	N/A	\$52.00
3" Meter	N/A	N/A	\$97.50
4" Meter	N/A	N/A	\$162.50
6" Meter	N/A	N/A	\$325.00

Gallons Included In Monthly Customer Charge:	0	0	0
Per 1,000 Gallons for 0 to 10,000 Gallons	\$2.83	\$3.50	\$2.83
Per 1,000 Gallons for Gallons in Excess of 10,000	\$4.18	\$4.80	\$4.18
Bulk Water Rate, per 1,000 gallons	\$2.83	\$3.50	\$2.83
Flat Rate/Standpipe, per 1,000 gallons	\$4.18	\$4.80	\$4.18

	Present	Company	Staff
	Rates	Proposed	Recommended
Service Line and Meter Installation Charges			
5/8" x 3/4" Meter	\$400.00	\$500.00	\$400.00
3/4" Meter	400.00	575.00	400.00
1" Meter	500.00	660.00	500.00
1 1/2" Meter	715.00	900.00	715.00
2" Meter	1,305.00	1,525.00	1,305.00
3" Meter	1,815.00	2,220.00	1,815.00
4" Meter	2,860.00	3,360.00	2,860.00
6" Meter	5,275.00	6,035.00	5,275.00

Service Charges			
Establishment	\$25.00	\$55.00	\$25.00
Establishment (After Hours)	30.00	65.00	30.00
Reconnection (Delinquent)	30.00	55.00	30.00
Reconnection (After Hours)	N/A	65.00	N/A
Meter Test (If Correct)	10.00	50.00	10.00
Back Flow Prevention	N/A	Cost	N/A
Deposit	*	45.00	*
Deposit Interest	*	*	*
Re-Establishment (Within 12 Months)	**	**	**
NSF Check	15.00	25.00	15.00
Deferred Payment	1.50%	1.50%	1.50%
Meter Re-Read (If Correct)	10.00	15.00	10.00
Late Fee	0.00	5.00	0.00

Monthly Service Charge for Fire Sprinkler			
4" or Smaller	***	***	***
6"	***	***	***
8"	***	***	***
10"	***	***	***
Larger than 10"	***	***	***

* Per Commission Rules (R14-2-403.B)
 ** Months off system times the minimum (R14-2-403.D)
 *** 1.00% of Monthly Minimum for a Comparable Sized Meter Connection, but no less than \$5.00 per month. The Service Charge for Fire Sprinklers is only applicable for service lines separate and distinct from the primary water service line.