

ORIGINAL



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MEMORANDUM

TO: THE COMMISSION 2006 FEB -7 A 10: 14

FROM: Ernest G. Johnson AZ CORP COMMISSION
Director DOCUMENT CONTROL
Utilities Division

DATE: February 7, 2006

RE: IN THE MATTER OF THE APPLICATION FOR EMERGENCY INTERIM
RATE RELIEF FOR:

- Miracle Valley Water Company, Inc., Docket No. W-01646A-06-0010
- Cochise Water Company, Docket No. W-01868A-06-0010
- Horseshoe Ranch Water Company, Docket No. W-02235A-06-0010
- Crystal Water Company, Docket No. W-02316A-06-0010
- Mustang Water Company, Docket No. W-02230A-06-0010
- Coronado Estates Water Company, Docket No. W-01629A-06-0010
- Sierra Sunset Water Company, Docket No. W-02240A-06-0010

Each owned by Johnny A. McClain

Introduction

On January 6, 2006, the Arizona Small Utilities Association of Arizona ("ASUA") submitted an application for emergency interim rate relief for the captioned companies and collectively referred to as the McClain Systems ("McClain Systems" or "Systems"). The Systems serve approximately 1,300 customers.

Summary of the ASUA Justification for Emergency Rate Relief

The McClain Systems are plagued with serious financial and operational problems that jeopardize the Systems' ability to provide ongoing adequate and reliable water service to its customers. The McClain Systems are currently undergoing bankruptcy proceedings. The Systems are being operated by ASUA as the interim manager. Several of the Systems have experienced water outages, sometimes lasting several days. The Systems have also experienced severe cash flow problems, more adequately described below. From the beginning of its tenure as interim manager, ASUA has infused its own money to operate the Systems. The Systems' rates are not sufficient to properly operate the utilities or fix the problems.

ASUA believes that these circumstances create an emergency situation that places customers at risk and must be addressed and corrected as soon as possible. An interim rate increase is in the public interest and necessary to resolve the Systems' problems.

Background

There are seven water systems owned and/or operated by Johnny A. McClain. Each of the systems and its current customer count is summarized in Attachment A. The Systems have been the subject of much scrutiny by various regulatory authorities such as the Arizona Department of Revenue ("ADOR"), the Arizona Department of Environmental Quality ("ADEQ") and the Arizona Corporation Commission ("Commission"). Mr. McClain has failed to comply with numerous notices of violations issued by ADEQ, and has not paid property taxes or sales taxes for a number of years.

The McClain Systems are currently in bankruptcy proceedings. A purchase and sale agreement is in escrow pending an evaluation and establishment of a rate base valuation by the Commission. Commission Staff has completed an evaluation of the system assets in Docket No. W-01646A-05-0506 et al. A Recommended Opinion and Order was issued on December 14, 2005. Commission Decision No. 68412, dated January 23, 2006, set the rate base of the McClain Systems at \$696,752.

General Condition of the Water Systems

The McClain Systems are in serious disrepair. For the last 20 years little has been done to adequately maintain the Systems. Staff has described the physical inadequacies of the Systems in its report in Docket No. W-01646A-05-0506. The Commission established hook-up moratoriums for the McClain Systems in Decision No. 68272. It also describes the system improvements and capital investment needed to upgrade the Systems (capital expenditures between \$750,000 and \$1,250,000).

However, there is a short term financial need in order to permit timely repairs and improve water service to existing customers.

Financial Status

The McClain Systems have experienced negative cash flow at least since ASUA was appointed as interim manager in July, 2004. For the nine-month period ending September 30, 2005, there has been a negative cash flow of approximately \$30,000 and estimates are that for the year 2005 the total will approximate \$40,000. Meanwhile, the Systems' Accounts Payable is nearing \$100,000. See Attachment B for a summary of the cash loss and Accounts Payable situation. This negative financial situation must be addressed as quickly as possible, as several vendors will no longer offer materials or services to ASUA, thus hampering its ability to make needed repairs.

The McClain Systems have received a Water Infrastructure Financing Authority loan for \$12,500 and a Pinal County loan of \$10,000 to assist in making emergency repairs. ASUA has forgone receipt of its interim management fees for several months and wishes to maintain the McClain Systems as financially viable as possible.

When ASUA became interim manager in July, 2004, its focus was primarily on repairing leaks and restoring service to customers. As such, the financial results of the operations through December 31, 2004 were atypical. Bill payment and expense recognition were primarily based upon available cash flow. For purposes of determining the current cash flow requirement, the expenses for the first nine months of 2005 are more consistent. Therefore, ASUA has prorated the first nine months of 2005 to estimate its annual cash flow needs. See Attachment B.

Clearly, the existing rates of each of the systems are inadequate to support either short-term or long-term financial viability.

Emergency Status

The Commission may order interim rate relief when there is an existing emergency. Staff believes that given the following facts, the need for emergency interim rate relief is appropriate and in the public interest:

1. The McClain Systems are currently in bankruptcy proceedings.
2. The McClain Systems are in a state of disrepair and significant amounts of capital are needed to upgrade the system.
3. The Systems are experiencing inadequate cash flow to sustain their operations.
4. The ability to maintain service to customers is in doubt and preparation and adjudication of a formal rate proceeding will not provide timely relief.

Emergency interim rates are a just and reasonable first step to remedy the McClain Systems' problems.

Surcharge Request

The McClain Systems will need to increase cash flow by approximately \$11,700 per month to sustain operations, make necessary System repairs, maintain adequate water supplies and make progress in eliminating the high level of Accounts Payable. A monthly per meter surcharge of \$9.00 would be adequate in the short-run. See Attachment C for the method used to determine the monthly surcharge.

Use of System Improvement Surcharge Proceeds

The System Improvement Surcharge ("SIS") amounts collected by ASUA shall be segregated in a separate bank account. Withdrawals shall be used to correct water outages as

they occur, pay debts to local vendors and make system improvements as prioritized in the "Proposed Capitol Improvements" in Attachment D. ASUA will file monthly reports to Docket Control detailing how such SIS funds were spent on each of the seven systems.

Conclusion

The McClain Systems current condition constitutes an emergency. Correction of the systems' problems will require significant capital expenditures over several years. The current McClain Systems' water rates are inadequate to meet even short-term cash flow needs.

The emergency interim SIS proposed by ASUA is reasonable and will allow it, as interim manager, to pay debts to local vendors, to make needed short-term system repairs and possibly make selected improvements. It is clearly in the best interests of the McClain Systems' customers to authorize this interim increase.

Recommendations

Therefore, Staff recommends that the Commission issue an order:

1. finding that the McClain Systems' problems constitute an emergency.
2. that concludes it is in the public interest to authorize the requested interim SIS of \$9.00 per meter.
3. allowing the ASUA to charge the interim surcharge requested herein pending a determination of a permanent rate case proceeding.
4. granting any additional and further relief as the Commission deems appropriate.
5. requiring ASUA to maintain the books and records of the McClain Systems in accordance with the National Association or Regulatory Utility Commissioner's Uniform System of Accounts.
6. requiring ASUA to maintain a separate bank account in which it will deposit and withdraw all funds received pursuant to its System Improvement Surcharge.
7. requiring ASUA to file monthly reports with Docket Control, in the docket (W-01642A-06-0010), as a compliance item in this matter, detailing how such System Improvement Surcharge funds were spent and on which of the seven Systems the money was spent.
8. requiring that, to the best of its ability, ASUA should apply the System Improvement Surcharge funds, on a pro rata basis to each of the systems to correct water outages as

they occur, pay debts to local vendors and make system improvements as prioritized in the "Proposed Capitol Improvements" in Attachment D.

9. requiring the ASUA to post a form of security in the amount of \$10 to the Utilities Division.¹
10. requiring the filing of a general rate case no later than March 15, 2007, using a 2006 test year.



Ernest G. Johnson
Director
Utilities Division

EGI:REL:red

Originated: Ronald E. Ludders

¹ See Naco Water Company, L.L.C., Decision 67984, dated July 18, 2005.

Service List for: McClain Systems
Docket Nos. W-01646A-06-0010 et al

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Mr. Christopher Pattock
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Mr. Christopher C. Kempley
Chief Counsel, Legal Division
1200 West Washington Street
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Mr. Ernest G. Johnson
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Ms. Lyn Farmer
Chief Administrative Law Judge, Hearing Division
1200 West Washington Street
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McClain Systems
Docket No. W-01646A-05-0010 et al
Customer Summary
As of November,30, 2005

ATTACHMENT A

<u>SYSTEM</u>	<u>Number of Customers</u>	<u>%</u>
Miracle Valley Water Company, Inc.	299	23.0%
Cochise Water Company	413	31.7%
Horseshoe Ranch Water Company	220	16.9%
Crystal Water Company	63	4.8%
Mustang Water Company	71	5.5%
Coronado Estates Water Company	209	16.1%
Sierra Sunset Water Company	26	2.0%
Total	<u>1,301</u>	<u>100.0%</u>

PRO FORMA INCOME STATEMENT

	9 Months Ended 9/30/2005	Pro Forma 12 Months Ended 12/31/2005	
Revenues	<u>\$312,767</u>	<u>\$417,022</u>	
Expenses			
Salaries & Contract Labor	\$ 90,989	\$ 121,319	For Certified Operator (\$38,000 annually) and 3 laborers.
Repairs & Maintenance	62,437	83,250	Primarily for new pumps and leak repairs.
Interim Manager Fees	51,067	68,089	At \$6.60 per meter per month.
Utilities	48,622	64,829	Primarily Sulpher Springs Coop electricity.
Supplies	26,382	35,175	Significant amount of bottled water & other supplies.
Insurance	14,742	19,656	Hazard and Work Comp Insurance.
Outside Services	9,268	12,358	Primarily CPA and Arizona Blue Stake.
Office Expense	7,671	10,227	Bank charges, printing and postage.
Payroll Taxes	15,245	20,327	Fica, unemployment, etc.
Rent	2,800	3,733	
Miscellaneous	13,120	17,493	ADEQ fees, miscellaneous.
Total Expenses	<u>\$ 342,343</u>	<u>\$ 456,457</u>	
Cash Basis Operating Loss	<u>(\$29,576)</u>	<u>(\$39,435)</u>	
Current Accounts Payable Balance:			
Arizona Small Utilities Association- interim mgmt fees		\$31,447	
Arizona Department of Revenue - sales taxes		22,341	
Water Supply Wholesaler - water related repair supplies		9,455	
Back-hoe Repair		7,819	
Electrical Contractor - repairs		6,949	
All other Vendors		18,406	
		<u>\$96,417</u>	

	<u>Annual Amount</u>	<u>Monthly Amount</u>
Current Estimated Annual Operating Cash Shortfall	\$40,000	\$3,333
Amortization of Current Accounts Payable over 24 Months	\$100,000	4,167
Additional Allowance for System Improvements for 12 months	\$50,000	4,167
		<u>\$11,667</u>
Current Number of Metered Customers		<u>1,300</u>
Average cost per meter (1 / 2)		<u>\$8.97</u>
Proposed System Improvement Surcharge at \$9 per meter per month		<u>\$11,709</u>

**Cochise Water Company
Proposed Capital Improvements**

Project Description	Cost
Naranja Well Site	
Add meters to wells	\$10,000
Construct a minimum 6 ft. high chain link fence with barbed wire 800 L.F.	\$12,000
Construct 12 ft wide chain link gate	\$800
Repair 5 hp booster pump	\$500
Rebuild Electrical Control and wiring system	\$10,000
Replace Air Compressor and controls on Pressure Tank	\$1,000
Replace Guages on Booster and Transfer Pumps	\$1,000
Replace check valves on booster and transfer pumps	\$500
Build concrete pads to mount booster and transfer pumps	\$1,000
Install well pump high level shut off level contoller to storage tank	\$5,000
Install low level sensor in storage tank for booster & transfer pump shut off	\$5,000
Install telemetry system to start and stop transfer pumps filling Horseshoe storage	\$10,000
Add sampling taps to wells	\$500
Survey property to establish property boundaries of well site	\$1,000
Remove old storage tank and trash and grade well site	\$5,000
Total	\$63,300
Jaxell Road Well site	
Add Meter to well	\$3,500
Add additional booster pump	\$3,500
Survey property to establish property boundaries of well site	\$1,000
Total	\$8,000
Long Term Improvements	
Add additional Storage at Naranja	
Develop more well capacity at Naranja or elsewhere	
Add chlorination to both sites	
Build equipment storage facility at Naranja and remove building at Horseshoe Ranch.	
Replace Distribution system	
Reconnect customers that are being served directly off transmission line	

**Horseshoe Ranch Water Company
Proposed Capital Improvements**

Main Storage and Pressure Tank Site

Project Description	Cost
Replace 3 inch meter measuring transfer flow from Cochise	\$3,000
Replace fence with a minimum 6 ft. high chain link fence with barbed wire 200 L.F.	\$3,000
Construct 12 ft wide chain link gate	\$800
Replace 2 - 7.5 hp booster pumps	\$5,000
Rebuild Electrical Control and wiring system	\$10,000
Replace 3,000 gallon pressure tank	\$13,000
Design and construct interconnection with Bella Vista south system	\$10,000
Repair doors on storage building	\$1,000
Add air relief valve to transmission line from Cochise and grade and secure site	\$6,000
Survey property to establish property boundaries of storage & well sites	\$1,000
Total	\$52,800

Long Term Improvements

Redesign entire main storage and booster site. Add storage capacity
 Determine if 38,000 gallon storage tank at secondary site is necessary. Either rebuild it or remove and sell land
 Add chlorination to both sites
 Build equipment storage facility at Naranja and remove building at Horseshoe Ranch.
 Abandon Sanks well and dispose of land
 Replace Distribution system

**Miracle Valley Water Company
Proposed Capital Improvements**

Main Well Site	
Project Description	Cost
Add meter to well	\$3,500
Construct a minimum 6 ft. high chain link fence with barbed wire 400 L.F.	\$6,000
Construct 12 ft wide chain link gate	\$800
Add two 7.5 hp booster pumps	\$5,000
Rebuild Electrical Control and wiring system	\$10,000
Add storage tank Minimum 150,000 gallons	\$150,000
Replace 5,000 gallon pressure tank	\$20,000
Add sampling tap to well	\$500
Survey property to establish property boundaries of two well sites	\$2,000
Total	\$197,800
<p>Note: If it is determined that the existing well site has no room for storage, construct storage and pressure tank at site two and pipe well to that site. Then develop second well</p>	
Long Term Improvements	
Add chlorination	
Add additional storage and well capacity	
Replace Distribution system	

**Mustang Water Company
Proposed Capital Improvements**

Main Well Site

Project Description	Cost
Add meter to well	\$3,500
Construct a minimum 6 ft. high chain link fence with barbed wire 400 L.F.	\$6,000
Construct 12 ft wide chain link gate	\$800
Replace existing well with new well	\$25,000
Replace well pump & piping	\$7,500
New Electrical Control and wiring system	\$10,000
New 5,000 Gallon Pressure Tank	\$20,000
New 60,000 gallon storage tank (At least this size)	\$80,000
Survey property to establish property boundaries of at least two well sites	\$2,000
Total	\$154,800

Note: As an alternative, determine if existing well can be rehabilitated
If so, rehab well, and replace well pump instead of drilling new well

Long Term Improvements

- Develop more well capacity
- Interconnect to Crystal Water and make one system
- Add chlorination
- Replace Distribution system

**Crystal Water Company
Proposed Capital Improvements**

Main Well Site

Project Description

Cost

Add meter to well	\$3,500
Construct a minimum 6 ft. high chain link fence with barbed wire 400 L.F.	\$6,000
Construct 12 ft wide chain link gate	\$800
Replace existing well with new well	\$25,000
Replace well pump & piping	\$7,500
New Electrical Control and wiring system	\$10,000
New 5,000 Gallon Pressure Tank	\$20,000
New 60,000 gallon storage tank (At least this size)	\$80,000
Survey property to establish property boundaries of well site	\$1,000
Total	\$153,800

Note: As an alternative, determine if existing well can be rehabilitated
If so, rehab well, and replace well pump instead of drilling new well

Long Term Improvements

- Develop more well capacity
- Interconnect to Mustang Water and make one system
- Add chlorination
- Replace Distribution system

**Sierra Sunset Water Company
Proposed Capital Improvements**

Main Well Site

Project Description

Cost

Construct a minimum 6 ft. high chain link fence with barbed wire 400 L.F.	\$6,000
Construct 12 ft wide chain link gate	\$800
Survey property to establish property boundaries of well site	\$1,000
Install customer meters to 30 customers	\$15,000
Total	\$22,800

Long Term Improvements

- Develop more well capacity
- Interconnect to Coronado Estates to make one system
- Add chlorination
- Investigate connection to mobile home park
- Replace Distribution system
- Add Storage

**Coronado Estates Water Company
Proposed Capital Improvements**

Main Well Site	
Project Description	Cost
Add meter to well	\$3,500
Construct a minimum 6 ft. high chain link fence with barbed wire 400 L.F.	\$6,000
Construct 12 ft wide chain link gate	\$800
Replace well pump & piping	\$7,500
New Electrical Control and wiring system	\$10,000
New 5,000 Gallon Pressure Tank	\$20,000
New 100,000 gallon storage tank	\$100,000
Survey property to establish property boundaries of well site	\$1,000
Total	\$148,800
 Long Term Improvements	
Develop more well capacity	
Interconnect to Sierra Sunset Water and make one system if possible	
Add chlorination	
Add more storage	
Replace Distribution system	

**McLain System General Expenditures
Necessary for all systems**

Project Description

Survey all land parcels obtained in bankruptcy sale - determine usefulness
Identify areas being served outside of CC&N's and include areas in ACC filings
Determine if there are customers that are not metered or not on the books.
Map distribution systems

Summary of Costs for McLain Capital Improvements

Cochise Water Company	\$71,300
Horseshoe Ranch Water Company	\$52,800
Miracle Valley Water Company	\$197,800
Mustang Water Company	\$154,800
Crystal Water Company	\$153,800
Sierra Sunset Water Company	\$22,800
Coronado Estates Water Company	\$148,800
Total	\$802,100