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BEFORE THE ARIZONA CORPORATION C

COMMISSIONERS
JEFF HATCH-MILLER - Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

IN THE MATTER OF THE APPLICATION OF
LAS QUINTAS SERENAS WATER CO. AN
INCREASE IN ITS WATER RATES.

DOCKET NO. W-01583A-04-0178

IN THE MATTER OF THE APPLICATION OF
LAS QUINTAS SERENAS WATER CO. FOR
AUTHORITY TO INCUR LONG-TERM
INDEBTEDNESS TO FINANCE WATER
SYSTEM IMPROVEMENTS AND ASSURE
COMPLIANCE WITH NEW ARSENIC
RULES.

DOCKET NO. W-01583A-05-0326

IN THE MATTER OF THE APPLICATION OF
LAS QUINTAS SERENAS WATER
COMPANY FOR AN OPINION AND ORDER
TO (I) RE-OPEN THE RECORD IN THE
RECENT RATE CASE SO AS TO CONSIDER
EVIDENCE IN SUPPORT OF AN ARSENIC
COST RECOVERY MECHANISM, AND (II)
MODIFY RATE CASE DECISION IN ORDER
TO ADD AN ARSENCI COST RECOVERY
MECHANISM AS AN AUTHORIZED RATE
SURCHARGE.

DOCKET NO. W-01583A-05-0340

NOTICE OF FILING STAFF'S
EXECUTIVE SUMMARIES

Arizona Corporation Commission Staff ("Staff") hereby submits the Executive Summaries
of Dorothy Hains and Daniel Zivan in this matter.

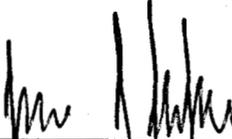
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AZ CORP COMMISSION
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1 RESPECTFULLY SUBMITTED this 27th day of February, 2006.

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10 AN ORIGINAL and seventeen (17)
11 copies were filed this 27th day
12 of February, 2006 with:

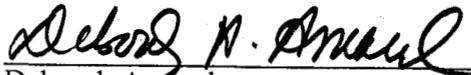
13 Docket Control
14 Arizona Corporation Commission
15 1200 West Washington Street
16 Phoenix, Arizona 85007

17 COPIES of the foregoing document
18 was filed this 27th day of February, 2006 to:

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Deborah Amfaral

February 27, 2006

EXECUTIVE SUMMARY
LAS QUINTAS SERENAS WATER CO.
DOCKET NOS. W-01583A-04-0178,
W-01583A-05-0326 AND W-01583A-05-0340

Las Quintas Serenas Water Co. ("LQS" or "Applicant" or "Company"), an Arizona "C" Corporation located in Sahuarita, Arizona, provides potable water services to approximately 826 customers and standpipe water services to approximately 146 additional customers. LQS's current rates were approved in Decision No. 67455, dated January 6, 2005.

LQS originally filed a financing application with the Arizona Corporation Commission ("Commission"), Docket No. W-01583A-05-0326, on March 7, 2005 requesting authorization to incur \$1,789,375 of long-term debt from either Commerce Bank of Arizona ("Commerce") or the Water Infrastructure Financing Authority ("WIFA") to finance the implementation of plant improvements that would reduce arsenic levels to comply with federal arsenic standards requiring that arsenic levels be reduced to 10 particles per billion ("ppb") by January 23, 2006 and plant improvements that are not arsenic-related. Then LQS filed a second application (Docket No. W-01583A-05-0339) requesting to re-open its previous rate case to consider its \$1,789,375 financing and recovery of arsenic related operation and maintenance expenses. Then LQS filed a third application (Docket No. W-01583A-05-0340) that reduced the financing request to only arsenic treatment facilities, which LQS asserted to be \$1,648,750. Docket No. W-01583A-05-0339 was administratively closed and Docket Nos. W-01583A-05-0326 and W-01583A-05-0340 were consolidated.

LQS proposes to borrow \$1,648,750 from Commerce and then refinance with a loan from WIFA. LQS has submitted as part of its application an approval letter from Commerce stating that it has been approved for a 10-year amortizing loan in the amount of \$1,650,000 with a fixed interest rate of 8.00 percent per annum. Closing costs for the Commerce loan are approximately \$12,675. In contrast, the WIFA loan is 20-year amortizing with an estimated interest rate of 7.40 percent per annum and has no closing costs.

Staff has determined that the appropriate cost to construct LQS's proposed plant improvements is \$1,324,688. Staff concludes that authorization of a loan for \$1,324,688 is appropriate to finance the arsenic treatment plant. Issuance of a 20-year \$1,324,688 amortizing loan at 7.40 percent with the operating income authorized in Decision No. 67455 would result in a 0.19 times interest earned ratio ("TIER") and a 0.52 debt service coverage ratio ("DSC"). A DSC of 0.52 demonstrates that LQS would not be able to meet debt obligations on such a loan with its existing rates. LQS would have even less ability to service debt on a 10-year amortizing loan. Accordingly, Staff concludes that approval of the Commerce loan is inappropriate. In order to provide LQS a pathway for servicing a 20-year loan, Staff recommends an arsenic removal surcharge mechanism ("ARSM").

An ARSM does not authorize the collection of surcharge revenue; however, it provides a method for determining the surcharge amount necessary to pay debt service obligations and additional income taxes that would result from the surcharge revenue. An ARSM requires LQS

financing. Staff calculated an estimated monthly surcharge of \$12.85 for a 5/8x3/4-inch meter customer based on debt financing in the amount of \$1,324,688.

LQS's existing capital structure is composed of 100 percent equity. A \$1,324,688 20-year amortizing loan at 7.40 percent would result in a capital structure composed of 1.7 percent short-term debt, 75.9 percent long-term debt and 22.3 percent equity. The resulting highly leveraged capital structure could restrict LQS's ability to obtain additional debt financing, may result in less favorable terms for future financing and places upward pressure on rates.

Staff concludes that authorization for the Company to issue long-term debt to WIFA in an amount not to exceed \$1,324,688 for the purposes stated in the application would be lawful and within LQS's corporate powers, compatible with the public interest, consistent with sound financial practice and would not impair its ability to provide services **if an ARSM is adopted.**

Staff recommends authorization for the Company to issue long-term debt to WIFA in an amount not to exceed \$1,324,688 only if Staff's recommended ARSM is approved.

Staff recommends denial of the Company's request to borrow any funds from Commerce.

Staff further recommends granting no provision for operation and maintenance expense ("O&M") in this proceeding because the amount is not known and measurable, any unrecovery of O&M is offset by anticipated surcharge profits and is consistent with the Commission's normal practice.

February 27, 2006

EXECUTIVE SUMMARY
LAS QUINTAS SERENAS WATER COMPANY
DOCKET NOS. W-01583A-04-0178, W-01583A-05-0326
AND W-01583A-05-0340

CONCLUSIONS

1. The Las Quintas Serenas Water Company is delivering water that will not meet the new arsenic standard of 10 micro grams per liter and therefore needs to install treatment equipment to meet the new standard.
2. Staff has reviewed the Company's proposed treatment project and concludes that the 400,000 gallon storage tank, on-site generator and three hypochlorite chlorination units are not required for arsenic treatment and recommends their associated costs be removed from the total project cost.
3. Based upon Staff's Engineering evaluation of the Las Quintas Serenas proposal, Staff concludes that the Arsenic Treatment Project is appropriate and that for purposes of an Arsenic Remedial Surcharge Mechanism ("ARSM") the cost of arsenic treatment should be \$1,324,688. Staff makes no determination of the capital improvements as "used and useful" at this time, but defers this determination until the Company files its next rate application.