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



ARIZONA CORPORATION COMMISSION

DATE: March 28, 2006

DOCKET NOS.: W-01646A-06-0010, W-01868A-06-0010, W-02235A-06-0010,
W-02316A-06-0010, W-02230A-06-0010, W-01629A-06-0010,
W-02240A-06-0010

TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Jane Rodda. The recommendation has been filed in the form of an Opinion and Order on:

MIRACLE VALLEY WATER COMPANY, INC., COCHISE WATER CO.,
HORSESHOE RANCH WATER COMPANY, CRYSTAL WATER COMPANY, MUSTANG
WATER COMPANY, CORONADO ESTATES WATER COMPANY, SIERRA SUNSET WATER
COMPANY

(EMERGENCY RATES)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by **4:00 p.m.** on or before:

APRIL 6, 2006

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Open Meeting to be held on:

MAY 2 AND 3, 2006

For more information, you may contact Docket Control at (602)542-3477 or the Hearing Division at (602)542-4250. For more information about the Open Meeting, contact the Executive Director's Office at (602) 542-3931.

BRIAN C. McNEIL
EXECUTIVE DIRECTOR

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ARIZONA CORPORATION COMMISSION
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1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 COMMISSIONERS

3 JEFF HATCH-MILLER, Chairman
4 WILLIAM A. MUNDELL
5 MARC SPITZER
6 MIKE GLEASON
7 KRISTIN K. MAYES

8 IN THE MATTER OF THE APPLICATION FOR
9 EMERGENCY INTERIM RATE RELIEF FOR
10 MIRACLE VALLEY WATER COMPANY, INC.,
11 COCHISE WATER COMPANY, HORSESHOE
12 RANCH WATER COMPANY, CRYSTAL WATER
13 COMPANY, MUSTANG WATER COMPANY,
14 SIERRA SUNSET WATER COMPANY AND
15 CORONADO ESTATES WATER COMPANY,
16 OWNED BY JOHNNY A. MCLAIN.

DOCKET NO. W-01646A-06-0010
W-01868A-06-0010
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W-02240A-06-0010

DECISION NO. _____

11 OPINION AND ORDER

12 DATE OF PUBLIC COMMENT: February 21, 2006
13 PLACE OF PUBLIC COMMENT: Sierra Vista, Arizona
14 DATE OF HEARING: February 28, 2006
15 PLACE OF HEARING: Tucson, Arizona
16 ADMINISTRATIVE LAW JUDGE: Jane L. Rodda
17 IN ATTENDANCE: Kristin K. Mayes, Commissioner
18 APPEARANCES: Timothy Edwards, Executive Director, Arizona
19 Small Utilities Association, Interim Manager for
20 the McLain Systems;
21 Stephen A. Cockrum, In propria persona,
22 Intervenor; and
23 Jason Gellman, Staff Attorney Legal Division,
on behalf of the Utilities Division of the Arizona
Corporation Commission.

24 **BY THE COMMISSION:**

25 * * * * *

26 Having considered the entire record herein and being fully advised in the premises, the
27 Arizona Corporation Commission ("Commission") finds, concludes, and orders that:
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1 9. On October 23, 2003, Johnny and Linda McLain, the Respondents in the OSC action,
2 filed with the Commission a Notice of Bankruptcy, indicating that on July 30, 2003, McLain had
3 filed for relief under Title 11 of the United States Code, initiating a Chapter 13 proceeding.

4 10. Among others things, Decision No. 66241 authorized Staff to appoint an Interim
5 Manager for the McLain water systems. On May 17, 2004, the Bankruptcy Court granted limited
6 relief from the automatic stay, and found that the Commission had authority to appoint an interim
7 manager to ensure the safe and reasonable operation and management of the McLain Water Systems.
8 ASUA began operating the McLain Systems as interim manger in July 2004.

9 11. The Bankruptcy Court in *In re Johnny A. McLain, et al.*, Case No. 4-03-bk-04125-
10 TUC-EWH, approved an Asset Purchase Agreement that sets the value of the McLain Water Systems
11 at \$1,000,000, but provided that the price is subject to adjustment depending on the rate base value
12 established by the Commission. In Decision No. 68412 (January 23, 2006) the Commission
13 approved a reconstruction cost new value for the McLain Systems of \$696,752.

14 12. The McLain Systems are in serious disrepair. All of the systems have suffered from
15 numerous, and often lengthy outages. As reported in the recent rate base docket W-01646A-05-0506,
16 most of the wells were drilled originally as domestic wells which have small diameter casings and
17 were drilled to limited depths. The only systems with storage tanks and booster pumps are the
18 Cochise and Horseshoe Ranch systems; the other five systems rely on the well pump to pressurize the
19 system, which is very inefficient and causes the well pump to cycle on and off too often leading to
20 premature pump failure. Many of the pressure tanks are leaking at the welds and/or have patches
21 welded to them, which is a serious safety hazard. Many of the well sites are not fenced and none of
22 the wells are metered. A majority of the pipe installed is Poly Vinyl Chloride ("PVC") irrigation pipe
23 which is not appropriate for potable water systems. Some of the very old pipe is asbestos cement
24 pipe which is no longer manufactured or allowed for use. Much of the location of the piping is
25 unknown as no plans were drawn, and it appears that much of the distribution piping strays outside
26 the official CC&N boundaries. The Sierra Sunset system has no record of a CC&N and has no
27 customer meters. None of the McLain Water Systems are chlorinated, which is serious because the
28 poor condition of the systems makes them prone to microbial contamination. See Decision No.

1 68412 (January 23, 2006).

2 13. Because of their serious inadequacies, the Commission established a hook-up
3 moratorium for the McLain Systems in Decision No. 68272 (November 8, 2005). That order
4 indicates that the needed capital improvements to bring the Systems into compliance, and providing
5 safe and reliable water, total between \$750,000 and \$1,250,000.

6 14. The McLain Systems have experienced negative cash flow since at least the time
7 ASUA was appointed interim manger. For the nine-month period ending September 30, 2005, there
8 was a negative cash flow of approximately \$30,000. Estimates for the year ended 2005 indicate the
9 negative cash flow will be \$40,000. The accounts payable for the McLain Systems totaled
10 approximately \$96,000 as of year end 2005.¹ Several vendors will no longer offer materials or
11 services to ASUA because there has not been sufficient cash flow to pay them for past services. The
12 inability to contract with local vendors has hampered ASUA's ability to make needed repairs in a
13 timely and cost efficient manner. ASUA has forgone receipt of its interim management fees for
14 several months.

15 15. Based on an estimated annual operating cash flow deficiency of almost \$40,000, a
16 need to pay down an accounts payable of nearly \$100,000 as of year end 2005, and a need for
17 \$50,000 for repairs in the next twelve months, AUSA estimated a need to increase cash flow by
18 \$11,700 per month. ASUA requested a surcharge of \$9.00 per meter, calculated as follows:

	<u>Annual</u>	<u>Monthly</u>
20 Current Estimated Annual Operating Cash Shortfall	\$40,000	\$ 3,333
21 Amortization of Accounts Payable over 24 months	\$100,000	\$ 4,167
22 System Improvements for 12 months	\$ 50,000	<u>\$ 4,167</u>
		<u>\$ 11,667</u>
24 Current number of metered customers		<u>1,300</u>
25 Average cost per meter		<u>\$8.97</u>
26 Proposed Surcharge at \$9 per meter		\$11,709

28 ¹ By the time of the hearing, the accounts payable had increased to approximately \$139,000.

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16. Each of the McLain Systems has a separate rate structure:

<u>Company</u>	<u>Monthly Charge</u>	<u>Gallons included in minimum</u>	<u>Commodity charge per 1,000 gal.</u>
Cochise	\$20.00	2,000	\$3.00
Horseshoe	\$17.00	1,000	\$3.00
Miracle Valley	\$10.00	2,000	\$1.00
Crystal	\$12.00	2,000	\$2.25
Mustang	\$15.00	1,000	\$2.50
Coronado	\$12.00	2,000	\$2.25
Sierra Sunset	\$25.00 ²		

17. The McLain Systems do not have the ability to raise additional equity or borrow more funds to make necessary capital improvements.

18. According to Attorney General Opinion No. 71-17, interim or emergency rates are proper when either all or any one 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.

19. Staff recommends the Commission issue an Order:

(a) Finding that the McLain Systems' problems constitute an emergency;

(b) Finding that it is in the public interest to authorize the requested interim SIS of \$9.00 per meter;

(c) Allowing ASUA to charge the interim surcharge requested pending a determination of a permanent rate case proceeding;

(d) Granting any additional and further relief as the Commission deems appropriate;

(e) Requiring ASUA to maintain the books and records of the McLain Systems in accordance with the National Association of Regulatory Utility Commissioners' Uniform System of

² Sierra Sunset does not have customer meters and users are charged a flat rate each month. There are approximately 30 connections on the Sierra Sunset system.

1 Accounts, and maintaining separate books and records for each of the seven systems;

2 (f) Requiring ASUA to maintain a separate bank account in which it will deposit and
3 withdraw all funds received pursuant to the System Improvement Surcharge;

4 (g) Requiring ASUA to file monthly reports with Docket Control, in Docket W-
5 01642A-06-0010, as a compliance item in this matter, detailing how the System Improvement
6 Surcharge funds were spent, on which of the seven Systems the money was spent, and a report of the
7 remaining amounts due on accounts payable;

8 (h) Requiring that to the best of its ability, ASUA apply the SIS funds, on a pro rata
9 basis to each of the systems to correct water outages as they occur, pay debts to local vendors and
10 make system improvements;

11 (i) Requiring ASUA to post a form of security in the amount of \$10 to the Utilities
12 Division; and

13 (j) Requiring the filing of a general rate case no later than March 15, 2007, using a
14 2006 test year.

15 20. Intervenor Cockrum believes that given the different rate structures of the seven
16 systems, and consequently the different revenue contributions each makes to the consolidated system,
17 a uniform surcharge placed on every meter is not equitable. Mr. Cockrum advocated an alternate rate
18 proposal that established a uniform rate structure with a minimum monthly charge of \$17.00 per
19 meter with no gallons included in the monthly charge, and a commodity charge of \$2.25 per 1,000
20 gallons for usage from 1 to 9,999 gallons, \$2.50 per 1,000 gallons for usage from 10,000 to 49,999
21 gallons; \$3.00 per 1,000 gallons for usage between 50,000 and 74,999 gallons, and \$4.50 per 1,000
22 gallons for usage from 75,000 gallons and above.

23 21. Mr. Cockrum believes that the situation at Sierra Sunset with no meters is
24 unacceptable, and that the "Operator" should install at its own expense a meter to measure the output
25 of the well, divide all gallons pumped between the connections on the system, and charge the Sierra
26 Sunset customers based on his proposed rates.

27 22. Mr. Cockrum also recommends that the interim manager post on its website budgets
28 for each of the Systems and an accounting of amounts owed to vendors, a cash flow statement for

1 each system, a profit and loss statement for each system, and a detailed plan for repairs and upgrades.

2 Mr. Cockrum also recommends that the interim manager create and publish a newsletter.

3 23. Mr. Cockrum further recommends that the operator solicit participation in an "Audit
4 Committee" to be comprised of at least one consumer of each system, a representative of the
5 operator, and one or more representatives of the Commission and ADEQ. This proposed committee
6 would review the performance and operations of the water companies and offer suggestions or
7 recommendations to the operator in an effort to improve performance.

8 24. Mr. Cockrum recommends that the majority of new revenues derived from the
9 adjustments, if granted and approved, be devoted exclusively to infrastructure upgrades at the
10 individual water companies in an effort to reduce the possibility of outages.

11 25. In *Residential Utility Consumer Office v. Arizona Corp. Com'n* 199 Ariz. 588, 20 P.3d
12 1169 (Ct. App. 2001), the court agreed with the *Scates*³ court's approval of the circumstances in
13 which interim rates may be considered and approved by the Commission. "*Scates* follows the
14 Attorney General's conclusion that, while the Commission has broad authority when setting rates, the
15 interim rate-making authority is limited to circumstances in which (1) an emergency exists; (2) a
16 bond is posted by the utility guaranteeing a refund to customers if the interim rates paid are higher
17 than the final rates determined by the Commission; and (3) the Commission undertakes to determine
18 final rates after a valuation of the utility's property. 118 Ariz. At 535, 578 P.2d at 616 (following the
19 conclusion drawn in Op. Att'y Gen 71-17)."⁴

20 26. The McLain System's inability to pay debts as they come due, its bankruptcy, and its
21 need to make immediate system repairs to prevent future outages is an emergency as defined under
22 Arizona law.

23 27. Mr. Cockrum raises important issues of rate design equity that should be investigated
24 at the time of the permanent rate case. His proposed rates are not based on meeting a revenue
25 requirement and thus cannot be shown to provide adequate cash flow to meet the operating needs of
26 the McLain Systems. The surcharge, as proposed by ASUA and recommended by Staff is a more

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28 ³ *Scates v. Arizona Corp. Comm'n*, 118 Ariz. 531, 578, P.2d 612.

⁴ *RUCO* at 591.

1 flexible way of recovering the cash flow deficiency until permanent rates can be established based on
2 auditable operating records. Mr. Cockrum's recommendations aimed at keeping consumers
3 informed, are well intentioned and understandable, but are likely to increase operating costs or take
4 valuable management time away from correcting system inadequacies. The monthly reports filed by
5 the interim manager pursuant to Staff's recommendations will be available to consumers via the
6 Commission's website. Further, we encourage ASUA to keep the McLain System consumers
7 informed to the best of its ability of planned improvements or scheduled outages through use of its
8 website, email, or other means of communication.

9 28. Staff's recommendations above comply with the law concerning the Commission's
10 ability to implement interim rates, and, we believe that a bond of \$10 is adequate under the
11 circumstances of this case.

12 **CONCLUSIONS OF LAW**

13 1. The McLain Systems are public service corporations pursuant to Article XV of the
14 Arizona Constitution and A.R.S. §§ 40-250 and 40-251.

15 2. The Commission has jurisdiction over the McLain Systems and the subject matter of
16 the application.

17 3. Notice of the application was provided in accordance with the law.

18 4. The McLain Systems are facing an "emergency" within the definition set forth in
19 Attorney General Opinion No. 71-17.

20 5. The emergency rate increase requested herein is just and reasonable on an interim
21 basis and should be granted.

22 6. The recommendations set forth in Findings of Fact No. 19 are reasonable and should
23 be adopted.

24 **ORDER**

25 IT IS THEREFORE ORDERED that Arizona Small Utilities Association shall file on or
26 before May 31, 2006, a revised tariff that allows for a monthly interim surcharge of \$9.00 per meter
27 for Miracle Valley Water Company, Inc., Cochise Water Co., Horseshoe Ranch Water Company,
28 Crystal Water Company, Mustang Water Company, Coronado Estates Water Company, and Sierra

1 Sunset Water Company.

2 IT IS FURTHER ORDERED that the surcharge approved herein shall be interim and subject
3 to refund pending resolution of a permanent rate case.

4 IT IS FURTHER ORDERED that the Arizona Small Utility Association, or the future owner
5 of the McLain Systems, shall file an application for a permanent rate increase no later than March 15,
6 2007, using a 2006 test year.

7 IT IS FURTHER ORDERED that the above rates and charges shall be effective for all service
8 provided on and after June 1, 2006.

9 IT IS FURTHER ORDERED that the Arizona Small Utility Association shall post a bond in
10 the amount of \$10 prior to the implementation of the interim surcharge.

11 IT IS FURTHER ORDERED that the Arizona Small Utility Association shall notify its
12 customers of the rates authorized herein and their effective date within 15 days of the effective date
13 of this Order.

14 IT IS FURTHER ORDERED that the Arizona Small Utility Association, and any future
15 owner of the McLain Systems, shall maintain the books and records of the McLain Systems in
16 accordance with the National Association of Regulatory Utility Commissioners' Uniform system of
17 Accounts, and shall maintain separate books and records for each of the seven systems.

18 IT IS FURTHER ORDERED that the Arizona Small Utility Association, and any future
19 owner of the McLain Systems, shall maintain a separate bank account in which it will deposit and
20 withdraw all funds received pursuant to its System Improvement Surcharge.

21 IT IS FURTHER ORDERED that the Arizona Small Utility Association, and any future
22 owner of the McLain Systems, shall file monthly reports with Docket Control, in Docket W-01642A-
23 06-0010, as a compliance item in this matter, detailing how the System Improvement Surcharge
24 funds were spent, on which of the seven Systems the money was spent, and a report on the remaining
25 amounts still due on accounts payable.

26 IT IS FURTHER ORDERED that the Arizona Small Utility Association, and any future
27 owner of the McLain Systems, shall to the best of its ability, apply the SIS funds, on a pro rata basis
28 to each of the systems to correct water outages as they occur, pay debts to local vendors and make

1 system improvements.

2 IT IS FURTHER ORDERED that the Utilities Division shall audit the SIS fund expenditures
3 on an annual basis and the results of the audit shall be filed with the Commission on April 1 of each
4 year, beginning April 1, 2007. The audit shall include an on-site visit to review records and
5 infrastructure.

6 IT IS FURTHER ORDERED that the Arizona Small Utility Association, or any future owner
7 of the McLain Systems, and Commission Staff shall work together to devise a priority list of system
8 improvements.

9 IT IS FURTHER ORDERED that Miracle Valley Water Company, Inc., Cochise Water Co.,
10 Horseshoe Ranch Water Company, Crystal Water Company, Mustang Water Company, Coronado
11 Estates Water Company, and Sierra Sunset Water Company shall annually file as part of its annual
12 report, an affidavit with the Utilities Division attesting that the companies are current in paying their
13 property taxes in Arizona.

14 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

15 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

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18 CHAIRMAN COMMISSIONER

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20 COMMISSIONER COMMISSIONER COMMISSIONER

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22 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive
23 Secretary of the Arizona Corporation Commission, have
24 hereunto set my hand and caused the official seal of the
Commission to be affixed at the Capitol, in the City of Phoenix,
this ____ day of _____, 2006.

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26 BRIAN C. McNEIL
EXECUTIVE SECRETARY

27 DISSENT _____

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DISSENT _____

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SERVICE LIST FOR:

MIRACLE VALLEY WATER COMPANY, INC.
COCHISE WATER CO.
HORSESHOE RANCH WATER COMPANY
CRYSTAL WATER COMPANY
MUSTANG WATER COMPANY
CORONADO ESTATES WATER COMPANY
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