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MEMORANDUM

TO: Docket Control

FROM: Ernest G. Johnson 
Director
Utilities Division

DATE: August 13, 2007

RE: STAFF REPORT FOR AMERICAN REALTY & MORTGAGE COMPANY, INC. DBA HACIENDA ACRES WATER SYSTEM'S APPLICATION FOR AN EMERGENCY RATE INCREASE (DOCKET NO. W-02258A-07-0414)

Attached is the Staff Report for American Realty & Mortgage Company, Inc. dba Hacienda Acres Water System's ("Company") application for an emergency rate increase. Staff recommends denial of the Company requested emergency rate increase, however Staff recommends approval of an alternative emergency rate increase. Staff further recommends approval of its bottled water tariff and water hauling tariff along with Staff's additional recommendations.

Any interested party wishing to file comments regarding the attached Staff Report may file those comments with the Arizona Corporation Commission's Docket Control no later than August 20, 2007.

Staff will be recommending an order to show cause.

EGJ:DWC:red

Originator: Darron W. Carlson

Attachment: Original and sixteen copies

Arizona Corporation Commission
DOCKETED
AUG 13 2007

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Service List for: American Realty & Mortgage Company, Inc. dba Hacienda Acres Water System

Docket No. W-02258A-07-0414

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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

AMERICAN REALTY & MORTGAGE COMPANY, INC.

DBA HACIENDA ACRES WATER SYSTEM

DOCKET NO. W-02258A-07-0414

**APPLICATION FOR AN
EMERGENCY RATE INCREASE**

AUGUST 13, 2007

STAFF ACKNOWLEDGMENT

The Staff Report for American Realty & Mortgage Company, Inc. dba Hacienda Acres Water System ("Company"), Docket No. W-02258A-07-0414 was the responsibility of the Staff members listed below. Darron W. Carlson was responsible for the financial review and analysis of the Company's application. Dorothy Hains was responsible for the engineering and technical analysis. Deborah Reagan was responsible for reviewing the Commission's records on customer complaints filed with the Commission.



Darron W. Carlson
Public Utilities Analyst Manager



Dorothy Hains
Utilities Engineer – Water/Wastewater



Deborah Reagan
Public Utilities Consumer Analyst II

EXECUTIVE SUMMARY
AMERICAN REALTY & MORTGAGE COMPANY, INC.
DBA HACIENDA ACRES WATER SYSTEM
DOCKET NO. W-02258A-07-0414

American Realty & Mortgage Company, Inc. dba Hacienda Acres Water System ("Company") is a Class D water utility located in Pinal County, Arizona

The Company filed its request for an emergency rate increase on July 06, 2007.

The Company's application requests an emergency rate increase be added to the Company's existing commodity charge. The emergency rate requested is an increase of \$39.00 per one thousand gallons of usage, or 3,900 percent over the current commodity charge of \$1.00 per one thousand gallons. The Company contends that the emergency rate increase would produce monthly revenue of \$9,500. However, based on the Company's 2005 average of 314,000 gallons pumped per month, the monthly revenue produced would be \$10,218, which is 1,567 percent greater than monthly revenue based on current rates of approximately \$652.

Staff recommends denial of the emergency rate increase requested by the Company.

Staff recommends an alternative emergency rate increase of \$3.34 per one thousand gallons of usage which will produce monthly revenues of \$1,048. Staff further recommends approval of its bottled water tariff and water hauling tariff along with Staff's additional recommendations.

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Introduction

On July 06, 2007, American Realty & Mortgage Company, Inc. dba Hacienda Acres Water System ("Hacienda" or "Company") filed an application for an emergency rate increase with the Arizona Corporation Commission ("Commission"). On July 13, 2007, a Procedural Order was issued setting August 20, 2007, as the date for the hearing on the application.

Hacienda has stated in its application that the Company's existing rates were set about 30 years ago and have almost made the Company insolvent or bankrupt. Hacienda claims losses of about \$100,000 and its inability to pay "even the interest" on its promissory notes. Further, Hacienda states that the Company must immediately borrow \$16,000 to avoid loss of the water business to a judgment creditor. Hacienda also states that the Company's electric bills exceed the total revenues of the water utility and that Hacienda must borrow money to pay its bills.

Background

Hacienda is an Arizona class D utility engaged in the business of providing potable water service. Hacienda was granted a Certificate of Convenience and Necessity ("CC&N") to provide water service per Decision No. 44444 effective September 1, 1974. The applicant's representative in 1974 is the same Mr. Joseph W. Lee currently representing the Company.

The current rates are the same as its initial rates and have been in effect for 33 years since 1974. The Commission's Docket history does not indicate that a rate case has ever been filed by the Company and it is clear that there has never been any rate Decision issued.

Customers

Hacienda provides water service to an area near Maricopa, Arizona in Pinal County. Hacienda provides service to 25 to 30 metered connections (the number fluctuates periodically). The Company's 2005 annual report reflects 34 ¾-inch customer meters. Staff believes all of the customers are residential class.

Engineering Analysis

System Analysis

Hacienda owns and operates a water system consisting of: one well (Arizona Department of Water Resources ("ADWR") #55-803963) that produces water at a rate of approximately 3½ gallons per minute ("GPM"); one 10,000 gallon storage tank; two small pressure tanks; and, a distribution system serving 25 – 30 residential meters.¹ For several years the Company has been

¹The water system plant description presented above is based on the information provided by the Company in Section 1 of its application. The well production information presented was obtained by Staff at the ADWR website.

leasing a backup well (ADWR #55-569475) equipped with a second 4,500 gallon storage tank². The backup well can produce 18 GPM of water³. Staff understands that the backup well lease was terminated in September 2006 and water from the leased well and second storage tank is no longer being delivered to the Company's system. The Company lacks adequate production if the Company is dependant solely on its own 3½ GPM well. Staff recommends the Company install a second well or reconnect the existing backup well (ADWR #55-569475). Staff further recommends that the Company obtain the required approvals from the Arizona Department of Environmental Quality ("ADEQ") for a new well installation or for the backup well reconnection. Staff further recommends that the Company docket the ADEQ approval of the new well installation or well reconnection with the Commission's Docket Control in this same docket by December 31, 2007.

Water Quality Issues

(A) ADEQ Compliance

Staff received a compliance status report from ADEQ dated July 12, 2007, in which ADEQ stated that the system has major deficiencies: (1) the system is exceeding the Maximum Contaminant Level ("MCL") for nitrate; (2) the system has had six or more multiple reporting violations for total coliform in the last 12 months; (3) the 2004, 2005, and 2006 annual monitoring for lead and copper were not done as required during the months of July, August and September; (4) the Company has not provided the consumer confidence report for the calendar years of 2004 and 2005. ADEQ has determined that the system is currently delivering water that **does not** meet the water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.

In a more recent ADEQ Compliance Inspection report dated August 2, 2007, regarding Hacienda's water system, ADEQ concluded the following based on its inspection on June 21, 2007 and ADEQ monitoring and reporting records: (1) ADEQ can not determine if the backup well (ADWR #55-569475) has been disconnected per ADEQ requirements; (2) the Hacienda Acres water system is not operated by a certified operator as required; (3) the nitrate levels in the wells exceeded the nitrate MCL in 1993, 2003, 2004, 2005 and 2006 samples; (4) the Company failed to report its monthly total coliform test results in 2005, 2006, and 2007; (5) the Company failed to report its lead and copper sample test results; and (6) the Company failed to submit its 2003, 2004, 2005 and 2007 Consumer Confidence reports.

Staff recommends that the Company begin a bacteria monitoring and reporting program immediately. Staff further recommends that the Company hire a Certified Operator and begin

² Staff understands that the backup well site is permanently interconnected to the Hacienda water system and shares common ownership with the water system. According to the Arizona Department of Environmental Quality ("ADEQ"), this well has never obtained the required ADEQ approvals to interconnect with the Hacienda water system.

³ The well production information presented was obtained by Staff at the ADWR website.

conducting the required monthly total coliform tests immediately. Staff estimates that annual expenses associated with this program will total \$700⁴. This testing is needed to insure that the system is being operated properly and the water delivered to customers contains no biological hazard. Staff further recommends that the Company file its monthly bacteria sampling results with the Commission's Docket Control as a compliance item in this docket until further order of the Commission. Staff recommends that monthly test results for the preceding month be filed within 45 days of the end of the reported month.

(B) United States Environmental Protection Agency ("US EPA") Compliance

On September 21, 2005, US EPA issued an Administrative Order against the Company. The Company's well contained nitrate levels of 12.8 mg/l which exceeds the nitrate MCL level of 10 mg/l in 2004 and the Company has not taken action to correct the nitrate violation. The Company also failed to monitor for lead and copper. The EPA cited the nitrate and the copper and lead violations in its Administrative Order against the Company.

(C) Arsenic

According to the Company, the arsenic level in its well is at 2 µg/l (or ppb) which is below the new 10 µg/l arsenic MCL.

Non-Account Water

The water usage data information submitted with the application was incomplete. The information provided was incomplete because it appears the Company failed to read the well meter and customer meters on a scheduled routine basis. Without this information Staff cannot determine the level of non-account water for the Hacienda system. Therefore, Staff recommends that the Company read the well meter(s) and customer meters on a monthly basis and file this information on a quarterly basis with the Commission's Docket Control as a compliance item in this same docket. Staff further recommends that the Company file monthly water use data within 45 days of the end of the preceding quarter.

ADWR Compliance

The Company is located in ADWR's Pinal Active Management Area ("AMA"). ADWR stated that the Company is in compliance with its monitoring and reporting requirements.

⁴ The \$700 estimate assumes \$100 to acquire a Certified Operator and \$600 to complete monthly bacteria tests for two wells.

Curtailment Tariff

On June 28, 2007, in Decision No. 69678 the Commission approved a curtailment tariff which will help the Company manage the available water supply in the event of a water shortage. The tariff requires the Company, under a Stage 3 or 4 Curtailment, to augment its supply of water by either hauling or through an emergency interconnect with an approved water supply. Staff recommends that the Company be ordered to adopt the water hauling tariff Staff recommends in this Report.

Summary

Conclusions:

1. ADEQ has determined that the system is currently delivering water that **does not** meet the water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.
2. According to ADWR Hacienda is in compliance with its monitoring and reporting requirements.

Consumer Services Analysis

The Company is currently **not** in good standing with the Corporations Division. The 2007 Annual Report is delinquent.

In researching the Utilities Division database for complaints on the Company from January 1, 2004 through July 31, 2007, the results are as follows:

- | | |
|------|--|
| 2007 | Two complaints – one quality of service and one billing
Seven inquiries and no opinions |
| 2006 | Three complaints – one new service fees, one billing, and one quality of service
No inquiries and no opinions |
| 2005 | No complaints
One inquiry and no opinions |
| 2004 | One complaint – billing
Two inquiries and no opinions |

All complaints and inquiries are closed.

Financial Viability and Ability to Maintain Service

Hacienda has requested an emergency rate increase of \$39.00 per one thousand gallons of usage. This amounts to a 3,900 percent increase in the current tier-one commodity charge of \$1.00 per one thousand gallons of usage. Hacienda states that this increase will produce approximately \$9,500 per month in operating revenue. However, based on the Company's 2005 average of 314,000 gallons pumped per month, the monthly revenue produced would be \$10,218, which is 1,567 percent greater than monthly revenue based on current rates of approximately \$652. Staff notes that the Company's 2005 Annual Report revenue is \$5,823 and, if Staff assumes no taxes or other charges are reflected in that number, the current rates would indicate that this revenue reflects a total annual usage level of no more than 1,767,000 gallons. This same report reflects that the usage level in just four months of 2005 totaled 2,848,305 gallons. Further clouding the revenue issue is the fact that the Company does not currently bill on a monthly basis but on an every two, three, or four month basis. Staff believes there is very little information in the Annual Reports that it can rely upon.

Hacienda blames its current financial position on the fact that its 33 year old rates have almost made the Company insolvent or bankrupt. Further, the Company states that it is unable to pay even the interest on its promissory notes. Still further, Hacienda states that it must immediately borrow \$16,000 to avoid a judgment creditor taking possession of the Company's assets.

In addition, the Company states that it must borrow money to pay its electric bills and avoid a suspension of electric service due to non-payment of its electric bills.

Staff believes that Hacienda's current situation meets the general conditions necessary for interim emergency rate consideration. Staff does **not** believe that Hacienda has experienced a situation of sudden change that brings hardship to the Company. On the contrary, Staff believes this situation has been growing and/or fomenting for years. However, Staff does believe that the situation where the ability of Hacienda to maintain service, pending a formal rate determination, is in serious doubt.

When an emergency rate increase request is filed, under normal circumstances, Staff simply does an analysis of necessity and reasonableness due to the abbreviated time for analysis. This can be done, because the emergency rate increase is considered interim and a follow-up full rate case is required to be filed within 6 to 12 months of the effective date of the interim emergency rates. In that follow-up case, Staff audits all of the pertinent information regarding the rate case and the prior emergency rate case and can recommend any adjustments/refunds accordingly.

In this particular case, Staff is extremely concerned with the emergency rate filing itself and the management of Hacienda. The Company has failed to supply any information to Staff that is not an estimate or already stale by two years or more. The 2004 and 2005 annual reports

accompanying the emergency rate increase request are so full of errors that nothing in the reports can be relied upon. Staff does not believe that the Company can produce a viable and current emergency rate increase request. The Company has not yet filed its 2006 Annual Report. However, since Staff believes an emergency does exist and the Company's 2005 Annual Report reflects some current estimates of expenses, Staff believes it prudent to estimate the Company's current expenses and recommend an appropriate level of emergency rate increase. Following is Staff's estimate of the Company's current, annual operating expense levels:

Salaries and Wages	\$2,850
Purchased Water (if leased well is reconnected)	2,400
Purchased Power	4,830
Bank Fees	84
Repairs and Maintenance	500
Office Rent / Overhead	5,000
Water Testing	700
Miscellaneous Expense	2,400
Depreciation Expense (Staff believes plant is fully depreciated)	-0-
Taxes other than income (Sales tax not included as it is a pass-thru tax)	25
Property Tax	1,500
Income Tax	<u>-0-</u>

Estimated total annual operating expenses: \$20,289

The above estimate converts to a monthly expense level of just under \$1,700 per month. If we reduce that number by the revenue currently produced by existing rates of \$652, as previously calculated above, the monthly shortfall in revenue is \$1,048. Further, if we use the 2005 monthly pumping average of 314,000 gallons, the shortfall of \$1,048 divided by the 314,000 gallons produces an emergency rate increase of \$3.34 per one thousand gallons of usage. While this increase represents a 334 percent increase over the current commodity charge of \$1.00 per 1,000 gallons of usage, it is much lower than the Company's proposed \$39.00 per 1,000 gallons of usage, or 3,900 percent over the current rate of \$1.00 per 1,000 gallons of usage.

In addition to Staff's recommended emergency rate increase as noted above, Staff will recommend that a bottled water tariff and a water hauling tariff be approved in this case. Staff does believe that an emergency exists and wishes to enable the operator of the system the ability to provide bottled drinking water to Hacienda's customers since it does not currently supply water to its customers that meets the drinking water requirements of the Arizona Department of Environmental Quality. Additionally, Staff notes that the water shortage problem currently being experienced by the Company may require the operator of the system to haul water into the system to meet customer needs. The Company has included some water hauling information in its application. The potential that these tariffs would cause larger increases in rates in the future

is likely. However, it is not possible for Staff to even estimate the potential costs to the ratepayers of this system. Staff has attached sample tariffs for both the bottled water and water hauling issues.

Staff believes the current management of Hacienda will have difficulty producing the required follow-up filing of a complete rate case and when it does so, will likely face an extended sufficiency period to enable Staff to actually process the application. The Company does not accept any responsibility for not filing a rate case in the past. The Company is expecting, without even requesting it, retroactive approval of long term debt for operating expenses (which is contrary to Arizona Revised Statute §40-302.A.) The Company requests funding/financing of a civil judgment that is not the responsibility of its ratepayers. Staff has only included normal operating expenses in its recommended emergency rate increase. Further to this concern, Staff recommends that the Company be ordered to provide the Commission with a Performance Bond (or similar financial instrument) in the amount of \$25,000, prior to commencing its billing of the emergency rate authorized in this Decision. This allows the Commission some guarantee of the Company's willingness to comply with the Commission's oversight and rules.

Staff Recommendations

Staff recommends denial of the emergency rate increase requested by the Company.

Staff further recommends that the Company be ordered to include Staff's emergency increase rate of \$3.34 per 1,000 gallons of usage as a separate line item in its monthly bills.

Staff further recommends that the Company be ordered to bill its customers on a monthly basis.

Staff further recommends that this emergency rate increase be considered an interim increase until further Order of this Commission.

Staff further recommends that the Company be ordered to provide the Commission with a Performance Bond (or similar financial instrument) in the amount of \$25,000, prior to commencing its billing of the emergency rate authorized in this Decision.

Staff further recommends that the Company be ordered to file a full, permanent rate increase request by May 31, 2008, using a 2007 test year.

Staff further recommends that the Company be ordered to adopt the bottled water and water hauling tariffs outlined as attachments to the Staff Report in this docket.

Staff further recommends the Company install a second well or reconnect the existing backup well.

Staff further recommends that the Company obtain the required approvals from ADEQ for a new well installation or for the backup well reconnection.

Staff further recommends that the Company docket the ADEQ Approval to Construct of the new well installation or well reconnection with the Commission's Docket Control in this same docket by December 31, 2007, and the Approval of Construction for such by April 30, 2008.

Staff further recommends that the Company begin a bacteria monitoring and reporting program immediately.

Staff further recommends that the Company hire a Certified Operator and begin conducting the required monthly total coliform tests immediately.

Staff further recommends that the Company file its monthly bacteria sampling results with the Commission's Docket Control as a compliance item in this docket until further order of the Commission.

Staff further recommends that monthly test results for the preceding month be filed within 45 days of the end of the reported month.

Staff further recommends that the Company read the well meter(s) and customer meters on a monthly basis and file this information on a quarterly basis with the Commission's Docket Control as a compliance item in this same docket.

Staff further recommends that the Company file monthly water use data within 45 days of the end of the preceding quarter.

Staff further recommends that Hacienda work with ADEQ to develop a detailed action plan which the Company proposes to follow to address each deficiency outlined in the ADEQ Compliance Inspection report dated August 2, 2007. This action plan developed with ADEQ guidance should be filed with the Commission Docket Control as a compliance item in this same docket within 45 days of the effective date of the Decision issued in this matter.

ATTACHMENT A

SAMPLE TARIFF

Utility: American Realty & Mortgage Company, Inc.
dba Hacienda Acres Water System
Docket No.: W-02258A-07-0414
Phone No.: 623-388-2949 or
623-388-0500

Tariff Sheet No. _____
Decision No. _____
Effective: _____

BOTTLED WATER SURCHARGE TARIFF

American Realty & Mortgage Company, Inc. dba Hacienda Acres Water System (“Company”) is authorized to make monthly adjustments to its rates and charges for water service to recover costs incurred for purchasing bottled water for its customers (“Bottled Water Costs”).

The Bottled Water Surcharge shall be calculated by dividing the total Bottled Water Costs incurred in a given month by the number of customers billed that month. The resulting rate per customer will be charged as the Bottled Water Surcharge in the next month’s bill as a separate line item on the customer’s bill.

ISSUED _____

EFFECTIVE _____

ATTACHMENT B

SAMPLE TARIFF

Utility: American Realty & Mortgage Company, Inc.
dba Hacienda Acres Water System
Docket No.: W-02258A-07-0414
Phone No.: 623-388-2949 or
623-388-0500

Tariff Sheet No. _____
Decision No. _____
Effective: _____

WATER HAULING SURCHARGE TARIFF

American Realty & Mortgage Company, Inc. dba Hacienda Acres Water System ("Company") is authorized to make monthly adjustments to its rates and charges for water service to recover costs incurred for bulk water purchases and transportation ("Water Hauling Costs").

The Water Hauling Surcharge shall be calculated by dividing the total Water Hauling Costs incurred in a given month by the amount of water sold that month. The resulting rate per 1,000 gallons will then be multiplied by the gallons used in that month for each customer to arrive at the surcharge per 1,000 gallons. The resulting Water Hauling Surcharge will be charged in the next month as a separate line item on the customer's bill.

ISSUED _____

EFFECTIVE _____