

ORIGINAL



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MEMORANDUM

TO: Docket Control

FROM: Ernest G. Johnson
[Signature]
Director
Utilities Division

DATE: November 9, 2007

RE: STAFF REPORT FOR VALLE VERDE WATER COMPANY'S
APPLICATION FOR AN EMERGENCY RATE INCREASE
(DOCKET NO. W-01431A-07-0547)

Attached is the Staff Report for Valle Verde Water Company's ("Company") application for an emergency rate increase. Staff concurs with the Company that an emergency exists. Staff recommends approval of the Company's request for an emergency rate increase, along with Staff's additional recommendations.

Any party who wishes may file comments to the Staff Report with the Commission's Docket Control by 12:00 p.m. on or before November 19, 2007.

EGJ:MEM:tdp

Originator: Marvin E. Millsap

Arizona Corporation Commission
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Docket No. W-01431A-07-0547

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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

VALLE VERDE WATER COMPANY

DOCKET NO. W-01431A-07-0547

**APPLICATION FOR AN
EMERGENCY RATE INCREASE**

November 9, 2007

STAFF ACKNOWLEDGMENT

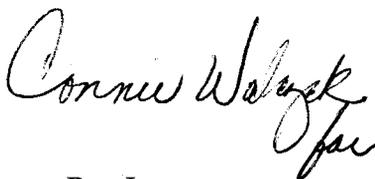
The Staff Report for Valle Verde Water Company, Docket No. W-01431A-07-0547, was the responsibility of the Staff members listed below. Marvin E. Millsap was responsible for the financial review and analysis of the Company's application. Dorothy Hains was responsible for the engineering and technical analysis. Reg Lopez was responsible for reviewing the Commission's records on customer complaints filed with the Commission.



Marvin E. Millsap
Public Utilities Analyst IV



Dorothy Hains *bow*
Utilities Engineer



Reg Lopez
Public Utilities Consumer Analyst

**EXECUTIVE SUMMARY
VALLE VERDE WATER COMPANY
APPLICATION FOR AN EMERGENCY RATE INCREASE
DOCKET NO. W-014316A-07-0547**

Valle Verde Water Company ("VVWC" or "Company") is a Class D water utility located in Santa Cruz County with service areas contiguous to and within the northern city limits of Nogales, Arizona on the east and west sides of Interstate 19. The water service infrastructure on each side of I-19 is considered a separate system as there is no interconnection. VVWC provides potable water to approximately 800 metered customers in its certificated area.

On September 24, 2007, Southwest Utilities Management, Inc. ("SUM"), the interim manager of VVWC filed a request for an emergency rate increase on behalf of VVWC. VVWC's filing includes requesting access to Water Infrastructure Finance Authority ("WIFA") assistance.

Valle Verde's application requested an emergency rate increase be added to the Company's existing commodity charge. The emergency rate requested is \$1.73 per one thousand gallons of usage in addition to the existing commodity rate. The typical residential customer's monthly bill will increase from \$21.67 to \$35.83; an increase of \$14.16, or 65.34 percent based on an average usage of 8,190 gallons. The emergency rate increase would produce an additional \$173,723 per year in revenues at the Company's current water sales level of 100,418,000 gallons per year. This additional revenue would allow the Company to continue to purchase water from the City of Nogales, as needed, to meet its metered customers' water demands and to pay other operating expenses and the capital improvements necessary to provide service in its certificated area.

Staff recommends approval of the emergency rate increase requested by the Company. Staff also has made several other recommendations to address the long-term viability of the Company.

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Introduction

On September 24, 2007, Southwest Utilities Management, Inc. ("SUM"), the interim manager of Valle Verde Water Company ("VVWC" or "Company"), filed a request for an emergency rate increase with the Arizona Corporation Commission ("Commission") on behalf of the Company. VVWC's filing includes requesting access to Water Infrastructure Finance Authority ("WIFA") assistance. On October 18, 2007, a Procedural Order was issued setting November 15, 2007, as the date for the hearing on the application.

VVWC is now owned by the Estate of William F. Randall, who had operated the water systems for many years. Following Mr. Randall's demise, the systems operated by the Company fell into financial and operational disarray and became non-compliant with several Arizona Department of Environmental Quality ("ADEQ") Rules, not the least of which was the lack of a Certified Water System Operator. On August 29, 2007, the Commission issued Decision No. 69882, Order to Show Cause ("OSC"), ordering VVWC to answer allegations of the violation of the Commission's Rules and ordering Staff to select and appoint an interim manager. A further Procedural Order reports that the Company did not file an answer to these allegations. Southwest Utilities Management ("SUM") was appointed to be the interim manager and filed an application on behalf of VVWC for emergency rate relief and access to WIFA assistance to address several of the issues in the OSC.

VVWC has stated that two of the Company's wells, number 5 and 6, have high arsenic levels and may become unusable in the near future. These wells supply approximately one third of the system requirements. Well numbers 1, 2 and 7 are out-of-compliance with ADEQ Rules due to Volatile Organic Compounds ("VOC") contamination and have been disconnected from the system with their production being replaced by water purchased from the City of Nogales. The twelve customers served by Well number 4, also out-of-compliance, are being provided with bottled water. VVWC has requested approval of an Arsenic Cost Recovery Mechanism (ACRM) surcharge. Staff has determined that the Company's arsenic problem can be controlled through blending and will not require a surcharge.

Background

VVWC is an Arizona class D utility engaged in the business of providing potable water service. Valle Verde was granted a Certificate of Convenience and Necessity ("CC&N") to provide water service per Decision No. 28887 effective April 27, 1955.

The current rates have been in effect since April 1, 1996, per Decision No. 59553.

Emergency

Staff believes that VVWC's current situation meets the general conditions necessary for interim emergency rate consideration. Staff believes that VVWC has experienced a situation of sudden change that brings hardship to the Company, and a situation where the ability of Valle

Verde to maintain service, pending a formal rate determination, is in serious doubt. Therefore, Staff recommends that VVWC's emergency rate increase be approved.

Customers

VVWC provides potable water to approximately 800 metered customers in its certificated area, which is contiguous to and within the northern City Limits of Nogales, Arizona on the east and west sides of Interstate 19.

Engineering Analysis

Valle Verde owns and operates two water systems, PWS #12-009 and PWS #12-025. PWS #12-009 consists of six wells that have 1,425 gallons per minute ("GPM") capacity, five pressure tanks and a distribution system serving approximately 700 metered customers. The PWS #12-025 system consists of two wells that have 1,100 GPM capacity, 800,000 gallon storage capacity, two pressure tanks and a distribution system serving approximately 90 metered customers. Due to water quality problems in PWS #12-009 (see the detail discussion below.), the Company purchases water from the City of Nogales to supplement the drinking water supply in PWS #12-009.

ADEQ Compliance

Staff received compliance status reports from ADEQ dated August 21, 2007 and September 20, 2007¹, in which ADEQ stated that both systems have major deficiencies: the Company had failed to monitor disinfection by products and annual lead /copper samples for 2005 and 2006 for both systems. ADEQ also states that tetrachloroethylene ("PCE") in the PWS #12-009 system exceeds the allowed maximum contaminant level ("MCL"). 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.

Arsenic

According to the Company, the arsenic level in PWS #12-025² exceeds the new arsenic MCL, a blending plan has been chosen to meet arsenic MCL. The arsenic level in PWS #12-009³ is below arsenic MCL. The well that contains arsenic exceeding the MCL is out of service. Staff concludes that the remaining two wells are able to serve its existing customers and reasonable growth using the blending technique to bring the arsenic level below the arsenic MCL standard. Staff concludes that the Company does not need an arsenic cost recovery mechanism ("ARCM") at this time.

¹ One report is for PWS #12-009 and another one is for PWS #12-025.

² Only well #5 and well #6 contain high arsenic level. 9 µg/l of arsenic was found in well #5 and 12 µg/l of arsenic was found in well #6. Arsenic level in Well #10 is at 7 µg/l.

Arizona Department of Water Resources (“ADWR”) Compliance

The Company is located in ADWR’s Santa Cruz Active Management Area (“AMA”). According to ADWR, the Company is in compliance with the AMA’s monitoring and reporting requirements.

Curtailment Tariff

A curtailment tariff is an effective tool to allow a water company to manage its resources during periods of shortages due to pump breakdowns, droughts, or other unforeseeable events. Since the Company does not have a curtailment tariff, this application provides an opportune time to prepare and file such a tariff. Staff recommends that the Company file a curtailment tariff as soon as possible, but no later than forty-five (45) days, after the effective date of the final Decision and Order in this matter. The tariff shall be docketed as a compliance item under this docket number for the review and certification by Staff.

Staff further recommends that the tariff shall generally conform to the sample tariff found on the Commission’s web site at www.azcc.gov. Staff recognizes that the Company may need to make minor modifications according to their specific management, operational, and design requirements as necessary and appropriate.

Proposal of PCE Treatment Plan

On October 11, 2007, the Company provided a proposal to resolve the PCE problem. In this proposal, the Company believes that the most cost effective plan is well head treatment. The well head treatment plan includes the use of an air stripper unit or granular activated carbon (“GAC”) absorption unit. The PCE removal plan also includes installation of a 140,000 gallon storage tank and a 250 gpm booster pump station. The Company proposes to install the well head treatment plant at the well #2⁴ site and the well #9⁵ site. The proposed storage tank and booster pump station would be located at the well #2 site. The estimated cost is between \$380,160⁶ and \$550,125⁷. Staff believes that air stripping method is more cost effective and the annual O&M fee for air stripping is less than GAC’s⁸. Staff recommends the Company select the air strip method to comply with PCE removal requirement. Staff used water usage data in Docket # W-01431A-07-0547 and included the proposed well capacity and storage capacity to verify that System #12-009 would have adequate capacity. Based on these calculations Staff concludes that the proposed PCE treatment plant should have adequate capacity to serve the customers in System #12-009 without purchasing water from another water supply source.

⁴ Well #2 has 350 gpm well production capacity.

⁵ Well #9, the Company does not own this well, has 420 gpm well production capacity.

⁶ This estimated cost is for air stripping.

⁷ This estimated cost is for GAC method.

⁸ In this case, the used GAC material considered a hazardous material; therefore it has to be disposed in landfill where hazardous material is acceptable.

Based on Staff's analysis, the following statements are submitted to summarize the condition of the VVWC water systems:

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. The Company is located in ADWR's Santa Cruz Active Management Area ("AMA"). According to ADWR, the Company is in compliance with the AMA's monitoring and reporting requirements.
3. The Company currently uses blending to lower the arsenic level in PWS #12-025 to meet the new arsenic standard.
4. Staff concludes that the proposed PCE treatment plant should have adequate capacity to serve the customers in System #12-009 without purchasing water from another water supply source.

Compliance

A check of the compliance database indicated that there are currently no delinquencies for VVWC.

Consumer Services

For the period of January 01, 2004 to October 26, 2007, Consumer Services records reflect the following customer complaints, inquiries and opinions:

2004 – No Complaints, Inquiries or Opinions.

2005 – One Opinion, no Complaints or Inquiries

2006 - One Complaint regarding a water outage, no Inquiries or Opinions.

2007 - Three complaints, which involved two billing issues and one main extension matter, 14 Inquiries and one Opinion.

All Complaints and Inquiries have been resolved and closed.

Financial Viability and Ability to Maintain Service

In order to meet the water needs of its metered customers, VVWC began purchasing water from the City of Nogales and currently owes more than \$15,000. Amounts owed to other goods and services providers total more than \$100,000.

VVWC has requested an emergency rate of \$1.73 per one thousand gallons of usage. This will increase the commodity charge for 1,001 to 8,000 gallons of usage to \$3.03 per one thousand gallons and increase the commodity charge for more than 8,000 gallons of usage to \$3.20 per one thousand gallons. The typical residential customer's monthly bill will increase from \$21.67 to \$35.83, an increase of \$14.16, or 65.34 percent based on an average usage of 8,190 gallons. Staff believes the funds generated by this increase are needed for the Company to consistently supply water when needed by its metered customers.

The Company's requested emergency rate would produce an additional \$173,723 per year in revenues at its projected water sales level of 100,418,000 gallons per year. These additional funds would be used to install and construct needed system improvements such as water treatment facilities, interconnections between existing wells, new wells, and storage facilities. VVWC's financial viability and ability to maintain service will also improve from the increased revenues.

Staff Recommendations

Staff recommends approval of the emergency rate increase sought by Valle Verde Water Company.

Staff further recommends that the emergency rate increase be interim.

Staff further recommends that the Company be directed to file within 30 days of the Order a revised rate schedule reflecting the emergency rate increase with Docket Control, as a compliance item in this docket.

Staff further recommends that the Company notify its customers of the revised rates, and their effective date, in a form acceptable to Staff, by means of an insertion in the Company's next regularly scheduled billing.

Staff further recommends that the Company file a full rate case no later than April 30, 2009, using a test year ending December 31, 2008.

Staff further recommends that the interim rates be subject to refund pending the decision on the permanent rate case and that the Company be required to post a performance bond of \$10.00, or similar financial instrument, prior to implementing the emergency rate increase authorized in this proceeding.

Staff further recommends that the Company's request for approval of an Arsenic Cost Recovery Mechanism surcharge be denied.

Staff further recommends that the Company file a curtailment tariff as soon as possible, but no later than forty-five (45) days after the effective date of the final Decision and Order in this matter. The tariff shall be docketed as a compliance item under this docket number for the

review and certification by Staff. Staff further recommends that the tariff shall generally conform to the sample tariff found on the Commission's web site at www.azcc.gov. Staff recognizes that the Company may need to make minor modifications according to their specific management, operational, and design requirements as necessary and appropriate.

Staff further recommends the Company select the air strip method to comply with the PCE removal requirement.