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MEMORANDUM

TO: Docket Control

FROM: Ernest Johnson
Director
Utilities Division

DATE March 18, 2008

RE: STAFF REPORT FOR SHEPARD WATER COMPANY'S APPLICATIONS FOR
A PERMANENT RATE INCREASE AND A FINANCING APPROVAL
(DOCKET NOS. W-01537A-07-0264 AND W-01537A-07-0265)

Attached is the Staff Report for Shepard Water Company's applications for a permanent rate increase and a financing approval. For residential customers, Staff recommends that the existing \$16.50 per month flat rate charge continue until all residential customers are metered (commercial customers are currently metered and billed on metered rates). After all residential customers are metered and properly noticed, Staff recommends that the Company implement an inverted three-tiered rate structure. Staff recommends no change to the Company's existing \$5.00 per month system replacement surcharge approved in Decision No. 62091. Staff recommends an inverted two-tier rate design for the Company's one-inch meter customers. Staff recommends approval of the requested financing and the associated arsenic remedial surcharge mechanism.

Any party who wishes may file comments to the Staff Report with the Arizona Corporation Commission's Docket Control by 4:00 p.m. on or before March 28, 2008.

EGJ:CSB:tdp

Originator: Crystal S. Brown

Arizona Corporation Commission
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Service List for: Shepard Water Company
Docket Nos. W-01537A-07-0264 and W-01537A-07-0265

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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

**SHEPARD WATER COMPANY
DOCKET NOS. W-01537A-07-0264 & W-01537A-07-0265**

**APPLICATION
FOR A
PERMANENT RATE INCREASE
AND
FINANCING AUTHORITY**

MARCH 18, 2008

STAFF ACKNOWLEDGMENT

The Staff Report for Shepard Water Company ("Company"), Docket Nos. W-01537A-07-0264 and W-01537A-07-0265, was the responsibility of the Staff members listed below. Crystal Brown was responsible for the review and analysis of the Company's application for a permanent rate increase, Staff's revenue requirement, rate base, rate design, and financing recommendations. Marlin Scott, Jr. was responsible for the engineering and technical analysis. John La Porta was responsible for reviewing the Arizona Corporation Commission's records on the Company and reviewing customer complaints filed with the Commission.



Crystal S. Brown
Public Utilities Analyst V



Marlin Scott, Jr.
Utilities Engineer



John La Porta
Public Utilities Consumer Analyst I

EXECUTIVE SUMMARY
SHEPARD WATER COMPANY
DOCKET NOS. W-01537A-07-0264 AND W-01537A-07-0265

Shepard Water Company (“Shepard” or “Company”) is an Arizona “C” corporation and is located approximately 30 miles northeast of Yuma along the Colorado River.

Shepard proposes a five dollar surcharge with no other change to its current rates, charges, and system replacement surcharge approved in Decision No. 62091, dated November 19, 1999. Additionally, Shepard requests authorization to incur \$112,100 in long-term debt.

For residential customers, Staff recommends that the existing \$16.50 per month flat rate charge continue until all residential customers are metered (commercial customers are currently metered and billed as such). After all residential customers are metered and properly noticed, Staff recommends that the Company implement an inverted three-tiered rate structure. Staff recommends no change to the Company’s existing \$5.00 per month system replacement surcharge approved in Decision No. 62091.

Further, Staff recommends an inverted two-tier rate design for the Company’s one-inch meter customers. Staff’s recommended rate design generates approximately the same level of revenue for the one-inch customers as does the Company’s current rate design. Staff does not recommend approval of the Company proposed five dollar surcharge.

Staff recommends a \$3.93 arsenic remediation surcharge mechanism (“ARSM”), in association with the approval of the requested long-term debt, to be implemented once the Company has met certain conditions.

The Company proposed total operating revenue of \$76,100¹, an increase of \$13,641, or 21.84 percent above the Company’s test year revenue of \$62,459. Once the ARSM is implemented, Staff recommends total operating revenue of \$60,699, an increase of \$10,781, or 21.60 percent above the Staff adjusted test year revenue of \$49,918. The Company’s proposed rates would increase the typical residential flat rate bill, from \$21.50 to \$26.50² for an increase of \$5.00 or 23.3 percent. Staff’s recommended flat rate (which is the same as the existing flat rate) would increase the typical residential flat rate bill, from \$21.50 to \$25.43³ for an increase of \$3.93 or 18.3 percent as shown on Schedule CSB-5, page 1. Staff’s recommended inverted three tiered rate design would increase the typical residential bill with an average usage of 4,796

¹ The Company requested total operating revenue of \$76,100 on the amended page 6 of the application. However, the Company’s proposed rates would actually produce \$75,899 in revenues.

² \$16.50 flat rate + \$5.00 system replacement surcharge + \$5.00 surcharge = \$26.50

³ \$16.50 flat rate + \$5.00 system replacement surcharge + \$3.93 ARSM = \$25.43

gallons, from \$21.50 to \$25.66⁴ for an increase of \$4.16 or 19.35 percent as shown on Schedule CSB-5, page 2.

⁴ \$16.73 average bill + \$5.00 system replacement surcharge + \$3.93 ARSM = \$25.66

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ATTACHMENTS

Engineering Report for Rate Application Attachment MSJ-1

Engineering Memorandum for Financing Application..... Attachment MSJ-2

Fact Sheet

Company:

Current Rates: Decision No. 62091, dated November 19, 1999
Type of Ownership: Arizona "C" corporation

Location: Approximately 30 miles northeast of Yuma along the Colorado River. The Company is not located in an Active Management Area.

Rates:

Permanent rate increase application filed: May 1, 2007
Current test year ended: December 31, 2006
Prior test year ended: September 30, 1998

Monthly Charges:

	<u>Current Rates</u>	<u>Company Proposed Rates</u>	<u>Staff Recommended Rates</u>
Unmetered Rate	\$16.50	\$16.50	\$16.50 ⁵
Monthly Minimum Charge 5/8 x 3/4 – inch meter	\$ 6.75	\$ 6.75	\$ 9.75
Gallons in Minimum	0	0	0
Uniform Metered Rate Per 1,000 gallons	\$ 2.05	\$ 2.05	\$ N/A
Commodity Charge			
0 to 3,000 gallons (per 1,000 gallons)	\$ N/A	\$ N/A	\$ 1.25
3,001 to 10,000 gallons (per 1,000 gallons)	\$ N/A	\$ N/A	\$ 1.80
10,001 and over gallons (per 1,000 gallons)	\$ N/A	\$ N/A	\$ 2.30
Surcharges for System Replacement			
Phase One	\$ 5.00	\$ 5.00	\$ 5.00
Phase Two	\$10.00	\$10.00	\$10.00
Arsenic Remedial Surcharge	\$ 0.00	\$ 5.00	\$ 3.93 ⁶

⁵ The unmetered flat rate is to remain in effect until all residential customers are metered and noticed.

Typical residential bill:

	Current <u>Rates</u>	Company Proposed <u>Rates</u>	Staff Recommended <u>Rates</u>
Average use (Flat Rate)	\$21.50	\$26.50	\$25.43 ⁷
Average use (4,796 gallons) (Inverted 3-Tiers)	\$21.50	\$26.50	\$25.67 ⁸

Customers:

Number of customers in prior test year (9/30/98) 222

Average Number of customers in the current test year (12/31/06): 224

Current test year customers by meter size:

5/8 X 3/4 – inch	221
3/4 – inch	0
1 – inch	3
1 1/2 – inch	0
2 – inch	0
4 – inch	0
6 – inch	0

Seasonal customers: N/A

Customer notification for financing application filed: March 14, 2008.

Customer notification for rate application filed: July 5, 2007.

Number of customer complaints and/or opinions concerning rate/financing applications filed: 0.

Percentage of complaints to customer base: 0%

Summary of Filing

The test year results as adjusted by Utilities Division Staff (“Staff”), for Shepard Water Company (“Shepard” or “Company”) show total operating revenue of \$49,918 and an operating income of \$5,098 or a 10.21 percent operating margin as shown on Schedule CSB-1. The original cost rate base (“OCRB”) is \$11,772.

⁶ Staff calculated a maximum arsenic remedial surcharge of \$3.93 based upon approval of the \$112,100 Staff recommended loan.

⁷ \$16.50 average bill + \$5.00 system replacement surcharge + \$3.93 ARSM = \$25.43

⁸ \$16.73 average bill + \$5.00 system replacement surcharge + \$3.93 ARSM = \$25.67

Shepard's proposed surcharge rate and other rates, as filed, would produce total operating revenue of \$76,100 and operating income of \$21,931, or a 28.82 percent operating margin. The Company claims an OCRB of \$39,412. The Company's proposed surcharge rate would increase the typical residential flat rate bill from \$21.50⁹ to \$26.50 for an increase of \$5.00, or 23.3 percent, as shown on Schedule CSB-5.

The Company has requested authorization to issue long-term debt to the Water Infrastructure Financing Authority ("WIFA") in an amount not to exceed \$112,100. Accordingly, in order to pay for the debt, Shepard has requested a rate increase in the form of a \$5.00 monthly surcharge.

Staff recommends approval of the financing and Staff's recommended arsenic remediation surcharge mechanism ("ARSM") to be implemented after the Company has met certain conditions. Implementation of the ARSM would enable the Company to meet its principal and interest obligations on the actual amount of the WIFA loan and pay income taxes on the surcharges. Staff recommends an OCRB of \$11,722.

Staff's estimated maximum ARSM surcharge would increase the typical residential flat rate bill from \$21.50 to \$25.43 for an increase of \$3.93 or 18.3 percent, as shown on Schedule CSB-5, page 1. Staff's estimated maximum ARSM surcharge would increase the typical residential bill with an inverted three tier rate design from \$21.73 to \$25.66 for an increase of \$3.93 or 18.1 percent.

Background

Shepard Water Company received its Certificate of Convenience and Necessity ("CC&N") in Decision No. 30467, dated August 19, 1957 under the name of Arthur E. Shepard, doing business as Arthur E. Shepard Water Company.

Decision No. 49481, dated November 28, 1978, authorized the sale of assets and transfer of CC&N to James L. and Francine S. Tomlinson, doing business as Shepard Water Company. Decision No. 52989 dated April 29, 1982, authorized the transfer of the CC&N and assets to Shepard Water Company, Inc., a corporation. The current owners, John and Gail Guth, purchased the Company in 2001 and are the sole stockholders.

In addition to Shepard Water Company, Mr. and Mrs. Guth also own Martinez Lake Sewer Company, Martinez Lake Resort, Martinez Lake Marina, and Martinez Lake Cantina.

Decision No. 62091, dated November 19, 1999, authorized a \$299,475 construction loan to upgrade Shepard's water system and install meters for its residential customers. The Decision also authorized a \$5.00 Phase I and \$10 Phase II system replacement surcharge to pay the debt service on the loan. The \$10 Phase II surcharge would be implemented after the Company filed a report showing satisfactory progress of completing the first phase of construction.

⁹ The Company currently has a \$16.50 flat rate and a \$5.00 surcharge in effect.

On August 7, 2006, the Company filed a Progress Report regarding the status of the Phase I surcharge authorized in Decision No. 62091 and requested authorization to implement the \$10 Phase II surcharge. During Staff's review of the Company's request, Staff found that the Company had received only one disbursement in the amount of \$3,900 in April 2002, during the approximately four year period since it had closed on the \$299,475 loan. The Company began making monthly payments in August of 2002. The Company began charging the Phase I \$5.00 charge in October 2005.

On September 29, 2006, Staff filed its report stating that the "Company was not in compliance with several Arizona Corporation Commission ("Commission") requirements. These included failure, among other things, to notify the Commission when implementing its Phase I surcharge, failure to comply with Arizona Department of Environmental Quality ("ADEQ") requirement as ordered in the decision, failure to install customer meters, and failure to provide timely support for any Water Infrastructure Finance Authority loan activity."

Staff recommended denial of the Company's request to implement the \$10 Phase II surcharge, to provide an accounting of all Phase I collections, and to file a rate application no later than December 31, 2006 using a September 30, 2006 test year in order to address its arsenic problem.

On October 25, 2006, a Procedural Order was issued that adopted Staff's recommendation to deny the implementation of the \$10 Phase II surcharge and to file a rate application no later than December 31, 2006 using a September 30, 2006 test year. On February 23, 2007, the Company filed a motion to extend the time to make the filings until May 1, 2007.

On May 1, 2007, the Company filed the instant financing and rate applications. On July 27, 2007, Staff filed a letter of sufficiency. On August 15, 2007, Staff filed a motion to consolidate the financing and rate applications. On August 28, 2007, the motion to consolidate was approved by Procedural Order.

During the test year ended December 31, 2006, Shepard provided water service to an average of 224 customers; 221 flat rate residential customers and 3 metered commercial customers.

Consumer Services

Staff reviewed the Commission's records and found that no complaints, inquiries or opinions were filed for the period from January 1, 2004 through May 9, 2007.

Engineering Analysis and Recommendations

Staff inspected the Company's plant facilities on August 2, 2007. A complete discussion of Staff's technical findings and recommendations and a complete description of the water system are provided in the attached Engineering Report.

Compliance

Shepard is current on its Utilities and Corporations Divisions' annual reports. Shepard is also current on its sales and property tax payments.

The U.S. Environmental Protection Agency announced that the arsenic standard in drinking water will be reduced from 50 parts per billion ("ppb") to 10 ppb by 2006. The Company is currently not in compliance with the new arsenic maximum contaminant level. The Company plans to use the funds from its financing request to build plant to address this issue.

Rate Base

Staff's adjustments decreased the Company's proposed rate base by \$27,690, from \$39,412 to \$11,722 as shown on Schedule CSB-2, page 1. Details of Staff's adjustments are discussed below.

Plant in Service

Staff's adjustments to plant in service resulted in a net decrease of \$4,831 as shown on Schedule CSB-2, page 2. The Company did not use the plant balances approved in Decision No. 62091. Staff made several adjustments to plant to reflect the plant balances approved in the prior rate order and to reclassify plant costs that were erroneously recorded as operating expenses.

Pumping Equipment - Adjustment "a" decreases this account by \$3,929, from \$12,581 to \$8,652 to reflect Staff's calculation of the ending plant balance. As shown on Schedule CSB-2, pages 2 and 3, Staff began with the \$6,335 plant balance adopted in Decision No. 62091 and reflected all plant additions and retirements from the end of the test year in the last rate proceeding to the end of the test year in the instant rate proceeding. Staff added \$1,048 to reflect capitalization of the labor cost incurred to install the Company's \$3,069 pump addition. The Company had erroneously included the labor cost in operating expenses. Further, Staff removed \$1,800 to reflect the cost of a pump that was no longer working and taken out of service.

Water Treatment Equipment - Adjustment "b" decreases this account by \$2,630, from \$2,630 to \$0 to reflect Staff's calculation of the ending plant balance as shown on Schedule CSB-2 pages 2 and 3. Decision No. 62091 adopted a \$2,630 plant balance. Staff, however, found no water treatment plant during its inspection of the water system. Moreover, Mr. Guth, the owner of Shepard Water Company, stated that there was no water treatment equipment when he purchased the system in 2001. Consequently, Staff removed the plant balance to reflect that the Company no longer had any water treatment plant.

Transmission and Distribution Equipment - Adjustment "c" increases this account by \$2,966, from \$5,796 to \$8,762 to reflect Staff's calculation of the ending plant balance. As shown on Schedule CSB-2, pages 2 and 3, Staff began with the \$8,762 plant balance adopted in Decision No. 62091 and reflected no plant additions or retirements (as reported by the Company)

from the end of the test year in the last rate proceeding to the end of the test year in the instant rate proceeding to calculate the ending plant balance.

Other Plant and Miscellaneous Equipment - Adjustment "d" decreases this account by \$879, from \$879 to \$0 to reflect Staff's calculation of the ending plant balance. As shown on Schedule CSB-2, pages 2 and 3, Staff began with the \$0 plant balance adopted in Decision No. 62091 and reflected no plant additions or retirements (as reported by the Company) from the end of the test year in the last rate proceeding to the end of the test year in the instant rate proceeding to calculate the ending plant balance.

Office Furniture and Equipment - Adjustment "e" decreases this account by \$359, from \$509 to \$150 to reflect Staff's calculation of the ending plant balance. As shown on Schedule CSB-2, pages 2 and 3, Staff began with the \$150 plant balance adopted in Decision No. 62091 and reflected no plant additions or retirements (as reported by the Company) from the end of the test year in the last rate proceeding to the end of the test year in the instant rate proceeding to calculate the ending plant balance.

Accumulated Depreciation

Staff increased accumulated depreciation by \$27,619 from \$9,118 to \$36,737 as shown on Schedule CSB-2, pages 12 and 13. The increase is based upon the adjustments Staff made to plant in service.

Advances and Contributions in Aid of Construction

The Company reported no advances in aid of construction ("AIAC" or "advances") or contributions in aid of construction ("CIAC" or "contributions"). Staff examined the reasonableness of these balances by reviewing the advances and contributions approved in the prior Decision and reviewing the Company's customer count since the last rate case.

Staff noted that no advances or additions were included in Decision No. 62091. Moreover, Decision No. 55890 discussed that the Company's certificated area was completely developed and that seven customers were lost during the September 30, 1998 test year because their mobile homes were converted to parking spaces (p. 1, lines 24-28 of Dec. No. 55890). Therefore, Staff concurs with the Company's reported balances of AIAC and CIAC.

Working Capital

Staff's adjustments to working capital resulted in a net increase of \$4,761 from \$0 to \$4,761 as shown on Schedule CSB-2, pages 1 and 14 primarily as a result of increasing cash working capital.

Cash working capital was calculated by using the formula method which equals one-eighth of the operating expenses less depreciation, taxes, purchased power and purchased water expenses, plus one twenty-fourth of purchased power and purchased water expenses.

Operating Income Statement

Operating Revenue

Staff decreased test year operating revenue by \$12,541, from \$62,459 to \$49,918 as shown on Schedule CSB-3, page 1. Details of Staff's adjustments are presented below.

Metered Water Revenue - Adjustment A increases this account by \$219, from \$5,347 to \$5,566 as shown on Schedule CSB-3, pages 1 and 2. Staff adjustment reflects Staff's calculation of revenue for the 1-inch customer using the Company provided billing determinants.

Unmetered Water Revenue - Adjustment B increases this account by \$660, from \$43,692 to \$44,352 as shown on Schedule CSB-3, pages 1 and 2. Shepard reported 224 customers per month for each month in the test year on its water usage data sheet (page 12 of the application). Staff multiplied the monthly flat rate by the number of customers for 12 months to obtain the unmetered water revenue of \$44,352 ($\$16.50 \times 224 \text{ customers} \times 12 \text{ months} = \$44,352$).

Other Water Revenue - Adjustment C decreases this account by \$13,420, from \$13,420 to \$0 as shown on Schedule CSB-3, pages 1 and 2. The \$13,420 is the revenue generated from the \$5.00 system replacement charge that was approved in Decision No. 62091 to fund construction of rebuilding the water system. Staff removed the surcharge revenue because the related expenses (i.e. depreciation expense on the plant and interest expense on the long-term debt) are not included in Staff's calculation of the amount of rate increase needed.

Operating Expenses

Staff's adjustments to operating expenses resulted in a net decrease of \$9,348 as shown on Schedule CSB-3, page 1. Details of Staff's adjustments are presented below.

Purchased Power - Adjustment D increases this account by \$97, from \$1,585 to \$1,682 as shown on Schedule CSB-3, pages 1 and 2. The Company's purchased power expense included expense for only 11 months of the test year. In response to a data request, the Company provided the December 2006 invoice in the amount of \$97. Staff added the \$97 in order to reflect 12 months of purchased power expense.

Materials and Supplies - Adjustment E decreases this account by \$1,048, from \$1,447 to \$399 as shown on Schedule CSB-3, pages 1 and 2. Staff removed and capitalized labor costs incurred for the installation of a pump.

Outside Services - Adjustment F increases this account by \$6,664, from \$10,920 to \$17,584 as shown on Schedule CSB-3, pages 1 and 3. Shepard has no employees and utilizes outside services to operate and manage the Company.

Staff added \$917 that was reclassified from water testing expense. Staff also added \$10,342 that was reclassified from miscellaneous expenses. A portion of the \$10,342 (i.e., \$6,126) reflected prudent and necessary costs that were higher than normal during the test year. Staff removed \$4,594 of the \$6,126, allowing only one-fourth of the amount in order to provide a normalized level of expenses for the test year. Staff's allowance of the one-fourth, or \$1,532, provides recovery for accounting, legal, management, or other types of outside services expense that may be non-routine in nature but expected to be encountered on an annual basis.

Water Testing - Adjustment G decreases this account by \$917, from \$3,786 to \$2,869 as shown on Schedule CSB-3, pages 1 and 4. This adjustment reclassifies \$917 to Outside Services and reflects the annual water testing costs reported in the attached Engineering Report.

Miscellaneous Expense - Adjustment H decreases this account by \$9,432, from \$12,343 to \$2,911 as shown on Schedule CSB-3, pages 1 and 4. Staff reclassified \$10,342 in legal and accounting costs to Outside Services expense. Staff added \$911 incurred for licenses and fees that was reclassified from Taxes Other Than Income.

Depreciation Expense - Adjustment I increases this account by \$743, from \$831 to \$1,574 as shown on Schedule CSB-3, pages 1 and 5. This adjustment reflects application of Staff's recommended depreciation rates to Staff's recommended plant balances.

Taxes Other Than Income Expense - The following is the account description for the NARUC USOA¹⁰ Account No. 408, Taxes Other Than Income:

These accounts shall include the amount of ad valorem, gross revenue or gross receipts taxes, regulatory agency general assessments for purposes of public utility regulation, state unemployment insurance, franchise taxes, federal excise taxes, social security taxes, and all other taxes assessed by federal, state, county, municipal, or other local governmental authorities, except income taxes. (emphasis added).

Staff's adjustment J decreased this account by \$911, from \$911 to \$0 to reclassify license and fees to the Miscellaneous Expense account.

Income Tax Expense - Staff's adjustment K decreased this account by \$4,544, from \$5,893 to \$1,349 to reflect calculation of income tax expense on Staff's adjusted test year taxable income.

¹⁰ National Association of Regulatory Commissioners' Uniform System of Accounts

Ratemaking Treatment for Undisbursed and Unauthorized Loans

As discussed previously in the “Background” section of this report, the Company was authorized a \$299,575 WIFA loan in Decision No. 62091, dated November 19, 1999. On May 17, 2004, the Company received \$3,900 of the loan. The remaining balance of \$295,575 (\$299,575 - \$3,900) was never funded. Although the Company has actually borrowed from WIFA only \$3,900, WIFA has required the Company to make monthly payments of \$2,662.80 in order to retain the entire \$299,575 loan. Mr. Guth, the owner of Shepard, has provided the funds for the Company to make these monthly payments over approximately 4 ½ years. The payments totaled \$140,919 (\$117,398 principal + \$23,521 interest).

The Company recorded Mr. Guth’s principal payments made on the loan in an account entitled, “Notes / Accounts Payable to Associated Companies”. At December 31, 2006, the balance of the account was \$118,956. The \$118,956 represents the \$117,398 principal paid on the WIFA loan plus \$1,558 of additional costs incurred on behalf of Shepard. Since no payments were made on the loan during the test year and the loan increased by \$68,956 from \$50,000 at the beginning of 2006 to \$118,956 at the end of 2006, Staff determined that the loan represents long-term debt that was not Commission approved. Consequently, for ratemaking purposes, Staff is not recognizing the loan to Mr. Guth in the revenue requirement calculation.

The Company also reports the remaining \$182,800 balance of the \$299,575 WIFA loan on its balance sheet as long-term debt. Because the Company has only drawn \$3,900 of the \$299,575 loan and has been authorized to collect a five dollar monthly customer surcharge specifically to pay the loan, Staff is not reflecting this loan in the revenue requirement calculation for the instant rate proceeding.

Revenue Requirement

Small water utilities will often have a rate base that is too small to earn a meaningful rate of return. Consequently, the revenues needed in order to make the companies financially viable will result in abnormally high rates of return. Shepard is among those water companies whose large debt service requirement and small rate base results in abnormally high rates of return when compared to other, more financially capable, companies.

Once the ARSM is implemented, Staff recommends total operating revenue of \$60,699, an increase of \$10,781, or 21.60 percent above the Staff adjusted test year revenue of \$49,918. Staff’s recommended revenue provides operating income of \$15,879 for an operating margin of 26.16¹¹ percent and a rate of return on original cost rate base of 135.45 percent as shown on Schedule CSB-1.

The 26.16 percent operating margin is high when the cost of the Company proposed \$112,100 WIFA loan is not considered. Staff, however, has recommended approval of the loan. Therefore, Staff’s revenue requirement is primarily driven by the revenues needed to pay the

¹¹Operating margin is calculated by dividing operating income by total operating revenue.

principal, interest, and to meet the minimum 1.2 debt service coverage (“DSC”) ratio required by WIFA on the loan. Additionally, Staff’s revenue requirement provides sufficient cash flow to pay operating expenses and contingencies as shown on Schedules CSB-1 and CSB-6.

Rate Design

Schedule CSB-4 presents a complete list of the Company’s present, proposed, and Staff’s recommended rates and charges.

The Company proposes an additional \$5.00 per month customer surcharge. The Company recommends no change to its existing \$16.50 per month flat rate charge and the \$5.00 per month system replacement surcharge (total of \$21.50 per month). The Company’s proposed surcharge rate would increase the typical residential flat rate bill from \$21.50¹² to \$26.50 for an increase of \$5.00, or 23.3 percent, as shown on Schedule CSB-5.

Shepard currently has no metered residential customers (commercial customers are metered) and is currently in the process of metering those customers. Staff recommends that the existing \$16.50 per month flat rate charge continue until all residential customers are metered and properly noticed. To promote efficient use of water, Staff recommends that after all residential customers are metered, the Company implement an inverted three-tiered rate structure of \$1.25 for 0 to 3,000 gallons; \$1.80 for 3,001 to 10,000 gallons; and \$2.30 for all usage over 10,000 gallons as shown on Schedule CSB-4.

Further, Staff recommends a \$3.93 ARSM to be implemented conditional upon certain requirements being met. Staff recommends no change to the Company’s existing \$5.00 per month system replacement surcharge approved in Decision No. 62091. Staff’s recommended flat rate (which is the same as the existing flat rate) would increase the typical residential flat rate bill, from \$21.50 to \$25.43¹³ for an increase of \$3.93 or 18.3 percent as shown on Schedule CSB-5, page 1. Staff’s recommended inverted three tiered rate design would increase the typical residential bill with an average usage of 4,796 gallons, from \$21.50 to \$25.66¹⁴ for an increase of \$4.16 or 19.35 percent as shown on Schedule CSB-5, page 2.

The Company currently has three metered one-inch customers that are charged a uniform rate of \$2.05 per thousand gallons. To promote efficient use of water, Staff recommends an inverted two-tiered rate structure of \$1.80 for 0 to 40,000 gallons and \$2.30 for all usage over 40,000 gallons as shown on Schedule CSB-4. Staff’s recommended rate design generates approximately the same level of revenue for one-inch customers as does the Company’s current rate design.

¹² The Company currently has a \$16.50 flat rate and a \$5.00 surcharge in effect.

¹³ \$16.50 flat rate + \$5.00 system replacement surcharge + \$3.93 ARSM = \$25.43

¹⁴ \$16.73 average bill + \$5.00 system replacement surcharge + \$3.93 ARSM = \$25.66

Staff Recommendations

Staff recommends approval of the Staff recommended rates and charges as shown in Schedule CSB-4.

Staff further recommends that the Company notify the Commission when all residential customers are metered.

Staff further recommends that the Company implement the inverted three-tiered rate design after all residential customers have been metered and properly noticed.

Staff further recommends that once all residential customers are metered, the Company notify the residential customers, in a form acceptable to Staff, of when the metered rates will begin.

Staff further recommends that metered residential rates not begin until the month after all customers have been notified of such in a form acceptable to Staff.

Staff further recommends that the Company be ordered to file with Docket Control a tariff schedule of its new rates and charges within 30 days after the effective date of the Decision in this proceeding.

Staff further recommends that the Company capitalize rather than expense labor costs incurred for installing plant items such as, but not limited to, pumps by recording them in the proper plant accounts in accordance with the NARUC USOA.

FINANCING APPLICATION AND ARSENIC REMEDIATION SURCHARGE MECHANISM (“ARSM”)

Introduction

On May 1, 2007, Shepard filed an application with the Commission requesting authorization to borrow \$112,100 from WIFA and a five dollar surcharge to service the debt related to the loan.

Public Notice

The Company filed its affidavit of customer notification for the \$112,100 financing application on March 14, 2008.

Purpose and Terms of the Proposed Financing and ARSM

The purpose of the financing is to provide funds for construction of arsenic removal treatment plant that will enable the Company to provide water that meets the U.S. Environmental Protection Agency ("EPA") arsenic standards. The amortization period and interest rate are the same as those used by WIFA.¹⁵

Because the final details of the WIFA loan will not be known until after the rate application has been filed, Staff is recommending an ARSM for the Company. An ARSM is appropriate because the Company currently does not provide water that meets federal drinking water standards for arsenic. Moreover, the Company does not have access to other funding sources to correct the arsenic problem due to its lack of financial capacity.

The ARSM will establish the methodology that will detail how the surcharge to provide funds for the debt service on the WIFA loan will be calculated and applied to the rates established in this rate application. The Company can submit an arsenic removal surcharge application to the Commission under this Docket in order to receive the surcharge using the methodology Staff has defined in this Report once Shepard has met the following conditions:

1. the Company closes on the loan, and
2. the Company meters all of its customers by May 31, 2008.

Engineering Analysis

Staff examined the construction plans and estimated costs for Shepard's construction projects and found them to be reasonable and appropriate. A complete discussion of the construction projects and costs are discussed in the attached Engineering Memorandum.

Financial Analysis

Revenue to Preserve Cashflow

The Company must comply with the EPA arsenic drinking water standard regardless of its financial position. Accordingly, Staff calculated the additional annual revenue that Shepard would require (given adoption and implementation of Staff's recommended ARSM) to meet its obligations on the Company proposed \$112,100 loan, and provide the Company with the same \$6,130 in cash flow it would have had before the loan. As shown on Schedule CSB-6, on the Company proposed \$112,100 WIFA loan, the Company would annually need an additional \$2,825 for principal, \$7,208 for interest expense, and \$747 for income taxes on the additional revenue for a total of \$10,780.

¹⁵ WIFA typically uses a 20 year amortization period. The WIFA interest rate calculation for this loan analysis is:
(Prime Rate + 2%) x Subsidy Rate = (7.25% + 2%) x .70 = 6.475%

TIER and DSC Ratios

Staff's analysis is based on Staff's recommended rates and the Company's financial statements dated December 31, 2006. The financial analysis shown on Schedule CSB-6 presents selected financial information from the financial statements and the pro forma effect of the Company proposed \$112,100 WIFA loan.

Schedule CSB-6 also shows the capital structure and ratios for DSC and times interest earned ratio ("TIER"). DSC represents the number of times internally generated cash (i.e., earnings before interest, income tax, depreciation, and amortization expenses) covers required principle and interest payments on debt. A DSC greater than 1.0 means operating cash flow is sufficient to cover debt obligations. TIER represents the number of times earnings before income tax expense covers interest expense on debt. A TIER greater than 1.0 means that operating income is greater than interest expense. A TIER less than 1.0 is not sustainable in the long term but does not necessarily mean that debt obligations cannot be met in the short term.

Schedule CSB-6, column B, shows that the pro forma effect on the Company's financial ratios of and fully drawing the proposed \$112,100 loan and implementation of Staff's ARSM results in a pro forma TIER and DSC of 2.16 and 1.74, respectively. These ratios indicate that Shepard would have sufficient earnings and operating cash flow to meet the long-term debt obligations of an \$112,100 loan.

Capital Structure

At December 31, 2006, Shepard's capital structure consisted of 100 percent equity. Shepard drawing the entire proposed loan of \$112,100 would result in a pro forma capital structure comprised of 1.3 percent short-term debt, 50.5 percent long-term debt and 48.2 percent equity as shown on Schedule CSB-6, page 1.

Calculation of Surcharge

The following is the methodology that Staff recommends to calculate the arsenic surcharge the Company would receive to provide funds for the debt service on the loan the Company will need to purchase an arsenic treatment system. For illustrative purposes, Staff utilized the previously mentioned Company proposed \$112,100 WIFA Loan applied to its methodology to calculate the arsenic surcharge. Schedule CSB-6 also shows Staff's calculation of the Company's arsenic surcharge with the Company proposed \$112,100 WIFA loan.

Staff recommends the following steps to calculate the arsenic surcharge once the Company has closed on the loan.

Example - For Illustrative Purposes Only

Loan amount: \$112,100
Term: 20 years
Interest Rate Before Subsidy: 9.25%
WIFA Subsidy: 70.00%
Subsidized Interest Rate: 6.475%

Step 1. Find the Annual Payment on the Loan

Refer to Table A, the Conversion Factor Table. Reading the table from top to bottom, find the interest rate in Column A that is equal to the stated annual interest rate of the loan. Reading across the table, find the Annual Payment Conversion Factor in Column B that corresponds with the loan interest rate (in the event that the loan interest rate is different from the interest rates in Table A, use the next higher interest rate that can be found in Table A). Multiply that annual payment conversion factor by the total amount of the loan to calculate the annual debt service on the loan.

Result

0.0895	Annual payment conversion factor
x \$112,100.00	(*) Times total amount of the loan
\$ 10,032.95	(=) Equals annual debt service on the loan (rounded)

Step 2. Find the Annual Interest Payment on the Loan

Refer to Table A and find the annual interest payment conversion factor in Column C that corresponds with the stated annual interest rate of the loan. Multiply the annual interest payment conversion factor by the total amount of the loan to calculate the annual interest expense on the loan.

Result

0.0643	Annual interest payment conversion factor
x \$120,000.00	(*) Times total amount of the loan
\$ 7,208.03	(=) Equals annual interest expense on the loan (rounded)

Step 3. Find the Annual Principal Payment on the Loan

Refer to Table A and find the annual principal payment conversion factor in Column D that corresponds with the stated annual interest rate of the loan. Multiply the annual principal payment conversion factor by the total amount of the loan to calculate the annual principal payment on the loan.

Result

0.0252	Annual principal payment conversion factor
x \$120,000.00	(*) Times total amount of the loan
\$ 2,824.92	(=) Equals annual principal payment on the loan

Step 4. Find the Gross Revenue Conversion Factor (GRCF)

The GRCF calculated below is used in step 5.

$$\text{GRCF} = \frac{1}{1 - \text{Effective incremental income tax rate}}$$

$$\text{GRCF} = \frac{1}{1 - 0.2092^{16}} = \frac{1}{0.7908} = 1.2645$$

Step 5. Find the Incremental Income Tax Factor

The incremental income tax factor is calculated below:

$$\begin{aligned} \text{Incremental Income Tax Factor} &= \text{GRCF} - 1 \\ &= 1.2645 - 1 \\ &= 0.2645 \end{aligned}$$

Step 6. Find the Annual Income Tax Component of the Surcharge Revenue

Multiply the incremental income tax factor by the annual principal payment on the loan determined in step 3 to calculate the income tax component of the annual surcharge revenue.

Result

0.2645	Incremental income tax conversion factor
x \$2,824.92	(*) Times the annual principal payment on the loan
\$ 747.19	(=) Equals the annual income tax component of the annual surcharge revenue

¹⁶ In this example, the “effective incremental income tax rate” is equal to the “combined federal and state income tax rate” shown on Schedule CSB-3, page 7, line 4.

Step 7. Find the Debt Service Component of the Annual Surcharge Revenue

Add the annual interest expense on the loan determined in step 2 to the annual principal payment determined in step 3. The sum is the debt service component of the annual surcharge revenue.

Result

\$ 7,208.03	Annual interest payment on the loan (Step 2)
+ 2,824.92	(+) Plus annual principal payment (Step 3)
<u>\$10,032.95</u>	(=) Equals the debt service component of the annual surcharge revenue

Step 8. Find the Total Annual Surcharge Revenue Requirement Needed for the Loan.

Add the annual income tax component determined in step 6 to the annual debt service component determined in step 7. The sum equals the annual surcharge revenue requirement for the loan.

Result

\$ 747.19	Annual income tax component (Step 6)
+ \$10,032.95	(+) Plus annual principal & interest payment (Step 7)
<u>\$10,780.14</u>	(=) Equals the total annual surcharge revenue requirement for the loan.

Step 9. Find the equivalent bills.

Multiply the NARUC meter capacity multiplier by the number of current customers and by the number of months per year. The sum of the products equals the equivalent bills.

Result

Col A	Col B	Col C	Col D	Col E
Meter Size	NARUC Meter Capacity Multiplier	Number of Customers	Number of Months in Year	Equivalent Bills Col B x C x D
5/8"x 3/4" Meter	1	21	12	2,652
3/4" Meter	1.5	0	12	0
1" Meter	2.5	3	12	900
1½" Meter	5	0	12	0
2" Meter	8	0	12	0
3" Meter	15	0	12	0
4" Meter	25	0	12	0
6" Meter	50	0	12	0
			Total	2,742

Step 10. Find the monthly surcharge for 5/8" x 3/4" customers.

Divide the result obtained in step 8 by the number of equivalent bills calculated in step 9 to obtain the monthly surcharge for 5/8" x 3/4" customers.

Result

\$10,780.14	Total annual surcharge revenue requirement for the loan (Step 8)
÷ 2,742.00	Number of equivalent bills (Step 9)
\$ 3.93	(=) Equals the total annual surcharge revenue requirement for the loan (rounded).

Step 11. Find the monthly surcharge for the remaining meter size customers.

Multiply the result obtained in step 10 by the NARUC meter capacity multipliers to obtain the monthly surcharge for all other meter sizes.

Col A	Col B	Col C	Col D
Meter Size	NARUC Meter Capacity Multiplier	5/8" x 3/4" Customer Surcharge	Surcharge by Meter Size Col B X C
5/8"x 3/4" Meter	1	3.93	\$ 3.93
3/4" Meter	1.5	3.93	\$ 5.90
1" Meter	2.5	3.93	\$ 9.83
1½" Meter	5	3.93	\$ 19.66
2" Meter	8	3.93	\$ 31.45
3" Meter	15	3.93	\$ 58.97
4" Meter	25	3.93	\$ 98.29
6" Meter	50	3.93	\$ 196.58

TABLE A
Conversion Factor Table (Based on a 20-year Loan)

<u>Column A</u>	<u>Column B</u>	<u>Column C</u>	<u>Column D</u>
Annual Interest	Annual Payment Conversion Factor	Annual Interest Payment Conversion Factor	Annual Principal Payment Conversion Factor
3.50%	0.0696	0.0344	0.0352
3.75%	0.0711	0.0369	0.0342
4.00%	0.0727	0.0394	0.0333
4.25%	0.0743	0.0419	0.0324
4.50%	0.0759	0.0444	0.0316
4.75%	0.0775	0.0468	0.0307
5.00%	0.0792	0.0493	0.0299
5.25%	0.0809	0.0518	0.0291
5.50%	0.0825	0.0543	0.0283
5.75%	0.0843	0.0568	0.0275
6.00%	0.0860	0.0593	0.0267
6.25%	0.0877	0.0618	0.0259
6.50%	0.0895	0.0643	0.0252
6.75%	0.0912	0.0668	0.0245
7.00%	0.0930	0.0692	0.0238
7.25%	0.0948	0.0717	0.0231
7.50%	0.0967	0.0742	0.0224
7.75%	0.0985	0.0767	0.0218
8.00%	0.1004	0.0792	0.0211

Conclusion

Staff concludes that the construction of an arsenic treatment system is necessary for Shepard to comply with the EPA’s revised drinking water standard that requires reducing the arsenic level in drinking water to 10 ppb.

Staff further concludes that the Company will need a loan up to the total of \$112,100 to purchase an arsenic treatment system to comply with the EPA revised drinking water standard.

Staff Recommendations

Staff recommends approval of the Staff recommended rates and charges as shown in Schedule CSB-4.

Staff recommends that the Company notify the Commission when all residential customers are metered.

Staff further recommends that the Company implement the inverted three-tiered rate design after all residential customers have been metered and properly noticed.

Staff further recommends that once all residential customers are metered, the Company notify the residential customers, in a form acceptable to Staff, of when the metered rates will begin.

Staff further recommends that metered residential rates not begin until the month after all customers have been notified of such in a form acceptable to Staff.

Staff further recommends that the Company be ordered to file with Docket Control a tariff schedule of its new rates and charges within 30 days after the effective date of the Decision in this proceeding.

Staff further recommends that the Company capitalize rather than expense labor costs incurred for installing plant items such as, but not limited to, pumps by recording them in the proper plant accounts in accordance with the NARUC USOA.

Staff further recommends approval of the requested \$112,100 financing.

Staff further recommends that the amount of ARSM be conditional upon the actual amount of the loan which is not to exceed \$112,100.

Staff further recommends that the ASRM be implemented only after the Company closes on the loan and all customers have been metered.

Staff further recommends that the Company make an ARSM filing within 60 days of the loan closing.

Staff further recommends that if the Company has not drawn funds from the loan within one year of the date of the Decision resulting from this proceeding, that approval of the loan and surcharge be rescinded.

Staff further recommends that all of its customers be metered by May 31, 2008.

Staff further recommends that the Company file for a rate application by no later than May 1, 2010, using a test year ending December 31, 2009.

ADEQ reported major deficiencies for failing to provide consumer confidence reports for 2002 and 2003. Staff recommends that the Company file with Docket Control, as a compliance item in this case, a copy of an updated ADEQ Compliance Status Report indicating that the

deficient consumer confidence reports issue has been resolved. Staff further recommends that any new rates and charges approved in this proceeding not become effective until the first day of the month following the Company's filing of the updated ADEQ Compliance Status Report indicating that the Company has resolved the noted deficiencies.

Staff further recommends that the Company file with Docket Control, as a compliance item in this case, by December 31, 2008, a copy of the ADEQ Certificate of Approval of Construction for the arsenic treatment system.

Staff further recommends that the Company use Staff's depreciation rates delineated in Table B.

Staff further recommends the continuance of the Company's existing "total" charges as shown in Table C, page 13 of the attached Engineering Report (MSJ-1), with separate installation charges for the service line and meter installations.

SUMMARY OF FILING

	-- Present Rates --		-- Proposed Rates --	
	Company as Filed	Staff as Adjusted	Company as Filed	Staff as Adjusted
Revenues:				
Metered Water Revenue	\$5,347	\$5,566	\$5,347	\$5,566
Unmetered Water Revenue	43,692	44,352	43,692	44,352
Other Water Revenues	13,420	0	26,860	10,781
Reconciling Amount ¹	0	0	201	0
Total Operating Revenue	\$62,459	\$49,918	\$76,100	\$60,699
Operating Expenses:				
Operation and Maintenance	\$43,842	\$39,206	\$43,842	\$39,206
Depreciation	831	1,574	831	1,574
Property & Other Taxes	3,603	2,692	3,603	2,692
Income Tax	5,893	1,349	5,893	1,349
Total Operating Expense	\$54,169	\$44,821	\$54,169	\$44,820
Operating Income/(Loss)	\$8,290	\$5,098	\$21,931	\$15,879
Rate Base O.C.L.D.	\$39,412	\$11,722	\$39,412	\$11,722
Rate of Return - O.C.L.D.	21.03%	43.49%	55.65%	135.45%
Operating Margin ²	13.27%	10.21%	28.82%	26.16%

NOTES:

¹ Operating Margin represents the proportion of funds available to pay interest and other below the line or non-ratemaking expenses.

² Amount to reconcile the Company proposed \$76,100 total revenue to the total revenue that the Company's proposed rates actually produce (i.e., \$75,899) .

RATE BASE

	----- Original Cost -----			
	Company	Adjustment	Ref	Staff
Plant in Service	\$ 48,530	\$ (4,831)	A	\$ 43,699
Less:				
Accum. Depreciation	9,118	27,619	B	36,737
Net Plant	\$ 39,412	\$ (32,450)		\$ 6,962
Less:				
Line Extension Advances	\$ -	\$ -		\$ -
Service Line and Meter Advances	0	-		0
Total Advances	\$ -	\$ -		\$ -
Contributions Gross	\$ -	\$ -		\$ -
Less:				
Amortization of CIAC	-	-		-
Net CIAC	\$ -	\$ -		\$ -
Total Deductions	\$ -	\$ -		\$ -
Plus:				
1/24 Purchased Power & Water	\$ -	\$ 70	C	\$ 70
1/8 Operation & Maint.	-	4,691	D	4,691
Inventory	-	-		-
Prepayments	-	-		-
Total Additions	\$ -	\$ 4,761		\$ 4,761
Rate Base	\$ 39,412	\$ (27,690)		\$ 11,722

Explanation of Adjustments

- A - See Schedule 2, Page 2
- B - See Schedule 2, Pages 12 and 13
- C - See Schedule 2, Page 14
- D - See Schedule 2, Page 14

PLANT ADJUSTMENT

	Company Exhibit	Adjustment		Staff Adjusted
301 Organization	\$ 708	\$ -		\$ 708
302 Franchises	\$ 2,708	\$ -		\$ 2,708
303 Land & Land Rights	\$ 250	\$ -		\$ 250
304 Structures & Improvements	\$ 2,257	\$ -		\$ 2,257
307 Wells & Springs	\$ 4,424	\$ -		\$ 4,424
311 Pumping Equipment	\$ 12,581	\$ (3,929)	a	\$ 8,652
320 Water Treatment Equipment	\$ 2,630	\$ (2,630)	b	\$ -
330.1 Distribution Reservoirs - Storage	\$ -	\$ -		\$ -
330.1 Distribution Reservoirs - Pressure	\$ 8,141	\$ -		\$ 8,141
331 Transmission & Distribution Mains	\$ 5,796	\$ 2,966	c	\$ 8,762
333 Services	\$ 7,205	\$ -		\$ 7,205
334 Meters & Meter Installations	\$ -	\$ -		\$ -
335 Hydrants	\$ -	\$ 0		\$ 0
336 Backflow Prevention Devices	\$ -	\$ 0		\$ 0
339 Other Plant and Misc. Equipment	\$ 879	\$ (879)	d	\$ 0
340 Office Furniture & Equipment	\$ 509	\$ (359)	e	\$ 150
341 Transportation Equipment	\$ -	\$ -		\$ -
343 Tools Shop & Garage Equipment	\$ 442	\$ 0		\$ 442
344 Laboratory Equipment	\$ -	\$ 0		\$ 0
345 Power Operated Equipment	\$ -	\$ -		\$ -
346 Communication Equipment	\$ -	\$ -		\$ -
347 Miscellaneous Equipment	\$ -	\$ -		\$ -
348 Other Tangible Plant	\$ -	\$ -		\$ -
105 C.W.I.P.	\$ -	\$ -		\$ -
TOTALS	\$ 48,530	\$ (4,831)		\$ 43,699

For Explanations of Adjustments, see Schedule 2, Page 3.

STAFF PLANT ADJUSTMENTS

a - PUMPING EQUIPMENT - Per Company	\$12,581	
Per Staff	8,652	(\$3,929)

To reflect the correct calculation of the ending balance as follows:

Per Company	Difference	Per Staff	
\$9,512	(\$3,177)	\$6,335	Plant balance of last Staff report adopted in Dec. No. 62091
\$3,069	\$0	\$3,069	Cost of 2005 pump addition
\$0	\$1,048	\$1,048	Labor cost of installing 2005 pump addition
\$0	(\$1,800)	(\$1,800)	Pump retirement
\$12,581	(\$3,929)	\$8,652	

b - WATER TREATMENT EQUIPMENT - Per Company	\$ 2,630	
Per Staff	0	(\$2,630)

To properly reflect plant that was taken out of service.

c - TRANSMISSION AND DISTRIBUTION MAINS - Per Company	\$5,796	
Per Staff	8,762	\$2,966

To properly reflect account by using the correct beginning balance as follows:

\$ 8,762	Staff's beginning bal (i.e. ending bal of last Staff report adopted in Dec. No. 62091)
\$ 5,796	Less: Company's beginning balance
\$ 2,966	Staff Account Balance

d - OTHER PLANT & MISCELLANEOUS EQUIP - Per Company	\$ 879	
Per Staff	0	(\$879)

To properly reflect account by using the correct beginning balance as follows:

\$ -	Staff's beginning bal (i.e. ending bal of last Staff report adopted in Dec. No. 62091)
\$ 879	Less: Company's beginning balance
\$ (879)	Staff Account Balance

e - OFFICE FURNITURE AND EQUIPMENT	\$ 509	
Per Staff	150	(\$359)

To properly reflect account by using the correct beginning balance as follows:

\$ 150	Staff's beginning bal (i.e. ending bal of last Staff report adopted in Dec. No. 62091)
\$ 509	Less: Company's beginning balance
\$ (359)	Staff Account Balance

PLANT & ACCUMULATED DEPRECIATION SCHEDULE

	Staff		Staff		Staff		Staff		1998		1998	
	30-Sep-98	30-Sep-98	30-Sep-98	30-Sep-98	30-Sep-98	30-Sep-98	30-Sep-98	30-Sep-98	Retirements	Oct to Dec	Total	Accumulated
	Original Cost	Depreciation	Cost	Depreciation								
301 Organization Cost	\$708	\$0	\$0	0.00%	\$0	\$0	\$0	\$0	\$0	\$0	\$708	\$0
302 Franchise Cost	2,708	0	0	0.00%	0	0	0	0	0	0	2,708	0
303 Land & Land Rights	250	0	0	0.00%	0	0	0	0	0	0	250	0
304 Structures & Improv	2,257	1,292	1,292	5.00%	0	0	28	0	0	0	2,257	1,320
307 Wells & Springs	4,424	4,424	4,424	5.00%	0	0	0	0	0	0	4,424	4,424
311 Electric Pumping Equip	6,335	3,625	3,625	5.00%	0	0	79	0	0	0	6,335	3,704
320 Water Treatment Equip	2,630	1,505	1,505	5.00%	0	0	33	0	0	0	2,630	1,538
330.1 Dist. Resrvr - Storage	0	0	0	5.00%	0	0	0	0	0	0	0	0
330.2 Dist. Resrvr - Pressure	8,141	4,659	4,659	5.00%	0	0	102	0	0	0	8,141	4,760
331 Trans. & Distr. Mains	8,762	8,762	8,762	5.00%	0	0	0	0	0	0	8,762	8,762
333 Services	7,205	7,205	7,205	5.00%	0	0	0	0	0	0	7,205	7,205
334 Meters	0	0	0	5.00%	0	0	0	0	0	0	0	0
335 Hydrants	0	0	0	5.00%	0	0	0	0	0	0	0	0
339 Other Plant & Misc. Equip	0	0	0	5.00%	0	0	0	0	0	0	0	0
340 Office Furniture & Fixt	150	86	86	5.00%	0	0	2	0	0	0	150	88
341 Transportation Equip	0	0	0	5.00%	0	0	0	0	0	0	0	0
343 Tools & Work Equip	442	442	442	5.00%	0	0	0	0	0	0	442	442
345 Power Operated Equip	0	0	0	5.00%	0	0	0	0	0	0	0	0
347 Miscellaneous Equip	0	0	0	5.00%	0	0	0	0	0	0	0	0
1998 Totals	\$44,012	\$31,999	\$31,999		\$0	\$0	\$244	\$0	\$244	\$44,012	\$32,243	
271 Contribs in Aid of Constr	0	0	0		0	0	0	0	0	0	0	0
Net	\$44,012	\$31,999	\$31,999		\$0	\$0	\$244	\$0	\$244	\$44,012	\$32,243	

PLANT & ACCUMULATED DEPRECIATION SCHEDULE

	1999 Additions		1999 Retirements		Fully Depreciated		1999 Depr. Expense		1999 Total Cost		1999 Accumulated Depreciation		1999 Net Book Value	
	Cost		Cost	Depreciation	Depreciated	Depreciated	Depr. Expense	Depr. Expense	Total Cost	Total Cost	Depreciation	Depreciation	Book Value	Book Value
301 Organization Cost	\$0		\$0	\$0	\$0	\$0	\$0	\$0	\$708	\$0	\$0	\$708	\$708	
302 Franchise Cost	0		0	0	0	0	0	0	2,708	0	0	2,708	2,708	
303 Land & Land Rights	0		0	0	0	0	0	0	250	0	0	250	250	
304 Structures & Improv	0		0	0	0	0	113	113	2,257	1,433	1,433	824	824	
307 Wells & Springs	0		0	0	4,424	0	0	0	4,424	4,424	4,424	0	0	
311 Electric Pumping Equip	0		0	0	0	0	317	317	6,335	4,021	4,021	2,314	2,314	
320 Water Treatment Equip	0		0	0	0	0	132	132	2,630	1,669	1,669	961	961	
330.1 Dist. Resrvr - Storage	0		0	0	0	0	0	0	0	0	0	0	0	
330.2 Dist. Resrvr - Pressure	0		0	0	0	0	407	407	8,141	5,167	5,167	2,974	2,974	
331 Trans. & Distr. Mains	0		0	0	8,762	0	0	0	8,762	8,762	8,762	0	0	
333 Services	0		0	0	7,205	0	0	0	7,205	7,205	7,205	0	0	
334 Meters	0		0	0	0	0	0	0	0	0	0	0	0	
335 Hydrants	0		0	0	0	0	0	0	0	0	0	0	0	
339 Plant Structures & Imprv	0		0	0	0	0	0	0	0	0	0	0	0	
340 Office Furniture & Fixt	0		0	0	0	0	8	8	150	95	95	55	55	
341 Transportation Equip	0		0	0	0	0	0	0	0	0	0	0	0	
343 Tools & Work Equip	0		0	0	442	0	0	0	442	442	442	0	0	
345 Power Operated Equip	0		0	0	0	0	0	0	0	0	0	0	0	
347 Miscellaneous Equip	0		0	0	0	0	0	0	0	0	0	0	0	
1999 Totals	\$0		\$0	\$0	\$20,833	\$0	\$976	\$976	\$44,012	\$33,219	\$33,219	\$10,793	\$10,793	
271 Contribs in Aid of Constr	0		0	0	0	0	0	0	0	0	0	0	0	
Net	\$0		\$0	\$0	\$20,833	\$0	\$976	\$976	\$44,012	\$33,219	\$33,219	\$10,793	\$10,793	

PLANT & ACCUMULATED DEPRECIATION SCHEDULE

	2000 Additions		2000 Retirements		Fully Depreciated	2000 Depr. Expense	2000 Total Cost	2000 Accumulated Depreciation	2000 Net Book Value
	Cost		Cost	Depreciation					
301 Organization Cost	\$0	\$0	\$0	\$0	\$0	\$0	\$708	\$0	\$708
302 Franchise Cost	0	0	0	0	0	0	2,708	0	2,708
303 Land & Land Rights	0	0	0	0	0	0	250	0	250
304 Structures & Improv	0	0	0	0	113	113	2,257	1,545	712
307 Wells & Springs	0	0	0	4,424	0	0	4,424	4,424	0
311 Electric Pumping Equip	0	0	0	0	317	317	6,335	4,338	1,997
320 Water Treatment Equip	0	2,630	2,630	0	66	66	0	(895)	895
330.1 Dist. Resrvr - Storage	0	0	0	0	0	0	0	0	0
330.2 Dist. Resrvr - Pressure	0	0	0	0	407	407	8,141	5,574	2,567
331 Trans. & Distr. Mains	0	0	0	8,762	0	0	8,762	8,762	0
333 Services	0	0	0	7,205	0	0	7,205	7,205	0
334 Meters	0	0	0	0	0	0	0	0	0
335 Hydrants	0	0	0	0	0	0	0	0	0
339 Plant Structures & Imprv	0	0	0	0	0	0	0	0	0
340 Office Furniture & Fixt	0	0	0	0	8	8	150	103	47
341 Transportation Equip	0	0	0	0	0	0	0	0	0
343 Tools & Work Equip	0	0	0	442	0	0	442	442	0
345 Power Operated Equip	0	0	0	0	0	0	0	0	0
347 Miscellaneous Equip	0	0	0	0	0	0	0	0	0
2000 Totals	\$0	\$2,630	\$2,630	\$20,833	\$910	\$41,382	\$31,498	\$9,884	
271 Contribs in Aid of Constr	0	0	0	0	0	0	0	0	0
Net	\$0	\$2,630	\$2,630	\$20,833	\$910	\$41,382	\$31,498	\$9,884	

PLANT & ACCUMULATED DEPRECIATION SCHEDULE

2001 Additions	2001 Retirements		Fully Depreciated	2001		2001 Accumulated Depreciation	2001 Net Book Value
	Cost	Depreciation		Depr. Expense	Total Cost		
\$0	\$0	\$0	\$0	\$0	\$708	\$0	\$708
0	0	0	0	0	2,708	0	2,708
0	0	0	0	0	250	0	250
0	0	0	0	113	2,257	1,658	599
0	0	0	4,424	0	4,424	4,424	0
0	0	0	0	317	6,335	4,655	1,680
0	0	0	0	0	0	(895)	895
0	0	0	0	0	0	0	0
0	0	0	0	407	8,141	5,981	2,160
0	0	0	8,762	0	8,762	8,762	0
0	0	0	7,205	0	7,205	7,205	0
0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0
0	0	0	0	8	150	110	40
0	0	0	0	0	0	0	0
0	0	0	442	0	442	442	0
0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0
2001 Totals	\$0	\$0	\$20,833	\$844	\$41,382	\$32,343	\$9,039
271	0	0	0	0	0	0	0
Net	\$0	\$0	\$20,833	\$844	\$41,382	\$32,343	\$9,039

PLANT & ACCUMULATED DEPRECIATION SCHEDULE

2002 Additions	2002 Retirements		Fully Depreciated	2002		2002 Accumulated Depreciation	2002 Net Book Value
	Cost	Depreciation		Depr. Expense	Total Cost		
\$0	\$0	\$0	\$0	\$0	\$708	\$0	\$708
0	0	0	0	0	2,708	0	2,708
0	0	0	0	0	250	0	250
0	0	0	0	113	2,257	1,771	486
0	0	0	4,424	0	4,424	4,424	0
0	0	0	0	317	6,335	4,971	1,364
0	0	0	0	0	0	(895)	895
0	0	0	0	0	0	0	0
0	0	0	0	407	8,141	6,389	1,752
0	0	0	8,762	0	8,762	8,762	0
0	0	0	7,205	0	7,205	7,205	0
0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0
0	0	0	0	8	150	118	32
0	0	0	0	0	0	0	0
0	0	0	442	0	442	442	0
0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0
2002 Totals	\$0	\$0	\$20,833	\$844	\$41,382	\$33,187	\$8,195
271 Contribs in Aid of Constr	0	0	0	0	0	0	0
Net	\$0	\$0	\$20,833	\$844	\$41,382	\$33,187	\$8,195

PLANT & ACCUMULATED DEPRECIATION SCHEDULE

	2003 Additions		2003 Retirements		Fully Depreciated	2003		2003 Total Cost	2003 Accumulated Depreciation	2003 Net Book Value
	Cost	Depreciation	Cost	Depreciation		Depr. Expense	Depr. Expense			
301 Organization Cost	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$708	\$0	\$708
302 Franchise Cost	0	0	0	0	0	0	0	2,708	0	2,708
303 Land & Land Rights	0	0	0	0	0	0	0	250	0	250
304 Structures & Improv	0	0	0	0	0	113	0	2,257	1,884	373
307 Wells & Springs	0	0	0	4,424	0	0	0	4,424	4,424	0
311 Electric Pumping Equip	0	0	0	0	0	317	0	6,335	5,288	1,047
320 Water Treatment Equip	0	0	0	0	0	0	0	0	(895)	895
330.1 Dist. Resrvr - Storage	0	0	0	0	0	0	0	0	0	0
330.2 Dist. Resrvr - Pressure	0	0	0	0	0	407	0	8,141	6,796	1,345
331 Trans. & Distr. Mains	0	0	0	8,762	0	0	0	8,762	8,762	0
333 Services	0	0	0	7,205	0	0	0	7,205	7,205	0
334 Meters	0	0	0	0	0	0	0	0	0	0
335 Hydrants	0	0	0	0	0	0	0	0	0	0
339 Plant Structures & Imprv	0	0	0	0	0	0	0	0	0	0
340 Office Furniture & Fixt	0	0	0	0	0	8	0	150	125	25
341 Transportation Equip	0	0	0	0	0	0	0	0	0	0
343 Tools & Work Equip	0	0	0	442	0	0	0	442	442	0
345 Power Operated Equip	0	0	0	0	0	0	0	0	0	0
347 Miscellaneous Equip	0	0	0	0	0	0	0	0	0	0
271 Totals	\$0	\$0	\$0	\$20,833	\$844	\$41,382	\$844	\$41,382	\$34,031	\$7,351
271 Contribs in Aid of Constr	0	0	0	0	0	0	0	0	0	0
Net	\$0	\$0	\$0	\$20,833	\$844	\$41,382	\$844	\$41,382	\$34,031	\$7,351

PLANT & ACCUMULATED DEPRECIATION SCHEDULE

2004 Additions Cost	2004 Retirements		Fully Depreciated	2004		2004 Total Cost	2004 Accumulated Depreciation	2004 Net Book Value
	Cost	Depreciation		Depr. Expense	Depr. Expense			
\$0	\$0	\$0	\$0	\$0	\$0	\$708	\$0	\$708
0	0	0	0	0	0	2,708	0	2,708
0	0	0	0	0	0	250	0	250
0	0	0	0	113	0	2,257	1,997	260
0	0	0	4,424	0	0	4,424	4,424	0
0	0	0	0	317	0	6,335	5,605	730
0	0	0	0	0	0	0	(895)	895
0	0	0	0	0	0	0	0	0
0	0	0	0	407	0	8,141	7,203	938
0	0	0	8,762	0	0	8,762	8,762	0
0	0	0	7,205	0	0	7,205	7,205	0
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	150	133	17
0	0	0	0	8	0	0	0	0
0	0	0	442	0	0	442	442	0
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
2004 Totals	\$0	\$0	\$20,833	\$844	\$41,382	\$34,875	\$6,507	
271 Contribs in Aid of Constr	0	0	0	0	0	0	0	0
Net	\$0	\$0	\$20,833	\$844	\$41,382	\$34,875	\$6,507	

PLANT & ACCUMULATED DEPRECIATION SCHEDULE

	2005 Additions		2005 Retirements		Fully Depreciated	2005		2005 Total Cost	2005 Accumulated Depreciation	2005 Net Book Value
	Cost	Depreciation	Cost	Depreciation		Depr. Expense	Total Cost			
301 Organization Cost	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$708	\$0	\$708
302 Franchise Cost	0	0	0	0	0	0	0	2,708	0	2,708
303 Land & Land Rights	0	0	0	0	0	0	0	250	0	250
304 Structures & Improv	0	0	0	0	0	113	0	2,257	2,110	147
307 Wells & Springs	0	0	0	4,424	0	0	0	4,424	4,424	0
311 Electric Pumping Equip	4,117	1,800	0	0	0	375	0	8,652	5,979	2,673
320 Water Treatment Equip	0	0	0	0	0	0	0	0	(895)	895
330.1 Dist. Resrvr - Storage	0	0	0	0	0	0	0	0	0	0
330.2 Dist. Resrvr - Pressure	0	0	0	0	0	407	0	8,141	7,610	531
331 Trans. & Distr. Mains	0	0	0	8,762	0	0	0	8,762	8,762	0
333 Services	0	0	0	7,205	0	0	0	7,205	7,205	0
334 Meters	0	0	0	0	0	0	0	0	0	0
335 Hydrants	0	0	0	0	0	0	0	0	0	0
339 Plant Structures & Imprv	0	0	0	0	0	0	0	0	0	0
340 Office Furniture & Fixt	0	0	0	0	0	8	0	150	140	10
341 Transportation Equip	0	0	0	0	0	0	0	0	0	0
343 Tools & Work Equip	0	0	0	442	0	0	0	442	442	0
345 Power Operated Equip	0	0	0	0	0	0	0	0	0	0
347 Miscellaneous Equip	0	0	0	0	0	0	0	0	0	0
2005 Totals	\$4,117	\$1,800	\$0	\$20,833	\$902	\$43,699	\$35,777	\$7,922		
271 Contribs in Aid of Constr	0	0	0	0	0	0	0	0	0	0
Net	\$4,117	\$1,800	\$0	\$20,833	\$902	\$43,699	\$35,777	\$7,922		

PLANT & ACCUMULATED DEPRECIATION SCHEDULE

2006 Additions Cost	2006 Retirements		Fully Depreciated	2006 Depr. Expense	2006 Total Cost	2006 Accumulated Depreciation	2006 Net Book Value
	Cost	Depreciation					
\$0	\$0	\$0	\$0	\$0	\$708	\$0	\$708
0	0	0	0	0	2,708	0	2,708
0	0	0	0	0	250	0	250
0	0	0	0	113	2,257	2,223	34
0	0	0	4,424	0	4,424	4,424	0
0	0	0	0	433	8,652	6,412	2,240
0	0	0	0	0	0	(895)	895
0	0	0	0	0	0	0	0
0	0	0	0	407	8,141	8,017	124
0	0	0	8,762	0	8,762	8,762	0
0	0	0	7,205	0	7,205	7,205	0
0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0
0	0	0	0	8	150	148	2
0	0	0	0	0	0	0	0
0	0	0	442	0	442	442	0
0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0
2006 Totals	\$0	\$0	\$20,833	\$960	\$43,699	\$36,737	\$6,962
271 Contribs in Aid of Constr	0	0	0	0	0	0	0
Net	\$0	\$0	\$20,833	\$960	\$43,699	\$36,737	\$6,962

ACCUMULATED DEPRECIATION ADJUSTMENT

	<u>Amount</u>
Accumulated Depreciation - Per Company	\$ 9,118
Accumulated Depreciation - Per Staff	36,737
Total Adjustment	<u>\$ 27,619</u> B

To reflect Staff's calculation of accumulated depreciation expense based upon Staff's adjustments to plant.

STAFF RATE BASE ADJUSTMENTS

F	-	WORKING CAPITAL (1/24 PURCHASED PWR & WTR) - Per Company Per Staff	\$	-	
				70	<u>\$70</u>
		To reflect Staff's calculation of working capital based upon Staff's recommendations for purchased power and purchased water.			
G	-	WORKING CAPITAL (1/8 OPERATION & MAINT EXP) - Per Company Per Staff	\$	-	
				4,691	<u>\$4,691</u>
		To reflect Staff's calculation of working capital based upon Staff's recommendations for operation and maintenance expense (excluding purchased power and purchased water expenses).			

STATEMENT OF OPERATING INCOME

	Company Exhibit	Staff Adjustments	Staff Adjusted
Revenues:			
461 Metered Water Revenue	\$ 5,347	\$ 219 A	\$ 5,566
460 Unmetered Water Revenue	\$ 43,692	\$ 660 B	\$ 44,352
474 Other Water Revenues	\$ 13,420	\$ (13,420) C	\$ -
Total Operating Revenue	\$ 62,459	\$ (12,541)	\$ 49,918
Operating Expenses:			
601 Salaries and Wages	\$ -	\$ -	\$ -
610 Purchased Water	\$ -	\$ -	\$ -
615 Purchased Power	\$ 1,585	\$ 97 D	\$ 1,682
618 Chemicals	\$ -	\$ -	\$ -
620 Materials and Supplies	\$ 1,447	\$ (1,048) E	\$ 399
621 Office Supplies & Expense	\$ 1,496	\$ -	\$ 1,496
630 Outside Services	\$ 10,920	\$ 6,664 F	\$ 17,584
635 Water Testing	\$ 3,786	\$ (917) G	\$ 2,869
641 Rents	\$ -	\$ -	\$ -
650 Transportation Expenses	\$ -	\$ -	\$ -
657 Insurance - General Liability	\$ 3,879	\$ -	\$ 3,879
659 Insurance - Health and Life	\$ -	\$ -	\$ -
666 Regulatory Commission Expense - Rate Case	\$ 8,386	\$ -	\$ 8,386
675 Miscellaneous Expense	\$ 12,343	\$ (9,432) H	\$ 2,911
403 Depreciation Expense	\$ 831	\$ 743 I	\$ 1,574
408 Taxes Other Than Income	\$ 911	\$ (911) J	\$ -
408.11 Property Taxes	\$ 2,692	\$ -	\$ 2,692
409 Income Tax	\$ 5,893	\$ (4,544) K	\$ 1,349
Total Operating Expenses	\$ 54,169	\$ (9,348)	\$ 44,821
OPERATING INCOME/(LOSS)	\$ 8,290	\$ (3,192)	\$ 5,098
Other Income/(Expense):			
419 Interest and Dividend Income	\$ -	\$ -	\$ -
421 Non-Utility Income	\$ 218	\$ -	\$ 218
427 Interest Expense	\$ 760	\$ -	\$ 760
426 Miscellaneous Non-Utility Expense	\$ -	\$ -	\$ -
	\$ -	\$ -	\$ -
Total Other Income/(Expense)	\$ (542)	\$ -	\$ (542)
NET INCOME/(LOSS)	\$ 7,748	\$ (3,192)	\$ 4,556

STAFF ADJUSTMENTS

A	- METERED WATER REVENUE - Per Company Per Staff	\$ 5,347 <u>5,566</u>	<u>\$219</u>
	To reflect Staff's calculation of metered water revenue for the 1-inch customers using the Company provided billing determinants.		
B	- UNMETERED WATER REVENUE - Per Company Per Staff	\$ 43,692 <u>44,352</u>	<u>\$660</u>
	To reflect Staff's calculation of metered water revenue for the flat rate residential customers using the Company provided billing determinants.		
		224 Customers per the Water Usage Data sheet on p.12 of application <u>12</u> Multiplied by 12 months 2,688 Number of bills per year \$ 16.50 Multiplied by monthly customer charge <u>\$ 44,352</u>	
C	- OTHER WATER REVENUE - Per Company Per Staff	\$ 13,420 <u>0</u>	<u>(\$13,420)</u>
	To remove revenue generated by the \$5.00 monthly system replacement surcharge authorized in Decision No. 62091.		
D	- PURCHASED POWER EXPENSE - Per Company Per Staff	\$ 1,585 <u>1,682</u>	<u>\$97</u>
	To reflect 12 months of purchased power expense by including the December 2006 purchased power bill in the amount of \$97.		
E	- MATERIAL AND SUPPLIES - Per Company Per Staff	\$ 1,447 <u>399</u>	<u>(\$1,048)</u>
	To capitalize \$1,048 in labor costs incurred to install a pump.		

STAFF ADJUSTMENTS (Cont.)

F -	OUTSIDE SERVICES - Per Company	\$	10,920	
	Per Staff		17,584	\$6,664

To reflect Staff's calculation of Outside Services expense which includes costs that were reclassified from Misc Expense and Water Testing expense.

Calculation of Outside Services

Bookkeeping, billing, & collections (Lili Whitiford)	\$	2,520
Water company operator (Jim Halliwell)	\$	8,400
Per Company	\$	10,920
Reclassified from Water Testing Expense	\$	917
Reclassified from Miscellaneous Expense & normalized	\$	5,748
Staff adjustment	\$	6,665
Total per Staff	\$	17,585

Accounting Services Reclassified from Miscellaneous Expenses and Normalized			
	Per Company	Staff Adjustment	Per Staff Normalized
Normal recurring accounting services	\$ 4,216	\$ -	\$ 4,216
Additional professional accounting svcs	\$ 6,126	\$ (4,594)	\$ 1,532
	\$ 10,342	\$ (4,594)	\$ 5,748

Professional Accounting Services	Reclassified From Misc Exp
Additional professional accounting services	\$ 945
Additional professional accounting services	\$ 1,666
Additional professional accounting services	\$ 1,135
Additional professional accounting services	\$ 1,825
Additional professional accounting services	\$ 555
Amount to be Normalized	\$ 6,126
Divided by 4 years	\$ 4
Normalized Amount	\$ 1,532

STAFF ADJUSTMENTS (Cont.)

G	- WATER TESTING - Per Company Per Staff	\$ 3,786 <u>2,869</u>	<u>(917)</u>
	To reflect Staff's annual water testing expense and to reclassify \$917 to Outside Services expense per Engineering Staff's recommendation.		
H	- MISCELLANEOUS EXPENSE - Per Company Per Staff	\$ 12,343 <u>2,911</u>	<u>(\$9,432)</u>
	To reflect reclassification of professional accounting services to account number 630, "Outside Services".		

Miscellaneous Expense			
	Per Company Invoices	Staff Adj	Per Staff
Director's Management Fee	\$ 2,000.00	\$ -	\$ 2,000.00
Additional professional accounting services	\$ 945.00	\$ (945.00)	\$ -
Additional professional accounting services	\$ 1,666.00	\$ (1,666.00)	\$ -
Additional professional accounting services	\$ 1,135.00	\$ (1,135.00)	\$ -
Additional professional accounting services	\$ 1,825.00	\$ (1,825.00)	\$ -
William Clements, CPA - Regarding ACC Utilities Annual Report	\$ 1,526.00	\$ (1,526.00)	\$ -
William Clements, CPA - Regarding preparation of financial stmts & taxes	\$ 2,690.00	\$ (2,690.00)	\$ -
Additional professional accounting services	\$ 555.00	\$ (555.00)	\$ -
	\$ -	\$ -	\$ -
	<u>\$ 12,342.00</u>	<u>\$ (10,342.00)</u>	<u>\$ 2,000.00</u>
Reclassified from acct. no. 408, "Taxes Other Than Income"	\$ -	\$ 911.00	\$ 911.00
	12,342	(9,431)	2,911.00

STAFF ADJUSTMENTS (Cont.)

I - DEPRECIATION - Per Company \$831
Per Staff 1,574 \$743

Acct No.	DESCRIPTION	[A]	[B]	[C]	[D]	[E]
		PLANT In SERVICE Per Staff	NonDepreciable or Fully Depreciated PLANT	DEPRECIABLE PLANT (Col A - Col B)	DEPRECIATION RATE	DEPRECIATION EXPENSE (Col C x Col D)
301	Organization	\$ 708	\$ 708	\$ -	0.00%	\$ -
302	Franchises	\$ 2,708	\$ 2,708	\$ -	0.00%	\$ -
303	Land & Land Rights	\$ 250	\$ 250	\$ -	0.00%	\$ -
304	Structures & Improvements	\$ 2,257	\$ -	\$ 2,257	3.33%	\$ 75
307	Wells & Springs	\$ 4,424	\$ 4,424	\$ -	3.33%	\$ -
311	Pumping Equipment	\$ 8,652	\$ -	\$ 8,652	12.50%	\$ 1,082
320	Water Treatment Equipment	\$ -	\$ -	\$ -	20.00%	\$ -
330.1	Distribution Reservoirs - Storage	\$ -	\$ -	\$ -	2.22%	\$ -
330.2	Distribution Reservoirs - Pressure	\$ 8,141	\$ -	\$ 8,141	5.00%	\$ 407
331	Transmission & Distribution Mains	\$ 8,762	\$ 8,762	\$ -	2.00%	\$ -
333	Services	\$ 7,205	\$ 7,205	\$ -	3.33%	\$ -
334	Meters & Meter Installations	\$ -	\$ -	\$ -	8.33%	\$ -
335	Hydrants	\$ 0	\$ -	\$ 0	0.00%	\$ -
336	Backflow Prevention Devices	\$ 0	\$ -	\$ 0	0.00%	\$ -
339	Other Plant and Misc. Equipment	\$ 0	\$ -	\$ 0	0.00%	\$ -
340	Office Furniture & Equipment	\$ 150	\$ -	\$ 150	6.67%	\$ 10
341	Transportation Equipment	\$ -	\$ -	\$ -	0.00%	\$ -
343	Tools Shop & Garage Equipment	\$ 442	\$ 442	\$ 0	0.00%	\$ -
	Total Plant	\$ 43,699	\$ 24,499	\$ 19,200		\$ 1,574

Depreciation Expense Before Amortization of CIAC: \$ 1,574
Less Amortization of CIAC*: \$ -
Test Year Depreciation Expense - Staff: \$ 1,574
Depreciation Expense - Company: \$ 831
Staff's Total Adjustment: \$ 743

*** Amortization of CIAC Calculation:**
Contribution(s) in Aid of Construction (Gross) \$ -
Less: Non Amortizable Contribution(s) 0
Less: Fully Amortized Contribution(s) 0
Amortizable Contribution(s) \$ -
Times: Staff Proposed Amortization Rate 0.00%
Amortization of CIAC \$ -

STAFF ADJUSTMENTS (Cont.)

J	-	TAXES OTHER THAN INCOME - Per Company	\$	911	
		Per Staff		0	<u>(\$911)</u>
		To reclassify expenses described as "licenses and permits" in the Company's general ledger to the miscellaneous expense account.			
K	-	INCOME TAXES - Per Company	\$	5,893	
		Per Staff		1,349	<u>(\$4,544)</u>
		To reflect Staff's income tax calculation as shown on CSB-3, page 7.			

GROSS REVENUE CONVERSION FACTOR

LINE NO.	DESCRIPTION	(A)	(B)	(C)	(D)
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Calculation of Gross Revenue Conversion Factor:

1	Billings	1.000000			
2	Uncollectible Factor	0.000000			
3	Revenues	1.000000			
4	Less: Combined Federal and State Tax Rate (Line 12)	0.209228			
5	Subtotal (L3 - L4)	0.7908			
6	Revenue Conversion Factor (L1 / L5)	1.26459			

Calculation of Effective Tax Rate:

7	Operating Income Before Taxes (Arizona Taxable Income)	100.0000%			
8	Arizona State Income Tax Rate	6.9680%			
9	Federal Taxable Income (L7 - L8)	93.0320%			
10	Applicable Federal Income Tax Rate (Line 34)	15.0000%			
11	Effective Federal Income Tax Rate (L9 x L10)	13.9548%			
12	Combined Federal and State Income Tax Rate (L8 +L11)	20.9228%			

13	Required Operating Income	\$ 60,699			
14	Adjusted Test Year Operating Income (Loss)	\$ 49,918			
15	Required Increase in Operating Income (L13 - L14)		\$ 10,781		
16	Income Taxes on Recommended Revenue (Col. (D), L33)	\$ 1,349			
17	Income Taxes on Test Year Revenue (Col. (B), L33)	\$ 1,349			
18	Required Increase in Revenue to Provide for Income Taxes (L16 -L17)		\$ (0)		
19	Total Required Increase in Revenue (L15 + L18)		\$ 10,781		

Calculation of Income Tax:

	Test Year		Staff Proposed
20	Revenue	\$ 49,918	\$ 49,918
21	Less: Operating Expenses Excluding Income Taxes	\$ 43,472	\$ 43,472
22	Less: Synchronized Interest (L37)	\$ -	\$ -
23	Arizona Taxable Income (L20 - L21 - L22)	\$ 6,447	\$ 6,446
24	Arizona State Income Tax Rate	6.968%	6.968%
25	Arizona Income Tax (L23 x L24)	\$ 449	\$ 449
26	Federal Taxable Income (L23 - L25)	\$ 5,997	\$ 5,997
27	Federal Tax on First Income Bracket (\$1 - \$50,000) @ 15%	\$ 900	\$ 900
28	Federal Tax on Second Income Bracket (\$51,001 - \$75,000) @ 25%	\$ -	\$ -
29	Federal Tax on Third Income Bracket (\$75,001 - \$100,000) @ 34%	\$ -	\$ -
30	Federal Tax on Fourth Income Bracket (\$100,001 - \$335,000) @ 39%	\$ -	\$ -
31	Federal Tax on Fifth Income Bracket (\$335,001 - \$10,000,000) @ 34%	\$ -	\$ -
32	Total Federal Income Tax	\$ 900	\$ 900
33	Combined Federal and State Income Tax (L25 + L32)	\$ 1,349	\$ 1,349

34	Applicable Federal Income Tax Rate [Col. (D), L32 - Col. (B), L32] / [Col. (C), L26 - Col. (A), L26]	15.0000%
----	--	----------

Calculation of Interest Synchronization:

35	Rate Base	\$ -
36	Weighted Average Cost of Debt (Col. [F], L1 + L2)	0.00%
37	Synchronized Interest (L35 X L37)	\$ -

RATE DESIGN

	Present Rates	-Proposed Rates-	
		Company	Staff
Unmetered Rates - Residential	\$ 16.50	\$ 16.50	\$ 16.50
5/8" x 3/4" Meter	\$6.75	\$6.75	9.75
3/4" Meter	15.13	15.13	15.13
1" Meter Only meter currently in use	31.88	31.88	31.88
1 1/2" Meter	73.75	73.75	73.75
2" Meter	124.00	124.00	124.00
3" Meter	241.25	241.25	241.25
4" Meter	408.75	408.75	408.75
6" Meter	827.50	827.50	827.50
Gallons Included in Monthly Customer Charge:			
For all meter sizes	0	0	0
Uniform Commodity Rate			
Per 1,000 gallons for all usage	\$ 2.05	\$ 2.05	N/A
5/8-Inch x 3/4-Inch Meters			
0 to 3,000 gallons	\$ 2.05	\$ 2.05	\$ 1.25
3,001 to 10,000 gallons	\$ 2.05	\$ 2.05	\$ 1.80
10,001 and above gallons	\$ 2.05	\$ 2.05	\$ 2.30
1-Inch Meters			
0 to 40,000 gallons	\$ 2.05	\$ 2.05	\$ 1.80
40,001 and above gallons	\$ 2.05	\$ 2.05	\$ 2.30
Surcharges (Implemented in Accordance to Dec. 62091)			
Phase I			\$ 5.00
Phase II			\$ 10.00 Not yet implemented
Service Line and Meter Installation Charges			
	Present Rates	Company Proposed	Staff Proposed Services Meters Total
5/8" x 3/4" Meter	\$ 410.00	\$ 410.00	\$ 290.00 \$ 120.00 \$ 410.00
3/4" Meter	440.00	440.00	290.00 150.00 \$440.00
1" Meter	470.00	470.00	310.00 160.00 \$470.00
1 1/2" Meter	715.00	715.00	330.00 385.00 \$715.00
2" Meter	1,820.00	1,820.00	395.00 1,425.00 \$1,820.00
3" Meter	2,410.00	2,410.00	475.00 1,935.00 \$2,410.00
4" Meter	3,455.00	3,455.00	710.00 2,745.00 \$3,455.00
6" Meter	6,650.00	6,650.00	1,070.00 5,580.00 \$6,650.00
Service Charges			
Establishment	\$ 25.00	\$ 25.00	\$ 25.00
Establishment (After Hours)	40.00	40.00	40.00
Reconnection (Delinquent)	25.00	25.00	25.00
Reconnection (Delinquent - After Hours)	N/A	N/A	N/A
Meter Test (If Correct)	40.00	40.00	40.00
Deposit	*	*	*
Deposit Interest	*	*	*
Re-Establishment (Within 12 Months)	**	**	**
NSF Check	20.00	20.00	20.00
Deferred Payment	1.50%	1.50%	1.50%
Meter Re-Read (If Correct)	15.00	15.00	15.00
Late Fee	1.50%	1.50%	1.50%
Fire Sprinkler System	***	***	***

* Per Commission Rules (R14-2-403.B)

** Months off system times the minimum (R14-2-403.D)

*** 1% of monthly minimum for a comparable sized meter connection, but no less than \$5.00 per month. The service charge for fire sprinklers is only applicable for service lines separate and distinct from the primary water service line.

N/A: Not applicable

TYPICAL BILL ANALYSIS

Residential Service
 Flat Rate Design

Average Number of Customers: 221

<u>Company Proposed</u>	Gallons	Present Rates ¹	Proposed Rates	Dollar Increase ²	Percent Increase
Average Usage	NA	\$21.50	\$26.50	\$5.00	23.3%
Median Usage	NA	\$21.50	\$26.50	\$5.00	23.3%
<u>Staff Proposed</u>					
Average Usage	NA	\$21.50	\$25.43	\$3.93	18.3%
Median Usage	NA	\$21.50	\$25.43	\$3.93	18.3%

Note 1:
 Present Flat Rate \$16.50
 Present System Replacement Surcharge \$5.00

 \$21.50

Note 2:
 Company proposed surcharge \$5.00
 Staff proposed ARSM \$3.93

TYPICAL BILL ANALYSIS

Residential Service
 Inverted Three Tierd Rate Design

Average Number of Customers: 221

<u>Company Proposed</u>	Gallons	Present Rates ¹	Proposed Rates ²	Dollar Increase	Percent Increase
Average Usage	NA	\$21.50	\$26.50	\$5.00	23.3%

<u>Staff Proposed</u>	Gallons	Present Rates ¹	Proposed Rates ²	Dollar Increase	Percent Increase
Average Usage	4,796	\$21.50	\$25.66	\$4.16	19.3%

Note 1:

Present Flat Rate	\$16.50
Present Syst. Replacement Surcharge	\$5.00
	<u>\$21.50</u>

Note 2, Company Proposed:

Present Flat Rate	\$16.50
Present Syst. Replacement Surcharge	\$5.00
	<u>\$21.50</u>
Company proposed surcharge	\$5.00
	<u>\$26.50</u>

Note 2, Staff Recommended:

Monthly Customer Charge		\$9.75
First 3,000 gallons	\$1.25	\$3.75
Next 1,796 gallons	\$1.80	<u>\$3.23</u>
Total gallons 4,796		6.98
Present Syst. Replacement Surcharge		\$5.00
Staff proposed ARSM		<u>\$3.93</u>
		\$16.73
		\$5.00
		<u>\$3.93</u>
		\$25.66

FINANCIAL ANALYSIS

Selected Financial Data
Including Immediate Effects of the Proposed Debt
Includes Arsenic Surcharge

Line No.	[A] Staff Recommended Permanent Rates Without Loan	[B] Adjustments	[C] Staff Recommended Rates with Surcharge, Loan Prin & Interest, and Income taxes	
1	INCOME STATEMENT			
2				
3	Operating Revenue			
4	\$ 5,566	\$ -	\$ 5,566	
5	\$ 44,352	\$ -	\$ 44,352	
6	\$ -	\$ 10,780	\$ 10,780	
7	\$ -	\$ -	\$ -	
8	Total Operating Rev:	\$ 10,780	\$ 60,698	
9				
10	Operating Expenses			
11	\$ 1,682	\$ -	\$ 1,682	
12	\$ 399	\$ -	\$ 399	
13	\$ 1,496	\$ -	\$ 1,496	
14	\$ 17,584	\$ -	\$ 17,584	
15	\$ 2,869	\$ -	\$ 2,869	
16	\$ 3,879	\$ -	\$ 3,879	
17	\$ 8,386	\$ -	\$ 8,386	
18	\$ 2,911	\$ -	\$ 2,911	
19	\$ 1,574	\$ -	\$ 1,574	
20	\$ 2,692	\$ -	\$ 2,692	
21	\$ 1,349	\$ 747	\$ 2,096	
22	Total Operating Expense	\$ 747	\$ 45,568	
23				
24	Operating Income	\$ 10,033	\$ 15,131	
25				
26	\$ -	\$ -	\$ -	
27	\$ 218	\$ -	\$ 218	
28	\$ 760	\$ 7,208	\$ 7,968	
29	\$ -	\$ -	\$ -	
30	Total Other Interest Expense	\$ (7,208)	\$ (7,750)	
31				
32	Net Income	\$ 2,825	\$ 7,381	
33				
34	Operating Margin	10.21%	24.93%	
35				
36	\$ -	\$ 2,825	\$ 2,825	
37				
38	Cash Flow (L 24 + L19 - L36)	\$ 0	\$ 6,130	
39				
40	TIER			
41	[L 21 + L 24] ÷ L 28	8.48	2.16	
42	DSC			
43	[L 19 + L 21 + L 24] ÷ [L 28 + L 36]	10.55	1.74	
44				
45				
46	Short-term Debt	0%	\$ 2,834	1.3%
47				
48	Long-term Debt	0%	\$ 109,266	50.5%
49				
50	Common Equity	100%	\$ 104,304	48.2%
51				
52	Total Capital	100%	\$ 216,404	100.0%

ARSM CALCULATION - EXAMPLE

Loan Amount: **\$112,100**
Term: **20 Years**
Interest Rate Before Subsidy: **9.25%**
WFA Subsidy Rate: **70%**
WFA Interest rate (9.25% x 70%): **6.475%** If interest rate is not found on TABLE A, use the next highest percentage

Step 1 - Find the Annual Payment on Loan

\$112,100 Total Amount of Loan
0.0895 TABLE A, Conversion Factor Table, Column B
\$10,032.95 Annual Principle and Interest Payment

Step 2 - Find the Annual Interest Payment on Loan

\$112,100 Total Amount of Loan
0.0643 TABLE A, Conversion Factor Table, Column C
\$7,208.03 Annual Interest Payment on Debt

Step 3 - Find the Annual Principal Payment on Loan

\$112,100 Total Amount of Loan
0.0252 TABLE A, Conversion Factor Table, Column D
\$2,824.92 Annual Principal and Interest Payment

Step 4 - Find the Gross Revenue Conversion Factor

1.2646

Step 5 - Find the Incremental Income Tax Factor

1.2646 minus 1 = 0.2646

Step 6 - Find the Annual Income Tax Component of Surcharge Revenue

0.2645 Incremental Income Tax Factor (from Step 5)
\$2,824.92 Multiplied by: Annual Principal Payment on Loan (from Step 3)
\$747.19 Annual Income Tax Component of the Annual Surcharge Revenue

Step 7 - Find the Debt Service Component of the Annual Surcharge Revenue

\$7,208.03 Annual Interest Payment on Debt (from Step 2)
\$2,824.92 Plus: Annual Principal Payment (from Step 3)
\$10,032.95 Debt Service Component of the Annual Surcharge Revenue

Step 8 - Find the Annual Surcharge Revenue Requirement Needed for the Loan

\$747.19 Annual Income Tax Component of the Annual Surcharge Revenue (from Step 6)
\$10,032.95 Plus: Debt Service Component of the Annual Surcharge Revenue (from Step 7)
\$10,780.14 Total Annual Surcharge Revenue Requirement for the Loan

Step 9 - Find the Equivalent Bills

Equivalent Bills				
Col A	Col B	Col C	Col D	Col E
Meter Size	NARUC Multiplier	Number of Customers	Number of Months in Year	Equivalent Bills Col B x C x D
5/8" x 3/4" Meter	1	221	12	2,652
3/4" Meter	1.5	0	12	-
1" Meter	2.5	3	12	90
1 1/2" Meter	5	0	12	-
2" Meter	8	0	12	-
3" Meter	15	0	12	-
4" Meter	25	0	12	-
6" Meter	50	0	12	-
		<u>224</u>		<u>2,742</u>

Step 10 - Find the Monthly Surcharge

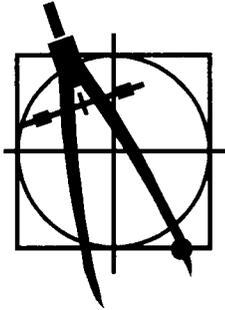
\$10,780.14 Total Annual Surcharge Revenue Requirement for the Loan (from Step 8)
2,742 Divided by: Total Number of Equivalent Bills
\$ 3.93 Monthly Surcharge for 3/4" Customers

Step 11 - Find the Monthly Surcharge for the Remaining Meter Size Customers

Equivalent Bills			
Col A	Col B	Col C	Col D
Meter Size	NARUC Multiplier	5/8" x 3/4" Customers' Surcharge	Surcharge by Meter Size Col B x C
5/8" x 3/4" Meter	1	\$ 3.93	\$ 3.93
3/4" Meter	1.5	\$ 3.93	\$ 5.90
1" Meter	2.5	\$ 3.93	\$ 9.83
1 1/2" Meter	5	\$ 3.93	\$ 19.66
2" Meter	8	\$ 3.93	\$ 31.45
3" Meter	15	\$ 3.93	\$ 58.97
4" Meter	25	\$ 3.93	\$ 98.29
6" Meter	50	\$ 3.93	\$ 196.57

TABLE A
Conversion Factor Table (Based on a 20-year Loan)

Line No.	Column A Annual Interest	Column B Annual Payment Conversion Factor	Column C Annual Interest Payment Conversion Factor	Column D Annual Principal Payment Conversion Factor
1	3.50%	0.0696	0.0344	0.0352
2	3.75%	0.0711	0.0369	0.0342
3	4.00%	0.0727	0.0394	0.0333
4	4.25%	0.0743	0.0419	0.0324
5	4.50%	0.0759	0.0444	0.0316
6	4.75%	0.0775	0.0468	0.0307
7	5.00%	0.0792	0.0493	0.0299
8	5.25%	0.0809	0.0518	0.0291
9	5.50%	0.0825	0.0543	0.0283
10	5.75%	0.0843	0.0568	0.0275
11	6.00%	0.0860	0.0593	0.0267
12	6.25%	0.0877	0.0618	0.0259
13	6.50%	0.0895	0.0643	0.0252
14	6.75%	0.0912	0.0668	0.0245
15	7.00%	0.0930	0.0692	0.0238
16	7.25%	0.0948	0.0717	0.0231
17	7.50%	0.0967	0.0742	0.0224
18	7.75%	0.0985	0.0767	0.0218
19	8.00%	0.1004	0.0792	0.0211



Engineering Report for Shepard Water Company

Docket No. W-01537A-07-0264 (Rates)

By: Marlin Scott, Jr. *msj*
Utilities Engineer

February 5, 2008

CONCLUSIONS

- A. Shepard Water Company's ("Company") system currently has no storage tank capacity. However, the Company is currently installing a new 55,000 gallon storage tank and with this new tank installation, along with the current well capacity of 80 GPM, this water system will have adequate capacities to serve the customer base.
- B. The Company is not located in an Active Management Area ("AMA") and is not subject to any AMA reporting and conservation requirements.
- C. The Company has an approved curtailment tariff that became effective on October 29, 2004.
- D. The Company has an approved backflow prevention tariff that became effective on August 22, 1994.

RECOMMENDATIONS

- 1. The Arizona Department of Environmental Quality ("ADEQ") reported major deficiencies for failing to provide consumer confidence reports for 2002 and 2003. Staff recommends that the Company file with Docket Control, as a compliance item in this case, a copy of an updated ADEQ Compliance Status Report indicating that the deficient consumer confidence reports issue has been resolved. Staff further recommends that any new rates and charges approved in this proceeding not become effective until the first day of the month following the Company's filing of the updated ADEQ Compliance Status Report indicating that the Company has resolved the noted deficiencies.
- 2. Staff recommends its annual water testing expense of \$2,869 be used for purposes of this application and further recommends that the remaining \$917 be classified as part of the water operator's fee.
- 3. The Company reported its arsenic concentration for its Well #1 at 12 parts per billion. Based on this arsenic concentration, the Company is currently installing an arsenic treatment system. The Company has filed a financing application to assist in funding this

project. See Attachment MSJ-2 for further discussion of the arsenic treatment financing request.

Staff recommends that the Company file with Docket Control, as a compliance item in this case, by December 31, 2008, a copy of the ADEQ Certificate of Approval of Construction for the arsenic treatment system.

4. A check with the Utilities Division Compliance Section indicated one delinquent Commission compliance item. Although the required quarterly report has yet to be submitted, Staff recommends that this compliance item has been complied with as a result of the ADEQ issuance of the Certificate for Approval to Construct (“ATC”) for the storage tank and booster system on November 13, 2006 and the Yuma County issuance of its ATC for the distribution system on September 14, 2006 and due to the construction progress discussed in this report.
5. Staff recommends that the Company use Staff’s depreciation rates delineated in Table B.
6. Staff recommends the continuance of the Company’s existing “total” charges as shown in Table C below, with separate installation charges for the service line and meter installations.

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A. LOCATION OF COMPANY

Shepard Water Company (“Company”) serves a community at Martinez Lake which is located approximately 30 miles northeast of Yuma along the Colorado River. Figure 1 shows the location of the Company within Yuma County and Figure 2 shows the certificated area covering one-quarter square-mile.

B. DESCRIPTION OF THE WATER SYSTEM

The water system was field inspected on August 2, 2007, by Marlin Scott, Jr., Staff Utilities Engineer, in the accompaniment of John Guth, Owner of the Company. The current system operation consists of one well site and a distribution system serving 221 un-metered residential customers and three metered commercial customers. The distribution system has many undersized mains of substandard quality.

A large portion of the service area is owned by Mr. Guth, who leases mobile home lots and small cabins on either a daily or long-term basis. There is also a laundry, a 25-unit RV park, a large restaurant/nightclub and a bait shop/general store.

A system schematic is shown as Figure 3 and a detailed plant facility listing is as follows:

Table 1. Well Site

Plant Items	Well #1	Well #2 (Abandoned)
Casing Size	8-inch	8-inch
Casing Depth	240 ft.	240 ft.
Submersible Pump	5-Hp	
Pumping Rate	80 GPM	(Well was high in nitrate.)
Meter Size	2-inch	
Pressure Tank	3,000 gallon	
Fencing	40 ft. by 40 ft.	

Table 2. Water Mains*

Diameter	Material	Length
1-3/4-inch	Copper	3,210 ft.
2-inch	Copper	2,130 ft.
2-inch	PVC	1,270 ft.

2-inch	PE	860 ft.
2-1/2-inch	Copper	265 ft.
3-inch	ACP	1,480 ft.
6-inch	ACP	100 ft.
	Total:	9,315 ft.

* Note: The above water main data and below customer meter data was taken from Staff's prior Engineering Report.

Table 3. Customer Meters*

Size	Quantity
5/8 x 3/4-inch	-
3/4-inch	1
1- inch	2
1-1/2-inch	-
2-inch	-
Total:	3

Construction Work

In March 2007, the Company began the construction a new well and the installation of a 55,000 gallon storage tank, booster system, waterlines and fire hydrants. The new well drilled was not productive and therefore, was abandoned. As of Staff's inspection date, the installation of storage tank and booster system was about 80% complete, while the construction of waterlines and hydrants was about 50% complete. The Arizona Department of Environmental Quality ("ADEQ") issued its Certificate for Approval to Construct ("ATC") for the storage tank and booster system on November 13, 2006, while Yuma County issued its ATC for the distribution system on September 14, 2006.

In July 2007, the Company began the installation of an arsenic treatment system. As noted on Staff's inspection, the concrete pad was completed and the skid-mounted tank vessels were set in place. This treatment system is estimated to be 50% complete. ADEQ issued its ATC for the arsenic treatment system on November 13, 2006.

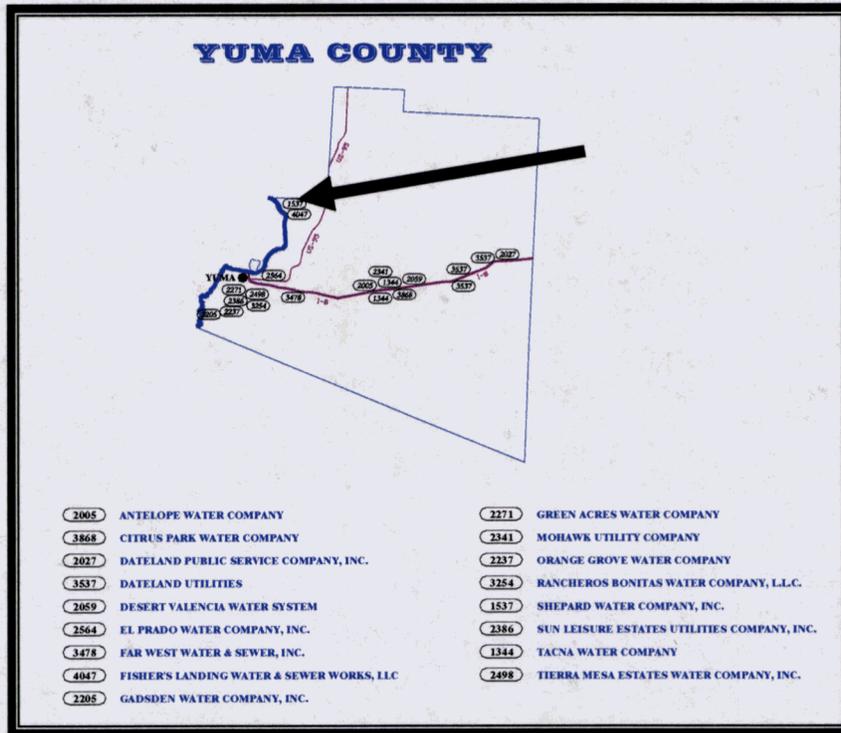


Figure 1. Yuma County Map

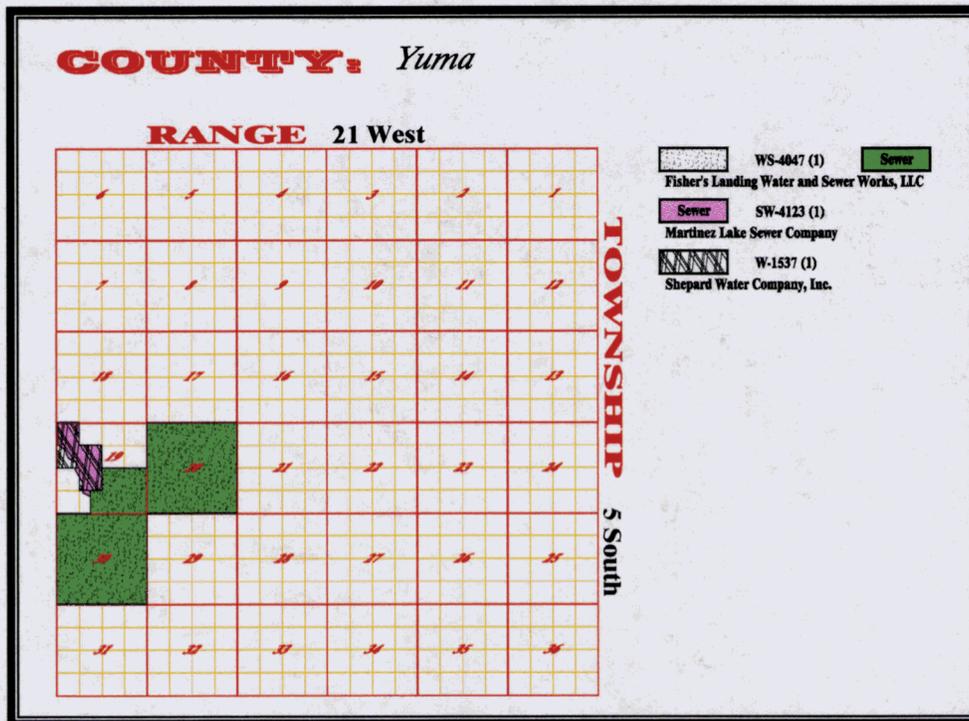


Figure 2. Certificated Areas

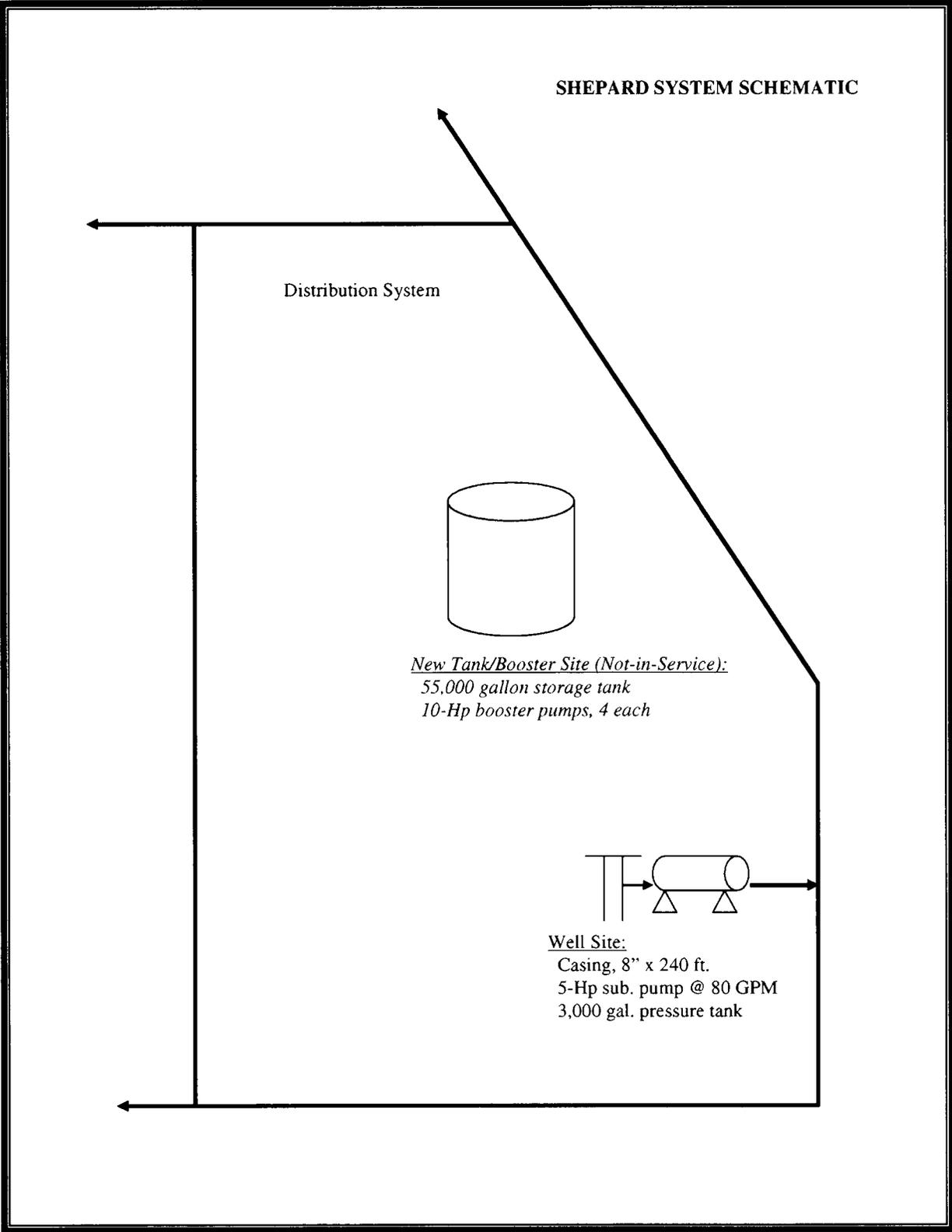


Figure 3. System Schematic

C. WATER USE

Water Sold

The Company submitted its rate application indicating 14,863,600 gallons of water sold during the test year to the 221 un-metered residential customers and three metered commercial customers. Since most of the customer's service lines are not metered, the gallons sold were measured by the wellhead meter.

Figure 4 represents data for the total gallons sold per month that was provided by the Company. This system experienced a high monthly water use of 1,660,200 gallons in July and a low monthly water use of 821,300 gallons in January.

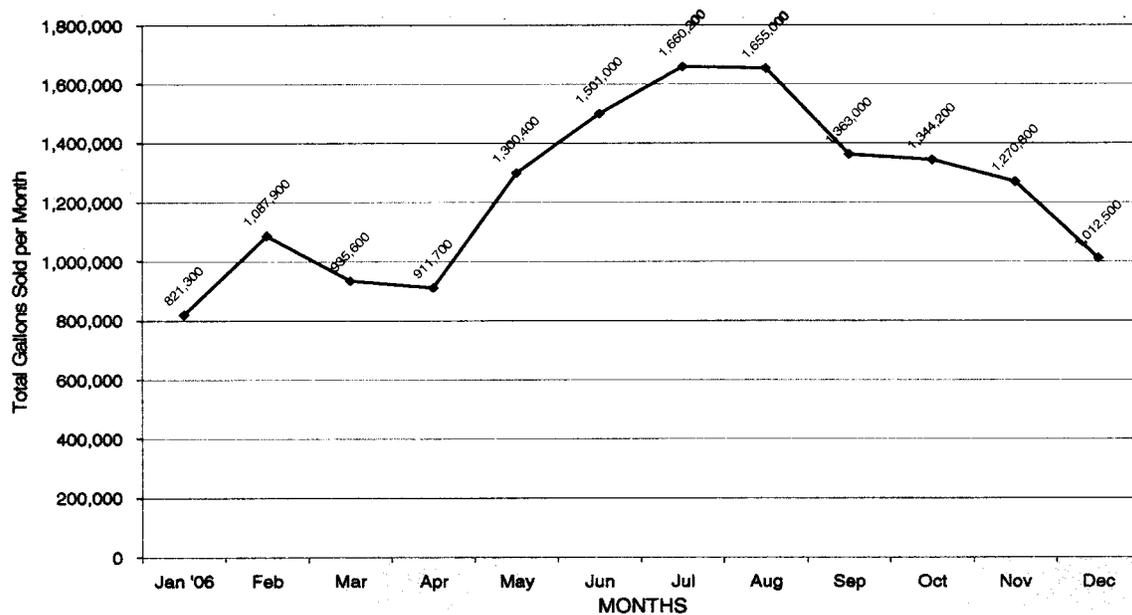


Figure 4. Water Use

Non-Account Water

Since the Company operates its water system serving 221 un-metered customers and three metered customers, the water loss cannot be determined at this time. The Company is currently reconstructing the entire distribution system and will be installing meters on all service lines. This project is expected to be completed by the end of November 2007.

System Analysis

At this time, the water system has no storage tank capacity. However, the Company is currently installing a new 55,000 gallon storage tank and with this new tank installation, the storage capacity issue will be resolved.

Using an estimated usage of 220 gallons per day per connection, the system's current well capacity of 80 GPM and the new 55,000 gallon storage tank capacity will be adequate to serve the current customer base of 224 connections.

D. GROWTH

The Company is located in a land locked area surrounded by government land. The certificated service area has reached build out and no new growth is anticipated above the current 224 customer base.

E. ARIZONA DEPARTMENT OF ENVIRONMENTAL QUALITY ("ADEQ") COMPLIANCE

Compliance

According to an ADEQ Compliance Status Report, dated April 30, 2007, ADEQ reported major deficiencies for failing to provide consumer confidence reports for 2002 and 2003, but has determined that the Company's system, PWS #14-014 is currently delivering water that meets the water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.

Staff recommends that the Company file with Docket Control, as a compliance item in this case, a copy of an updated ADEQ Compliance Status Report indicating that the deficient consumer confidence reports issue has been resolved. Staff further recommends that any new rates and charges approved in this proceeding not become effective until the first day of the month following the Company's filing of the updated ADEQ Compliance Status Report indicating that the Company has resolved the noted deficiencies.

Water Testing Expense

The Company is subject to mandatory participation in the Monitoring Assistance Program ("MAP"). Starting January 1, 2002, water companies paid a fixed \$250 per year fee, plus an additional fee of \$2.57 per service connection, regardless of meter size for participation in MAP. Participation in the MAP program is mandatory for water systems, which serve less than 10,000 persons (approximately 3,300 service connections).

The Company reported its water testing expense at \$3,786 during the test year by combining the testing costs and water operator's fees. Staff has reviewed the Company's testing expense and has separated the testing costs from the water operator's fees. Table A shows Staff's annual monitoring expense estimate of \$2,869 with participation in the MAP.

Table A. Water Testing Cost

Monitoring (Tests per 3 years, unless noted.)	Cost per test	No. of tests per year	Annual Cost
Total coliform – monthly	\$25	12	\$300
Inorganics – Priority Pollutants	MAP	MAP	MAP
Radiochemical – per 4 years	MAP	MAP	MAP
Phase II and V:			
Nitrate – annual	\$38	1	\$38
Nitrite – once per period	MAP	MAP	MAP
Asbestos – per 9 years	MAP	MAP	MAP
MAP – IOCs, SOCs, & VOCs	MAP	MAP	\$821
Lead & Copper – per year	\$75	10	\$750
Microscopic Particulate Analyses	\$800	1	\$800
Fluoride	\$40	4	\$160
Total			\$2,869

Note: ADEQ - MAP invoice for the 2007 Calendar Year is \$820.54.

Staff recommends an annual water testing expense of \$2,869 be used for purposes of this application and further recommends that the remaining \$917 be classified as part of the water operator's fee.

Arsenic

The Company reported its arsenic concentration for its Well #1 at 12 parts per billion (“ppb”). Based on this arsenic concentration, the Company is currently installing an arsenic treatment system. As noted on Staff's inspection, the concrete pad was completed and the skid-mounted tank vessels were set in place. This treatment system is estimated to be 50% complete. The Company has filed a financing application to assist in funding this project. See Attachment MSJ-2 for further discussion of the arsenic treatment financing request.

Staff recommends that the Company file with Docket Control, as a compliance item in this case, by December 31, 2008, a copy of the ADEQ Certificate for Approval of Construction for the arsenic treatment system.

F. ARIZONA DEPARTMENT OF WATER RESOURCES COMPLIANCE

The Company is not located in an Active Management Area (“AMA”) and therefore, is not subject to any AMA reporting and conservation requirements.

G. ARIZONA CORPORATION COMMISSION COMPLIANCE

A check with the Utilities Division Compliance Section indicated one delinquent Commission compliance item for:

1. Decision No. 62091 – “Company to file quarterly updates on construction progress”. This quarterly update was due on January 30, 2008.

Although the above quarterly report has yet to be submitted, Staff recommends that this compliance item has been complied with as a result of the ADEQ issuance of the ATC for the storage tank and booster system on November 13, 2006 and the Yuma County issuance of its ATC for the distribution system on September 14, 2006 and due to the construction progress discussed above.

H. DEPRECIATION RATES

The Company has been using a depreciation rate of 5.00% in every National Association of Regulatory Utility Commissioners (“NARUC”) plant category. In recent orders, the Commission has been shifting away from the use of composite rates in favor of individual depreciation rates by NARUC category. (For example, a uniform 5% composite rate would not really be appropriate for either vehicles or transmission mains and instead, different specific retirement rates should be used.)

Staff has developed typical and customary depreciation rates within a range of anticipated equipment life. These rates are presented in Table B and it is recommended that the Company use depreciation rates by individual NARUC category on a going-forward basis.

Table B. Depreciation Rates

NARUC Acct. No.	Depreciable Plant	Average Service Life (Years)	Annual Accrual Rate (%)
304	Structures & Improvements	30	3.33
305	Collecting & Impounding Reservoirs	40	2.50
306	Lake, River, Canal Intakes	40	2.50
307	Wells & Springs	30	3.33

308	Infiltration Galleries	15	6.67
309	Raw Water Supply Mains	50	2.00
310	Power Generation Equipment	20	5.00
311	Pumping Equipment	8	12.5
320	Water Treatment Equipment		
320.1	Water Treatment Plants	30	3.33
320.2	Solution Chemical Feeders	5	20.0
330	Distribution Reservoirs & Standpipes		
330.1	Storage Tanks	45	2.22
330.2	Pressure Tanks	20	5.00
331	Transmission & Distribution Mains	50	2.00
333	Services	30	3.33
334	Meters	12	8.33
335	Hydrants	50	2.00
336	Backflow Prevention Devices	15	6.67
339	Other Plant & Misc Equipment	15	6.67
340	Office Furniture & Equipment	15	6.67
340.1	Computers & Software	5	20.00
341	Transportation Equipment	5	20.00
342	Stores Equipment	25	4.00
343	Tools, Shop & Garage Equipment	20	5.00
344	Laboratory Equipment	10	10.00
345	Power Operated Equipment	20	5.00
346	Communication Equipment	10	10.00
347	Miscellaneous Equipment	10	10.00
348	Other Tangible Plant	----	----

NOTES:

1. These depreciation rates represent average expected rates. Water companies may experience different rates due to variations in construction, environment, or the physical and chemical characteristics of the water.
2. Acct. 348, Other Tangible Plant may vary from 5% to 50%. The depreciation rate would be set in accordance with the specific capital items in this account.

I. OTHER ISSUES

1. Service Line and Meter Installation Charges

In the prior rate case and its Decision No. 62091, the Company was granted service line and meter installation charges. In this filing, the Company did not request changes to these charges.

However, during Staff's field inspection, Staff and the Company discussed that the "total" installation charges should be separated between the service line and meter installation charges. Since the Company will be installing meters on existing service lines, it would be appropriate for some customers to be only charged for the meter installation. Therefore, Staff recommends the continuance of the existing "total" charges as shown in Table C below, with separate installation charges for the service line and meter installations.

Table C. Service Line and Meter Installation Charges

Meter Size	Service Line Charges	Meter Charges	Company's Existing Total Charges
5/8 x 3/4-inch	\$290	\$120	\$410
3/4-inch	\$290	\$150	\$440
1-inch	\$310	\$160	\$470
1-1/2-inch	\$330	\$385	\$715
2-inch	\$395	\$1,425	\$1,820
3-inch	\$475	\$1,935	\$2,410
4-inch	\$710	\$2,745	\$3,455
6-inch	\$1,070	\$5,580	\$6,650

2. Curtailed Tariff

The Company has an approved curtailed tariff that became effective on October 29, 2004.

3. Backflow Prevention Tariff

The Company has an approved backflow prevention tariff that was docketed on August 22, 1994.

MEMORANDUM

DATE: September 18, 2007

TO: Crystal Brown
Public Utilities Analyst V
Utilities Division

FROM: Marlin Scott, Jr. 
Utilities Engineer
Utilities Division

RE: Shepard Water Company
Docket No. W-01537A-07-0265 (Financing)

Introduction

Shepard Water Company ("Company") has submitted a financing application to assist in funding the installation of an arsenic treatment system. This project is estimated at \$112,100 in which the Company is requesting approval of funding through the use of Water Infrastructure Financing Authority ("WIFA") indebtedness. The Company operates a water system at Martinez Lake in Yuma County.

Existing Water System

The existing system consists of one well and a distribution system serving approximately 224 customers. The well produces at 80 gallons per minute ("GPM") and the system has no storage tank at this time. The arsenic concentration reported for Well #1 is at 12 parts per billion ("ppb") which exceeds the new arsenic standard of 10 ppb.

Construction Work

In March 2007, the Company began the construction of a new well and the installation of a 55,000 gallon storage tank, booster system, waterlines and fire hydrants. The new well was not productive and therefore, was abandoned. As of Staff's inspection date on August 2, 2007, the installation of the storage tank and booster system was about 80% complete, while the construction of waterlines and hydrants was about 50% complete.

In July 2007, the Company began the installation of an arsenic treatment system. As noted on Staff's inspection, the concrete pad was completed and the skid-mounted tank vessels were set in place. This treatment system is estimated to be 50% complete.

Financing Application

Based on the Company's well source exceeding the arsenic standard, the Company has filed a financing application to assist in funding the arsenic treatment system project. The Company is requesting WIFA financing approval in the amount of \$112,100 for the arsenic project as follows:

1. Arsenic treatment system	\$ 71,400
- Solmete X ArsenX treatment	
2. Treatment system installation	\$ 17,140
3. Shade structure, 10 ft. by 15 ft.	\$ 7,800
4. Concrete pad	\$ 760
5. Contingency	\$ 15,000
	=====
Total:	\$112,100

Staff concludes that the arsenic treatment system project is appropriate and the cost estimate totaling \$112,100 is reasonable.

Arizona Department of Environmental Quality ("ADEQ") Compliance

Compliance

According to an ADEQ Compliance Status Report, dated April 30, 2007, ADEQ reported major deficiencies for failing to provide consumer confidence reports for 2002 and 2003, but has determined that the Company's system, PWS #14-014 is currently delivering water that meets the water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.

Approval to Construct

The Company was issued an ADEQ Certificate for Approval to Construct for the arsenic treatment system on November 13, 2006.

Conclusion

Staff concludes that the arsenic treatment system project is appropriate and the cost estimate totaling \$112,100 is reasonable. No "used and useful" determination of the proposed project items was made and no particular treatment should be inferred for rate making or rate base purposes in the future.