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ORIGINAL

MEMORANDUM

666

TO: Docket Control

FROM: Ernest G. Johnson *EA for EGJ*
Director
Utilities Division

DATE: February 3, 2009

RE: RESPONSE TO MOUNTAIN GLEN WATER SERVICE, INC.'S OBJECTIONS TO THE STAFF REPORT (DOCKET NO. W-03875A-08-0421).

Pursuant to a Procedural Order dated January 5, 2008, Staff submits its responses to Mountain Glen Water Services, Inc.'s objections filed on January 2, 2009, to the Staff Report previously filed, and analysis of the additional information filed by Mountain Glen Water Services, Inc., on January 20, 2009.

EGJ:JMM:tdp

Originator: Jeffrey M. Michlik

Arizona Corporation Commission

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Docket No. W-03875A-08-0421

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**EXECUTIVE SUMMARY
MOUNTAIN GLEN WATER SERVICE, INC.
APPLICATION FOR A PERMANENT RATE INCREASE
DOCKET NO. W-03875A-08-0421**

Staff recommends that repair and maintenance expense be increased by \$16,605 from \$7,583 to \$24,188. Staff now recommends an increase in revenue of \$11,836, or 6.36 percent over adjusted test year revenue of \$186,184. Staff's recommended revenues of \$198,020 result in an operating income of \$29,705, and an operating margin of 15.00 percent. As a result of the increase to the repairs and maintenance account, Staff now recommends an original cost rate base of \$60,233.

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INTRODUCTION

Pursuant to a Procedural Order dated January 5, 2008, Mountain Glen Water Service, Inc. ("Company") was ordered to file documentation by January 20, 2009 to (1) support the post-test year 2008 repairs and maintenance expenses of \$16,591 (2) justify the use of post-test year 2008 repairs and maintenance expenses, and (3) provide justification for the proposed increases in metered water revenues and income tax expense.

The Company filed this information on January 20, 2009.

The same Procedural Order asked Staff to comment on the objections filed by the Company, and to perform an analysis on the additional information filed by the Company. The analysis is to include the revenue impact that would result if any or all of the adjustments were adopted, and is to be filed by February 3, 2009. Below is a summary of Staff's analysis:

BACKGROUND

As a result of the Company contracting with Ferrell Utility Management ("FUM") Company after the end of the test year, Staff made several adjustments to the Company's operating expenses. Staff believes these operating expenses are more representative of the Company's on-going expenses.

The Company, on January 2, 2009, filed an objection to the Staff Report that to accurately reflect the management agreement, Staff should increase the repairs and maintenance expense. The Company proposed to increase repairs and maintenance expense by \$16,951. To necessitate this change the Company proposed increasing revenues by \$21,558 from \$186,184 to \$207,742. This would result in an operating income of \$37,091, and an operating margin of 17.85 percent. These numbers are substantially different from what the Company originally proposed and are shown in Staff revised schedules.

The Company filed documentation (invoices) on January 20, 2009, to support repair and maintenance expenses of \$24,188.

STAFF ANALYSIS

Staff has reviewed the Company's invoices and finds the repair and maintenance expenses to be reasonable, and as a result Staff has revised its Schedules. However, Staff now recommends an operating margin of 15.00 percent as opposed to the recommended 17.98 percent in the Staff Report.

As a result of making several changes to the Company's operating expenses Staff, by design, did not recommend a rate decrease, but rather decided to allow the Company to maintain its current rates and the resulting operating margin number of 17.98.

Staff typically recommends an operating margin of between 10.00 and 15.00 percent for small sized utilities (class D and E).

The operating margin is 10.93 percent if repairs and maintenance expense is increased by \$16,605 from \$7,583 to \$24,188 with no change to the Company's current rates. This operating margin falls within Staff's typical operating margin of between 10 and 15 percent. If the Commission so chooses it could recommend this operating margin, and leave the current rates in place.

However, Staff recommends an operating margin of 15.00 percent which is higher than the operating margin of 12.47 percent proposed by the Company in its original filing.

STAFF RECOMMENDATION

Staff is now recommending an increase in revenue of \$11,836, or 6.36 percent over adjusted test year revenue of \$186,184. Staff's recommended revenues of \$198,020 result in an operating income of \$29,705, and an operating margin of 15.00 percent. Due to the increase in repairs and maintenance expense, Staff now recommends an original cost rate base of \$60,233.

Staff's recommended rates would increase the typical residential bill with a median usage of 3,957 gallons from \$30.93 to \$33.05, for an increase of \$2.12 or 6.85 percent.

SUMMARY OF FILING

	-- Present Rates --		-- Proposed Rates --	
	Company as Filed	Staff as Adjusted	Company as Revised	Staff as Revised
Revenues:				
Metered Water Revenue	\$182,699	\$182,699	\$204,257	\$194,535
Unmetered Water Revenue	0	0	0	0
Other Water Revenues	3,485	3,485	3,485	3,485
Other Water Revenues	30,180	0	0	0
Total Operating Revenue	\$216,364	\$186,184	\$207,742	\$198,020
Operating Expenses:				
Operation and Maintenance	\$163,622	\$124,647	\$124,993	\$124,647
Depreciation	31,473	31,035	31,035	31,035
Property & Other Taxes	13,188	5,551	5,551	5,551
Income Tax	50	4,605	9,072	7,082
Total Operating Expense	\$208,333	\$165,838	\$170,651	\$168,315
Operating Income/(Loss)	\$8,031	\$20,346	\$37,091	\$29,705
Rate Base O.C.L.D.	\$47,517	\$60,223	\$47,517	\$60,223
Rate of Return - O.C.L.D.	16.90%	33.78%	78.06%	49.33%
Times Interest Earned Ratio (Pre-Tax)	2.75	3.89	5.78	5.74
Debt Service Coverage Ratio (Pre-Tax)	13.45	8.73	8.52	8.48
Operating Margin	3.71%	10.93%	17.85%	15.00%

NOTES: 1. The times interest earned ratio (TIER) represents the ability of the Company to pay interest expenses before taxes.

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

RATE BASE

	----- Original Cost -----			Staff
	Company	Adjustment		
Plant in Service	\$710,007	(\$2,190)	A	\$707,817
Less:				
Accum. Depreciation	310,321	(219)	B	310,102
Net Plant	\$399,686	(\$1,971)		\$397,715
Less:				
Advances in Aid of Construction	\$343,116	\$0		\$343,116
Customer Deposits	7,703	0		7,703
Total Advances	\$350,819	\$0		\$350,819
Contributions Gross	\$2,000	\$0		\$2,000
Less:				
Amortization of CIAC	650	0		650
Net CIAC	\$1,350	\$0		\$1,350
Total Deductions	\$352,169	\$0		\$352,169
Plus:				
1/24 Power	\$0	\$452	C	\$452
1/8 Operation & Maint.	0	14,226	C	14,226
Inventory	0	0		0
Prepayments	0	0		0
Total Additions	\$0	\$14,677		\$14,677
Rate Base	\$47,517	\$12,706		\$60,223

Explanation of Adjustment:

- A See Schedule JMM-2, page 2.
- B See Schedule JMM-2, page 3.
- C Staff's inclusion of the formula-method for determining cash working capital based on Staff's recommended operating expenses.

PLANT ADJUSTMENT

	Company Exhibit	Adjustment	Staff Adjusted
301 Organization	\$8,500	\$0	\$8,500
302 Franchises	0	0	0
303 Land & Land Rights	8,110	0	8,110
304 Structures & Improvements	39,852	0	39,852
307 Wells & Springs	61,665	0	61,665
311 Pumping Equipment	100,531	0	100,531
320 Water Treatment Equipment	10,000	0	10,000
330 Distribution Reservoirs & Star	91,945	0	91,945
331 Transmission & Distribution M	265,757	0	265,757
333 Services	21,108	0	21,108
334 Meters & Meter Installations	43,611	0	43,611
335 Hydrants	36,000	0	36,000
336 Backflow Prevention Devices	0	0	0
339 Other Plant and Misc. Equipm	0	0	0
340 Office Furniture & Equipment	751	0	751
340.1 Computers & Software	4,164	0	4,164
341 Transportation Equipment	16,728	(2,190) A	14,538
343 Tools Shop & Garage Equipm	666	0	666
344 Laboratory Equipment	0	0	0
345 Power Operated Equipment	619	0	619
346 Communication Equipment	0	0	0
347 Miscellaneous Equipment	0	0	0
348 Other Tangible Plant	0	0	0
105 C.W.I.P.	0	0	0
TOTALS	\$710,007	(\$2,190)	\$707,817

Explanation of Adjustment:

A Staff disallowed plant in service in the amount of \$2,190. The owners of the Company on August 18, 2008, sold to the Company a 1989 Toyota 4x4 Pickup for \$5,000. As this is not an arms length transaction, Staff gained additional information (i.e. mileage, engine, model, condition etc.) through a Staff data request. Staff then went to the official Kelly Blue Book Site, and entered this information into the website and derived a blue book private party value (the private party value is what a buyer can expect to pay when buying a used car from a private party as is) of \$2,810.

ACCUMULATED DEPRECIATION ADJUSTMENT

	<u>Amount</u>
Accumulated Depreciation - Per Company	\$310,321
Accumulated Depreciation - Per Staff	310,102 B
Total Adjustment	<u>(\$219)</u>

Explanation of Adjustment:

B - See Schedule 2 page 2 of 3

STATEMENT OF OPERATING INCOME

	Company Exhibit	Staff Adjustments	Staff Adjusted
Revenues:			
461 Metered Water Revenue	\$182,699	\$0	\$182,699
460 Unmetered Water Revenue	0	0	0
474 Other Water Revenues	3,485	0	3,485
474.1 Other Water Revenues - WIFA	30,180	(30,180) A	0
Total Operating Revenue	\$216,364	(\$30,180)	\$186,184
Operating Expenses:			
601 Salaries and Wages	\$91,742	(\$91,742) B	\$0
610 Purchased Water	0	0	0
615 Purchased Power	10,841	0	10,841
618 Chemicals	0	0	0
620 Repairs and Maintenance	7,583	16,605 C	24,188
621 Office Supplies & Expense	11,534	(8,448) D	3,086
630 Outside Services	6,722	68,746 E	75,468
635 Water Testing	3,887	494 F	4,381
641 Rents	15,944	(15,944) G	0
650 Transportation Expenses	3,626	(3,626) H	0
657 Insurance - General Liability	9,158	(4,475) I	4,683
659 Insurance - Health and Life	0	0	0
666 Regulatory Commission Expense - Rate Case	1,500	500 J	2,000
675 Miscellaneous Expense	1,085	(1,085) K	0
403 Depreciation Expense	31,473	(438) L	31,035
408 Taxes Other Than Income	7,637	(7,637) M	0
408.11 Property Taxes	5,551	0	5,551
409 Income Tax	50	4,555 N	4,605
Total Operating Expenses	\$208,333	(\$42,495)	\$165,838

OPERATING INCOME/(LOSS)	\$8,031	\$12,315	\$20,346
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Other Income/(Expense):			
419 Interest and Dividend Income	\$138	\$0	\$138
421 Non-Utility Income	0	0	0
427 Interest Expense	2,941	0	2,941
4XX Reserve/Replacement Fund Deposit	0	0	0
426 Miscellaneous Non-Utility Expense	5,011	(5,011) O	0
Total Other Income/(Expense)	(\$7,814)	\$5,011	(\$2,803)

NET INCOME/(LOSS)	\$217	\$17,326	\$17,543
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STAFF ADJUSTMENTS

A -	OTHER WATER REVENUES - Per Company	\$30,180	
	Per Staff	0	<u>(\$30,180)</u>
	To reflect the elimination of the separate arsenic surcharge that ratepayers are currently paying.		
B -	SALARIES AND WAGES - Per Company	\$91,742	
	Per Staff	0	<u>(\$91,742)</u>
	To reflect the Company's new management contract with FUM.		
C -	REPAIRS AND MAINTENANCE - Per Company	\$7,583	
	Per Staff	24,188	<u>\$16,605</u>
	To reflect the Company's ongoing repairs and maintenance expenses.		
D -	OFFICE SUPPLIES & EXPENSE - Per Company	\$11,534	
	Per Staff	3,086	<u>(\$8,448)</u>
	To reflect the Company's new management contract with FUM.		
E -	OUTSIDE SERVICES - Per Company	\$6,722	
	Per Staff	75,468	<u>\$68,746</u>
	To reflect the Company's new management contract with FUM, and disallowance of legal expenses and some accounting expenses.		
F -	WATER TESTING - Per Company	\$3,887	
	Per Staff	4,381	<u>\$494</u>
	To reflect the amount recommended by Staff Engineering.		
G -	RENTS - Per Company	\$15,944	
	Per Staff	0	<u>(\$15,944)</u>
	To reflect the Company's new management contract with FUM.		
H -	TRANSPORTATION EXPENSE - Per Company	\$3,626	
	Per Staff	0	<u>(\$3,626)</u>
	To reflect the Company's new management contract with FUM.		

STAFF ADJUSTMENTS (Cont.)

I -	INSURANCE - GENERAL LIABILITY - Per Company	\$9,158	
	Per Staff	4,683	<u>(\$4,475)</u>

This adjustment reduces workers compensation insurance as the Company stated it no longer has any employees, and thus no longer has an ongoing expense.

J -	RATE CASE EXPENSE - Per Company	\$1,500	
	Per Staff	2,000	<u>\$500</u>

To normalize rate case expense over three years.

K -	MISCELLANEOUS EXPENSE - Per Company	\$1,085	
	Per Staff	0	<u>(\$1,085)</u>

To disallow IRS penalties and the the disallowance of the medical expense and business meeting expenses are the result of the Company no longer having any employees.

L -	DEPRECIATION - Per Company	\$31,473	
	Per Staff	31,035	<u>(\$438)</u>

Staff decreased depreciation expense as a result of the plant in service adjustment.

Pro Forma Annual Depreciation Expense:

Plant in Service	\$707,817
Less: Non Depreciable Plant	16,610
Fully Depreciated Plant	0
Depreciable Plant	<u>\$691,207</u>
Times: Staff Proposed Depreciation Rate	4.50%
Credit to Accumulated Depreciation	<u>\$31,125</u>
Less: Amort. of CIAC* @ 4.50%	90
Pro Forma Annual Depreciation Expense	<u><u>\$31,035</u></u>

*** Amortization of CIAC:**

Contribution(s) in Aid of Construction (Gross)	\$2,000
Less: Non Amortizable Contribution(s)	0
Fully Amortized Contribution(s)	0
Amortizable Contribution(s)	<u>\$2,000</u>
Times: Staff Proposed Amortization Rate	4.50%
Amortization of CIAC	<u><u>\$90</u></u>

STAFF ADJUSTMENTS (Cont.)

M -	TAXES OTHER THAN INCOME - Per Company	\$7,637	
	Per Staff	0	<u>(\$7,637)</u>

As these amounts relate to payroll taxes and the company stated it no longer has any employees, this is no longer a valid expense.

N -	TAXES OTHER THAN INCOME - Per Company	\$50	
	Per Staff	4,605	<u>\$4,555</u>

To reflect Staff's adjusted test year expense level based on taxable income.

O -	MISCELLANEOUS NON-UTILITY EXPENSE - Per Company	\$5,011	
	Per Staff	0	<u>(\$5,011)</u>

As these expenses relate to the retirement of some assets when the Company changed ownership, these expenses are not ongoing.

RATE DESIGN

Monthly Usage Charge	Present	-Proposed Rates-	
	Rates	Company	Staff
5/8" x 3/4" Meter	\$20.25	\$27.50	\$21.65
3/4" Meter	30.38	41.25	32.48
1" Meter	50.63	68.75	54.13
1½" Meter	101.25	137.50	108.24
2" Meter	162.00	220.00	173.19
3" Meter	303.75	440.00	324.72
4" Meter	506.25	687.50	228.32
6" Meter	1,012.50	1,375.00	1,082.44
Arsenic Surcharge	4.82	0.00	0.00
Excess of Minimum - per 1,000 Gallons	\$0.00	\$0.00	\$0.00
Gallons Included in Minimum	0	0	0
Commodity Rate (per 1,000 gallons)			
<u>All Meter Sizes</u>			
Up to 5,000 gallons	2.70	N/A	2.88
5,001 to 20,000 gallons	3.30	N/A	3.52
Over 20,000 gallons	3.80	N/A	4.06
<u>All Meter Sizes</u>			
Up to 5,000 gallons	N/A	2.95	N/A
5,001 to 18,000 gallons	N/A	4.05	N/A
Over 18,000 gallons	N/A	5.70	N/A

RATE DESIGN (Cont.)

Service Line and Meter Installation Charges	Present	- Company Proposed Rates-			- Staff Proposed Rates-		
		Service Line Charge	Meter Installation	Total Recommended	Service Line Charge	Meter Installation	Total Recommended
5/8" x 3/4" Meter	\$550.00	\$430.00	\$130.00	\$560.00	\$430.00	\$130.00	\$560.00
3/4" Meter	580.00	\$430.00	\$230.00	\$660.00	\$430.00	\$230.00	\$660.00
1" Meter	675.00	\$480.00	\$240.00	\$720.00	\$480.00	\$240.00	\$720.00
1 1/2" Meter	710.00	\$535.00	\$500.00	\$1,035.00	\$535.00	\$500.00	\$1,035.00
2" Turbine Meter	1,110.00	\$815.00	\$1,020.00	\$1,835.00	\$815.00	\$1,020.00	\$1,835.00
2" Compound Meter	N/A	\$815.00	\$1,865.00	\$2,680.00	\$815.00	\$1,865.00	\$2,680.00
3" Turbine Meter	1,490.00	\$1,030.00	\$1,645.00	\$2,675.00	\$1,030.00	\$1,645.00	\$2,675.00
3" Compound Meter	N/A	\$1,150.00	\$2,520.00	\$3,670.00	\$1,150.00	\$2,520.00	\$3,670.00
4" Turbine Meter	2,295.00	\$1,460.00	\$2,620.00	\$4,080.00	\$1,460.00	\$2,620.00	\$4,080.00
4" Compound Meter	N/A	\$1,640.00	\$3,595.00	\$5,235.00	\$1,640.00	\$3,595.00	\$5,235.00
6" Turbine Meter	4,305.00	\$2,180.00	\$4,975.00	\$7,155.00	\$2,180.00	\$4,975.00	\$7,155.00
6" Compound Meter	N/A	\$2,300.00	\$6,870.00	\$9,170.00	\$2,300.00	\$6,870.00	\$9,170.00

Service Charges	Present	Company Proposed Rates	Staff Proposed Rates
Establishment	\$30.00	\$35.00	\$35.00
Establishment (After Hours)	45.00	45.00	45.00
Reconnection (Delinquent)	35.00	40.00	40.00
Reconnection (Delinquent) after hours	45.00	50.00	50.00
Meter Test (If Correct)	40.00	40.00	40.00
Deposit	*	*	*
Deposit Interest	*	*	*
Re-Establishment (Within 12 Months)	**	**	**
NSF Check	15.00	25.00	25.00
Deferred Payment	1.50%	1.50%	1.50%
Late Payment	N/A	N/A	1.50%
Meter Re-Read (If Correct)	15.00	20.00	20.00
Main Extension	Cost	Cost	Cost

* Per Commission Rules (R14-2-403.B)
 ** Months off system times the monthly minimum (R14-2-403.D)

TYPICAL BILL ANALYSIS

General Service 5/8 X 3/4 - Inch Meter

Average Number of Customers: 368

<u>Company Proposed</u>	<u>Gallons</u>	<u>Present Rates</u>	<u>Proposed Rates</u>	<u>Dollar Increase</u>	<u>Percent Increase</u>
Average Usage	6,314	\$38.08	\$47.57	\$9.49	24.92%
Median Usage	3,957	\$30.93	\$39.17	\$8.24	26.64%
<u>Staff Recommend</u>					
Average Usage	6,314	\$38.08	\$40.67	\$2.59	6.80%
Median Usage	3,957	\$30.93	\$33.05	\$2.12	6.85%

Present & Proposed Rates (Without Taxes)
General Service 5/8 X 3/4 - Inch Meter

<u>Gallons Consumption</u>	<u>Present Rates</u>	<u>Company Proposed Rates</u>	<u>% Increase</u>	<u>Staff Proposed Rates</u>	<u>% Increase</u>
0	\$20.25	\$27.50	35.80%	\$21.65	6.91%
1,000	22.95	30.45	32.68%	24.53	6.88%
2,000	25.65	33.40	30.21%	27.41	6.86%
3,000	28.35	36.35	28.22%	30.29	6.84%
4,000	31.05	39.30	26.57%	33.17	6.83%
5,000	33.75	42.25	25.19%	36.05	6.81%
6,000	37.05	46.30	24.97%	39.57	6.80%
7,000	40.35	50.35	24.78%	43.09	6.79%
8,000	43.65	54.40	24.63%	46.61	6.78%
9,000	46.95	58.45	24.49%	50.13	6.77%
10,000	50.25	62.50	24.38%	53.65	6.77%
15,000	66.75	82.75	23.97%	71.25	6.74%
20,000	83.25	106.30	27.69%	88.85	6.73%
25,000	102.25	134.80	31.83%	109.15	6.75%
50,000	197.25	277.30	40.58%	210.65	6.79%
75,000	292.25	419.80	43.64%	312.15	6.81%
100,000	387.25	562.30	45.20%	413.65	6.82%
125,000	482.25	704.80	46.15%	515.15	6.82%
150,000	577.25	847.30	46.78%	616.65	6.83%
175,000	672.25	989.80	47.24%	718.15	6.83%
200,000	767.25	1,132.30	47.58%	819.65	6.83%