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FENNEMORE CRAIG
A Professional Corporation
Norman D. James (No. 006901)
Jay L. Shapiro (No. 014650)
3003 North Central Avenue, Suite 2600
Phoenix, Arizona 85012
Telephone (602) 916-5000

Attorneys for Far West Water
& Sewer Company

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF FAR WEST WATER & SEWER COMPANY, AN ARIZONA CORPORATION, FOR APPROVAL OF INTERIM RATES AND CHARGES.	DOCKET NO: WS-03478A-08-0608

FAR WEST WATER & SEWER COMPANY'S CLOSING BRIEF

(June 22, 2009)

Arizona Corporation Commission
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I. SUMMARY OF REQUEST FOR EMERGENCY RATE RELIEF

This emergency rate proceeding was initiated by Far West Water & Sewer, Inc. ("FWWS" or "the Company") on December 19, 2008 – more than six months ago. The Company seeks interim rate increases designed to produce additional revenue of $2,161,788 on an annualized basis, which, if approved, will result in an operating margin of 0.00%. The rate increases will be in effect only until the Commission issues a decision in the Company's general rate case, which was filed on August 29, 2008. In the event that the permanent rates established in that case are less than the interim rates, the difference will be subject to refund with appropriate interest.

Arizona Attorney General Opinion 71-17[1] has established guidelines to determine when an "emergency" exists for the purpose of approving interim rates. According to that Opinion, an emergency exists when "sudden change brings hardship to a company, when a company is insolvent or when the condition of a company is such that its ability to maintain service pending a formal rate determination is in serious doubt."[2] In 1999, the Commission authorized interim rate increases for FWWS, finding that an emergency existed based on these criteria because the Company was unable to meet debt service requirements necessary to borrow funds to complete its surface water treatment plant.[3] Very recently, the Commission determined that Arizona Public Service Company ("APS") was faced with an emergency because its bonds could be downgraded from investment to non-investment grade, which could make it difficult for that utility to access the credit markets or make the procurement of credit prohibitively expensive, even though

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[1] Op. Att'y Gen. 71-17, *1971 Opinions and Report of the Attorney General.*

[2] *Id.* at 50. *See also* Staff Rpt. at 2. Citations to a witness' pre-filed testimony are abbreviated using the format set forth on pages ii to iii above, following the Table of Contents, which also lists the hearing exhibit numbers of the parties' pre-filed testimony. Other hearing exhibits are cited by the hearing exhibit number and, where applicable, by page number, e.g., R-3 at 1. The transcript of the hearings is cited by page number, e.g., Tr. at 1.

[3] Decision No. 61833 (July 20, 1999).

the utility had positive earnings and cash flow.[4]

Here, the evidence before the Commission shows that all three of the conditions identified in the Attorney General's Opinion are either present or threatened. All parties agree, moreover, that the Commission does not have to wait until the utility and its customers are actually harmed by emergency circumstances – a serious threat of an emergency is sufficient to justify emergency rate relief.[5]

First, FWWS cannot pay its debts as they come due. This year, the Company is projected to experience a company-wide cash flow shortage in excess of $6.4 million.[6] FWWS has already invested more than $18 million in improvements in the last 36 months, none of which is subject to recovery through rates. Moreover, the Company is paying debt service on more than $20 million of new debt used to pay for these improvements.

To make matters worse, FWWS is unable to complete the sewer system improvements necessary to comply with its October 2006 Consent Order with ADEQ.[7] About 80 percent of the cost of these improvements has been paid by FWWS, and they are nearly completed.[8] When these improvements are completed, the Company will have increased its investment in sewer plant by <u>more than 1,500%</u>.[9] But the Company has been unable to raise the additional capital needed to pay for cost overruns related to its sewer system renovation project.[10] Critical water system improvements have also been

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4 Decision No. 70667 (Dec. 24, 2008). APS's parent, Pinnacle West Capital Corp., had a return on equity of 6.1% at December 31, 2008. *AUS Utility Reports* 7-8 (Feb. 2009).

5 Tr. at 1136, 1232.

6 Exh. S-3.

7 The term "Consent Order" will be used to refer to the October 2006 order, as distinguished from the March 2006 "Del Oro Consent Order," which was superseded by the Consent Order. *See* Exh. R-1.

8 *See* Exhs. A-8, A-11.

9 Capestro Rb. at 31.

10 *E.g.*, Capestro Rb. at 6-7; Tr. at 489-90.

postponed, and will require an additional capital investment of as much as $15 million over the next few years.[11]

In other words, FWWS is, for all practical purposes, insolvent. FWWS cannot complete the plant, it cannot comply with the Consent Order, and it cannot obtain permanent rate relief quickly enough to address its severe cash flow shortage. FWWS's inability to make necessary improvements to its water and wastewater utility systems has left FWWS's ability to maintain safe and reliable water and sewer utility service in doubt. Candidly, short of bankruptcy, water outages and untreated sewage flowing in the streets, it is hard to imagine more exigent circumstances than those FWWS is presently experiencing. Certainly, this situation is far more severe than the possibility of a downgrade in credit rating.

Perhaps this is why Staff and RUCO have largely ignored the facts and, instead, have attempted to turn this emergency proceeding into a referendum on just about every decision FWWS has made in the past 36 months, and a few decisions that are even older. The bulk of these arguments are irrelevant to the narrow issues before the Commission, which are whether there is an emergency and, if so, what remedy is appropriate. Since Staff and RUCO deny the existence of an emergency, they have provided no effective remedy for the Company's present circumstances. Only FWWS offers a proposed solution that will provide critically needed cash flow.

FWWS understands and appreciates that rate increases are not welcomed by ratepayers. But neither is the alternative, FWWS being unable to complete the renovation of its wastewater treatment system and to meet the needs of its water and sewer customers. No one disputes that FWWS is trying to fix its problems, despite some mistakes that have been made. There will be ample time and opportunity to point fingers

[11] Tr. at 855-87.

and argue about foregone alternatives. Right now, FWWS needs more revenues to continue operating, and only a prompt decision by the Commission authorizing interim rate increases can provide such relief.

II. THE PAST - HOW DID FWWS GET HERE?

A. Introduction

In order to place this emergency application in proper context, it is necessary to provide as background the events that led up to the Company's decision to seek emergency rate relief in December 2008. As shown below, there was a combination of circumstances that, despite the best efforts of the Company, culminated in its inability to complete its sewer facilities renovation while simultaneously paying its creditors and meeting debt service requirements on its outstanding borrowings.

FWWS currently provides water utility service to about 15,500 customers, while also providing sewer utility service to about 7,300 of those customers.[12] By contrast, in 1998, when FWWS was incorporated and authorized to provide water and sewer service, it had 8,400 water customers and 260 sewer customers.[13] Since that time, its service territory, which is located east of the City of Yuma in an unincorporated portion of Yuma County, has experienced explosive growth. By 2005, FWWS was serving 5,500 sewer customers and, as stated, currently serves about 7,300 sewer customers.[14] A corresponding increase in water customers also took place.

The Company, unfortunately, was unable to keep up with this explosive growth, especially with regard to its wastewater treatment facilities.[15] As a result, FWWS found itself operating seven developer-contributed "package-type" treatment plants in seven

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[12] Capestro Rb. at 2, 14.

[13] Decision No. 60779 (April 8, 1998). *See also* Capestro Rb. at 7-8.

[14] Decision No. 69335 (Feb. 26, 2007).

[15] Tr. at 90; Capestro Rb. at 7-9.

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locations spread across its service territory.[16] Each of these plants operated independently of the others, with little meaningful overlap in equipment and process, and each with its own unique set of problems. At the same time, FWWS also experienced substantial changes in upper management in the early to mid-part of the decade, including the departure of its long-time president and operator, Brent Weidman.[17]

These problems led to the two consent orders with the Arizona Department of Environmental Quality ("ADEQ"). The Company's ownership and current management has taken full responsibility for the failure to keep up with growth, and acknowledged their responsibility to build and maintain an adequate wastewater treatment and collection system.[18] They have been working tirelessly to do so for almost four years, as explained below.

B. <u>Late 2005 to April 2006</u>

In the wake of the substantial changes occurring in the first half of the decade, in the latter part of 2005, FWWS began the process of making systemwide improvements to its water and wastewater utility systems. Even before ADEQ began to issue notices of violation ("NOVs"), the Company was working with an expert to evaluate what to do about the shortcomings in its wastewater treatment system.[19] The first consent order with ADEQ, limited to the Del Oro treatment facility, was executed on March 10, 2006.[20] Almost immediately thereafter, FWWS hired Coriolis to engineer and oversee its entire renovation process.[21]

Specifically, in April 2006, Coriolis was hired to perform a "comprehensive review

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[16] Tr. at 673-75.

[17] Tr. at 471-72.

[18] Tr. at 90, 470-71; Capestro Rb. at 7-9.

[19] Tr. at 283, 661.

[20] Exh. R-1.

[21] Tr. at 283, 659-60.

of the entire utility, water and sewer" including "addressing the issues of the wastewater plants."[22] Coriolis found that FWWS was facing a "long litany" of issues besides the Del Oro treatment plant.[23] A number of these issues concerned the Company's water division. As a result, Coriolis' initial contract included design and engineering services for both water and sewer system improvements, including upgrading and expanding the Company's surface water treatment plant.[24] Gary Lee of Universal Asset Management, a member of the Coriolis group, was the lead engineer. Mr. Lee and Coriolis have significant expertise with large civil engineering projects, with an emphasis on utility projects.[25] Coriolis' approach was to address the short-term challenges that FWWS faced while keeping one eye on the long-term growth and the upgrades and improvements needed to ensure reliable service.[26]

C. May 2006 to September 2006

Before Coriolis could prepare a comprehensive engineering study of the Company's water and sewer infrastructure, the Del Oro Consent Order had to be addressed. By May 2006, the Company had about two months to get an operating plant at Del Oro capable of treating 300,000 gpd.[27] Coriolis was able to locate a temporary treatment facility in Canada that was just coming off line.[28] Immediate arrangements were made to have the facility serviced and cleaned, and then delivered to the Del Oro site, which site also underwent alterations so it could receive the new facility upon arrival.

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22 Tr. at 660.

23 Tr. at 660-61.

24 Tr. at 663.

25 Tr. at 657-58.

26 Tr. at 668.

27 Exh. R-1 at Exhibit 3.

28 Tr. at 669-70.

This temporary facility was in place and operating before the ADEQ-imposed deadline.[29]

Coriolis then turned to the Company's systemwide odor problem. It concluded that this situation had to be corrected quickly so that the focus could be on the plants themselves.[30] Odor control measures, including the injection of bioxide chemicals throughout the system and installation of carbon filters, were recommended by Coriolis and immediately implemented by FWWS. Within days to weeks, the Company had achieved "dramatic" reductions in its odor emissions.[31]

Having cleared these two "priority" issues "off the plate," Coriolis set out to conduct the comprehensive review of FWWS's systems. The goal of this review was to provide FWWS with guidance on long-term and short-term goals for its water and sewer infrastructure needs.[32] Coriolis' took a holistic approach to advising FWWS. As Mr. Lee explained:

> And I have cautioned this from the beginning with this utility is that while you have a fire to put out immediately, which was the case in terms of wastewater, is that these utility systems are living systems. They age. They deteriorate. There is also a continual improvement process that needs to be evaluated as you, you know, as you go forward, the risk being, if you devote all your attention to one, then the other starts, then you end up putting – you end up in a constant fire drill type setup.
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> * * *
>
> What we are trying to do is give them a plan to ultimately get ahead of the curve and get this in a more manageable position.[33]

Early on, it became apparent to Coriolis that FWWS did not have proper plant

[29] Tr. at 355-56; 670.

[30] Tr. at 670.

[31] Tr. at 671-72.

[32] Tr. at 672.

[33] Tr. at 688.

inventories or maps of its systems.[34] As a result, the Company had a difficult time locating facilities for repairs and maintenance and keeping track of customers. Moreover, it was unable to undertake the type of systemwide renovation project that was required to ensure safe and reliable service without mapping and inventory.[35] Coriolis also recommended and the Company purchased new software – "a more robust utility billing system."[36] This system provided enhanced and integrated accounting, customer relations, budgeting and similar upgrades over the Company's existing software. Although the comprehensive engineering study, mapping and software upgrades were expensive, they were necessary to enable the Company to properly address its infrastructure needs. Like its plant, the sophistication of the Company's basic management and data collection systems failed to keep up with the growth in customers.[37] Moreover, by conducting all of these systemwide efforts together, there were economies of scale and cost savings.[38]

In the meantime, in July 2006, the Company's shareholders obtained the first of two bridge anticipation notes ("BANs"). This first BAN, in the amount of $11.1 million, was secured by the pledge of the shareholders' stock in FWWS.[39] The purpose of this BAN was to allow FWWS to begin funding the costs of systemwide improvements, including paying for the design/engineering costs and other fees charged by Coriolis and undertaking the procurement process related to the system improvements.[40]

D. <u>October 2006 to December 2006</u>

During its engineering evaluation, it became obvious to Coriolis that all of the

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[34] Tr. at 684.

[35] Tr. at 684, 689-90.

[36] Tr. at 696-97.

[37] Tr. at 688-89.

[38] Tr. at 682-701.

[39] Tr. at 475-76. *See also* Exh. A-12.

[40] *Id.*

Company's treatment plants, with the exception of Marwood, "required major modification."[41] To begin with, the Company had too many treatment plants for the size of the communities being served. This hodgepodge of plants was the result of the rapid development that had occurred in the area, with individual developers building the plant capacity they needed and then dedicating it to FWWS.[42] Coriolis also determined that the treatment systems were not working properly and, moreover, could not easily be made to work properly.[43] Other wastewater system problems included inadequate aeration in the tanks, and inadequate mechanisms for handling sludge and removing effluent. As a result of these plant deficiencies, FWWS's treatment plants were not meeting the applicable nitrogen requirements and were sometimes exceeding turbidity and fecal coliform limits.[44]

For the water division, Coriolis discovered that FWWS is not able to use all of the surface water available under its contract with the Yuma Mesa Irrigation and Drainage District because FWWS's surface water treatment facility required upgrades and expansion.[45] Coriolis designed and engineered an expansion of this facility to be carried out in phases, with the ability to ultimately add another 6 million gallons per day of surface water treatment capacity.[46] Over time, this would allow the Company to utilize its full allocation of Colorado River water and minimize its reliance on poor quality groundwater.[47] Coriolis also concluded that many of the Company's wells required

[41] Tr. at 673.

[42] Tr. at 673.

[43] Tr. at 664.

[44] Tr. at 665.

[45] Tr. at 680.

[46] Tr. at 682.

[47] The poor quality of the groundwater in the Company's service territory was a significant customer service issue in the water division's prior rate cases, and resulted in the Company's substitution of Colorado River water for groundwater, despite the additional cost to use surface water. *See* Decision No. 60437 (Sept. 29, 1997); Decision No. 62649 (June 13, 2000). If the surface water treatment plant cannot be upgraded and expanded, the Company will be forced to use greater amounts of groundwater, despite customer objections, to meet service requirements.

rehabilitation and that the Company's storage tanks required significant refurbishment.[48]

In the meantime, ADEQ was continuing to issue NOVs, and the Consent Order was being negotiated. Coriolis was working closely with ADEQ permit review and engineering staff on the major modifications necessary to address the NOVs, and the information gathered and recommendations made by Coriolis were used by FWWS to reach an agreement with ADEQ on the terms of the Consent Order.[49] The Consent Order was executed on October 25, 2006, and superseded the Del Oro Consent Order that applied only to the Del Oro plant.[50]

The new Consent Order required FWWS to apply for new or amended aquifer protection permits ("APPs") for the Del Oro, Seasons and Section 14 plants, as well as closure permits for Villa Royale, Villa Del Rey and Palm Shadows, among various other approvals.[51] The Company was required to submit APP applications relating to these projects in 30 to 90 days, with FWWS having to pay ADEQ for expedited review in some cases.[52] With Coriolis' help, the Company met all of the deadlines for submissions imposed by the Consent Order.[53]

On December 31, 2006, FWWS's shareholders closed on a second BAN in excess of $17.7 million.[54] The purpose of this second bridge loan, which was again secured by the shareholders' pledge of their stock in the Company, was to pay off the first BAN and to provide additional funds to cover the costs of the ongoing water and sewer system

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[48] Tr. at 685-86. *See also* Capestro Rb. at 9-10 and 15-16.

[49] Tr. at 740-41.

[50] Exh. R-1 at Exh. 3.

[51] Exh. R-1 at Exh. 3.

[52] Exh. R-1 at Exh. 3.

[53] Tr. at 799-821.

[54] Exh. A-12.

renovation, including the projects needed to comply with the Consent Order.[55]

E. January 2007 to July 2008

Coriolis' goal was to complete its work for FWWS by February 2007.[56] FWWS's shareholders were using the BANs to continue the procurement process and begin construction activities.[57] As stated, the permit applications were timely filed with ADEQ, and expedited approval sought as required under the Consent Order. Unfortunately, however, ADEQ directed the Company to cease all construction-related activities, including procuring equipment needed for the plant renovation, until the APPs were issued.[58] The Company and Coriolis urged ADEQ to allow the Company to proceed at its own risk with procurement and construction activities, but ADEQ would not agree.[59] Consequently, all construction and most procurement activities stopped until ADEQ had issued the permits. And despite substantial costs to expedite the permits, it took ADEQ more than 18 months to issue all of them.[60]

While waiting for ADEQ to act, FWWS and Coriolis undertook those activities that did not require an ADEQ permit, such as preparing the sites for the renovation projects and preparing the long-range engineering study. FWWS also sought permanent financing for its systemwide improvement program. Initially, the Company obtained a commitment for the issuance of Industrial Development Authority ("IDA") bonds through the Yuma County IDA in the amount of $32.5 million.[61] From the outset, FWWS identified its projects to include "the acquisition, construction and installation of

[55] Tr. at 477-78.

[56] Tr. at 734-35

[57] *E.g.,* Exhs. A-8 and A-12 and Tr. at 475-479.

[58] Tr. at 477-78, 735-738.

[59] *Id.*

[60] Tr. at 736.

[61] Exh. A-24; Tr. at 1040.

improvements to FWWS's wastewater treatment plants and drinking water treatment system."[62] By this time, however, it had become clear that ADEQ was not going to issue the permits expeditiously.

The IDA financing required Commission approval pursuant to A.R.S. §§ 40-285, 40-301 and 40-302. FWWS, with the help of its experts, concluded that it might not be able to support an application to borrow the full $32.5 million.[63] Given that the sewer system renovation program was the highest priority, the Company reduced its IDA funding request to just over $25 million.[64] This amount would allow FWWS to pay off its existing WIFA loan in the amount of $4.45 million (a requirement of the IDA bondholders) and to pay off the second BAN, the proceeds of which were being used to fund the Company's water and wastewater systems and improvement program, in addition to constructing its sewer system upgrades when ADEQ finally acted.[65]

Accordingly, FWWS sought and obtained financing approval for the IDA bonds in Decision No. 69950 (October 30, 2007). The Commission's approval was premised on the Company's request for financing approval to pay off existing short- and long-term debt and to finance the costs of wastewater system improvements necessary to comply with the Consent Order.[66]

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[62] Exh. A-24; Tr. at 1037, 1040.

[63] Tr. at 1043-45.

[64] *See* Exhs. A-8 and A-12.

[65] *See* Exhs. A-8 and A-12; Tr. at 479-84.

[66] Decision No. 69950 at 1, 5. *See also* at Exh. R-1. Notably, the Company's financing application, filed July 26, 2007, specifically stated that a portion of the IDA funds would be used to repay and consolidate the outstanding debt, which debt had been used, in part, for water system improvements. By the time the IDA funds were taken down, the Company had already spent nearly $1 million to improve its water system, and had committed to spend roughly $1.8 million on the water-related improvements. Approval to finance improvements to the water system, as well as certain sewer projects falling outside those improvements strictly necessary to comply with the Consent Order, were inadvertently omitted from the Company's request for financing approval. This was an oversight by the Company, and it never intended to act in a manner that was contrary to Decision No. 69950. Tr. at 1035-38, 1041.

The Company closed on the IDA loans on or about December 13, 2007.[67] The Company incurred approximately $1.3 million in costs and fees to obtain the IDA financing, which amount was taken off the top.[68] After payoff of the $4.45 million WIFA note and the second BAN in the amount of $17.7 million, the Company was left with roughly the same $8.5 million of construction funding it had before the IDA funds were obtained. This meant that by December 2007, FWWS had already spent more than $8 million improving its water and sewer utility systems.[69]

Unfortunately, the remaining funds would sit in the bank for a while longer, as ADEQ continued to process the Company's permit applications. To make matters worse, by mid-2007, the Company began to incur extraordinary costs to haul effluent from the Palm Shadows treatment plant.[70] This was necessary because the effluent ponds at Palm Shadows had ceased to percolate.[71] By working with its affiliate, H&S Developers, FWWS has been able to deliver the effluent from Palm Shadows to the City of Yuma for disposal at a monthly cost of approximately $45,000, including the amounts paid to the City, as opposed to charges that were several times higher when unaffiliated entities were used.[72]

F. <u>August 2008 to December 2008</u>

In August 2008, ADEQ issued the last of the APPs and other approvals necessary for FWWS to proceed with its wastewater treatment plant renovation project.[73] The Company and Coriolis restarted the stalled procurement process and began to seek final

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[67] Exh. A-12.

[68] Tr. at 480-82.

[69] *See* Exh. A-8.

[70] Exh. R-28; Tr. at 984; Capestro Rb. at 14.

[71] Tr. at 743-45.

[72] Tr. at 984-85.

[73] Tr. at 92, 97, 736.

bids for the project. By this time, however, prices had increased dramatically, including prices for plastic and plastic piping, metals, electronics, and mechanical equipment.[74] The dollar had also lost significant strength against the Canadian dollar, causing additional increases in the cost of the membranes.[75] Additional cost increases resulted from requirements imposed in the permits issued by ADEQ, including the construction of vadose wells.[76] The total cost overrun was approximately $4.5 million.[77]

While the Company and Coriolis continued the process of procurement and construction, FWWS sought the additional capital needed to complete the sewer system renovations. By September 2008, the Company had a loan commitment from Wells Fargo for an additional $5 million.[78] However, in late September 2008 – less than two months after ADEQ issued the final APP – ADEQ publicly announced that the agency was filing a lawsuit against FWWS for past violations. Moreover, shortly afterward, in October 2008, the federal government declared that the nation's banks were in trouble and the stock market began to plummet.[79] Amidst these events, Wells Fargo withdrew its loan commitment. The Company continued its efforts to obtain additional funding, through loans to the Company and/or its shareholders, secured by their personal assets and stock in the utility.[80] Those efforts were unsuccessful. Meanwhile, the Company was incurring costs for equipment and construction, rapidly depleting the remaining funds from the IDA financing.

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[74] Tr. at 738-39.

[75] Tr. at 738-39.

[76] Tr. at 526-27.

[77] Tr. at 616; Exh. R-28.

[78] Tr. at 313, 489, 528.

[79] Tr. at 489, 618. *See also* Decision No. 70667 (Dec. 2008) at 31-32 (discussing the impact of the financial markets' collapse on APS's ability to borrow in finding that APS's possible credit rating downgrade qualified as an emergency supporting interim rates).

[80] *E.g.,* Tr. at 311-13, 567-69, 618.

By December 2008, FWWS was already over budget and owed vendors nearly $2 million in connection with the sewer system project that it could not pay.[81] There was no money available to continue with the water improvements, including repairs that were critically needed. In addition, FWWS was struggling to keep up with its operating expenses. For example, it was unable to pay the irrigation district all of the charges owed for purchased water, or Yuma County the amount owed in October 2008 for property taxes.[82] Unable to pay its bills and unable to fund the remainder of the improvements necessary to comply with the Consent Order, the Company filed this emergency rate case on December 19, 2008.

In its application and supporting testimony and schedules, FWWS explained that an immediate increase in revenue is necessary to prevent the Company from insolvency and to ensure that it can continue providing water and sewer utilities service to its customers.[83] The interim revenue increase sought by the Company in its filing was (and remains today) $2,161,788 per year, which is an increase of 101% over the Company's 2007 adjusted test year revenues.[84] The Company's requested revenue increase is premised on generating operating revenue to service the IDA debt and allow FWWS to achieve a 0.00% operating margin.[85] In short, the Company has proposed a three-year phase in of the requested overall rate increase in its pending general rate case. The

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[81] Exhs. A-9, A-10 and A-11.

[82] Capestro Rb. at 3-7; Exh. A-5.

[83] Emergency App. at 1; Bourassa Dt. at 2-3.

[84] Bourassa Dt. at Sch. A-1.

[85] Tr. at 57, 535-536, 612, 626-627, 973. Emergency App. at 2, 6. Bourassa Dt. at 1, 4. *See also* Tr. at 1125; Bourassa Dt. at 1, Bourassa Rb. at 2, 6 and 9. Because the Company's filing by necessity incorporated the Income Statement and 2007 Test Year from its pending but stayed general rate case, some operating expense increases are picked up (i.e., salaries and wages). The annual debt service cost on the IDA bonds plus the reserve funding is in excess of $2.4 million annually, or more than $200,000 monthly. Capestro Rb. at 5. The Company's recommended emergency revenue increase was designed to cash flow sufficient revenue to cover the annual debt service on the IDA bond in the amount of roughly $1.74 million.

emergency rates proposed in this proceeding would be, in effect, a preliminary phase of the permanent rate increases sought by the Company.[86]

III. THE PRESENT – FWWS FACES AN EMERGENCY

At the time this emergency rate case was filed, the Company did not have year-end 2008 data available. Therefore, its filing, like its pending general rate case, utilized the 2007 test year data. The unaudited financial information for 2008 reflects a sewer division net loss of over $2.7 million, and a Company-wide loss of over $972,000.[87] FWWS also ended 2008 with a positive cash flow of only $13,058.[88] And the situation has deteriorated over the past five months.

As of late April 2009, FWWS owed more than $3.3 million to vendors for equipment and construction of plant associated with the wastewater treatment renovations necessary to comply with the Consent Order.[89] This does not include the more than $1.27 million of additional costs that must be incurred before the renovation project can be completed.[90] Nor does it include the more than $300,000 owed for property taxes as of May 1, 2009, the past due amounts owed to the Yuma Mesa Irrigation and Drainage District for Colorado River water, or any other unpaid or late paid operating expense.[91] The Company also has a projected cash flow shortage in excess of $6.4 million for 2009.[92] Because the Company can no longer pay its debts as they come due in the ordinary course of business, FWWS now meets the definition of insolvency.[93]

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86 Capestro Rb. at 23.

87 Exh. S-1 at Sch. GWB-1; Capestro Rb. at 19, 20; Bourassa Rb. Exh. 1.

88 Exh. S-3. Tr. at 892. Bourassa Rb. Exh. 1.

89 Exh. A-9.

90 Exh. A-11.

91 *E.g.,* Capestro Rb. at 3-7; Exh. A-5.

92 Exh. S-3.

93 Tr. at 122, 893, 898, 1132-33, 1231-33.

Meanwhile, FWWS cannot finish the sewer renovations necessary to comply with the Consent Order. The vendors, which are owed substantial sums for equipment, will not finish the plant installation and start-up until they are paid.[94] While the shareholders were able to infuse $400,000 of capital to help pay critical expenses and keep the Company afloat,[95] they have not been able to raise either equity or debt in amounts sufficient to complete the project.[96] This is true despite the shareholders' willingness to offer personal guarantees and pledge their own assets, including the stock of the Company. The latest opportunity to raise the necessary capital went down in flames at the end of April 2009 when that lender decided it needed a security interest in all of FWWS's assets.[97] As a consequence, FWWS is stuck in limbo. The project needed to comply with the Consent Order and allow the Company to provide safe and reliable sewer service is nearly complete, but FWWS cannot complete it.[98] As a result, FWWS continues to incur some $45,000 a month to haul away effluent from Palm Shadows.[99]

FWWS is suffering extreme hardship under these conditions, which would not exist but for the combination of events described above, which resulted in a budget shortfall in excess of $4 million.[100] This situation was exacerbated by the financial markets' collapse less than two months later, which caused credit from conventional sources to disappear. This financial crisis was found to support APS's request for interim rate relief last December.[101]

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[94] Capestro Rb. at 4; Tr. at 99.

[95] Tr. at 570, 641-642.

[96] *E.g.,* Tr. at 615-620.

[97] Tr. at 490-91. All of FWWS's assets are encumbered by the IDA bondholders.

[98] Tr. at 99, 635-36, 863-864.

[99] Tr. at 750.

[100] Tr. at 620, 734-39.

[101] Decision No. 70667 (Dec. 24 2008) at 31-32.

At present, the Company is not operating a wastewater system that meets regulatory requirements, and its ability to maintain safe and reliable sewer service under these circumstances is in doubt. Additionally, the postponement of critical water system improvements is problematic.[102] To date, water shortages have not occurred, and the Company has been able to meet customer demand. How long water system upgrades can be delayed without service problems occurring, however, is uncertain.

The Company's inability to timely pay its bills, including operating expenses, casts further doubt on its ability to maintain water and sewer service to its customers. Should one or more creditors force the Company into bankruptcy, the situation will worsen precipitously. In sum, at best, FWWS and its customers are living under the constant threat of service being compromised. This threat is clearly sufficient to warrant emergency rate relief.

IV. THE FUTURE – AN INFUSION OF CASH FLOW GIVES FWWS A CHANCE

A. <u>The Relief Sought By the Company</u>

The Company seeks interim rate increases designed to produce additional revenue of $2,161,788 on an annualized basis, which, if approved, will result in an operating margin of 0.00%. The rate increases will be in effect only until the Commission issues a decision in the Company's general rate case, which was filed on August 29, 2008. In the event that the permanent rates established in that case are less than the interim rates, the difference will be subject to refund with appropriate interest.

As explained, the Company's recommended interim revenue increase is intended to provide funds for payment of the monthly debt service on the IDA bonds plus achieve a 0.00% operating margin.[103] Monthly debt service payments plus the reserve funding in

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[102] Tr. at 857.

[103] Tr. at 535, 536-537, 612, 626; Emergency App. at 2, 6; Bourassa Dt. at 1, 4.

the total amount of $201,096.61 began in January 2008, following receipt of the IDA funds in late December 2007.[104] This debt service must be paid.[105] But at this time, it is not included in the Company's sewer rates. Therefore, interim rate increases equivalent to the debt service requirement would immediately free up that amount of funds for completion of the treatment plant renovations.[106]

Additionally, the additional revenue stream will allow FWWS to work out payment plans with vendors that want their money before they will commission the renovated treatment facilities, allowing them to be brought online.[107] Alternatively, the additional revenue stream will give lenders comfort that FWWS can make payments on a loan for the amount needed to finish the treatment plant renovations and comply with the Consent Order. Thereafter, such plant will be "in service," and the Company can obtain permanent rate relief and earn a return on and of its investment. In this way, the Company proposes to immediately address and eventually cure itself of the emergency it faces.

B. <u>The Relief Sought Is Authorized Under Arizona law</u>

The requested relief is clearly authorized under Arizona law and within the scope of the Commission's regulatory authority. Under Attorney General Opinion 71-17, there are two circumstances under which interim rates may be authorized. First, "as an emergency measure when sudden change brings hardship to a company, when the company is insolvent, or when the condition of the company is such that its ability to maintain service pending a formal rate determination is in serious doubt."[108] Second,

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[104] Capestro Rb. at 5.

[105] Capestro Rb. at 4.

[106] Tr. at 566, 635, 983.

[107] Tr. at 540-541, 569, 887, 934.

[108] Op. Att'y Gen. 71-17, at 50. Although Attorney General's opinions are not binding, the Arizona Court of Appeals has cited with approval and followed this opinion. *See RUCO v. Ariz. Corp. Comm'n*, 199 Ariz. 588, 591, 20 P.3d 1169, 1172 (App. 2001); *Scates v. Ariz. Corp. Comm'n*, 118 Ariz. 531, 535, 578 P.2d 612, 616 (App. 1978).

interim rates may be authorized when "the Commission [is unable] to grant permanent rate relief within a reasonable time." *Id.* The first standard is applicable to this case. In fact, Staff's "general conditions" are taken from the Opinion,[109] and the Commission has cited the Opinion as authoritative in prior interim rate decisions, including the decision approving APS's interim rate request last December.[110]

The Commission issued emergency rate relief for FWWS's water division in Decision No. 61833 (July 20, 1999) (copy attached). At that time, the Company was facing serious cash flow problems as a result of converting its water system from groundwater (which contained high concentrations of dissolved solids and generated numerous customer complaints) to Colorado River water, which required the construction of a surface water treatment plant and related transmission and storage improvements. The cost of this project was estimated to be $6 million. Its rate base in its prior rate case (decided in mid-1997) was about $3 million.

To finance the project, FWWS arranged to borrow $6 million from WIFA. In order to qualify, however, the Company needed to meet certain debt coverage ratios. It also needed to substantially complete the plant before the hearing on the permanent rate increase to ensure that the plant would be included in rate base.[111] Consequently, FWWS requested an interim rate increase sufficient, on a pro forma basis, to generate a debt service coverage ratio of 1.78, an interest coverage ratio of 1.12, and positive net income of $51,000 (a return on equity of 1 percent).

Staff opposed any interim rate relief, arguing that FWWS was not facing an actual

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109 *See* Exh. S-1 at 2.

110 Decision No. 70667 (Dec. 24, 2008) at 21 (quoting Opinion).

111 Interim construction financing was being provided by an affiliate, which was repaid by the WIFA debt. Consequently, the plant was being constructed during the rate case. This is an example of the classic "chicken and egg" problem created by using an historic test year.

"emergency" under the criteria in the Attorney General Opinion.[112] RUCO believed that FWWS's situation qualified as an "emergency" because of the size of the construction project relative to rate base, the debt needed to finance construction and its impact on cash flow, and the utility's inability to service the debt with current rates.[113] RUCO, however, disagreed with the amount of FWWS's request, arguing that the utility was not entitled to interim rates that would produce even a small profit margin. Instead, the Company was entitled only to an increase sufficient to address the emergency, i.e., to service the new debt.

The Commission agreed and adopted RUCO's recommendation. The Commission found that interim rate relief was needed to allow FWWS to obtain funding from WIFA and complete its project, which was very large relative to the utility's current rate base and necessary to address serious water quality issues.[114] But the interim rates should be designed to provide sufficient cash flow to meet WIFA's debt service requirements, and not to provide a positive return on equity.[115] In other words, the interim relief was authorized, but only to the extent needed to address the emergency created by the new debt service.

RUCO was unable to reconcile its position in FWWS's 1999 interim rate case with its position in this case.[116] In fact, RUCO's witness didn't even consider this precedent on emergency rate relief.[117] In any event, according to RUCO, there is no emergency because the Company has a debt service coverage above 1.0.[118] RUCO, however, has

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[112] Decision No. 61833 at 6-7.

[113] Decision No. 61833 at 5-6.

[114] Decision No. 61833 at 7-8.

[115] Decision No. 61833 at 8.

[116] Tr. at 1155-59.

[117] Tr. at 1159.

[118] Tr. at 1104, 1115-16.

ignored every other measure and metric of the Company's financial condition. And even if there is a financial crisis, according to RUCO, no relief should be granted because it is the Company's own fault.[119] Incredibly, RUCO also wants to postpone all rate relief for what would likely amount to at least two years.[120] That RUCO believes FWWS can survive another two years is mind-boggling given the evidence presented. It is apparent that RUCO is more concerned about the precedent this case may set than helping residential utility consumers by ensuring safe and reliable water and sewer utility service.

Staff's witness testified the sewer division had a loss in excess of $2.7 million last year, that the Company had a loss of nearly $1 million.[121] He also testified that that "fault" was not an issue in an emergency rate case.[122] Nevertheless, Staff remains fixated on past decisions, including the Company's decision to undertake improvements to its water system at the same time as the sewer renovation project was being designed.[123] But no evidence was presented that the Company acted imprudently based on the information available at the time. Instead, Staff, with the benefit of hindsight, is now arguing that the Company shouldn't have started addressing its water division problems until it finished its sewer renovation project. This argument, like the majority of the arguments made by RUCO and Staff, relates to why the Company faces an emergency, not whether an emergency currently exists or how to address it. Like RUCO, Staff's failure to acknowledge the emergency FWWS faces and to provide a solution that squarely addresses that emergency leaves the Commission without any recommended remedy except the Company's requested relief.

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[119] *E.g.*, Tr. at 1118-19.

[120] Tr. at 1143-1146; Bourassa Rb. at 2-3.

[121] Exh. S-1.

[122] Tr. at 1232.

[123] Tr. at 550-556, 944-946.

V. CONCLUSION

For the foregoing reasons, FWWS urges the Commission to grant its requested emergency rate relief. The Company's dire financial condition, coupled with its immediate need for cash flow to complete the sewer treatment plant upgrades, as ordered by ADEQ, and to pay creditors (including Yuma County and the Yuma Mesa Irrigation and Drainage District), satisfies the criteria set forth in the Attorney General Opinion. Such relief is further supported by Commission decisions, including the 1999 decision authorizing FWWS interim rate relief to complete its surface water treatment plant and the 2008 decision granting APS interim rate relief to maintain its credit rating.

The positions taken by Staff and RUCO are myopic at best. Pretending that the financial difficulties FWWS currently faces will go away is not only inconsistent with the authorities discussed above, it is bad public policy. Allowing a utility with more than 15,000 customers to fail will benefit no one – certainly not the utility's customers – and will lead to a myriad of additional problems. Yet that is what Staff and RUCO are effectively advocating - an ostrich-like approach to this utility's financial crisis. Their positions must be rejected, and FWWS must be granted relief.

RESPECTFULLY SUBMITTED this 22nd day of June, 2009.

FENNEMORE CRAIG, P.C.

By: ______________________
Norman D. James
Jay L. Shapiro
Attorneys for Far West Water & Sewer Company

ORIGINAL and 13 copies delivered
this 22nd day of June, 2009 to:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

COPY sent via e-mail and U.S. mail this 22nd day of June, 2009, to:

Jane Rodda, Administrative Law Judge
Hearing Division
Arizona Corporation Commission
400 West Congress
Tucson, AZ 85701

COPY hand-delivered this 22nd day of June, 2009 to:

Kevin Torrey, Esq., Legal Division
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ 85007

Michelle Wood, Esq.
Residential Utility Consumer Office
1110 W. Washington St., Suite 220
Phoenix, Arizona 85007

COPY mailed this 22nd day of June, 2009 to:

Seth and Barbara Davis
2006 S. Arboleda Drive
Merced, CA 95341

By: Maria San Jose

BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission
DOCKETED

JUL 20 1999

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N. JAMES

JUL 26 1999

ACTION________

CARL J. KUNASEK
CHAIRMAN
JIM IRVIN
COMMISSIONER
WILLIAM A. MUNDELL
COMMISSIONER

IN THE MATTER OF THE APPLICATION OF FAR WEST WATER & SEWER, INC., FOR A RATE INCREASE.

DOCKET NO. WS-03478A-99-0144

DECISION NO. 61833

OPINION AND ORDER
(Interim Rates)

DATE OF HEARING: June 9, 1999

PLACE OF HEARING: Tucson, Arizona

PRESIDING OFFICER: Jane L. Rodda

APPEARANCES: Mr. Norman D. James, Fennemore Craig, on behalf of Applicant;

Mr. Kevin D. Quigley, Streich Lang, P.A., on behalf of Yuma Park Associates, Ltd., Intervenor;

Mr. Scott Wakefield, Chief Counsel, on behalf of Residential Utility Consumer Office, Intervenor; and

Mr. Robert Metli, Staff Attorney, Commission Legal Division, on behalf of the Utilities Division Staff.

BY THE COMMISSION:

On February 10, 1999, Far West Water & Sewer, Inc. ("Far West" "Applicant" or "Company") filed with the Arizona Corporation Commission ("Commission") an application to increase its water rates. On April 9, 1999, Far West filed an application for interim rates to provide Far West with adequate cash flow to obtain financing for the construction of a water treatment plant and related facilities to permit the use of Colorado River water. By Procedural Order dated April 16, 1999, a hearing on the interim increase was set for June 9, 1999, in Tucson, Arizona.[1]

Pursuant to Procedural Orders dated April 13, 1999, May 26, 1999 and May 28, 1999, the Commission granted intervention to the Residential Utility Consumer Office ("RUCO"), to Yuma

[1] The hearing on Far West's permanent rate case is set to commence on December 9, 1999, in Yuma, Arizona.

Park Associates, Ltd. ("Yuma Park"), a commercial customer of Far West's, and to George T. Broucek, President of the Mesa Del Sol Property Owners Association. In conformance with the Procedural Orders dated May 17, 1999 and May 19, 1999, the Commission's Utilities Division Staff ("Staff") and RUCO filed direct testimony regarding the interim rate increase on May 28, 1999, and Far West filed rebuttal testimony on June 4, 1999. A hearing on the interim rate increase was held on June 9, 1999 in Tucson, Arizona.

DISCUSSION

Background

Far West provides water service to more than 9,000 customers in an area immediately east of the City of Yuma, Arizona. Historically, Far West's sole source of water has been groundwater from wells within its certificated area. During Far West's last rate case (Decision No. 60437, September 29, 1997), a large number of Far West customers complained about the Company's service quality and the quality of its water. The Company's groundwater contains a high level of total dissolved solids ("TDS"), which, although within federal and state water quality standards, affected the taste and caused scale deposits on plumbing fixtures and filters and problems with appliances. In Decision No. 60437, the Commission ordered Far West to perform a study of its water quality problems, addressing in particular, ways to efficiently and cost-effectively meet customer expectations for safe and potable water.

The Company filed a report with the Commission's Utilities Division, as required in Decision No. 60437, in which the Company's engineers and consultants discussed various alternatives. The Company concluded that its best alternative to alleviate the TDS problem is to acquire a source of Colorado River water and construct water treatment and delivery facilities. Consequently, to address the TDS problem and to ensure a long-term supply, Far West initiated a program to substitute Colorado River water for groundwater.

In June 1998, Far West entered into a contract with the Yuma Mesa Irrigation and Drainage District ("District") under which Far West will purchase 5,000 acre-feet of Colorado River water annually. The contract price for Colorado River water is $75.00 per acre-foot, or $375,000 annually. This quantity of water will satisfy about 70 percent of Far West's current customer demand. Far

West intends to contract with the District for additional acre-feet in the next several years.

In conjunction with a finance request by Far West to finance the construction of the treatment plant and delivery system, Commission Engineering Staff reviewed the Company's report and agreed that the treatment plant and related facilities as proposed by the Company were its most reasonable option for addressing the TDS problem. Staff recommended that the Company's finance request be granted.

Construction Project

Far West has estimated that the new plant will cost $6.0 million. The construction project will nearly double the Company's gross utility plant in service. In Far West's last rate case, the Commission determined that the Company had gross plant in service of $6.4 million and an original cost rate base ("OCRB") of $2.9 million.

Far West commenced constructing the facilities in 1998, and by the time of the interim rate hearing, a substantial portion of the facilities had already been completed, including a 3.0 million gallon storage tank, 20-inch raw water transmission main, the raw water pump station and the finished water pump station. Construction on the treatment plant itself had commenced and the Company's president testified that Far West had already committed $4.0 million to this project. Far West expected the treatment facilities to be completed and in operation by October 1999.

In Decision No. 61713 (May 13, 1999), the Commission authorized Far West to borrow up to $5 .0 million on a short-term basis as an interim loan from H&S Developers, an affiliate of Far West, and $6.0 million on a long-term basis to construct the Colorado River water treatment plant and delivery system. The short-term debt bears an interest rate of prime plus 1.5 percent, or 9.25 percent at the time of the hearing. Far West initially intended to obtain long-term financing from a conventional lender, but also sought assistance from the Water Infrastructure Finance Authority of Arizona ("WIFA"). In March 1999, WIFA adopted a resolution authorizing a binding commitment to assist Far West with its construction project. At the time of the hearing, the precise form of WIFA's financial assistance was unclear. WIFA will either make a direct loan in the amount of $6.0 million or provide financial assistance in the form of a "linked deposit guarantee," under which funds will be deposited with a conventional lender in order to reduce the interest rate that would otherwise be payable by Far West. In either case, the interest rate for the long-term debt will be reduced to approximately 75 percent of the prime lending. WIFA has conditioned its financial assistance on the approval of rates and charges for services that are "sufficient to make principal repayments and interest payments and generate net revenues coverage."

Requested Revenue Increase

In Far West's permanent rate application, the Company sought an increase of $2.5 million, or 140 percent, over test year revenues. In its interim application, Far West is seeking a revenue increase of $1,258,630 (on an annualized basis). Based on its projected changes in operating expenses associated with the new plant and the anticipated debt service requirements resulting from the long-term debt, Far West projected negative net income of $948,612, negative operating income of $520,941 and a negative cash flow of $547,194 for the period June 1999 through May 2000, if interim rates are not granted. The Company contended that the lack of operating income and positive cash flow would result in debt service coverage of only 0.06, negative interest coverage of (1.22) and a negative return on rate base of (4.8) percent. Far West argued that without interim rates, the negative coverage ratios would prevent the Company from obtaining long-term debt financing and Far West would have to either halt construction of the facilities or finance those facilities with equity which would substantially increase the Company's cost of capital, and increase the accrual of a substantial allowance for funds used during construction ("AFUDC") which would inflate Far West's rate base in future.

Far West assumed that the interim rates would go into effect in August 1999 and remain in effect until May 2000 when it is expected the permanent rates would go into effect. The actual revenue increase produced by Far West's proposed interim rates would be $1,015,213 over the ten month period. Far West calculated this revenue increase would result in a debt service coverage of 1.78, an interest coverage of 1.12 and a positive net income of $51,000, and a return on common equity of approximately 1.0 percent.

Far West recognized that the magnitude of its interim request is substantial, nearly a 70 percent increase. Far West argued, however, that its existing rates are very low compared with other water utilities. Far West noted that under its proposed interim rates the average monthly bill for a

5/8" x 3/4" meter would increase from \$12.73 to \$21.47. In addition to the Colorado River project, Far West has made capital improvements of approximately \$2.0 million since its last rate case.

Criteria For Interim Rates

RUCO supported the Company's interim rate request, although it recommended lower interim rates than those sought by the Company. RUCO based its recommendation on the criteria established in Arizona Attorney General Opinion No. 71-17 (May 25, 1971) regarding when the Commission can set interim rates. Attorney General Opinion No. 71-17 found that the Commission has jurisdiction to grant interim rates to be effective until the Commission establishes permanent rates without having to make a finding of fair value if the need for interim rates qualifies as an "emergency." Specifically, the Attorney General's Opinion found an emergency exists "when sudden change brings hardship to a company, when the company is insolvent, or when the condition of the company is such that its ability to maintain service pending a formal rate determination is in serious doubt."

In formulating its recommendation, RUCO noted the precedent set in Arizona Public Service Company ("APS") Decision No. 53909 (January 30, 1984) when the Commission issued emergency rates for APS because of severe cash flow restraints associated with extensive construction projects. At that time APS was engaged in an extensive construction program to build the Palo Verde nuclear plants. Due to the large investment requirements for the nuclear plants and resultant debt issuances, APS had negative cash flow indicators. Absent interim rate relief, APS's commercial paper rating was in danger of being downgraded which would have increased its cost of debt and further eroded APS's cash flow ratios. In Decision No. 53909, the Commission recognized the severe drain that a massive construction project has on cash flow, and the resulting adverse effects on the financial viability of the utility. Accordingly, the Commission found these conditions to constitute an emergency that qualified for interim rates.

RUCO believed that the situation faced by APS in the 1984 Decision and by Far West currently are similar in that they both involve proportionately large construction projects, large debt issuances to finance the projects and a cash flow problem associated with the debt issuance during the construction period. Consequently, RUCO concluded that Far West's situation meets the criteria for emergency interim rates as set forth in Attorney General Opinion No. 71-17 and Decision No. 53909.

RUCO believed Far West's situation qualified as an "emergency" because the construction project is very large relative to the current rate base; the debt necessary to finance the construction has a severe impact on cash flow, and ultimately on the Company's continued viability; and the Company is unable to service the debt with current rates. RUCO disagreed with Far West that the timing differences that arise as a result of the lag between the plant construction period and the time when the plant enters service and is included in rates constitutes an "emergency" justifying interim rates. RUCO believed such "timing differences" were faced by all regulated utilities and alone do not constitute an emergency.

RUCO also disagreed with the amount of the interim rate increase Far West requested because in RUCO's opinion, the increase exceeded the amount necessary to address the emergency. RUCO argued that under Attorney General Opinion 71-17, interim rates are reserved for emergencies and are not used to compensate a utility for a mere inability to generate profits or pay dividends, and consequently, the magnitude of Far West's request, which included a small profit margin, was more than needed to address the emergency situation. RUCO calculated that an increase of $837,817 (on an annual basis) is necessary to address the emergency. This is the amount, RUCO argued, that the Company would require to service the new debt and provide for increased operating costs associated with the new treatment plant. To provide a margin of safety, RUCO's recommendation provided a debt service coverage ratio of 1.5. Far West calculated that under RUCO's recommendation, the Company would experience a net loss of $215,828 during the expected interim period ending May 31, 2000.

Staff and Yuma Park opposed the interim rate increase because in their opinions, Far West was not facing an "emergency" under the criteria of the Attorney General's Opinion. Staff testified that historically Staff recommends interim rate increases in cases where an operating change has or will create a hardship for the company, the company is insolvent, or it is doubtful that the company can maintain service pending a rate determination. After review of the submitted income statements, Staff determined that Far West's request for interim rates did not meet the criteria Staff historically applies. Staff did not believe that the cash flow of the Company as of September 30, 1998, the test year used in the permanent rate case, indicated an insolvent entity or an entity unable to provide service to its customers. Even utilizing the Company's cash flow projections Staff did not believe Far West was unable to provide service to its customers and remain solvent. Yuma Park did not present witnesses of its own, but participated in the questioning of witnesses and agreed with Staff that the current request did not meet the "emergency" criteria established in the Attorney General Opinion as the Company was not insolvent or unable to continue providing service.

Analysis

Under the unique circumstances presented by this case, we concur with RUCO and the Company that Far West is facing an "emergency" caused by severe cash flow shortfalls associated with the financing of a substantial construction project. The Company's move to utilize Colorado River water for a large portion of its supply needs represents a significant operating change. The additional plant associated with the project will almost double the Company's gross utility plant in service (based on its last rate case). Without the interim increase, Far West will not be able to obtain debt financing for the project until permanent rates are in place. It is uncertain whether Far West would be able to finance the project with equity in the event it cannot obtain debt financing, but we note that even if it could command an equity infusion of such magnitude, equity funding will substantially increase the Company's cost of capital and affect the ultimate rates customers will be required to bear at some point in the future.

The Company has determined that acquiring a source of Colorado River water is necessary for it to address water quality issues that have plagued the Company. We concurred with that determination in Decision No. 61713. Consequently, the Company has engaged in a relatively large project to acquire Colorado River water and to construct the facilities necessary to deliver the treated water to its customers. Absent sufficient rates to cover debt service, including interest, principal and reserve requirements, neither WIFA nor conventional financing will be available for the Colorado River water project. Far West's current rates are not sufficient to meet WIFA's or a conventional lender's lending requirements, and Far West has not been able to make interest or principal payments on its existing short-term loan. The construction project is very large in proportion to the Company's current rate base, and the substantial debt required to finance the construction of the project, along with the increased operating expenses associated with the river water treatment will have a severe negative impact on cash flow. This will damage the Company's credit worthiness and cause the Company hardship until permanent rates can be put in place. Based on the foregoing, we find Far West is facing an "emergency" under the criteria established in Attorney General Opinion 71-17. The interim rates we approve herein shall be subject to refund in the event they are not justified in the final determination of the permanent rate case.

We agree with RUCO that the interim rates should be designed to address the "emergency" situation. In this case, interim rates should provide sufficient cash flow to enable the Company to meet debt service requirements of WIFA and/or a conventional lender and should not provide a return on equity during the interim period. We accept RUCO's recommended revenue level and rate design because we agree with RUCO that in calculating cash flow requirements the same time period must be utilized for determining revenues and expected expenses. RUCO utilized a twelve month period in analyzing both sources and uses of cash. The Company appears to have utilized a ten month period for calculating revenue and a twelve month period for calculating debt service costs.

In general, we agree with the Company that an AFUDC component in rate base is reasonable. In balancing the Company's entitlement to recover costs during construction with the effect of the emergency rate increase on customers, we find that it is reasonable in this case to require that any AFUDC that may be approved in the permanent rate case shall be offset by the amount of revenues collected from the emergency rate increase.

* * * * * * * * * *

Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

1. On February 10, 1999, Far West filed with the Commission an application to increase its water rates. The hearing on Far West's application for permanent rates is set to commence on December 9, 1999, in Yuma, Arizona.

2. On April 9, 1999, Far West filed an application for the implementation of interim rates to provide the Company with adequate cash flow to obtain financing for the construction of a water treatment plant and related facilities to permit the use of Colorado River water to improve water

quality and to provide a long-term source of supply.

3. By Procedural Order dated April 16, 1999, a hearing on the interim increase was set for June 9, 1999, in Tucson, Arizona.

4. Pursuant to Procedural Orders dated April 13, 1999, May 26, 1999 and May 28, 1999, respectively, the Commission granted intervention to RUCO, to Yuma Park, a commercial customer of Far West's and to George T. Broucek, President of the Mesa Del Sol Property Owners Association.

5. In conformance with the Procedural Orders dated May 17, 1999 and May 19, 1999, Staff and RUCO filed direct testimony regarding the interim rate increase on May 28, 1999, and Far West filed rebuttal testimony on June 4, 1999.

6. A hearing on the interim rate increase was held on June 9, 1999, in Tucson, Arizona.

7. Far West, Staff and RUCO presented witnesses at the hearing and Yuma Park participated in the examination of witnesses.

8. Following the hearing, Far West and RUCO filed a joint submission for the purpose of explaining a dispute that developed during the hearing concerning the computation of Far West's debt service coverage.

9. Far West provides water utility service to over 9,000 customers, many of whom are seasonal.

10. Historically, groundwater has been Far West's sole source of water and has been characterized by high concentrations of TDS. Far West's groundwater supply meets or exceeds federal and state drinking water quality standards, but the high levels of TDS caused deposits of scale on plumbing fixtures and filters, undesirable taste, and in certain cases, damage to plumbing and appliances.

11. Far West's current rates and charges for water utility service were approved in Decision No. 60437, as modified in Decision No. 60826 (April 13, 1998).

12. During Far West's last rate case, many customers complained about the appearance, odor and taste of Far West's water and its corrosive effect on appliances.

13. In Decision No. 60826, the Commission ordered Far West to perform a study of its

water quality problems, addressing in particular, ways to efficiently and cost-effectively meet customer expectations for safe and potable water.

14. The Company filed a report with the Commission's Utilities Division as required in Decision No. 60437. The Company concluded that its best alternative to alleviate the TDS problem is to acquire a source of Colorado River water.

15. Far West has entered into a contract with the District to purchase up to 5,000 acre-feet of Colorado River water annually at a cost of $75.00 per acre-foot (an annual cost of $375,000).

16. In order to utilize the Colorado River water, Far West is constructing a water treatment plant with a capacity of 4.0 million gallons per day, together with a 3.0 million gallon storage reservoir, a six mile 20-inch raw water transmission main, raw water pumping station, finished water pumping station and other transmission mains and improvements.

17. Far West estimates a cost of $6.0 million for constructing the water treatment plant and other facilities required to use Colorado River water.

18. In November 1998, Far West filed an application requesting authority to incur long-term debt in the amount of $6.0 million and to incur a short-term bridge loan in the amount of $5.0 million to finance the construction of the facilities needed to utilize Colorado River water. Staff investigated Far West's proposal to use Colorado River water in connection with analyzing the Company's financing application, and concurred with the Company that the use of Colorado River water is the best and most cost-effective option currently available for improving water quality.

19. In Decision No. 61713 the Commission approved Far West's request for authority to incur long-term debt in the amount of $6.0 million, at an interest rate not to exceed 8.0 percent per annum, and to incur short-term debt in the amount of $5.0 million in connection with constructing the Colorado River water treatment plant and related facilities.

20. Far West commenced construction of the facilities in 1998, and as of the date of the hearing, had completed a significant portion of the facilities, including the 20-inch raw water transmission main, 3.0 million gallon storage tank, raw water pump station and turn-out on the District canal, and finished water pump station. As of the date of the hearing, Far West had already expended, or had committed to spend, approximately $4.0 million in connection with the purchase of

materials, labor, engineering and design services and other activities related to the construction of the facilities.

21. Far West anticipates completing the treatment plant and related facilities by early October 1999.

22. Far West has applied for and obtained a binding commitment for financial assistance from WIFA, under which WIFA will either loan funds directly to Far West or provide a "linked deposit guarantee" to a conventional lender in order to reduce the interest rate for the loan.

23. WIFA's financial assistance is expected to reduce the interest rate that Far West must pay in connection with the long-term debt to approximately 75 percent of the prime interest rate, or about 6.0 percent.

24. WIFA has informed Far West that to obtain WIFA assistance, Far West must obtain approval of rates and charges sufficient to make interest payments, principal repayments and satisfy other requirements of WIFA and any conventional lender.

25. Far West's current rates and charges are not sufficient to generate sufficient cash flow to make debt service payments on either its existing short-term note or its anticipated long-term financing.

26. Far West requested approval of interim rates that would produce, on an annualized basis, additional revenue of $1,258,630, to become effective on August 1, 1999, and remain in effect until the effective date of the rates established in the permanent rate case.

27. For the period June 1999 through May 2000, Far West projects that it will have a negative cash flow of $547,194 and negative operating income of $520,941 without the interim rate increase.

28. Without an interim rate increase, Far West's debt service coverage, interest coverage and other negative financial indicators will undermine Far West's credit-worthiness and prevent Far West from obtaining long-term debt financing for its Colorado River project on reasonable terms prior to the establishment of permanent rates.

29. Far West had not been able to make interest or principal payments on its short-term bridge loan from its affiliate H & S Developers. Interest continues to accrue on the short-term debt at

the rate of 9.25 percent.

30. The long-term debt financing will allow Far West to achieve a balanced capital structure of approximately 50 percent equity and 50 percent debt, which will reduce the Company's cost of capital.

31. RUCO testified that the proportionately large construction project, the large debt financing required to fund the project and the resulting severe negative impact on Far West's cash flow constituted an "emergency" under Arizona Attorney General Opinion 71-17. RUCO recommended that the Commission grant Far West interim rates that would generate additional revenue of $837,817 on an annual basis.

32. Staff and intervenor Yuma Park did not believe that Far West's financial position constituted an emergency and recommended against the Company's request for interim rates.

33. The proportionately large capital improvement project, the large amount of financing required to fund the project and the severe cash flow shortfalls caused by the debt service and increased operating costs will cause a hardship on Far West that will negatively impact its credit worthiness and ability to provide quality water utility service until permanent rates can be put in place, thus constituting an "emergency" under Arizona Attorney General Opinion 71-17.

34. It is reasonable to set interim rates at a level that will allow Far West to make interest and principal payments and meet reserve requirements on the proposed long-term debt. Interim rate relief should not include any sums to generate a positive operating income.

35. An interim increase in water revenues of $837,817 (on an annual basis) is sufficient to insure adequate cash flow, debt service and interest coverage to alleviate the emergency and to allow Far West to proceed with its long-term financing and complete construction of the treatment plant and other facilities needed to use Colorado River water.

CONCLUSIONS OF LAW

1. Far West is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. sections 40-250 and 40-251.

2. The Commission has jurisdiction over Far West and of the subject matter of the application.

3. Notice of the application was provided in the manner prescribed by law

4. Far West is facing an "emergency" within the definition set forth in Arizona Attorney General Opinion No. 71-17.

5. The emergency rates approved herein and set forth in Exhibit A, attached hereto, and incorporated by reference, are just and reasonable on an interim basis and should be granted.

6. It is reasonable to require that any AFUDC that may be approved in the permanent rate case shall be offset by the amount of revenues collected from the emergency rate increase approved herein.

ORDER

IT IS THEREFORE ORDERED that Far West Water & Sewer, Inc. shall file on or before July 30, 1999, a schedule of interim rates reflecting the monthly minimum changes and commodity rate set forth in Exhibit A hereto.

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

IT IS FURTHER ORDERED that the above rates and charges shall be effective for all service provided on and after August 1, 1999.

IT IS FURTHER ORDERED that Far West Water & Sewer, Inc. shall notify its customers of the interim rates and charges authorized herein and the effective date of same as well as the fact such rates are subject to refund in the event they are not justified in the permanent rate case, by means of an insert in its next regular monthly billing.

IT IS FURTHER ORDERED that in the event of any refund, interest is to be paid at the legal rate.

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IT IS FURTHER ORDERED that any AFUDC that may be approved in the permanent rate case shall be offset by the amount of revenues collected from the emergency rate increase approved herein.

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

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 20th day of July, 1999.

BRIAN C. McNEIL
EXECUTIVE SECRETARY

DISSENT ______________
JR:bbs

SERVICE LIST FOR: FAR WEST WATER & SEWER, INC.

DOCKET NO. WS-03478A-99-0144

Brent H. Weidman, President
FAR WEST WATER AND SEWER, INC.
12486 Foothills Boulevard
Yuma, Arizona 85367

Norman D. James
Jay L. Shapiro
FENNEMORE CRAIG
3003 N. Central Avenue
Suite 2600
Phoenix, Arizona 85012-2913

Scott S. Wakefield, Chief Counsel
RESIDENTIAL UTILITY CONSUMER OFFICE
2828 North Central Avenue, Suite 1200
Phoenix, Arizona 85004

Don P. Martin
Kevin D. Quigley
STREICH LANG, P.A.
Two North Central Avenue
Phoenix, Arizona 85004-2391

George T. Broucek, President
MESA DEL SOL PROPERTY OWNERS ASSOCIATION
11881 Fortuna Road #209
Yuma, AZ 85367-7686

Paul Bullis, Chief Counsel
Legal Division
ARIZONA CORPORATION COMMISSION
1200 W. Washington Street
Phoenix, Arizona 85007

Director of Utilities
ARIZONA CORPORATION COMMISSION
1200 W. Washington Street
Phoenix, Arizona 85007

EXHIBIT A

LINE NO.	METER SIZE	
	MONTHLY MINIMUMS	
1	5/8 x ¾ INCH	9.50
2	¾ INCH	14.25
3	1 INCH	23.75
4	1.5 INCH	47.50
5	2 INCH	76.00
6	3 INCH	152.00
7	4 INCH	237.50
8	6 INCH	475.00
9	FIRE HYDRANTS (CONSTRUCTION)	152.00
10	GALLONS INCLUDED IN MINIMUM	1,000
11	COMMODITY RATES – 1,000 GALS	$1.042