



0000100985

MEMORANDUM

TO: Docket Control

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

DATE: July 24, 2009

RE: STAFF REPORT FOR BOB B. WATKINS dba EAST SLOPE WATER COMPANY'S APPLICATION FOR AN EMERGENCY RATE INCREASE (DOCKET NO. W-01906A-09-0283)

Attached is the Staff Report for Bob B. Watkins dba East Slope Water Company's ("East Slope" or "Company") application for an emergency rate increase. Staff recommends approval of the Company's request for an emergency rate increase using Staff's recommended rates, along with Staff's additional recommendations.

Any party who wishes may file comments to the Staff Report with the Commission's Docket Control by 4:00 p.m. on or before August 3, 2009.

EGJ:DRE:lm\CH

Originator: Darak R. Eaddy

Arizona Corporation Commission  
DOCKETED

JUL 24 2009

DOCKETED BY *ME*

ARIZONA CORPORATION COMMISSION  
DOCKET CONTROL

2009 JUL 24 11:00

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Service List for: Bob B. Watkins dba East Slope Water Company  
Docket No. W-01906A-09-0283

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**STAFF REPORT  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION**

**BOB B. WATKINS dba EAST SLOPE WATER COMPANY**

**DOCKET NO. W-01906A-09-0283**

**APPLICATION FOR AN  
EMERGENCY RATE INCREASE**

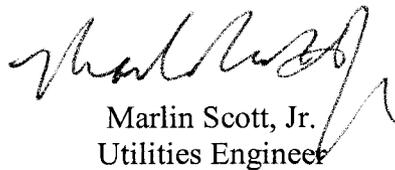
**JULY 24, 2009**

## STAFF ACKNOWLEDGMENT

The Staff Report for Bob B. Watkins dba East Slope Water Co., Docket No. W-01906A-09-0283, was the responsibility of the Staff members listed below. Darak R. Eaddy was responsible for the financial review and analysis of the Company's application. Marlin Scott, Jr. was responsible for the engineering and technical analysis. Carmen Madrid was responsible for reviewing the Commission's records on customer complaints filed with the Commission.



Darak R. Eaddy  
Public Utilities Analyst II



Marlin Scott, Jr.  
Utilities Engineer



Carmen Madrid  
Public Utilities Consumer Analyst I

**EXECUTIVE SUMMARY**  
**BOB B. WATKINS dba EAST SLOPE WATER COMPANY**  
**APPLICATION FOR AN EMERGENCY RATE INCREASE**  
**DOCKET NO. W-01906A-09-0283**

Bob B. Watkins dba East Slope Water Company (“East Slope” or “Company”) is a Class C water utility located in Sierra Vista in Cochise County, Arizona. East Slope provides potable water to approximately 822 metered customers in its certificated area.

East Slope filed a request for an emergency rate increase on June 2, 2009. The Company stated in its emergency rate application that the Company’s owner, Mr. Bob Watkins, no longer possessed the ability to fund the ailing water system. Consequently, East Slope anticipates that the Company will become insolvent, without emergency rate relief, as the Company has been unable to generate revenues sufficient to meet its operating expenses. The Company also stated that East Slope was in desperate need of additional storage and its owner lacked the necessary funds to acquire it at this time. Finally, the Company stated that the water table in the area has dropped significantly and that there was no other adequate alternative source of water available for the Company.

East Slope’s application requested an emergency rate increase be added to the Company’s existing minimum charge. The emergency surcharge requested is \$19.55 per customer per month, which would result in a monthly minimum charge of \$28.55 per customer, an increase of 217.2 percent over the current minimum charge of \$9.00 per month. The Company’s proposed rates would increase the typical residential bill<sup>1</sup> with 8,000 gallons of usage from \$19.26 to \$38.81, an increase of \$19.55 or 101.5 percent. The emergency rate increase would produce an additional \$16,070 per month in revenues.

Staff has recommended an emergency surcharge of \$7.60 to be added to the Company’s existing minimum charge. Staff’s recommended emergency surcharge would result in a monthly minimum charge of \$16.60 per customer, an increase of 84.5 percent over the current minimum charge of \$9.00 per month. Staff’s recommended rates would increase the typical residential bill<sup>2</sup> with 8,000 gallons of usage from \$19.26 to \$26.86, an increase of \$7.60 or 39.5 percent. The emergency rate increase would produce an additional \$6,251 per month in revenues.

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

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<sup>1</sup> Includes both the 5/8 x 3/4-inch and 3/4-inch meter sizes.

<sup>2</sup> Includes both the 5/8 x 3/4-inch and 3/4-inch meter sizes.

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## **Introduction**

On June 2, 2009, Bob B. Watkins dba East Slope Water Company ("East Slope" or "Company") filed an application for an emergency rate increase with the Arizona Corporation Commission ("Commission"). On June 30, 2009, a Procedural Order was issued setting August 18, 2009, as the date for the hearing on the application.

East Slope has stated that the Company will become insolvent and/or run out of water without emergency rate relief. The Company is unable to generate sufficient funds to meet its operating expenses with its current rates, and the Company's owner, Mr. Bob Watkins, no longer has the ability to fund the Company's operations. The application states that the Watkins family has advanced East Slope a total of \$53,523 as well as acquiring a line of credit debt in the amount of \$114,867 to fund operating shortfalls. The Company has also accumulated an accounts payable balance of \$46,000.

In addition to operating shortfalls, East Slope stated it has only one primary source for water and the water table in the Company's area is dropping drastically. The Company fears that its pumps are in danger of running dry with the heat of the summer months. According to the Company, the situation is further exacerbated by East Slope's desperate need of additional storage on the system. The Company states in its application that one of the storage tanks is 40 years old and is in need of sandblasting and recoating due to corrosion. The electrical panels on the storage tanks need to be replaced as well. Due to the Company's lack of necessary storage to maintain the entire system, the Company asserts that hauling water is not a viable option to address the declining water table.

## **Background**

East Slope is an Arizona class C utility engaged in the business of providing potable water service. East Slope was granted a Certificate of Convenience and Necessity ("CC&N") to provide water service per Decision No. 34783, effective October 1, 1963.

The current rates have been in effect since October 1, 1990 per Decision No. 57076.

## **Engineering Analysis**

A complete discussion of Staff's technical findings and recommendations and a complete description of the water system are provided in the attached Engineering Report (Attachment A).

## **System Evaluation**

### **Current Water System**

According to the Company, the existing system consists of five active wells (with total production capacity of 562 gallons per minute), two storage tanks (with total storage capacity of

250,000 gallons), two booster systems, fire hydrants and a distribution system serving approximately 822 service connections.

Using the Company's 2008 Annual Report, the Company reported the peak use month as June with 10,458,000 gallons sold. Based on this data, the Company has adequate production and storage.

#### Water System Improvements

In its filing, the Company stated that the water system improvements include, 1) additional storage capacity, 2) refurbishment of an existing storage tank, 3) deepening of wells due to the depletion of the water table, and 4) electrical control panels need to be replaced. In addition, the Company stated that due to the high water demand being placed on the system during these summer months, the water system cannot keep up with the customer demand, resulting in loss of water pressure in the distribution system. The Company, however, did not submit any cost estimates for these water system improvements.

Staff noticed that the Company has recently made filings with the Water Infrastructure Finance Authority of Arizona ("WIFA"). The Company filed for WIFA financial assistance in the amount of \$7,292,647 in March 2009 that included the above mentioned system improvements, plus replacement of water mains, looping of distribution system, new booster systems, and replacement of customer meters. In May 2009, the Company updated this same WIFA financial assistance application to an amount of \$5,416,973. Also in May 2009, the Company filed for WIFA technical assistance in an amount of \$605,794.

#### **Arizona Department of Environmental Quality ("ADEQ") Compliance**

According to an ADEQ Compliance Status Report, dated April 22, 2009, ADEQ reported no deficiencies and has determined that the Company's system, Public Water System No. 02-028, is currently delivering water that meets the water quality standards required by 40 CFR141/Arizona Administrative Code, Title 18, Chapter 4.

#### **Conclusions**

At this time and under normal operating conditions, the Company's water system appears to have adequate well and storage capacities.

Based on the above, Staff cannot determine that an emergency exists from an engineering perspective.

#### **Compliance**

The Utilities Division Compliance Section shows no outstanding compliance issues.

The Company is in good standing with the Corporations Division of the Commission.

### **Consumer Services**

A review of the Consumer Services Section database from January 1, 2006 to July 14, 2009, revealed that two inquiries were received in 2006. There have been no complaints or opinions filed for East Slope.

### **Financial Viability and Ability to Maintain Service**

In its emergency rate application, the Company has stated that because its owner, Mr. Bob Watkins, no longer has the ability to fund its operating shortfalls the Company is in danger of becoming insolvent and/or running out of water. Although the Company, in the narrative portion of its emergency rate application, states that an emergency exists in regards to both well and storage capacity, East Slope never offers any projected amount to alleviate the emergency. In addition, East Slope's surcharge calculation methodology does not include any provision for funds to address a lack of well or storage capacity. Based on Staff's engineering analysis, and its conclusion that the Company presently and under normal operating conditions, possesses adequate well and storage capacity, Staff does not recommend any emergency surcharge to address the lack of well or storage capacity.

In its emergency rate application, East Slope included several items in calculating its requested emergency surcharge of \$19.55. The Company's emergency surcharge includes delinquent accounts payable in the amount of \$51,977; a Wells Fargo credit line in the amount of \$113,868; a \$50,545 note payable from N. Watkins; and finally provisions for a 2009 projected net loss of \$44,748. Staff gave consideration to the appropriateness of each item in calculating a recommended emergency surcharge.

Staff agrees with the Company that an emergency situation exists from a financial standpoint. Based on the Company's emergency rate application, Staff believes an emergency exists in regards to the Company meeting its financial obligations and therefore maintaining its solvency, satisfying Condition No. 2 of the situations necessary for an interim, emergency rate set forth in Attorney General Opinion No. 71 - 17. Because of the timing limitations inherent in emergency rate applications, Staff was unable to perform a full audit and based its determination on the Company's emergency rate application and other, readily available, sources.

Staff disagrees with the Company's request to include \$51,977 in delinquent accounts payable in calculating the Company's emergency surcharge. Staff notes that these delinquent accounts payable are for previous periods of service and to include them in calculating current rates would amount to retroactive ratemaking which is improper. The Company was provided rates in prior periods that were designed to provide for expenses and give East Slope a return on its investment. If the Company's rates failed to provide this, then it was incumbent upon the Company's management to address the situation in a timely manner. The Company's accounts payable balance has been increasing for several years, yet the Company has not filed a full rate

application since 1989. East Slope's customers should not be required to provide a remedy or make the Company "whole" for management's lack of timely action or guidance.

Staff also disagrees with the Company's request to include \$113,868 for a Wells Fargo credit line in calculating the Company's emergency surcharge. Staff notes that the Company has never sought approval of the debt with the Commission, and Staff has never examined this line of credit for its appropriateness nor for the manner in which the Company utilized this instrument. The Company has utilized this line of credit since at least 1999 without any rate consideration, so Staff does not believe that this item constitutes an emergency nor that emergency rate relief is appropriate. In addition, given the Company's prior issues with the intermingling of utility funds with personal funds (and possibly other corporate entities) discovered in the last rate case, Staff recommends that the line of credit balance and its associated interest expense be removed from the calculation of the Company's emergency surcharge.

For similar reasons as listed in the preceding paragraph, Staff disagrees with the Company's request to include a \$50,545 note payable to N. Watkins in calculating the Company's emergency surcharge. Once again, Staff notes that it has never examined the appropriateness of the note payable nor how and for what entity the funds gained from this note payable was utilized. The Company has held this note payable since at least 1999 without any rate consideration, so Staff does not believe that this item constitutes an emergency nor that emergency rate relief is appropriate.

East Slope is requesting that the emergency cover its projected 2009 net loss of \$44,748. Although Staff agrees with the Company that inclusion of operating results in calculating the emergency surcharge is appropriate, Staff's calculation differs from that of the Company. Staff's calculation only includes operating income and does not include "below the line" expenses such as interest expense. Beyond Staff's typical utilization of operating income rather than net income in calculating rates, the principal reason Staff recommends removal of interest expense is Staff's recommendation to remove the Wells Fargo credit line from inclusion in the emergency surcharge calculation. Staff also believes it is more appropriate to calculate an emergency surcharge that provides for coverage of the Company's monthly loss of \$6,251 (the Company's monthly average of \$5,342 in operating loss plus \$909 per month for property taxes that was not included in that monthly operating loss) rather than the Company's projected 2009 net loss. While Staff's recommended rate is higher than the Company's requested rate for this particular item, Staff believes it is more reflective of East Slope's additional monthly financial requirements needed in order to continue to provide service.

East Slope has requested an emergency rate increase be added to the Company's existing minimum charge. The emergency surcharge requested is \$19.55 per customer per month, which would result in a monthly minimum charge of \$28.55 per customer, an increase of 217.2 percent over the current minimum charge of \$9.00 per month. Staff recommends an emergency surcharge of \$7.60 to be added to the Company's existing minimum charge. Staff's recommended emergency surcharge would result in a monthly minimum charge of \$16.60 per

customer, an increase of 84.4 percent over the current minimum charge of \$9.00 per month, as shown on Schedule DRE-1.

The Company's proposed rates would increase the typical residential bill<sup>3</sup> with 8,000 gallons of usage from \$19.26 to \$38.81, an increase of \$19.55 or 101.5 percent. The Company's requested emergency rate increase would produce an additional \$16,070 per month in revenues.

Staff's recommended rates would increase the typical residential bill<sup>4</sup> with 8,000 gallons of usage from \$19.26 to \$26.86, an increase of \$7.60 or 39.5 percent, as shown on Schedule DRE-1. Staff's recommended emergency surcharge would produce an additional \$6,251 per month in revenues, a sufficient amount to address the Company's operating shortfall.

Staff also recommends that the Company be required to post a bond or irrevocable sight draft letter of credit in the amount of \$35,000 to ensure that there is money available to refund to ratepayers if the Commission determines in the permanent rate case that the emergency surcharge was too large. Although Staff's recommended emergency surcharge will produce approximately \$75,000 on an annual basis, Staff's recommended bond or irrevocable sight draft letter of credit is significantly less, recognizing the difficulty a company the size of East Slope may have in securing such a significant bond or irrevocable sight draft letter of credit. In addition, Staff noted the Commission in Mount Tipton Water Company's ("Mount Tipton") recent emergency rate filing (Docket No. W-02105A-08-0262) reduced Staff's recommended bond from \$89,040 to \$20,000 in Decision No. 70559 because Mount Tipton lacked the financial resources and ability to secure such a high bond.

### **Conclusions**

The Company's current situation does constitute an emergency from a financial standpoint.

The Company should be granted emergency rate relief in the form of an emergency surcharge in order to meet its financial operating obligations.

### **Staff Recommendations**

Staff recommends approval of an emergency rate increase sought by Bob B. Watkins dba East Slope Water Company utilizing Staff's recommended emergency surcharge of \$7.60.

Staff further recommends that the emergency surcharge be interim.

Staff further recommends that the interim rate be subject to refund pending the decision resulting from the permanent rate increase case required to be filed in this proceeding.

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<sup>3</sup> Includes both the 5/8 x 3/4-inch and 3/4-inch meter sizes.

<sup>4</sup> Includes both the 5/8 x 3/4-inch and 3/4-inch meter sizes.

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

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

Staff further recommends that the Company file a full rate application utilizing a 2009 test year no later than April 30, 2010.

Staff further recommends that if the Company believes it will need to incur debt in order to solve its operational problems, that it file a financing application concurrent with the rate application.

Staff further recommends that the Company file with Docket Control, as a compliance item in this docket, documentary evidence that the Company has posted a bond or an irrevocable sight draft letter of credit in the amount of \$35,000, prior to implementing the emergency rate increase authorized in this proceeding.

**EMERGENCY MONTHLY SURCHARGE CALCULATION**

	<u>2009 Monthly Projection</u>	<u>Monthly Per Connection</u>
<b>Calculation of Surcharge</b>		
Total Operating Revenues	\$ 10,029	
Property Taxes - per month	909	
Operating Expenses	<u>15,371</u>	
Operating Income/ (Loss)	\$ (6,251)	
Current Customer Connections	<u>822</u>	
<b>Proposed Surcharge Amount</b>		<b>\$ 7.60</b>
<b>Current Rates:</b>		
Monthly Minimum (5/8" x 3/4" & 3/4")	\$ 9.00	
Commodity Rate	\$ 1.71	
Gallons (2,000 included in monthly minimum)	6,000	
Amount based on usage	<u>\$ 10.26</u>	
<b>Monthly Bill at Current Rates Based on 8,000 gallons of usage</b>		<b>\$ <u>19.26</u></b>
<b>Monthly Bill based on 8,000 gallons of Usage plus Proposed Surcharge Amount</b>		<b>\$ <u><u>26.86</u></u></b>

**MEMORANDUM**

DATE: July 14, 2009

TO: Darak Eaddy  
Public Utilities Analyst II

FROM: Marlin Scott, Jr.   
Utilities Engineer

RE: East Slope Water Company  
Docket No. W-01906A-09-0283 (Emergency Surcharge Implementation)

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**Introduction**

East Slope Water Company ("Company") has filed an application requesting an emergency surcharge to pay for necessary system improvements. The Company seeks a monthly surcharge of \$19.55 per customer in order to provide the needed repairs and add storage to its water system. The Company operates a water system in Sierra Vista, Cochise County.

**System Evaluation**Current Water System

According to the Company, the existing system consists of five active wells (with total production capacity of 562 gallons per minute), two storage tanks (with total storage capacity of 250,000 gallons), two booster systems, fire hydrants and a distribution system serving approximately 820 service connections.

Using the Company's 2008 Annual Report, the Company reported the peak use month as June with 10,458,000 gallons sold. Based on this data, the Company has adequate production and storage.

Water System Improvements

In its filing, the Company stated that the water system improvements include, 1) additional storage capacity, 2) refurbishment of an existing storage tank, 3) deepening of wells due to the depletion of the water table, and 4) electrical control panels need to be replaced. In addition, the Company stated that due to the high water demand being placed on the system during these summer months, the water system cannot keep up with the customer demand, resulting in loss of water pressure in the distribution system. The

Company, however, did not submit any cost estimates for these water system improvements.

Staff took notice of three filings with the Water Infrastructure Finance Authority of Arizona ("WIFA"). The Company filed for WIFA financial assistance in the amount of \$7,292,647 in March 2009 that included the above mentioned system improvements, plus replacement of water mains, looping of distribution system, new booster systems, and replacement of customer meters. In May 2009, the Company updated this same WIFA financial assistance application to an amount of \$5,416,973. Also in May 2009, the Company filed for a WIFA technical assistance in an amount of \$605,794.

### **Arizona Department of Environmental Quality ("ADEQ") Compliance**

According to an ADEQ Compliance Status Report, dated April 22, 2009, ADEQ reported no deficiencies and has determined that the Company's system, Public Water System No. 02-028, is currently delivering water that meets the water quality standards required by 40 CFR141/Arizona Administrative Code, Title 18, Chapter 4.

### **ACC Compliance**

On July 1, 2009, the Utilities Division Compliance Section indicated that there are currently no delinquencies for the Company.

### **Conclusions**

At this time and under normal operating conditions, the Company's water system appears to have adequate well and storage capacities.

ADEQ reported that the Company's water system has no deficiencies and has determined that this system is currently delivering water that meets the water quality standards required by 40 CFR141/Arizona Administrative Code, Title 18, Chapter 4.

Based on the above, Staff cannot determine that an emergency exist from an engineering perspective.