ORIGINAL

000010848

Memorandum

RECEIVED

ARICOR Water Solutions

2010 MAR 19 P 3: 45

25213 North 49th Drive
Phoenix, AZ 85083

Phone: 623.341.4771
Fax: 623.582.5160
Email: ray.jones@aricor.com

AZ CORP COMMISSION
DOCKET CONTROL

Arizona Corporation Commission
DOCKETED

MAR 19 2010

DOCKETED BY

To: Docket Control
Arizona Corporation Commission

From: Ray L. Jones
Consultant to White Horse Ranch Owners Association

Date: March 19, 2010

Re: Response to Staff Report
DOCKET NO. W-04161A-09-0471

Introduction

ARICOR Water Solutions has reviewed the Staff Report dated March 10, 2010 pertaining to the White Horse Ranch Owners Association's application for a permanent rate increase (Docket No. W-04161A-09-0471). The following is presented on behalf of the White Horse Ranch Owners Association ("WHROA").

WHROA wishes to express its gratitude to Staff for its work and cooperation in preparing the Staff Report. WHROA is a small homeowner's association with the responsibility to operate and manage a public water supply system. Aspects of managing the system can prove to be challenging for the all volunteer Board of Directors. WHROA appreciates Staff's willingness to work with the Association and its consultant, ARICOR Water Solutions, to reconcile accounting records and prepare adjustments needed to present accurate test year revenue, expenses and rate base.

Staff Adjustment and Recomendations

WHROA accepts all of the adjustments to rate base and operating expenses proposed by Staff. The agreed to adjustments result in a Rate Base of $78,856 and a test year operating loss of $33,048. Additionally, WHROA is in agreement with Staff's recommendations with the exception of the revenue requirement and rate design proposed by Staff.

Revenue Requirement

Staff has recommends total revenue of $81,730, which is the same amount proposed by WHROA in its filing. Staff's recommended revenue requirement does not include the cost of hauled water and is believed by Staff to be sufficient to "allow the Company to recover all routine test year expenses."

Staff's recommendation and WHROA's original filing are based on an underlying assumption that hauled water can be eliminated through a combination of reduced consumption due to water conservation and increased production from new wells. As discussed in the Staff Report, WHROA has experienced diminished well production in wells No. 1 and No. 2[1]. The two new wells, Wells 3 and 4, have a combined capacity of approximately 5 GPM[2], well below the projected capacity of the wells. WHROA agrees with Staff's conclusion that is likely that White Horse Ranch will have to haul water in the future.

---

[1] The two well produced approximately 50 GPM in 2003 and produced between 16 and 22 GPM in 2009.

[2] Capacity based on initial pumping of the newly completed wells. The long-term reliable capacity of the new wells is unknown. Only after sustained pumping in the summer months of 2010 will WHROA be able to ascertain the long-term reliable capacity of the wells.

WHROA's diminishing well capacity and likely need to continue hauling water, causes concern that its initial proposal and Staff's recommendation of a revenue requirement of $81,730 will be insufficient to recover WHROA's ongoing expenses. In addition, WHROA is likely to need to continue to invest in new water supply wells as existing well capacity decreases. The need to fund future well investments increases WHROA's need to recover hauled water costs and earn a reasonable positive rate on return on investments made to date. Accordingly, WHROA believes that Staff's Alternative #1 has merit and should be considered by the Commission.

Rate Design

Due to the large cost of hauled water in the test year, this case presents unique rate design issues. It is the goal of both WHROA and Staff to produce a rate design that encourages substantial water conservation. To this end, WHROA proposed a four tier inverted rate design with a fourth tier rate of $12.95 per gallon for usage above 9,000 gallons. WHROA intended this rate to be punitive and expected a large reduction in water usage over the 9,000 gallon usage level. In its original rate request, WHROA asked for less revenue than it was entitled to on the assumption that conservation in this upper tier would eliminate a substantial amount of hauled water expense while reducing realized revenue by a much smaller amount.

Staff's rate design also includes a four tier rate design. However, Staff reduces the base charge, compresses the first two usage tiers, and substantially increases the usage charges in the first three tiers. Staff's rate design has two significant impacts. First, it should encourage additional water conservation as compared to the WHROA rate design. Second, revenue lost due to water conservation will be increased.

WHROA is in agreement with Staff that additional water conservation should be encouraged and supports Staff's compressed rate tiers and Staff's proposed rates for tiers 3 and 4. However WHROA is concerned that the combination of reduced base charges and increased usage charges could result in insufficient revenues after considering expected increases in water conservation. Additionally, WHROA is concerned that Staff's relatively high tier 1 and tier 2 rates will be perceived negatively by WHROA members[3].

WHROA proposes WHROA Alternative # 1 rate design to achieve a base revenue requirement of $82,036.

WHROA's Alternative #1 rate design

Monthly Usage Charge	
5/8" by 3/4" Meter	$35.00
¾" Meter	42.00
1' Meter	70.00
1½" Meter	140.00
2" Meter	224.00
3" Meter	448.00
4" Meter	700.00
6" Meter	1,400.00
Commodity Rates	
Zero to 2,000 gallons	$2.50
2,001 to 4,000 gallons	3.50
4,001 to 9,000 gallons	8.00
Over 9,000 gallons	12.00

[3] WHROA understands that the impact of Staff's increases to tier 1 and tier 2 rates is substantially mitigated by the reduction in the base charge. However, WHROA is fearful that low water usage customers will focus on the 100% increase in tier 1 and tier 2 usage rates without appreciating the mitigation provided by the 20% lower base charge. WHROA also notes that nearly all of its costs are of a fixed nature, making substantial revenue recovery from the base charge appropriate.

WHROA Alternative #1 rate design adopts Staff's water usage tiers and Staff's proposed usage rates for tiers 3 and 4. WHROA proposes maintaining the existing $35.00 base charge for 5/8" by 3/4" meters rather than adopting Staff's proposed 20% reduction to from $35.00 to $28.00. WHROA adopts Staff's recommended base charge for all other meter sizes[4]. WHROA proposes to decrease the rates in tiers 1 and 2, where little conservation is likely to occur, to offset the increase in base charges. WHROA believes this rate structure will be better accepted by its members and be more likely to produce sufficient revenues to cover ongoing expenses after considering the impact of expected water conservation.

As noted previously, WHROA believes Staff's Alternative #1 has merit. Staff's rate design for Staff Alternative #1 is the same rate design used for Staff's base recommendation with the tier 4 rate increased from $12.00 to $48.50.

Since the Staff Alternative 1 rate design is virtually unchanged from Staff's base rate design, WHROA has the same concerns regarding the base charge and the tier 1 and tier 2 commodity rates. In regard to the tier 4 rate, WHROA has two observations.

First the rate is sufficiently high that severe water conservation is likely to occur in usage above 9,000 gallons, making it unlikely that substantial actual revenue will be generated by the rate. The primary benefit to WHROA will not be increased revenue, but severe water conservation resulting in a lower likelihood of needing to haul water. Given its dire water supply situation, WHROA understands the merit of a large punitive rate to encourage water conservation. However, since significant actual revenue will not be generated, WHROA's concern over the decrease in its base charge is compounded

Secondly, the $48.50 rate proposed by Staff was arbitrarily selected to produce the $99,778 revenue requirement. WHROA believes that it would be better to select a rate that has a known basis so that customers will better understand and accept the punitive rate. WHROA proposes to use WHROA's cost of hauled water, which is approximately $35.00 as the tier 4 rate.

WHROA proposes WHROA Alternative # 2 rate design to achieve a revenue requirement of $94,118.

WHROA's Alternative #2 rate design

Monthly Usage Charge	
5/8" by 3/4" Meter	$35.00
¾" Meter	42.00
1' Meter	70.00
1½" Meter	140.00
2" Meter	224.00
3" Meter	448.00
4" Meter	700.00
6" Meter	1,400.00
Commodity Rates	
Zero to 2,000 gallons	$2.50
2,001 to 4,000 gallons	3.50
4,001 to 9,000 gallons	8.00
Over 9,000 gallons	35.00

WHROA Alternative #2 rate design adopts Staff's Alternative #1 water usage tiers and Staff's proposed usage rate for tier 3. WHROA proposes maintaining the existing $35.00 base charge for 5/8" by 3/4" meters rather than adopting Staff's proposed 20% reduction to from $35.00 to $28.00. WHROA adopts Staff's recommended base charge for all other meter sizes. WHROA proposes to decrease the rates in tiers 1 and 2, where little conservation is likely to occur, to offset the increase in

[4] Currently all WHROA customers have a 5/8" by 3/4" meter.

base charges. WHROA proposes to adopt a tier 4 charge of $35.00 based on the cost of hauled water, rather than Staff's proposed charge of $48.50.

Comparative Schedules

Attached Schedule RLJ-1 provides a summary of impacts of the rate designs proposed by WHROA and Staff on the revenue and expenses of WHROA. The schedule also includes key metrics to assist in fully evaluating the various alternatives. Due to the unique circumstances in this case regarding the need to incentivize water conservation to address a deteriorating water supply situation and large costs of hauled water, Schedule RLJ-1 contains a proforma analysis of impacts of the various rate designs after taking into account the effects of expected water conservation on revenues and hauled water expenses.

White Horse Ranch Owners Association
Docket No. W-04131A-09-0471
Test Year Ended July 31, 2009

Schedule RLJ-1

	Proposed Rates				
	Lower Revenue Requirement			Increased Rev. Requirement	
	Company as Filed	Staff as Adjusted	Company Alternative #1	Staff Alternative #1	Company Alternative #2
Non Adjusted Results					
Total Operating Revenue	$ 81,730	$ 81,730	$ 82,036	$ 99,778	$ 94,118
Total Operating Expenses	95,602	99,778	99,778	99,778	99,778
Operating Income/(Loss)	$ (13,872)	$ (18,048)	$ (17,742)	$ -	$ (5,660)
Rate Base O.C.L.D.	$ 9,369	$ 78,856	$ 78,856	$ 78,856	$ 78,856
Rate of Return O.C.L.D.	-148.06%	-22.89%	-22.50%	0.00%	-7.18%
Operating Margin	-16.97%	-22.08%	-21.63%	0.00%	-6.01%
Authorized Increase in Rates	23.78%	23.66%	25.54%	50.71%	44.03%
Percent Revenue from Base Charge	68.79%	48.20%	59.35%	39.55%	51.73%
Adjust for Impact of Water Conservation					
Total Operating Revenue	$ 81,730	$ 81,730	$ 82,036	$ 99,778	$ 94,118
Reduced Revenue due to water conservation	$ (4,898)	$ (6,827)	$ (6,701)	$ (21,505)	$ (15,992)
Adjusted Operating Revenue	$ 76,832	$ 74,903	$ 75,336	$ 78,273	$ 78,126
Total Operating Expenses	95,602	99,778	99,778	99,778	99,778
Remove Purchased Water Cost	(23,605)	(27,345)	(27,345)	(27,345)	(27,345)
Adjusted Operating Expenses	71,997	72,433	72,433	72,433	72,433
Adjusted Operating Income/(Loss)	$ 4,835	$ 2,470	$ 2,903	$ 5,840	$ 5,693
Rate Base O.C.L.D.	$ 9,369	$ 78,856	$ 78,857	$ 78,857	$ 78,858
Adjusted Rate of Return O.C.L.D.	51.60%	3.13%	3.68%	7.41%	7.22%
Adjusted Operating Margin	6.29%	3.30%	3.85%	7.46%	7.29%
Adjusted Increase in Rates	16.28%	13.21%	15.29%	17.80%	19.56%
Adjusted Percent Revenue from Base Charge	73.22%	52.65%	64.62%	50.59%	62.32%