

ORIGINAL



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MEMORANDUM

TO: Docket Control

FROM: Steve Olea  
Director  
Utilities Division

A handwritten signature in black ink, appearing to be 'Steve Olea', written over the 'FROM' field.

DATE: August 31, 2011

RE: STAFF REPORT FOR CERBAT WATER COMPANY'S REQUEST FOR AUTHORIZATION TO INCUR LONG-TERM DEBT (DOCKET NO. W-02391A-11-0309)

Arizona Corporation Commission

DOCKETED

AUG 31 2011

DOCKETED BY A rectangular stamp with the text 'DOCKETED BY' and a handwritten signature in black ink.

Attached is the Staff Report for Cerbat Water Company's application for authorization to incur long-term debt. Staff recommends approval with conditions.

EGJ:AII:red

Originator: Alexander Ibhade Igwe, CPA

RECEIVED  
2011 AUG 31 P 12:46  
AZ CORP COMMISSION  
DOCKET CONTROL

Service List for: Cerbat Water Company  
Docket No. W-02391A-11-0309

Mr. Rick Neal  
Cerbat Water Company, LLC.  
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1850 North Central Avenue  
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**STAFF REPORT  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION**

**CERBAT WATER COMPANY  
DOCKET NO. W-02391A-11-0309**

**APPLICATION FOR APPROVAL  
OF FINANCING**

**AUGUST 31, 2011**

## STAFF ACKNOWLEDGMENT

The Staff Report for Cerbat Water Company, Docket No. W-02391A-11-0309 was the responsibility of the following Staff members listed below. Alexander Ihhade Igwe was responsible for reviewing the application and performing pertinent financial analysis; Dorothy Hains analyzed the engineering issues; and Alfonso Amezcua researched the Consumer Service issues.



Alexander Ihhade Igwe  
Executive Consultant III



Dorothy Hains  
Utilities Engineer



Alfonso Amezcua  
Public Utilities Consumer Analyst II

**EXECUTIVE SUMMARY  
CERBAT WATER COMPANY  
DOCKET NO. W-02391A-11-0309**

On August 3, 2011, Cerbat Water Company ("Cerbat" or "Company") filed an application with the Arizona Corporation Commission ("Commission") for authorization to obtain \$534,710 in long-term debt from the Water Infrastructure Finance Authority of Arizona ("WIFA"). The only detail on what the Company was requesting was the WIFA application, which was filed with WIFA in January of 2011. Based on the Company's WIFA application, Staff assumes that it was the Company's intention to use the requested loan proceeds to drill a new back-up well (\$89,000), to pay for past repairs to the existing well (\$110,000), and to purchase the existing well from the Claude K. Neal Family Trust ("Trust") (\$335,715).<sup>1</sup> The Company has since revised its application to request \$171,319 in projected cost to drill a new well. Additionally, Cerbat is no longer seeking approval to obtain financing in the amount of \$335,710 to purchase the existing well from the Trust.<sup>2</sup> The well was transferred to Cerbat on May 12, 2011.

On August 22, 2011, Commission Staff ("Staff") filed a motion seeking consolidation of the financing docket with the rate case docket (Docket Nos. W-02391A-10-0218 and W-02391A-11-0166). To date, Staff's motion has not been ruled on.

Staff has reviewed Cerbat's debt financing application and determined that the Company's proposal to construct a new well is reasonable and appropriate. However, Staff does not find that it is in the public interest to recommend repayment of past due obligations through debt financing, as proposed by the Company. Based on these findings, Staff recommends that the Commission authorize Cerbat to obtain long-term debt in an amount no greater than \$131,000 for the sole purpose of constructing a new back-up well. Finally, Staff's analysis indicates that upon Commission approval of Cerbat's pending rate case with Staff's recommended rates, the Company will have adequate cash flow from its operations to cover its operating costs as well as make principal and interest repayments on a loan in the amount of \$131,000.

Staff recommends that:

1. The Commission authorize Cerbat to obtain a WIFA long-term debt in an amount up to \$131,000.
2. The Commission authorize Cerbat to engage in any transactions and to execute or cause to be executed any documents so as to effectuate the authorization requested in this application.

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<sup>1</sup> Cerbat Water Company's January 10, 2011 WIFA Application, page 1, section 2.4

<sup>2</sup> Company's Response to Staff's First & Second Set of Data Request, AII 2.1.

3. The Commission order Cerbat to file with Docket Control, as a compliance item in this docket, a copy of all notes and other documents memorializing the authorized transaction, within 60 days of the loan package closing.
4. The Commission order Cerbat to file with Docket Control, as a compliance item in this docket, a Certificate of Approval of Construction for its proposed new well by June 30, 2012.

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## INTRODUCTION

On August 3, 2011, Cerbat Water Company (“Cerbat” or “Company”) filed an application with the Arizona Corporation Commission (“Commission”) for authorization to obtain \$534,710 in long-term debt from the Water Infrastructure Finance Authority of Arizona (“WIFA”). The only detail on what the Company was requesting was the WIFA application, which was filed with WIFA in January of 2011. Based on the Company’s WIFA application, Staff assumes that it was the Company’s intention to use the requested loan proceeds to drill a new back-up well (\$89,000), to pay for past repairs to the existing well (\$110,000), and to purchase the existing well from the Claude K. Neal Family Trust (“Trust”) (\$335,715).<sup>3</sup> The Company has since revised its application to request \$171,319 in projected cost to drill a new well. Additionally, Cerbat is no longer seeking approval to obtain financing in the amount of \$335,710 to purchase the existing well from the Trust.<sup>4</sup> The well was transferred to Cerbat on May 12, 2011.

On August 22, 2011, Commission Staff (“Staff”) filed a motion seeking consolidation of the financing docket with the rate case docket (Docket Nos. W-02391A-10-0218 and W-02391A-11-0166). To date, Staff’s motion has not been ruled on.

## PUBLIC NOTICE

Rick Neal has indicated to Staff that Cerbat’s *Public Notice* regarding its pending financing application will be published in a newspaper of general circulation around the City of Kingman, in the week of August 29, 2011. A copy of the *Affidavit of Publication* attesting to the publication of its *Public Notice* will be docketed by the Company, immediately upon receipt.

## BACKGROUND

Cerbat is a public service corporation certificated to provide water service four miles northwest of the City of Kingman, Mohave County, Arizona. The Company serves approximately 265 customers utilizing rates and charges approved in Decision No. 64886, June 5, 2002. Prior to May 12, 2011, the Company purchased all of its water supply from the Trust because it did not own any producing well. On May 12, 2011, the Trust transferred ownership and operation of its well to Cerbat through a “Quit Claim Deed” and a “Bill of Sale”. Cerbat now owns its water source. The Company has a back-up interconnection with the City of Kingman’s water system that it may utilize twice a year, upon the approval of the City. Cerbat is a corporation wholly owned by the Trust. The Trust has delegated management of the Company to Rick Neal.

On June 1, 2010, the Company filed an application for a permanent rate increase in Docket No. W-02391A-10-0218. This rate case is currently under consideration by the Hearing

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<sup>3</sup> Cerbat Water Company’s January 10, 2011 WIFA Application, page 1, section 2.4

<sup>4</sup> Company’s Response to Staff’s First & Second Set of Data Request, AII 2.1.

Division. On April 27, 2011, the Commission approved a motion requiring the Company to file for an emergency rate increase or surcharge for the purpose of repaying accrued repair costs related to the Trust well. The Commission motion stated that approval of an emergency rate increase or surcharge for recovery of past due repair costs incurred for the Trust well was contingent upon the Trust transferring ownership and operations of the well to Cerbat. On May 13, 2011, Cerbat filed an application for an emergency rate increase or surcharge under consolidated Docket Nos. W-02391A-10-0218 and W-02391A-11-0166. Also, the Company filed exhibits evidencing that, consistent with Commission directives, the Trust transferred ownership of the Trust well to Cerbat on May 12, 2011. On May 27, 2011, the Commission in Decision No. 72385, approved a \$12.52 Well Repairs Surcharge, in the amount of \$12.52 per customer per month. The intended purpose of the Well Repairs Surcharge was to allow the Company to recover \$119,444 so that they may pay for past well repairs.

## **ENGINEERING ANALYSIS**

Staff's engineering analysis in this proceeding only addresses the estimated costs of drilling a new well. Staff analyzed the Company's existing water systems and concludes that the Company's proposed well addition, as modified by Staff's recommendation, is reasonable and appropriate. Further, Staff reviewed the various cost elements reflected in the Company's proposed cost of \$171,319 for drilling a new well. Staff concludes that \$131,000 is a reasonable cost estimate for drilling the Company's proposed well and installing related appurtenances. Please see Staff Engineering memorandum attached herewith as Exhibit A for detailed analysis.

### *Approval of Construction*

Staff recommends that the Company file with Docket Control, as a compliance item in this docket, a Certificate of Approval of Construction for its new well by June 30, 2012.

### *Water Quality Compliance*

The Arizona Department of Environmental Quality ("ADEQ") Drinking Water Report Status Report dated June 24, 2011, indicates that Cerbat has major deficiencies and that ADEQ cannot determine if Cerbat is delivering water that meets water quality standards required by 40CFR 141/Arizoan Administrative Code, Title 18, Chapter 4.

## **STAFF ANALYSIS**

Staff has separately analyzed the Company's financing application under the following categories.

### *Cost of Drilling a New Back-up Well*

The Company seeks Commission authority to utilize \$171,319 of its proposed loan proceeds for drilling a new back-up well and installing related appurtenances. Staff finds that

\$131,000 is a reasonable cost estimate for constructing the Company's proposed well. Also, Staff concludes that the Company's proposal to drill a back-up well is reasonable and appropriate. Based on this finding, Staff recommends that the Commission authorize Cerbat to incur long-term debt in an amount up to \$131,000 from WIFA.

#### *Accrued Cost of Repairs to Existing Well*

As contained in the WIFA application, Staff believes Cerbat is seeking Commission authority to utilize \$110,000 of the proposed loan proceeds to repay past obligations related to well repairs. The Company's financing application with WIFA predates Commission Decision No. 72385, which authorized a Well Repairs Surcharge in the amount of \$12.52 per customer per month. The Well Repairs Surcharge was approved by the Commission for the purpose of paying past due obligations related to the Trust well in the amount of \$119,444. Cerbat's vendors are fully aware and agreeable to the Commission approved surcharge that results in repayment of their past due invoices, over a period of three years.

Subsequent to the transfer of the well to Cerbat, Staff filed on May 24, 2011, a Supplemental Staff Report for Cerbat Water Company's Application for a Permanent Rate Increase, recommending that \$29,707 incurred as purchased water expense during the test year should not be removed from cost of service even though the Company will no longer incur purchase water expense, but instead should be reclassified under repairs and maintenance. This recommendation increases the Company's annual repairs and maintenance expense from \$10,581 to \$40,288, as discussed in the pending rate case, providing adequate funding to maintain the Company's newly acquired well. Finally, Staff's recommended operating income of \$16,928 in the pending rate case, will further enhanced the Company's ability to timely meet its financial obligations.

Based on these facts, Staff recommends that the Commission deny the Company's proposal to utilize debt financing to accelerate repayment of past due obligations for which the Commission has already authorized a surcharge.

#### *Financial Analysis*

Upon Commission approval of Staff's recommended operating income of \$16,923 in the pending rate case, Staff's recommended long-term debt amount of \$131,000 will result in a Debt Service Coverage ("DSC") ratio of 2.85 and a Times Interest Earned Ratio ("TIER") of 2.48. The DSC represents the number of times internally generated cash will cover required principal and interest payments on long-term debt. A DSC greater than 1.0 indicates that operating cash flow is sufficient to cover debt obligations. The TIER represents the number of times earnings will cover interest expense on long-term debt. A TIER greater than 1.0 means that operating income is greater than interest expense. As shown on Schedule AII-1, Staff's proposed operating income in Cerbat's pending rate case will provide it with adequate cash flow to cover its operating costs and to make interest and principal repayments on a loan amount up to \$131,000.

## **CONSUMER SERVICES ISSUES**

Staff's inquiry from the Corporations Section of the Commission, indicates that the Company is not in good corporate standing. The Company failed to file its 2011 Corporate Annual Report as of August 16, 2011.

Staff's search of the Consumer Services database found that in 2011, Cerbat has had 1 complaint regarding service quality and 6 opinions in opposition to a rate increase. In 2010, the Company had 2 complaints regarding billing and quality of service, and 24 opinions in opposition to an emergency surcharge; 27 complaints and 9 opinions in 2009; and 1 complaint in 2008. All complaints and/or inquiries have been fully resolved and closed.

## **RECOMMENDATIONS**

Staff recommends that:

1. The Commission authorize Cerbat to obtain a WIFA long-term debt in an amount up to \$131,000.
2. The Commission authorize Cerbat to engage in any transactions and to execute or cause to be executed any documents so as to effectuate the authorization requested in this application.
3. The Commission order Cerbat to file with Docket Control, as a compliance item in this docket, a copy of all notes and other documents memorializing the authorized transaction, within 60 days of the loan package closing.
4. The Commission order Cerbat to file with Docket Control, as a compliance item in this docket, a Certificate of Approval of Construction for its new well by June 30, 2012.

**FINANCIAL ANALYSIS**

Selected Financial Data  
Including Immediate Effects of the Proposed Debt

	[A] <u>12/31/2009</u>	[B] <u>Pro Forma</u>
1 Staff Adjusted Operating Income	\$ 2,805	\$ 16,923
2 Depreciation & Amort.	13,141	13,141
3 Income Tax Expense	6,758	740
4		
5 Interest Expense	0	7,111
6 Repayment of Principal	0	3,700
7		
8		
9 <b>TIER</b>		
10 [1+3] ÷ [5]	N/A	2.48
11 <b>DSC</b>		
12 [1+2+3] ÷ [5+6]	N/A	2.85
13		
14		
15		
16		
17		
18 Short-term Debt	\$0	\$0
19		
20 Long-term Debt	\$119,444	\$250,412
21		
22 Common Equity	(\$480,434)	(\$480,434)
23		
24 Total Capital	(\$360,990)	(\$230,022)

**MEMORANDUM**

**DATE:** August 17, 2011

**TO:** Alexander Igwe  
Executive Consultant III

**FROM:** Dorothy Hains, P. E. *DH*  
Utilities Engineer

**RE:** **Application for Financing Approval for Cerbat Water Company  
Docket No. W-02391A-11-0309**

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**Introduction and Background**

On August 3, 2011, Cerbat Water Company (“Cerbat” or “Company”) filed a financing application (“Financing Application”) with the Arizona Corporation Commission (“ACC” or “Commission”) requesting authorization to incur long term debt from the Water Infrastructure Finance Authority of Arizona (“WIFA”) in an amount of \$534,710. Proceeds from the loan would be used to fund the construction of a new production well and other items not specified in the application. This report will only address the new well installation.

The Company’s Certificate of Convenience and Necessity (“CC&N”) includes approximately three sections of land (Sections 1 and 12, of Township 22 North and Range 17 West and a portion of Section 13, of Township 22 North and Range 17 West) northwest of the City of Kingman (“Kingman”), in Mohave County, Arizona.

The Company owns and operates a water system that consists of one well (DWR # 55-624996), two storage tanks, a booster pump station, and a distribution system. The current well yields 1,000 gallons per minute.

**Construction Projects and Cost Estimates to be Financed**Breakdown of Project Cost Estimate

The Company’s WIFA application, attached to the Financing Application, estimates a well construction cost of \$89,000. The Company submitted a revised estimate with a total construction cost and funding amount of \$171,319. Below is a general description and breakdown of the revised funding amount requested:

Project Description	Company Proposed Costs To Be Financed (\$) <sup>1</sup>	Staff Recommended Costs To Be Financed (\$)
<b>Drill A New Well</b>		
Earth work includes site grade, survey, County permitting fee (from Raymond W Stadler, P. E.)	3,575	1,375 <sup>2</sup>
Hydrologic Study, Engineering design and construction plan drawings	0	10,000
Booster improvements	23,300	0 <sup>3</sup>
Drill a 1,000' deep with 8" steel casing and well installation	55,335 <sup>4</sup>	0
Drill a 1,000' deep, 6" steel casing with yield of 200 gpm and well installation	0	43,000 <sup>5</sup>
Test pumping	26,700	27,000
New Source Water Quality tests	3,325 <sup>6</sup>	2,769 <sup>7</sup>
A 50-HP, 150 gpm well pump, motors, parts, labor & other electrical associated with pump installation	33,584 <sup>8</sup>	33,584
6" concrete pad around well head & discharging piping	5,000	5,000
Connecting the 50-HP pump to 60' from existing electric service	18,000 <sup>9</sup>	0
Electric Conduit, (including parts, labor and installation)		5,740.20 <sup>10</sup>
ADEQ Permit fee	2,500 <sup>11</sup>	2,500
<b>Total</b>	<b>171,319</b>	<b>130,968</b>

Notes:

1. Referred to the Response to DR #1.4.
2. Staff removed the \$2,200 for engineering construction plan cost and put to engineering design cost in row #4.2
3. This item is for existing plant improvement, not for the new well installation. Staff determined that this item should not be included in this job. Further, the Company failed to provide engineering design and construction information, Staff cannot determine whether the proposed water system addition is appropriate and the cost estimates reasonable or not.
4. This is Brown Drilling's estimates.
5. Staff received the information from B J Drilling who installed a new well for Mt. Tipton Water (located in northwest of Kingman) in 2010.
6. This is Mohave Environmental Lab estimates.
7. This is Legend Technical Services, Inc. estimates.
8. This is Short Enterprises LLC estimates.
9. This is Walker Service Electric Inc estimates.
10. Data came from 2010 Granite Mountain Water financial project.
11. This is Company's estimates.

Staff concludes that the Company's proposed water system additions, as modified by Staff's recommendations, are reasonable and appropriate. Staff recommends that the estimates listed under the column heading "Staff recommended Cost to be Financed" should be used and adopted. However, while Staff believes that its modified recommendations are reasonable and

appropriate, Staff is not making a "used and useful" determination of the proposed plant, and no particular future treatment should be inferred for rate making or rate base purposes.

### **Approval of Construction**

Staff recommends that Cerbat file with Docket Control, as a compliance item in this docket, a Certificate of Approval of Construction from ADEQ, for this new well installation by June 30, 2012.

### **Water Quality Compliance**

The Arizona Department of Environmental Quality ("ADEQ") regulates the Cerbat water system under ADEQ Public Water System ("PWS") ID No. 08-341. According to ADEQ Drinking Water Compliance Status Report dated May 19, 2011, Cerbat has major deficiencies and ADEQ cannot determine if Cerbat is delivering water that meets water quality standards required by 40CFR 141/Arizona Administrative Code, Title 18, Chapter 4.

### **Arizona Department of Water Resources ("ADWR") Compliance Status**

Cerbat's service area is not located within any ADWR Active Management Area. As of August 15, 2011, Cerbat was compliant with ADWR requirements governing water providers and/or community water systems.

### **ACC Compliance**

A check of the Utilities Division compliance database indicated that there are currently no delinquent compliance items for Cerbat.

### **Conclusions and Recommendations**

1. Cerbat is not operating its water system in compliance with ADEQ and ACC requirements.
2. Cerbat is in compliance with ADWR requirements.
3. Staff recommends \$131,000 in estimated costs to be used in this application proceeding.
4. Staff recommends that Cerbat file with Docket Control, as a compliance item in this docket, a Certificate of Approval of Construction for this new well installation by June 30, 2012.