

ORIGINAL

OPEN MEETING AGENDA ITEM



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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

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BRENDA BURNS

AZ CORP COMMISSION
DOCKET CONTROL

DOCKETED BY

IN THE MATTER OF THE APPLICATION OF
OF CERBAT WATER COMPANY FOR
APPROVAL OF A RATE INCREASE

DOCKET NO. W-02391A-10-0218

IN THE MATTER OF STAFF'S REQUEST
FOR THE COMMISSION ISSUANCE OF AN
ORDER TO SHOW CAUSE FOR THE
FAILURE OF CERBAT WATER COMPANY
TO COMPLY WITH COMMISSION RULES
AND REGULATIONS

DOCKET NO. W-02391A-11-0166

IN THE MATTER OF THE APPLICATION OF
OF CERBAT WATER COMPANY FOR
APPROVAL TO INCUR LONG-TERM DEBT

DOCKET NO. W-02391A-11-0309

STAFF'S NOTICE OF ERRATA

On December 12, 2011, Staff of the Arizona Corporation Commission ("Staff") filed a Supplemental Staff Report for Cerbat Water Company's Request for Authorization to Incur Long-Term Debt, in the above captioned dockets. Staff's filing inadvertently did not include the necessary attachments: Supplemental Schedule EOA-1 and the Engineering Memorandum. By way of this Notice of Errata, Staff hereby provides Supplemental Schedule EOA-1 and the Engineering Memorandum attached to the Staff Report to provide a complete record as intended.

RESPECTFULLY SUBMITTED this 13th day of December 2011.

Kimberly A. Ruht, Attorney
Charles H. Hains, Attorney
Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

1 Original and thirteen (13) copies
2 of the foregoing filed this
13th day of December 2011 with:

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

6 Copies of the foregoing mailed this
14th day of December 2011 to:

7 B. Marc Neal
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MEMORANDUM

TO: Docket Control

FROM: Steven M. Olea
Director
Utilities Division

DATE: December 12, 2011

RE: SUPPLEMENTAL STAFF REPORT FOR CERBAT WATER COMPANY'S
REQUEST FOR AUTHORIZATION TO INCUR LONG-TERM DEBT
(DOCKET NO. W-02391A-11-0309, W-02391A-10-0218 AND W-02391A-11-
0166)

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

SMO:EA:red

Originator: Elijah Abinah

INTRODUCTION

On October 25, 2011, pursuant to the Arizona Corporation Commission's ("Commission") directive at the Open Meeting on October 11, 2011, Cerbat Water Company ("Cerbat" or "Company") docketed an Amendment to clarify the proposed uses of the loan proceeds.

According to the Company, Cerbat is requesting the Commission authorization to incur long term debt in the amount of \$386,646 from the Water Infrastructure Finance Authority of Arizona ("WIFA"). Of the \$386,646, \$186,646 of the proceeds will be utilized to pay the vendors who performed work on the Company's well between June 2009 and August 2011. The additional \$200,000 will be utilized to fund the construction of a new 8-inch well and other related improvement to the booster pump, electric plant and storage tank.

STAFF REVIEW AND ANALYSIS

Based on the additional information provided by the Company in its amendment to clarify proposed uses of the loan proceeds, and consistent with the Staff Engineering Report (see Exhibit A), Staff recommends that the Commission authorize Cerbat to obtain long term debt in the amount of \$172,436, which should be utilized to pay the vendors who performed work for the Company from June 2009 through August 2011. The recommended amount reflects a decrease in Company's request to reflect amounts already collected through the Emergency Well Repair Surcharge (\$11,819) and for amounts associated with late fees and finance charges (\$2,391).

Also, consistent with the Engineering Report, Staff recommends that the Commission authorized Cerbat to incur additional long term debt in the amount of \$171,319, which should be utilized to fund the construction of a new 8-inch well. The above recommendation is a revision to Staff's August 31, 2011 recommendation. Therefore, the total long term debt would be \$343,755.

Staff further recommends that the Commission deny the Company's request to incur \$28,256 for additional professional services (Engineer, Hydrologist inspector, etc.) and contingency. See Exhibit A.

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 Claude K. Neal Family Trust ("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. The Hearing Division issued a Recommended Opinion and Order concerning both the rate application and subsequent financing application, on September 26, 2011. 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 monthly \$12.52 Well Repairs Surcharge. The intended purpose of the Well Repairs Surcharge was to allow the Company to recover \$119,444 so that it could pay for past well repairs.

ENGINEERING ANALYSIS

Staff's engineering analysis in this proceeding addresses the estimated costs of drilling a new well and reasonableness of requested well repair expenses. 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 8-inch well. Staff concludes that \$171,319 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 8-inch 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 analyzed the Company's financing application under the following categories.

Accrued Cost of Repairs to Existing Well

As contained in the amendment, Staff believes Cerbat is seeking Commission authority to utilize \$186,646 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.

Based on these facts, Staff's initial recommendation to the Commission was to 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. However Staff has revisited the issue and found that the Company's proposal is in the public interest, and recommends that the Commission authorized the Company to obtain long term debt in the amount of \$172,436 to pay for past well repairs. This amount is the \$186,646 requested by the Company less the \$11,819, that the Company has collected from its customers through the Wells Repair Surcharge and less \$2,391 in late fees and finance charges.

Financial Analysis

The Debt Service Coverage ("DSC") represents the number of times internally generated cash will cover required principal and interest payments on long-term debt. Staff's recommended long-term debt in the amount of \$343,755, will result in a DSC ratio of 1.26 and a Times Interest Earned Ratio ("TIER") of 1.27. 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 EOA-1, Staff's believes that the 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 the loan amount of \$343,755.

CONSUMER SERVICES ISSUES

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 the 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.

REVISED RECOMMENDATIONS

Staff recommends that:

1. The Commission authorize Cerbat to obtain WIFA long-term debt in an amount up to \$343,755.
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 30 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 8-inch well by June 30, 2012.
5. The Commission Order Cerbat to cease collecting the Emergency Well Repair Surcharge approved in Decision No. 72385.
6. The Commission order Cerbat to set up a separate interest bearing bank account the same month the new rates take effect. Starting the first month that the new rates are collected, the Company shall be required to first deposit from revenues in that separate interest bearing account \$2,000 per month. This amount should equal the actual monthly payments once the WIFA loan is obtained. Funds from this account shall only be used for disbursements to WIFA.
7. The Commission order Cerbat to file a rate case by April 30, 2013, utilizing a 2012 test year.
8. Staff further recommends that the Commission deny the Company's request to incur \$28,256 for additional professional services (Engineer, Hydrologist inspector, etc.) and contingency.

SERVICE LIST FOR: CERBAT WATER COMPANY
DOCKET NO. W-02391A-11-0309

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Ms. Lyn Farmer
Chief Administrative Law Judge, Hearing Division
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FINANCIAL ANALYSIS

Selected Financial Data
Including Immediate Effects of the Proposed Debt [\$343,755 @ 5% over 20yrs]

	[A] <u>12/31/2009</u>		[B] <u>Pro Forma</u>	
1	Operating Income	\$ 16,928	\$ 16,928	
2	Depreciation & Amort.	13,141	13,141	
3	Income Tax Expense	4,479	4,479	
4				
5	Interest Expense	0	16,955	
6	Repayment of Principal	0	10,269	
7				
8				
9	TIER			
10	[1+3] ÷ [5]	N/A	1.26	
11	DSC			
12	[1+2+3] ÷ [5+6]	N/A	1.27	
13				
14				
15				
16				
17				
18	Short-term Debt	\$0	0.0%	0.0%
19				
20	Long-term Debt	\$119,444	-33.1%	\$463,199 -2687.5%
21				
22	Common Equity	(\$480,434)	133.1%	(\$480,434) 2787.5%
23				
24	Total Capital	(\$360,990)	100.0%	(\$17,235) 100.0%
25				

Column B based on Staff rate case recommendations. There is \$29,707 for purchased water reclassified to repairs and maintenance. This \$29,707 is an added cash flow that could be applied for calculation of DSC and TIER and would increase both values substantially.

ATTACHMENT

A

MEMORANDUM

DATE: November 29, 2011

TO: Elijah Abinah
Assistant Division Director

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

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

Introduction and Background

On October 25, 2011, Cerbat Water Company ("Cerbat" or "Company") filed "Amendment to Clarify Proposed Uses of Loan Proceeds" ("Amendment") with the Arizona Corporation Commission ("ACC" or "Commission") requesting authorization to incur long term debt from the Water Infrastructure Finance Authority of Arizona in a revised amount of \$386,646 ("Financing Application"). Proceeds from the loan would be used as follows: \$186,646 to pay vendors for previously-completed repairs and \$200,000 to fund the construction of a new production well and related improvements.

Repair Expenses

Breakdown per Vendor

The Company's Amendment listed a total cost of \$186,646 for seven items from six different vendors. A general description and breakdown per item for each vendor has been identified by Staff as follows:

Vendor	Description	Company Requested To Be Financed (\$)¹	Staff Recommended Costs To Be Financed (\$)
UNISOURCE	Unpaid power bills	8,344	8,344
	subtotal	8,344	8,344
Mertens Heavy Equipment Repairs, LLC	A. Rebuilt Turbo pump, head. B. Replaced filter, main bearings, rod bearing, thermostat, oil pump, labors, etc	15,344.44¹	14,965.04¹ᵃ
	Finance charge	217.04²	0
	subtotal	15,561	14,965.

Gilbert Pump & Equipment, CO.	Replace well pump including head shaft, check valve, screen, labors, etc	13,532.84 ³	13,532.84
	Installed 350-HP pump, including electric service, starter, rebuilt motor, change head shaft, conduit, concrete pad, labors, etc.	47,542.63 ⁴	47,542.63
	8 week rental (@ \$2,100/wk)	17,706.36 ⁵	17,706.36
	Credited to Cerbat	(12,930.43) ⁶	(12,930.43)
	Finance charge	722.18 ⁷	0 ¹⁴
	Finance charge	733.01 ⁷	0 ¹⁴
	Finance charge	177.06 ⁸	0 ¹⁴
	Finance charge	178.83 ⁹	0 ¹⁴
	Subtotal	67,662	65,851.4
Empire Pump Corporation, dba Duncan Pump	Rig rental, move rig, oil rubber bowl bearings, labor, tax, etc	22,816.30 ¹⁰	22,816.30
	Subtotal	22,8168	22,816.30
Henderson Electric Motors, Inc.	Install a Vaskawa 350-HP pump, labor, tax, etc.	5,058	5,075.72 ¹¹
	Subtotal	5,058	5,075.72
Weber Group, LC	Move the crane truck from Goodyear to Kingman, replace three 20' section of 8" casing, labor, tax, etc.	23,953.96 ¹²	23,953.96
	Subtotal	23,954	23,953.96
Weber Group, LC	Move the crane truck from Goodyear to Kingman, replace fifteen section of 8" casing, labor, tax, etc.	43,248.73 ¹³	43,248.73
	Subtotal	43,249	43,248.73
Total		186,646	184,255

Notes:

1. Statement of Account, dated April 29, 2011 that was included in Attachment 1 in the Open Meeting Agenda Item docketed on October 25, 2011.
- 1A. Refer to Invoice # 2009-1666, dated March 23, 2009 that was received via 11/28/11 e-mail from the Company regarding the invoice reflected in the Statement of Account dated 4/29/11.
2. Referred to Attachment 1, Mertens Heavy Equipment Repairs, LLC Statement of Account dated April 29, 2011.
3. Refer to Invoice # 84053, dated June 30, 2009.
4. Refer to Invoice # 84789, dated December 14, 2009.
5. Refer to the Statement of Account dated on October 15, 2010.
6. Refer to Reference # Aug0005-FC in the Statement of Account dated October 15, 2010.
7. Refer to Reference # SEP0006-FC in the Statement of Account dated October 15, 2010.
8. Refer to Reference # MAR0003-FC in the Statement of Account dated March 31, 2011.
9. Refer to Reference # APR0003-FC in the Statement of Account dated April 30, 2011.
10. Refer to Invoice # 16950, dated December 21, 2010.
11. Refer to Invoice # 91974, dated January 14, 2011 in Attachment 2 in the Open Meeting Agenda Item docketed on October 25, 2011.
12. Refer to Invoice # 0009711-IN, dated June 8, 2011.

13. Refer to Invoice # 0009939-IN, dated August 18, 2011.

14. Staff believes that rate payers should not be required to pay a late fee due to the Company's failure.

Staff concludes that the expenses listed in the vendor invoices as adjusted by Staff, less the amounts for finance charges, appear reasonable.

Well Construction and Improvements

The Company's Amendment listed a total cost of \$200,000 for construction of a well with an eight-inch casing and related improvements. In Staff's August 17, 2011 Engineering memorandum, Staff recommended approval of \$130,968 to install a six-inch casing and 1,000-foot deep new well at the Company's existing well site. However, in the Amendment and at the Commission's Open Meeting of October 11, 2011, the Company provided sufficient evidence that an 8-inch well would be more effective and efficient for this system. The Amendment's \$200,000 estimate reflects an increase of \$425 for earth work and an additional \$28,256 for professional services such as hydrologic study, engineering expenses and contingency over the Company's prior cost estimate for the well. Staff previously recommended \$130,968 already included hydrologic study, engineering design and other professional service. Staff recommends approval of an additional \$40,351 to its previous recommended \$130,968 to cover the added cost of the larger 8-inch well excluding the duplicate costs referenced above.

Staff concludes that an adjusted amount of \$171,319 is reasonable to cover the cost of constructing a new 8-inch, 1,000-foot deep well.

Approval of Construction

In addition, 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.