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MEMORANDUM

TO: Docket Control

FROM: Steven M. Olea
Director
Utilities Division

DATE: March 6, 2012

Arizona Corporation Commission

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DOCKETED BY

RE: STAFF REPORT PURSUANT TO DECISION NO. 72667 TO REVIEW AND ANALYZE A FILING BY LITTLE PARK WATER COMPANY, INC. CONCERNING THE ACTIONS NECESSARY FOR LITTLE PARK WATER COMPANY, INC. AND BIG PARK WATER COMPANY, INC. TO MERGE INTO AND OPERATE AS ONE PUBLIC SERVICE CORPORATION (DOCKET NO. W-02192A-10-0395)

On November 17, 2011, the Arizona Corporation Commission ("Commission") issued Decision No. 72667 authorizing Little Park Water Company, Inc. ("Little Park") to incur long-term debt, in the form of a 7-year loan based on a 20-year amortizing schedule in an amount not to exceed \$140,000 at an interest rate not to exceed 7 percent for specified purposes. Decision No. 72667 also directs Little Park to file, by January 6, 2012, a document describing in detail the actions necessary for Little Park and Big Park Water Company, Inc. ("Big Park") to merge into and operate as one public service corporation and, further, analyzing the positives and negatives of combining the two entities into one public service corporation. Decision No. 72667 also directs the Commission's Utilities Division to review and analyze the filing made by Little Park and to file by March 6, 2012, a Staff Report including Staff's findings and recommendation concerning whether Little Park and Big Park should be combined into one public service corporation. Pursuant to Decision No. 72667, Staff hereby submits the attached Report which supports Little Park's opposition to a merger.

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 March 16, 2012.

EGJ:GLF:red

Originator: Gordon Fox

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Service List for: Little Park Water Company, Inc.
Docket No. W-02192A-10-0395

Mr. Stevan Gudovic
President
Little Park Water Company
45 Castle Rock Road, Suite 4
Sedona, Arizona 86351

Mr. Craig Marks
Craig A Marks, PLC
10645 North Tatum Blvd, Suite 200-676
Phoenix, Arizona 85028

Ms. Janice Alward, Esq.
Chief Counsel, Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Mr. Steven Olea
Director, Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Ms. Lyn Farmer
Chief Administrative Law Judge, Hearing Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

**STAFF REPORT PURSUANT TO DECISION NO. 72667
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

LITTLE PARK WATER COMPANY, INC.

DOCKET NO. W-02192A-10-0395

**APPLICATION FOR APPROVAL TO
INCUR LONG TERM DEBT**

MARCH 6, 2012

STAFF ACKNOWLEDGMENT

The Staff Report pursuant to Decision No. 72667 for Little Park Water Company, Inc., Docket No. W-02192A-10-0395 is the responsibility of the Staff members listed below. Gordon L. Fox is responsible for the review of the Company's application.



Gordon L Fox

Public Utilities Analyst Manager

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INTRODUCTION

Little Park Water Company, Inc. (“Little Park” or “Company”) is an investor-owned Arizona corporation and a class E certificated public service corporation providing water services to approximately 72 customers in Yavapai County near the City of Sedona, Arizona.

On September 27, 2010, Little Park filed an application with the Arizona Corporation Commission (“Commission”) requesting authorization to incur \$140,000 of long-term debt from JPMorgan Chase & Co. (“Chase”) to refinance a short-term bridge loan from its affiliate Big Park Water Company (“Big Park”).¹ Commission Decision No. 72667, dated November 17, 2011, authorized Little Park “to incur long-term debt, in the form of a 7-year loan based on a 20-year amortizing schedule in an amount not to exceed \$140,000, at an interest rate not to exceed 7 percent, for the purpose of financing the existing arsenic-treatment facilities, and reimbursing Little Park Water Company, Inc. for any previously repaid principal on the \$118,000 loan obtained from Big Park Water Company, Inc., in August 2008.” Decision No. 72667 also directs Little Park to file “[b]y January 6, 2012, a document describing in detail the actions necessary for Little Park Water Company, Inc. and Big Park Water Company, Inc. to merge into and operate as one public service corporation and, further, analyzing the positives and negatives of combining Little Park Water Company, Inc. and Big Park Water Company, Inc. into one public service corporation.” Decision No. 72667 also directs the Commission’s Utilities Division to “[r]eview and analyze the filing made by Little Park Water Company, Inc. concerning the actions necessary for Little Park Water Company, Inc. and Big Park Water Company Inc. to merge into and operate as one public service corporation and shall file by March 6, 2012, a Staff Report including Staff’s findings and recommendation concerning whether Little Park Water Company, Inc. should be combined into one public service corporation and what actions would be necessary to make that happen.”

On January 6, 2012, the Company made a Compliance Filing addressing the actions necessary to merge Little Park into Big Park Water Company, Inc. (“Big Park”) and identified positives and negatives of combining the two entities. On February 8, 2012, the Company filed its Response To Staff Report that restated the positives and negatives of merging Little Park and Big Park into one public service corporation, and it clarifies that it is opposed to merging the two companies.

STAFF ANALYSIS

Actions Necessary for Merging

Little Park’s Compliance Filing identifies six actions necessary for merging Little Park into Big Park to operate as one public service corporation, as presented below.

¹ The Water Infrastructure Finance Authority of Arizona rejected the Company’s request for financing because it is a refinancing of existing debt.

1. Execute corporate resolutions from both companies authorizing the transaction.
2. Apply with the Commission for approval for Big Park to acquire Little Park and to charge Little Park customers the rates currently in effect for Big Park.
3. Because Little Park rates are generally lower than Big Park rates, a rate application would likely be necessary to adjust rates for both companies to common levels.
4. Provide notice to the customers of both companies of the proposed transaction and the potential rate impacts.
5. If the Commission approves the proposed transaction, file the necessary paperwork with Commission to dissolve Little Park.
6. Begin operating as one Company, charging all customers the rate authorized for Big Park.

Staff concludes that the six activities noted by the Company provide a good representation of the necessary actions for merging the two companies into one public service corporation.

Positive and Negative Attribute of Combining Companies

Little Park's Compliance Filing identifies five positive and nine negative attributes related to merging Little Park into Big Park to operate as one public service corporation, as presented below.

Positive Attributes – Per Company

1. The combined company would only have one rate schedule to administer.
2. The combined company would only have to file one rate case if rate changes were needed.
3. The combined company would only have to file one annual report to the Commission's Utilities Division.
4. The combined company would only have to file one annual report to the Commission's Corporations Division.
5. There could be a larger customer base to bear the costs of required systems upgrades to one part of the system.

Negative Attributes – Per Company

1. Little Park's rates are generally lower than Big Park's. Exhibit A compares rates for residential customers with 5/8" x 3/4" and 1" meters at various consumption levels.
2. Little Park and Big Park have drastically different hook-up fee structures for new customers. (See page two of Exhibit A.) Combining the companies

could cause customer confusion concerning why one customer would pay a \$1,320 hook-up fee for a new one-inch meter and another customer pays a \$3,300 hook-up fee for the same sized meter. This could cause more inquiries for Commission Staff to handle.

3. Except for an emergency interconnection, the two systems operate separately, with separate water supply, treatment, and distribution facilities. Even in an emergency, because of differing system elevations, water can only flow from Big Park to Little Park.
4. The Little Park water system was built and owned by the original developer without any inspection and proper supervision. The system was then owned by the developer homeowner association. Due to the poor quality of the initial construction, the Little Park system requires significantly more maintenance per customer than does the Big Park system. If the systems were consolidated, Big Park customers would be forced to subsidize Little Park customers for their higher maintenance expense.
5. Because the two companies are already jointly administered, there would be no material cost savings as a result of a consolidation.
6. The cost of a prosecuting a merger application would be a significant expense, which would presumably be recoverable from customers.
7. Preparing and prosecuting a merger application could divert management's time and attention from more important short and long-term customer issues.
8. Eliminating separate books could result in the loss of separate operational and financial data. The Commission would lose the ability to exercise regulatory oversight and control as it pertains to the currently separate systems, which would make it less able to evaluate the effectiveness and efficiency of each system.
9. Consolidating the two systems would conflict with historic cost-of-service principles, where rates are set based on the costs of serving discrete geographical areas. As a result, one group of customers could be forced to subsidize another. Further, cost signals to customers could be distorted, which could lessen the incentives to conserve water.

While Staff could quibble over whether the Company's positive and negative attributes are properly represented here, Staff concludes that such arguments are inconsequential since none are persuasive. Staff's perspective is that in this instance, the ability for customers to economically receive safe, adequate and reliable service is the overriding factor for determining whether Little Park should merge into Big Park. Staff finds that Little Park has a good history demonstrating its ability to provide safe, adequate and reliable service economically, and there are currently no outstanding compliance delinquencies for the Company. Staff also concludes that the Company's opposition to the merger should be given significant consideration.

STAFF RECOMMENDATIONS

Staff recommends:

- Taking no action to require Little Park to merge into Big Park as long as both continue to economically provide safe, adequate and reliable service.