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MEMORANDUM

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TO: Docket Control

FROM: Thomas M. Broderick
Director
Utilities Division

T. M. Broderick

2016 JAN 20 P 4: 57

AZ CORP COMMISSION
DOCKET CONTROL

DATE: January 20, 2016

RE: SUPPLEMENTAL STAFF REPORT FOR LOS CERROS WATER COMPANY, INC.'S APPLICATION FOR A PERMANENT RATE INCREASE (DOCKET NO. W-02747A-15-0293)

Attached is the Supplemental Staff Report for Los Cerros Water Company's application for a permanent rate increase. Staff recommends approval of the rate application using Staff's recommended rates and charges.

Any party who wishes may file comments to the Supplemental Staff Report with the Commission's Docket Control by 4:00 p.m. on or before January 25, 2016.

TMB:DWC:nr/RWG

Originator: Darron Carlson

Arizona Corporation Commission

DOCKETED

JAN 20 2016

DOCKETED BY	<i>KE</i>
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Service List for: Los Cerros Water Company
Docket No. W-02747A-15-0293

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Los Cerros Water Company
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Tucson, Arizona 85705

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**SUPPLEMENTAL STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

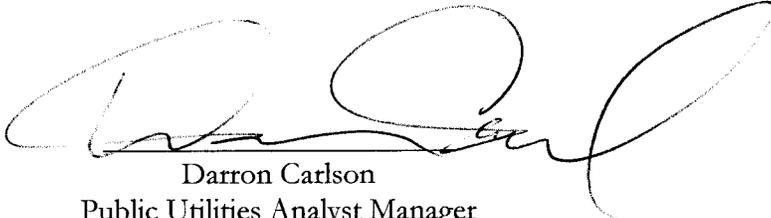
**LOS CERROS WATER COMPANY
DOCKET NO. W-02747A-15-0293**

**APPLICATION FOR A
PERMANENT RATE INCREASE**

JANUARY 20, 2016

STAFF ACKNOWLEDGMENT

The Supplemental Staff Report for Los Cerros Water Company ("Los Cerros" or "Company") Docket No. W-02747A-15-0293 is the responsibility of Staff members listed below. Darron Carlson was responsible for the review and analysis of the Company's application, recommended revenue requirement, rate base, and rate design. Dorothy Hains was responsible for the engineering and technical analysis.



Darron Carlson
Public Utilities Analyst Manager



Dorothy Hains
Utilities Engineer

**EXECUTIVE SUMMARY
LOS CERROS WATER COMPANY, INC.
DOCKET NO. W-02747A-15-0293
SUPPLEMENTAL STAFF REPORT**

Los Cerros Water Company (“Los Cerros” or “Company”) is a for profit “S” Corporation and a Class D public service corporation serving potable water to approximately 833 customers approximately fifteen miles north of Tucson, Arizona in Pima County.

On August 18, 2015, the Company filed an application for a permanent rate increase. On September 17, 2015, Staff filed a letter declaring the application sufficient. On December 16, 2015, the Original Staff Report was filed.

The Company proposed operating revenues of \$444,957, an increase of \$94,499, or 26.96 percent, over test year revenue of \$350,458. This provides operating income of \$92,601. The Company proposed an original cost rate base (“OCRB”) of negative \$95,471. The Company proposed rates would increase the typical monthly bill for a 5/8-inch meter residential customer, with median usage of 3,000 gallons by \$6.43 or 32.44 percent from \$19.82 to \$26.25.

Staff continues to recommend operating revenues of \$384,708, an increase of \$34,250, or 9.77 percent, over test year revenue of \$350,458. In the Original Staff Report filed December 16, 2015, the resulting operating income was \$57,809. In this filing, the resulting operating income is \$53,435. Staff recommends an OCRB of negative \$101,079. Staff’s proposed rates would increase the typical monthly bill for a 5/8-inch meter residential customer, with median usage of 3,000 gallons by \$1.18 or 5.95 percent from \$19.82 to \$21.00 as a partial result of Staff recommending a three tier rate structure.

Since calculating a rate of return on a negative rate base is meaningless when setting rates, Staff calculated a cash flow allowance of \$91,935 in its original Staff Report, but in this supplemental Staff Report the cash flow allowance is \$87,561 and provides the Company adequate funds for contingencies and emergencies.

Staff recommendations are unchanged from the Original Staff Report.

TABLE OF CONTENTS

	PAGE
REVISIONS	1
ENGINEERING	2
STAFF RECOMMENDATIONS	2

SCHEDULES

Summary of Filing	REVISED DWC-1
Statement of Operating Income.....	REVISED DWC-3
Cash Flow Analysis	REVISED DWC-6

REVISIONS

The Original Staff Report for the instant rate case was filed on December 16, 2015. After comments from Los Cerros Water Company, Inc. ("Los Cerros" or "Company") were filed in response to the Original Staff Report, Staff reviewed the comments and noted some anomalies in the income statement portion (Staff Schedule DWC-3) of the Original Staff Report. These revisions also resulted in changes to Staff Schedules DWC-1 and DWC-6. This Supplemental Staff Report includes Revised Staff Schedules DWC-1, DWC-3 (pages 1 through 5), and DWC-6. There are no revised schedules for DWC-2, DWC-4, and DWC-5, as these schedules are unchanged from the Original Staff Report.

Schedule DWC-3, page 1, of the Original Staff Report reflected Company test year revenue of \$350,458, and expenses of \$328,736, resulting in operating income of \$21,722. Staff made four adjustments to the test year expenses lowering them by \$9,718 to \$319,018. Staff's adjusted test year operating income was \$31,440. The attached Revised Schedule DWC-3, page 1, reflects Company test year revenue of \$350,458, and expenses of \$352,356, resulting in an operating loss of \$1,898. Staff made six adjustments to the test year expenses lowering them by \$28,333 to \$324,023. Staff's revised adjusted test year operating income is \$26,435.

Continuing on the same page of the Original Staff Report, Staff recommended a revenue increase of \$34,250, resulting in a recommended revenue requirement of \$384,708. Allowing for changes to property tax and income tax, the resulting operating income was \$57,809. Revised Schedule DWC-3, page 1, reflects the same recommended revenue requirement of \$384,708. Allowing for changes to property tax and income tax, the resulting operating income is \$53,435.

The attached Revised Schedule DWC-3, page 2, explains four of the six adjustments mentioned above. The attached Revised Schedule DWC-3, page 3, explains the depreciation expense adjustment. The attached Revised Schedule DWC-3, page 4, explains the property tax expense adjustment. Additionally, the attached Revised Schedule DWC-4, page 5, calculates the income tax allowance Staff includes in going-forward expenses.

The revisions noted above resulted in changes to Staff Schedule DWC-1. The attached Revised Schedule DWC-1 reflects the altered test year numbers at current rates as reflected above. The Company proposed revenue and expenses remain the same as in the Original Staff Schedule DWC-1. The Staff recommended revenue remains the same however the Staff recommended expenses are different as noted above and result in an operating income of \$53,435, resulting in a 13.89 percent operating margin.

Staff notes that Staff Schedule DWC-6 was not included in its Original Staff Report. For clarity, Staff includes the attached Revised Schedule DWC-6, which reflects cash flow from Staff's recommended revenue requirement at \$87,561.

Staff continues to recommend its rates and charges as reflected on Staff Schedule DWC-4.

ENGINEERING

The Original Engineering Report, under Conclusions at page 2, item 7 indicated that the Company did not have an approved Curtailment Tariff on file with the Commission. Staff Engineering issued a memo on January 5, 2016, indicating that the Company now has an approved Curtailment Tariff on file with the Commission.

STAFF RECOMMENDATIONS

Staff continues to recommend:

- Approval of Staff's rates and charges as shown in Schedule DWC-4.
- In addition to collection of its regular rate and charges, that the Company may collect from its customers a proportionate share of any privilege, sales or use tax, per Arizona Administrative Code ("A.A.C.") Rule 14-2-409(D)(5).
- Directing the Company to docket with the Commission a schedule of its approved rates and charges within 30 days after the date the Decision in this matter is issued.
- Utilization of depreciation rates by individual National Association of Regulatory Utility Commissioners category, as delineated in Exhibit 6, of the Engineering Report.
- Staff recommends that the Company file with Docket Control, as a compliance item in this docket within 90 days of the effective date of a decision in this proceeding, three Best Management Practices ("BMPs") in the form of tariffs that substantially conform to the templates created by Staff.

That the plant items listed in Exhibit B be reclassified for accounting purposes as indicated.

- Directing Los Cerros, as a compliance item in this case, to notify its customers of the authorized rates and charges approved in this proceeding, and their effective date, in a form acceptable to Staff, by means of an insert in its next regular scheduled billing and to file copies with Docket Control within 10 days of the date notice is sent to customers.
- Directing Los Cerros to file a rate case application no later than five years from the date of the Decision in this matter is issued.

LOS CERROS WATER COMPANY, INC.

Docket No. W-02747A-15-0293

Test Year Ended December 31, 2014

Revised Schedule DWC-1

SUMMARY OF FILING

	-- Present Rates --		Proposed		Recommended	
	Company as Filed	Staff as Adjusted	Company as Filed	Company as Filed	Staff as Recommended	Staff as Recommended
Revenues:						
Metered Water Revenue	\$ 343,507	\$ 343,507	\$ 431,207	\$ 431,207	\$ 380,007	\$ 380,007
Unmetered Water Revenue	-	-	-	-	-	-
Other Water Revenues	6,951	6,951	13,750	13,750	4,701	4,701
Total Operating Revenue	\$ 350,458	\$ 350,458	\$ 444,957	\$ 444,957	\$ 384,708	\$ 384,708
Operating Expenses:						
Operation and Maintenance	\$ 274,107	\$ 256,394	\$ 274,107	\$ 274,107	\$ 256,394	\$ 256,394
Depreciation	44,358	\$ 34,126	44,358	44,358	34,126	34,126
Property & Other Taxes	33,891	\$ 33,503	33,891	33,891	33,057	33,057
Income Tax	-	-	-	-	7,696	7,696
Total Operating Expense	\$ 352,356	\$ 324,023	\$ 352,356	\$ 352,356	\$ 331,273	\$ 331,273
Operating Income/(Loss)	\$ (1,898)	\$ 26,435	\$ 92,601	\$ 92,601	\$ 53,435	\$ 53,435
Rate Base O.C.L.D.	\$ (95,471)	\$ (101,079)	\$ (95,471)	\$ (95,471)	\$ (101,079)	\$ (101,079)
Operating Margin	N/M	7.54%	20.81%	20.81%	13.89%	13.89%

OPERATING INCOME STATEMENT - ADJUSTED TEST YEAR AND STAFF RECOMMENDED

	Company Adjusted Test Year	Staff Test Year Adjustments	Staff's Adjusted Test Year	Staff's Proposed Changes	Staff's Recommendations
Revenues:					
461 Metered Water Revenue	\$ 343,507	\$ -	\$ 343,507	\$ 36,500	\$ 380,007
460 Unmetered Water Revenue	-	-	-	-	\$ -
471 Miscellaneous Service Revenues	6,951	-	6,951	(2,250)	\$ 4,701
Total Operating Revenue	\$ 350,458	\$ -	\$ 350,458	\$ 34,250	\$ 384,708
Operating Expenses:					
601 Salaries and Wages	137,260	(12,000) (a)	125,260	-	125,260
610 Purchased Water	-	-	-	-	-
615 Purchased Power	36,893	-	36,893	-	36,893
618 Chemicals	1,456	-	1,456	-	1,456
620 Repairs and Maintenance	8,375	-	8,375	-	8,375
621 Office Supplies & Expense	31,153	(6,000) (b)	25,153	-	25,153
630 Outside Services	25,533	-	25,533	-	25,533
635 Water Testing	4,784	(186) (c)	4,598	-	4,598
641 Rents	-	-	-	-	-
650 Transportation Expenses	4,414	-	4,414	-	4,414
657 Insurance - General Liability	2,690	-	2,690	-	2,690
659 Insurance - Health and Life	16,360	473 (d)	16,833	-	16,833
666 Regulatory Commission Exp.	-	-	-	-	-
675 Miscellaneous Expense	5,189	-	5,189	-	5,189
403 Depreciation Expense	44,358	(10,232) (e)	34,126	-	34,126
408 Taxes Other Than Income	12,888	-	12,888	-	12,888
408.11 Property Taxes	21,003	(388) (f)	20,615	(446)	20,169
409 Income Tax	-	-	-	7,696	7,696
Total Operating Expenses	\$ 352,356	\$ (28,333)	\$ 324,023	\$ 7,250	\$ 331,273
OPERATING INCOME/(LOSS)	\$ (1,898)	\$ 28,333	\$ 26,435	\$ 27,000	\$ 53,435

STAFF ADJUSTMENTS

a	SALARIES AND WAGES	Per Company	\$	137,260	
		Per Staff		125,260	<u>\$ (12,000)</u>

Staff removed bonus from annual salary expense.

b	OFFICE SUPPLIES & EXPENSE	Per Company	\$	31,153	
		Per Staff		25,153	<u>\$ (6,000)</u>

Staff removed the Company's pro forma adjustment to include projected credit card expenses. Credit cards are not currently being accepted by the Company and offering such a service is costly and would only benefit a small percentage of total customers.

c	WATER TESTING	Per Company	\$	4,784	
		Per Staff		4,598	<u>\$ (186)</u>

Staff adjusted expense level per the Staff Engineering recommendation.

d	INSURANCE - HEALTH AND LIFE	Per Company	\$	16,360	
		Per Staff		16,833	<u>\$ 473</u>

Staff allowed adjustment for health insurance expense, adjusted to recent cost estimate provided by the Company.

e	DEPRECIATION - Per Company	\$	44,358	
	Per Staff		34,126	
	To reflect Staff's calculation of depreciation expense.			\$ (10,232)

OPERATING INCOME ADJUSTMENT C - DEPRECIATION EXPENSE

LINE NO.	ACCT NO.	DESCRIPTION	UTILITY PLANT SERVICE BALANCE	FULLY/NON-DEPR PLANT BALANCES	DEPRECIABLE PLANT IN SERVICE	DEPREC. RATE	DEPRECIATION EXPENSE
Plant In Service							0.00%
1	301	Organization Costs	\$ -			0.00%	\$ -
3	303	Land & Land Rights	\$ 6,164	5,650	-	0.00%	-
4	304	Structures & Improvements	\$ 17,018		16,405	3.33%	567
5	307	Wells & Springs	\$ 515,527		539,075	3.33%	17,167
	309	Supply Mains	\$ -				
6	311	Electric Pumping Equipment	\$ 116,861	135,957	(19,096)	12.50%	-
7	320	Water Treatment Equipment	\$ -		-	0.00%	-
8	320.1	Water Treatment Plants	\$ -		-	3.33%	-
9	320.2	Solutions & Feeders	\$ 4,145		4,075	20.00%	829
11	330	Distribution Reservoirs & Standpipes	\$ 55,578		-	2.22%	-
12	330.1	Storage Tank	\$ -	55,578	-	2.22%	-
13	330.2	Pressure Tanks	\$ 6,490		-	5.00%	325
14	331	Transmission & Distribution Mains	\$ 517,697		517,697	2.00%	10,354
15	333	Services	\$ 138,946		119,201	3.33%	4,627
16	334	Meters & Meter Installations	\$ 167,686		167,447	8.33%	13,968
17	335	Hydrants	\$ 24,357		8,957	2.00%	487
18	336	Backflow Prevention Devices	\$ -		-	6.67%	-
19	339	Other Plant & Misc. Equip.	\$ 261		261	6.67%	17
20	340	Office Furniture & Fixtures	\$ 6,908		11,208	6.67%	461
21	340.1	Computer & Software	\$ 14,257		11,557	20.00%	2,851
22	341	Transportation Equipment	\$ 15,000		15,000	20.00%	3,000
23	342	Stores Equipment	\$ -		-	4.00%	-
24	343	Tools & Work Equipment	\$ -		-	5.00%	-
25	344	Laboratory Equipment	\$ -		-	10.00%	-
26	345	Power Operated Equipment	\$ -		-	5.00%	-
27	346	Communications Equipment	\$ 1,600		-	10.00%	-
28	347	Miscellaneous Equipment	\$ 1,017		1,017	10.00%	102
29	348	Other Intangibles	\$ (427)		-	10.00%	-
			\$ 1,609,085	197,185	1,392,804		\$ 54,755
30		Gross CIAC:	\$ 524,744				
31		Composite Depreciation Rate (Depr Exp / Depreciable Plant):		3.93%			
32		Amortization of CIAC	\$ 20,629				
33		Depreciation Expense Before Amortization of CIAC:	\$ 54,755				
34		Less Amortization of CIAC:	\$ 20,629				
35		Test Year Depreciation Expense - Staff:	\$ 34,126				
36		Depreciation Expense - Company:	\$ 44,358				
37		Staff's Total Adjustment:	\$ (10,232)				
CIAC Adjustment							
		Company Test Year ending 12/31/14	\$ 26,237				
		Staff Recommended	\$ 20,629				
		CIAC Amortization Adjustment	\$ 5,608				

OPERATING INCOME ADJUSTMENT f - PROPERTY TAX EXPENSE

LINE NO.	Property Tax Calculation	[A] STAFF AS ADJUSTED	[B] STAFF RECOMMENDED
1	Staff Adjusted Test Year Revenues	\$ 350,458	\$ 350,458
2	Weight Factor	<u>2</u>	<u>2</u>
3	Subtotal (Line 1 * Line 2)	700,916	\$ 700,916
4	Staff Recommended Revenue, Per Schedule CLP-1	<u>350,458</u>	<u>384,708</u>
5	Subtotal (Line 4 + Line 5)	1,051,374	1,085,624
6	Number of Years	3	3
7	Three Year Average (Line 5 / Line 6)	350,458	\$ 361,875
8	Department of Revenue Mutilplier	2	2
9	Revenue Base Value (Line 7 * Line 8)	700,916	\$ 723,749
10	Plus: 10% of CWIP -	-	-
11	Less: Net Book Value of Licensed Vehicles	-	\$ -
12	Full Cash Value (Line 9 + Line 10 - Line 11)	700,916	\$ 723,749
13	Assessment Ratio	19.0%	18.0%
14	Assessment Value (Line 12 * Line 13)	133,174	\$ 130,275
15	Composite Property Tax Rate	<u>15.48%</u>	<u>15.48%</u>
16	Staff Test Year Adjusted Property Tax (Line 14 * Line 15)	\$ 20,615	
17	Company Proposed Property Tax	<u>21,003</u>	
18	Staff Test Year Adjustment (Line 16-Line 17)	<u>\$ (388)</u>	
19	Property Tax - Staff Recommended Revenue (Line 14 * Line 15)	.	\$ 20,169
20	Staff Test Year Adjusted Property Tax Expense (Line 16)	.	\$ 20,615
21	Increase in Property Tax Expense Due to Increase in Revenue Requirem .	.	<u>\$ (446)</u>
22	Increase to Property Tax Expense	.	\$ (446)
23	Increase in Revenue Requirement	.	34,250
24	Increase to Property Tax per Dollar Increase in Revenue (Line 19/Line 2 .	.	-1.301732%

Recommended Income Taxes

NO.	DESCRIPTION	75% Friedman (Single)		25% Storms (MFJ)	
		Test Year	Test Year	Test Year	Test Year
<i>Calculation of Income Tax:</i>					
1	Revenue	\$	384,708	\$	384,708
2	Less: Operating Expenses - Excluding Income Taxes	\$	323,577	\$	323,577
3	Less: Synchronized Interest (L17)	\$	-		
4	Taxable Income (L1 - L2)	\$	61,131	\$	61,131
5	Pro-rata share of income		75%		25%
6	Taxable Income	\$	45,848	\$	15,283
7	Federal Income Taxes @ 10%	\$	4,585	\$	1,528
8	Arizona State Taxes @ 2.59%		1,187	\$	396
9	Total Combined Federal & Arizona Taxes		5,772		1,924
10	COMBINED TOTAL FEDERAL & ARIZONA TAXES PAYABLE				7,696
11	Income Tax - Per Staff	\$	7,696		
12	Income Tax - Per Company	\$	-		
13	Staff Adjustment	\$	7,696		

CASH FLOW ANALYSIS

	Staff Adjusted TY	Staff's Adjustments	Staff Recommended
Cash Inflows:			
1 461 Metered Water Revenue	\$ 343,507	\$ 36,500	\$ 380,007
2 460 Unmetered Water Revenue	-	-	-
3 471 Miscellaneous Service Revenues	6,951	(2,250)	4,701
4 Total Operating Revenue	<u>\$ 350,458</u>	<u>\$ 34,250</u>	<u>\$ 384,708</u>
Cash Outflows:			
5 601 Salaries and Wages	\$ 125,260	\$ -	\$ 125,260
6 610 Purchased Water	\$ -	\$ -	\$ -
7 615 Purchased Power	\$ 36,893	\$ -	\$ 36,893
8 618 Chemicals	\$ 1,456	\$ -	\$ 1,456
9 620 Repairs and Maintenance	\$ 8,375	\$ -	\$ 8,375
10 621 Office Supplies & Expense	\$ 25,153	\$ -	\$ 25,153
11 630 Outside Services	\$ 25,533	\$ -	\$ 25,533
12 635 Water Testing	\$ 4,598	\$ -	\$ 4,598
13 641 Rents	\$ -	\$ -	\$ -
14 650 Transportation Expenses	\$ 4,414	\$ -	\$ 4,414
15 657 Insurance - General Liability	\$ 2,690	\$ -	\$ 2,690
16 659 Insurance - Health and Life	\$ 16,833	\$ -	\$ 16,833
17 666 Regulatory Expense - Rate Case	\$ -	\$ -	\$ -
18 675 Miscellaneous Expense	\$ 5,189	\$ -	\$ 5,189
19 403 Depreciation Expense	\$ 34,126	\$ -	\$ 34,126
20 408 Taxes Other Than Income	\$ 12,888	\$ -	\$ 12,888
21 408.11 Property Taxes	\$ 20,615	\$ (446)	\$ 20,169
22 409 Income Tax	\$ -	\$ 7,696	\$ 7,696
23 Total Operating Expenses	<u>\$ 324,023</u>	<u>\$ 7,250</u>	<u>\$ 331,273</u>
24 Operating Income	<u>\$ 26,435</u>	<u>\$ 27,000</u>	<u>\$ 53,435</u>
			\$ -
25 Plus: Depreciation Expense	\$ 34,126	\$ -	\$ 34,126
26 Less Loan Interest and Fee Payment	-	-	-
27 Less: Loan Debt Service Reserve Payment	-	-	-
28 Less: Loan Principal Payment	-	-	-
29 Cash Flow from Operations	<u>\$ 60,561</u>	<u>\$ 27,000</u>	<u>\$ 87,561</u>