

BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION

IN THE MATTER OF THE APPLICATION OF)
INDEPENDENT UTILITY COMPANY FOR APPROVAL)
TO ABANDON ASSETS AND RETAIN CERTAIN)
WATER RIGHTS; THE JOINT APPLICATION OF)
INDEPENDENT UTILITY COMPANY AND NEW MEXICO)
WATER SERVICE COMPANY FOR THE SEVERAL)
APPROVALS AND AUTHORIZATIONS REQUIRED IN)
CONNECTION WITH THE ACQUISITION OF)
INDEPENDENT UTILITY COMPANY'S ASSETS BY)
NEW MEXICO WATER SERVICE COMPANY; AND THE)
APPLICATION BY NEW MEXICO WATER SERVICE)
COMPANY FOR APPROVAL TO OPERATE CERTAIN)
WATER FACILITIES,)

INDEPENDENT UTILITY COMPANY AND)
NEW MEXICO WATER SERVICE COMPANY,)

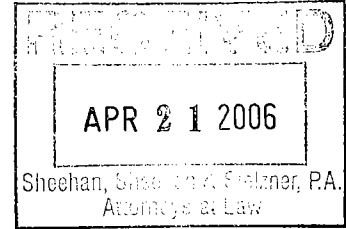
Applicants.)

and)

IN THE MATTER OF THE APPLICATION OF INDEPENDENT)
UTILITY COMPANY FOR APPROVAL OF WATER RATE)
INCREASE,)

INDEPENDENT UTILITY COMPANY,)

Applicant.)



Case No. 05-00208-UT

Case No. 05-00305-UT

RECOMMENDED DECISION OF THE HEARING EXAMINER

Marilyn S. Hebert, Hearing Examiner in this case, hereby submits this Recommended Decision to the New Mexico Public Regulation Commission ("Commission") pursuant to 17.1.2.32 NMAC and 17.1.2.39 NMAC.

STATEMENT OF THE CASE

On May 12, 2005, Independent Utility Company ("IUC") and New Mexico Water Service Company ("NM Water") filed an application ("Sale Application") seeking an order from the Commission for approval and authorization for the following:

1. IUC to sell and NM Water to acquire certain assets of IUC, and NM Water to own and operate IUC as a public water utility pursuant to NMSA 1978, Sections 62-6-12.A and 62-6-13;
2. IUC, pursuant to NMSA 1978, Section 62-9-5, to abandon its certificate of public convenience and necessity issued by the Commission in 1992;
3. IUC to abandon its facilities and retain and hold certain water rights determined to be surplus;
4. issuance of an amended certificate of public convenience and necessity pursuant to NMSA 1978, Sections 62-9-1 and 62-9-6 to NM Water to include the ownership and operation of IUC's water facilities including any rate increase approved by the Commission;
5. determination of whether IUC has any surplus water rights; and
6. determination of rate base for the purposes of the acquisition.

On June 16, 2005, the Commission issued its Order Designating Hearing Examiner designating the undersigned to preside over this matter. On June 20, 2005, the Hearing Examiner issued an Order Setting Prehearing Conference setting the conference for July 7, 2005. On June 27, 2005, IUC and NM Water filed a Motion for Continuance of Prehearing Conference asking that the conference be rescheduled, in part, because of the impending filing by IUC of a rate case, which IUC and NM Water intended to ask the Commission to consolidate with Case No. 05-00208-UT. The Hearing Examiner rescheduled the conference for August 3, 2005.

On July 21, 2005, IUC filed an application and advice notice ("Rate Application") seeking a rate increase. On that date, IUC and NM Water also filed a Joint Motion to Consolidate Cases asking the Commission to consolidate the rate case, Case No. 05-

00305-UT, with the pending sale and acquisition case, Case No. 05-00208-UT. On August 9, 2005, the Commission issued its Order Consolidating Cases and Suspending Implementation of the Proposed Rates, which granted the request to consolidate the two cases and referred the consolidated cases to the undersigned Hearing Examiner. The order also suspended the proposed rates for a nine-month period beginning August 20, 2005.

The August 3, 2005 prehearing conference was attended by representatives of IUC, NM Water, Capital Concepts, Inc. and the Commission's Utility Division ("Staff"). On August 11, 2005, a Procedural Order was issued that set a hearing date of November 30, 2005, and required IUC to mail a copy of a Notice, which set forth the proposed rates and the date of hearing, to each of its customers and publish the Notice in a newspaper of general circulation in the area IUC provides service. The Notice also set a deadline for filing motions to intervene of September 16, 2005.

On September 15, 2005, IUC filed an affidavit indicating that IUC mailed a copy of the Notice to each of its customers on August 19, 2005. Also on September 15, 2005, IUC filed affidavits indicating the Notice was published in the *Mountain View Telegraph* on August 18, 2005, and in the *Albuquerque Journal* on August 22, 2005.

The following filed motions to intervene in this matter, which were granted: Henry G. Coors ("Coors"); Capital Concepts, Inc. ("Capital"); Entranosa Water & Wastewater Association ("Entranosa"); and Sandia Knolls Neighborhood Association ("Sandia Knolls").

On October 7, 2005, Sandia Knolls filed a motion to vacate the hearing and extend filing deadlines. This motion was supported by Entranosa and not opposed by

NM Water; Capital Concepts opposed the motion. Following a prehearing conference, on October 25, 2005, the Hearing Examiner issued a Third Procedural Order vacating the November 30, 2005 hearing and rescheduling the hearing for February 1, 2006 and setting filing deadlines.

Subsequent to the hearing, NM Water, Sandia Knolls, Coors, Capital and Staff filed proposed findings of fact and conclusions of law.

The following appearances were entered at the February 1, 2006 public hearing:

Appearances:

<u>For NM Water:</u>	Maria O'Brien, Esq.
<u>For Henry G. Coors:</u>	Henry G. Coors, <i>pro se</i>
<u>For Sandia Knolls:</u>	Susan C. Kery, Esq.
<u>For Entranosa:</u>	Elizabeth Newlin Taylor, Esq.
<u>For Capital Concepts:</u>	John E. Farrow, Esq.
<u>For Staff:</u>	Cydney Beadles, Esq.

The following witnesses appeared and gave testimony at the hearing.

<u>For NM Water:</u>	Mr. Paul D. Risso Mr. V. Phillip Soice
<u>For Entranosa:</u>	Mr. John L. Jones
<u>For Sandia Knolls:</u>	Ms. Joanne Hilton
<u>For Henry G. Coors:</u>	Mr. Coors
<u>For Staff:</u>	Ms. Phillis Stevens Ms. Patricia Griego Mr. Anthony R. Sisneros Mr. Steven Schwebke

Public Comment

On August 29, 2005, the Hearing Examiner filed a letter from Lois I. Trim of Sandia Park, New Mexico received by the Hearing Examiner on August 26, 2005. Ms. Trim stated that she believes IUC desires to increase its assets by raising the rates to an unjustifiable level to enhance the sale of the water company and that the Commission is to protect ratepayers from such fraudulent behavior. Additionally, on September 1, 2005, Bill Williford of Edgewood, New Mexico filed a letter stating his opposition to the proposed increase in water rates. At the hearing John Helmich, president of Sandia Knolls, requested the opportunity to comment. Mr. Helmich inquired as to the length of time the Commission required to process this case. The Commission's Utility Division Procedures, 17.1.2.26.F NMAC, specifically provide for commenters to make either oral or written statements for the record.

DISCUSSION

Sale and Acquisition – Case No. 05-00208-UT

IUC is a New Mexico corporation engaged in the business of distribution of water to approximately 400 residential customers in the Sandia Knolls and the Juan Tomas subdivisions in Bernalillo County, New Mexico. IUC is a public utility subject to the jurisdiction of the Commission. Randy Lykins and Paulette Lykins together own 80%, and Henry Coors owns 20% of IUC.

On January 23, 2002, IUC filed for bankruptcy relief,¹ and since that date, IUC has continued to operate as a debtor-in-possession. On April 22, 2004, the Bankruptcy Court approved the sale of IUC's assets, free and clear of liens and encumbrances, to NM Water.

¹ United States Bankruptcy Court for the District of New Mexico, Case No. 11-02-10475 MA.

NM Water is a New Mexico corporation and a public utility subject to the jurisdiction of the Commission. NM Water distributes water to and collects wastewater in the Rio Communities and provides water service to Meadow Lakes Estates in Valencia County and in Elephant Butte Estates in Sierra County pursuant to a certificate of public convenience and necessity ("CCN") approved by the Commission on March 11, 2004.²

According to the Sale Application, NM Water is a wholly owned subsidiary of California Water Service Group, Inc. ("Group"), whose principal business, since 1926, is the ownership of water and wastewater utility companies; Group has assets in excess of \$940 million and annual revenues of \$315 million providing utility services to more than two million people in New Mexico, California, Washington and Hawaii. The Application states that Group's water and wastewater systems comprise the second largest such utility in the United States.

Pursuant to the Asset Purchase and Sale Agreement ("Purchase Agreement") between IUC and NM Water, NM Water will acquire certain IUC assets including (1) water treatment equipment and facilities, wells, pumping equipment, connections, tanks, reservoirs, mains, meters and hydrants; (ii) four lots and associated easements in Sandia Knolls Subdivision; (iii) water rights in the Sandia and Estancia Underground Water Basins, (iv) other tangible assets including vehicles, office furniture, other tangible personal property, and all rights of IUC under contracts relating to the operation

² On September 6, 2005, the Commission amended NM Water's CNN to allow it to acquire and operate Cypress Gardens Water Users, Inc., distributing water to approximately 280 customers in the area of Cypress Gardens and Eastland Hills in Valencia County, New Mexico, adjacent to the Rio Communities area also served by NM Water.

of the public utility; (v) accounts receivable; (vi) inventory; (vii) books and records; (viii) licenses; (ix) deposits; and (x) other property.

The Sale Application and Purchase Agreement both state that the agreed purchase price is the Commission's approved amount of IUC's rate base less the working capital allowance and those components of the rate base NM Water has or will advance on IUC's behalf and certain other adjustments.

According to the Sale Application, IUC is emerging from bankruptcy, and the owners desire to sell IUC's utility plant and property. IUC's service area will require additional facilities and improvements to existing facilities to meet demands and upgrade water services, including a SCADA system,³ well upgrades, booster upgrades, support equipment and engineering. IUC claims it is not financially capable of raising funds for these improvements, and that professional water system personnel should manage IUC. NM Water believes it can provide such service to IUC customers. NM Water plans to finance acquisition of IUC's assets with a combination of short-term debt and equity: 50% of the purchase price will be funded with equity, and the remaining 50% will be borrowed.

Closing of the transaction set out in the Purchase Agreement is conditional on approval by the Bankruptcy Court, the State Engineer, the New Mexico Environment Department and the Commission.

Water Rights

Both IUC and NM Water request that the Commission determine whether IUC has any surplus water rights. If the Commission determines there are surplus water

³ At the hearing, Mr. Risso explained that SCADA stands for supervisory control and data acquisition. Tr. 2/1/06 at 40.

rights, IUC and NM Water ask for an order from the Commission allowing IUC to hold such water rights, maintain such water rights in good standing and not to sell, lease or encumber the water rights determined to be surplus except as provided in the Purchase Agreement. IUC and NM Water agree that should the Commission determine that IUC does not have any surplus water rights, all water rights held by IUC will be included as water rights transferred from IUC to NM Water under the Purchase Agreement with no additional compensation paid to IUC.

In the event the Commission determines there are surplus water rights, under the terms of the Purchase Agreement, IUC and NM Water agree to a formula for payment to IUC's shareholders by NM Water for such water rights. For a period of 10 years following the closing date, NM Water will not pay an additional amount for surplus water rights put to use within IUC's existing service area, but will pay IUC's existing shareholders for surplus water rights put to use outside the existing service area at the prevailing market value of water rights in the Sandia Underground Water Basin. At the end of 10 years, NM Water will pay IUC's existing shareholders 60% of the prevailing market rate for their remaining water rights in the Sandia Underground Water Basin.

The Rate Case – Case No. 05-00305-UT

The Purchase Agreement requires IUC to file an application for a rate increase ("Rate Application"), which IUC filed on July 21, 2005. NM Water proposes to commence operation of utility service to IUC's service areas under rates, tariffs and rules of service identical to those in effect for IUC at the time of the acquisition, including any rate increase approved by the Commission. IUC and NM Water state that the acquisition is contingent upon the establishment of a satisfactory rate increase, and that

NM Water is under no obligation to acquire or make the proposed improvements to the IUC system unless requested approvals and sufficient rate relief are obtained.

IUC filed the Rate Application with Advice Notice No. 7 requesting water rate increases for Rate Nos. 1 and 4. IUC states that it is a small water utility, a Class C water utility as defined in Rule 710.4,⁴ with annual revenues of less than \$500,000, but that the proposed rate increase would have the effect of increasing rates by more than 50% and therefore certain requirements of NMSA 1978, Section 62-8-7.1 apply to the Rate Application.

The Rate Application states that IUC's current water rates were set for Sandia Knolls in 1994, and for Juan Tomas in 2001. IUC states that the current revenues are not sufficient to cover expenses; IUC's 2004 Annual Report shows a loss of \$14,091.

The Rate Application states that IUC's water plant is in need of major renovations to improve its reliability. NM Water has estimated that \$122,000 of capital investment is required, including the following: \$80,000 for a SCADA system; \$2,500 to upgrade Well No. 1; \$2,500 to upgrade Well No. 2; \$3,500 to upgrade Booster No. 1; \$3,500 to upgrade Booster No. 2; \$2,000 for treatment equipment; \$18,000 for transportation; \$3,000 for computers and furniture; \$2,000 for tools; and \$5,000 for engineering.

The Rate Application states that IUC's revenue requirement analysis is based on financial information for calendar year 2004, which is the Base Period that has been adjusted for known and measurable changes. Revenue requirements for Test Year 2004 were computed to be \$225,860 compared to revenues of approximately \$172,966.

⁴ 17.12.1.7 NMAC.

IUC's proposed rate base is \$633,888. IUC requests new rates that will increase IUC's Base Period revenues by a 46.7% increase to cover expenses and provide a 10.4% return on equity. IUC proposes a uniform 46.7% increase in both the monthly system charges and the blocks of quantity rates. The present and proposed monthly system charges and commodity charges for IUC's residential customers are as follows:⁵

MONTHLY SYSTEM CHARGES		
Service Area	Present Charge	Proposed Charge
Sandia Knolls	\$16.67	\$24.45
Juan Tomas	\$25.00	\$24.45

COMMODITY CHARGES		
Level of Monthly Consumption	Present Rate per 1000 gallons	Proposed Rate per 1000 gallons
0 – 10,000 gallons	\$3.50	\$5.13
Above 10,000 gallons	\$4.00	\$5.87

Testimony

Mr. Lykins testified⁶ that he is the president of IUC. He stated that after IUC filed for bankruptcy, it was determined that it was in the best interest of IUC customers to secure an acceptable buyer for its assets. He stated that IUC required a purchase price that would allow it, at a minimum to repay its current indebtedness. Mr. Lykins described the Purchase Agreement and stated that the acquisition of IUC by NM Water is contingent on a satisfactory rate increase. Mr. Lykins summarized the provisions

⁵ See NMWS Exhibit 9, Supplemental Direct Testimony of V. Phillip Soice, at 3.

⁶ Mr. Lykins filed testimony in both the Sale and Acquisition Case and the Rate Case, but he was not present at the hearing. The parties stipulated to the admittance of his testimony into evidence and waived the right to cross-examine Mr. Lykins. Tr. 2/1/06 at 17-18.

regarding water rights in the Purchase Agreement. He testified that IUC will remain in existence as the holder of any surplus water rights during the ten years following the date of closing on the Purchase Agreement.

Mr. Lykins testified that IUC's customers can expect numerous operating benefits from the sale of IUC's system to NM Water. He stated that the acquisition of IUC's utility assets by NM Water, a well-capitalized company with particular expertise in the operation and management of water and wastewater utilities, would provide operating benefits to IUC customers.

Mr. Lykins testified that for many years IUC's revenues have failed to cover the utility's cost to serve its customers. He stated that since the 1994 rate case for Sandia Knolls, IUC has experienced escalating costs to construct operate and maintain the utility. He stated that IUC desires to adjust its rates to earn a reasonable return on equity. He stated that NM Water estimates that \$122,000 in capital investment is needed for major renovations to improve the reliability of IUC's water plant, and IUC's current revenues are insufficient to cover these expenses. He stated that IUC had a loss of \$14,091 for 2004, as documented in its Annual Report, attached to the Rate Application as Exhibit F.

Mr. Lykins testified that IUC's current rates for Sandia Knolls were set in 1994, and the rates for Juan Tomas were set in 2001. He stated that the proposed rates are fair, just and reasonable, and will provide IUC with the revenues required to meet its expenses, provide a reasonable rate of return and ensure the utility will be able to provide reliable service to its customers.

Mr. Risso testified that he is the general manager of NM Water and is responsible for NM Water's operational, administrative, customer service, capital improvement, budgets and human resource matters. He stated that his responsibilities include those matters concerning rates, customer complaints and acquisitions.

Mr. Risso testified that NM Water holds a CCN issued by the Commission and currently serves approximately 5,800 customers in Valencia and Sierra counties. He stated that NM Water is a wholly owned subsidiary of California Water Service Group, Inc. ("Group"), a publicly traded company. He explained that Group's mission is to locate and acquire additional water and/or wastewater utility companies that will strengthen and broaden the base of the Group system of companies.

Mr. Risso testified that NM Water became interested in acquiring IUC's assets when it learned that IUC was interested in selling, even though IUC is in poor physical and financial condition. At the hearing, Mr. Risso identified the bankruptcy order stating that the order approves the sale of IUC's assets to NM Water.⁷ He stated that NM Water concluded that it could make the needed improvements to the IUC system and has the administrative functions to provide high quality water service.

Mr. Risso stated that IUC's physical system is in disrepair and in need of significant capital infusion for the needed repairs and improvements. He stated that he does not believe IUC has any monitoring capability of the system other than direct visual inspection, which is not reliable. He stated that this situation leaves the system and its customers vulnerable to low/no pressure events, low/no chlorine residuals and an inability to react to emergency situations in a timely manner. He stated that system

⁷ Tr. 2/1/06 at 27; the order is NMWS Exhibit 6.

chlorination is currently being accomplished manually by opening the hatch covers on the top of the tanks and pouring chlorine directly into the tank. He explained that NM Water would install an automated system that provides a continuous regulated dosage of chlorine to the system. He stated that there appear to be inefficiencies in the design and operation of the pumping/booster system. He also explained that there is no mechanism in place to monitor what is going on in the IUC system on a regular or constant basis.

Mr. Risso testified that IUC does not have a proper, automated accounting system, which makes it extremely difficult, if not impossible, to comply with the various regulatory financial reporting requirements. He stated that administrative records have not been kept in compliance with regulations.

Mr. Risso testified that major renovations are needed to improve system reliability; NM Water proposes to make immediate capital improvements of approximately \$122,000⁸ including a SCADA system, new computer, chlorination equipment and engineering work. He stated that NM Water proposes that conditional approval of \$122,000⁹ in capital improvements be approved, but that those costs not be made part of rates until the improvements have been completed and NM Water has provided notice to the Commission.

Mr. Risso testified that NM Water has the resources and expertise to make the needed physical and administrative improvements and place the system on sound financial footing. He testified that IUC has sufficient water rights to serve existing

⁸ Tr. 2/1/06 at 22.

⁹ NMWS Exhibit 4, Rebuttal Testimony of Paul D. Risso at 2.

