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MEMORANDUM

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FROM: Ernest G. Johnson
Director
Utilities Division

DATE: March 30, 2004

RE: STAFF REPORT FOR TABLE TOP TELEPHONE COMPANY'S REQUEST FOR
FINANCING AUTHORIZATION.
(DOCKET NO. T-02724A-03-0750)

Attached is the Staff Report regarding Table Top Telephone Company's application for financing authorization.

Staff recommends approval.

EGJ:AXR:hml

Originator: Alejandro Ramirez

Arizona Corporation Commission

DOCKETED

MAR 31 2004

DOCKETED BY	
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Service List for: Table Top Telephone Company
Docket No. T-02724A-03-0750

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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

TABLE TOP TELEPHONE COMPANY

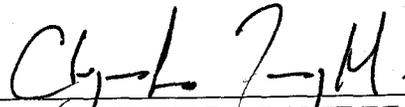
DOCKET NO. T-02724A-03-0750

APPLICATION FOR FINANCING AUTHORIZATION

MARCH 2004

STAFF ACKNOWLEDGMENT

The Staff Report for Table Top Telephone Company (Docket No. T-02724A-03-0750) was the responsibility of the Staff members listed below. Alejandro Ramirez was responsible for the financial review and analysis. Richard Boyles was responsible for the engineering and the technical analysis.



ALEJANDRO RAMIREZ
PUBLIC UTILITIES ANALYST I



RICHARD BOYLES
UTILITIES ENGINEER (TELECOMMUNICATIONS)

EXECUTIVE SUMMARY

Table Top Telephone Company, Inc. ("Table Top" or "Applicant") provides telecommunication services to customers located in the exchanges of Aguila, Ajo, Bagdad, Inscription Canyon Ranch, Sanders and Seligman in Arizona. On October 9, 2003, the Applicant filed an application with the Arizona Corporation Commission ("Commission") requesting authorization to borrow \$11,235,000 from the United States Department of Agriculture, Rural Service ("RUS"), and \$6,540,450 from the Rural Telephone Bank ("RTB"), for a total of \$17,775,450.

The general purpose of this financing is to fund additions to meet telecommunications growth needs and improve the Applicant's service in its Arizona exchanges. The proceeds would provide funds to connect new subscribers, construct a new central office building, install new fiber-fed Digital Loop Carriers ("DLCs"), install microwave facilities, purchase Computer Aid Design ("CAD") equipment, and construct new aerial and buried fiber optics. Further, the Applicant would invest in RTB Class B stock as it is required for the RTB loan.

Appropriate notice has been given to ratepayers by legal advertisements in a newspaper of general circulation serving the certificated areas.

Staff concludes that issuance of the proposed \$17,775,450 debt may result in a capital structure that is more leveraged than normal.

Staff concludes that the purposes of the proposed financing are lawful and issuance of the debt is within Table Top Telephone Company's corporate powers, compatible with the public interest, consistent with sound financial practice and will not impair its ability to provide services.

Staff recommends approval subject to the condition that any drawdown from the proposed loans must leave the Applicant with at least 35 percent equity in its capital structure.

Staff further recommends that Table Top should submit an annual status report to the Director of the Utilities Division summarizing the amount of loan drawn each year for each project under construction and/or completed during the preceding year. It should be due to the Director thirty (30) days after the end of the calendar year and will cease to be required after January 31, 2009.

Staff further recommends that the Commission authorize Table Top's pledge, mortgage, lien and/or encumbrance of its utility plant and assets as security for the loans as may be required by RUS and RTB.

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Introduction

On October 9, 2003, Table Top Telephone Company, Inc. ("Table Top" or "Applicant") filed an application with the Arizona Corporation Commission ("Commission") requesting authorization to borrow \$11,235,000 from the U.S. Department of Agriculture, Rural Utilities Service ("RUS"), and \$6,540,450 from the Rural Telephone Bank ("RTB"), for a total of \$17,775,450. Further, the Applicant requests that the Commission authorize the pledge, mortgage, lien and/or encumbrance of its utility plant and assets as security for the loans as may be required by RUS and RTB.

Notice

The Applicant notified its customers of the application for the proposed loans by having notice published in the *Arizona Business Gazette* on November 17, 2003. A copy of the notice is attached.

Background

Table Top provides telecommunication services within the Aguila, Ajo, Bagdad, Inscription Canyon Ranch, Sanders and Seligman Exchanges in Arizona. There were 5,013 access lines in the exchanges on August 31, 2003. The rural service area encompasses approximately 2,976 square miles with an average density of approximately 1.7 access lines per square mile.

Table Top serves in all quadrants of Arizona except the southeast. The Applicant offers service in six non-contiguous exchanges in central, southwestern, northwestern and northeastern Arizona. Therefore, it faces challenges in maintaining high quality telecommunications services in its low density areas.

Table Top's current rates were approved in Decision No. 62840, dated August 24, 2000.

Purpose of the Financing

The purpose of the proposed debt is to provide funding for the Applicant's five-year improvement plan. The following projects would be funded:

1. Connect 2,122 new subscribers.
2. Construct a new central office building.
3. Install 77 new fiber-fed DLCs.
4. Install new microwave facilities.
5. Purchase Computer Aid Design equipment.

6. Construct new aerial and buried fiber optic facilities.
7. Purchase of RTB Class B stock equal to 5 percent of the loan advances as required by RTB.

Engineering Analysis

Table Top plans to modernize its infrastructure and expand its network support facilities. The Applicant plans expansion to accommodate projected annual growth rates that vary between 2.9 and 12.4 percent in its exchanges. The Applicant's plans for outside plant additions, new digital loop carrier deployment, interoffice facility additions, central office facility additions, and miscellaneous other revisions to its network are based on anticipated needs. The Applicant anticipates the improvements will provide operating efficiency from both a cost and performance perspective. The improvements will also improve service quality and allow provision of new services such as broadband.

Staff concludes that the planned use of the proceeds of the loans is appropriate modernization and expansion of the Applicant's network and support assets. Staff has not made a determination of the aforementioned telephone facilities as "used and useful" at this time, but defers this determination until the Applicant files its next rate application.

The Applicant should submit an annual status report to the Director of the Utilities Division summarizing the amount of loan drawn each year for each project under construction and/or completed during the preceding year. It should be due to the Director thirty (30) days after the end of the calendar year and will cease to be required after January 31, 2009.

Description of Proposed Financing

The RUS and RTB loans would bear interest rates at the rate applicable to each advance of loan funds based on the average yield on outstanding marketable obligations of the United States having a final maturity comparable to the final maturity of the advance. The RUS loan interest would be fixed at the time of each advance. The interest rate on each RTB loan advance would be an interim rate. A permanent rate would be determined on each RTB loan advance at the end of the fiscal year in which the advance is made based on RTB's cost-of-money rate for the fiscal year. The maturity period for the loans is 17 years.

The proposed pledge assets would consist of the assets purchased with the proceeds of the loans. However, the mortgage is an all-encompassing mortgage; therefore, if the value of the pledge asset is insufficient to satisfy the debt, then the mortgagee can look to other assets to satisfy the debt. The pledge assets would include a central office building, a central office, central office switch additions in five exchanges, 77 DLC sites, DSL equipment additions in six exchanges, 37 standby generators, an FAA microwave system, 250 miles of fiber, and computer equipment.

Financial Analysis

Staff's analysis is based on the audited financial statements for the year ended June 30, 2003. The attached Schedule AXR-1 presents selected financial information from the Applicant's financial statements and pro forma information reflecting the issuance of the proposed \$11,235,000 (RUS at 5 percent annual interest rate) and \$6,540,450 (RTB at 5 percent annual interest rate) loans for a total of \$17,775,450. The Schedule also presents adjusted and pro forma operating income, debt service coverage ratio ("DSC"), times interest earned ratio ("TIER") and capital structure assuming a 100 percent drawdown of the funds.

Table Top's capital structure was composed of 8.5 percent short-term debt, 49.5 percent long-term debt, and 42.0 percent equity at June 30, 2003. The Applicant's capital structure would change to 6.1 percent short-term debt, 73.7 percent long-term debt and 20.2 percent equity as a result of issuing the entire proposed \$17,775,450 debt. According to *Standard & Poor's Corporate Ratings Criteria* (2003), the median debt ratio for utilities with a rating of BBB is 62.6 percent. Instant issuance of the entire proposed loans would result in a capital structure that is more leveraged than other investment grade utilities.

The debt service coverage ratio 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 times interest earned ratio represents the number of times earnings will cover interest expense on a long-term debt. A TIER greater than 1.0 means that operating income is greater than interest expense.

Schedule AXR-1, column B reflects the pro forma effect of the proposed loans on the Applicant's financial ratios. The proposed \$17,775,450 loans at five (5) percent per annum would produce a TIER of 1.16, and a DSC of 1.20. These pro forma ratios indicate that Table Top has adequate earnings and cash flows to meet all obligations.

The Applicant has submitted a schedule (Table Top's Debt and Equity Projections Attachment) showing its projected debt and equity for the next five years. According to this schedule, Table Top is not planning an immediate 100 percent drawdown of the proposed debt. The Applicant is planning to draw down 13.95 percent of the proposed debt in 2004, 9.42 percent in 2005, 18.93 percent in 2006, 29.54 percent in 2007 and 28.16 percent in 2008. Table Top's schedule also shows that the Applicant is planning to increase its equity through retained earnings in the next five years. The attached Schedule AXR-2 presents the Applicant's projected five-year capital structure. Table Top's capital structure would not be more leveraged than normal throughout the five years if the Applicant's debt and equity projections are correct. However, projections are uncertain and the applicant's projected earnings and equity growth may not be realized.

Compliance

There were no compliance issues with the Applicant as of March 17, 2004.

Conclusion and Recommendations

Staff concludes that instant issuance of the entire \$17,775,450 debt on the terms described in the filing may result in a capital structure that is more leveraged than normal, a condition that is not compatible with sound financial practices. However, the Applicant's debt and equity projections provide for a capital structure that is reasonably balanced.

Staff concludes that issuance of \$17,775,450 debt on the terms described in the filing is for lawful purposes, within Table Top's corporate powers, compatible with the public interest, compatible with sound financial practices and will not impair its ability to provide public service.

Staff recommends approval of Table Top's request for authorization to borrow \$11,235,000 from the RUS and \$6,540,450 from the RTB on the terms and conditions described in the application, subject to the condition that subsequent to any drawdown from the proposed loans the Applicant's capital structure must consist of no less than 35 percent equity.

Staff further recommends the Commission authorize the Applicant's pledge, mortgage, lien and/or encumbrance of its utility plant and assets as security for the loans as may be required by RUS and RTB.

Staff further recommends that Table Top should submit an annual status report to the Director of the Utilities Division summarizing the amount of loan drawn each year for each project under construction and/or completed during the preceding year. It should be due to the Director thirty (30) days after the end of the calendar year and will cease to be required after January 31, 2009.

Staff further recommends authorizing the Applicant to execute any documents necessary to effectuate the authorizations granted.

Staff further recommends ordering Table Top to provide to the Utilities Division Director copies of all executed financing documents within 60 days after the loan agreements are signed.

FINANCIAL ANALYSIS

Selected Financial Data

	[A] <u>6/30/2003 Normalized</u>		[B] <i>Pro Forma^a</i>	
1	Operating Income	\$ 1,230,678	\$ 1,230,678	
2	Depreciation & Amort.	\$ 2,564,392	\$ 2,564,392	
3	Income Tax Expense	\$ 532,242	\$ 532,242	
4				
5	Interest Expense	\$ 645,738	\$ 1,519,046	
6	Repayment of Principal	\$ 1,405,018	\$ 2,085,971	
7				
8				
9	TIER¹			
10	[1+3] ÷ [5]	2.73	1.16	
11	DSC			
12	[1+2+3] ÷ [5+6]	2.11	1.20	
15				
16				
17				
18	Short-term Debt	\$ 1,405,018	8.5%	\$ 2,085,971 6.1%
19				
20	Long-term Debt	\$ 8,181,427	49.5%	\$ 25,275,924 73.7%
21				
22	Common Equity	\$ 6,941,532	42.0%	\$ 6,941,532 20.2%
23				
24	Total Capital	\$ 16,527,977	100.0%	\$ 34,303,427 100.0%
25				
26				
27	^a Reflects effects of the proposed \$17,775,450 loans.			

FINANCIAL ANALYSIS [A]

Capital Structure (\$)

Year	Short-term Debt	Long-term Debt	Equity	Total
2004	\$ 45,484	\$ 2,354,427	\$ 7,623,369	\$ 10,023,280
2005	\$ 125,140	\$ 3,849,764	\$ 8,665,358	\$ 12,640,263
2006	\$ 224,715	\$ 6,881,405	\$ 10,007,676	\$ 17,113,797
2007	\$ 395,716	\$ 11,566,135	\$ 11,542,347	\$ 23,504,199
2008	\$ 606,366	\$ 15,802,579	\$ 12,834,541	\$ 29,243,487

Capital Structure (Percent)

Year	Short-term Debt	Long-term Debt	Equity
2004	0.5%	23.5%	76.1%
2005	1.0%	30.5%	68.6%
2006	1.3%	40.2%	58.5%
2007	1.7%	49.2%	49.1%
2008	2.1%	54.0%	43.9%

[A] Based in the applicant's projected debt and equity for the next five years.

Table Top Telephone Company

Projected Debt Information

Capital Lease

	Beg of Year Balance	Additions	Debt Retirement	End of Year Balance
2004	\$ 81,719.27	\$ -	\$ 75,167.05	\$ 6,552.22
2005	\$ 6,552.22	\$ -	\$ 6,552.22	\$ -
2006	\$ -	\$ -	\$ -	\$ -
2007	\$ -	\$ -	\$ -	\$ -
2008	\$ -	\$ -	\$ -	\$ -

RTFC Debt

	Beg of Year Balance	Additions	Debt Retirement	End of Year Balance
2004	\$ 8,757,838.57	\$ -	\$ 1,261,195.48	\$ 7,496,643.09
2005	\$ 7,496,643.09	\$ -	\$ 1,344,531.32	\$ 6,152,111.77
2006	\$ 6,152,111.77	\$ -	\$ 1,433,373.68	\$ 4,718,738.09
2007	\$ 4,718,738.09	\$ -	\$ 1,528,086.66	\$ 3,190,651.43
2008	\$ 3,190,651.43	\$ -	\$ 1,629,057.86	\$ 1,561,593.57

RUS Debt

	Beg of Year Balance	Additions	Debt Retirement	End of Year Balance
2004	\$ -	\$ 2,399,911.00	\$ 45,483.59	\$ 2,354,427.41
2005	\$ 2,354,427.41	\$ 1,620,477.00	\$ 125,140.16	\$ 3,849,764.25
2006	\$ 3,849,764.25	\$ 3,256,356.00	\$ 224,714.78	\$ 6,881,405.47
2007	\$ 6,881,405.47	\$ 5,080,446.00	\$ 395,716.22	\$ 11,566,135.25
2008	\$ 11,566,135.25	\$ 4,842,810.00	\$ 606,365.83	\$ 15,802,579.42

Total Debt

	Beg of Year Balance	Additions	Debt Retirement	End of Year Balance
2004	\$ 8,839,557.84	\$ 2,399,911.00	\$ 1,381,846.12	\$ 9,857,622.72
2005	\$ 9,857,622.72	\$ 1,620,477.00	\$ 1,476,223.70	\$ 10,001,876.02
2006	\$ 10,001,876.02	\$ 3,256,356.00	\$ 1,658,088.46	\$ 11,600,143.56
2007	\$ 11,600,143.56	\$ 5,080,446.00	\$ 1,923,802.88	\$ 14,756,786.68
2008	\$ 14,756,786.68	\$ 4,842,810.00	\$ 2,235,423.69	\$ 17,364,172.99

Table Top Telephone Company

Projected Equity Information

Owners Equity

	<u>Beg of Year Balance</u>	<u>Additions*</u>	<u>Reductions</u>	<u>End of Year Balance</u>
2004	\$ 6,938,289.34	\$ 685,080.00	\$ -	\$ 7,623,369.34
2005	\$ 7,623,369.34	\$ 1,041,989.00	\$ -	\$ 8,665,358.34
2006	\$ 8,665,358.34	\$ 1,342,318.00	\$ -	\$ 10,007,676.34
2007	\$ 10,007,676.34	\$ 1,534,671.00	\$ -	\$ 11,542,347.34
2008	\$ 11,542,347.34	\$ 1,292,194.00	\$ -	\$ 12,834,541.34

* From Projected Net Income

MEMORANDUM

T0: Alejandro Ramirez
Public Utilities Analyst I

FROM: Richard Boyles *RB*
Utilities Engineer

DATE: January 8, 2004

RE: TABLE TOP TELEPHONE COMPANY, INC. ENGINEERING REPORT
DOCKET NO. T-02724A-03-0750

This engineering report was prepared in response to the *APPLICATION OF TABLE TOP TELEPHONE COMPANY, INC. ("TTC, ") FOR AUTHORIZATION TO ASSUME NEW DEBT ("Application")*. On October 9, 2003, TTC filed its application requesting authorization to encumber its utility plant and assets in connection with new debt with the U.S. Department of Agriculture, Rural Utilities Service ("RUS") in the estimated amount of \$11,235,000 and the amount of \$6,540,450 from the Rural Telephone Bank ("RTB") for a combined total of \$17,775,450. The loan amounts for TTC are inclusive of the required purchase of Class B Rural Telephone Bank Stock (\$311,450).

After review of the Applications, supporting material submitted to RUS and the Company's responses to data requests, Staff has prepared its report for the Application. In general, the proceeds of the loans will be used for the following purposes:

1. provision of service to new subscribers (growth)
2. construction of a new central office building
3. modernization of outside plant facilities
4. modernization of interoffice facilities
5. acquisition of Computer Aided Design ("CAD") equipment
6. construction of new aerial and buried fiber optic cable
7. modernization of central office equipment
8. deployment of new service offerings such as broadband data for Internet access or video

An approximate general breakdown of the various construction categories as summarized in the Company's Applications allocates the loan proceeds as follows:

- | | |
|--|-----|
| - New central office equipment | 4% |
| - New fiber terminal equipment, digital loop carrier and DSLAM equipment | 21% |
| - New microwave facilities | 1% |
| - New outside plant facilities | 60% |
| - New emergency generator equipment | 2% |
| - New central office building | 1% |

- CAD equipment and other 2%
- Engineering 7%
- RTB Class B stock 2%

GROWTH

The loan application which TTC has submitted to RUS provides funding for the Company's plans over a 5 year period with December 31, 2002 as the baseline. Using historical growth data and other economic data the Company has developed a forecast for growth by exchange. The projected growth rates for TTC exchanges¹ vary between 2.9 and 12.4 percent with a composite rate of 7.3 percent. The composite growth rate for the previous six-year period was approximately 4.1 percent with individual exchanges varying between 2.3 and 15.2 percent.

The Company's have incorporated the results from these forecasts to determine where outside plant additions, new digital loop carrier deployment, interoffice facility additions, central office facility additions and miscellaneous other revisions to its network will be required. This forecasting process and network augmentation is normal business practice that is routinely performed by local exchange carriers on an ongoing basis.

In Staff's opinion, the Company's projections for growth, based in part upon anticipated new subdivision development, that may or may not materialize, and the resulting additional network requirements identified are within reasonable bounds.

MODERNIZATION

Modernization of the Company's infrastructure may facilitate meeting growth requirements, provisioning of new services, accommodating changes in the availability of equipment, and obtaining operating efficiencies from both a cost and performance perspective. While the Company's plans address all of these areas, there is also specific focus on obsolescence and service quality improvement.

Several of the Company's inter-office facilities utilize microwave radio systems that are manufacturer discontinued and tend to have high maintenance cost. Other inter-office facilities utilize copper T-1 circuits and are on routes that have been prone to extended outage durations. The new fiber optic facilities that are planned should provide improved service quality as well as additional capacity to accommodate growth and broadband services.

While the Company has not yet made a determination regarding a central office switch technology for Inscription Canyon Ranch, it has indicated that in lieu of a traditional circuit switched voice network it is considering use of a soft switch². Staff

¹ Excluding the new Inscription Canyon Ranch exchange which started serving customers in 1999.

² In general, a "soft switch" is a type of switch that supports open standards, is capable of a wide variety of voice, data and multimedia services, and tends to be less expensive and have a much smaller footprint as

concur that this trend has begun for carriers and is a solution that can efficiently integrate voice and data.

The Company also plans fiber connectivity and upgrades to its digital loop carrier (DLC) systems. In addition, new DLC sites will allow the Company to continue its plan to eliminate loaded plant whenever possible to improve service quality and enhance data capabilities. These upgrades, in addition to the interoffice facility and switching system upgrade discussed above, provide a basis that may allow the Company to expand its service offering to include services such as broadband data and streaming video. Staff concurs that there may be a desire for services of these types in rural communities just as there is in urban communities. However, TTC provided no analysis showing actual demand for these new services.

CONCLUSION AND RECOMMENDATION

Any concerns Staff might have, have in large part, been mitigated by several factors. First, the company does not have to draw the entire amount of the loan if a change in business objectives or growth occurs. Second, the RUS must approve the engineering design and equipment selection before funds can be used and the funds must be used for the purpose requested in the loan applications. Finally, the RUS performs an ongoing over-sight role of the projects.

Staff would recommend that if the Commission approves the Application, that the Order include a requirement for the Company to provide an annual status report to the Director of the Utilities Division summarizing the amount of loan drawn each year for each project under construction and/or completed during the preceding year. It should be due to the Director thirty (30) days after the end of the calendar year and will cease to be required after January 31, 2009.

It appears that the planned use of the proceeds of the loans is appropriate modernization and expansion of the Company's network and support assets. Therefore, Staff finds that the proposal of Table Top is reasonable and appropriate. Staff defers judgement of all aforementioned telephone facilities as "used and useful" until such time that the Companies apply for a rate adjustment. A more thorough review of facilities will be undertaken at that time.

opposed to the more traditional central office switch that provides voice-grade service on a circuit-switched basis.

THE ARIZONA REPUBLIC

NOTICE OF APPLICATION OF TABLE TOP TELEPHONE COMPANY FOR AUTHORITY TO BORROW MONEY (DOCKET NO. T-02724A-03-0750)

On October 9, 2003, Table Top Telephone Company ("Company") filed an application ("Application") with the Arizona Corporation Commission ("Commission") in Docket No. T-02724A-03-0750 for authority to borrow \$11,235,000 from Rural Utilities Services under \$6,540,450 from Rural Telephone Bank to finance new construction, upgrades and capacity enhancements within the Company's telephone exchanges at Agula, Ajo, Bagdad, Inscription, Canyon Ranch, Sanders and Seligman.

The Commission may act on the Application with or without a hearing. The Application is available for inspection during regular business hours at the Commission's offices at 1200 West Washington Street, Phoenix, Arizona 85007, or at the offices of Table Top Telephone Company, 600 North Second Avenue, Ajo, Arizona, 85321.

Intervention in the Commission's proceedings on the Application shall be permitted to any person entitled by law to intervene and having a direct and substantial interest in this matter. Persons desiring to intervene must file a motion to intervene with the Commission which must be served upon the applicants and which, at a minimum, must contain the following information:

1. The name, addresses and telephone number of the proposed intervenor, and of any person upon whom service of documents is to be made (if different than the intervenor);
2. A short statement of the proposed intervenor's interest in the proceeding;
3. Whether the proposed intervenor desires a formal evidentiary hearing on the application and the reasons for such a hearing;
4. A statement certifying that a copy of the motion to intervene has been mailed to the applicants.

The granting of motions to intervene shall be in accordance with A.A.C. R14-3-105. The Commission does not discriminate on the basis of disability in admission to its public meetings. Persons with a disability may request reasonable accommodations such as a sign language interpreter, as well as request this document in an alternative format, by contacting Yvonne McFarlin, ADA Coordinator, voice phone number 602-547-3931, email ymcfarlin@ccr.state.az.us. Requests should be made as early as possible to allow time to arrange the accommodation.

1576-November 17, 2003

STATE OF ARIZONA }
COUNTY OF MARICOPA } SS.

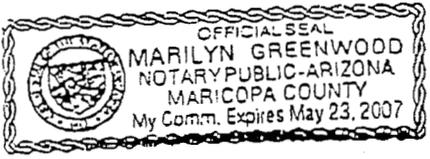
Gloria Saldivar, being first duly sworn, upon oath deposes and says: That she is a legal advertising representative of the Arizona Business Gazette, a newspaper of general circulation in the county of Maricopa, State of Arizona, published at Phoenix, Arizona, by Phoenix Newspapers Inc., which also publishes The Arizona Republic, and that the copy hereto attached is a true copy of the advertisement published in the said paper on the dates as indicated.

The Arizona Republic

November 17, 2003

Gloria Saldivar

Sworn to before me this
17TH day of
November A.D. 2003



Marilyn Greenwood
Notary Public