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COMMISSIONERS
JEFF HATCH-MILLER - Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

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ARIZONA CORPORATION COMMISSION

2005 JAN 19 P 2:07

DATE: January 19, 2005
DOCKET NO: W-02169A-04-0363

AZ CORP COMMISSION
DOCUMENT CONTROL

TO ALL PARTIES:

Enclosed please find the recommendation of Assistant Chief Administrative Law Judge Dwight D. Nodes. The recommendation has been filed in the form of an Opinion and Order on:

KEATON DEVELOPMENT COMPANY, INC.
(FINANCING)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by 4:00 p.m. on or before:

JANUARY 28, 2005

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Open Meeting to be held on:

FEBRUARY 8 AND 9, 2005

For more information, you may contact Docket Control at (602)542-3477 or the Hearing Division at (602)542-4250. For information about the Open Meeting, contact the Executive Secretary's Office at (602) 542-3931

Arizona Corporation Commission
DOCKETED

JAN 19 2005

BRIAN C. McNEIL
EXECUTIVE SECRETARY

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

IN THE MATTER OF THE APPLICATION OF
KEATON DEVELOPMENT COMPANY, INC.
FOR FINANCING AUTHORIZATION.

DOCKET NO. W-02169A-04-0363

DECISION NO. _____

OPINION AND ORDER

DATE OF HEARING:	December 16, 2004
PLACE OF HEARING:	Phoenix, Arizona
ADMINISTRATIVE LAW JUDGE:	Dwight D. Nodes
APPEARANCES:	Mr. William S. Scott, on behalf of Keaton Development Company, Inc.; and
	Mr. Jason Gellman, Staff Attorney, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

On May 13, 2004, Keaton Development Company, Inc. ("Keaton" or "Company") filed with the Arizona Corporation Commission ("Commission") an application seeking authorization to incur \$40,000 of long-term debt in the form of a loan from the Water Infrastructure Finance Authority ("WIFA").

On October 18, 2004, the Commission's Utilities Division Staff ("Staff") filed its Staff Report recommending denial of the application based on Staff's conclusion that the incurrence of additional debt by Keaton is not in the public interest.

On November 5, 2004, Keaton filed a letter disputing Staff's recommendation, as well as documents the Company contends support approval of its application. Keaton filed additional supporting documentation on November 8, 2004.

A Procedural Order was issued on November 17, 2004 scheduling this matter for hearing on

1 December 16, 2004, and directing the Company to mail notice of the application and hearing date to
 2 all customers and publish notice in a newspaper of general circulation in its service area.

3 On December 16, 2004, a hearing was convened before a duly authorized Administrative Law
 4 Judge of the Commission at its offices in Phoenix, Arizona. At the conclusion of the hearing, the
 5 matter was taken under advisement pending submission of a Recommended Opinion and Order.

6 * * * * *

7 Having considered the entire record herein and being fully advised in the premises, the
 8 Commission finds, concludes, and orders that:

9 **FINDINGS OF FACT**

10 1. Keaton Development Company is an Arizona corporation which owns and operates a
 11 public service corporation providing water utility service to 429 customers in Salome, Arizona, in La
 12 Paz County.

13 2. Keaton filed an application on May 13, 2004 seeking authority to incur \$40,000 in
 14 long-term debt through a loan from WIFA¹. The WIFA loan is expected to carry an interest rate of
 15 5.5 percent and would be repaid over a 20-year term with monthly payments of approximately \$275.
 16 The proceeds of the loan and grant from WIFA would be used to: develop a master plan to deal with
 17 future growth; upgrade the chlorination system; develop information on existing ground storage
 18 reservoirs; and provide backup electrical power for electricity outages by purchasing an on-site
 19 generator (Ex. S-1, at 1).

20 3. Keaton is owned by William Scott, who bought all the outstanding shares of common
 21 stock of the Company on March 4, 2003. Prior to Mr. Scott's purchase of the Company, the former
 22 owner (Mr. Matthews) had entered into a line extension agreement with a developer in Keaton's
 23 service area, Keller Retirement Community ("KRC"), but the agreement was not submitted to the
 24 Commission for approval. Mr. Scott described the terms of that agreement as "draconian in nature"
 25 because Keaton was required to pay 10 percent of the Company's entire gross revenues over 24
 26 years, rather than the standard line extension agreement terms of 10 percent of gross revenues only

27 _____
 28 ¹ According to the Company's consultant, Roderick Sebree, a \$35,000 grant from WIFA would also be given to Keaton in addition to the \$40,000 loan (Tr. 59).

1 from the connections served by the line extension over 10 years² (Tr. 8-9).

2 4. According to Mr. Scott, the Company's prior owner was able to make the refund
3 payments for only a short period of time and, after Keaton was approximately two years in arrears
4 under the line extension agreement, KRC sued the Company and was awarded a Superior Court
5 judgment of more than \$31,000. Mr. Scott testified that neither Mr. Matthews nor the Company had
6 the resources to pay the Superior Court judgment and, on March 4, 2003, Mr. Scott purchased Mr.
7 Mathews' interest in the Company and took over its operations (Tr. 9).

8 5. Shortly after the purchase, on June 23, 2003, Mr. Scott took the Company into Chapter
9 11 Bankruptcy and filed a Plan of Reorganization (Ex. A-3) that excluded liability for the judgment
10 owed to KRC. Mr. Scott claims that once the KRC liability was removed from Keaton's books, and
11 arrangements were made to resolve arrears on taxes owed to La Paz County, Keaton became a viable
12 company and is expected to show a profit for 2004 (Tr. 10). Mr. Scott testified that Keaton's Plan of
13 Reorganization has been approved by the Bankruptcy Court, but the Company has not received a
14 final decree from the court because its attorney is serving in the military in Iraq. Mr. Scott contends
15 that "[u]pon his return, the time has expired, everything is in order, and we will receive our final
16 decree at that point." (*Id.*).

17 6. On October 18, 2004, Staff filed its Staff Report recommending denial of the
18 financing application. Although Staff Engineering concluded that the stated purposes for the loan
19 proceeds (*i.e.*, growth planning, investigation of reservoirs, chlorination project, purchase of on-site
20 generator) were appropriate, Staff's financial analysis determined that Keaton is not currently a
21 viable candidate for additional long-term debt. According to Staff's analysis, Keaton reported
22 revenues of \$151,525 for the year ending December 31, 2003, but experienced an operating loss of
23 \$16,228 for that time period. Staff claims that Keaton's existing capital structure is comprised
24 completely of debt due to its negative equity position. Staff calculated the Company's times interest
25 earned ratio ("TIER") to be negative 1.70 and its debt service coverage ("DSC") ratio to be 1.15³ (Ex.
26

27 ² As set forth in Arizona Administrative Code ("A.A.C.") R14-2-406(D)

28 ³ The TIER represents the number of times earnings will cover interest expense on long-term debt. The DSC ratio represents the number of times internally generated cash will cover required principal and interest payments on long-term debt.

1 S-1, at 2).

2 7. On November 5, 2004, Keaton filed a letter and other attached documents disputing
3 Staff's conclusions (Ex. A-2). According to the Company, Staff's analysis fails to take into account
4 Keaton's improved financial condition as a result of its Bankruptcy Reorganization. Keaton claims
5 that, as of June 30, 2004, the Company had a pro forma net worth of more than \$119,000 and a debt
6 coverage ratio of 1.70. Mr. Sebree testified that actual revenues received by the Company during the
7 first four months of 2004 closely tracked projected revenues, with income of \$51,000 and net cash of
8 \$11,000 during that time period (Tr. 16). Based on the more recent financial information, Keaton
9 seeks approval of its proposed WIFA loan.

10 8. According to the Staff Report, Staff reviewed the Company's updated projections for
11 2004, but concluded that the information provided by Keaton was insufficient to support the proposed
12 debt in the absence of a documented history of profitability so soon after a Chapter 11 Bankruptcy,
13 especially in the absence of a final decree from the Bankruptcy Court. Staff suggests an infusion of
14 equity capital as an alternative to incurring additional long-term debt (Ex. S-1, at 2). At the hearing,
15 Staff witness Jim Johnson reiterated Staff's concerns with the recent bankruptcy filing, the lack of a
16 final decree from the Bankruptcy Court, and the use of pro forma financial data (Tr. 36). Mr.
17 Johnson conceded that removal of approximately \$22,000 in non-recurring costs related to the
18 Company's bankruptcy would significantly improve Keaton's coverage ratios (Tr. 38-39). However,
19 even if the Bankruptcy Court had issued a final decree regarding Keaton's Plan of Reorganization,
20 Mr. Johnson expressed ongoing concern with the lack of actual operating expenses and revenues as a
21 basis for obtaining an accurate portrayal of the Company's financial health (Tr. 40-43).

22 9. Pursuant to A.R.S. §40-301(A), a public service corporation must obtain the
23 Commission's approval prior to issuing stocks, bonds, notes and other evidences of indebtedness.
24 A.R.S. §40-301(C) provides as follows:

25 The commission shall not make any order or supplemental order granting
26 any application as provided by this article unless it finds that such issue is
27 for lawful purposes which are within the corporate powers of the
28 applicant, are compatible with the public interest, with sound financial
practices, and with the proper performance by the applicant of service as a

1 public service corporation and will not impair its ability to perform that
2 service.

3 10. We agree with Staff's concerns regarding Keaton's financial status at this time. The
4 relatively rosy financial picture portrayed in the Company's supporting documents is based almost
5 entirely on pro forma data, even though Keaton claims that its recent actual revenues and expenses
6 are closely tracking those prior projections. Although the Company's witness stated that the judge in
7 the bankruptcy case has approved the Plan of Reorganization, we are concerned that the Company
8 has not received a final decree from the Bankruptcy Court. At the hearing, Keaton introduced only
9 its original filing with the court (Ex. A-3), but did not produce any subsequent documentation as to
10 the status of the bankruptcy case.

11 11. Given the uncertainties that currently exist in the record, we do not believe it would be
12 in the public interest, at this time, to grant the financing approval requested by Keaton. We will,
13 however, keep this docket open for an additional 180 days to allow the Company an opportunity to
14 submit additional documentation to support its financing request. If Keaton wishes to supplement its
15 application, it must file, within 90 days of this Decision, a final decree from the Bankruptcy Court, a
16 minimum of six months of actual audited revenue and income data, and any other documentation
17 requested by Staff. Staff shall file within 45 days thereafter a revised Staff Report setting forth its
18 recommendation after reviewing the Company's updated information.

18 CONCLUSIONS OF LAW

19 1. Keaton Development Company, Inc. is a public service corporation within the
20 meaning of Article XV of the Arizona Constitution and A.R.S. §§40-301 and 40-302.

21 2. The Commission has jurisdiction over Keaton and the subject matter of the
22 application.

23 3. Staff's recommendation to deny approval of the financing application is reasonable
24 based on the totality of facts presented in the record of this proceeding.

25 4. Pursuant to A.R.S. §40-301(C), Keaton's application is not compatible with the public
26 interest or sound financial practices.

ORDER

1
2 IT IS THEREFORE ORDERED that the application of Keaton Development Company, Inc.
3 for authority to incur \$40,000 of long-term debt in the form of a loan from the Water Infrastructure
4 Finance Authority is denied.

5 IT IS FURTHER ORDERED that this docket shall remain open for an additional 180 days to
6 allow the Company an opportunity to submit additional documentation to support its financing
7 request. If Keaton wishes to supplement its application, it must file, within 90 days of this Decision,
8 a final decree from the Bankruptcy Court approving its Plan of Reorganization, a minimum of six
9 months of actual audited revenue and income data, and any other documentation requested by Staff.
10 Staff shall file within 45 days thereafter a revised Staff Report setting forth its recommendation after
11 reviewing the Company's updated information.

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1 IT IS FURTHER ORDERED that this docket shall be closed 180 days from the date of this
2 Decision unless otherwise ordered by the Commission.

3 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

4 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

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7 CHAIRMAN COMMISSIONER COMMISSIONER

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11 COMMISSIONER COMMISSIONER

12
13 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive
14 Secretary of the Arizona Corporation Commission, have
15 hereunto set my hand and caused the official seal of the
16 Commission to be affixed at the Capitol, in the City of Phoenix,
17 this ____ day of _____, 2005.

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19 _____
20 BRIAN C. McNEIL
21 EXECUTIVE SECRETARY

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1 SERVICE LIST FOR: KEATON DEVELOPMENT COMPANY, INC..

2 DOCKET NO.: W-02169A-04-0363

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