



BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

Arizona Corporation Commission

DOCKETED

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

SEP 09 2005

DOCKETED BY [Signature]

IN THE MATTER OF THE APPLICATION OF ARIZONA WATER COMPANY, AN ARIZONA CORPORATION, FOR AN ORDER AUTHORIZING THE EXECUTION OF A NEW LOAN AGREEMENT OR AMENDMENT TO AN EXISTING LOAN AGREEMENT AND THE DELIVERY OF A PROMISSORY NOTE IN CONNECTION THEREWITH.

DOCKET NO. W-01445A-05-0358

DECISION NO. 68118

ORDER

Open Meeting  
September 7 and 8, 2005  
Phoenix, Arizona

BY THE COMMISSION:

Having considered the entire record herein and being fully advised in the premises, the Arizona Corporation Commission ("Commission") finds, concludes, and orders that:

FINDINGS OF FACT

1. Arizona Water Company ("AWC" or "Company") is an Arizona Corporation that owns and operates water systems providing water service to approximately 73,000 customers located in Cochise, Coconino, Gila, Maricopa, Navajo, Pima, Pinal and Yavapai Counties in Arizona, pursuant to authority granted by the Commission.

2. AWC is a wholly owned subsidiary of Utility Investment Company, which is a wholly owned subsidiary of United Resources, Inc.

3. AWC charges rates approved in Decision Nos. 58120 (December 23, 1992) (Western Group), 64282 (December 28, 2001) (Northern Group), and 66849 (March 19, 2004) (Eastern Group).

4. On May 17, 2005, AWC filed the above-captioned application with the Commission requesting authorization to extend its current line of credit by means of one or more amendments to its existing loan agreement with Bank of America Arizona (the "Bank") through June 1, 2006 in an

1 amount not to exceed \$21.0 million.

2 5. On July 13, 2005, AWC filed certification that it caused notice of the application to be  
3 published in the *Arizona Republic* on June 6, 2005, and in the *Arizona Daily Star/Tucson Citizen* on  
4 June 6, 2005.

5 6. In the case of either a new loan agreement or an amendment to the existing loan  
6 agreement, AWC expects the terms and conditions of the line of credit to remain the same as those  
7 previously approved by the Commission. AWC established a \$9.0 million line of credit with the  
8 Bank in 1997, which was approved in Decision No. 60272 (July 2, 1997). Decision No. 64996 (June  
9 26, 2002) approved a loan to replace the 1997 loan agreement with a credit line of \$11.5 million  
10 ("2002 Loan Agreement"). Decision No. 66104 (July 25, 2003) approved the First Amendment to  
11 the 2002 Loan Agreement to increase the line of credit to \$15.0 million ("First Amendment"). The  
12 First Amendment to the 2002 Loan Agreement expired on June 1, 2004. In Decision No. 67274  
13 (October 5, 2004), the Commission authorized the Second Amendment to the 2002 Loan Agreement  
14 ("Second Amendment"). Under the current terms of the Second Amendment AWC's ability to draw  
15 on the \$15,000,000 line of credit expired on August 1, 2005. AWC stated that currently, the unpaid  
16 principal balance of all advances under the 2002 Loan Agreement, as amended, bears interest at the  
17 bank's reference rate minus .25 of a percentage point or at one of two optional rates<sup>1</sup> elected by the  
18 Company as provided by the First Amendment.

19 7. AWC stated that it needs to increase the line of credit in order to finance future  
20 construction, including arsenic treatment facilities and expansion of its water facilities and to  
21 maintain and continue a high quality of service to its customers. The Company requests authority to  
22 utilize the proceeds of the proposed line of credit to pay for construction of improvements and  
23 additions to the Company's utility plant within the State of Arizona and for the reimbursement of  
24 monies actually expended from the Company's treasury for such purposes.

25 8. AWC stated that as of March 31, 2005, the Company's short-term indebtedness was  
26 \$2,100,000.

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28 <sup>1</sup> The optional rates are equal to or less than the bank's reference rate minus .25 of a percentage point.

1           9.     On July 27, 2005 the Commission's Utilities Division Staff ("Staff") filed its Staff  
2 Report on the application, recommending approval.

3           10.    Staff stated that it examined AWC's 2004 construction budget and found the projects  
4 to be both reasonable and appropriate.

5           11.    Staff stated that under the terms of the proposed \$21.0 million line of credit through  
6 June 1, 2006, all advances will bear interest during each calendar month under one of three rates  
7 depending on the timing and amount of the draws. Staff stated that AWC may choose between one  
8 of three options: 1) the Bank's reference rate minus 0.25 percentage points; 2) a fixed rate to be  
9 determined by the Bank; or 3) an interest rate computed using a formula based on the London  
10 Interbank Offered Rate ("LIBOR")<sup>2</sup>.

11          12.    Staff stated that as of June 10, 2005, the rates under the three options were as follows:

12               Option 1: Reference Rate: 5.75

13               Option 2: Fixed rate on amounts not less than \$500,000 for periods of 30, 60, 90, 120,  
14 150 and 180 days:

- 15                   a. 30 days = 4.21 percent  
16                   b. 60 days = 4.30 percent  
17                   c. 90 days = 4.40 percent  
18                   d. 120 days = 4.46 percent  
19                   e. 150 days = 4.51 percent  
20                   f. 180 days = 4.57 percent

21               Option 3: LIBOR formula rate on amounts not less than \$500,000 for periods of 30,  
22 60, 90, 120, 150 and 180 days:

- 23                   a. 30 days:     3.21625 + 1.0 = 4.21625 percent  
24                   b. 60 days:     3.30813 + 1.0 = 4.30813 percent  
25                   c. 90 days:     3.40000 + 1.0 = 4.40000 percent  
26                   d. 120 days:    3.45563 + 1.0 = 4.45563 percent  
27                   e. 150 days:    3.51750 + 1.0 = 4.51750 percent  
28                   f. 180 days:    3.59188 + 1.0 = 4.59188 percent

29          13.    Staff performed an analysis of AWC's financial statements for the twelve-month  
30 period ended December 31, 2004.

31 \_\_\_\_\_  
32 <sup>2</sup> Staff explained that the formula is the LIBOR divided by the sum of 1.00 minus the Reserve Percentage, and that  
33 components of the formula are defined and discussed in detail in the 2002 Agreement.

1 14. As of December 31, 2004, AWC's capital structure consisted of 0.45 percent short-  
2 term debt,<sup>3</sup> 24.12 percent long-term debt, and 75.43 percent equity.

3 15. Staff's analysis showed that if AWC were to draw the entire \$21.0 million from the  
4 proposed line of credit, the resulting pro forma capital structure would consist of approximately 19.51  
5 percent short-term debt,<sup>4</sup> 19.51 percent long-term debt, and 60.99 percent equity.

6 16. The Debt Service Coverage ("DSC") ratio represents the number of times internally  
7 generated cash will cover required principal and interest payments on long-term debt. A DSC ratio  
8 greater than 1.0 means that operating cash flow is sufficient to cover debt obligations. A DSC less  
9 than 1.0 means that debt service obligations cannot be met from operations and that another source of  
10 funds is needed to avoid default.

11 17. The Times Interest Earned Ratio ("TIER") represents the number of times earnings will  
12 cover interest expense on short-term and long-term debt. A TIER greater than 1.0 means that  
13 operating income is greater than interest expense. A TIER of less than 1.0 is not sustainable in the  
14 long term but does not necessarily mean that debt obligations cannot be met in the short term.

15 18. Based on its analysis of the Company's December 31, 2004 financial results, Staff  
16 determined that the pro forma effect of AWC's proposed \$21.0 million line of credit if fully drawn  
17 would be a lowering of the Company's TIER from 5.76 to 4.43 and a lowering of the Company's  
18 DSC ratio from 6.88 to 5.52.<sup>5</sup> Staff stated that the pro forma TIER and DSC ratios show that the  
19 Company has adequate cash flow to make interest payments on the proposed line of credit.

20 19. Staff Engineering reviewed the Company's construction budget for the year 2005, and  
21 stated that without making any "used and useful" determination from which any conclusions should  
22 be inferred for ratemaking or rate base purposes, Staff found the estimated project costs provided by  
23 the Company to be reasonable and appropriate.

24 20. Based on its review and analysis, Staff concluded that the proposed financing is for  
25 lawful purposes, within AWC's powers as a corporation, compatible with the public interest,

26 <sup>3</sup> Includes \$0 in short-term debt and \$400,000 in current maturities on long-term debt as of December 31, 2004.

27 <sup>4</sup> Includes \$21,000,000 in short-term debt and \$400,000 in current maturities on long-term debt.

28 <sup>5</sup> The interest rate Staff used for short-term debt in its projection was 5.75 percent, the highest and most conservative interest rate option currently available under the proposed credit agreement. Staff's DSC calculation included no principal repayment on short-term debt and assumed that the principal would be refinanced when due.

1 consistent with sound financial practices and will not impair its ability to provide public service.  
2 Staff recommended approval of the Company's application for authorization to enter into a loan  
3 agreement with Bank of America Arizona for a line of credit through June 1, 2006, not to exceed  
4 \$21.0 million, at an interest rate not to exceed the Bank's reference rate minus 0.25 percentage  
5 points.

6 21. Staff stated that the Arizona Department of Environmental Quality ("ADEQ") and the  
7 Maricopa Environmental Services Department ("MCESD") regulate the water systems operated by  
8 the Company. Staff stated that based on data submitted by ADEQ and MCESD, it has determined  
9 that the Company's systems are currently delivering water that meets water quality standards required  
10 by Title 18, Chapter 4 of the Arizona Administrative Code.

11 22. The Company currently has a curtailment tariff on file that covers all its systems.

12 23. Staff's recommendations are reasonable and should be adopted.

13 **CONCLUSIONS OF LAW**

14 1. AWC is a public service corporation within the meaning of Article XV of the Arizona  
15 Constitution and A.R.S. §§ 40-281, 40-282, 40-301 and 302.

16 2. The Commission has jurisdiction over AWC and the subject matter of the application.

17 3. Notice of the application was given in accordance with the law.

18 4. The recommendations set forth in Findings of Fact No. 20 are reasonable and should  
19 be adopted.

20 5. The financing approved herein is for lawful purposes within AWC's corporate powers,  
21 is compatible with the public interest, with sound financial practices, and with the proper  
22 performance by AWC of service as a public service corporation, and will not impair AWC's ability to  
23 perform that service.

24 6. The financing approved herein is for the purposes stated in the application and is  
25 reasonably necessary for those purposes, and such purposes are not, wholly or in part, reasonably  
26 chargeable to operating expenses or to income.

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**ORDER**

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IT IS THEREFORE ORDERED that the application of Arizona Water Company for authority to increase its current line of credit to \$21.0 million and to extend its current line of credit by means of one or more amendments to its existing loan agreement with Bank of America Arizona through June 1, 2006, or in the alternative, to enter into a new loan agreement for a \$21.0 million line of credit through June 1, 2006, is hereby approved.

IT IS FURTHER ORDERED that such authority is expressly contingent on Arizona Water Company's use of the proceeds for the purposes set forth in its application.

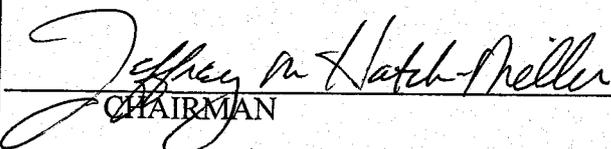
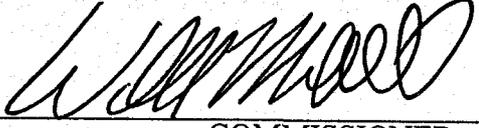
IT IS FURTHER ORDERED that Arizona Water Company is hereby authorized to engage in any transactions and execute any documents necessary to effectuate the authorization granted hereinabove.

IT IS FURTHER ORDERED that Arizona Water Company shall file with the Director of the Utilities Division, within 90 days of this Decision, a copy of all executed documents associated with the financing authorized herein.

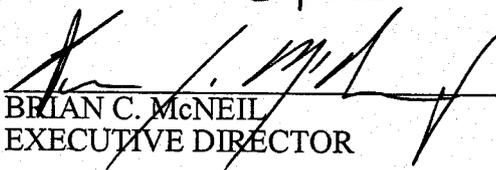
1 IT IS FURTHER ORDERED that the financing approved herein shall not guarantee or imply  
2 any specific treatment of any capital additions for rate base or rate making purposes.

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  
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10 COMMISSIONER COMMISSIONER COMMISSIONER

11 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive  
12 Director of the Arizona Corporation Commission, have  
13 hereunto set my hand and caused the official seal of the  
14 Commission to be affixed at the Capitol, in the City of Phoenix,  
15 this 9<sup>th</sup> day of Sept., 2005.

16   
BRIAN C. McNEIL  
EXECUTIVE DIRECTOR

17 DISSENT \_\_\_\_\_

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19 DISSENT \_\_\_\_\_

20 AB:mj

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1 SERVICE LIST FOR: ARIZONA WATER COMPANY

2 DOCKET NO.: W-01445A-05-0358

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