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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF WATER UTILITY OF GREATER BUCKEYE, INC., AN ARIZONA CORPORATION, FOR AUTHORITY TO ISSUE DEBT.

DOCKET NO. W-02451A-05-0615

EXCEPTIONS OF WATER UTILITY OF GREATER BUCKEYE, INC. TO STAFF'S RECOMMENDED ORDER

Water Utility of Greater Buckeye, Inc. ("WUGB"), pursuant to A.A.C. R14-3-110(B), respectfully files Exceptions to the Recommended Order ("RO") submitted December 16, 2005 in the above-captioned matter. As explained more fully herein, WUGB takes exception to:

1. Reducing the amount of authorization from $165,000 to $114,500;
2. Restricting distributions if WUGB's equity falls below 30% (based upon the Commission's rationale set forth in Decision No. 68336); and
3. The requirement that the plan to increase its equity to 40% filed by April 30, 2006 must be "acceptable to Staff." (WUGB takes no issue with filing a proposed plan by April 30, 2006. WUGB is only concerned that it be afforded due process before being deemed out of compliance with a Commission Decision in the event WUGB and Staff disagree on an appropriate plan).

BACKGROUND

WUGB owns and operates four separate potable water systems serving approximately 500 customers. WUGB has requested authorization to borrow $165,000 from the Water Infrastructure Finance Authority of Arizona ("WIFA"). These funds, together with $10,251 in local funding supplied by WUGB, are necessary to install $175,251 in treatment facilities at two WUGB wells that currently do not meet or exceed the new (10 ppb) arsenic standards established by the Environmental Protection Agency ("EPA") and the Arizona Department of Environmental Quality ("ADEQ").

In calendar year 2004, WUGB received $266,011 in operating revenues, resulting in operating income of only $13,242. When proforma operating expenses related solely to the operation of the arsenic treatment plant are taken into account, WUGB's operating income falls to a negative $656. However, even with the full $165,000 loan, WUGB's Debt Service Coverage ("DSC") will remain 3.41, well above the minimum 1.2 DSC required by WIFA.[1]

THE FULL LOAN AMOUNT SHOULD BE APPROVED

There is no dispute that (1) the facilities to be financed are necessary and appropriate for WUGB to fulfill its duty to the public WUGB serves, (2) the facilities are being installed to meet external governmental mandates, (3) WIFA financing is the cheapest

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[1] By Decision No. 64890 dated June 5, 2002, the Commission approved a $55,000 WIFA loan to fund the interconnection of two of WUGB's separate operating systems to increase redundancy and improve production capacity. The approval of that loan caused WUGB's DSC to decline from 3.34 to 2.78. The requested $165,000 loan still allows WUGB to maintain a higher DSC of 3.41.

source of funds available to WUGB, and (4) WUGB's DSC will be sufficient to pay the principal and interest on the full $165,000 loan. However, Staff and the RO recommend the Commission limit its authorization to $114,500 and that WUGB be required to finance the remaining construction with $50,500 of equity. In reality, WUGB would be required to pay $60,672, when WUGB's initial commitment is considered. Requiring WUGB stockholders to fund approximately 35% of plant installed solely to meet a governmental mandate is unreasonable, especially for a small system that already must absorb any cost increases, as well as locate funding to operate the treatment facilities until an adjustment in rates is authorized.[2]

The RO's recommendation to approve less than the full loan amount requested is driven by Staff's desire that WUGB maintain a capital structure with 30 percent equity. Yet Staff recognizes that the appropriate capital structure is determined by a number of factors, including, "but not limited to, the utility's access to capital, current level of debt, age of the system, management's experience, the adequacy of existing or proposed rates, etc." WUGB last received a rate adjustment six years ago by Decision No. 63092, dated November 19, 1999. It has less than $90,000 in other long-term debt, all of which has been approved by the Commission. Its internal cash flow cannot provide the equity portion of the funding suggested by the RO, while staying current on its debt and meeting operating expenses, including those associated with operating the new arsenic treatment. Moreover, utilizing equity will only necessitate higher rates. As the Commission is well aware, dollar amounts

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[2] Once the facility is installed, WUGB projects operating expenses associated with the treatment facilities will be more than $12,000 per year.

and equity levels are relative (i.e., small dollar amounts can have disproportionate impacts on the equity structure of small systems). WUGB capital structure totals only $133,938 before the addition of the approximately $175,251 in treatment facilities.[3]

As Staff and the RO have failed to justify limiting the loan to $114,500, the entire $165,000 loan should be approved.

Distributions Should Not Be Prohibited If Equity Falls Below 30%

In Decision No. 68336, dated December 9, 2005 involving the Valencia Water Company, Inc., this Commission found:

> "While the Commission is concerned about the under capitalization of public service companies, we do not believe that at this time Valencia's reduction in equity requires a restriction as recommended by Staff . . . Valencia's capital reverses as a consequence of financing the arsenic remediation project(s). If Valencia did not have to comply with the unfunded mandate of the Federal government to reduce the arsenic standard, Valencia's equity position would be very strong. Further there is no evidence in the record that Valencia has made any inappropriate distributions to principals or employees. As the record is devoid of any improper disbursements and since this company appears to be doing the right thing by complying with the Federal mandate, we do not believe in this instance it is necessary to restrict any distribution as recommended . . . We do believe, however, that Valencia should file an affidavit stating its current and prospective capital structure with the Commission."

While WUGB understands that its starting equity position is not as strong as

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[3] Equity is eroded through operating losses. Thus, WUGB's $496,848 of additional paid in capital is largely negated by $478,711.65 in negative retained earnings. Additionally, most of WUGB's plant has been financed through advances, which places the risk of success primarily on the developers where it belongs. Since these developments have been slow to materialize, only limited revenues have been generated and only a small portion of the original cost of the plant has been returned to the developer. Thus, had the systems been profitable more often and had the developments been more successful, WUGB's equity interest in the plant would be significantly greater than it is today.

was the case with Valencia, Staff does find its current 30% equity position acceptable under the circumstances. The weakening of WUGB's equity position, like that of Valencia, is directly attributable to the need to comply with an unfunded Federal mandate.[4] WUGB, like Valencia, is doing the right thing by complying with the Federal mandate and the record is devoid of any improper disbursements on the part of WUGB. Therefore, WUGB respectfully requests the Commission reject Staff's Recommendation set forth in Finding of Fact 19 and remove the requirement from the first ordering paragraph.

Requiring WUGB's Equity Plan Be Acceptable To Staff Is Inappropriate

WUGB has no objection to proposing and filing by May 1, 2006, a plan to increase its equity position to 40% over time. Such a plan will necessarily be dependent upon internal cash flow, growth and the level of rates approved by the Commission. This is not a case where the Commission has weighed a record developed regarding the pros and cons of a particular plan versus alternatives and rendered a decision on the appropriate plan. Rather, Staff as a condition of recommending approval of a loan, is unilaterally recommending that a plan be submitted. Under such circumstances, WUGB should not be placed in a position of possibly being in violation of a Commission order because there is a disagreement with Staff regarding what constitutes an appropriate plan. WUGB respectfully requests that the words "that is acceptable to Staff" be deleted from the third ordering paragraph.

[4] Staff projects WUGB's equity would fall to 13.10 percent if the entire $165,000 loan were approved.

Recommended Changes to RO

Based on the foregoing, WUGB recommends that the final Decision of the Commission contain the following amendments to the RO:

Amend Finding of Fact 25 to read:

25. While the Commission is concerned about the under capitalization of public service companies, we do not believe that at this time Applicant's reduction in equity requires us to limit our approval below the requested $165,000 or to impose the restriction recommended by Staff in Finding of Fact 19. Applicant's capital reverses as a consequence of financing the arsenic remediation project(s). If Valencia did not have to comply with the unfunded mandate of the Federal government to reduce the arsenic standard, Valencia's equity position would be consistent with our Decision No. 64890 where we last approved a financing request of Applicant. Further there is no evidence in the record that Applicant has made any inappropriate distributions to principals or employees. As the record is devoid of any improper disbursements and since Applicant appears to be doing the right thing by complying with the Federal mandate, we do not believe in this instance it is necessary to limit the amount of loan as recommended in Finding of Fact 16 and 17 or to restrict any distribution as recommended in Finding of Fact 19. We do believe, however, that Applicant should file an affidavit stating its current and prospective capital structure with the Commission. While the Commission at this time does not agree with the proposed restriction, Applicant is placed on notice that the Commission will review Applicant's capital structure and may, at a later date, impose similar conditions if the Commission is not satisfied that Applicant is making reasonable progress in strengthening its equity component of its capital structure."

Add Finding of Fact 26:

26. Staff's recommendations with the exception of Finding of Facts 16, 17 and 19 are reasonable. In the event Applicant's May 1, 2006 filing is not acceptable to Staff, Staff shall prepare a Staff report outlining the plans deficiencies. Applicant shall submit a plan addressing the deficiencies to Staff's satisfaction or, upon request of either Staff or Applicant, the Hearing Division shall set the matter

for an evidentiary hearing and make recommendations as to an appropriate plan.

Amend the First Ordering Paragraph by deleting "$114,500" and replacing it with "$165,000" and deleting everything after "approved."

Amend the Second Ordering Paragraph by deleting everything following "docket," and adding "an affidavit of its current and prospective capital structures."

Amend the Third Ordering Paragraph by deleting "that is acceptable to Staff,".

Amend the Fourth Ordering Paragraph by deleting "no less than" and adding "up to".

DATED this 27th day of December, 2005.

Curtis, Goodwin, Sullivan,
Udall & Schwab, P.L.C.

By: [signature]
William P. Sullivan, Esq.
Nancy A. Mangone
2712 North Seventh St.
Phoenix, AZ 85006-1090
Attorneys for Water Utility of Greater Buckeye, Inc.

PROOF OF AND CERTIFICATE OF MAILING

I hereby certify that on this 27th day of December, 2005, I caused the foregoing document to be served on the Arizona Corporation Commission by delivering the original and thirteen (13) copies of the above to:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

COPIES of the foregoing hand delivered this 27th day of December, 2005 to:

Christopher Kempley, Chief Counsel
Keith Layton
Legal Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Ernest G. Johnson, Director
Utilities Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Mary Walker