

EXCEPTION

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BEFORE THE ARIZONA CORPORATION COMMISSION RECEIVED

1
2 **WILLIAM A. MUNDELL**
3 **Chairman**

Arizona Corporation Commission

DOCKETED

2001 SEP -7 P 4: 35

3 **JIM IRVIN**
4 **Commissioner**

SEP 07 2001

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4 **MARC SPITZER**
5 **Commissioner**

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6 **IN THE MATTER OF THE APPLICATION)**
7 **OF DIVERSIFIED WATER UTILITIES,)**
8 **INC., AN ARIZONA CORPORATION, FOR)**
9 **AUTHORITY TO ISSUE DEBT.)**

Docket No. W-02859A-00-0964

**STAFF'S EXCEPTIONS TO THE
ADMINISTRATIVE LAW JUDGE'S
PROPOSED ORDER**

10 Diversified Water Utilities, Inc. ("Diversified") has filed a financing application,
11 seeking the Commission's approval to obtain a WIFA loan. The Administrative Law Judge has
12 issued a Proposed Order, approving the application but requiring Diversified to obtain additional
13 equity before it may draw funds from the WIFA loan. Staff respectfully disagrees with this
14 requirement for three reasons: 1) it may discourage small water companies from availing
15 themselves of WIFA loans, 2) it places too much emphasis on the Company's capital structure,
16 and 3) it treats Diversified differently than other utilities.

17 First, if the Commission requires water companies that have negative equity --and there
18 are many-- to infuse equity before drawing funds from WIFA loans, the companies may hesitate
19 or completely avoid availing themselves of WIFA funds. To the owners, such a requirement
20 would drive up the "cost" of any loan.

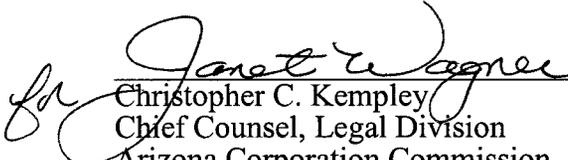
21 Second, the Proposed Order indicates that requiring the owners to infuse equity in the
22 Company will enhance the Company's likelihood of obtaining the WIFA loan because the capital
23 structure will be stronger. WIFA's primary interest, as is any bank's, is the Company's ability to
24 service the debt, not the Company's capital structure. This is based on the fact that a company's
25 capital structure reflects its entire financial history rather than only current financial health. To
26 illustrate how little significance this Commission and lending institutions have placed on capital
27 structure, Tucson Electric Power Company, Arizona Electric Power Cooperative, Graham
28 County Utilities, Dragoon Water Company, Cienega Springs Water Company, and Shepard

1 Water Company, among many others, have obtained debt at reasonable terms, as well as
2 Commission approval of that debt, when their capital structures were comprised of negative
3 equity and over one-hundred percent debt.

4 Third, and finally, the Proposed Order may ultimately result in higher rates. Although
5 the Proposed Order concludes that infusing equity in place of an equal amount of debt will
6 reduce the impact on rates, this conclusion implies that equity carries a zero cost. This
7 Commission has long recognized the financial precept that the cost of equity is higher than the
8 cost of debt. Depending on how the Commission sets rates in Diversified's next rate case, an
9 infusion of equity could result in a higher cost of capital and higher rates.

10 Staff believes that its recommendation that Diversified file a cash flow statement in July
11 2002, and a subsequent rate case if cash flow is shown to be insufficient, provides enough
12 protection to the ratepayers' interests and the Company's financial health. Staff continues to
13 support its recommendations as filed and incorporated into the attached amendments.

14 RESPECTFULLY SUBMITTED this 7th day of September, 2001.

15
16 
17 Christopher C. Kempley
18 Chief Counsel, Legal Division
19 Arizona Corporation Commission
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20 Original and ten copies of the foregoing
21 were filed this 7th day of September, 2001 with:

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

24
25 Copies of the foregoing were mailed and/or
26 hand-delivered this 7th day of September,
2001, to:

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UTILITIES DIVISION PROPOSED AMENDMENT 1

TIME/DATE PREPARED: September 7, 2001

COMPANY: DIVERSIFIED WATER UTILITIES, INC.

AGENDA NO.: U-9

DOCKET NO.: W-02859A-00-0964

OPEN MEETING DATE: September 11, 2001

Page 1, Line 28: **INSERT:**

After the filing of the proposed Order in this matter, the Company filed two letters, one on August 24, 2001 and the other on August 31, 2001, regarding the Company's current financial status.

Page 6, Line 17 **INSERT:**

Based on increased revenues since January 1, 2001 and the Company's projections of future revenues, the Company believes it can now support the entire debt service requirements without reliance on hook-up fees.

After receiving and reviewing the Company's August 24th and August 31st letters, Staff has not changed its recommendations.

Page 6, Line 17 through page 7 line 25 **DELETE.**

Page 10, line 14 **DELETE:** the word "not"

Page 10, Line 15, **DELETE:** the word "not"

Page 10, Lines 17 through 12 **DELETE**

Page 10, Lines 28 through Page 11, Line 5 **DELETE**

Page 11, Line 22 **DELETE:** (,) after "draw". **Insert** (.) after "draw".

Page 11, Line 22. through 26 **DELETE:** "only" through and including "purpose"

Page 11, Line 22 **INSERT:**

IT IS FURTHER ORDERED that Diversified Water Utilities, Inc. is hereby authorized to obtain \$58,428 in unsecured long-term financing from Skyline Vista Ranch, L.L.C. at terms of 8.0 percent interest with repayment over five years.