



ORIGINAL

BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MIKE GLEASON
KRISTIN K. MAYES
GARY PIERCE

2007 APR 11 P 3:20

AZ CORP COMMISSION
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IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS MOHAVE WATER AND WASTEWATER DISTRICTS

DOCKET NO. WS-01303A-06-0014

ARIZONA-AMERICAN WATER COMPANY

REPLY TO STAFF'S COMMENTS

1 Arizona-American Water Company hereby replies to Staff's "Clarifying Comments To
2 Recommended Opinion And Order."

3 **THE ALJ CORRECTLY USED A HYPOTHETICAL CAPITAL STRUCTURE**

4 Staff argues that a hypothetical capital structure should not be used for setting Arizona-
5 American's rates unless a corresponding reduction to the authorized return on equity is made to
6 reflect reduced financial leverage. However, the Administrative Law Judge has already fully
7 considered and rejected this argument.

8 Arizona-American has only been able to forestall further equity erosion by taking two
9 drastic steps—steps that no other financially troubled Arizona utility has been willing to take:

- 10 1. The Company has requested and received a \$35 million cash contribution from its equity
- 11 shareholder—a likely impossible feat for any other publicly-traded Arizona utility; and
- 12 2. The Company has suspended all shareholder dividends.

13 Arizona-American has asked the Commission to further help the Company maintain its equity
14 position by basing rates on a hypothetical capital structure. Staff has previously recommended,
15 and the Commission has previously approved, use of a hypothetical capital structure for

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16 UniSource and Southwest Gas, two other companies in financial distress.¹ The ALJ agreed with
17 Arizona-American's request in this case.

18 Even though it would withhold use of a hypothetical structure for Arizona-American,
19 Staff rather off-handedly suggests that Arizona-American's parent could issue even more new
20 equity to improve Arizona-American's equity ratio.² First, Staff has never suggested, nor has the
21 Commission ordered, that any other publicly-traded utility in the state that claims financial
22 distress sell additional equity shares for the purpose of building equity—not TEP, not Southwest
23 Gas, not Qwest, and certainly not APS. At the same time, all of these utilities continue to pay
24 dividends, even though each dividend payment further reduces equity. Yet, despite Arizona-
25 American being the only utility in the state that has actually obtained additional equity
26 investment from its shareholder in the face of a dire financial situation, Staff suggests that
27 American Water inject even more equity into Arizona-American.

28 Staff also alleged that Arizona-American wants to exclusively "resort to a hypothetical
29 capital structure" to improve its equity ratio.³ As Arizona-American has shown, this is hardly
30 the case. In its testimony and its brief, Arizona-American discussed its equity plan and how it
31 has attempted to improve its equity ratio. Use of a hypothetical capital structure was only one of
32 eleven measures that the Company proposed to take to that end.⁴

33 Staff has repeatedly asked Arizona-American to improve its equity ratio. However, it
34 would withhold from Arizona-American one of the tools that Staff has offered to other distressed
35 Arizona utilities—use of a hypothetical capital structure—and ignore the extreme self-help
36 measures that only Arizona-American has taken, such as requesting and receiving additional
37 equity investment, and eliminating dividends.

38

¹ See direct testimony of Staff witness James J. Dorf in Docket No. E-0933A-04-0408, dated June 24th, 2005, and direct testimony of Staff witness Stephen G. Hill in Docket No. G-01551A-04-0876, dated July 26, 2005, as well as previous rate case dockets for Tucson Electric Power Company and Decision No. 68487, dated February 23, 2006 (Southwest Gas Corporation.).

² Staff Brief at 8:1-2.

³ *Id.* at 8:2-3.

⁴ Ex. A-6 at Ex. TMB-4.

39 RESPECTFULLY SUBMITTED on April 11, 2007.

40
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42
43
44 Craig A Marks *CRM*
45 Craig A. Marks
46 Craig A. Marks, PLC
47 3420 E. Shea Blvd
48 Suite 200
49 Phoenix, Arizona 85028
50 (602) 953-5260
51 Craig.Marks@azbar.org
52 Attorney for Arizona-American Water Company

53 Original and 13 copies **filed**
54 on April 11, 2007, with:

55
56 Docket Control
57 Arizona Corporation Commission
58 1200 West Washington
59 Phoenix, Arizona 85007

60
61 Copies of the foregoing **mailed**
62 on April 11, 2007, to:

63
64 Dwight D. Nodes
65 Assistant Chief Hearing Officer
66 Hearing Division
67 Arizona Corporation Commission
68 1200 West Washington St.
69 Phoenix, Arizona 85007

70
71 Keith A. Layton
72 Legal Division
73 Arizona Corporation Commission
74 1200 West Washington St.
75 Phoenix, Arizona 85007

76
77 Daniel W. Pozefsky
78 Residential Utility Consumer Office
79 1110 West Washington Street
80 Suite 220
81 Phoenix, Arizona 85007

82
83
84
85 By: Courtney Appelhaus
86 Courtney Appelhaus