

OPEN MEETING ITEM



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

ARIZONA CORPORATION COMMISSION

22

DATE: JULY 9, 2007  
DOCKET NO: WS-01303A-07-0145  
TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Marc E. Stern. The recommendation has been filed in the form of an Order on:

ARIZONA-AMERICAN WATER COMPANY, INC.  
(FINANCE)

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 ten (10) copies of the exceptions with the Commission's Docket Control at the address listed below by **4:00** p.m. on or before:

JULY 18, 2007

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 Commission's Working Session and Open Meeting to be held on:

JULY 24, 2007 and JULY 25, 2007

For more information, you may contact Docket Control at (602)542-3477 or the Hearing Division at (602)542-4250.

BRIAN C. McNEIL  
EXECUTIVE DIRECTOR

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AZ CORP COMMISSION  
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Arizona Corporation Commission  
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1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 COMMISSIONERS

3 MIKE GLEASON, Chairman  
4 WILLIAM A. MUNDELL  
5 JEFF HATCH-MILLER  
6 KRISTIN K. MAYES  
7 GARY PIERCE

8 IN THE MATTER OF THE APPLICATION OF  
9 ARIZONA-AMERICAN WATER COMPANY,  
10 INC., AN ARIZONA CORPORATION, FOR  
11 AUTHORITY TO INCUR LONG-TERM DEBT  
12 THROUGH ITS AFFILIATE, AMERICAN WATER  
13 CAPITAL CORPORATION.

DOCKET NO. WS-01303A-07-0145

DECISION NO. \_\_\_\_\_

**ORDER**

14 Open Meeting  
15 July 24 and 25, 2007  
16 Phoenix, Arizona

17 **BY THE COMMISSION:**

18 On March 8, 2007, Arizona-American Water Company, Inc. ("Arizona-American" or  
19 "Company") filed with the Arizona Corporation Commission ("Commission") an application for  
20 authority to incur long-term debt through its affiliate, American Water Capital Corporation  
21 ("AWCC").

22 \* \* \* \* \*

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

25 **FINDINGS OF FACT**

26 1. Pursuant to authority granted by the Commission, Arizona-American is a Class "A"  
27 Arizona public service corporation that provides water and wastewater utility services to customers in  
28 its various water and wastewater districts located in portions of Maricopa, Mohave, and Santa Cruz  
counties in Arizona. Arizona-American provides service to approximately 100,000 water customers  
and 50,000 sewer customers.

2. Arizona-American is a wholly-owned subsidiary of American Water Works, Inc.  
("AWW"). The ultimate parent of AWW is RWE AG ("RWE").

3. Arizona-American currently has three rate cases in progress for the following districts:

1 (1) Mohave Water and Wastewater, Docket No. WS-01303A-06-0014; (2) Anthem Water and  
2 Anthem/Agua Fria Wastewater, Docket No. WS-01303A-06-0403; and (3) Sun City Wastewater and  
3 Sun City West Wastewater, Docket No. WS-01303A-06-0491.

4 4. On March 8, 2007, Arizona-American filed an application with the Commission  
5 requesting permission to incur long-term debt in the amount of \$10,000,000 at an interest rate not to  
6 exceed 6.5 percent and for a term not to exceed 30 years. Arizona-American proposes to borrow the  
7 funds from its affiliate AWCC. AWCC is a subsidiary of Arizona-American's parent company,  
8 AWW, and is the primary funding vehicle for all of AWW's subsidiary utility companies.

9 5. On April 27, 2007, Arizona-American filed certification that it had caused to be  
10 published notice of its financing application in *The Arizona Business Gazette*, *The Nogales*  
11 *International*, and *The Mohave Valley Daily News*.

12 6. On May 14, 2007, the Commission's Utilities Division Staff ("Staff") filed its Staff  
13 Report in this matter, recommending approval of the financing request.

14 7. Arizona-American did not file a response to the Staff Report.

15 8. Arizona-American states that the purpose of the proposed debt is to finance the partial  
16 repayment of previously approved long-term debt to AWCC totaling \$25,000,000. According to the  
17 Staff Report, the Company owes this debt to AWCC from a single promissory note which AWCC  
18 intends to call early because RWE intends to return AWW to its prior status as a publicly traded  
19 United States corporation which it was when acquired by RWE. This corporate divestiture will be  
20 accomplished by means of an initial public offering ("IPO"). As part of this restructuring, AWW has  
21 agreed to provide \$15 million in new equity to refinance the remainder of Arizona-American's  
22 existing debt to AWCC.<sup>1</sup>

23 9. According to the Staff Report, Arizona-American anticipates a five to thirty year  
24 interest-only loan of \$10,000,000 at an interest rate not to exceed six and one-half percent per annum  
25 from AWCC, with all principal due at maturity. Staff states that the actual interest rate will be  
26 determined by market conditions at the time of the transaction. There are no expected financing costs

27 \_\_\_\_\_  
28 <sup>1</sup> On March 5, 2007, Arizona-American's Board of Directors unanimously approved a corporate resolution to borrow the \$10 million and refinance the existing note.

1 or issuance fees and AWCC has no coverage ratios for Arizona-American.

2 10. Staff based its financial analysis of the proposed debt on the Company's financial  
3 statements for the fiscal year ended December 31, 2006. Staff made pro forma adjustments assuming  
4 the repayment of the \$25 million note, the issuance of \$10 million of new debt, a \$15 million equity  
5 infusion and the issuance of \$6.45 million in previously authorized debt which has not yet been  
6 drawn.<sup>2</sup>

7 11. According to financial statements for the fiscal year ended December 31, 2006,  
8 Arizona-American's capital structure consisted of 36.1 percent equity, 59.8 percent long-term debt  
9 and 4.2 percent short-term debt. Following the proposed transactions, based on Staff's pro forma  
10 adjustments, Arizona-American's capital structure would consist of 39.6 percent equity, 56.3 percent  
11 long-term debt, and 4.1 percent short-term debt. Additionally, the proposed transaction brings  
12 Arizona-American closer to Staff's recommended minimum common equity ratio of 40 percent.

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

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

22 14. Cash Coverage Ratio ("CCR") represents the number of times internally generated  
23 cash covers required interest payments on short-term and long-term debt. A CCR greater than 1.0  
24 means that operating cash flow is greater than interest expense.

25 15. For the year ended December 31, 2006, Staff's financial analysis shows Arizona-  
26 American had a 0.44 TIER, a 2.22 DSC and a 2.22 CCR. Staff's pro forma analysis, reflecting the  
27

28 <sup>2</sup> See Decision No. 68994 (October 20, 2006).

1 effect of the AWCC debt proposed by Arizona-American assuming a 6.5 percent annual interest rate  
2 shows an increase to a 0.45 TIER, a 2.25 DSC and a 2.26 CCR.

3 16. Arizona-American's TIER results reflect that operating income would suffice to cover  
4 interest expense in the short-term, but not in the long-term. However, DSC results indicate that  
5 Arizona-American will be able to meet all short-term and long-term obligations with cash generated  
6 from operations. Therefore, operating cash flow is sufficient to cover both principal and interest  
7 payments on short-term and long-term debt obligations.

8 17. The Staff Report does not recommend any limitation of the terms the Company  
9 proposed in the application.

10 18. Staff recommends granting the requested authorization to incur \$10 million in long-  
11 term debt, authorizing the Company to execute any documents necessary to effectuate the  
12 authorization granted, and requiring a copy of executed loan documents to be filed with the  
13 Commission's Docket Control, as a compliance item, within 60 days of the effective date of this  
14 Decision.

15 19. Accordingly to the Staff Report, Arizona-American has no outstanding compliance  
16 issues with the Commission or any other regulatory agencies.

17 20. Staff's recommendations are reasonable and we will adopt them.

18 21. Because an allowance for the property tax expense of the Company is included in the  
19 Company's rates and will be collected from its customers, the Commission seeks assurances from the  
20 Company that any taxes collected from ratepayers have been remitted to the appropriate taxing  
21 authority. It has come to the Commission's attention that a number of companies have been  
22 unwilling or unable to fulfill their obligation to pay the taxes that were collected from ratepayers,  
23 some for as many as twenty years. It is reasonable, therefore, that as a preventive measure Arizona-  
24 American annually file, as part of its annual report, an affidavit with the Utilities Division attesting  
25 that the Company is current in paying its property taxes in Arizona.

#### 26 CONCLUSIONS OF LAW

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



1 IT IS FURTHER ORDERED that Arizona-American Water Company, Inc. shall annually  
2 file, as part of its annual report, an affidavit with the Utilities Division attesting that the Company is  
3 current in paying its property taxes in Arizona.

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

5 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.  
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7

8 CHAIRMAN \_\_\_\_\_ COMMISSIONER

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11 COMMISSIONER \_\_\_\_\_ COMMISSIONER \_\_\_\_\_ COMMISSIONER

12  
13 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive  
14 Director 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 \_\_\_\_\_, 2007.

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20 \_\_\_\_\_  
21 BRIAN C. McNEIL  
22 EXECUTIVE DIRECTOR

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1 SERVICE LIST FOR: ARIZONA-AMERICAN WATER COMPANY, INC.

2 DOCKET NO.: WS-01303A-07-0145

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4 Craig Marks  
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15 Utilities Division  
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