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1 **OPEN MEETING AGENDA ITEM** ARIZONA CORPORATION C  
2 **COMMISSIONERS**

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Arizona Corporation Commission 6670

DOCKETED

3 MIKE GLEASON, Chairman  
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AZ CORP COMMISSION  
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6 IN THE MATTER OF THE APPLICATION OF  
7 BEAVER DAM WATER COMPANY, INC., FOR  
8 A CERTIFICATE OF CONVENIENCE AND  
NECESSITY TO PRVIDE WASTEWATER  
SERVICE IN MOHAVE COUNTY, ARIZONA.

DOCKET NO. SW-03067A-06-0397

**STAFF'S MODIFICATIONS TO THE  
RECOMMENDED OPINION AND  
ORDER**

9 Staff generally supports the Recommended Opinion and Order ("ROO") dated February 25,  
10 2008 prepared by Administrative Law Judge Yvette Kinsey regarding Beaver Dam Water Company,  
11 Inc. for a Certificate of Convenience and Necessity. Staff recommends its adoption by the  
12 Commission with the following modifications.

13 First, the treatment of debt should be clarified. The ROO adopts a capital structure composed  
14 of 40 percent equity and 60 percent advances. Traditionally, the term "capital structure" is used to  
15 refer to a truncated version that includes only debt and equity. A more extended definition includes  
16 equity, debt, advances-in-aid-of-construction ('advances') and contributions-in-aid-of-construction  
17 ("contributions"). Examples of truncated and extended capital structures are illustrated below.

<u>Component</u>	<u>Capital Structure (Truncated)</u>	
Equity	\$ 60,000	75%
Debt	20,000	25%
Total	\$100,000	100%

<u>Component</u>	<u>Capital Structure (Extended)</u>	
Equity	\$ 60,000	60%
Debt	10,000	10%
Advances	10,000	10%
Contributions	20,000	20%
Total	\$100,000	100%

25 The adopted capital structure apparently uses the extended definitive since it includes  
26 advances. However since the adopted capital structure is silent regarding the debt component, it  
27 could conceivably be interpreted as 40 percent equity and 60 percent debt using the truncated  
28 definition and then providing for 60 percent of that total as advances. In order to avoid the potential

1 for misinterpretation, Staff recommends that the adopted percentages for each component (equity,  
2 debt, advances and contributions) of the capital structure be specified.

3 Staff did not explicitly specify the recommended percentage for each component of its  
4 extended capital structure in its Staff Report or during the hearing. Further, Staff did not explicitly  
5 state that its recommendation regarding capital structure included no debt authorizations. The  
6 following presents Staff's extended capital structure to clarify Staff position.

<u>Component</u>	<u>Capital Structure (Extended)</u>
Equity	70%
Debt	0%
Advances/Contributions	<u>30%</u>
Total	100%

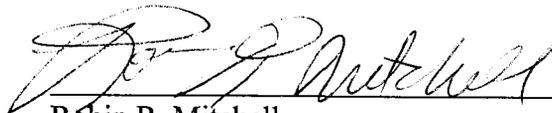
11 Second, Staff seeks to clarify the capital structure composed of 40 percent equity and 60  
12 percent advances adopted by the ROO. As shown above, Staff alternately recommends a capital  
13 structure composed of 70 percent equity; 0 percent debt; and 30 percent advances and/or  
14 contributions. A strong equity position is fundamental to the long-term financial health and the  
15 dedication of owners to the utility's operational efficiency and effectiveness. The need for a strong  
16 equity position leads Staff to its recommendation to limit advances and contributions to 30 percent of  
17 total extended capital. Debt is inappropriate for a utility with no history of proven profitability or  
18 demonstrated ability to pay debt service.

19 Lastly, the \$45 residential minimum monthly flat rate adopted by the ROO is inconsistent  
20 with the capital structure adopted by the ROO. The ROO adopted rates in combination with the ROO  
21 adopted capital structure of 40 percent equity, 0 percent debt, and 60 percent advances provides a  
22 projected 15.8 percent rate of return for year 5 of operations, while the adopted rate of return is only  
23 8.1 percent. In order to achieve the 8.1 percent rate of return recommended by Staff with the ROO's  
24 recommended capital structure, the monthly residential rate would have to be reduced from \$45 to  
25 \$40.65.

26 In summary, Staff suggests the following modifications to the ROO. First, the Order should  
27 explicitly state that no authorizations to issue debt are granted. Second, the Commission should  
28 adopt a capital structure composed of 70 percent equity, 0 percent debt, and 30 percent advances

1 and/or contributions to be consistent with the proposed authorized rates. The capital structure in the  
2 ROO composed of 40 percent equity and 60 percent advances is inconsistent with the rates adopted  
3 resulting in a return far exceeding that otherwise contemplated. Moreover, inadequate equity capital  
4 at start-up contributes to undermining the long-term financial health of a utility; it provides an  
5 insufficient earnings base for funding growth and future replacement of facilities; and discourages a  
6 long-term interest and commitment from owners. Therefore, a low initial level of equity  
7 capitalization is not in the public interest.

8 RESPECTFULLY submitted this 5<sup>th</sup> day of March, 2008.

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16 Original and thirteen (13) copies  
17 of the foregoing were filed this  
18 5<sup>th</sup> day of March, 2008 with:

19 Docket Control  
20 Arizona Corporation Commission  
21 1200 West Washington Street  
22 Phoenix, Arizona 85007

23 Copy of the foregoing mailed this  
24 6<sup>th</sup> day of 2008 to:

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28 Beaver Dam, Arizona 86432

