



0000095321

MEMORANDUM

ORIGINAL

TO: Docket Control
FROM: Ernest G. Johnson
Director
Utilities Division

EA for EGJ

DATE: April 10, 2009

RE: STAFF REPORT FOR SAHUARITA WATER COMPANY L.L.C. APPLICATION FOR AUTHORITY TO INCURE LONG-TERM INDEBTEDNESS TO FINANCE WATER SYSTEM IMPROVEMENTS (DOCKET NO. W-03718A-09-0122)

Attached is the Staff Report for the Company's application for authority to borrow funds from the Water Infrastructure Finance Authority of Arizona. Staff recommends approval.

Any party who wishes may file comments to the Staff Report with the Commission's Docket Control by 4:00 p.m. on or before April 20, 2009.

EGJ:JCM:tdp

Originator: Juan C. Manrique

Arizona Corporation Commission
DOCKETED

APR 10 2009

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DOCKET CONTROL

Service List for: Sahuarita Water Company L.L.C.
Docket No. W-03718A-09-0122

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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

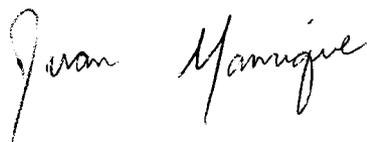
**SAHUARITA WATER COMPANY, L.L.C.
DOCKET NO. W-03718A-09-0122**

**APPLICATION FOR AUTHORITY TO
INCUR LONG-TERM INDEBTEDNESS**

APRIL 10, 2009

STAFF ACKNOWLEDGMENT

The Staff Report for Company, Docket No. W-03718A-09-0122 is the responsibility of the Staff members listed below. Juan C. Manrique is responsible for the financial analysis. Dorothy Hains is responsible for the engineering review.



JUAN C. MANRIQUE
PUBLIC UTILITIES ANALYST I



DOROTHY HAINS
UTILITIES ENGINEER – WATER/WASTEWATER

EXECUTIVE SUMMARY
SAHUARITA WATER COMPANY L.L.C.
DOCKET NO. W-03718A-09-0122

On March 16, 2009, Sahuarita Water Company L.L.C. ("Sahuarita" or "Company"), filed an application with the Arizona Corporation Commission ("Commission") requesting authorization to execute a loan agreement with the Water Infrastructure Finance Authority of Arizona ("WIFA").

The U.S. Congress enacted the American Recovery and Reinvestment Act of 2009 ("ARRA") on February 17, 2009. WIFA's *Supplemental 2009 ARRA Intended Use Plan* asserts that projects that receive ARRA funds will need to be capable of moving forward rapidly; hence, expedited regulatory consideration is appropriate.

The Company is a for-profit Class B Arizona public service corporation that owns and operates a public water utility in and around Sahuarita, AZ. The Company seeks a \$4,694,523 WIFA loan. However, the Company will receive \$1,880,000 of forgivable principal which reduces the repayable indebtedness to \$2,820,000. A 20-year amortizing loan at approximately 5 percent per annum is anticipated. The purpose of the loan is to fund construction of a 2,000 gallon per minute centralized arsenic treatment facility and related plant.

As of December 31, 2008, Sahuarita's capital structure consisted of 0.0 percent short-term debt, 0.0 percent long-term debt, and 100.0 percent equity. Staff calculated a pro forma capital structure reflecting issuance of a \$2,820,000 20-year amortizing loan at 5 percent per annum, and it is composed of 0.5 percent short-term debt, 17.5 percent long-term debt and 81.9 percent equity. Staff also calculated pro forma times interest earned ("TIER") and debt service coverage ("DSC") ratios of 2.90 and 4.04, respectively. The DSC results show that cash flow from operations is sufficient to cover all obligations.

Staff concludes that the Company's proposed capital projects are appropriate and that the related cost estimates are reasonable. Staff makes no "used and useful" determination of the proposed improvements nor any conclusions for rate base or ratemaking purposes

Staff further concludes that issuance of the proposed debt financing for the purposes stated in the application is within Sahuarita's corporate powers, is compatible with the public interest, is consistent with sound financial practices and will not impair its ability to provide services.

Staff recommends authorization to incur amortizing debt in an amount not to exceed \$2,820,000 (the difference between the \$4.7 million requested and the \$1.88 million of forgivable principal) for a period of 18-to-22 years and at a rate not to exceed that available from WIFA.

Staff further recommends authorizing Sahuarita to engage in any transaction and to execute any documents necessary to effectuate the authorizations granted.

Staff further recommends that the Commission authorize Sahuarita to pledge its assets in the State of Arizona pursuant to A.R.S. § 40-285 and R18-15-104 in connection with the WIFA loan.

Staff further recommends that Sahuarita file with Docket Control, as a compliance item in this matter, a copy of the loan documents within 60 days of the execution of any financing transaction authorized herein.

Staff further recommends that the Company file with Docket Control as a compliance item in this docket by December 31, 2010, copies of the Certificates of Approval of Construction issued by Arizona Department of Environmental Quality for the arsenic treatment plant and transmission mains.

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INTRODUCTION

On March 16, 2009, Sahuarita Water Company L.L.C. (“Sahuarita” or “Company”), filed an application with the Arizona Corporation Commission (“Commission”) requesting authorization to execute a loan agreement with the Water Infrastructure Finance Authority of Arizona (“WIFA”).

PUBLIC NOTICE

On April 3, 2009, the Applicant filed an affidavit of publication verifying public notice of its financing application. The Applicant published notice of its financing application in the *Arizona Daily Star* on March 29, 2009. The *Arizona Daily Star* is a daily newspaper of general circulation in the county of Pima, State of Arizona. The affidavit of publication is attached along with a copy of the Notice.

BACKGROUND

The U.S. Congress enacted the American Recovery and Reinvestment Act of 2009 (“ARRA”) on February 17, 2009. WIFA’s *Supplemental 2009 ARRA Intended Use Plan* shows that ARRA authorizes it to provide an additional subsidy on loans. In addition, the *Supplemental 2009 ARRA Intended Use Plan* asserts that projects that receive ARRA funds will need to be capable of moving forward rapidly; hence, expedited regulatory consideration is appropriate.

Sahuarita is a for-profit Class “B” Arizona public service corporation located in Sahuarita, Arizona. The Company owns and operates public water utilities in and around Sahuarita, in the County of Pima, State of Arizona.

COMPLIANCE

There are no compliance issues with Company.

PURPOSE AND DESCRIPTION OF THE REQUESTED FINANCING

The purpose of Company’s request for the WIFA loan is to fund construction of a 2,000 gallon per minute centralized arsenic treatment facility and related plant.

The Company requests that the Commission authorize it to secure financing in an amount not to exceed \$4,694,523 from WIFA. However, due to an anticipated \$1,880,000 of forgivable principal, the expected repayable indebtedness is \$2,820,000. Company expects a 20-year amortizing loan at 4.46 percent per annum. The current base interest rate on a WIFA loan is 5.25 percent. The base interest rate is calculated by using the current prime rate of 3.25 percent plus 2.00 percent. The interest rate for each debtor is determined by multiplying the base interest rate by a subsidy rate set by WIFA for each individual entity. Multiplying the 0.85 subsidy rate for Sahuarita by the 5.25 base interest rate yields an interest rate of 4.46 percent.

WIFA rule R18-15-104 requires borrowers to pledge their assets when borrowing funds from WIFA. A.R.S. § 40-285 requires public service corporations to obtain Commission authorization to encumber certain utility assets.

ENGINEERING ANALYSIS

The Staff Engineering Memorandum is attached. Staff reviewed the Company's proposed capital improvements and found the project costs appropriate and the related cost estimates reasonable. Staff makes no "used and useful" determination of the proposed improvements nor any conclusions for rate base or ratemaking purposes.

FINANCIAL ANALYSIS

Staff's analysis is illustrated on Schedule JCM-1. Column [A] reflects The Company's historical financial information for the year ended December 31, 2008. Column [B] presents pro forma financial information that modifies Column [A] to reflect a 20-year, \$2,820,000 amortizing loan at 5.0 percent per annum.

Times interest earned ratio ("TIER") and Debt service coverage ratio ("DSC")

TIER represents the number of times earnings cover interest expense on short-term and long-term debt. A TIER greater than 1.0 means that operating income is greater than interest expense. A TIER less than 1.0 is not sustainable in the long-term but does not mean that debt obligations cannot be met in the short-term.

DSC represents the number of times internally generated cash will cover required principal and interest payments on short-term and long-term debt. A DSC greater than 1.0 indicates that cash flow from operations is sufficient to cover debt obligations. A DSC less than 1.0 means that debt service obligations cannot be met by cash generated from operations and that another source of funds is needed to avoid default.

Schedule JCM-1, Column [A] shows that for the year ended December 31, 2008, the Company's TIER and DSC were 106.36 and 235.32, respectively. The pro forma TIER and DSC for the Company under the scenario described above for Column [B] are 2.90 and 4.04, respectively.

Capital Structure

At December 31, 2008, the Company's capital structure consisted of 0.0 percent short-term debt, 0.0 percent long-term debt, and 100.0 percent equity (Schedule JCM-1, Column [A], lines 17-25). Staff calculated a pro forma capital structure reflecting issuance of a \$2,820,000, 20-year amortizing loan at 5.0 percent per annum, and it is composed of 0.5 percent short-term debt, 17.5 percent long-term debt and 81.9 percent equity (Schedule JCM-1, Column [B], lines 20-26).

Capital Structure inclusive of AIAC and CIAC

At December 31, 2008, the Company's capital structure, inclusive of Advances-In-Aid-of-Construction ("AIAC") and Net Contributions-In-Aid-of-Construction ("CIAC")¹ consisted of 0.0 percent short-term debt, 0.0 percent long-term debt, 52.6 percent equity, 38.4 percent AIAC and 9.0 percent CIAC (Schedule JCM-1, Column [A], lines 31-41).

Encumbrance

Arizona Administrative Code ("A.A.C.") R18-15-104 requires WIFA borrowers to pledge their revenue sources to repay the financial assistance. A.R.S. § 40-285 requires public service corporations to obtain Commission authorization to encumber certain utility assets. The statute serves to protect captive customers from a utility's act to dispose of any of its assets that are necessary for the provision of service, thus, it serves to preempt any service impairment due to disposal of assets essential for providing service. Pledging assets as security typically provides benefits to the borrower in the way of increased access to capital funds or preferable interest rates, and it is often an unavoidable condition for procurement of funds for small or financially stressed entities.

CONCLUSION AND RECOMMENDATIONS

Staff concludes that the Company's proposed capital projects are appropriate and that the related cost estimates are reasonable. Staff makes no "used and useful" determination of the proposed improvements nor any conclusions for rate base or ratemaking purposes.

Staff further concludes that issuance of the proposed debt financing for the purposes stated in the application is within the Company's corporate powers, is compatible with the public interest, is consistent with sound financial practices and will not impair its ability to provide services.

Staff recommends authorization to incur amortizing debt in an amount not to exceed \$2,820,000 (\$4.7 million less \$1.88 million forgivable principal) for a period of 18-to-22 years and at a rate not to exceed that available from WIFA.

Staff further recommends authorizing the Company to engage in any transaction and to execute any documents necessary to effectuate the authorizations granted.

Staff further recommends that the Commission authorize Sahuarita to pledge its assets in the State of Arizona pursuant to A.R.S. § 40-285 and R18-15-104 in connection with the WIFA loan.

¹ Contributions in Aid of Construction less Amortization of Contributions in Aid of Construction.

Staff further recommends that the Applicant file with Docket Control, as a compliance item in this matter, a copy of the loan documents within 60 days of the execution of any financing transaction authorized herein.

Staff further recommends that the Company file with Docket Control as a compliance item in this docket by December 31, 2010, copies of the Certificates of Approval of Construction issued by Arizona Department of Environmental Quality for the arsenic treatment plant and transmission mains.

FINANCIAL ANALYSIS

| | [A] ¹ <u>12/31/2008</u> | | [B] ² <u>Pro forma</u> | |
|----|--|--------------|--------------------------------------|-----------------------|
| 1 | Operating Income | \$415,246 | | \$415,246 |
| 2 | Depreciation & Amort. | \$503,454 | | \$503,454 |
| 3 | Income Tax Expense | \$0 | | \$0 |
| 4 | | | | |
| 5 | Interest Expense | \$3,904 | | \$142,991 |
| 6 | Repayment of Principal | \$0 | | \$84,242 |
| 7 | | | | |
| 8 | | | | |
| 9 | TIER | | | |
| 10 | [1+3] ÷ [5] | 106.36 | | 2.90 |
| 11 | | | | |
| 12 | DSC | | | |
| 13 | [1+2+3] ÷ [5+6] | 235.32 | | 4.04 |
| 14 | | | | |
| 15 | | | | |
| 16 | | | | |
| 17 | | | | |
| 18 | Capital Structure | | | |
| 19 | | | | |
| 20 | Short-term Debt | \$0 | 0.0% | \$84,242 ³ |
| 21 | | | | 0.5% |
| 22 | Long-term Debt | \$0 | 0.0% | \$2,735,758 |
| 23 | | | | 17.5% |
| 24 | Common Equity | \$12,789,805 | 100.0% | \$12,789,805 |
| 25 | | | | 81.9% |
| 26 | Total Capital | \$12,789,805 | 100.0% | \$15,609,805 |
| 27 | | | | 100.0% |
| 28 | | | | |
| 29 | Capital Structure (inclusive of AIAC and Net CIAC) | | | |
| 30 | | | | |
| 31 | Short-term Debt | \$0 | 0.0% | \$84,242 |
| 32 | | | | 0.3% |
| 33 | Long-term Debt | \$0 | 0.0% | \$2,735,758 |
| 34 | | | | 10.1% |
| 35 | Common Equity | \$12,789,805 | 52.6% | \$12,789,805 |
| 36 | | | | 47.1% |
| 37 | Advances in Aid of Construction ("AIAC") | \$9,334,999 | 38.4% | \$9,334,999 |
| 38 | | | | 34.4% |
| 39 | Contributions in Aid of Construction ("CIAC") ⁴ | \$2,197,590 | 9.0% | \$2,197,590 |
| 40 | | | | 8.1% |
| 41 | Total Capital (Inclusive of AIAC and CIAC) | \$24,322,394 | 100.0% | \$27,142,394 |
| 42 | | | | 100.0% |
| 43 | AIAC and CIAC Funding Ratio ⁵ | 47.4% | | 42.5% |
| 44 | (37+39)/(41) | | | |
| 45 | | | | |
| 46 | | | | |

¹ Column [A] is based on the Company's Financial Statements for the year ended December 31, 2008.

² Column [B] is Column [A] modified to reflect issuance of the proposed \$2.82 million debt financing amortized for 20 years at 5.00 percent.

³ Pro Forma Short-term Debt represents the annual principal portion of the proposed loan.

⁴ Net CIAC balance (i.e. less: amortization of contributions).

⁵ Staff typically recommends that combined AIAC and Net CIAC funding not exceed 30 percent of total capital, inclusive of AIAC and Net CIAC, for private and investor owned utilities.

MEMORANDUM

DATE: April 3, 2009

TO: Juan Manrique
Public Utility Analyst

FROM: Dorothy Hains, P. E. *DH*
Utilities Engineer

RE: **Application of Sahuarita Water Company, LLC. For Authority to Incur Long-Term Indebtedness to Finance Water System Improvements**
Docket No. W-03718A-09-0122

Introduction and Background

On March 16, 2009, Sahuarita Water Company, LLC (“the Company”) filed with the Arizona Corporation Commission (“ACC”) a financing application requesting ACC approval of long-term financing in the amount of \$4,694,523 for the purchase of a centralized arsenic treatment facility and transmission mains necessary to transport water from the existing wells to the centralized arsenic treatment facility and to the Company’s storage tanks. The centralized arsenic treatment facility is estimated to cost \$2,686,523, and the transmission mains are estimated to cost \$2,008,000, for a total capital expenditure of \$4,694,523.

In 2007, the Company’s two existing production wells were tested and determined to be in compliance with the 10 parts per billion (“ppb”) of arsenic standard that went into effect in 2006. However, one of the wells was barely in compliance, because it tested at 9.9 ppb. Those same wells were tested again in 2008 and were found to be in excess of 10 ppb. In addition, during 2007 the Company initiated a well exploratory program, which was designed to enhance then Company’s water production capability and quality. The program results indicated that water produced from each of five exploratory wells that had been drilled would require arsenic treatment.

Under the Safe Drinking Water Act (“SDWA”) Reduced Monitoring Cycle program, 2010 will be the next arsenic concentration sample test year for the Company. Given the background of its existing production wells and the presence of elevated arsenic levels within its anticipated future sources of water supply, the Company concluded that it should implement arsenic treatment at this time, in order to ensure that the Company is in compliance with the SDWA and the Federal Environmental Protection Agency arsenic concentration regulations at all times, including the forthcoming 2010 sample test year.

Accordingly, the Company has contracted to construct a 2,000 gallon per minute (“GPM”) centralized arsenic treatment facility during 2009, which would be connected to the Company’s production wells by approximately 2.5 miles of transmission mains.¹

The Water Infrastructure Financing Authority (“WIFA”) has advised the Company that the centralized arsenic treatment facility will qualify for funding under the American Recovery and Reinvestment Act (“ARRA”).

System Analysis

The Company operates a water system that consists of two drinking water wells² (having a combined well capacity of 3,450 GPM), three storage tanks (having a combined capacity of 2,550,000 gallons). The Company serves an existing customer base of approximately 4,700 customers.³ Staff concludes that the Company has adequate capacity to serve its existing base of customers plus reasonable growth.

Arizona Department of Environmental Quality (“ADEQ”) Compliance Status

ADEQ has determined that Sahuarita is currently in full compliance with its requirements.⁴ ADEQ further states that Sahuarita is currently delivering water that meets the water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.

Arizona Department of Water Resources (“ADWR”) Compliance Status

Sahuarita Water Company is located in the Pima Active Management Area (“AMA”), as designated by ADWR. ADWR has determined that the Company is currently in compliance with departmental requirements governing water providers and/or community water systems⁵.

ACC Compliance Status

The Company is currently in compliance with prior ACC orders, a check of the Utilities Division Compliance database showed there were no delinquent compliance items for the Company.

¹ The proposed treatment facility includes four 10-ft diameter Layne manufactured vessels.

² The Company owns one well and leases another well.

³ According to data submitted, the Company served 4,669 customers at the end of January 2009.

⁴ ADEQ compliance status report dated May 30, 2008.

⁵ ADWR compliance status report dated June 23, 2008.

Cost

The Company estimates a total construction cost of \$4,694,523.

A general description of the costs is as follows:

| Project Description | Estimated Cost (\$) |
|--|----------------------------|
| Arsenic Treatment Plant | |
| One 2,000 GPM arsenic treatment plant (four 10-ft diameter vessels manufactured by Layne) | 1,505,910 |
| Transformer | 30,000 |
| Earth work/site design | 397,500 |
| Fiber optics (design/program) | 16,667 |
| Engineering (construction inspection) | 19,013 |
| Labor | 10,000 |
| Subtotal (Arsenic Treatment Facility) | 2,633,846 |
| Contingency | 52,677 |
| Total (Arsenic Treatment Facility) | \$2,686,523 |
| Transmission Mains | |
| Well #18 Mains | |
| Includes 24" DIP (349') @123\$/ft; 12" PVC (1,050') @80\$/ft; 24" PVC (4,005') @110\$/ft; 1" air relief valve @ 2,000\$/unit; 4" air relief valve @ 4,000\$/unit | 1,018,000 |
| Contingency | 204,000 |
| Subtotal (Well #18 Mains) | 1,222,000 |
| Well #14 Mains | |
| Includes 16" PVC (867') @100\$/ft; 24" PVC (2,513') @110\$/ft; 4" air relief valve @ 4,000\$/unit | 655,000 |
| Contingency | 131,000 |
| Subtotal (Well #14 Mains) | 786,000 |
| Total (Arsenic Treatment Facility & Mains) | 4,694,523 |

Staff concludes that the proposed project is appropriate and the cost estimates presented above are reasonable for purposes of this financing request. However, no "used and useful" determination of the proposed project item was made and no particular treatment should be inferred for rate making or rate base purpose in the future.

Construction Schedule

The Company plans to begin the construction of the transmission mains in May 2009. The construction of arsenic treatment plant is scheduled to begin in June 2009. According to the Company, all construction work will be completed by December 2009.

Staff recommends that the Company file with Docket Control as a compliance item in this docket by December 31, 2010, copies of the Certificates of Approval of Construction ("AOC") issued by ADEQ for the arsenic treatment plant and transmission mains.

Summary

I. Conclusions

1. ADEQ has determined that the Company is currently delivering water that meets the water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.
2. ADWR has determined that the Company is currently in compliance with departmental requirements governing water providers and/or community water systems.
3. The Company is currently is in compliance with prior ACC orders.
4. Staff concludes that the proposed project is appropriate and the cost estimates presented herein are reasonable for purposes of this financing request. However, no "used and useful" determination of the proposed project item was made and no particular treatment should be inferred for rate making or rate base purpose in the future.
5. The Company has adequate capacity to serve its existing base of customers plus reasonable growth.

II. Recommendations

1. Staff recommends that the Company file with Docket Control as a compliance item in this docket by December 31, 2010, copies of the Certificates of AOC issued by ADEQ for the arsenic treatment plant and transmission mains.

TUCSON NEWSPAPERS

Tucson, Arizona

STATE OF ARIZONA)
COUNTY OF PIMA)

Debbie Capanear, being first duly sworn deposes and says: that she is the Legal Advertising Representative of **TNI PARTNERS, DBA TUCSON NEWSPAPERS**, a General Partnership organized and existing under the laws of the State of Arizona, and that it prints and publishes the Arizona Daily Star and Tucson Citizen, daily newspapers printed and published in the City of Tucson, Pima County, State of Arizona, and having a general circulation in said City, County, State and elsewhere, and that the attached

Legal Notice

was printed and published correctly in the entire issue of the said Arizona Daily Star and Tucson Citizen on each of the following dates, to-wit:

March 29, 2009

Debbie Capanear

Subscribed and sworn to before me this 30 day of March, 2009

Silvia H. Valdez
Notary Public



SILVIA H. VALDEZ
Notary Public - Arizona
Pima County
Expires 12/15/09

My commission expires _____

TNI AD NO. 6685408

PUBLIC NOTICE OF AN APPLICATION FOR AN ORDER AUTHORIZING THE ISSUANCE OF SUBPOENAS (copy sent to all by Saltwater Water Company)
Saltwater Water Company, L.L.C. ("Company") filed an Application on March 11, 2009 with the Arizona Corporation Commission ("Commission") for an order authorizing Applicant to issue subpoenas to any person who has possession of water system facilities. The Application is available for inspection during regular business hours at the office of the Commission in Phoenix, Arizona, Tucson, Arizona, and the Company's office at 125 W. Via Encino, Saltwater, in Saltwater, Arizona, 85629. The Application has assigned Hearing Docket No. W-034124-09-0224.
Intervention in the Commission's proceedings on the Application shall be permitted to any person entitled by law to intervene and having a direct and substantial interest in this matter. Persons desiring to intervene must file a Motion to Intervene with the Commission which must be served upon the Company and which, if a motion, shall contain the following information:
1. The name, address and telephone number of the proposed intervenor and of any person upon whom service of process is to be made if different than the intervenor.
2. A short statement of the proposed intervenor's interest in the proceeding.
3. Whether the proposed intervenor desires a formal evidentiary hearing on the application and the reasons for such a hearing.
4. A statement certifying that a copy of the Motion to Intervene has been mailed to Applicant.
The granting of Motions to Intervene shall be governed by A.R.C. 14-1-102, which states that all Motions to Intervene must be filed on or before the 15th day after the notice.
Held on March 25, 2009
Arizona Daily Star