

ORIGINAL

OPEN MEETING ITEM



0000097208

COMMISSIONERS
KRISTIN K. MAYES - Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP



Interim Executive Director

ARIZONA CORPORATION COMMISSION

DATE: MAY 22, 2009
DOCKET NO: WS-01303A-09-0152
TO ALL PARTIES:

Arizona Corporation Commission

DOCKETED

MAY 22 2009

DOCKETED BY

Enclosed please find the recommendation of Administrative Law Judge Dwight D. Nodes. The recommendation has been filed in the form of an Order on:

ARIZONA-AMERICAN WATER COMPANY
(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 thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by 4:00 p.m. on or before:

JUNE 1, 2009

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 Open Meeting to be held on:

JUNE 11, 2009

For more information, you may contact Docket Control at (602)542-3477 or the Hearing Division at (602)542-4250. For information about the Open Meeting, contact the Executive Director's Office at (602) 542-3931.

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AZ CORP COMMISSION
DOCKET CONTROL

MICHAEL P. KEARNS
INTERIM EXECUTIVE DIRECTOR

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 COMMISSIONERS

3 KRISTIN K. MAYES, Chairman
4 GARY PIERCE
5 PAUL NEWMAN
6 SANDRA D. KENNEDY
7 BOB STUMP

8 IN THE MATTER OF THE APPLICATION OF
9 ARIZONA-AMERICAN WATER COMPANY FOR
10 AUTHORITY TO INCUR LONG-TERM DEBT
11 THROUGH THE WATER INFRASTRUCTURE
12 FINANCE AUTHORITY OF ARIZONA.

DOCKET NO. WS-01303A-09-0152

DECISION NO. _____

ORDER

13 Open Meeting
14 June 11, 2009
15 Phoenix, Arizona

16 **BY THE COMMISSION:**

17 Having considered the entire record herein and being fully advised in the premises, the
18 Arizona Corporation Commission ("Commission") finds, concludes, and orders that:

19 * * * * *

20 **FINDINGS OF FACT**

21 1. On March 25, 2009, Arizona-American Water Company ("AAWC" or "Company")
22 filed an application with the Commission for authorization to execute a loan agreement with the
23 Water Infrastructure Finance Authority of Arizona ("WIFA").¹

24 2. AAWC is a for-profit Class "A" Arizona public service corporation that provides
25 water service to approximately 100,000 customers and wastewater service to approximately 50,000
26 customers in parts of Maricopa, Mohave and Santa Cruz Counties, Arizona. The Company's Tubac
27 water district, which is the subject of the application in this case, provides water service to
28 approximately 532 customers in Santa Cruz County.

3. On May 5, 2009, the Company filed an affidavit of publication verifying that it

¹ This application was filed to take advantage of federal "stimulus" funds provided under the American Recovery and Reinvestment Act of 2009 ("ARRA"), the distribution of which is being administered by WIFA for capital projects undertaken by water and wastewater utilities in Arizona.

1 published notice of its application on April 26, 2009, in *The Green Valley News and Sun*, a
2 publication of general circulation in the Tubac area.

3 4. On May 13, 2009, the Commission's Utilities Division ("Staff") issued a Staff Report
4 recommending approval of the application subject to certain conditions.

5 5. On May 14, 2009, Staff filed an Amended Staff Report to correct a typographical error
6 contained in the original Staff Report.

7 6. On February 17, 2009, the ARRA went into effect. WIFA's *Supplemental 2009 ARRA*
8 *Intended Use Plan* shows that the ARRA authorizes WIFA to provide an additional subsidy on loans,
9 which can include forgivable principal and/or additional interest rate subsidies. In addition, the
10 *Supplemental 2009 ARRA Intended Use Plan* provides that projects that receive ARRA funds would
11 need to be capable of moving forward rapidly and, hence, expedited regulatory consideration is
12 appropriate.

13 7. In its application, AAWC requested a WIFA loan in the amount of \$2,300,000 to
14 finance an arsenic removal project for the Tubac water district that is needed comply with current
15 federal arsenic maximum contaminant levels ("MCL"). The federal MCLs require that arsenic levels
16 not exceed 10 parts per billion ("ppb").

17 8. According to the Staff Engineering Report, the Company's Tubac water district
18 currently utilizes three wells that contain varying levels of arsenic. Based on 2007 samples, Well No.
19 2.1 contained 24 ppb; Well No. 4.1 contained 36 ppb; and Well No. 5.1 contained 16 ppb of arsenic.
20 Under the arsenic remediation plan proposed by AAWC, water would be transported via a new 4,900
21 foot, 12-inch main from Well No. 4.1 to a centralized media arsenic removal treatment plant located
22 at the Well No. 5.1 site. Once this is accomplished, Well No. 2.1 would be taken out of service, and
23 water from Well Nos. 4.1 and 5.1 would be treated for distribution to customers. Major components
24 of the proposed plant include two 9-foot diameter, by 5-foot high, arsenic removal vessels
25 manufactured by Severn Trent. The treatment plant would be designed to treat 500 gallons per
26 minute ("GPM"), and the Company plans to alternate treatment between the two wells, each of which
27 has a flow rate of 500 GPM. AAWC's estimated costs, as set forth in the Staff Report, are as
28 follows:

	Project Description	Estimated Cost (\$)
1	Arsenic Treatment Plant & Transmission Line Planning & Design	
2	Hydraulic modeling study	20,786*
3	Design of a 500 GPM Arsenic Removal Facility & 4,900' transmission line	258,138*
4	Bidding Services	8,900*
5	Reimbursable items (prints, permit fees, title report fees, etc.)	8,500*
6	Construction Administration	53,700*
7	Subtotal	350,000
8	Arsenic Treatment Plant Construction	
9	Media	75,000*
10	Plant installation, piping, vessel transportation, earth work, concrete work including footing installation, backwash water holding basin installation, retaining basin installation, etc.	340,000*
11	Subtotal	415,000
12	Transmission & Distribution Line Construction	
13	Installation of 4,900' 12" PVC between Well #5.1 and Well #4.1	550,000*
14	Purchase of Arsenic Treatment Vessels	
15	Two 9'-Diameter, 5'-deep vessels (manufactured by Severn Trent)	150,000*
16	Land Acquisition	
17	Purchasing easement for transmission line project	30,000*
18	Other	
19	Including AFUDC, internal labor, overhead (labor & general)	455,000*
20	Contingency	
21	Contingency (18%)	350,000*
22	Total	2,300,000

Note: *Tax is included.

9. Staff indicates that based on its existing Tubac district customer base of approximately 590 customers², AAWC has adequate storage and well production to serve its existing customer base and reasonable growth. However, Staff expressed concern that the operation of the system at a maximum of 500 GPM, with the proposed alternating well plan for arsenic treatment, would leave the system short of storage capacity. Therefore, Staff recommends that the Company be required to install a minimum of 500,000 gallons of additional storage capacity by no later than April 30, 2010, as a condition of approval of the application in this case.

10. Staff indicates that there are currently four delinquent compliance issues for AAWC related to Decision No. 70209 (March 20, 2008). However, the Staff Report indicates that the Company has now submitted the delinquent items for Staff's review.

² As indicated above, AAWC's application states that its Tubac water district serves 532 customers. However, the Staff Report indicates that data submitted by the Company shows 588 customers as of December 2008.

1 11. AAWC requests that the Commission authorize it to secure WIFA financing in an
2 amount not to exceed \$2,300,000. Due to an anticipated \$1,150,000 of forgivable principal, pursuant
3 to WIFA's authority under its *Supplemental 2009 ARRA Intended Use Plan*, the Company expected
4 repayable indebtedness of \$1,150,000, with an anticipated 20-year amortizing loan and an interest
5 rate of 6.0 percent per annum.³

6 12. According to Staff, as of December 31, 2008, the Company's capital structure
7 consisted of 14.9 percent short-term debt, 46.5 percent long-term debt, and 38.6 percent equity.
8 Including Advances In Aid Of Construction ("AIAC") and net Contributions In Aid Of Construction
9 ("CIAC"), AAWC's capital structure consisted of 9.0 percent short-term debt, 27.9 percent long-term
10 debt, 23.1 percent equity, 28.6 percent AIAC and 11.4 percent CIAC.

11 13. Staff calculated a pro forma capital structure reflecting issuance of a \$2,300,000,
12 twenty-year amortizing loan, at an interest rate of 6.0 percent per annum, and determined that
13 AAWC's capital structure would be comprised of 14.9 percent short-term debt, 46.8 percent long-
14 term debt and 38.4 percent equity.

15 14. Staff's financial analysis shows that as of December 31, 2008, the Company had a
16 Times Interest Earned Ratio ("TIER") of 0.52, a Debt Service Coverage ("DSC") ratio of 1.25, and a
17 Cash Coverage Ratio ("CCR") of 2.24.⁴ The pro forma TIER, DSC and CCR for AAWC, assuming
18 issuance of the 20-year WIFA loan in the amount of \$2,300,000, at an interest rate of 6.0 percent per
19 annum, would be 0.52, 1.24, and 2.21, respectively. According to Staff, the pro forma DSC shows
20 that cash flow from operations is sufficient to cover all obligations, including WIFA's requirement to
21 fund a Debt Service Reserve Fund equal to 20 percent of debt service.

22 15. Arizona Administrative Code ("A.A.C.") R18-15-104 requires WIFA borrowers to

23 ³ According to Staff, the current base interest rate on a WIFA loan is 6.0 percent, and is calculated by using the current
24 prime rate of 3.25 percent plus 2.75 percent.

25 ⁴ TIER represents the number of times earnings cover interest expense on short-term and long-term debt. A TIER greater
26 than 1.0 means that operating income is greater than interest expense. A TIER less than 1.0 is not sustainable in the long
27 term but does not mean that debt obligations cannot be met in the short term. DSC represents the number of times
28 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 operating cash flow 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. CCR represents the number of times internally generated cash covers required interest payments on short-
term and long-term debt. A CCR greater than 1.0 means that cash flow from operations is greater than interest expense.

1 pledge their revenue sources to repay the financial assistance. A.R.S. § 40-285 requires public
2 service corporations to obtain Commission authorization to encumber certain utility assets. Staff
3 states that the statute serves to protect captive customers from a utility's act to dispose of any of its
4 assets that are necessary for the provision of service, and thus, it serves to preempt any service
5 impairment due to disposal of assets essential for providing service. Staff states further that pledging
6 assets as security typically provides benefits to the borrower in the way of increased access to capital
7 funds or preferable interest rates, and it is often an unavoidable condition of procuring funds for small
8 or financially stressed entities.

9 16. Staff concludes that issuance of the proposed debt financing for the purposes stated in
10 the application is within the Company's corporate powers, is compatible with the public interest, is
11 consistent with sound financial practices and will not impair its ability to provide service. Staff
12 recommends authorizing AAWC to incur debt in an amount not to exceed \$2,300,000, for a period of
13 18-to-22 years, pursuant to a loan agreement with WIFA that provides for 50 percent of the principal
14 amount to become forgiven upon compliance with the ARRA.

15 17. As a condition of approval, Staff recommends that the Company:

- 16
- 17 a. be authorized to engage in any transactions and to execute any
18 documents necessary to effectuate the authorizations granted
19 herein;
 - 20 b. be authorized to pledge its assets in the State of Arizona pursuant
21 to A.R.S. § 40-285 and A.A.C. R18-15-104 in connection with the
22 WIFA loan;
 - 23 c. that the authorization to incur debt granted by this Decision
24 terminate on December 31, 2012;
 - 25 d. be required to use its best efforts and to act in good faith to comply
26 with all the requirements of the American Recovery and
27 Reinvestment Act of 2009 and all requirements of WIFA in order
28 to obtain the 50 percent of forgivable principal;
 - e. be required to install, at a minimum, an additional 500,000 gallons
 of storage capacity prior to April 30, 2010;
 - f. file with Docket Control, as a compliance item in this docket,
 copies of the loan documentation within 60 days of the execution
 of any financing transaction authorized herein;
 - g. 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 the Arizona Department of Environmental

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Quality (“ADEQ”) for the arsenic treatment plant and transmission mains; and
h. that the Commission take the regulatory measures it deems appropriate due to any detrimental consequences to ratepayers that may result from the Company’s failure to use best efforts and act in good faith to comply with the ARRA that results in a reduction in the amount of the loan that would otherwise qualify as forgivable principal.

18. Staff recommendations are reasonable and should be approved.

CONCLUSIONS OF LAW

1. AAWC is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. §§ 40-285, 40-301, 40-302, and 40-303.

2. The Commission has jurisdiction over AAWC and of the subject matter of the application.

3. Notice of the application was given in accordance with the law.

4. The financing as approved herein is for lawful purposes within AAWC’s corporate powers, is compatible with the public interest, with sound financial practices, and with the proper performance by AAWC of service as a public service corporation, and will not impair AAWC’s ability to perform the service.

5. The financing approved herein is for the purposes stated in the application, is reasonably necessary for those purposes and such purposes may not be reasonably chargeable to operating expenses or to income.

6. Staff’s recommendations are reasonable and should be adopted.

ORDER

IT IS THEREFORE ORDERED that Arizona-American Water Company is hereby authorized to incur long-term indebtedness in an amount up to \$2,300,000 pursuant to a loan agreement with WIFA, under which 50 percent of the principal amount would become forgivable principal upon compliance with the American Recovery and Reinvestment Act of 2009, at an interest rate not to exceed the current WIFA subsidized rate at the time the loan is executed, for the purpose of funding an arsenic treatment plant and related facilities as described in the application.

IT IS FURTHER ORDERED that Arizona-American Water Company shall use best efforts

1 and act in good faith to comply with all requirements of the American Recovery and Reinvestment
2 Act of 2009 and all requirements of WIFA in order to obtain 50 percent of the principal amount as
3 forgivable principal.

4 IT IS FURTHER ORDERED that if Arizona-American Water Company fails to use best
5 efforts and to act in good faith to comply with the ARRA, resulting in a reduction of the amount of
6 the loan that qualifies as forgivable principal, the Commission shall take the regulatory measures it
7 deems appropriate, including but not limited to disallowing recovery for ratemaking purposes of the
8 amount of the loan that would otherwise have qualified as forgivable principal.

9 IT IS FURTHER ORDERED that the finance authority granted herein is expressly contingent
10 upon Arizona-American Water Company's use of the proceeds for the purposes stated in its
11 application and approved herein.

12 IT IS FURTHER ORDERED that Arizona-American Water Company is authorized to pledge
13 its assets in the state of Arizona pursuant to A.R.S. § 40-285 and A.A.C. R18-15-104 in connection
14 with the loan approved herein.

15 IT IS FURTHER ORDERED that Arizona-American Water Company is authorized to engage
16 in any transactions and to execute any documents necessary to effectuate the authorizations granted.

17 IT IS FURTHER ORDERED that Arizona-American Water Company shall file with Docket
18 Control, as a compliance item in this docket, copies of all executed financing documents related to
19 this authority within 60 days after the date of execution.

20 IT IS FURTHER ORDERED that Arizona-American Water Company shall file with Docket
21 Control, as a compliance item in this docket, by December 31, 2010, copies of the Certificates of
22 Approval of Construction issued by ADEQ for the arsenic treatment plant and transmission mains.

23 IT IS FURTHER ORDERED that that the authorization to incur debt granted by this Decision
24 shall terminate on December 31, 2012.

25 IT IS FURTHER ORDERED that Arizona-American Water Company shall install, at a
26 minimum, an additional 500,000 gallons of storage capacity prior to April 30, 2010.

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IT IS FURTHER ORDERED that approval of the financing set forth hereinabove does not constitute or imply approval or disapproval by the Commission of any particular expenditure of the proceeds derived thereby for purposes of establishing just and reasonable rates.

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

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN

COMMISSIONER

COMMISSIONER

COMMISSIONER

COMMISSIONER

IN WITNESS WHEREOF, I, MICHAEL P. KERNS, Interim Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this _____ day of _____, 2009.

MICHAEL P. KERNS
INTERIM EXECUTIVE DIRECTOR

DISSENT _____

DISSENT _____

DN:

1 SERVICE LIST FOR: ARIZONA-AMERICAN WATER COMPANY

2 DOCKET NO.: WS-01303A-09-0152

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