OPEN MEETING ITEM

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Executive Director

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

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ARIZONA CORPORATION COMMISSION

2010 MAR -3 P 1:58

ORIGINAL

DOCKET CONTROL

DATE: MARCH 3, 2010

DOCKET NO.: W-01380A-09-0106

TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Belinda A. Martin. The recommendation has been filed in the form of an Opinion and Order on:

RAY WATER COMPANY, INC.
(FINANCING)

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:

MARCH 12, 2010

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:

MARCH 31, 2010 AND APRIL 1, 2010

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.

Arizona Corporation Commission
DOCKETED
MAR - 3 2010
DOCKETED BY

ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

This document is available in alternative formats by contacting Shaylin Bernal, ADA Coordinator, voice phone number 602-542-3931, E-mail SABernal@azcc.gov

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF THE APPLICATION OF RAY WATER COMPANY, INC. FOR APPROVAL OF LONG-TERM FINANCING FOR REPLACEMENT OF AN EXISTING WELL.	DOCKET NO. W-01380A-09-0106 DECISION NO. _____ **OPINION AND ORDER**

DATES OF HEARING:	December 17, 2009
PLACE OF HEARING:	Tucson, Arizona
ADMINISTRATIVE LAW JUDGE:	Belinda A. Martin
APPEARANCES:	Mr. Hugh Holub, Esq., on behalf of Ray Water Company, Inc.; and Mr. Kevin O. Torrey, Staff Attorney, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

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

* * * * * * * * * * * * * *

FINDINGS OF FACT

1. The Commission granted Ray Water Company, Inc. ("RWC" or "Company"), its Certificate of Convenience and Necessity ("CC&N") to provide water service in Pima County, Arizona, pursuant to Decision No. 27546 (April 23, 1953). RWC is an Arizona 'C' corporation and a Class C public water utility, serving approximately 1,500 customers.

2. On March 11, 2009, RWC filed an application for approval of long-term financing in the amount of $500,000 for replacement of an existing well ("Application").

3. On March 26, 2009, RWC filed its Affidavit of Publication, indicating that Public Notice of its Application was published on March 17, 2009, in *The Daily Territorial.*

4. On September 18, 2009, the Commission's Utilities Division Staff ("Staff") filed its Staff Report recommending denial of the requested financing authorization. The Staff Report also set forth certain recommended terms and conditions with which the Company should comply if the Commission chooses to grant the Application.

5. On October 12, 2009, RWC filed a Request for Hearing in this matter.

6. On October 16, 2009, a Procedural Order was issued setting this matter for hearing on December 17, 2009.

7. On November 4, 2009, the Company filed an Affidavit of Publication indicating notice of the hearing had been published on October 26, 2009, in *The Daily Territorial.*

8. On December 17, 2009, a public hearing was held and the parties appeared through counsel. No members of the public appeared to provide public comment.

THE APPLICATION

9. In its Application, RWC states that it seeks approval of a $500,000 loan for the engineering and construction of the replacement of an existing well that the Company believes is on the verge of failing. The Company provided as part of its Application correspondence from WestLand Resources, Inc., Engineering and Environmental Consultants, delineating why it believed the well is in danger of failing and must be replaced.

10. RWC also attached to the Application copies of loan proposals from two local banks, both of which would require a security interest in RWC. Instead, the Company proposes to borrow $500,000 from R & M Real Estate Limited Partnership, L.L.P. ("R & M Real Estate"), which is a separate independent entity owned by the shareholders of RWC. The terms of the proposed loan are similar to those proposed by the two lenders.

11. RWC is a family-owned company and current board members are its general manager, Rhonda Mallis Rosenbaum, her husband, Joe Rosenbaum, and her mother, Dorleen Mallis. These board members are also members of R & M Real Estate.[1]

12. Under the terms of the loan from R & M Real Estate, the loan would be amortized over 10 years at 9.0 percent interest. R & M Real Estate will not require a security interest in RWC's assets. At hearing, the Company's representative, Ms. Rosenbaum, indicated that RWC would take the necessary steps to ensure that the transaction between RWC and R & M Real Estate remains an arms-length transaction.[2]

13. The Company is not seeking a rate increase to provide debt service on the loan.

STAFF REPORT

Financial Analysis

14. Staff used RWC's audited financial report for the year ended December 31, 2008, to conduct its financial analysis and determine the effects of the *pro forma* financial information reflecting a $500,000 loan amortized for 10 years at a maximum 9.0 percent per annum.

15. Staff's analysis indicates that for the year ended December 31, 2008, a meaningful debt service coverage ratio ("DSC")[3] could not be calculated because RWC has no outstanding debt. The proposed debt will result in a *pro forma* DSC of 1.70. Staff's *pro forma* DSC indicates that RWC will be able to meet all obligations with cash generated from operations.

16. As of December 31, 2008, RWC's capital structure consisted of 100 percent equity. Its capital structure inclusive of Advances-in-Aid of Construction ("AIAC") and net Contributions-in-Aid of Construction ("CIAC") consisted of 0.0 percent short-term debt, 0.0 percent long-term debt, 44.3 percent equity, 39.5 percent AIAC and 16.2 percent CIAC.

17. A *pro forma* capital structure reflecting the loan terms and conditions described herein, results in 1.9 percent short-term debt, 27.6 percent long-term debt and 70.5 percent equity.

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[1] Transcript of December 17, 2009, Hearing, at page 28-29.
[2] Tr., at 29.
[3] DSC represents the number of times internally generated cash will cover required principal and interest payments on long-term debt. A DSC greater than 1.0 indicates that operating cash flow is sufficient to cover debt obligations.

18. Staff typically recommends a company capital structure consisting of a minimum of 30 percent equity of total capital as appropriate to provide a balance of cost and financial risk for regulated utilities and ratepayers. Staff concludes that RWC's *pro forma* capital structure is consistent with Staff's capital structure for companies.

19. In its analysis of the loan terms, Staff stated that the majority of loans offered to water utilities in Arizona come from the Water Infrastructure Financing Authority of Arizona ("WIFA"), rather than banks. According to Staff, the typical WIFA loan provides for loans amortized over 20 years at the prime rate plus 2.00 percent, an amount significantly lower than that proposed by the Company. Staff concludes that, "in the absence of a good faith effort to obtain a WIFA loan, the authorized terms should not be significantly less favorable than those available from WIFA."[4]

20. The Company stated at hearing that it did not approach WIFA for a loan because it did not believe that RWC would be able to obtain financing from WIFA because of its stable financial status.[5] Ms. Rosenbaum testified that the proposed lender is willing to accept a lower interest rate on the loan as recommended in Staff's alternate recommendations.[6] (The alternate recommendations are addressed in Findings of Fact No. 31.)

Engineering Analysis

21. In the Engineering Report attached as Attachment A to the Staff Report, Engineering Staff stated as follows:

> On or about December 6, 2008, Ray Water Well #6 stopped operating. After the pump and submersible motor were pulled and the well was videoed, it was determined that there were many holes in both the well's blank casing and screen. Because of the poor condition of the casing and screen, [the] Company's hydrology consultants, Clear Creek Associates, recommended abandoning the existing well and drilling a replacement well.[7]

22. According to Staff, RWC's current water system consists of four wells capable of producing approximately 1,125 gallons per minute, and a storage tank capacity of 775,000 gallons. Staff notes that, based on 2008 water use data provided by the Company, RWC's existing water

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[4] Staff Report, page 3.
[5] Tr., at 31.
[6] Tr., at 19.
[7] Engineering Report, page 1.

system, exclusive of the production from Well #6, still produces enough water to adequately support an additional 780 additional connections. Staff notes that, if RWC's highest producing well providing approximately 400 gallons per minute is taken off-line, the Company would not then have sufficient water to meet its customers' needs.

23. Staff also stated that RWC has an interconnection with the City of Tucson water system, which Staff believes can be used as an additional source of water for the Company in the event of an emergency.

24. Staff states that because the Company can provide sufficient water to meet its customers' needs without the production from Well #6, Staff cannot conclude that the construction of additional well capacity is reasonable and appropriate.

25. Staff also conducted a cost analysis of the proposed replacement cost of Well #6.

PROJECT	COST
Drill Replacement Well	$ 252,000
Site Work to Install Pump, Electric, and Connect to Existing Storage	215,000
Hydrology Consultant	21,050
Source Approval Sampling	3,500
Engineering Design & Inspection Work	47,300
TOTAL	$ 538,850

26. Staff reviewed RWC's proposed plant additions and concluded that the associated cost estimates are reasonable. However, no used and useful determination of the proposed plant was made, and no particular future treatment should be inferred for rate-making or rate base purposes.

Compliance Issues

27. The Arizona Department of Environmental Quality ("ADEQ") regulates RWC's water system under ADEQ Public Water System #10-095. An ADEQ report dated October 30, 2008, indicates that RWC's system has no deficiencies and ADEQ determined that the system is currently delivering water that meets water quality standards required by Arizona Administrative Code, Title 18, Chapter 4.

28. RWC is located in the Tucson Active Management Area ("AMA") and is subject to AMA reporting and conservation requirements.

29. On July 16, 2009, Staff received a compliance report from the Arizona Department of Water Resources ("ADWR") indicating that RWC is currently in compliance with ADWR requirements.

30. Staff states that RWC has no Commission compliance delinquencies.

Staff Recommendations

31. Based on its review of the Application, Staff makes the following conclusions and recommendations:

a) Staff concludes that RWC's existing water system has adequate production and storage capacity. Therefore, Staff cannot conclude that constructing the proposed additional well capacity is reasonable and appropriate, even though the Company's cost estimates for the construction are reasonable;

b) Staff concludes that the Company's proposed lender, an affiliate, may not offer the best available terms; accordingly, in the absence of a good faith effort to obtain a WIFA loan and in the event that the proposed financing is approved, the authorized terms should not be significantly less favorable than those available from WIFA;

c) Staff further concludes that issuance of the proposed debt financing for the purposes stated in the application is within RWC's corporate powers and would not impair its ability to provide services and would consistent with sound financial practices if obtained with terms consistent with the best available. However, the loan would not be compatible with the public interest since the intended use of the proceeds is unnecessary for the provision of service and would be an inefficient use of financial and other resources;

d) Staff recommends denial of RWC's request for authorization to incur a 10-year amortizing loan in an amount not to exceed $500,000 from R & M Real Estate at 9 percent interest rate;

e) Staff is not recommending authorization to incur debt; however, in the event that the Commission grants such authorization to RWC, Staff recommends authorization to incur a 10-to-22 year amortizing loan in an amount not to exceed $500,000 from R & M Real Estate or another lender at an interest rate not to exceed the prime rate plus 3.00 percent;

f) Staff further recommends, in the event that debt incurrence is authorized, that the Commission authorize RWC to pledge its assets in the State of Arizona pursuant to A.R.S. § 40-285, if necessary, in connection with the loan;

g) Staff further recommends, in the event that debt incurrence is authorized, authorizing RWC to engage in any transactions and to execute any documents necessary to effectuate the authorization granted;

h) Staff further recommends, in the event that debt incurrence is authorized, that RWC file with Docket Control, as a compliance item in this docket, within 60 days of their execution, copies of the fully executed loan documents;

i) Staff further recommends, in the event that debt incurrence is authorized, that RWC shall file with Docket Control, as a compliance item in this docket, no later than one year from the effective date of this Decision, a copy of the ADEQ Certificate of Approval to Construct for the replacement well; and

j) Staff recommends that any unused authorization to issue debt granted in this proceeding terminate on April 29, 2011.[8]

32. RWC objects to Staff's determination that the construction of the replacement well is unnecessary and presented extensive evidence at hearing in support of its position.[9] The Company asserts that not only is Well #6 in danger of failing, but its other wells are between 25 and 40 years old and are also deteriorating.[10] In addition, the wells are filling with sand on the bottom.[11]

33. Regarding the interconnection with the City of Tucson ("City"), RWC notes that the interconnection exists pursuant to an Emergency Services Agreement ("Agreement") with the City, which was entered into when the City annexed a portion of RWC's service area. Under this Agreement, the City will provide water in the event of a fire emergency if the Company does not have enough flow to meet the needs of the fire department. Water used by RWC for purposes other than a fire event is billed to the Company at twice the City's commercial rate.[12] According to RWC, the Agreement expires in May 2010 and it will no longer have the interconnection.[13]

34. Ms. Rosenbaum testified that because of these issues, the Company is attempting to take a proactive approach in addressing these problems so that RWC's customers will not experience any interruption in service.[14]

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[8] In its Staff Report, Staff recommended a termination date of December 31, 2010. This date has been changed to April 29, 2011, to reflect the passage of time since the issuance of the Staff Report.

[9] See for example, Testimony of Marvin Glotfelty, Principal Hydrologist, Clear Creek Associates, Tr., at 38-52, and Testimony of Kara Festa, Civil Engineer, WestLand Resources, Tr., at 52-72.

[10] Tr., at 13.

[11] Tr., at 15.

[12] Tr., at 19-20.

[13] Tr., at 21.

[14] Tr., at 14-15.

35. RWC's proactive efforts to replace a failing well before the Company's ability to provide water to its customers becomes compromised seem reasonable. Although Staff is not convinced that the well is needed at this time, we believe in order to encourage the Company's proactive approach to system upkeep and adequate water production, the financing request should be approved, providing it is fiscally sound. We note Staff determined that the proposed financing will not impair RWC's ability to provide service and would be consistent with sound financial practices if obtained with terms consistent with the best available.

36. In this matter, where the Company currently has no debt, where the Company is not seeking a rate increase to provide debt service for repayment of the loan, where the Company has done extensive research and demonstrated the necessity for the replacement well, and where the Company is taking a proactive approach in ensuring the adequate production of water for its customers, we should not discourage RWC from obtaining a loan for the proposed construction. For these reasons, we find that it is in the public interest to approve the requested financing.

37. Staff's position that the well is not necessary at this time puts RWC on notice that any construction of plant may be determined to be not used and useful during a future rate increase proceeding. This is a business risk that any utility takes when installing new plant, and at hearing Ms. Rosenbaum testified that the Company understands this risk.[15] However, we also note that, although Staff believes the replacement well is not necessary at this time, this does not mean that it will not be found to be used and useful plant at some future date.

Conclusion

38. For the foregoing reasons, we find it is reasonable, consistent with sound financial practices, and in the public interest to grant RWC the requested financing authority to fund its proposed financing, subject to certain conditions.

39. Staff's alternative recommendations conditions noted in Findings of Fact No. 31 (e)-(i), as modified, are reasonable and should be adopted.

. . .

[15] Tr., at 33.

CONCLUSIONS OF LAW

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

2. The Commission has jurisdiction over RWC and the subject matter of the Application.

3. Notice of the financing was provided in accordance with Arizona law.

4. Staff's alternative recommendations, as modified, are reasonable and should be adopted.

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

6. The financing approved herein is for the purposes set forth in RWC's request filed on March 11, 2009, is reasonably necessary for those purposes, and such purposes are not, wholly or in part, reasonably chargeable to operating expenses or to income.

ORDER

IT IS THEREFORE ORDERED that Ray Water Company, Inc., is hereby authorized to incur $500,000 of debt financing for the purposes stated in the Application, and pursuant to the terms and conditions set forth in the Application and as modified herein.

IT IS FURTHER ORDERED that such authority is expressly contingent upon Ray Water Company's use of the proceeds for the purposes set forth in its Application.

IT IS FURTHER ORDERED that the interest rate on any loan obtained by Ray Water Company shall not exceed the prime rate at the time of the transaction's closing, plus three percent.

IT IS FURTHER ORDERED that Ray Water Company, Inc., may pledge its Arizona assets to secure the authorized financing pursuant to A.R.S. § 40-285, if such pledge is necessary under the terms of the loan documents.

IT IS FURTHER ORDERED that Ray Water Company, Inc. is hereby authorized to engage in any transactions and to execute or cause to be executed any documents so as to effectuate the authorizations requested with the Application.

IT IS FURTHER ORDERED that Ray Water Company, Inc. shall file with Docket Control, as a compliance item in this docket, within 60 days of closing, copies the loan documents memorializing the authorized transaction.

IT IS FURTHER ORDERED that Ray Water Company, Inc., shall file with Docket Control, as a compliance item in this docket, upon receipt by Ray Water Company, Inc., but no later than one year of the effective date of this Decision, a copy the ADEQ Certificate of Approval to Construct the replacement well.

IT IS FURTHER ORDERED that any unused authorization to issue debt granted in this proceeding shall terminate on April 29, 2011.

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IT IS FURTHER ORDERED that approval of the financing set forth herein 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, ERNEST G. JOHNSON, 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 _____, 2010.

ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

DISSENT _____

DISSENT _____

SERVICE LIST FOR: RAY WATER COMPANY, INC.

DOCKET NO.: W-01380A-09-0106

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