OPEN MEETING AGENDA ITEM

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BEFORE THE ARIZONA CORPORATION CC

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AZ CORP COMMISSION DOCKET CONTROL

Arizona Corporation Commission
DOCKETED
OCT 15 2010

DOCKETED BY

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

IN THE MATTER OF THE APPLICATION OF CORONADO UTILITIES, INC. FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS WATER AND WASTEWATER RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.

DOCKET NO. SW-04305A-09-0291

NOTICE OF FILING STAFF'S CLARIFYING COMMENTS

The Utilities Division of the Arizona Corporation Commission ("Staff") hereby files the following clarifying comments regarding the Recommended Opinion and Order ("ROO") in this matter.

The ROO correctly notes that Coronado Utilities, Inc. ("Company") and Staff agree that 7.36 percent is an appropriate overall rate of return. The Company calculated its weighted average cost of capital based on its actual amounts of long-term debt, preferred stock and common equity using the stated cost rates for long-term debt (6.25%) and preferred stock (6.50%) and an estimate for its equity (14.0%) based on an analysis prepared by its witness.

Staff recognized that the Company's proposed 7.36 percent overall rate of return was comparable to that adopted by the Commission for other utilities in recent decisions. Accordingly, in order to save costs, limit contested issues, and better utilize resources, Staff did not perform a cost of equity analysis. Nevertheless, Staff recognized that the Company's proposed 14.0 percent cost of equity exceeded, by a wide margin, the cost of equity recommendations made by Staff in other rate cases. Staff presented testimony that a 10.5 percent cost of equity is more in line with Staff's recommendations in other rate cases. Although not explicitly stated in Staff's testimony, Staff's 7.36 percent overall rate of return in combination with its 10.5 percent cost of equity can only be achieved via a hypothetical capital structure as follows:

Staff-Recommended Capital Structure				
Capital Component	Amount ($)	Percent of Total	Cost/Rate	Weighted Cost
Long-Term Debt	$ 2,575,000	61.1%	6.25%	3.82%
Preferred Stock	570,000	13.5%	6.50%	0.88%
Stockholder Equity - Hypothetical	1,066,524	25.3%	10.50%	2.66%
Totals	$ 4,211,524	100.0%		7.36%

The ROO agrees with Staff that a 14.0 percent cost of equity is higher than the Commission has been approving in recent rate cases, and instead adopts a 13.2 percent cost of equity, noting that the Commission adopted a 10.2 percent cost of equity in the Black Mountain Sewer Company rate case (Decision No. 71865, dated September 1, 2010), and then allowing for a 3.0 percent financial risk adjustment in this case to provide a 7.25 percent overall rate of return, as presented in the following table:

ROO-Recommended Capital Structure				
Capital Component	Amount ($)	Percent of Total	Cost/Rate	Weighted Cost
Long-Term Debt	$ 2,575,000	70.6%	6.25%	4.41%
Preferred Stock	570,000	15.6%	6.50%	1.02%
Stockholder Equity - Actual	504,024	13.8%	13.20%	1.82%
Totals	$ 3,649,024	100.0%		7.25%

Similar to Staff's observation that the Company's proposed cost of equity exceeded Staff recommendations in other rate cases, Staff notes that a 3.0 percent upward financial risk adjustment is not comparable to other upward financial risk adjustments recommended by Staff.

Staff is further concerned that adoption of a 13.2 percent cost of equity in the current economic environment is not likely to be well-received by the Company's customers, and it sends a dubious and potentially unrealistic expectation to other utilities. These potential undesirable consequences can be avoided without changing the revenue requirement, and consequently the rate design, by simply adopting a hypothetical capital structure that includes Staff's recommended 10.5 percent cost of equity, as presented in the following table.

ROO as Adjusted				
Capital Component	Amount ($)	Percent of Total	Cost/Rate	Weighted Cost
Long-Term Debt	$ 2,575,000	63.3%	6.25%	3.96%
Preferred Stock	570,000	14.0%	6.50%	0.91%
Stockholder Equity - Hypothetical	923,859	22.7%	10.50%	2.38%
Totals	$ 4,068,859	100.0%		7.25%

Staff encourages the Commission to adopt the hypothetical capital structure, 10.5 percent cost of equity and the 7.25 percent overall rate of return, as presented in the above table.

RESPECTFULLY SUBMITTED this 15th day of October, 2010.

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15th day of October, 2010 with:

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