



BEFORE THE ARIZONA CORPORATION CC

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Arizona Corporation Commission

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AZ CORP COMMISSION
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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.

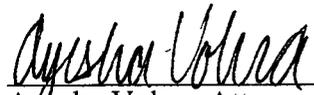
Staff is further concerned that adoption of a 13.2 percent cost of equity in the current economic environment is not likely to be well-received by the Company's customers, and it sends a dubious and potentially unrealistic expectation to other utilities. These potential undesirable consequences can be 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.

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| 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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Original and thirteen (13) copies of the foregoing filed this 15th day of October, 2010 with:

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