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MEMORANDUM
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ARIZONA CORPORATION COMMISSION
DOCKET CONTROL

Arizona Corporation Commission

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A handwritten signature in black ink, appearing to be 'CSB' or similar, written over a rectangular box.

DATE: February 17, 2011

RE: STAFF REPORT IN THE MATTER OF THE APPLICATION OF EAGLETAIL
WATER COMPANY, L.C. FOR APPROVAL OF FINANCING
(DOCKET NO. W-03936A-10-0446)

Attached is the Staff Report for Eagletail Water Company, L.C.'s application for approval of financing. Staff recommends denial.

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 February 24, 2011.

SMO:CSB:tdp

Originator: Crystal Brown

Service List for: Eagletail Water Company, L.C.
Docket No. W-03936A-10-0446

Ms. Susan Haas
Post Office Box 157
Eagletail Water Company L. C.
Tonopah, Arizona 85354

**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

**EAGLETAIL WATER COMPANY, L. C.
DOCKET NO. W-03936A-10-0446**

**APPLICATION FOR APPROVAL
OF FINANCING**

FEBRUARY 17, 2011

STAFF ACKNOWLEDGMENT

The Staff Report for Eagletail Water Company, L. C., Docket No. W-03936A-10-0446 is the responsibility of the Staff member listed below. Crystal S. Brown is responsible for the financial analysis.


Crystal S. Brown
Public Utilities Analyst V

**EXECUTIVE SUMMARY
EAGLETAIL WATER COMPANY, L. C.
DOCKET NO. W-03936A-10-0446**

Eagletail Water Company, L. C. ("Eagletail" or "Company") is owned by a group of approximately 20 individuals. It is a Class "E" Arizona public service corporation that provides water service to approximately 55 customers in Harquahala Valley in Maricopa County, Arizona.

On November 2, 2010, Eagletail filed an application for approval of long-term debt in the amount of \$57,400. According to the application, the purpose of the loan is to provide funds to the current owners who, in turn, would pay the prior owner \$57,400 for the purchase of Eagletail. The \$57,400 is an offer in which the prior owner will reduce the \$80,000 loan that the current owners owe to him for their purchase of Eagletail. The \$80,000 is not a debt incurred by the Company, nor was it authorized by the Commission. Rather, it is the debt of the owners for their purchase of the Company.

Staff concludes that use of the loan proceeds to buy the Company from the prior owner is an inappropriate use of the funds as it is not compatible with the public interest, is not consistent with sound financial practices and could impair the Company's ability to provide services. Therefore, Staff recommends denial.

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INTRODUCTION

Eagletail Water Company, L.C. (“Eagletail” or “Company”) is owned by a group of approximately 20 individuals. It is a Class “E” Arizona public service corporation that provides water service to approximately 55 customers in Harquahala Valley in Maricopa County, Arizona.

On November 2, 2010, Eagletail filed an application for approval of long-term debt in the amount of \$57,400.

PUBLIC NOTICE

The Company provided an affidavit of publication verifying public notice of its financing application. The Company published notice of its financing application in the *Buckeye Valley News* on November 4, 2010. The *Buckeye Valley News* is a newspaper of general circulation in Buckeye, Maricopa County, Arizona. The affidavit of publication is attached along with a copy of the Notice.

BACKGROUND

The current owners (approximately 20 individuals) represent 36 percent of the 55 customers that are served by Eagletail. Eagletail was sold four times before the current owners purchased the Company.

Prior to January 2000, the utility assets of what was then the Eagle Water Company (“Eagle”) were owned by four different individuals or entities. In January 2000, the utility assets of Eagle were abandoned and sold at a sheriff’s auction to Mr. Randolph Brownell, owner of Sunup Water Company, L.C., doing business as Eagle.¹ The assets were purchased for \$80,000 in May 2000, by the current owners. Mr. Brownell provided the financing for the \$80,000 loan for the current owners to purchase the Company from him. In Decision No. 63684, dated May 24, 2001, the Commission authorized the issuance of a Certificate of Convenience and Necessity (“Certificate”) and a transfer of assets from Mr. Brownell to the Company.

According to the Company, Mr. Brownell had represented to the current owners that no property taxes were owed because the Company was sold at a sheriff’s auction. However, after the current owners purchased the Company for \$80,000 from Mr. Brownell, they found that over \$234,000 in delinquent property taxes were still owed. The \$234,000 should have been paid by the prior owner(s) but was not. The delinquent taxes covered the period from 1983 to 2001.

On November 9, 2005, Eagletail filed a financing application to obtain the Commission’s approval for an \$82,000 loan to take advantage of an amnesty program wherein the Company could eliminate the \$234,000 in delinquent taxes if it could pay the \$82,000 by December 31, 2005. The amnesty program was offered by the Maricopa County Treasurer’s Office.

¹ Decision No. 67982, page 2, footnote 2.

In Decision No. 68344, dated December 9, 2005, the Commission authorized the \$82,000 loan, in part, because of the unique circumstances that precipitated the need for the loan.

On November 2, 2010, the new owners filed an application for approval of long-term debt in the amount of \$57,400.

COMPLIANCE

The Company has no outstanding compliance items.

PURPOSE AND DESCRIPTION OF THE REQUESTED APPROVAL

According to the application, the purpose of the \$57,400 loan is to provide funds to the current owners who, in turn, would pay the prior owner \$57,400 for their purchase of Eagletail. The \$57,400 is an offer in which the prior owner will reduce the \$80,000 loan that the current owners owe to him for the purchase of Eagletail to \$57,400 if the current owners could pay cash by a certain date. The \$80,000 is not a debt incurred by the Company, nor was it authorized by the Commission. Rather, it is the debt of the owners for their purchase of the Company.

Although the application states that the proposed loan is \$57,400, the total amount that the Company will be requesting from the lender, Harquahala Valley Community Benefits Foundation, is \$119,533. The \$119,533 loan would refinance a \$62,148.43 existing balance from a loan that the Commission has previously approved and add an additional \$57,400 for the proposed loan.

FINANCIAL ANALYSIS

Staff's analysis is illustrated on Schedule CSB-1. Column [A] reflects financial information based on the year ended December 31, 2010. Column [B] presents pro forma financial information to reflect issuance of a 20-year, \$119,533 amortizing loan at 4.00 percent interest rate.

DSC

Debt service coverage ratio ("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 CSB-1, Column [A] shows that for the year ended December 31, 2010, the Company's DSC was 1.61. The pro forma DSC for the proposed \$119,533 is 0.19 (Column [B]). The pro forma DSC results show that cash flow from operations is not sufficient to cover all obligations with the Company's proposed debt issuance and use of funds.

Capital Structure

At December 31, 2010, the Company's capital structure consisted of 6.80 percent short-term debt, 93.20 percent long-term debt and 0.0 percent equity. Issuance of a \$119,533, 20-year amortizing loan results in a pro forma capital structure composed of 3.33 percent short-term debt, 96.67 percent long-term debt and 0.0 percent equity. Staff normally recommends that non-profit water utilities maintain capital structures with a minimum of 30 percent equity as appropriate to provide a balance of cost and financial risk for regulated utilities and ratepayers.

CONCLUSION AND RECOMMENDATIONS

Staff concludes that use of the loan proceeds to buy the Company from the prior owner is an inappropriate use of the funds as it is not compatible with the public interest, is not consistent with sound financial practices and could impair the Company's ability to provide services. Therefore, Staff recommends denial of the \$57,400 loan.

FINANCIAL ANALYSIS

Selected Financial Information
Pro forma Includes Immediate Effects of the Proposed Long-term Debt

	[A]		[B]	
	<u>12/31/2010</u>		<u>12/31/2010</u>	
			<u>With \$119,533 Proposed Loan¹</u>	
1	Operating Income	\$ 1,657	\$ 1,657	
2	Depreciation & Amortization Expense	\$ 8,568 (a)	\$ 8,568	
3	Income Tax Expense	\$ -	\$ -	
4	Interest Expense on Debt	\$ 1,203	\$ 4,709 (b)	
5	Repayment of Principal	\$ 5,129	\$ 47,800 (c)	
	TIER			
6	[1+3] + [4]	1.38	0.35	
	DSC			
7	[1+2+3] + [4+5]	1.61	0.19	
8	Short-term Debt	\$ 5,129 (d)	\$ 3,983 (e)	6.80% 3.33%
9	Long-term Debt	\$ 70,265	\$ 115,550	93.20% 96.67%
10	Equity	\$ -	\$ -	0.00% 0.00%
11	Total Capital	\$ 75,394	\$ 119,533	100.00% 100.00%

¹ The \$119,533 is the total amount to be requested from the Harquahala Community Benefits Foundation. It would refinance a \$62,148.43 existing balance from a loan that the Commission has previously approved and add an additional \$57,400 for the proposed loan.

- (a) The income statement provided by the Company did not include depreciation expense. Staff obtained the \$8,568 in depreciation expense by multiplying the plant balances reported in the Company's 2010 balance sheet by the Commission approved depreciation rates.
- (b) The amount represents the annual interest, at 4%, paid on the 20-year \$119,533 amortizing loan.
- (c) The amount represents the annual principal paid on the 20-year \$119,533 amortizing loan.
- (d) Includes \$0 in short-term debt and \$5,129 in estimated current maturities on long-term debt at 12/31/10.
- (e) Includes \$0 in short-term debt and \$3,983 in estimated current maturities on long-term debt at 12/31/10 and principal repayment on the full amount of the proposed loan.

**AFFIDAVIT OF
PUBLICATION**

I, Sharon Torres, Publisher of the *Buckeye Valley News*, published weekly at Buckeye, Maricopa County, Arizona, do solemnly swear that a copy of

Public Notice Of An Application For An Order :
Authorizing The Issuance Of Long Term Debt (security)

A.A.C. R14-3-105

published the issue dated
November 04, 2010

Marlene M. Turner

Marlene Turner

Subscribed and sworn to before this 4th Day of Nov 2010.

[Signature]
(Notary Public)

My Commission Expires

June 30, 2014

June 30, 2014



SHARON TORRES
Notary Public, State of Arizona
Maricopa County
My Commission Expires
June 30, 2014

PUBLIC NOTICE
OF
AN APPLICATION FOR AN ORDER

AUTHORIZING THE ISSUANCE OF Long Term Debt (security)
BY Eagletail Water Co. L.L.C. (company)

Eagletail Water ("Company") filed an Application with the Arizona Corporation Commission ("Commission") for an order authorizing Applicant to issue \$52,400. (gross proceeds) of Debt (security to be issued). The application is available for inspection during regular business hours at the office of the Commission in Phoenix, Arizona, and the Company's offices in Hanguahale Valley, Arizona.

Intervention in the Commission's proceedings on the application shall be permitted to any person entitled by law to intervene and having a direct substantial interest in this matter. Persons desiring to intervene must file a Motion to Intervene with the Commission which must be served upon applicant and which, at a minimum, shall contain the following information:

1. The name, address and telephone number of the proposed intervenor and of any person upon whom service of documents 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.A.C. R14-3-105, except that all Motions to Intervene must be filed on, or before, the 15th day after this notice.