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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission

COMMISSIONERS

DOCKETED

BOB STUMP - Chairman
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH

MAR 19 2014

DOCKETED BY ne

IN THE MATTER OF THE APPLICATION OF
CHAPARRAL CITY WATER COMPANY FOR
AUTHORITY TO REFINANCE LONG-TERM
DEBT.

DOCKET NO. W-02113A-13-0047

DECISION NO. 74388

ORDER

Open Meeting
March 11 and 12, 2014
Phoenix, Arizona

BY THE COMMISSION:

* * * * *

Having considered the entire record herein and being fully advised in the premises, the
Commission finds, concludes, and orders that:

FINDINGS OF FACT

Background and Procedural History

1. Chaparral City Water Company ("CCWC" or "Company") is a C Corporation and a
Class "A" Arizona public service corporation authorized by the Arizona Corporation Commission
("Commission") to provide public water utility service to approximately 13,500 metered customers
located in the Town of Fountain Hills, and in a small portion of the City of Scottsdale, all in
Maricopa County, Arizona.

2. CCWC is a wholly-owned subsidiary of EPCOR Utilities, Inc. ("EPCOR").¹ EPCOR
Water (USA) Inc. ("EPCOR USA"), a subsidiary of EPCOR, assumed direct ownership of CCWC on
May 11, 2011. Prior to that date, CCWC had been owned by American States Water Company.

3. The Company's current rates were approved in Decision No. 71308 (October 21,
2009).²

¹ EPCOR is wholly owned by the City of Edmonton, Alberta, Canada.

² As corrected nunc pro tunc by Decision No. 71424 (December 8, 2009), and as amended by Decision No. 72258 (April 7, 2011).

1 4. On March 1, 2013, CCWC filed a financing application requesting authorization to
2 refinance its existing long-term debt, originally authorized in Decision No. 60473 (November 25,
3 2007), with replacement debt to be borrowed indirectly from EPCOR, CCWC's ultimate parent,
4 through a promissory note with CCWC's direct parent EPCOR USA.

5 5. On May 8, 2013, CCWC docketed a Notice of Filing Affidavit of Publication,
6 indicating that notice of the financing request was published on May 1, 2013, in the *Fountain Hills*
7 *Times*.

8 6. On August 13, 2013, CCWC filed a Notice of Errata to which was attached a corrected
9 first page of Exhibit B to the application.

10 7. On November 22, 2013, CCWC filed an amendment to the financing application
11 modifying the terms of its proposed replacement debt.

12 8. On February 5, 2014, the Commission's Utilities Division ("Staff") issued a Staff
13 Report recommending approval of CCWC's amended financing application with conditions. The
14 Staff Report indicated that any comments to the Staff Report should be filed by February 14, 2014.

15 9. On February 13, 2014, CCWC filed a letter stating that it had reviewed the Staff
16 Report and is willing to abide by Staff's recommendations. The letter requested that the financing
17 application be considered at the Commission's next Open Meeting.

18 10. On February 21, 2014, CCWC filed a letter stating that it agrees to waive the ten day
19 period for filing exceptions to a Recommended Order.

20 **Financing Proposal**

21 11. CCWC's existing long-term debt is comprised entirely of outstanding Industrial
22 Development Authority ("IDA") bonds issued through the IDA of the County of Maricopa, with a
23 maturity date of December 1, 2022.

24 12. CCWC plans to borrow, on an unsecured basis, a portion of the debt proceeds
25 obtained from a recent Canadian bond issuance by EPCOR, and to use the proceeds to pay off the
26 remaining \$4.935 million balance of its existing debt.

27 13. In its original filing, CCWC proposed an unamortized loan (no principal payment due
28 until the term of the loan), with a maturity date of February 28, 2042, and an interest rate that would

1 include costs of a cross currency interest rate swap at the time of loan closing. The application stated
2 that at current market conditions, the interest rate would be 5.845 percent.

3 14. The proposed refinancing would result in elimination of the requirement, under
4 CCWC's current IDA bond agreement, that an annual external audit be performed. This would result
5 in an annual cost savings for CCWC. The annual external audit costs averaged \$49,813 in 2010
6 through 2012.

7 15. In the original application, CCWC stated that the refinancing would only occur if the
8 transaction could be completed at or less than its calculated all-in effective interest rate of 6.86
9 percent. CCWC calculated this 6.86 percent effective interest rate on its existing debt using cost
10 inputs that included interest rate equivalents of the IDA bond agreement's required external audit
11 costs.

12 16. The Staff Report states that prior to the issuance of the Staff Report, Staff informed
13 CCWC of the following issues in the original application which kept Staff from recommending
14 approval of the original financing application: the structuring of the debt as non-amortizing as
15 opposed to amortizing; the inclusion of the annual audit cost component in the calculation of an
16 effective interest rate on the existing debt; and the inclusion in the calculation of the 5.845 percent
17 replacement debt cost of the costs of the proposed currency rate swap. CCWC subsequently filed the
18 amended application.

19 17. In the amended application, CCWC proposes an amortized loan with the same
20 December 1, 2022 maturity date as CCWC's current debt. CCWC also recalculated the existing
21 effective interest rate on its current debt to be 5.92 percent, which it reached by adding the debt
22 weighted average of the interest rates of the two remaining IDA series bonds of 5.38 percent to the
23 0.54 percent interest rate equivalent of the continuing \$26,501 amortization of the IDA bonds'
24 issuance costs. CCWC proposes a new all-in interest rate of 5.97 percent, which includes new
25 issuance costs at a 0.05 interest rate, and states that the proposed refinancing will not occur if the new
26 all-in debt costs exceed 5.97 percent. This calculation does not include costs of a cross currency
27 interest rate swap.

28 18. CCWC requests that recoverability of the unamortized debt issuance costs for the

1 existing IDA bonds and the additional new debt issuance costs be explicitly recognized in this
2 Decision.

3 19. CCWC states that the reduction in expenses to be realized by eliminating the external
4 audit required by the IDA bond agreement will be reflected in the cost of service in CCWC's pending
5 rate case in Docket No. W-02113A-13-0018.

6 **Staff's Analysis**

7 20. The Staff Report states that the amended application eliminates some issues Staff
8 found objectionable in the original application. However, Staff remains concerned that CCWC's use
9 of the weighted average 5.38 percent cost of CCWC's existing IDA bond debt as the basis for the
10 effective interest rate to be applied to its proposed replacement debt with EPCOR USA overstates the
11 cost of the replacement debt. Staff points out that the effective cost rate for the new issue yield on the
12 Canadian bonds issued by EPCOR is 4.565 percent.

13 21. Staff recommends that the effective interest rate on the new debt not exceed 5.152
14 percent. Staff reached this result by adding: the annual interest expense of the EPCOR new issue
15 yield of 4.565 percent; the 0.537 percent interest rate equivalent of the continuing \$26,501
16 amortization of the IDA bonds' issuance costs; and new issuance costs at a 0.05 interest rate.

17 22. In the amended application, CCWC provided its 2012 audited balance sheet and
18 income statement.²

19 23. Based on the 2012 information, Staff analyzed the impact of the proposed financing
20 on CCWC's finances. That analysis is set forth in Schedule JAC-1 to the Staff Report, which is
21 attached hereto as Exhibit 1 and incorporated herein. Exhibit 1 shows that, for the year ending
22 December 31, 2012, CCWC had a Debt service coverage ratio ("DSC")³ of 5.50, indicating sufficient
23 cash flow from operations to cover CCWC's debt obligations. Staff determined that with the
24 proposed replacement debt, at an actual effective interest rate of 5.152 percent, CCWC would have a
25 pro forma DSC of 5.64, also indicating sufficient cash flow from operations to cover debt obligations.

26 ² The original application included CCWC's 2011 audited balance sheet and income statement.

27 ³ DSC represents the number of times internally generated cash will cover required principal and interest payments on
28 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 the debt service obligations cannot be met by cash generated from
operations and that another source of funds is needed to avoid default.

1 24. CCWC does not have any existing unused financing authorizations.

2 25. Staff notes that because the proposed replacement debt is to be unsecured, approval of
3 the proposed refinancing does not necessitate encumbrance of CCWC's assets.

4 **Staff Recommendations**

5 26. Staff recommends approval of CCW's requested financing under the following terms
6 and conditions:

- 7 - Conditional approval of CCWC's request to issue replacement long-term debt in an
8 amount not to exceed \$4.935 million in the form of an unsecured, 10-year amortizing loan
at an effective interest rate not to exceed 5.152 percent per annum;
- 9 - Approval of the Company's request that the processing of CCWC's financing application
10 not be consolidated with the processing of the Company's rate application;
- 11 - Denial of CCWC's request that the all-in interest rate on the proposed replacement long-
term debt be authorized at a maximum interest rate of 5.97 percent per annum;
- 12 - That the proceeds of the borrowing authority authorized herein be used to pay off the
13 remaining \$4.935 million balance of CCWC's outstanding IDA long-term bond debt, as
described in the application;
- 14 - That CCWC be allowed to recover, in rates, the unamortized debt issuance costs
15 associated with its original IDA bonds;
- 16 - That CCWC be allowed to recover, in rates, amortization of debt issuance costs associated
with the EPCOR Canadian bond issuance, as recommended by Staff;
- 17 - Denial of CCWC's request for recovery of a currency exchange rate cost component in
18 the replacement debt to be authorized in this proceeding;
- 19 - That any unused authority to issue replacement debt granted in this proceeding expire on
20 December 31, 2014;
- 21 - Authorizing CCWC to engage in any transaction and to execute any document necessary
to effectuate the authorizations granted; and
- 22 - That CCWC file with Docket Control, as a compliance item in this matter, a copy of the
23 loan documents within 60 days of the execution of any refinancing transaction authorized
herein.

24 27. The Staff Report states that a check of the Commission's compliance database
25 indicated that as of August 13, 2013, there were no compliance delinquencies for CCWC.

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1 **Conclusion**

2 28. Staff's recommendations, as described herein, are reasonable and appropriate. We
 3 note that CCWC indicated in its February 13, 2014 letter that it has reviewed the Staff Report and is
 4 willing to abide by the conditions contained in the Staff Report. We agree with Staff that a reduction
 5 to CCWC's long term debt borrowing costs is a desirable objective, and that ratepayers should
 6 benefit from a reduced cost of debt when a utility refinances higher cost debt with lower cost debt.
 7 The interest rate proposed by Staff and agreed to by CCWC appropriately includes the unamortized
 8 debt issuance costs associated with CCWC's original IDA bonds and amortization of debt issuance
 9 costs associated with the EPCOR Canadian bond issuance, which will be reflected in rates via the
 10 cost of capital. We will therefore adopt Staff's recommendations.

11 **CONCLUSIONS OF LAW**

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

14 2. The Commission has jurisdiction over CCWC and the subject matter of the financing
 15 application.

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

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

21 5. The financing approved herein is for the purposes stated in the application and is
 22 reasonably necessary for those purposes, and such purposes are not, wholly or in part, reasonably
 23 chargeable to operating expenses or to income.

24 6. Staff's recommendations, as described herein, are reasonable and appropriate and should
 25 be adopted.

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ORDER

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IT IS THEREFORE ORDERED that Chaparral City Water Company is hereby authorized to issue replacement long-term debt in an amount not to exceed \$4.935 million in the form of an unsecured, 10-year amortizing loan as set forth in its amended application, except that the effective interest rate shall not exceed 5.152 percent per annum.

IT IS FURTHER ORDERED that the maximum 5.152 percent per annum interest rate approved herein includes the unamortized debt issuance costs associated with Chaparral City Water Company's original IDA bonds and amortization of debt issuance costs associated with the EPCOR Utilities, Inc. Canadian bond issuance.

IT IS FURTHER ORDERED that the proceeds of the borrowing authority authorized herein shall be used to pay off the remaining \$4.935 million balance of Chaparral City Water Company's outstanding IDA long-term bond debt, as described in the application.

IT IS FURTHER ORDERED that any unused authority to issue replacement debt granted in this proceeding shall expire on December 31, 2014.

IT IS FURTHER ORDERED that Chaparral City Water Company is hereby authorized to engage in any transaction and to execute any document necessary to effectuate the authorizations granted herein.

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1 IT IS FURTHER ORDERED that Chaparral City Water Company shall file, within 60 days of
2 the execution of any refinancing transaction authorized herein, with Docket Control, as a compliance
3 item in this matter, a copy of the loan documents.

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

5 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

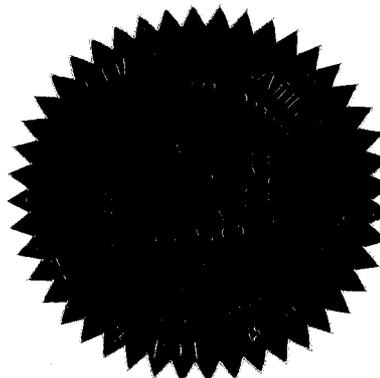
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IN WITNESS WHEREOF, I, JODI JERICH, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 19th day of March 2014.

JODI JERICH
EXECUTIVE DIRECTOR

DISSENT _____

DISSENT _____
TJ:ru

1 SERVICE LIST FOR: CHAPARRAL CITY WATER COMPANY

2 DOCKET NO.: W-02113A-13-0047

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EXHIBIT A**FINANCIAL ANALYSIS**

Selected Financial Information

	[A] ¹ 12/31/2012		[B] ² Pro Forma		[C] ³ Pro Forma	
1 Operating Income	\$ 1,770,154		\$ 1,770,154		\$ 1,770,154	
2 Depreciation & Amort.	1,852,898		1,852,898		1,852,898	
3 Income Tax Expense	(58,397)		(58,397)		(58,397)	
4						
5 Interest Expense ⁴	283,567		284,549		245,190	
6 Repayment of Principal	365,000		372,022		387,339	
7						
8						
9						
10						
11 DSC						
12 [1+2+3] + [5+6]	5.50		5.43		5.64	
13						
14						
15						
16						
17 Capital Structure						
18						
19 Short-term Debt	390,000	1.2%	394,850	1.2%	407,773	1.3%
20						
21 Long-term Debt	4,545,000	14.3%	4,540,150	14.2%	4,527,227	14.2%
22						
23 Common Equity	26,949,123	84.5%	26,949,123	84.5%	26,949,123	84.5%
24						
25 Total Capital	\$ 31,884,123	100.0%	\$31,884,123	100.0%	\$31,884,123	100.0%
26						
27						
28 Capital Structure (inclusive of AIAC and Net CIAC)						
29						
30 Short-term Debt	390,000	0.8%	394,850	0.8%	407,773	0.8%
31						
32 Long-term Debt	4,545,000	9.4%	4,540,150	9.4%	4,527,227	9.3%
33						
34 Common Equity	26,949,123	55.6%	26,949,123	55.6%	26,949,123	55.6%
35						
36 Advances in Aid of Construction ("AIAC")	3,933,916	8.1%	3,933,916	8.1%	3,933,916	8.1%
37						
38 Contributions in Aid of Construction ("CIAC") ⁵	12,637,731	26.1%	12,637,731	26.1%	12,637,731	26.1%
39						
40 Total Capital (Inclusive of AIAC and CIAC)	\$ 48,455,770	100.0%	\$48,455,770	100.0%	\$48,455,770	100.0%
41						
42						
43 AIAC and CIAC Funding Ratio ⁶	34.2%		34.2%		34.2%	
44 (36+38)/(40)						
45						

¹ Column [A] is based on financial information for the year ended December 31, 2012. Income tax expense is calculated on a pro forma basis due to CCWC having realized an income tax recovery in 2012.

² Column [B] is Column [A] modified to reflect replacement of the remaining \$4.935 million outstanding IDA debt with \$4.935 million of amortizing debt from EPCOR Water (USA) Inc., at CCWC's proposed new all-in effective interest rate of 5.97 percent per annum.

³ Column [C] is Column [A] modified to reflect replacement of the remaining \$4.935 million outstanding IDA debt with \$4.935 million of amortizing debt from EPCOR Water (USA) Inc., at Staff's recommended effective interest rate of 5.152 percent per annum.

⁴ In 2012, CCWC realized an income tax recovery of \$58,397. As this figure is not representative of the income tax liability owing based upon CCWC's 2012 operating income and expenses,

Staff made pro forma adjustments to income tax expense in Columns [A], [B] and [C] to reflect the income tax expense based upon the Company's 2012 operating performance.

⁵ Net CIAC balance (i.e. less: accumulated amortization of contributions).

⁶ Staff typically recommends that combined AIAC and Net CIAC funding not exceed 30 percent of total capital, inclusive of AIAC and Net CIAC, for private and investor owned utilities.