

OPEN MEETING ITEM



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COMMISSIONERS
SUSAN BITTER SMITH - Chairman
BOB STUMP
BOB BURNS
DOUG LITTLE
TOM FORESE



ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION
DOCKET CONTROL

DATE: APRIL 17, 2015
DOCKET NO.: SW-03437A-14-0377

ORIGINAL

TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Sarah Harpring. The recommendation has been filed in the form of an Order on:

VERDE SANTA FE WASTEWATER CO., INC.
(FINANCE)

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:

APRIL 27, 2015

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:

MAY 12, 2015 and MAY 13, 2015

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

APR 17 2015

JODI JERICH
EXECUTIVE DIRECTOR

DOCKETED BY

1200 WEST WASHINGTON STREET, PHOENIX, ARIZONA 85007-2927 / 400 WEST CONGRESS STREET, TUCSON, ARIZONA 85701-1347

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

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

- SUSAN BITTER SMITH - Chairman
- BOB STUMP
- BOB BURNS
- DOUG LITTLE
- TOM FORESE

IN THE MATTER OF THE APPLICATION OF
 VERDE SANTA FE WASTEWATER CO., INC.,
 FOR APPROVAL OF FINANCING TO ISSUE
 LONG-TERM DEBT INSTRUMENTS AND TO
 ENCUMBER ITS REAL PROPERTY AND
 UTILITY PLANT AS SECURITY.

DOCKET NO. SW-03437A-14-0377

DECISION NO. _____

ORDER

Open Meeting
 May 12 and 13, 2015
 Phoenix, Arizona

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

Background and Procedural History

1. Verde Santa Fe Wastewater Co., Inc. ("VSF") is a certificated Class D utility providing wastewater utility service to approximately 950 customers in a master-planned development located near the City of Cottonwood in Yavapai County. VSF has no employees and contracts with Pivotal Utility Management ("Pivotal") for management and administrative services and with A Quality Water Company for operations services.¹ VSF and Pivotal are owned by the same three individuals.²

2. On July 30, 2014, the Commission issued Decision No. 74608, authorizing a rate increase for VSF and requiring VSF to file, within 90 days after the effective date of the Decision, a

¹ Decision No. 74608 (July 30, 2014) at 4. Decision No. 74608 was issued in Docket No. SW-03437A-13-0292 ("rate case"). Official notice is taken of this decision.
² *Id.*

1 financing application designed to result in VSF's obtaining ownership of plant leased from Pivotal
2 during the test year, which plant VSF asserted to have an original cost of \$250,000. VSF was
3 directed to request Commission authorization to enter into long-term debt in the form of a note
4 receivable issued by Pivotal in an amount equal to the net book value of the plant and with a term of
5 14 years and an interest rate of 5 percent.³ VSF was further required to include with its financing
6 application the source documents supporting the net book value of the plant. The Decision also
7 required the Commission's Utilities Division ("Staff") to review the financing application and make a
8 filing providing Staff's recommendations for Commission action on the financing application.

9 3. On October 29, 2014, VSF filed with the Commission an application requesting
10 authorization to incur long-term debt in the form of a note receivable in an amount not to exceed
11 \$137,500, for a term not to exceed 11 years, at an interest rate not to exceed 5 percent, and to
12 encumber its real property and utility plant as security for such indebtedness ("financing
13 application"). VSF included a board resolution with the financing application. The financing
14 application did not address source documentation for the plant or the differences between the terms of
15 the requested financing and the financing as described in Decision No. 74608.

16 4. On November 26, 2014, VSF filed an Affidavit of Publication showing that notice of
17 the financing application had been published in the *Sedona Red Rock News* on November 7, 2014.

18 5. On January 26, 2015, VSF filed a Notice of Change of Address for VSF's counsel.

19 6. On January 29, 2015, Staff filed a Staff Report recommending approval of VSF's
20 financing application. Staff did not address source documentation for the plant or the differences
21 between the terms of the requested financing and the financing as described in Decision No. 74608.

22 7. On February 6, 2015, a Procedural Order was issued requiring VSF to make a filing
23 regarding the inconsistencies between its financing application and the requirements of Decision No.
24 74608 and requiring Staff to file a Staff response.

25 8. On February 27, 2015, VSF filed a Response to Procedural Order explaining the
26

27 ³ In a May 2, 2014, filing in the rate case, Staff had estimated that the book value for the plant after 6.5 years would be
28 \$168,740, based on the original cost reported at \$250,000 and \$81,250 in accumulated depreciation. (Decision No. 74608
at 9.) The lease agreement for the equipment was actually executed in June 2005. (*Id.*) The monthly lease payments of
\$2,587.95 resulted in an annual expense of \$31,055.40. (Financing App. at 2.)

1 difference in the repayment term for the requested financing.

2 9. On March 9, 2015, a Procedural Order was issued directing VSF to make a filing
3 specifically regarding the lack of source documents with its financing application and extending
4 Staff's deadline to review VSF's filing and file a Staff Response.

5 10. On March 17, 2015, VSF filed a Response to March 9, 2015 Procedural Order ("2nd
6 Response") explaining the lack of source documentation and providing a copy of a project cost sheet
7 and data response previously provided to Staff.

8 11. On April 6, 2015, Staff filed a Staff Response stating that Staff supports the use of an
9 11-year term for the requested financing and providing a copy of the same documents filed by VSF in
10 its 2nd Response.

11 12. VSF is in good standing with the Commission's Corporations Division and has no
12 deficiencies according to Staff's compliance database.

13 13. No public comments were filed in this matter.

14 **Financing Proposal**

15 14. VSF requests authority to issue long-term debt instruments in the form of a note
16 receivable in an amount not to exceed \$137,500, with Pivotal as the lender, a maturity not to exceed
17 11 years, and an interest rate not to exceed 5 percent. VSF also requests authority to encumber all of
18 its utility plant and assets by granting Pivotal a security interest in VSF's real property and its
19 wastewater plants and systems.

20 15. VSF's financing application requests a term not to exceed 11 years for its financing,
21 rather than the 14-year term contemplated in Decision No. 74608, so that the term of the repayment
22 will coincide with the estimated remaining useful life of the plant assets being transferred from
23 Pivotal to VSF. VSF asserts that this complies with the spirit and intent of the Staff recommendation
24 that was adopted by the Commission in Decision No. 74608.⁴

25 16. VSF's requested financing is for the purpose of purchasing the following property that
26 VSF has been leasing from Pivotal:

27 ⁴ VSF also stated that it was willing to modify its financing request to use a 14-year term if the Commission does not
28 agree that VSF's financing application conforms to the intent of Decision No. 74608 and the Commission also does not
desire to reopen Decision No. 74608 pursuant to A.R.S. § 40-252 to modify the requirement.

Quantity	Description
1	Horizontal cylindrical fiberglass sludge holding tank (12' x 25' = 20,092 gallons)
1	Vertical cylindrical chlorine contact tank (8' x 13.5' = 5,076 gallons)
1	Olympian D150PL 150kW standby generator with transfer switch
1	Inline Franklin Miller SS600 comminutor
2	Horizontal cylindrical fiberglass anoxic tanks (10' x 18.5' = 10,094 gallons each)
2	Horizontal cylindrical fiberglass aeration tanks (12' x 47.75' = 39,362 gallons each)

17. VSF did not provide source documentation for the plant assets being acquired because neither VSF nor Pivotal possesses such documentation. The plant was originally purchased as a complete design/build plant prior to being acquired by Pivotal. The plant components separated out for purposes of the current lease arrangement were assigned estimated values by Santec Corporation ("Santec") at the time of construction.⁵

18. VSF's proposed loan would have a monthly payment of approximately \$1,350.74, resulting in an annual cost of approximately \$16,208.88.⁶

19. VSF states that it will file true and correct copies of all debt instruments issued within 30 days after the loan finalization date.

20. The Resolution by VSF's Board of Directors unanimously approved VSF's entering into a standard loan agreement with Pivotal to replace the existing lease agreement for VSF's use of the plant listed above; Pivotal's transferring ownership of the plant to VSF upon execution of the loan agreement; VSF's obtaining financing in an amount not to exceed \$137,500, at an interest rate not to exceed 5 percent, for a term not to exceed 11 years; and VSF's applying to the Commission for approval of the proposed financing.

...

...

⁵ Santec is also unable to provide source documentation beyond the project cost sheet and summary that VSF and Staff have filed herein.

⁶ This amount is significantly lower than VSF's annual lease payments to Pivotal.

1 **Statutory Requirements**

2 21. A.R.S. §§ 40-301 and 40-302 prohibit a public service corporation from issuing
3 evidence of indebtedness payable at periods of more than 12 months after the date of issuance
4 without first obtaining a Commission order authorizing such issuance. Before issuing such an order,
5 the Commission must find that the issue is for lawful purposes which are within the corporate powers
6 of the applicant, are compatible with the public interest, with sound financial practices, and with the
7 proper performance by the applicant of service as a public service corporation and will not impair its
8 ability to perform that service. The Commission must specify in the order the amount of
9 indebtedness authorized, the purposes to which the issue or proceeds thereof are to be applied, and
10 that in the opinion of the Commission, the issue is reasonably necessary or appropriate for the
11 purposes specified in the order, pursuant to A.R.S. § 40-301, and that, except as otherwise permitted
12 in the order, such purposes are not, wholly or in part, reasonably chargeable to operative expenses or
13 to income.

14 22. A.R.S. § 40-285 requires a public service corporation to obtain Commission
15 authorization prior to encumbering the whole or any part of its line, plant, or system necessary or
16 useful in the performance of its duties to the public and renders void any encumbrance made without
17 Commission authorization.

18 **Engineering & Financial Analysis**

19 23. The equipment to be purchased by VSF is in service on VSF's system and is used and
20 useful in VSF's provision of service.

21 24. The total estimated original cost of \$250,000 for the equipment to be purchased is
22 reasonable and appropriate.

23 25. The requested \$137,500 amount for the financing represents the net book value of the
24 equipment to be purchased as of the financing application.

25 26. VSF's current capital structure is 100 percent equity, unchanged from the end of the
26 2013 test year for the rate case.

27 27. VSF's financing application shows that drawing the entire amount of the proposed
28 financing would result in a capital structure of approximately 70.75 percent common equity and

1 29.25 percent debt and in VSF's having a debt service coverage ratio ("DSC")⁷ of 6.18 and a times
2 interest earned ratio ("TIER") of 9.63.

3 28. Staff reports that VSF's drawing the entire amount of the proposed financing would
4 result in a capital structure of 70.6 percent equity, 2.1 percent short-term debt, and 27.3 percent long-
5 term debt and in VSF's having a DSC of 1.93. Staff did not provide a TIER calculation.

6 29. While the DSC calculations provided by VSF and Staff differ significantly,⁸ both DSC
7 calculations indicate that VSF generates sufficient cash flow to cover the obligations of the long-term
8 debt for which it is requesting approval.

9 30. Staff concluded that the long-term debt for which VSF requests approval is for lawful
10 purposes, is within VSF's corporate powers, is compatible with the public interest, is compatible with
11 sound financial practices, is compatible with VSF's proper performance as a PSC, and will not impair
12 VSF's ability to perform that service.

13 **Staff Recommendations**

14 31. Staff recommends that the Commission:

- 15 (a) Approve VSF's application for authority to issue a note receivable in an
16 amount not to exceed \$137,500 for a period of 11 years at an interest rate not
17 to exceed 5.0 percent;
- 18 (b) Order VSF to file a copy of all executed financing documents setting forth the
19 terms of the financing with the Utilities Division Director ("Director"); and
- 20 (c) Order VSF to file with Docket Control, within 60 days of providing one copy
21 of the executed financing documents to the Director, a notice indicating the
22 date that the documents were provided.

23 32. VSF does not object to Staff's recommendations.

24 ...

25 _____
26 ⁷ DSC represents the number of times internally generated cash will cover required principal and interest payments on
27 debt. A DSC of less than 1.0 means that debt service obligations cannot be met by cash generated from operations and
28 that another source of funds is necessary to preclude default on the debt obligation. A DSC higher than 1.0 means that
debt service obligations can be met by cash generated from operations. (Official notice is taken of this meaning.)

⁸ VSF and Staff used significantly different operating income figures and slightly different principal and interest
figures in their calculations.

1 **Resolution**

2 33. Staff's recommendations, set forth in Findings of Fact No. 31, are reasonable and
3 appropriate and should be adopted, with a slight modification to allow the note to be issued for a
4 period not to exceed 11 years. This will allow VSF the flexibility to adjust the term downward to
5 reflect the months that have passed since its financing application was filed, to coincide with the
6 remaining useful life of the plant, should it desire to do so.

7 34. It is reasonably necessary and appropriate, pursuant to A.R.S. § 40-301, for VSF to
8 incur indebtedness in an amount not to exceed \$137,500, by issuing a note receivable with a
9 maturation not to exceed 11 years, at an interest rate not to exceed 5.0 percent, for the purpose of
10 acquiring ownership of the equipment described in Findings of Fact No. 16, which purpose is not,
11 wholly or in part, reasonably chargeable to operative expenses or to income.

12 35. It is reasonable and appropriate for VSF to encumber its utility plant and assets by
13 granting Pivotal a security interest therein.

14 36. VSF's financing application and the subsequent filings made by VSF in this docket
15 substantially comply with the requirements imposed by Decision No. 74608. In future, VSF should
16 ensure that it obtains and retains source documentation to support the original cost of all plant
17 acquired.

18 **CONCLUSIONS OF LAW**

19 1. VSF is a public service corporation within the meaning of Article XV of the Arizona
20 Constitution and A.R.S. §§ 40-285, 40-301, and 40-302.

21 2. The Commission has jurisdiction over VSF and the subject matter of the financing
22 application.

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

24 4. The plant described in Findings of Fact No. 16 is currently in service and is used and
25 useful for VSF's provision of wastewater utility services.

26 5. The financing for which VSF requests approval is for lawful purposes within the
27 corporate powers of VSF; is compatible with the public interest, with sound financial practices, and
28

1 IT IS FURTHER ORDERED that Verde Santa Fe Wastewater Company, Inc. shall, within 30
2 days after executing any financing transaction authorized herein, provide to the Utilities Division
3 Director one copy of all executed financing documents setting forth the terms of the financing
4 transaction.

5 IT IS FURTHER ORDERED that Verde Santa Fe Wastewater Company, Inc. shall, within 60
6 days after executing any financing transaction authorized herein, file with the Commission's Docket
7 Control Center, as a compliance item in this docket, a notice in which an authorized representative of
8 Verde Santa Fe Wastewater Company, Inc. certifies the date that the financing documents were
9 executed, the date that a copy of the financing documents was provided to the Utilities Division
10 Director, and that the terms of the financing transaction executed fully comply with the authorization
11 granted herein.

12 IT IS FURTHER ORDERED that approval of the financing set forth herein does not
13 constitute or imply approval or disapproval by the Commission of any particular expenditure of the
14 proceeds derived thereby for purposes of establishing just and reasonable rates.

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1 IT IS FURTHER ORDERED that any unused authorization to incur debt granted in this
2 Decision shall expire on the date 24 months after the effective date of this Decision.

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

4 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.
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7 CHAIRMAN _____ COMMISSIONER _____

8
9 COMMISSIONER _____ COMMISSIONER _____ COMMISSIONER _____

10
11 IN WITNESS WHEREOF, I, JODI JERICH, Executive
12 Director of the Arizona Corporation Commission, have
13 hereunto set my hand and caused the official seal of the
14 Commission to be affixed at the Capitol, in the City of Phoenix,
15 this _____ day of _____ 2015.

16 JODI JERICH _____
EXECUTIVE DIRECTOR

17 DISSENT _____

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SERVICE LIST FOR: VERDE SANTA FE WASTEWATER COMPANY, INC.

DOCKET NO.: SW-03437A-14-0377

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