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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission
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AZ Corporation Commission
Director Of Utilities

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

IN THE MATTER OF THE APPLICATION OF RINCON WATER COMPANY FOR AUTHORITY TO ISSUE DEBT.

DOCKET NO. W-01723A-04-0731

DECISION NO. 67947

ORDER

Open Meeting
June 14 and 15, 2005
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:

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FINDINGS OF FACT

1. On October 5, 2004, Rincon Water Company ("RWC" or "Company") filed an application with the Commission requesting authorization to borrow $143,000 from the Water Infrastructure Finance Authoirty ("WIFA").

2. On October 5, 2004, RWC published notice of its application in the *Daily Territorial*, a newspaper of general circulation in its service area.

3. On December 6, 2004, Commission Utilities Division Staff ("Staff") filed a Staff Report that recommends denial of the application.

4. A Procedural Order dated December 8, 2004, gave RWC until January 7, 2005 to file comments to the Staff Report or request a hearing. The Procedural Order notified the Company that if it did not request a hearing, the Commission could issue a final Order without a hearing.

5. As of May 12, 2005, RWC had not filed a response to the Staff Report, nor did it request a hearing.

6. RWC is located about 10 miles northeast of Vail in Pima County, Arizona, and serves approximately 110 people through 37 water connections. The subdivision lots are typically 40 acres in size.

7. Rincon has requested to borrow $143,000 from WIFA to replace distribution lines within its certificated area. The cost of construction is estimated at $136,740, with the $6,260 balance of the request set aside for contingencies. The distribution main to the 188,000 gallon storage tank is at the end of its useful life and subject to numerous breaks and service disruptions.

8. The proposed loan was expected to have a term of 20 years at a rate equal to 70 percent of Prime plus 2 percent, or 4.725 percent per annum. Required monthly payments of principal and interest, not including the WIFA required reserve, would be $922.

9. Staff conducted its financial analysis based on Company-prepared financial statements for the year ended December 31, 2003 and for the nine months ended September 30, 2004. The Company reported a $3,966 operating loss for the year ended December 31, 2003. Staff calculated a pro forma annualized operating loss for 2004 of $47,248, and determined that taking account of depreciation expense, the Company would have a positive cash flow of $5,600 available for repayment of debt. Staff's annualized 2004 operating results show that the Company would have a Debt Service Coverage ("DSC") of 0.47 and a Times Interest Earnings Ratio ("TIER") of negative 6.21.[1] Staff's analysis indicates that the Company would not meet WIFA's minimum DSC requirement of 1.25, nor have sufficient cash flow or earnings to service the proposed debt.

10. Staff's analysis indicates that the proposed loan would result in a capital structure composed of 3.5 percent short-term debt, 64.6 percent long-term debt, and 31.9 percent equity. Staff reports RWC's capital structure is more leveraged than industry average.

11. RWC indicated to Staff that it did not want to apply for a rate increase to improve its debt service ability. The Staff Report indicates that RWC may have other options to fund the needed

[1] TIER represents the number of times earnings cover interest expense on long-term debt. A TIER greater than 1.0 means that operating income is greater than interest expense. A TIER of less than 1.0 is not sustainable in the long term but does not mean that debt obligations cannot be met in the short term. DSC represents the number of times internally generated cash will cover required principal and interest payments on long-term debt. A DSC ratio greater than 1.0 indicates that operating cash flow 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.

repairs including an equity infusion from its owners or selling land which is not used in the provision of service.

12. The Staff Report indicates that there are no outstanding compliance issues. The Arizona Department of Environmental Quality ("ADEQ") reports that RWC is delivering water that meets the water quality standard required by A.A.C. Title 18 Chapter 4, but has ordered the Company to replace the transmission line connecting its storage tank to its distribution main. ADEQ has indicated that it would not consider RWC to be in non-compliance as long as it was making satisfactory progress toward replacement.

13. The Staff Engineering Report concludes that the cost estimates of the work to be performed appears to be within the customary range and experience for such a project and further states that the proposed improvements are reasonable and appropriate, although no conclusions about the proposed plant should be inferred for rate making purposes.

14. Staff concludes that the issuance of debt in the amount of $143,000 on the terms described in the application is within the corporate powers of the Company.

15. Staff concludes that the issuance of any additional debt is not compatible with the public interest and not compatible with sound financial practices due to RWC's inability to service the debt. Consequently, Staff recommends denial of the request to borrow $143,000 from WIFA.

16. Staff further recommends that within 90 days of a Decision in this case, RWC should file a plan with Docket Control explaining how it will accomplish the needed repairs to come into compliance with ADEQ.

CONCLUSIONS OF LAW

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

2. The Commission has jurisdiction over RWC and of the subject matter of the application.

3. Notice of the application was given in accordance with the law.

4. The recommendations set forth in Findings of Fact Nos. 15 and 16 are reasonable and should be adopted.

5. The requested financing is not compatible with the public interest, with sound financial practices, nor with the proper performance by RWC of service as a public service corporation.

ORDER

IT IS THEREFORE ORDERED that the application of Rincon Water Company to borrow $143,000 from WIFA is denied.

IT IS FURTHER ORDERED that Rincon Water Company shall file, within 90 days of the effective date of this Decision, a plan detailing how it will accomplish the needed repairs and come into compliance with the Arizona Department of Environmental Quality.

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

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN COMMISSIONER COMMISSIONER

COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary 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 21st day of June, 2005.

BRIAN C. McNEIL
EXECUTIVE SECRETARY

DISSENT _____

DISSENT _____

JR:mlj

SERVICE LIST FOR: RINCON WATER COMPANY

DOCKET NO. W-01723A-04-0731

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