

OPEN MEETING ITEM



0000010388

ORIGINAL



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

22

ARIZONA CORPORATION COMMISSION

DATE: OCTOBER 20, 2004

Arizona Corporation Commission
DOCKETED

DOCKET NO: E-01461A-04-0299

OCT 20 2004

TO ALL PARTIES:

DOCKETED BY

Enclosed please find the recommendation of Administrative Law Judge Lyn Farmer. The recommendation has been filed in the form of an Opinion and Order on:

TRICO ELECTRIC COOPERATIVE, 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 ten (10) copies of the exceptions with the Commission's Docket Control at the address listed below by **4:00 p.m.** on or before:

OCTOBER 22, 2004

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 a Commission's Open Meeting to be held on:

OCTOBER 26, 2004 and OCTOBER 27, 2004.

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 Secretary's Office at (602) 542-3931.

RECEIVED

2004 OCT 20 P 12:4

AZ CORP COMMISSION
DOCUMENT CONTROL

BRIAN C. McNEIL
EXECUTIVE SECRETARY

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF THE APPLICATION OF
TRICO ELECTRIC COOPERATIVE, INC., AN
ARIZONA NONPROFIT CORPORATION, FOR
AUTHORITY TO BORROW THE ADDITIONAL
SUM OF \$57,992,000 FROM, OR GUARANTEED
BY THE UNITED STATES OF AMERICA (RUS)
AND TO EVIDENCE SAID LOAN BY THE
EXECUTION OF A LOAN AGREEMENT,
PROMISSORY NOTE AND SECURITY
DOCUMENTS REQUIRED BY THE LENDER.

DOCKET NO. E-01461A-04-0299

DECISION NO. _____

OPINION AND ORDER

DATE OF HEARING: October 1, 2004
PLACE OF HEARING: Phoenix, Arizona
ADMINISTRATIVE LAW JUDGE: Lyn Farmer
APPEARANCES: Messers. D. Michael Mandig and Russell E. Jones,
WATERFALL, ECONOMIDIS, CALDWALL,
HANSHAW, VILLAMANA, P.C., on behalf of
Applicant; and
Ms. Lisa VandenBerg, Staff Attorney, Legal Division,
on behalf of the Utilities Division of the Arizona
Corporation Commission.

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

1. On April 19, 2004, Trico Electric Cooperative, Inc. ("Trico" or "Cooperative"), an
Arizona nonprofit corporation, filed an application with the Commission requesting authorization to
borrow \$57,992,000 from, or guaranteed by the United States of America, through the Rural Utilities
Services ("RUS").

1 2. The proposed loan is under the hardship provision of the RUS loan program and
2 provides for a 5 percent interest rate for the term of the loan. The funds from the loan will be used to
3 finance the Cooperative's 2004-2007 Construction Work Plan ("Work Plan") which includes
4 construction of additional and supplemental facilities to provide for expected growth in its service
5 territory and to maintain its plant in sound operating condition.

6 3. Trico published notice of the Application in the May 6, 2004 edition of the *The Daily*
7 *Territorial*, the May 7, 2004 edition of the *Nogales International*, and the May 6, 2004 edition of the
8 *Casa Grande Dispatch*, all newspapers of general circulation in its service territory.

9 4. On September 22, 2004, the Commission's Utilities Division Staff ("Staff") filed a
10 Staff Report recommending approval of Trico's Application.

11 5. By Procedural Order issued September 28, 2004, this matter was set for hearing on
12 October 1, 2004.

13 6. The hearing was held as scheduled and Mr. Kevin Ritter, Ms. Sylvia Wallis, and Mr.
14 Charles Emerson testified on behalf of Trico. Mr. James Johnson testified on behalf of Staff.

15 7. Trico is a public service corporation providing electric distribution service in parts of
16 Pima, Pinal and Santa Cruz counties pursuant to authority granted by the Commission. Its principal
17 place of business is located in Marana, Arizona.

18 8. Trico serves more than 28,000 customers in a service area ranging from Mt. Lemmon
19 on the north side of Tucson to areas west and south of Tucson to Sasabe on the Mexican border.
20 Trico has no generating capacity of its own and is an all-requirement cooperative, receiving all of its
21 power supply from Arizona Electric Power Cooperative.

22 9. Although portions of the Cooperative's service territory are sparsely populated, areas
23 such as Avra Valley, Sahuarita, and Three Points are experiencing rapid growth.

24 10. The Cooperative's Work Plan includes new underground and overhead distribution
25 lines for line extensions to new customers; new tie lines; conversions and line upgrades in
26 distribution lines; new substations and upgrades; addition of new equipment including transformers,
27 meters, and voltage regulators; security lights; and new transmission lines to the new substations.

28 11. Trico proposes to borrow \$57,992,000, with draw downs to occur as construction

1 work is completed, over four years. Beginning in year 2005, Trico expects to draw down
2 approximately \$15,039,773, and approximately \$14 million per year in years 2006, 2007, and 2008.

3 12. The Work Plan's costs are \$55,839,491 and the remaining \$2,152,509 is for
4 construction costs incurred from mid October 2003 to January 1, 2004.

5 13. Although Trico has \$25,000,000 in interim financing granted in Decision No. 66779
6 (February 13, 2004), Trico does not anticipate that it will be necessary to use that interim financing
7 because it believes that RUS will have the appropriation to fund the loan when Trico is ready to draw
8 down funds pursuant to this financing application.

9 14. Trico's current rates were set in Decision No. 57915 (June 19, 1992), using a test year
10 ending December 31, 1990.

11 15. On August 18, 2004, Trico filed a rate application¹, requesting a rate increase of 5.13
12 percent, which it believes will provide a Times Interest Earned Ratio ("TIER") of 1.5 and a Debt
13 Service Coverage ("DSC") of 1.75 if the requested rate relief is granted in its entirety.²

14 16. As of December 31, 2002, Trico's capital structure consisted of approximately 64.5
15 percent debt, and 35.5 percent equity.

16 17. As of December 31, 2003, Trico's capital structure consisted of 70.97 percent debt,
17 and 29.03 percent equity. The TIER was 1.66 and the DSC was .43.

18 18. According to Trico's witness at the hearing, as of August 31, 2004, Trico's capital
19 structure consisted of 72 percent debt and 28 percent equity. The TIER was 1.29 and the DSC was
20 1.61.

21 19. According to Trico's witness at the hearing, the RUS and CFC require a minimum
22 TIER and DSC of 1.25.

23 20. Staff analyzed the forecasting models provided by Trico which forecasted Trico's
24 financial performance for the next ten years. Staff believes due to unforeseen future financial
25 performance, forecasted results may not be attained and therefore Staff relied primarily on the

26 ¹ Docket No. E-01461A-04-0607.

27 ² The TIER represents the number of times earnings will cover interest expense on long-term debt. A TIER ratio greater
28 than 1.0 means that operating income is greater than interest expense. The DSC ratio 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.

1 forecast for 2005. Assuming that the Commission approves Trico's pending rate application and that
2 Trico draws down the anticipated \$15 million during 2005, Staff calculated that Trico would have a
3 TIER of 1.39 and a DSC of 1.71 (Exhibit S-1; Schedule JHJ-1). The Cooperative's forecast predicts
4 that equity will decrease to a low of 20.25 percent in 2009 and reflects an additional five percent rate
5 increase in 2010 in order to keep Trico within the TIER and DSC lender requirements. At the
6 hearing, Staff testified that if the Commission approves this financing, but does not approve the rate
7 increase, in 2005, the TIER would fall to 1.07 and the DSC to 1.03.

8 21. The Commission Engineering Staff reviewed the Work Plan, visited a Trico
9 substation, and met with Trico's General Manager and Manager of Technical Services to discuss the
10 need and justification of the projects included in the Work Plan.

11 22. Staff concluded that the plant expenditures for capital projects as listed in the
12 Construction Work Plan are necessary for Trico to operate and maintain its electric system in a safe
13 and reliable manner and the expenditure amounts associated with these projects appear to be
14 reasonable.

15 23. Staff concludes that approval of the financing in an amount not to exceed \$57,992,000
16 as contemplated in the Application is consistent with sound financial practices, is compatible with the
17 public interest, and will not impair Trico's ability to perform its duty as a public service corporation.

18 24. Staff recommended that Trico be authorized to borrow an amount not to exceed
19 \$57,992,000 under the terms and conditions and for the purposes described in the application, the
20 Staff Engineering Report, and in Exhibit A-11.

21 25. Staff also recommended that:

22 a. Trico be required to file with Docket Control copies of all executed loan
23 documents, including agreements, notes, any appropriate board resolution, and opinion
24 of counsel, within 60 days of closing of the loan.

25 b. Trico be ordered to docket a capital plan, within six months of the decision in
26 this case, which will demonstrate how Trico will improve and or maintain its equity
27 position at not less than 30 percent of total capital by December 31, 2009.

28 26. At the hearing, Trico objected to the Staff recommendation that it file a capital plan to

1 target reaching a 30 percent equity level. Trico argued that the appropriate time to address that issue
2 was in the context of its pending rate case. Trico's Board of Directors on January 29, 2004 approved
3 an amended "Mission Statement, Core Ideologies & Corporate Strategic Concepts and Position"
4 document that states:

5
6 FC – Financial Condition Because of Trico's rapid growth
7 and therefore future significant projected plant investment, the
8 Board of Directors and Management believe that a 25% equity
9 level is reasonable for the foreseeable future. It is further
10 determined as reasonable to allow equity to drop slightly below the
11 25% level (as long as annual TIER is above 1.25) to avoid
12 excessive rate increases. With Trico's rapidly escalating plant
13 investment, it is very important that the Cooperative have adequate
14 funds and lines of credit for not only the normal operation of the
15 Cooperative, but also for times of emergency and for delays in
16 receiving long-term loan funds. For long-range financial planning
17 purposes, a general funds level goal of approximately 2% of utility
18 plant with a maximum of \$5,000,000 has been set.

19 Trico believes that it has balanced the Cooperative's interests in maintaining its financial condition
20 and in keeping rates low for its members.

21 27. In response to the Cooperative's argument that a capital plan is not needed, Staff
22 testified that in its experience, a fast-growing company needs more capital and more cash reserves,
23 not less. Staff also testified that it believes that RUS also thinks that 30 percent equity should be a
24 threshold, as evidenced by the RUS requirement in its mortgage agreements that return to patrons of
25 capital contributed by members is limited when the equity is less than 30 percent. In response to
26 Trico's argument that this issue should be held and addressed in the pending rate case, Staff stated
27 that there are ways to affect capital structure other than by increasing revenues, and that this is the
28 appropriate time for Trico to begin addressing the issue.

29 28. At the time of its last rate case, Trico was requesting a TIER of 2.02 which was driven
30 by a goal of achieving a 35 percent equity ratio, based upon a CFC recommendation that cooperatives
31 take steps to obtain a minimum equity ratio of 40 percent. In a subsequent financing order, Decision
32 No. 59941 (December 19, 1996), there is a discussion about financial ratios that states that Trico's
33 board had determined that \$7 million is an appropriate *minimum* cash reserve level as "large cash
34

1 reserves are prudent during the current period of rapid growth and given the uncertainties associated
2 with retail competition.” In January of 2004, Trico’s board determined that a *maximum* of \$5 million
3 is appropriate. It is clear that Trico’s board of directors has changed its opinion about what financial
4 ratios are appropriate. However, despite the testimony of Trico’s witness at hearing that the change
5 of opinion is due to Trico’s rapid growth, it is not clear why that opinion has changed, as Trico was in
6 1996, and continues to be, in a period of rapid growth.

7 29. We agree with Staff that Trico should submit a capital improvement plan. Although it
8 is commendable to want to maintain low rates for its members, the Cooperative’s financial condition
9 should not deteriorate as a result. Trico’s financial projections show that equity will reach a low of
10 20.85% in 2009. These projections also indicate that Trico intends to continue to retire capital credits
11 to its members of over one million dollars per year. During the hearing, Trico’s witness
12 acknowledged that in 2003 it was in violation of its mortgage requirements with RUS when it retired
13 over a million dollars of capital credits, stating that “it was a mistake on our part”. RUS requires that
14 when the Cooperative has between 20 and 30 percent equity, the Cooperative must limit its
15 retirement of capital credits to no more than 25 percent of its net margin. Exhibit A-11, Trico’s
16 audited Financial Statements, Note 8 Return of Capital, concludes that the “2003 retirement was in
17 excess of that permitted in the mortgage agreement.” We believe that Trico must also look at means
18 other than merely raising rates to address its soon to be highly leveraged capital structure, and will
19 approve this financing with the condition that Trico not retire capital credits in excess of 25 percent
20 of its net margins when its capital structure is between 20 and 30 percent, and no retirement when
21 equity is 20 percent or less. This is in accordance with the existing mortgage requirements of RUS,
22 and will insure that Trico makes a start toward improving its capital structure. Trico, in its capital
23 improvement plan, should also address other methods of improving the capital structure. We do not
24 agree that this issue should be put off until the rate case, as we recognize that by our approval of this
25 financing application, Trico’s equity ratio will be further diminished.

26 30. No post hearing objection to the admission of Exhibit A-8 was docketed, therefore it is
27 admitted.

28

CONCLUSIONS OF LAW

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

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

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

6 4. The financing approved herein is for lawful purposes within Trico's corporate powers,
7 is compatible with the public interest, with sound financial practices, and with the proper
8 performance by Trico of service as a public service corporation, and will not impair Trico's ability to
9 perform that service.

10 5. The financing approved herein is for the purposes stated in the Cooperative's
11 Construction Work Plan as set forth in the Staff Engineering Report and in Exhibit A-1 and is
12 reasonably necessary for those purposes, and is not reasonably chargeable to operating expenses or to
13 income.

14 6. It is reasonable and in the public interest to authorize Trico to borrow \$57,992,000
15 from RUS at an interest rate of 5 percent on the condition that Trico not retire capital credits in excess
16 of 25 percent of its net margins when its capital structure is between 20 and 30 percent equity, and no
17 retirement when equity is 20 percent or less.

18 7. It is reasonable and in the public interest to require Trico to provide to the
19 Commission copies of loan agreements, notes, any appropriate board resolution, and opinion of
20 counsel, within 60 days of funding of the new loan from RUS.

21 8. It is reasonable and in the public interest to require Trico to file a capital improvement
22 plan as discussed herein.

ORDER

23
24 IT IS THEREFORE ORDERED that Trico Electric Cooperative, Inc. is hereby authorized to
25 borrow \$57,922,000 from the Rural Utilities Service at an interest rate of 5 percent.

26 IT IS FURTHER ORDERED that Trico Electric Cooperative, Inc. shall not retire capital
27 credits in excess of 25 percent of its net margins when its capital structure is between 20 and 30
28 percent equity, and no retirement shall occur when equity is 20 percent or less.

1 IT IS FURTHER ORDERED that Trico Electric Cooperative, Inc. is authorized to engage in
2 any transaction and to execute or modify, or cause to be executed or modified, any new or existing
3 documents necessary to effectuate the authorization granted herein, including notes or mortgage
4 agreements evidencing or securing the indebtedness authorized herein.

5 IT IS FURTHER ORDERED that Trico Electric Cooperative, Inc. shall use the financing
6 approved herein for the purposes set forth in Exhibit A-1 and as described in the Staff Engineering
7 Report.

8 IT IS FURTHER ORDERED that Trico Electric Cooperative, Inc. shall file with the
9 Commission, within 60 days of the funding of the new loan, copies of executed documents and
10 agreements of any kind in connection with the approved transactions, including but not limited to
11 loan agreements, notes, any appropriate board resolution, and opinion of counsel.

12 IT IS FURTHER ORDERED that Trico Electric Cooperative, Inc. shall file with the
13 Commission's Docket Control, a capital improvement plan as discussed herein, no later than
14 December 31, 2004.

15 ...
16 ...
17 ...
18 ...
19 ...
20 ...
21 ...
22 ...
23 ...
24 ...
25 ...
26 ...
27 ...
28 ...

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

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

5 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

6
7
8 CHAIRMAN COMMISSIONER COMMISSIONER

9
10 COMMISSIONER COMMISSIONER

11 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive
12 Secretary 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 _____, 2004.

16 _____
17 BRIAN C. McNEIL
18 EXECUTIVE SECRETARY

19 DISSENT _____

20 DISSENT _____

21 LF:mj

22
23
24
25
26
27
28

1 SERVICE LIST FOR:

E-01461A-04-0299

2 DOCKET NO.:

TRICO ELECTRIC COOPERATIVE, INC.

3

4 Russell E. Jones
5 WATERFALL ECONOMIDIS CALDWELL
6 HANSHAW & VILLAMANA, P.C.
7 5210 East Williams Circle, Ste. 800
8 Tucson, AZ 85711
9 Attorneys for Applicant

7 Christopher C. Kempley, Chief Counsel
8 Legal Division
9 ARIZONA CORPORATION COMMISSION
10 1200 West Washington Street
11 Phoenix, AZ 85007

10 Ernest G. Johnson, Director
11 Utilities Division
12 ARIZONA CORPORATION COMMISSION
13 1200 West Washington Street
14 Phoenix, AZ 85007

13

14

15

16

17

18

19

20

21

22

23

24

25

26

27

28