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BEFORE THE ARIZONA CORPORATION COMMISSION

DOCKETED

DEC 03 2002

1
2 WILLIAM A. MUNDELL
Chairman
3 JIM IRVIN
Commissioner
4 MARC SPITZER
Commissioner
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6 IN THE MATTER OF THE EMERGENCY)
APPLICATION OF ARIZONA PUBLIC)
7 SERVICE COMPANY FOR A PARTIAL)
WAIVER OF A.A.C. R14-2-804(B)(1) AND (2))
8

DOCKET NO. E-01345A-02-0840

DECISION NO. 65434

ORDER

9 Special Open Meeting
November 22, 2002
10 Phoenix, Arizona

11 BY THE COMMISSION:

12 FINDINGS OF FACT

13 1. On November 8, 2002, Arizona Public Service Co. ("APS" or "Company") filed an
14 application for a waiver of Arizona Administrative Code ("A.A.C.") R14-2-804(B)(1) and (2) (the
15 "Rules"). Specifically, APS seeks to make short-term advances of funds to its parent, Pinnacle West
16 Capital Corporation ("Pinnacle West"), or to make short-term guarantees of Pinnacle West's debt, as
17 more fully described below.

18 2. The financing statutes would allow APS to execute this transaction without Commission
19 approval but for Rule 804, one of the Commission's affiliated interests rules. Those rules state in
20 relevant part:

21 R14-2-804. Commission Review of Transactions Between Public Utilities and Affiliates

22 B. A utility will not consummate the following transactions without prior approval by the
23 Commission:

- 24 1. Obtain a financial interest in any affiliate not regulated by the Commission, or guarantee,
25 or assume the liabilities of such affiliate;
- 26 2. Lend to any affiliate not regulated by the Commission, with the exception of short-term
27 loans for a period less than 12 months in an amount less than \$100,000...

28 and

1 R14-2-806. Waiver from the Provisions of this Article

2 A. The Commission may waive compliance with any of the provisions of this Article upon a
3 finding that such waiver is in the public interest.

4 3. APS intends to loan Pinnacle West up to an aggregate principle amount of \$125,000,000
5 for a period of up to 364 days ("Backup Line of Credit") or to guarantee Pinnacle West debt up to an
6 aggregate principle amount of \$125,000,000 ("Interim Guarantee") for the same period. APS wants to
7 undertake these obligations because Pinnacle West recently lost the ability to renew a \$125,000,000
8 364-day bank facility ("Bank Facility") that was used to support Pinnacle West's commercial paper
9 program. The Bank Facility expires November 29, 2002. The commercial paper program funds
10 Pinnacle West's ongoing operations. Commercial paper programs are normally backed by some form
11 of credit, such as the expiring Bank Facility, and loss of such backup would normally result in loss of
12 an ability to sell commercial paper in the same amount.

13 4. Staff confirmed that Pinnacle West is expected to suffer liquidity problems if it was
14 unable to access its full commercial paper program, including the \$125,000,000 commercial paper or
15 similar program. Pinnacle West needs the credit facility or a similar cash source to manage its cash
16 flows over the next year. Without access to these or similar sources, Pinnacle West's cash flow will
17 likely become negative relatively soon.

18 5. The application states that the Backup Line of Credit or Interim Guarantee is necessary to
19 stabilize the financial condition of Pinnacle West and its affiliates and to avoid rating downgrades. On
20 November 4, 2002, Standard & Poor's Ratings Services ("S&P") lowered APS' corporate credit rating
21 to BBB from BBB+. The downgrade was the result of S&P's consolidating the ratings of APS and
22 Pinnacle West because of a lack of regulatory insulation between the two entities.

23 6. APS' application asserts that it will not be required to borrow funds to finance either the
24 Backup Line of Credit or the Interim Guarantee and that neither would result in a loss of APS' overall
25 credit quality or debt rating or in any manner adversely affect APS customers. The application further
26 indicates that APS would avoid further deleterious financial consequences through Pinnacle West if
27 the application was granted and APS was allowed to support its parent through the Backup Line of
28 Credit or the Interim Guarantee.

1 7. APS asserts that "it is making this emergency request to address a deteriorating financial
2 situation arising from the Arizona Corporation Commission's ("Commission") dramatic "reversal of
3 course" on divestiture of generation assets by APS and the necessary integration of APS and Pinnacle
4 West Energy Corporation ("PWEC") generation as called for under the 1999 APS Settlement
5 Agreement and the Commission's Electric Competition Rules." Staff, however, established that the
6 exigent circumstances are due to market conditions quite apart from any Arizona action. Those market
7 conditions include a reduction in credit extended to the energy industry generally. APS' assertion is
8 erroneous and, therefore, is not a justification for APS' emergency request.

9 8. In Staff's assessment, the situation described by APS presents an exigent circumstance,
10 especially when viewed in the context of the energy sector as a whole. Failing to address the liquidity
11 problem at Pinnacle West could cause significant problems for APS. Because of this risk and because
12 of the attendant turmoil currently surrounding the energy industry, prompt action by the Commission is
13 appropriate. The limited size and duration of the request weighed against the potential harm that could
14 accrue to APS indicates that the waiver is in the public interest. Finally, granting this application will
15 preserve the status quo without prejudicing the Commission's ability to evaluate the pending APS
16 financing application. Approval of this waiver application is not intended to prejudice the pending
17 financing application in Docket No. E-10345A-02-0707

18 9. Staff further believes that the lack of regulatory insulation between APS and Pinnacle
19 West has the potential to result in APS suffering further deleterious derivative financial consequences,
20 such as rating downgrades, if Pinnacle West suffered liquidity problems. For these reasons, Staff
21 recommends that the Commission examine methods for improving the regulatory insulation between
22 APS and its affiliates in the pending financing application.

23 10. Staff recommends that APS be granted a waiver of Rule 804(B)(1) and, to the extent
24 necessary, Rule 804(B)(2) subject to the following four conditions:

25 (a) The pricing schedule between Pinnacle West and APS for the Backup Line of Credit
26 shall be the existing pricing schedule on the expiring Bank Facility at Level IV status (or Level
27 V if Pinnacle West's ratings fall below either BBB- by S&P or Baa3 by Moody's). Other
28 terms and conditions of the Backup Line of Credit shall be the same as the expiring Bank

1 Facility.

2 (b) APS shall acquire a \$125,000,000 security interest in certain Pinnacle West Energy Corp.
3 assets.

4 (c) All revenues received by APS pursuant to this authority shall be deferred and accounted
5 for in a manner to allow amortization as a credit to customers in the next rate case.

6 (d) The Commission shall examine methods for improving the regulatory insulation between
7 APS and its affiliates in the pending financing application.

8 These conditions are designed to ensure that APS' ratepayers will be adequately protected from
9 any potential risk associated with this transaction.

10 CONCLUSIONS OF LAW

11 1. Arizona Public Service Co. is an Arizona public service corporation within the meaning
12 of Article XV, Section 2 of the Arizona Constitution.

13 2. The Commission has jurisdiction over Arizona Public Service Co., and over the subject
14 matter of the application.

15 3. The Commission having reviewed the application and Staff's memorandum dated
16 November 26, 2002, concludes that it is in the public interest to approve a waiver to A.A.C. R14-2-
17 804(B)(1) and (2) under the terms and conditions described above, including conditions (a) through (d)
18 articulated in Finding of Fact 10.

19 ORDER

20 IT IS THEREFORE ORDERED that Arizona Public Service Corp. be approved a waiver to
21 A.A.C. R14-2-804(B)(1) and (2) under the terms and conditions described above, including conditions
22 (a) through (d) articulated in Finding of Fact 10.

23 IT IS FURTHER ORDERED that APS shall not be allowed to seek financing for either the
24 Backup Line of Credit or the Interim Guarantee discussed herein.

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

26 **BY ORDER OF THE ARIZONA CORPORATION COMMISSION**

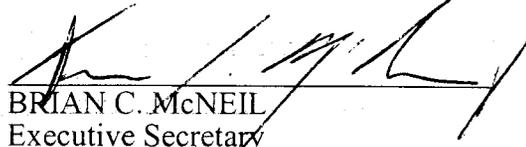
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28 CHAIRMAN

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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 this Commission to be affixed at the Capitol, in the City of Phoenix, this 3rd day of December, 2002.


BRIAN C. McNEIL
Executive Secretary

DISSENT: _____

EGJ:JST

1 SERVICE LIST FOR: Arizona Public Service Co.
DOCKET NO. E-01345A-02-0840

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