



MEMORANDUM

TO: Docket Control

FROM: Ernest G. Johnson
for Director
Utilities Division

DATE: February 6, 2006

RE: STAFF REPORT FOR ARIZONA ELECTRIC POWER COOPERATIVE, INC. –
APPLICATION FOR AUTHORIZATION FOR FINANCING (DOCKET NO. E-
01773A-06-0007)

Attached is the Staff Report for Arizona Electric Power Cooperative, Inc.'s application for authorization for financing. Staff recommends approval.

EGJ:DTZ:tdp

Originator: Daniel Zivan

Attachment: Original and fourteen copies

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Docket No. E-01773A-06-0007

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STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

ARIZONA ELECTRIC POWER COOPERATIVE, INC.

DOCKET NO. E-01773A-06-0007

APPLICATION FOR AUTHORIZATION
FOR FINANCING

FEBRUARY 2006

STAFF ACKNOWLEDGMENT

The Staff Report for Arizona Electric Power Cooperative, Inc., Docket No. E-01773A-06-0007 was the responsibility of the Staff member signed below. Daniel Zivan was responsible for the review and financial analysis of the Company's application.

A handwritten signature in black ink, appearing to be 'DZ', is centered on the page.

DANIEL ZIVAN
PUBLIC UTILITIES ANALYST III

EXECUTIVE SUMMARY
ARIZONA ELECTRIC POWER COOPERATIVE, INC.
APPLICATION FOR AUTHORIZATION
FOR FINANCING
DOCKET NO. E-01773A-06-0007

Arizona Electric Power Cooperative, Inc. ("AEPCO" or "Cooperative") filed an application requesting authorization for financing with the Arizona Corporation Commission ("Commission") on January 6, 2006. AEPCO is a Class "A" Arizona cooperative that supplies the power needs of its five Arizona class "A" cooperatives and other customers.

AEPCO requests Commission authorization, pursuant to A.R.S. 40-302.D., to temporarily exceed the statutory short-term borrowing limit of seven percent of total capital through 2006. Specifically, AEPCO requests authorization to increase its short-term borrowing to \$30 million. AEPCO had short-term borrowings of approximately \$15.2 million as of December 31, 2005, and its application anticipates that it will be at the threshold of the seven percent limit (estimated at \$16.3 million) by January 31, 2006. The Cooperative asserts that the larger short-term borrowing limit is needed to finance large under-collections caused by increasing costs of natural gas and purchased power and other operational efficiencies. Absent increased borrowing authority, AEPCO may default on accounts payable obligations to purchased power providers. AEPCO must repay short-term draws within one year.

AEPCO filed an application with the Commission requesting authorization to accelerate the implementation date for the Fuel and Purchased Power Cost Adjustor ("FPPCA") approved in the Cooperative's most recent rate case (Decision No. 68071) from October 1, 2006 to April 1, 2006, to improve its cash flow.

Staff concludes that the proposed use of funds is appropriate and that authorization to increase short-term borrowing to \$30 million for those purposes is lawful and within the corporate powers of the applicant, is compatible with the public interest, and would not impair AEPCO's ability to provide service. Extending the borrowing authorization is also sound practice from the perspective that not extending the authorization has potentially greater detrimental effects for AEPCO and its customers than any temporary cash flow shortfall for servicing the additional requested debt.

Staff concludes that AEPCO will not meet its obligations as they become due beginning in March 2006 without additional borrowing. Further, AEPCO needs additional cash to provide flexibility for its physical hedging program that saves fuel costs for the benefit of customers. In addition, AEPCO needs access to cash for contingencies. AEPCO also needs cash flow to reduce its existing and any additional short-term debt that the Commission may authorize. Accelerated recovery of cash flows via the FPPCA could support these needs for cash.

Staff recommends granting authorization to increase the limit on short-term debt borrowing to an amount not to exceed \$30 million until January 31, 2007, under the terms proposed and for the purposes described in this report.

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Introduction

Arizona Electric Power Cooperative, Inc. ("AEPCO" or "Cooperative"), an Arizona class "A" cooperative located in Benson, Arizona, filed an application requesting authorization for financing with the Arizona Corporation Commission ("Commission") on January 6, 2006.

Notice

Staff counsel has been notified that the Cooperative published notice of its financing application in *Tucson Citizen*, *The Daily Star* and *Kingman Daily Minor* on January 26, 2006. Staff is awaiting the affidavit of publication.

Background

AEPCO is a class "A" Arizona cooperative that supplies the power needs of its five Arizona class "A" cooperatives and other customers. AEPCO's current rates were approved in Decision No. 68071, dated August 17, 2005.

Purpose and Description of the Proposed Financing

AEPCO requests Commission authorization, pursuant to A.R.S. 40-302.D., to temporarily exceed the statutory short-term borrowing limit of seven percent of total capital. Specifically, AEPCO requests authorization to increase its short-term borrowing to \$30 million, or approximately 13 percent of total capital. The Cooperative's application states that "AEPCO has only about \$1 million in short-term debt capacity remaining to support fuel, purchased power and other working capital needs." The Cooperative asserts that the larger short-term borrowing limit is needed to finance large under-collections caused by increasing costs of natural gas and purchased power and its physical hedging program designed to limit future gas costs. AEPCO may default on accounts payable obligations to purchased power providers absent increased borrowing authority. AEPCO must repay short-term draws within one year.

Financial Analysis

AEPCO currently has two sources of short-term borrowing: a line of credit from the National Rural Utilities Cooperative Finance Corporation ("CFC") and a member investment program ("MIP"). As of December 31, 2005, AEPCO had borrowed approximately \$10 million from the CFC line of credit and approximately \$5 million from the MIP for a total of approximately \$15 million. The Cooperative's application anticipates that its short-term debt will be at the threshold of its seven percent of total capital limit (estimated at \$16.3 million) by January 31, 2006. AEPCO asserts that CFC will not grant additional short-term borrowings unless the Commission authorizes such borrowings to exceed seven percent of total capital.

AEPCO's projections show that a cash flow deficit (an inability to meet all obligations as they come due) will occur in March 2006 with its current authorizations (Refer to Schedule

DTZ-1). Granting AEPCO's request to extend short-term borrowing authorization to \$30 million would increase its borrowing capacity by approximately \$14 million. Schedule DTZ-1 shows that AEPCO projects a cumulative cash deficit of \$14.3 million at the end of September 2006. In other words, AEPCO's projections indicate that it would have sufficient cash to meet its anticipated obligations through September 2006 with the additional short-term borrowings of \$14 million. CFC's offer to extend short-term borrowing from \$10 million to \$25 million includes a stop order provision at \$20 million that allows CFC to perform a reevaluation when borrowing reaches \$20 million that could result in discontinuation of further lending.

AEPCO's projections show an additional \$10 million cash flow deficit in the last quarter of 2006 without recognition of Fuel and Purchased Power Cost Adjustor ("FPPCA") collections which the Commission authorized (Decision No. 68071) to begin in October 2006. AEPCO's cash flow projections do not provide for any unexpected contingencies nor do they provide the desired flexibility for purchases under its physical hedging program designed to limit future gas costs.

AEPCO filed an application with the Commission requesting authorization to accelerate the implementation date for the FPPCA approved in the Cooperative's most recent rate case (Decision No. 68071) from October 1, 2006 to April 1, 2006, to improve its cash flow.

Staff concludes that AEPCO will not meet its obligations as they become due beginning in March 2006 without additional borrowing. Further, AEPCO needs additional cash to provide flexibility for its physical hedging program that saves customers fuel costs. In addition, AEPCO needs access to cash for contingencies. AEPCO also needs cash flow to reduce its existing and any additional short-term debt that the Commission may authorize. Accelerated recovery of cash flows via the FPPCA could support these needs for cash.

Compliance

There are no compliance issues with AEPCO.

Conclusions and Recommendations

Staff concludes that the proposed use of funds is appropriate and that authorization to increase short-term borrowing to \$30 million for those purposes is lawful and within the corporate powers of the applicant, is compatible with the public interest and would not impair AEPCO's ability to provide service. Extending the borrowing authorization is also sound practice from the perspective that not extending the authorization has potentially greater detrimental effects for AEPCO and its customers than any temporary cash flow shortfall for servicing the additional requested debt.

Staff concludes that AEPCO (1) will not meet its obligations as they become due beginning in March 2006 without additional borrowing; (2) needs cash to save its customers fuel

costs via its physical hedging program; (3) needs access to cash for contingencies; (4) needs cash flow to reduce its existing and any additional short-term debt that the Commission may authorize; and (5) could have improved cash flow if the Commission were to authorize acceleration of the implementation date of the FPPCA.

Staff recommends granting authorization to increase the limit on short-term debt borrowing to an amount not to exceed \$30 million until January 31, 2007, under the terms proposed and for the purposes described in this report.

Staff further recommends approval of granting liens in favor of the lender as required to secure the borrowings authorized.

Staff further recommends authorizing AEPCO to engage in any transactions and to execute any documents necessary to effectuate the authorizations granted.

Staff further recommends that one copy of the executed loan documents be filed with Docket Control, as a compliance item, within 90 days of the decision in this matter.

Arizona Electric Power Cooperative, Inc. Cash Flow Projections for 2006

	Jan-06	Feb-06	Mar-06	Apr-06	May-06	Jun-06	Jul-06	Aug-06	Sep-06	Oct-06	Nov-06	Dec-06
CASH FLOWS FROM:												
OPERATIONS ¹	\$2,929,238	\$695,617	\$1,083,926	(\$9,882)	\$2,214,142	\$1,455,075	(\$1,469,140)	\$1,194,562	(\$2,409)	(\$4,200,512)	(\$505,631)	\$1,446,914
FINANCING ACTIVITIES	\$1,022,481	(\$1,181,162)	(\$5,809,733)	(\$351,821)	(\$1,572,890)	(\$5,580,356)	(\$268,321)	(\$2,469,239)	(\$6,166,090)	(\$411,022)	(\$1,201,308)	(\$5,369,495)
INVESTMENTS ACTIVITIES	\$28,155	\$25,445	\$28,189	\$187,419	\$28,520	\$27,616	\$28,681	\$28,698	\$27,953	\$189,030	\$28,110	\$29,064
TOTAL NET CASH FLOWS	\$3,979,874	(\$460,100)	(\$4,697,618)	(\$174,284)	\$669,772	(\$4,097,665)	(\$1,708,780)	(\$1,245,979)	(\$6,140,546)	(\$4,422,504)	(\$1,678,829)	(\$3,893,517)
BEGINNING CASH BALANCE	\$2,260,236	\$6,240,110	\$5,780,010	\$1,082,392	\$908,108	\$1,577,880	(\$2,519,785)	(\$4,228,565)	(\$5,474,544)	(\$11,615,090)	(\$16,037,594)	(\$17,716,423)
ENDING CASH BALANCE	\$6,240,110	\$5,780,010	\$1,082,392	\$908,108	\$1,577,880	(\$2,519,785)	(\$4,228,565)	(\$5,474,544)	(\$11,615,090)	(\$16,037,594)	(\$17,716,423)	(\$21,609,940)
RESTRICTED FUNDS	(\$2,680,331)	(\$2,680,331)	(\$2,680,331)	(\$2,680,331)	(\$2,680,331)	(\$2,680,331)	(\$2,680,331)	(\$2,680,331)	(\$2,680,331)	(\$2,680,331)	(\$2,680,331)	(\$2,680,331)
ENDING CASH BALANCE	\$3,559,779	\$3,099,679	(\$1,597,939)	(\$1,772,223)	(\$1,102,451)	(\$5,200,116)	(\$6,908,896)	(\$8,154,875)	(\$14,295,421)	(\$18,717,925)	(\$20,396,754)	(\$24,290,271)

¹ Includes the sale of 1,000 tons of SO2 allowances in January, 2006 for \$1,530,000