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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission

DOCKETED

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COMMISSIONERS

JEFF HATCH-MILLER, Chairman  
 WILLIAM A. MUNDELL  
 MIKE GLEASON  
 KRISTIN K. MAYES  
 GARY PIERCE

IN THE MATTER OF THE APPLICATION OF  
 ARIZONA ELECTRIC POWER COOPERATIVE,  
 INC. FOR AUTHORIZATION TO INCUR DEBT  
 AND SECURE LIENS IN ITS PROPERTY TO  
 FINANCE ITS CONSTRUCTION WORK PLAN.

DOCKET NO. E-01773A-06-0084

DECISION NO. 69238

ORDER

Open Meeting  
 January 16 and 17, 2007  
 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

1. On February 10, 2006, Arizona Electric Power Cooperative, Inc. ("AEP" or "Cooperative") filed an application with the Commission requesting authorization to incur debt and secure liens in its property to finance its construction work plan for 2005-2008 ("CWP").

2. The Cooperative requests authorization to secure interim financing for its CWP in an amount not to exceed \$29.2 million from the National Rural Utilities Cooperative Finance Corporation ("CFC") and to secure a permanent loan in an amount not to exceed \$29.2 million from the Rural Utilities Service/Federal Financing Bank ("RUS/FFB") long-term loan program, when available, to repay and replace the CFC interim financing. In addition, AEP requests authorization to change the specific facilities to be financed in the CWP without the necessity of filing an amended application so long as the total amount financed remains below the requested financing amount.

1           3.       On March 14, 2006, the Cooperative filed an affidavit of publication verifying that it  
2 had published notice of its financing application in the *The Kingman Daily Miner* on February 23,  
3 2006 and in the *The Arizona Daily Star/Tucson Citizen* on the same date. These publications are  
4 newspapers of general circulation within AEPCO's service area.

5           4.       On October 11, 2006, Commission Utilities Division Staff ("Staff") filed a Staff  
6 Report, recommending approval of the proposed financing. Staff recommended that the Commission  
7 not approve the request to allow the finance authority to apply to changes to the CWP.

8           5.       On October 17, 2006, AEPCO filed a Response to the Staff Report. In its Response,  
9 AEPCO urges the Commission to approve its interim and long-term financing requests in relation to  
10 the 2005-2008 CWP "as the same may be amended" in an amount not to exceed \$29.2 million.  
11 AEPCO argues that growth, technological changes and other factors which impact the CWP over the  
12 time horizon of the plan, will inevitably require changes to the CWP. AEPCO asserts that by its  
13 request, it is trying to conserve both the Commission's and Cooperative's time and resources.  
14 AEPCO asserts that several safeguards would prevent abuse. First, AEPCO states it is a member-  
15 owned cooperative whose members comprise its Board of Directors, and any changes to the CWP  
16 must be approved by the Board, whose members, AEPCO argues, are vitally concerned with its  
17 continued ability to provide reliable and safe service. Second, AEPCO notes that any changes to the  
18 projects within the CWP have to be fully justified to, and approved by, RUS. Third, AEPCO states  
19 that all of RUS's extensive material specifications and competitive procurement practices must be  
20 followed in relation to all projects. Fourth, AEPCO cannot finance any more than the total amount of  
21 debt authorized by the Commission. Finally, AEPCO states, if and when changes are made to any of  
22 the individual projects which currently comprise the CWP, AEPCO is willing to file and provide  
23 Staff with details on the CWP changes and respond to any questions.

24           6.       AEPCO is an Arizona non-profit, member-owned cooperative located in Benson,  
25 Arizona. AEPCO provides power and energy at wholesale primarily to its six Class A member  
26 distribution cooperatives—Anza Electric Cooperative, Duncan Electric Cooperative, Graham County  
27 Electric Cooperative, Mohave Electric Cooperative, Sulphur Springs Valley Electric Cooperative,  
28 and Trico Electric Cooperation. AEPCO also provides service to the City of Mesa as a Class B

1 member and to the Salt River Project Agricultural Improvement District as a Class C member.

2 7. AEPCO's rates, and two additional phases to become effective in September of the  
3 years 2006 and 2007, were approved in Decision No. 68071, dated August 17, 2005.

4 8. The proposed CFC loan would have a maturity of December 31, 2035. At the time of  
5 the Staff Report, the interest rate for a CFC loan was 7.15 percent. No pre-payment penalties would  
6 apply to the proposed interim CFC financing.

7 9. The RUS/FFB loan would replace the CFC loan. The Cooperative has requested  
8 RUS/FFB loan terms with a final maturity date of December 31, 2035. The United States Treasury  
9 establishes daily the interest rate that will be applicable to draws on the RUS/FFB loans on that date.  
10 The interest rate as of the date of the Staff Report for a RUS/FFB loan was 5.19 percent.

11 10. AEPCO expected to receive RUS/FFB approval of its loan application by the third  
12 quarter of 2006. The applicable interest rate on the RUS/FFB loan will be fixed at the time that each  
13 advance is made and AEPCO would be able to draw down on the loan as needed to proceed with the  
14 Cooperative's CWP.

15 11. Commission Engineering Staff has reviewed the current list of projects in AEPCO's  
16 2005-2008 CWP, which total \$29,201,061, to be disbursed over the plan's years as follows:

2005	2006	2007	2008	Total
\$136,261	\$6,435,570	\$7,350,827	\$15,278,403	\$29,201,061

20 Engineering Staff finds that the items included in the list of capital projects are appropriate to meet  
21 new load growth of the member cooperatives and will enable AEPCO to operate and maintain the  
22 generating plant at the Apache Station in a safe and reliable manner. Staff also concludes that the  
23 expenditure amounts associated with the projects are reasonable. Staff states that it makes no "used  
24 and useful" determination in this proceeding, and that treatment of the proposed plant improvements  
25 for rate-making purposes is deferred to a future rate proceeding.

26 12. AEPCO's existing capital structure is highly leveraged. At December 31, 2005,  
27 AEPCO's capital structure consisted of 7.7 percent short-term debt, 87.0 percent long-term debt and  
28

1 5.4 percent equity. The 2006 pro forma reflects that issuance of the proposed debt would further  
2 exacerbate AEPCO's highly leveraged capital structure, and would result in a capital structure  
3 comprised of 7.3 percent short-term debt, 87.7 percent long-term debt and 5.0 percent equity.  
4 AEPCO's 2008 pro forma capital structure indicates 8.5 percent short-term debt, 85.7 percent long-  
5 term debt and 5.9 percent equity.

6 13. The Times Interest Earned Ratio ("TIER") represents the number of times earnings  
7 cover interest expense on long-term debt. A TIER greater than 1.0 means that operating income is  
8 greater than interest expense. A TIER less than 1.0 is not sustainable in the long term but does not  
9 mean that debt obligations cannot be met in the short term.

10 14. Debt Service Coverage Ratio ("DSC") represents the number of times internally  
11 generated cash will cover required principal and interest payments on long-term debt. A DSC greater  
12 than 1.0 indicates that operating cash flow is sufficient to cover debt obligations. A DSC less than  
13 1.0 means that debt service obligations cannot be met by cash generated from operations and that  
14 another source of funds is needed to avoid default.

15 15. Staff's financial analysis indicates that the 2006 pro forma TIER and DSC for  
16 AEPCO's proposed debt are 1.60 and 1.00, respectively, which Staff states shows that operating  
17 results are barely sufficient to meet all obligations. The 2007 pro forma TIER and DSC for  
18 AEPCO's proposed debt are 1.71 and 0.99, respectively. The 2008 pro forma TIER and DSC for  
19 AEPCO's proposed debt are 2.01 and 1.12, respectively, which Staff states indicate that AEPCO's  
20 operating results are expected to be sufficient to meet all obligations after all phases of the rate  
21 increase are implemented.

22 16. RUS has a coverage ratio requirement that requires AEPCO to achieve a minimum  
23 TIER and DSC of 1.00 in two out of three years. At the time of the last rate case, AEPCO was not in  
24 compliance with this RUS requirement. The rates authorized in Decision No. 68071 were expected  
25 to improve AEPCO's future TIER and DSC results.

26 17. Staff believes that two factors mitigate the otherwise low TIER and DSC projections.  
27 First, in its assumptions, Staff utilized the current CFC interest rate for all of its calculations, although  
28 the RUS/FFB loans are expected to bear a lower interest rate. The current rate differential is 1.96

1 percent (7.15 percent less 5.19 percent). Second, Staff notes that the Cooperative will not draw the  
2 entire \$29.2 million immediately after the loan is approved.

3 18. Staff concludes that issuance of the proposed debt financing not to exceed  
4 \$29,200,000 for the CWP, is within AEPCO's corporate powers, is compatible with the public  
5 interest, is consistent with sound financial practices, and will not impair its ability to provide services.

6 19. Staff reports there are no compliance issues with AEPCO.

7 20. Staff recommends:

- 8 a. The Commission should authorize AEPCO to incur debt and secure liens in its  
9 property to finance its CWP for \$29.2 million;
- 10 b. The Commission should authorize AEPCO's request for authorization to obtain  
11 interim CWP financing from CFC in an amount not to exceed \$29,200,000;
- 12 c. The Commission should authorize the Cooperative to secure a permanent loan in an  
13 amount not to exceed \$29,200,000 from RUS/FFB to repay and replace the interim  
14 CFC loan;
- 15 d. The Commission should authorize AEPCO to engage in any transactions and to  
16 execute any documents necessary to effectuate the authorizations granted;
- 17 e. AEPCO should be required to file copies of the executed loan documents with Docket  
18 Control, as a compliance item in this docket, within 30 days of execution; and
- 19 f. The Commission should deny AEPCO's request for authorization to change the  
20 specific facilities to be financed in the CWP without the necessity of filing an  
21 amended application.

22 21. Staff's financial projections are based on conservative assumptions concerning the  
23 applicable interest rate and timing of the draw-downs of the loans. The projections indicate that  
24 AEPCO will be able to meet RUS required financial ratios.

25 22. In Decision No. 68071 the Commission ordered AEPCO to file by March 31, 2006,<sup>1</sup>  
26 an equity improvement plan, and ordered AEPCO not to make any patronage refunds while its equity  
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28 <sup>1</sup> Later extended to June 15, 2006.

1 remains below 20 percent of total capitalization, and to limit patronage refunds to 25 percent of net  
2 earnings if its equity is between 20 and 30 percent of its capitalization.

3 23. On June 15, 2006, AEPCO filed an Equity Improvement Analysis in compliance with  
4 Decision No. 68071. AEPCO's equity analysis shows equity climbing to 20.36 percent of total assets  
5 by 2012 without any rate increases for the period 2008 to 2015.

6 24. Decision No. 68071 requires AEPCO to file another rate case no later than five years  
7 after the date of that Decision, or August 2010.

8 25. We concur with Staff's conclusion that approving the finance request is in the public  
9 interest. The capital improvements projects that comprise the CWP are reasonably necessary to meet  
10 the needs of AEPCO's members and to provide safe and reliable generation service. Financial  
11 projections indicate that AEPCO will be able to meet its on-going obligations.

12 26. The Staff Report did not elaborate on Staff's recommended denial of AEPCO's  
13 request that the finance authorization be extended to include capital projects different than those  
14 listed in the CWP. We believe that in general it is not good public policy to approve financing  
15 requests for unknown projects. The statutes that give the Commission authority to approve finance  
16 requests require as a prerequisite to approval that the Commission find the financing request to be  
17 reasonably necessary or appropriate for the purposes specified in the order: A.R.S. §40-302. We  
18 cannot make a finding of reasonableness or appropriateness without knowing the purposes of the  
19 financing request. In this case, however, we believe that with AEPCO's willingness to submit the  
20 proposed changes to Staff in advance, and with the added safeguards provided by RUS oversight,  
21 AEPCO makes a good case to allow some flexibility to allow this finance authority to extend to  
22 minor modifications of its CWP that generally conform to the approval granted herein. To provide  
23 this flexibility, we will allow the finance authorization approved herein to extend the modifications of  
24 the CWP that substantially conform to the purposes of the projects in the CWP, and that, in aggregate  
25 over the term of the CWP, cost no more than \$500,000, without additional Commission approval.  
26 Although such minor modifications are reasonable considering their cost in relation to the maximum  
27 authorized amount of \$29.2 million, we will require AEPCO to file in this docket a description of any  
28 such modification and its cost before starting the project. Further, we will allow the finance

1 authorization approved herein to apply to the CWP, as it may be amended with Staff oversight and  
2 agreement, in an amount greater than \$500,000, but not to exceed \$29.2 million. To accomplish  
3 AEPCO's goal of streamlining Commission approval process of potential modifications to the CWP  
4 greater than \$500,000, AEPCO should file any such proposed modifications to its CWP in this  
5 docket, and unless Staff files an objection to the proposed CWP changes within 30 days of AEPCO's  
6 filing the same, the proposed modifications to the CWP shall be deemed approved. Any proposed  
7 changes should substantially conform to the types of projects presented in the CWP before us. We  
8 find further than the flexibility we approve in connection with this financing request is expressly  
9 conditioned on the individual facts and circumstances of this case, including, but not limited to the  
10 cooperative status of the applicant and extensive federal regulation and oversight associated with  
11 financing the CWP, and this Decision should not be relied upon as precedent in future financing  
12 applications.

#### 13 CONCLUSIONS OF LAW

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

16 2. The Commission has jurisdiction over AEPCO and of the subject matter of the  
17 application.

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

19 4. The recommendations set forth in Findings of Fact No. 20, as modified by Findings of  
20 Fact No. 26, are reasonable and should be adopted.

21 5. The financing approved herein is for lawful purposes within AEPCO's corporate  
22 powers, is compatible with the public interest, with sound financial practices, and with the proper  
23 performance by AEPCO of service as a public service corporation, and will not impair AEPCO's  
24 ability to perform the service.

25 6. The financing approved herein is for the purposes stated in the application, is  
26 reasonably necessary for those purposes, and such purposes are not, wholly or in part, reasonably  
27 chargeable to operating expenses or to income.

28 ...

**ORDER**

1  
2 IT IS THEREFORE ORDERED that Arizona Electric Power Cooperative, Inc. is hereby  
3 authorized to borrow up to \$29,200,000 from the National Rural Utilities Cooperative Finance  
4 Corporation with a maturity date of 2035, at the interest rate prevailing when the draw is executed.

5 IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. is hereby  
6 authorized to borrow up to \$29,200,000 from the Rural Utilities Service/Federal Financing Bank, to  
7 repay and replace the National Rural Utilities Cooperative Finance Corporation loan, with a maturity  
8 date of 2035, at the interest rate prevailing when the draw is executed.

9 IT IS FURTHER ORDERED that such finance authority shall be expressly contingent upon  
10 Arizona Electric Power Cooperative, Inc.'s use of the proceeds for the purposes stated in its  
11 application and approved herein.

12 IT IS FURTHER ORDERED that use of the loan proceeds authorized herein shall be  
13 restricted to financing capital improvement projects as described in Arizona Electric Power  
14 Cooperative, Inc.'s 2005-2008 Construction Work Plan as that plan may be amended as set forth  
15 herein, in an amount not to exceed \$29.2 million.

16 IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. may, without  
17 additional Commission approval, use the loan proceeds authorized herein for modifications to the  
18 2005-2008 Construction Work Plan that, in aggregate over the term of the Plan, cost no more than  
19 \$500,000 and that substantially conform to the purposes of the projects in the Plan. Before  
20 implementing any such modification, Arizona Electric Power Cooperative, Inc. shall file in this  
21 docket a description of the project and its cost.

22 IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. may file in this  
23 docket any proposed modifications to the 2005-2008 Construction Work Plan which substantially  
24 conform to the purposes of the 2005-2008 Construction Work Plan and which cost more than  
25 \$500,00, but do not exceed the authorized amount of \$29.2 million, and unless Staff files an objection  
26 to the proposed modifications within 30 days of Arizona Electric Power Cooperative, Inc. filing the  
27 proposed changes, the proposed modifications shall be deemed approved.

28 IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. is authorized to

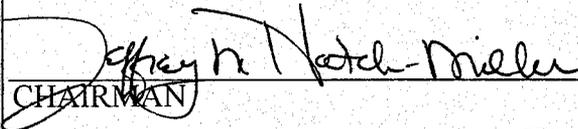
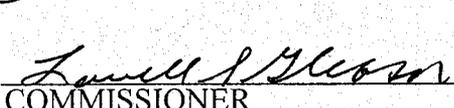
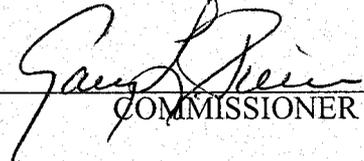
1 execute any documents necessary to effectuate the authorizations granted.

2 IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. shall file with  
3 Docket Control, as a compliance item in this docket, copies of all executed financing documents  
4 within 30 days after the date of execution.

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

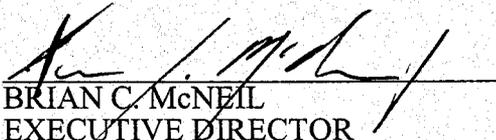
8 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

9 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

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 12 CHAIRMAN COMMISSIONER  
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 14 COMMISSIONER COMMISSIONER COMMISSIONER

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IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Director 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 19<sup>th</sup> day of Jan., 2007.

  
BRIAN C. McNEIL  
EXECUTIVE DIRECTOR

DISSENT \_\_\_\_\_

DISSENT \_\_\_\_\_

JR:mlj

1 SERVICE LIST FOR: ARIZONA ELECTRIC POWER COOPERATIVE, INC.

2 DOCKET NO.: E-01773A-06-0084

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