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BEFORE THE ARIZONA CORPORATION COMMISSION
Arizona Corporation Commission

DOCKETED

JAN 19 2007

DOCKETED BY [Signature]

COMMISSIONERS

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

DOCKET NO. E-04100A-06-0058

DECISION NO. 69239

ORDER

IN THE MATTER OF THE APPLICATION OF
SOUTHWEST TRANSMISSION COOPERATIVE,
INC. FOR AUTHORITY TO BORROW UP TO
\$49.575 MILLION FROM THE RUS/FFB TO
FUND THE CONSTRUCTION OF FACILITIES.

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 1, 2006, and as amended on May 8, 2006,¹ Southwest Transmission Cooperative, Inc., an Arizona nonprofit corporation, ("SWTC" or "Cooperative") filed an application with the Commission requesting authorization to borrow \$49.575 million from the United States of America, Rural Utilities Service Guaranteed Federal Financing Bank ("RUS/FFB") to finance plant construction according to SWTC's construction work plan for 2005-2008 ("CWP"). In addition, the Cooperative asks the Commission to authorize it to change the specific facilities to be financed in the CWP without the necessity of filing an amended application as long as the total amount financed remains below the requested financing authorization.

2. SWTC is an Arizona member-owned cooperative located in Benson, Arizona. SWTC provides network and point-to-point transmission service to wholesale entities under various

¹ SWTC's amended application reduced its requested debt authorization from \$58.015 million to \$49.575 million and withdrew its request for interim financing from the National Rural Utilities Cooperative Finance Corporation ("CFC").

1 transmission service agreements. SWTC provides wholesale firm network transmission service to
2 Arizona Electric Power Cooperative, Inc. ("AEPCO") on behalf of Anza Electric Cooperative,
3 Duncan Valley Electric Cooperative, Graham County Electric Cooperative, Sulphur Springs Valley
4 Electric Cooperative, and Trico Electric Cooperative. SWTC also provides firm network
5 transmission service to Mohave Electric Cooperative, Phelps Dodge Corporation and the City of
6 Safford. SWTC also provides firm point-to-point service to AEPCO, Mohave Electric Cooperative,
7 the City of Thatcher and the Salt River Agricultural Improvement Project and Power District. SWTC
8 was formed in August 2001 as part of the reorganization of AEPCO.

9 3. SWTC published notice of the Application in the February 22, 2006 edition of *The*
10 *Kingman Daily Miner* and the February 23, 2006 edition of *The Arizona Daily Star/Tucson Citizen*,
11 all newspapers of general circulation in its service territory.

12 4. On October 5, 2006, the Commission's Utilities Division Staff ("Staff") filed a Staff
13 Report recommending partial approval of SWTC's Application. Staff recommended that based on
14 projected financial ratios, only \$14.1 million of the requested borrowing authorization be approved.
15 Staff further recommended that the Commission deny the request for authorization to change the
16 specific facilities to be financed in the CWP without the necessity of filing an amended application.

17 5. On October 17, 2006, SWTC filed a Response to the Staff Report. SWTC disputed
18 Staff's assumptions and methodology of calculating the Times Interest Earned Ratio ("TIER")² and
19 Debt Service Coverage ("DSC")³ ratios, and argued that the Commission should approve the full
20 amount of its finance request. SWTC asserts that draws on the loan will be made over the four-year
21 term of the CWP and that Staff's assumption that the entire loan amount will be drawn down at once
22 is exceptionally conservative. SWTC states that Staff's analysis did not include the 1.5 percent rate
23 increase that was authorized in Decision No. 68072 and is scheduled to take effect on September 1,
24 2007. In addition, SWTC asserts, Staff's methodology of calculating the TIER and DSC are not
25 consistent with the methodology that the RUS employs, as Staff does not include \$612,000 in non-

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

28 ³ 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 operating income in its calculation of the TIER, while the RUS allows this income to be included to
2 determine TIER/DSC levels. Furthermore, SWTC argues that Staff's analysis did not take into
3 account that about \$19.7 million of the total CWP finance request is supported by Direct Assignment
4 Facility ("DAF") revenues from members where the transmission projects are used to deliver power
5 to only one distribution cooperative. SWTC states that DAF revenues associated with the CWP
6 projects total \$2,298,828. In addition, SWTC asserts that Staff's analysis did not account for
7 SWTC's reduction of its 150 MW contractual wheeling obligation on the Westwing-Vail-Greenlee
8 transmission path which will reduce expenses by \$923,520, and did not take into account
9 depreciation adjustments associated with CWP projects. SWTC states that using these adjustments,
10 and using Staff's methodology, the TIER is 1.06 and the DSC is 1.15. According to SWTC, using
11 the RUS methodology results in a TIER of 1.14. Under either methodology, SWTC claims, the
12 ratios exceed the mortgage requirements of a 1.05 TIER and a 1.0 DSC. SWTC argues that these
13 ratios support approval of the full financing request of \$49.575 million.

14 6. On November 30, 2006, Staff filed a Response to the SWTC Response to the Staff
15 Report. In its Response, Staff revised its financial analysis based on SWTC's October 17, 2006,
16 comments. Staff believes that it is not appropriate to include the effect of the September 1, 2007
17 rate increase without also including expenses for the same period, and that projected expenses would
18 be too unreliable to include. Staff also believes that including the depreciation on plant not yet built
19 is problematic and would have little effect on Staff's ultimate conclusions. After conducting
20 discovery of SWTC, Staff did, however, amend its financial analysis to include the effect of future
21 DAF revenue and the reduction in contractual obligations due to a reduction in a firm transmission
22 service obligation.

23 7. In its November 30, 2006, Response, Staff revised its recommendation. Based on its
24 revised financial analysis, Staff recommends that the Commission approve SWTC's request to issue
25 \$49,575,000 in debt conditioned on SWTC adopting an equity improvement plan to achieve an equity
26 percentage of total capital of 30 percent by the year 2015. Staff continues to recommend that the
27 Commission deny SWTC's request for authorization to change the specific facilities to be financed in
28 the CWP without the necessity of filing an amended application.

8. On December 13, 2006, SWTC filed a Reply to the November 30, 2006, Staff Response. SWTC objects to the recommended condition that SWTC adopt an equity accumulation plan to build equity to at least 30 percent of total capital by the year 2015. The Cooperative argues that based on the Equity Analysis it filed on June 15, 2006, Staff's condition would require an almost 30 percent rate increase in the next five years. Such increase, SWTC asserts, is unnecessary to service current debt, finance capital projects and maintain its financial integrity. SWTC also continues to object to Staff's recommended denial of authority to change specific projects without filing another application.

9. SWTC's current rates were approved in Decision No. 68072 (August 17, 2005).

10. The Cooperative has requested a final maturity date for the RUS/FFB loan of December 31, 2035. Interest rates for draws on the loan will depend on the interest rate in effect at the time of the draw. The interest rate for a 30-year RUS/FFB loan at the time of the Staff Report was 5.19 percent. The applicable interest rate will be fixed at the time of each advance, and SWTC would be able to draw down on the loan as needed to proceed with the Cooperative's CWP.

11. SWTC's CWP includes capital projects consisting of upgrades and new additions to the existing transmission system to meet the projected transmission needs of SWTC's Class A members. A summary of the CWP, by year follows:

| <u>Capital Projects</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> | <u>2008</u> | <u>Total</u> |
|---|-------------|--------------|--------------|--------------|--------------|
| Transmission Lines | | \$3,350,658 | \$1,949,774 | \$4,613,387 | \$9,913,819 |
| New Substations and Switching Stations | | \$6,122,689 | \$2,977,357 | \$4,406,639 | \$13,506,685 |
| Line and Substation Changes | \$2,262,228 | \$2,432,783 | \$10,660,243 | \$6,694,471 | \$22,049,725 |
| Communications & SCADA | \$610,000 | \$685,000 | \$950,000 | \$200,000 | \$2,445,000 |
| Line and Substation Ordinary Replacements | \$430,000 | \$415,000 | \$415,000 | \$400,000 | \$1,660,000 |
| TOTAL | \$3,302,228 | \$13,006,130 | \$16,952,374 | \$16,314,497 | \$49,575,229 |

12. Staff reviewed SWTC's CWP. Staff finds that the items included in the list of capital

1 projects are appropriate to meet new load growth of the member cooperatives and will enable SWTC
2 to operate and maintain the electric system in a safe and reliable manner. Staff also concluded that
3 the \$49,575,000 cost estimates of the proposed CWP appear reasonable, but stated that its conclusion
4 does not imply a specific treatment for rate base or rate making purposes.

5 13. Based upon SWTC's December 31, 2005 financial statement, Staff calculates SWTC's
6 current TIER to be 0.23 and its DSC to be 0.81 before recognition of any additional debt. After
7 taking account of SWTC's approved rate increase that took effect in September 2006, the TIER and
8 DSC improve to 1.18 and 1.16, respectively, under Staff's analysis.

9 14. Staff's revised financial analysis assumes that SWTC would draw the entire \$49.575
10 million loan at once. Assuming a draw down of \$49.575 million, Staff calculates a pro forma TIER
11 and DSC, of 1.21 and 1.13, respectively. Staff's revised analysis includes recognition of future DAF
12 revenue and reduced contractual wheeling obligations. Staff states that with these revisions to its
13 initial analysis, the Cooperative is able to fund the CWP with debt and meet the TIER and DSC
14 requirements of its lender.

15 15. As of December 31, 2005, SWTC's capital structure consisted of approximately 8.3
16 percent short-term debt, 90.4 percent long-term debt, and 1.3 percent equity. The proposed RUS/FFB
17 debt would have the effect of decreasing the Company's short-term debt from 8.3 percent to 5.9
18 percent, and increasing its long-term debt from 90.4 percent to 93.3 percent. Equity would be
19 reduced to 0.8 percent of total capital.

20 16. Staff concludes that issuing \$49,575,000 in new debt would exacerbate SWTC's
21 excessively leveraged capital structure, but that there are no other known alternatives available to
22 SWTC to finance the necessary capital improvements.

23 17. Staff further concludes and recommends:

24 (a) The estimated costs associated with the CWP appear to be reasonable;

25 (b) Issuance of debt financing not to exceed \$49,575,000 would be compatible with the
26 public interest, consistent with sound financial practice and would not impair SWTC's ability to
27 provide services only if SWTC adopts an equity improvement plan to achieve an equity percentage of
28 total capital of 30 percent by the year 2015;

1 (c) SWTC's demonstrated ability to fund its CWP and service the related debt
 2 combined with a committed equity plan dispenses with a need to prepare an analysis of methods to
 3 increase its cash flow and file a summary report as was recommended in the October 5, 2006 Staff
 4 Report⁴;

5 (d) The Commission should authorize SWTC to issue long-term debt to RUS/FFB in
 6 an amount not to exceed \$49.575 million to finance its CWP subject to the condition that the
 7 Commission require it to adopt an equity accumulation plan to build equity to at least 30 percent of
 8 total capital by the year 2015;

9 (e) Deny the Cooperative's request for authorization to change the specific facilities to
 10 be financed in the CWP without the necessity of filing an amended application;

11 (f) SWTC be authorized to engage in any transaction and to execute any documents
 12 necessary to effectuate the authorizations granted; and

13 (g) Copies of the executed loan documents be filed with Docket Control within 30
 14 days of execution.

15 18. SWTC opposes Staff's recommendation that it be required to adopt an equity
 16 accumulation plan to build equity to at least 30 percent of total capital by 2015. SWTC argues that
 17 the Commission has rejected this recommendation three times in the past 16 months⁵, and should do
 18 so again.

19 19. In Decision No. 68072 the Commission held:

20 We do not adopt a requirement now, nor do we read Decision No. 64227
 21 as requiring, that SWTC achieve any specific equity goal. We do adopt
 22 the rates herein with the expectation that SWTC will be able to build much
 23 needed equity. Because we are requiring SWTC to file another rate case
 in no more than five years, in any case, adopting an ultimate goal of 30
 percent at this time is not necessary.

24 Decision No. 68072 requires SWTC to file a rate case no later than August 17, 2010. Consistent with

25 ⁴ The Staff Report contained the recommendation that SWTC (1) perform an analysis to determine how to increase its
 26 cash flow so it is sufficient to finance its total CWP, adhere to its equity plan, service its debt and meet all debt covenants;
 27 and (2) docket a written summary of this analysis, along with conclusions and recommendations, as a compliance item in
 this matter within 60 days of a decision in this case. Staff recommended that the report should specify the actions SWTC
 would take, including but not limited to filing a rate application, to remedy any shortcomings identified in the analysis.

28 ⁵ Staff recommended a 30 percent equity goal in the last rate case (Decision No. 68072) and two subsequent financing
 matters (Decision Nos. 68179 and 68490).

1 our findings in Decision No. 68072, Decision No. 68179 (September 30, 2005) and Decision No.
2 68490 (February 23, 2006), we believe that adopting an ultimate goal of 30 percent equity at this time
3 is not necessary. We do not find support in the record that 30 percent equity is an appropriate goal
4 for SWTC. The 30 percent equity goal was hotly debated in the rate case that resulted in Decision
5 No. 68072. The Commission found at that time that the rates it was approving were expected to raise
6 equity significantly. See Decision No. 68072, Findings of Fact No. 39 and Decision No. 68179,
7 Findings of Fact No. 17.

8 20. Although we do not adopt a 30 percent equity goal at this time, we are concerned
9 about the Cooperative's highly leveraged position. However, our decision not to set an equity goal of
10 30 percent of total capitalization for SWTC should not be interpreted as a finding on any particular
11 equity requirement in the future. The financial projections and equity analysis that SWTC filed on
12 June 15, 2006 pursuant to Decision No. 68072, which includes the proposed debt that is part of the
13 application before us, shows that SWTC's equity is expected to grow to 3.92 percent at the end of
14 2006, 4.28 percent in 2007 and 4.38 percent in 2008. Thereafter, the percentage of equity declines
15 and would become negative 1.86 percent in 2012, without further action. Equity is important as it
16 gives public service corporations the flexibility to weather unforeseen difficulties, such as the loss of
17 a contract, without having to manage a financial crisis. We continue to believe that SWTC needs to
18 accumulate equity, and will order the Cooperative to file annual updates to the equity analysis it filed
19 in June 2006, such reports to explain deviations from SWTC's initial projections in June 2006. If
20 equity does not grow in substantial conformance with initial projections, we may require that SWTC
21 file a rate case sooner than August 2010. Staff should review and investigate SWTC's annual equity
22 analyses and make appropriate recommendations to the Commission for future action.

23 21. In both its Response to the Staff Report and Reply to Staff's Response, SWTC
24 reiterates its request that \$49.575 million be approved to finance its CWP "as the CWP is amended
25 from time to time." (emphasis added) SWTC states that the CWP spans more than five years, and
26 given the growth in the member cooperatives' territories, changes to specific projects within the CWP
27 are inevitable. SWTC states it is simply trying to reduce the considerable time and costs associated
28 with amending the CWP. SWTC cites several factors that it believes would act as safeguards against

1 abuse of the requested flexibility. First, SWTC states that any changes to the CWP would have to be
2 approved by the SWTC Board of Directors which is vitally interested in service reliability.
3 Secondly, SWTC states that all changes would need to be fully documented and approved by RUS as
4 well as follow all RUS equipment specifications, bidding and competitive procurement procedures.
5 SWTC states that it is willing to file and provide Staff information concerning any changes to the
6 CWP so that Staff can monitor any changes and request further details.

7 22. The Staff Report did not elaborate on Staff's recommended denial of SWTC's request
8 that the finance authorization be extended to include capital projects different than those listed in the
9 CWP. We believe that in general, it is not good public policy to approve financing for unknown
10 projects. The statutes that grant the Commission its authority over financing approval require the
11 Commission to find that the financing requests are reasonably necessary or appropriate for the
12 purposes specified in the order. A.R.S. § 40-302. We cannot make a finding of reasonableness or
13 appropriateness without knowing the purposes of the financing request. In this case, however, we
14 believe that with SWTC's willingness to submit the proposed changes to Staff in advance, and with
15 the added safeguards provided by RUS oversight, SWTC makes a good case to allow some flexibility
16 for this finance authority to extend to minor modifications of its CWP that generally conform to the
17 approval granted herein. To provide this flexibility, we will allow the finance authorization approved
18 herein to extend to modifications of the CWP that substantially conform to the purposes of the
19 projects in the CWP, and that, in aggregate over the term of the CWP, cost no more than \$500,000,
20 without additional Commission approval. Although such minor modifications are reasonable
21 considering their cost in relation to the maximum authorized amount of \$49,575,000, we will require
22 SWTC to file in this docket a description of any such modification and its cost before starting the
23 project. Further, we will allow the finance authorization approved herein to apply to the CWP, as it
24 may be amended with Staff oversight and agreement, in an amount greater than \$500,000, but not to
25 exceed \$49.575 million. To accomplish SWTC's goal of streamlining the Commission's approval
26 process for potential modifications to the CWP greater than \$500,000, SWTC should file any such
27 proposed modifications to its CWP in this docket, and unless Staff files an objection to the proposed
28 CWP changes within 30 days of SWTC filing the same, the proposed modifications to the CWP shall

1 be deemed approved. Any proposed changes should substantially conform to the types of projects
2 presented in the CWP before us. We find further that the flexibility we approve in connection with
3 this financing request is expressly conditioned on the individual facts and circumstances of this case,
4 including, but not limited to the cooperative status of the applicant and extensive federal regulation
5 and oversight associated with financing the CWP, and neither SWTC nor other applicants should rely
6 on this Decision as precedent in future financing applications.

7 23. Staff states that as of October 5, 2006, SWTC has no outstanding compliance issues
8 with the Commission.

9 CONCLUSIONS OF LAW

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

12 2. The Commission has jurisdiction over SWTC and the subject matter of the
13 application.

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

15 4. With the conditions imposed herein, the financing approved herein is for lawful
16 purposes within SWTC's corporate powers, is compatible with the public interest, with sound
17 financial practices, and with the proper performance by SWTC of service as a public service
18 corporation, and will not impair SWTC's ability to perform that service.

19 5. The financing approved herein is for the purposes stated in the application and is
20 reasonably necessary for those purposes, and is not reasonably chargeable to operating expenses or to
21 income.

22 6. It is reasonable and in the public interest to authorize SWTC issue to the long-term
23 debt as discussed and authorized herein.

24 ORDER

25 IT IS THEREFORE ORDERED that Southwest Transmission Cooperative, Inc. is hereby
26 authorized to borrow from the Rural Utilities Service Guaranteed Federal Financing Bank, an amount
27 not to exceed \$49,575,000, at the then prevailing interest rate, conditioned on compliance with the
28 requirements set forth below.

1 IT IS FURTHER ORDERED that Southwest Transmission Cooperative, Inc. shall file by
2 June 30, 2007, and annually by June 30th thereafter, as a compliance item with Docket Control, an
3 equity analysis, consistent with the discussion in Findings of Fact No. 20.

4 IT IS FURTHER ORDERED that Staff shall review and investigate Southwest Transmission
5 Cooperative, Inc.'s annual equity analyses and make appropriate recommendations to the
6 Commission for further action.

7 IT IS FURTHER ORDERED that the Commission may require Southwest Transmission
8 Cooperative, Inc. to file a rate case sooner than August 2010, if Southwest Transmission Cooperative,
9 Inc.'s equity position does not improve.

10 IT IS FURTHER ORDERED that Southwest Transmission Cooperative, Inc. may, without
11 additional Commission approval, use the loan proceeds authorized herein for modifications to its
12 CWP that, in aggregate over the term of the CWP, cost no more than \$500,000 and that substantially
13 conform to the purposes of the current CWP. Before implementing any such modification,
14 Southwest Transmission Cooperative, Inc. shall file in this docket a description of the project and its
15 cost.

16 IT IS FURTHER ORDERED that Southwest Transmission Cooperative, Inc. may file in this
17 Docket, any proposed modifications to its CWP which substantially conform to the purposes of the
18 current CWP and which cost more than \$500,000 but do not exceed the authorized amount of
19 \$49,575,000, and unless Staff files an objection to the proposed CWP modifications within 30 days
20 of Southwest Transmission Cooperative, Inc. filing the proposed changes, the proposed modifications
21 to the CWP shall be deemed approved.

22 IT IS FURTHER ORDERED that Southwest Transmission Cooperative, Inc. is authorized to
23 grant liens in favor of the lender as required to secure the borrowings authorized herein.

24 IT IS FURTHER ORDERED that Southwest Transmission Cooperative, Inc. is authorized to
25 engage in any transaction and to execute any documents necessary to effectuate the authorization
26 granted herein.

27 IT IS FURTHER ORDERED that Southwest Transmission Cooperative, Inc. shall use the
28 financing approved herein for the purposes set forth in the application.

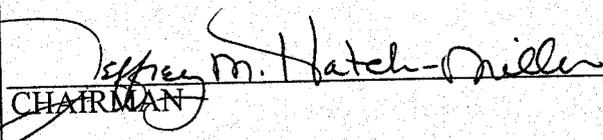
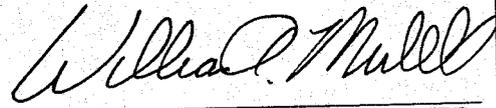
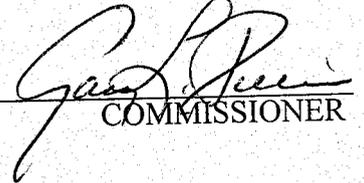
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IT IS FURTHER ORDERED that Southwest Transmission Cooperative, Inc. shall file as a compliance item with Commission Docket Control, within 30 days of the funding of the new loan, copies of executed loan documents.

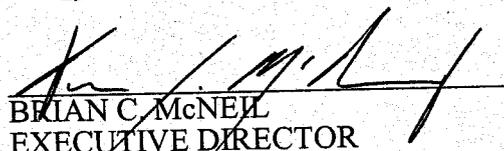
IT IS FURTHER ORDERED that approval of the financing set forth herein does not constitute or imply approval or disapproval by the Commission of any particular expenditure of the proceeds derived thereby for purposes of establishing just and reasonable rates.

IT IS FURTHER ORDERED that this Decision shall become effective immediately

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

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| CHAIRMAN | COMMISSIONER | |
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| COMMISSIONER | COMMISSIONER | COMMISSIONER |

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 19th day of Jan., 2007.


BRIAN C. McNEIL
EXECUTIVE DIRECTOR

DISSENT _____

DISSENT _____
TW:mlj

1 SERVICE LIST FOR: SOUTHWEST TRANSMISSION COOPERATIVE,
2 INC.

3 DOCKET NO.: E-04100A-06-0058

4 Michael M. Grant
5 Todd C. Wiley
6 2575 E. Camelback Road
7 Phoenix, AZ 85016

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

13 Ernest G. Johnson, Director
14 Utilities Division
15 ARIZONA CORPORATION COMMISSION
16 1200 West Washington Street
17 Phoenix, AZ 85007

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