

OPEN MEETING ITEM



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



ARIZONA CORPORATION COMMISSION

ORIGINAL

Arizona Corporation Commission

DOCKETED

DATE: OCTOBER 3, 2007

OCT 03 2007

DOCKET NO: E-01345A-06-0779

DOCKETED BY	
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TO ALL PARTIES:

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:

ARIZONA PUBLIC SERVICE COMPANY, ET AL.
(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 12, 2007

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 the Commission's Working Session and Open Meeting to be held on:

OCTOBER 23, 2007 AND OCTOBER 24, 2007

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.

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BRIAN C. McNEIL
EXECUTIVE DIRECTOR

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 COMMISSIONERS

3 MIKE GLEASON - Chairman
4 WILLIAM A. MUNDELL
5 JEFF HATCH-MILLER
6 KRISTIN K. MAYES
7 GARY PIERCE

DOCKET NO. E-01345A-06-0779

8 IN THE MATTER OF THE APPLICATION OF
9 ARIZONA PUBLIC SERVICE COMPANY FOR
10 AN ORDER OR ORDERS AUTHORIZING IT TO
11 ISSUE, INCUR, AND AMEND EVIDENCES OF
12 LONG-TERM INDEBTEDNESS AND SHORT-
13 TERM INDEBTEDNESS, TO EXECUTE NEW
14 SECURITY INSTRUMENTS TO SECURE ANY
15 SUCH INDEBTEDNESS, TO REPAY AMOUNTS
16 PAID UNDER ANY PINNACLE WEST CAPITAL
17 CORPORATION GUARANTEE OF ARIZONA
18 PUBLIC SERVICE COMPANY INDEBTEDNESS
19 AND FOR DECLARATORY ORDER.

20 IN THE MATTER OF THE APPLICATION OF
21 PINNACLE WEST CAPITAL CORPORATION
22 FOR AN ORDER OR ORDERS AUTHORIZING IT
23 TO GUARANTEE THE INDEBTEDNESS OF
24 ARIZONA PUBLIC SERVICE COMPANY.

DECISION NO. _____

OPINION AND ORDER

25 DATE OF HEARING: July 23, 2007
26 PLACE OF HEARING: Phoenix, Arizona
27 ADMINISTRATIVE LAW JUDGE: Lyn Farmer
28 IN ATTENDANCE: Mike Gleason, Chairman
Kristin K. Mayes, Commissioner
APPEARANCES: Mr. Thomas L. Mumaw and Ms. Meghan Grable, on
behalf of Arizona Public Service Company; and
Ms. Janet Wagner, Senior Counsel, Legal Division, on
behalf of the Utilities Division of the Arizona
Corporation Commission.

BY THE COMMISSION:

On December 15, 2006, Arizona Public Service Company ("APS" or "Company") filed a verified application with the Arizona Corporation Commission ("Commission") for authorization to:
1) incur the Continuing Long-Term Debt; 2) redeem, refinance, refund, renew, reissue, roll-over,

1 repay and re-borrow from time to time such Continuing Long-Term Debt, and establish and amend
2 the terms and provisions of Continuing Long-Term Debt from time to time; 3) incur the Continuing
3 Short-Term Debt; 4) redeem, refinance, refund, renew, reissue, roll-over, repay, and re-borrow from
4 time to time such Continuing Short-Term Debt, and establish and amend the terms and provisions of
5 Continuing Short-Term Debt from time to time; 5) determine the form of security, if any, for the
6 Continuing Long-Term Debt and the Continuing Short-Term Debt, execute and deliver one or more
7 Security Instruments in connection with the Continuing Long-Term Debt and the Continuing Short-
8 Term Debt, and establish and amend the terms and provisions of any such Security Instruments from
9 time to time; and 6) reimburse any amounts paid by Pinnacle West Capital Corporation ("PWCC")
10 under any Guarantee. PWCC also filed an application (together, "Joint Application") pursuant to
11 A.A.C. R14-2-806 requesting an ongoing waiver or authorization under A.A.C. R14-2-803 for
12 PWCC to guarantee the indebtedness of APS from time to time. APS further requested a declaratory
13 order that confirms that only traditional indebtedness for borrowed money constitutes an "evidence of
14 indebtedness" under A.R.S. §§ 40-301 and 40-302 and that such other arrangements do not require
15 prior Commission authorization and do not count against the Continuing Long-Term Debt or
16 Continuing Short-Term debt authorizations requested in the application.

17 On January 11, 2007, APS and PWCC filed a letter waiving the requirements of A.A.C. R14-
18 2-806's thirty day "time clock" for ruling on requests for waivers of the Commission's affiliate rules.

19 On March 6, 2007, APS and PWCC filed a Notice of Publication.

20 On May 18, 2007, the Commission's Utilities Division ("Staff") filed its Staff Report. In its
21 report, Staff recommended conditional approval of the various financing transactions and denial of
22 the request for a declaratory order.

23 On May 29, 2007, APS and PWCC filed their comments to the Staff Report.

24 On June 22, 2007, a Procedural Order was issued setting the matter for hearing.

25 On July 18, 2007, Staff filed the testimony of Gordon L. Fox, and APS filed its list of
26 witnesses and exhibits.

27 The hearing was held as scheduled on July 23, 2007. Ms. Barbara Gomez, Vice President and
28 Treasurer of APS and PWCC, testified on behalf of APS, and Mr. Gordon Fox, Financial Analyst

1 Manager, testified on behalf of Staff. No members of the public appeared to make public comment.

2 On August 1, 2007, APS filed its late-filed exhibits Nos. 4 and 5.¹

3 * * * * *

4 Having considered the entire record herein and being fully advised in the premises, the
5 Commission finds, concludes, and orders that:

6 **FINDINGS OF FACT**

7 1. APS is a public service corporation principally engaged in furnishing electricity in the
8 State of Arizona. APS provides either retail or wholesale electric service to substantially all of
9 Arizona, with the major exceptions of the Tucson metropolitan area and about one-half of the
10 Phoenix metropolitan area. APS also generates, sells and delivers electricity to wholesale customers
11 in the western United States.

12 2. On December 15, 2006, APS and PWCC filed the Joint Application.

13 3. Notice of the Application was published in the *Arizona Republic* on February 24,
14 2007. Notice of the hearing was published in the *Arizona Republic* on June 30, 2007 in accordance
15 with the June 22, 2007, Procedural Order.

16 4. The hearing commenced on July 23, 2007 and testimony and evidence was presented
17 by APS and Staff.

18 **Long-Term and Short-Term Debt**

19 5. APS currently has financing authority pursuant to Decision No. 55017 (May 6, 1986)
20 which allows the Company to have long-term indebtedness (including current maturities) in an
21 aggregate principal amount of up to \$2,698,917,000² and pursuant to Decision No. 65796 (April 4,
22 2003) which authorized APS to issue \$500 million of long-term debt and to loan the proceeds to
23 PWCC or Pinnacle West Energy Corporation ("PWEC"), its merchant subsidiary, to finance the
24

25 ¹ Exhibit No. 4 is in response to Commissioner Mayes' request for additional detail regard the construction expenditure
26 projections contained in the APS response to Staff's Data Requests, as reflected in Staff Exhibit No. 1. Exhibit No. 5 is
an update of the proposed ordering language contained in Exhibit F to APS Exhibit No. 2.

27 ² Decision No. 55017 also allows redemptions, refinancings, refundings, renewals, reissuances, and roll-overs of
28 outstanding debt, the incurrence or issuance of long-term debt and the amendment or revision of any terms or provisions
of or relating to any long-term debt, as long as the total long-term debt at any one time outstanding does not exceed
\$2,698,917,000 during any period of more than 30 days.

1 construction of PWEC's electric generating plants.³ The total current authorized long-term debt limit
2 is \$3,198,917,000.

3 6. The Joint Application requests authorization to increase the long-term indebtedness
4 limitation set forth in Decision No. 55017 so that APS may have, at any one time outstanding, up to
5 an aggregate principal amount of long-term indebtedness of \$4.2 billion, including the \$500 million
6 authorized in Decision No. 65796. APS also requests that, similar to Decision No. 55107, the
7 authorization permit any redemptions, refinancings, refundings, renewals, reissuances, roll-overs,
8 repayments, and re-borrowings of such outstanding indebtedness, the incurrence or issuance of any
9 additional long-term indebtedness, and the establishment, amendment, or revision of any terms or
10 provisions of or relating to any long-term indebtedness, as long as total long-term indebtedness
11 (including current maturities thereof) at any one time outstanding does not exceed \$4.2 billion for any
12 period of more than 30 days.⁴ This authorization would supersede the long-term indebtedness
13 limitation authorized by Decision No. 55017 and would include the debt authorized by Decision No.
14 65796.

15 7. A.R.S. § 40-302(D) allows APS to issue short-term debt in an amount not to exceed
16 seven percent (7%) of its capitalization without Commission approval, but restricts the refunding or
17 roll-over of any such notes. Decision No. 54230 (November 8, 1984) allows APS to reissue, renew,
18 and resell any such short-term indebtedness with or into additional short-term indebtedness, as long
19 as the seven percent limit is not exceeded.

20 8. APS witness Gomez testified that as APS continues to grow, so does its need for
21 working capital. As APS' load has grown, APS has an increased exposure to contracted commodity
22 and purchased power which have collateral provisions that can result in significant liquidity demands
23 as market prices change. This increased liquidity required to respond to volatile and increasing
24 collateral requirements has caused the need for short-term debt in excess of the currently authorized
25 amount. According to witness Gomez, the Company recently completed an assessment of its

26 ³ Decision No. 65796 specified that the \$500 million financing would not be classified or treated as continuing debt in the
27 context of the debt limits contained in Decision No. 55017.

28 ⁴ Allowing the long-term debt limit to be exceeded for a period of thirty days or less enables APS to issue new long-term
debt in advance of an upcoming planned redemption. APS Exhibit 1, Affidavit of Barbara M. Gomez, Vice President and
Treasurer of APS and PWCC.

1 liquidity needs and determined that an additional \$500 million short-term debt authorization was
2 necessary.⁵

3 9. In the Joint Application, APS requests Commission authorization to issue short-term
4 debt at any time and from time to time (excluding current maturities of long-term debt) in an amount
5 not to exceed the sum of: (i) seven percent (7%) of the Company's capitalization and (ii) \$500
6 million. APS requests that such authorization permit any redemptions, refinancings, refundings,
7 renewals, reissuances, roll-overs, repayments, and re-borrowings of any such outstanding
8 indebtedness, the incurrence or issuance of any additional short-term indebtedness, and the
9 establishment, amendment, or revision of any terms or provision of or relating to any short-term
10 indebtedness, as long as total short-term indebtedness at any one time outstanding (excluding current
11 maturities of long-term debt) does not exceed, for a period of more than thirty (30) days, the sum of:
12 (i) seven percent (7%) of the Company's capitalization and (ii) \$500 million without further
13 Commission authorization.

14 10. APS proposes to determine the nature of the Continuing Long-Term Debt and
15 Continuing Short-Term Debt, the maturities, the interest and/or discount rates, the necessity for and
16 form of any security, the applicable financial markets (e.g., whether domestic or foreign) or lenders,
17 the nature (e.g., whether public or private) of the offerings or borrowings, and the type or types of
18 transaction in which debt would be sold or incurred, by reference to the conditions in the financial
19 markets at the time(s) of commitment or sale. According to APS, the terms would be negotiated with
20 the intent of obtaining the most favorable results for the Company and its customers.

21 11. APS proposes that the net proceeds from its issuances of Continuing Long-Term Debt
22 and Continuing Short-Term Debt will be applied, directly or indirectly, to augment the funds
23 available to finance its construction, resource acquisition and maintenance programs, to redeem or
24 retire outstanding securities, to repay or refund other outstanding long-term or short-term debt, and to
25 meet certain of the Company's working capital and other cash requirements.

26

27 ⁵ This estimate includes \$250 million for normal working capital requirements; \$350 million for additional collateral
28 needed if the price of gas moved by 33 percent; and \$110 million for collateral contracts and \$175 million for prepaid fuel
requirements if APS were to become non-investment grade. These items provided the basis for the requested additional
\$500 million. TR pp 27-28, 113-115.

1 12. According to the Joint Application, APS believes that the proposed issuance or
2 incurrence of the Continuing Long-Term Debt and the Continuing Short-Term Debt, the
3 establishment and amendment of any terms and provisions of long-term or short-term indebtedness,
4 the execution and delivery of security instruments, and the establishment and amendment of any
5 terms and provision of the security instruments are for lawful purposes that are within its corporate
6 powers and are compatible with the public interest, with sound financial practices, and with the
7 proper performance by the Company as a public service corporation and will not impair its ability to
8 perform that service; and that further, they are reasonably necessary or appropriate for such purposes
9 and that such purposes are not, wholly or in part, reasonably chargeable to the Company's operating
10 expenses or to income, except to the extent required by generally accepted accounting principles or
11 by other accounting requirements applicable to the Company, including regulatory requirements. To
12 the extent that the purposes may be considered reasonably chargeable to operating expenses or to
13 income, APS requests that the Commission authorize such charge(s).

14 13. Staff provided testimony based upon its financial review and analysis and included an
15 engineering analysis and review in its filed Staff Report. Staff's witness testified that there are two
16 overriding considerations that the Commission should use in making its determination whether or not
17 to grant the authorizations. The first is whether a company has the technical and financial expertise
18 to make decisions on an ongoing basis under a general authorization as requested in the Joint
19 Application, or whether a company should be required to apply for specific authorizations on a case-
20 by-case basis. Staff noted that under a general authorization a company has more flexibility and
21 when used properly, it can provide many benefits to not only a company, but also to its ratepayers.⁶
22 Staff concluded that APS has the technical and financial expertise to operate under a general
23 authority, citing APS' healthy capital structure, its history of prompt rate cases and emergency rate
24 cases, and its requests for recovery of under-collections of the adjustor mechanism. Staff also noted
25 APS' demonstrated ability to use its financial flexibility to benefit and lower its capital costs, and
26 indicated that the Company also needs that flexibility to manage its operating cash needs well.

27
28

⁶ TR p. 177.

1 Secondly, Staff recommended that the Commission should consider the integrity of the management
2 of the Company. Staff points out these considerations because unless the Commission believes the
3 Company meets them, adding conditions such as equity ratios or modified debt service ratios may
4 ultimately do little to protect the Company's ratepayers.

5 14. According to the Engineering Staff Report, Staff reviewed APS' anticipated load and
6 customer growth, customer reliability statistics, and the 2007-2011 Construction Work Plans and
7 concluded that:

- 8 1. The load and customer growth rates of APS are reasonably projected based on past
9 load and customer growth rates and overall population growth expected for Arizona.
- 10 2. The customer reliability measures for the last five years on an aggregate system basis
11 indicate APS is managing its distribution system on a comparable par with the better
12 performing utilities in the nation with regard to reliability. APS is in a good position
13 to continue this trend with continued emphasis on reliability and appropriate
14 infrastructure investment.
- 15 3. APS is making investment in its capital plant over the next five years in a manner that
16 indicates new customers will be adequately and timely served and all customers can
17 expect a reasonable level of reliability. APS' Five Year Construction Work Plan is
18 appropriate and associated cost estimates are reasonable. However, this does not
19 imply a specific treatment or recommendation for rate base or rate making purposes
20 in APS' future rate filings.
- 21 4. Staff finds that APS' growth, reliability and capital investment plans are integrally
22 related and dependent on access to capital.⁷

23 15. APS filed its late-filed APS Exhibit No. 4, which included the detailed project-by-
24 project description and projected cash flows for 2007 to 2011 for nuclear, fossil, transmission,
25 distribution, and general plant.

26 16. Staff's financial review and analysis of the Joint Application indicated that an increase
27 in APS' long-term debt to \$4.2 billion would create a capital structure of 43.3 percent equity and 56.7
28 percent long-term debt.⁸

29 17. Staff analyzed the financial effects of the requested authorizations and concluded, with
30 Staff's modifications, that the request is within APS' corporate powers, is compatible with the public
31 interest, would not impair APS' ability to provide service and would be consistent with sound

⁷ Staff Exhibit No. 1, Staff Report, Attachment A p. 6.

⁸ Approval of the Joint Application will not eliminate the 40 percent common equity test for issuance of dividends as required in Decision No. 65796 (April 4, 2003) TR p. 68.

1 financial practices if after the debt issuance, the conditions recommended by Staff are met.

2 18. Staff recommended increasing the long-term debt threshold to \$4.2 billion subject to
3 the following conditions: (1) common equity divided by common equity and long-term debt
4 (including current maturities) is 40 percent or greater using the most recent audited financial
5 statements adjusted to reflect changes to outstanding debt; and (2) the debt service coverage ratio
6 ("DSC") as modified to exclude principal debt repayments ("Modified DSC"), must be equal to or
7 greater than 2.0.

8 19. Staff recommended authorization for APS to incur short-term debt in an amount not to
9 exceed \$500 million above seven percent (7%) of total capital provided that "(1) the excess over 7
10 percent of total capital shall be used solely for costs relating to natural gas or power purchases and (2)
11 APS has an authorized adjustor mechanism for recovery of these kinds of costs."⁹ Staff also
12 recommended that if APS' adjustor mechanism is terminated, "the short-term debt authorizations
13 granted should continue for an additional twelve months."¹⁰ This would allow APS to address its
14 short-term debt balances. Currently, the short-term limit of seven percent of capitalization is
15 approximately \$425 million, and with the additional \$500 million, the total short-term debt
16 authorization would be \$925 million.

17 20. Staff recommended that the authorizations to incur short-term and long-term debt
18 obligations should replace all existing authorizations to incur new short-term and long-term debt
19 obligations, and that all existing authorizations to incur new short-term and long-term debt
20 obligations should terminate upon the effective date of this Decision, and that all existing obligations
21 remain valid. Staff testified that this recommendation does not affect the authorizations related to the
22 Palo Verde sale/leaseback transactions/obligations contained in Decision Nos. 55017 and 54230.¹¹

23 21. In its initial Staff Report, Staff also recommended that the "short-term and long-term
24 debt levels authorized in this proceeding terminate on December 31, 2012."¹² In response to APS'
25 comments, Staff agreed that only authorizations of new debt should terminate at December 31, 2012,

26
27 ⁹ Staff Exhibit No. 2, Fox Direct Testimony, p. 12.

¹⁰ Ibid.

¹¹ TR pp. 155-156, 171, 174-175.

28 ¹² Staff Exhibit No. 1, Staff Report, p. 6.

1 and that existing obligations at that date should remain valid. In its Comments, APS requested that
2 the December 31, 2012 termination date be extended until the Commission issues a new financing
3 order replacing the then-existing order, provided that "(a) APS files an application for a new
4 financing order on or before December 31, 2011 and (b) the Commission has not issued an order
5 pursuant to such application on or before December 31, 2012."¹³ According to APS, this will "ensure
6 that APS' ability to access the capital markets is not abruptly terminated, which would prohibit APS
7 from funding its ongoing operations and meeting its obligations as a public service corporation."¹⁴
8 Staff agreed with APS' suggestion as it pertains to short-term authorizations due to the immediate
9 needs to fund natural gas and power acquisitions, but disagreed as applied to long-term debt. Staff
10 noted that "the needs for long-term debt are of a different nature and have greater long-term
11 effects."¹⁵ Because the Company could file a request for a specific debt issuance, instead of raising
12 the general threshold, Staff recommends that the Commission not prematurely assess the
13 circumstances that may exist in the future, but instead reserve its decision until the circumstances at
14 that time can be evaluated. We agree with this recommendation of Staff. Although the
15 authorizations to issue new long-term debt pursuant to this Decision will expire, APS has the ability
16 to ask for specific financing approval for any necessary purpose, and knowing the expiration date will
17 allow it to plan accordingly.

18 22. APS requested that to the extent that the purposes of the debt may be considered
19 reasonably chargeable to operating expenses or to income, APS be authorized to issue such debt.
20 A.R.S. § 40-302 specifically provides that before a public service corporation issues notes and other
21 evidences of indebtedness, it must first secure an order from the Commission stating "the purposes to
22 which the issue or proceeds thereof are to be applied, and that, in the opinion of the commission, the
23 issue is reasonably necessary or appropriate for the purposes specified in the order, pursuant to
24 section 40-301, and that, except as otherwise permitted in the order, **such purposes are not, wholly**
25 **or in part, reasonably chargeable to operative expenses or to income.**" (emphasis added) APS
26 did not offer any explanation of why it needed to issue debt that would be chargeable to operating

27 ¹³ APS Exhibit No. 2, APS Comments, p. 9.

28 ¹⁴ Ibid.

¹⁵ Staff Exhibit No. 2, Fox Direct Testimony, p. 9.

1 expenses or to income, except to say that the purposes for which it plans to use the debt may be
2 required by Generally Accepted Accounting Principles ("GAAP") or "other accounting requirements
3 applicable to the Company" to be charged to operating expenses or income. This is not an
4 explanation, but just recognition that the "purpose" has been found to be chargeable to operating
5 expense or income.

6 23. The ordering language proposed by APS in its late-filed Exhibit 5 (" . . . and to meet
7 certain of the Company's working capital and other cash requirements. Such purposes are within
8 those permitted by A.R.S. Section 40-301 and are permitted regardless of the extent to which they
9 may be reasonably chargeable to operating expenses or to income.") is very broad and does not
10 specify why a statutory exception should apply for those purposes. Apparently, allowing APS this
11 exception would enable it to use cash proceeds from debt to pay its on-going operating expenses and
12 to pay dividends. We decline to adopt such a "blanket exception" to this statutory language in a
13 general financing authorization. While there may be purposes that would justify authorizing APS to
14 use debt to pay operating expenses or to charge it to income, those purposes should be evaluated
15 either by classification or as they occur on an individual basis.

16 24. Staff recommends that when APS enters into a single agreement/transaction or an
17 aggregate of similar agreements/transactions or an amendment(s) to an existing agreement(s) with a
18 single entity in which APS incurs long-term debt exceeding \$5,000,000 within a calendar year, that
19 APS should file with Docket Control within 90 days of the transaction or aggregation of transactions
20 of at least \$5,000,000, a description of the transaction(s) and a demonstration that the rates and terms
21 were consistent with those generally available to comparable entities at the time. Staff's
22 recommendation is reasonable and we will adopt it.

23 25. We find that with the appropriate conditions and safeguards adopted in this Decision,
24 it is appropriate to increase APS' authorized debt limits for short-term and long-term debt as set forth
25 herein.

26 **Declaratory Order**

27 26. APS further requested a declaratory order that confirms that only traditional
28 indebtedness for borrowed money constitutes an "evidence of indebtedness" under A.R.S. §§ 40-301

1 and 40-302 and that such other arrangements do not require prior Commission authorization and do
2 not count against the Continuing Long-Term Debt or Continuing Short-Term Debt authorizations
3 requested in the application.

4 27. Staff recommended denial of APS' request for a declaratory order in its initial Staff
5 Report. According to the Staff Report, APS currently has two agreements that are classified as long-
6 term debt per GAAP. APS wants to exclude those agreements from treatment as debt. Staff believes
7 that incurring excessive debt is a concern, regardless of the form the debt takes, and that a declaratory
8 order would exempt certain financing activities from appropriate controls established by the long-
9 term debt limitations established by the Commission. Staff believes that the point is to identify debt
10 as debt,¹⁶ and if the Company needs additional authorizations, it should seek them.

11 28. APS witness Gomez testified that as a result of changes in accounting principles and
12 interpretations, there could be instances where other types of financial obligations could be classified
13 as debt in the Company's financial statements in order to comply with GAAP. Examples include
14 long-term power purchase agreements, which, depending upon the length and nature of the
15 agreement, may be classified as capital leases and reflected as debt on the balance sheet; and long-
16 term fuel supply contracts. Ms. Gomez testified that these could potentially erode the debt-issuing
17 capability of APS and greatly affect the ability of APS to plan its normal financing activities.

18 29. In its Comments, APS suggested the following additional provisions to "avoid
19 unintended and patently unfair consequences" if APS were to exceed its authorized debt limits solely
20 as a result of future changes in GAAP or future changes in the interpretation of GAAP (collectively,
21 "GAAP change"):

- 22 a) Any contract or other legally-binding arrangement to which APS was a party as of the
23 date of the Commission's order in this matter (the "Existing Obligations"), will not be
24 considered indebtedness for purposes of the order (including the order's debt
25 limitations, common equity test, and debt service coverage test) if the Existing
26 Obligation was not considered indebtedness under GAAP as of such date;
27 b) If a GAAP change subsequently occurs that results in an Existing Obligation being
28 reclassified as indebtedness, APS will notify the Commission of such GAAP Change
within 30 days after APS files its Quarterly Report on Form 10-Q or its Annual Report

¹⁶ GAAP status is the determinant for compliance filings and how the condition test for issuance of debt or equity is calculated. TR p. 190.

1 on Form 10-K with the Securities and Exchange Commission following the end of the
2 fiscal quarter in which such GAAP Change occurs (the "Notification Period");

- 3 c) If, after the Commission's issuance of an order in this matter, APS enters into a
4 contract or binding arrangement that is not considered indebtedness under GAAP but
5 subsequently is considered indebtedness because of a GAAP Change, APS'
6 obligations under such contract or arrangement will not be considered indebtedness for
7 purposes of this order (including the order's debt limitations, common equity test, and
8 debt service coverage test) until further Commission action, if within the Notification
9 Period, APS files an application with the Commission specifically requesting approval
10 of such reclassified debt obligations.¹⁷

11 30. In response, Staff agreed that future changes in GAAP could have unintended
12 consequences as they pertain to the Staff conditions, and making provisions to avoid such unintended
13 consequences is prudent. Staff had no objection to: establishment of a "Notification Period"
14 consistent with APS' proposal; and exempting from debt, for purposes of applying the conditions for
15 issuances of debt, (1) existing legally-binding arrangements that are not considered indebtedness
16 under GAAP as of the effective date of this Decision and (2) future legally-binding arrangements that
17 are not considered indebtedness under GAAP on their effective dates but that subsequently become
18 indebtedness under GAAP due to changes in GAAP, until further Commission action if APS files an
19 application within the Notification Period that specifically requests a decision regarding whether to
20 include or exclude the obligation(s) that are subject to the GAAP change in calculations for purposes
21 of applying the conditions for issuance of debt that are established in this Decision.¹⁸

22 31. We agree with Staff that APS' request for a declaratory order should be denied. The
23 purpose of long-term debt limits would be frustrated if APS could structure the form of its debt to
24 avoid those limits. However, while we disagree that a declaratory order is necessary or appropriate at
25 this time, we agree with APS that future changes in GAAP or its interpretation may have unintended
26 collateral effects on APS' ability to issue debt pursuant to this order. We find that APS' alternative
27 proposal, as agreed to by Staff, that establishes a process where an application can be filed with the
28 Commission during the notification period, allowing the Commission to make a determination
29 whether the "now GAAP" arrangements/obligations should fall under the limits and conditions of this
30 Decision, is a good solution and will adopt it.

¹⁷ APS Exhibit No. 2, Comments pp. 7-8.

¹⁸ Staff Exhibit No. 2, Fox Direct, p. 6; TR pp. 162-166.

1 **Mortgage/Security Interests**

2 32. APS redeemed the last of its secured debt in April, 2004. Prior to then, APS had
3 issued debt that was secured by substantially all of the property of APS, pursuant to its 1946
4 Mortgage and Deed of Trust. According to APS, the 1946 Mortgage did not reflect current market
5 standards for utility secured bond indentures and contained restrictive covenants, so by eliminating it,
6 APS has had greater financial flexibility. APS witness Gomez testified that there may come a time
7 when it is advantageous for APS to enter into a new mortgage or other security agreements and once
8 again issue secured debt. The security could consist of a mortgage or lien, or a letter of credit of a
9 third party, bond purchase agreement, or other security instrument. Therefore, APS is requesting
10 authorization to enter into a new mortgage and deed of trust that establishes a lien on all or
11 substantially all of the Company's property, including after-acquired property, and authority to enter
12 into separate security instruments for one or more particular debt issuances.

13 33. Staff recommended that the Commission grant authorization for APS to (1) conduct
14 the activities enumerated in the application that are necessary to secure and maintain debt; (2) to
15 determine the form of security, if any, for the continuing long-term debt and the continuing short-
16 term debt, execute and deliver the security instruments, and establish and amend the terms and
17 provisions of the security instruments, as may be deemed appropriate by APS in connection with the
18 long-term debt and the short-term debt; and (3) to pay all related expenses, all as contemplated in the
19 application and by the exhibits and testimony.

20 34. We agree with APS and Staff that APS should have the flexibility to enter into a new
21 mortgage or other security agreements and once again issue secured debt. However, we find that
22 APS should make an informational filing as a compliance filing in this docket when and if it enters
23 into a new mortgage and deed of trust.

24 **PWCC Guarantee**

25 35. APS witness Gomez testified that from time to time, it may be advantageous for
26 PWCC to guarantee debt issued, incurred or sold by APS.¹⁹ The Joint Application requests either an

27 ¹⁹ If APS were to be rated non-investment grade by at least one rating agency, the new Securities and Exchange rules
28 require a parent guarantee in order for APS to use the expedited rules that allow it easier access to the capital markets.
TR, pp. 34, 70-76. PWCC does not intend to guarantee APS debt unless APS is downgraded. TR p.76.

1 ongoing waiver of A.A.C. R14-2-803²⁰ or alternatively, that the Commission expressly grant to
 2 PWCC the authority to guarantee APS' debt from time to time in indeterminate amounts. APS seeks
 3 authorization to reimburse PWCC for any amounts that PWCC is required to pay under any such
 4 guarantee, along with interest until the date of reimbursement, at a rate not greater than the rate of
 5 interest payable on the debt guaranteed and paid by PWCC. According to the Joint Application, the
 6 purpose of any guarantees by PWCC would be to allow APS to achieve greater access to the financial
 7 markets.

8 36. Staff recommended denial of PWCC's request for a waiver of A.A.C. R14-3-803 but
 9 recommended authorization for PWCC to guarantee APS' debt from time to time in indeterminate
 10 amounts. Staff also recommended authorization for APS to reimburse PWCC for debt service costs
 11 paid by PWCC on behalf of APS in conjunction with the provision of guarantees of APS debt and a
 12 cost of money on those payments not to exceed that of the underlying loan(s).

13 37. We agree with Staff that a blanket waiver of A.A.C. R14-2-803 is not appropriate, but
 14 that allowing PWCC to guarantee APS' debt in order for APS to access debt on more favorable terms
 15 would benefit APS ratepayers. We find that APS should be authorized to reimburse PWCC for
 16 reasonable debt service costs, together with the cost of money on those payments at a rate not to
 17 exceed that of the underlying loan(s). APS should make an informational filing as a compliance filing
 18 in this docket when and if PWCC guarantees APS debt.

CONCLUSIONS OF LAW

19
 20 1. Arizona Public Service Company is a public service corporation within the meaning of
 21 Article XV of the Arizona Constitution and A.R.S. §§ 40-285, 40-301, and 40-302 and A.A.C. R-14-
 22 2-804.

23 2. The Commission has jurisdiction over Arizona Public Service Company and the
 24 subject matter of the application.

25 3. Notice of the application and hearing were provided in accordance with the law.

26
 27 ²⁰ A.A.C. R14-2-803 requires notice to the Commission of reorganizations by a public utility holding company such as
 28 PWCC and includes the acquisition or divestiture of a financial interest in an affiliate or a Class A utility such as APS, as
 limited by Commission Decision No. 58063 (November 3, 1992) to increases or decreases to existing financial interests
 in excess of a specified exempt amount (now \$150 million for APS and PWCC, TR p. 91).

1 this matter.

2 IT IS FURTHER ORDERED that Arizona Public Service Company is authorized to issue
3 short-term debt at any time and from time to time (excluding current maturities of long-term debt) in
4 an amount not to exceed seven percent (7%) of Arizona Public Service Company's capitalization plus
5 up to an additional \$500 million. The amount of the short-term debt issued in excess of seven percent
6 (7%) of Arizona Public Service Company's capitalization shall be used for purchases of natural gas
7 and power. (All short-term indebtedness outstanding on the date of this Order or hereafter issued or
8 incurred pursuant to this paragraph is referred to as "Continuing Short-Term Debt.")

9 IT IS FURTHER ORDERED that prior to the issuance or incurrence of short-term debt in
10 excess of seven percent (7%) of Arizona Public Service Company's capitalization (up to \$500 million
11 relating to purchases of natural gas and power), Arizona Public Service Company must have a
12 Commission authorized adjustor mechanism for recovery of natural gas or power purchases and, if
13 such mechanism is terminated, the authorization for the additional \$500 million of short-term debt
14 will terminate 12 months thereafter.

15 IT IS FURTHER ORDERED that if all or a portion of the authorized short-term debt relating
16 to natural gas and power purchases becomes classified as long-term debt because the amount remains
17 outstanding for more than 12 months, such debt will continue to be counted as Continuing Short-
18 Term Debt and should not be counted against the Continuing Long-Term Debt limit.

19 IT IS FURTHER ORDERED that immediately subsequent to the issuance of any Continuing
20 Long-Term Debt:

21 (a) Arizona Public Service Company must have a minimum common equity ratio
22 of forty percent (40%) (the "Common Equity Test"). For purposes of this test, the
23 common equity ratio is calculated as common equity divided by the sum of such
24 common equity and Arizona Public Service Company's long-term debt (including
25 current maturities of long-term debt). The Common Equity Test will be calculated
26 using the most recent audited financial statements available prior to the date of
27 calculation, adjusted to give effect to the issuance of any new indebtedness (including
28

1 the proposed indebtedness for which the calculation is being made).

2 (b) Arizona Public Service Company's debt service coverage ratio ("DSC") must
3 be equal to or greater than 2.0. For purposes of this test, the DSC is calculated as
4 operating income plus depreciation and amortization plus income tax, divided by
5 interest on short-term and long-term debt, using the most recent audited financial
6 statements adjusted to reflect the interest impact of changes to outstanding debt to the
7 date of calculation, calculated as the annualized interest at the actual interest rate on
8 any new debt issued after the 12 month period covered by the applicable audited
9 financial statements and remaining outstanding on the date of calculation and further
10 including, for purposes of this calculation, the annualized interest at the expected
11 interest rate on the new long-term debt to be issued or incurred and for which the DSC
12 calculation is being made.

13 IT IS FURTHER ORDERED that changes in United States generally accepted accounting
14 principles ("GAAP") or changes in the interpretation of GAAP (collectively, "GAAP Changes") shall
15 be treated as follows: any contract or other legally-binding arrangement to which Arizona Public
16 Service Company is or becomes a party (each, an "Obligation") will not be considered indebtedness
17 for purposes of this Order, including the Continuing Long-Term Debt limit, the Continuing Short-
18 Term Debt limit, the Common Equity Test, and the DSC, until further Commission action, if (a) the
19 Obligation was not considered indebtedness under GAAP as of the date Arizona Public Service
20 Company became a party to the Obligation; (b) a GAAP Change subsequently occurs that results in
21 the Obligation being considered indebtedness for purposes of GAAP; (c) Arizona Public Service
22 Company notifies the Commission of the GAAP Change that results in the Obligation being
23 classified as indebtedness for GAAP purposes within 30 days after Arizona Public Service Company
24 files its Quarterly Report on Form 10-Q or its Annual Report on Form 10-K with the Securities and
25 Exchange Commission following the end of the fiscal quarter in which such GAAP Change occurs
26 (the "Notification Period"); and (d) within the Notification Period, Arizona Public Service Company
27 files an application with the Commission specifically requesting a decision regarding whether such
28

1 reclassified Obligation should be included in, or excluded from, the Continuing Long-Term Debt
2 limit, the Continuing Short-Term Debt limit, the Common Equity Test, and the DSC calculation.

3
4 IT IS FURTHER ORDERED that the authorizations to incur short-term and long-term debt
5 obligations provided in this Order shall replace all existing authorizations for the incurrence of short-
6 term and long-term debt, and all such existing authorizations shall terminate upon the effective date
7 of this Order. Notwithstanding the above, the Commission's Decision No. 55120 (July 24, 1986) and
8 Decision No. 55320 (December 5, 1986) (the "Sale-Leaseback Authorizations") will remain in full
9 force and effect.

10 IT IS FURTHER ORDERED that the short-term and long-term debt levels authorized in this
11 Order will terminate on December 31, 2012, provided that all short-term and long-term debt
12 outstanding at December 31, 2012 that was previously authorized pursuant to the Order shall remain
13 authorized and valid obligations of Arizona Public Service Company. The December 31, 2012
14 termination date will be extended for Continuing Short-Term Debt until the Commission issues a new
15 financing order replacing the then-existing order, provided that (a) Arizona Public Service Company
16 files an application for a new financing order on or before December 31, 2011 and (b) the
17 Commission has not issued an order pursuant to such application on or before December 31, 2012.

18 IT IS FURTHER ORDERED that on each occasion when Arizona Public Service Company
19 enters into a new long-term debt agreement, Arizona Public Service Company must file with Docket
20 Control as a compliance item in this docket, a description of the transaction and a demonstration that
21 the rates and terms are consistent with those generally available to comparable entities at the time.
22 No such filing need be made for any such new long-term debt agreement that has a principal value of
23 less than \$5 million within a calendar year for (a) any individual agreement or transaction or (b) the
24 aggregate of similar agreements or transactions with a single entity.

25
26 IT IS FURTHER ORDERED that in the event that Arizona Public Service Company enters
27 into a new mortgage and deed of trust, Arizona Public Service Company shall file documentation
28 with Docket Control as a compliance filing in this docket within 60 days of entering into the

1 mortgage or deed of trust.

2
3 IT IS FURTHER ORDERED that Arizona Public Service Company is hereby authorized to
4 sign and deliver such documents and to engage in such acts as are reasonably necessary to effectuate
5 the authorizations granted hereinabove.

6 IT IS FURTHER ORDERED that the purposes for which the proposed issuances of
7 Continuing Long-Term Debt and the Continuing Short-Term Debt are herein authorized are to
8 augment the funds available from all sources to finance Arizona Public Service Company's
9 construction, resource acquisition and maintenance programs, to redeem or retire outstanding
10 securities, to repay or refund other outstanding long-term or short-term debt and to meet certain of
11 Arizona Public Service Company's working capital and other cash requirements and such purposes
12 are not, wholly or in part, reasonably chargeable to operating expense or to income.

13 IT IS FURTHER ORDERED that Pinnacle West Capital Corporation is hereby authorized
14 under A.A.C. R14-2-803 to guarantee Arizona Public Service Company's indebtedness from time to
15 time in indeterminate amounts. Arizona Public Service Company is hereby authorized to reimburse
16 Pinnacle West Capital Corporation for any reasonable amounts paid by Pinnacle West Capital
17 Corporation under any guarantee of Arizona Public Service Company's debt from time to time, along
18 with interest thereon to the date of reimbursement at a rate of interest not greater than the rate payable
19 on the debt so guaranteed and paid by Pinnacle West Capital Corporation.

20
21 IT IS FURTHER ORDERED that in the event that Pinnacle West Capital Corporation
22 guarantees debt of Arizona Public Service Company, Arizona Public Service shall file documentation
23 with Docket Control as a compliance filing in this docket within 60 days of the guarantee.

24 IT IS FURTHER ORDERED that such authority is expressly contingent upon Arizona Public
25 Service Company's use of the proceeds for the purposes set forth in its application.
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

9
10 COMMISSIONER

COMMISSIONER

COMMISSIONER

11
12
13 IN WITNESS WHEREOF, I, DEAN S. MILLER, Interim
14 Executive Director of the Arizona Corporation Commission,
15 have hereunto set my hand and caused the official seal of the
16 Commission to be affixed at the Capitol, in the City of Phoenix,
17 this ____ day of _____, 2007.

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20 _____
21 DEAN S. MILLER
22 INTERIM EXECUTIVE DIRECTOR

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1 SERVICE LIST FOR:

ARIZONA PUBLIC SERVICE COMPANY

2 DOCKET NO.:

E-01345A-06-0779

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