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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

MIKE GLEASON, Chairman
WILLIAM A. MUNDELL
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AZ CORP COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION
OF ARIZONA PUBLIC SERVICE
COMPANY FOR AN ORDER OR
ORDERS AUTHORIZING IT TO ISSUE,
INCUR, AND AMEND EVIDENCES OF
LONG-TERM INDEBTEDNESS AND
SHORT-TERM INDEBTEDNESS, TO
EXECUTE NEW SECURITY
INSTRUMENTS TO SECURE ANY SUCH
INDEBTEDNESS, TO REPAY AMOUNTS
PAID UNDER ANY PINNACLE WEST
CAPITAL CORPORATION GUARANTEE
OF ARIZONA PUBLIC SERVICE
COMPANY INDEBTEDNESS AND FOR
DECLARATORY ORDER

DOCKET NO. E-01345A-06-0779

IN THE MATTER OF THE APPLICATION
OF PINNACLE WEST CAPITAL
CORPORATION FOR AN ORDER OR
ORDERS AUTHORIZING IT TO
GUARANTEE THE INDEBTEDNESS OF
ARIZONA PUBLIC SERVICE COMPANY

**EXCEPTIONS OF ARIZONA PUBLIC SERVICE COMPANY TO
RECOMMENDED OPINION AND ORDER**

Arizona Corporation Commission
DOCKETED
OCT 12 2007

DOCKETED BY *nr*

1 **I. INTRODUCTION**

2 Arizona Public Service Company (“APS” or “Company”) hereby submits the
3 following Exceptions to the Recommended Opinion and Order (“Recommended Order”) filed
4 in the above docket on October 3, 2007. Overall, the Recommended Order demonstrates a
5 clear understanding of the significant benefits that inure to both APS and its customers under
6 a general financing authorization from the Commission. The Company has operated under
7 such an authorization for the past 21 years, and the Company has requested a similar
8 authorization in this Docket. Indeed, as the Recommended Order recognizes, the past two
9 decades have proven that broad financing authority from the Commission gives APS the
10 financial flexibility it needs to access the capital markets in a timely and efficient manner,
11 thereby allowing the Company to take advantage of optimal financial conditions at the time
12 of each financing. The financing authority granted by this Commission in the past [pursuant
13 to Decision Nos. 54230 (the “1984 Order”), 55017 (the “1986 Order”) and 65796 (the “2003
14 Order”)] has historically allowed APS to reduce its financing costs and the costs of capital
15 that are reflected in its customers’ rates.

16 Although the Recommended Order recognizes that APS and its customers should
17 continue to reap the benefits of financial flexibility going forward, it places two potentially
18 significant obstacles in the path of such a goal. First, it restricts any use of the proceeds from
19 the Company’s debt issuances to purposes that are “not, wholly or in part, reasonably
20 chargeable to operating expense or to income.” Second, the Recommended Order makes the
21 entire requested financing authority “expressly contingent” upon the Company’s subsequent
22 use of that debt’s proceeds for such purposes. In doing so, the Recommended Order makes
23 ambiguous the extent of the financing authority granted to APS and limits the very financial
24 flexibility the Recommended Order would otherwise achieve. It also may impose new and
25 higher risks on lenders – risks for which they may expect to be compensated, either through
26 higher interest rates or more onerous terms or both. Importantly, these limitations materially
27 depart from the Commission’s past financing authorization, which contained no such
28 restrictions and may discourage lenders from extending credit to APS. Moreover, to the

1 extent the Recommended Order intends such restrictions to apply to proceeds from
2 statutorily-authorized short-term debt, it is inconsistent with normal commercial practice and
3 the customary utility uses of short-term debt, as well as the clear meaning and scope of
4 A.R.S. § 40-302(D).¹

5 The Company respectfully requests that the Commission address these issues by
6 adopting the Company's exceptions. This will preserve the financing flexibility that has
7 benefited both the Company and its customers for the past two decades.²

8 II. DISCUSSION

9 For the most part, APS is pleased with the provisions of the Recommended Order.
10 Indeed, the Recommended Order recognizes that the financial flexibility that naturally results
11 from the type of general financing authorization requested by the Company in this matter,
12 and under which the Company has operated successfully for more than 20 years, provides
13 significant benefits and cost-savings to both APS and its customers. However, the
14 Recommended Order places two potentially significant limitations on APS's ability to
15 borrow under the proposed financing authorization – limitations that leave the scope of
16 APS's financing authority ambiguous and thus may significantly reduce the very financial
17 flexibility that the Recommended Order had otherwise hoped to achieve. These limitations
18 may also impose new risks on APS lenders that would result in higher costs to APS and its
19 customers.

20 First, the Recommended Order prohibits APS from using the proceeds of any debt
21 issuance (either short-term or long-term) for purposes that are "wholly or in part, reasonably
22 chargeable to operating expenses or to income." (Recommended Order at 19). Second, the
23 Recommended Order makes APS's borrowing authority "expressly contingent upon Arizona
24 Public Service Company's use of the proceeds for the purposes set forth in its application."

25 ¹ The Recommended Order placed a number of other restrictions on the Company that did not exist in the
26 1986 Order, including a limitation on the duration of the financing authority and various financial covenants.
27 APS does not object to these added precautions.

28 ² APS also noticed a relatively minor error with respect to the Decision numbers of the sale/leaseback orders in
Finding of Fact 20 of the Recommended Order. The relevant decisions numbers are Decision Nos. 55120 and
55320. APS Proposed Amendment 3 addresses this error, and is attached hereto at Tab 3.

1 (Recommended Order at 19). Neither restriction was proposed by Staff, nor was there any
2 discussion on either issue generated at the hearing in this matter. Importantly, these
3 restrictions are absent from the Company's current financing authorization, in which the
4 Commission expressly authorized APS to issue debt for the purposes approved in the 1986
5 Order (and which are substantively identical to those proposed here and which the
6 Recommended Order approved) "regardless of the extent to which such purposes may be
7 reasonably chargeable to operative expenses or to income." (Decision No. 55017 at 7).

8 **1. The Ordering Language Restricting the Purposes for which Proceeds from**
9 **Company Debt May be Used Should be Clarified to Preserve the Company's**
10 **Financing Authority.**

11 While the Recommended Order's language prohibiting the Company from using the
12 proceeds of any short-term or long-term debt issuances for purposes chargeable to operating
13 expense or income may appear innocuous, it is not. To the contrary, as a practical matter,
14 the restrictions are irreconcilable with other provisions in the Recommended Order, and thus
15 significantly limit the financing authority it otherwise intends to grant the Company.

16 As explained in the Application and in the hearing in this matter, financing orders
17 such as that requested here (and as granted in the 1984, 1986 and 2003 Orders) require
18 highly specific language to satisfy prospective lenders. (Application at ¶ 11; Tr. Vol. I at
19 36:6-18). The operative statute, A.R.S. § 40-302(A), specifically requires that any
20 Commission order authorizing a public service company to incur debt must: (1) set forth the
21 purposes for which such funds may be used; and (2) state that the purposes are not
22 chargeable to operative expenses or income **except as authorized by the Order**. The
23 statutory exception to the general rule expressed in this second requirement is important: the
24 Commission may permit the Company to incur debt for a purpose that is chargeable to
25 operating expense or income, but must expressly state in the order that it is allowing the
26 Company to do so.

27 If the Commission Order authorizing the debt issuance is deficient in either of these
28 respects, any debt issuance made pursuant to that Order may be called into question, with

1 potentially severe consequences to both the Company and its lenders. Significantly,
2 Arizona's statutory scheme declares as *void* any note or other "evidence of indebtedness"
3 that does not comply with the Commission order authorizing the debt issuance. It also
4 imposes criminal penalties. *See* A.R.S. § 40-303. Thus, under this statutory regime, the
5 precise authorization granted in a public service corporation's financing order must be
6 crystal clear, or a lender may reasonably refuse to extend financing to that entity.

7 In light of that fact, APS took extreme care in proposing language for its requested
8 financing order that would give its lenders comfort that the authority under which it sought
9 to issue debt strictly adhered to the terms of A.R.S. § 40-302.³ Specifically, the Company
10 explained that it intended to use the net proceeds from its issuance of Continuing Long-Term
11 Debt and Continuing Short-Term Debt to "augment the funds available from all sources to
12 finance its construction, resource acquisition and maintenance programs, to redeem or retire
13 outstanding securities, to repay or refund other outstanding long-term or short-term debt, and
14 to meet certain of the Company's working capital and other cash requirements."
15 (Application at ¶ 15).

16 Importantly, as was also true for the purposes approved by the Commission in the
17 1986 Order, some of these authorized purposes are, by their nature, chargeable to operating
18 expense or income. For example, certain expenses routinely financed by short-term debt are
19 operating expenses, as are working capital and other cash requirements. Indeed, under the
20 applicable SEC exemption, APS's commercial paper program can only be used for "current
21 transactions." So that its Financing Order would precisely comply with the terms of A.R.S.
22 § 40-302, the Company asked the Commission to do two things: (1) to state that the
23 Company's issuances of Continuing Long-Term and Continuing Short-Term Debt are
24

25 ³ The 1986 Order ordered that "the purposes for which the proposed issuances of New Debt and Continuing
26 Debt are herein authorized are to augment the funds available from all sources to finance Arizona Public
27 Service Company's construction program, to redeem or retire outstanding securities, to repay or refund other
28 outstanding long-term debt, to repay short-term debt which has previously financed construction projects, and,
if necessary, to meet certain working capital and other cash requirements, *regardless of the extent to which
such purposes may be reasonably chargeable to operative expenses or to income.*" (Decision No. 55017 at 7)
(Emphasis Added).

1 reasonably necessary or appropriate for these purposes; and (2) to permit such purposes to
2 the extent that they may be reasonably chargeable to operating expenses or income, precisely
3 as the Commission had ordered in 1986. (Application at ¶ 11). Staff did not oppose APS's
4 requests. Neither was any testimony concerning them elicited during the hearing in this
5 matter.

6 Significantly, the Recommended Order expressly approved the purposes proposed by
7 the Company, and agreed to by Staff, for the use of its Continuing Long-Term and
8 Continuing Short-Term Debt proceeds, without commenting on the fact that several of these
9 purposes are, by definition, chargeable to operating expense or income. Indeed, the
10 Recommended Order adopted verbatim the Company's proposed language describing the
11 purposes for which the funds may be used, authorizing the Company to issue debt to
12 "augment the funds available from all sources to finance Arizona Public Service Company's
13 construction, resource acquisition and maintenance programs, to redeem or retire outstanding
14 securities, to repay or refund other outstanding long-term or short-term debt, and to meet
15 certain of the Company's working capital and other cash requirements." (Recommended
16 Order at 19). But, while it approved these purposes, the Recommended Order
17 simultaneously rejected the Company's request that it be allowed to issue debt for these same
18 purposes to the extent that they may be reasonably chargeable to operating expenses or
19 income. (Recommended Order at 19). To the contrary, the Recommended Order
20 specifically – and erroneously – stated that the purposes authorized "are not, wholly in part,
21 reasonably chargeable to operating expense or to income." This confusing addition, which
22 appears intended to operate as a restriction on the purposes for which APS may use the
23 proceeds of its debt, not only materially departed from the express language of the 1986
24 Order, it rendered the Recommended Order's simultaneous authorization of several of the
25 purposes outlined in APS's Application and approved by the Recommended Order
26 essentially meaningless.

27 The impact of this apparent restriction is most significant on the Company's short-
28 term debt authorization. Under the terms of the Recommended Order, APS is authorized to

1 incur short-term debt in two distinct "buckets": (1) short term debt issuances of up to 7% of
2 the Company's total capitalization, which is authorized by statute; and (2) short-term debt
3 issuances for another \$500 million in addition to the 7% of total capitalization statutory
4 allowance. With respect to the first "bucket," as the Recommended Order recognizes, APS's
5 authority to issue short-term debt in an amount not to exceed 7% of its total capitalization is
6 derived from statute, A.R.S. § 40-302(D). (See Finding of Fact 7). Importantly, A.R.S. §
7 40-302(D) does not limit the use of the Company's short-term debt proceeds (up to 7% of the
8 Company's total capitalization) to purposes that are "not chargeable to operative expenses or
9 income." Rather, the statute broadly allows a public service corporation to use such funds
10 for any "proper purpose," which Arizona courts have construed to include any valid
11 "business or tax purposes." See *Desert Sun Loan Corp. v. Consolidated Water Utilities Ltd.*
12 *Partnership*, 184 Ariz. 430 (App. 1995). Because A.R.S. § 40-302(D) does not condition the
13 use of proceeds from short-term debt to non-operating expenditures, such limitation by the
14 Recommended Order is inconsistent with the intent of that authorizing statute. Although the
15 Company seeks a continuation of the Commission's approval granted in the 1984 Order
16 allowing refunding and roll-overs of this statutory short-term debt amount, it never intended
17 to limit the uses of the resulting proceeds beyond those limitations provided for in A.R.S. §
18 40-302(D), and the 1984 Order did not do so.

19 As a practical matter, such a restriction on the uses of the Company's short-term debt
20 could severely disrupt APS's ability to manage its finances during those periods when its
21 revenue is not sufficient to cover its operating expenses. This is largely a function of the
22 timing of APS's cash flow from revenues and the fact that such revenues are seasonal. Any
23 business that has a seasonal element to its sales must often borrow money in order to operate
24 in its slow sales times. The borrowings are then repaid with revenues from the high sales
25 seasons. As the evidence in the record makes clear, in line with general commercial practice,
26 APS generally meets certain of its working capital requirements with short-term borrowings,
27 generally in the form of commercial paper (issuing short-term debt, for example, to make
28 property tax payments twice a year when the Company's operating revenue sources are

1 inadequate to cover such requirements). (Affidavit of Barbara M. Gomez at ¶ 15). This
2 broad financing authorization has provided APS with the flexibility it needs to continue to
3 meet its growing working capital needs. This purpose, which is seemingly expressly
4 permitted by the Recommended Order and authorized in the 1986 Order, is composed of
5 items entirely chargeable to operating expenses. Indeed, cash working capital is by
6 definition the lag between expenditures and receipts – both of which are charged to operating
7 expense or income. Any restriction limiting the Company’s ability to issue debt to cover
8 such working capital expenses would be fundamentally inconsistent with general commercial
9 practice and would significantly restrict APS’s ability to operate its business. By apparently
10 requiring the Company to seek Commission approval of each specific short-term debt
11 transaction that may be chargeable to operating expenses or income, the Recommended
12 Order significantly undermines the financial flexibility inherent in the Company’s current
13 short-term debt financing authority.

14 With respect to the second “bucket,” the Recommended Order granted APS’s request
15 that it be allowed to issue \$500 million in short-term debt in addition to the statutorily
16 authorized amount. The Company requested this increase specifically so that it would be
17 able to respond promptly to the increasing liquidity demands created by the volatile and
18 increasing cash collateral provisions contained in the Company’s commodity and purchased
19 power contracts. (Affidavit of Barbara M. Gomez at 25). In addition, in the event that APS
20 becomes non-investment grade, the collateral calls will increase and many vendors will
21 require APS to pay cash prior to delivery. Consistent with Staff’s recommendation, the
22 Recommended Order granted APS’s request to increase the Company’s short-term debt
23 authorization as requested, with the caveat that the additional \$500 million authorization be
24 used only “for purchases of natural gas and power.” (Recommended Order at 16). But
25 purchases of natural gas and power are themselves generally chargeable to operating expense
26 or income. Again, by apparently requiring the Company to seek Commission approval of
27 any debt issuance under this authorization that may be “chargeable to operating expense or
28 income,” the Recommended Order renders meaningless its approval of the \$500 million

1 additional short-term debt authorization and puts the Company back to square one,
2 effectively requiring the Company to seek specific approval of every short-term debt
3 issuance above the 7% capitalization statutory threshold.

4 The restriction on the purposes to which APS may use its Continuing Long-Term
5 Debt issuances also impacts the Company's ability to manage its costs. In order to keep
6 financing costs at a minimum (with measurable benefits to both the Company and its
7 customers) and consistent with the terms of the 1986 Order, the Company routinely uses the
8 proceeds of the long-term debt it issues in anticipation of upcoming capital expenditure
9 obligations to pay outstanding short-term debt balances, which balances, as previously
10 described, may consist of debt used to pay for items that are chargeable to operating expense.
11 While the Recommended Order appears to approve such use (authorizing the Company to
12 use its Continuing Long-Term Debt issuances to "repay or refund other outstanding long-
13 term or short-term debt"), the added language requiring that such purpose not be "chargeable
14 to operating expense or to income" makes its precise meaning in this regard unclear. To the
15 extent the Recommended Order intends to remove APS's authority to use long-term debt
16 proceeds to pay such short-term debt balances, it would require the Company to appear
17 before the Commission on issues related to debt issuances on a routine basis, thereby
18 hampering the Company's ability to advantageously manage its costs and creating added
19 administrative and cost burdens on both the Commission and the Company.

20 Money is fungible, and monies from long-term debt issuances are generally
21 commingled with revenues from other sources in the Company's general account that is used
22 to pay its various obligations, some of which will be chargeable to operating expense. Any
23 requirement that APS must use the specific proceeds it receives from a long-term debt
24 issuance for purposes not chargeable to operating expense or to income could potentially
25 obligate the Company to keep such funds in an escrow account devoted to an authorized
26 purpose or to employ other tracing mechanisms – a result that would be administratively
27 burdensome and costly to both the Company and its customers. Such a requirement would
28 prevent the Company from being able to use customary and financially prudent cash-

1 management procedures and would thus severely undermine the financial flexibility and
2 benefits that the Company and its customers have enjoyed under the Commission's past
3 financing authorization for more than 20 years.

4 To resolve the inconsistencies and related problems that may arise from the language
5 of the Recommended Order as described above, and consistent with the 1986 Order, the
6 Commission should clarify that it authorizes the purposes described in APS's Application
7 even to the extent such purposes may be chargeable to operating expense or income.
8 Requested language in this regard is contained in the first three suggested changes in APS
9 Proposed Amendment 1, which is attached hereto at Tab 1. To address the Administrative
10 Law Judge's concern that APS not be given too overly-broad of financing authority, the
11 Commission can include an additional provision that prohibits APS from incurring debt for
12 any purpose that is chargeable to operating income or expense, except as otherwise
13 authorized in the Order. Such language would preserve APS's financing authority with
14 respect to the purposes described in the Application while preventing APS from engaging in
15 debt transactions not contemplated in this proceeding without specific Commission approval.
16 The last change in APS Proposed Amendment 1 suggests such language.

17 **2. Making APS's Financing Authority Expressly Contingent on the Use of the**
18 **Proceeds from Such Debt Potentially Hinders APS's Borrowing Ability and**
19 **Increases its Cost of Debt.**

20 The Recommended Order includes an additional provision that makes APS's financing
21 authority "expressly contingent upon Arizona Public Service Company's use of the proceeds
22 for the purposes set forth in its application." This provision was not included in the 1984
23 Order, the 1986 Order or the 2003 Order. Although the Company does not object to being
24 held accountable for its use of the proceeds from debt issued pursuant to its financing Order,
25 it is concerned that if its financing *authority* is made "expressly contingent" upon such use,
26 lenders may impose burdensome restrictions on or simply refuse to deal with the Company as
27 a result of that term.
28

1 As described above, lenders require certainty that their loans be authorized and that the
2 Company be required to repay those loans. However, making APS's authority contingent on
3 the *use* of such funds, as opposed to the *purpose* for which the debt is issued, the lender
4 suffers the risk that APS's authority may be rescinded both retroactively and after the lender
5 has already released the money to the Company. Thus, in order to avoid any possibility that
6 the new debt might later become void under Arizona law, a lender might reasonably take the
7 position that the Company should place the proceeds in an escrow account or should
8 otherwise restrict release of the actual proceeds to ensure that the funds are actually used only
9 for authorized purposes. Clearly, any such requirement would impose unduly burdensome
10 and costly requirements on the Company and its customers, and may hamper APS's
11 borrowing ability at the outset. As noted previously, money is fungible, and any such escrow
12 or tracing requirement would severely limit the Company's ability to operate in the ordinary
13 course of business or to employ prudent and customary cash management procedures.

14 To address this concern, the Company has attached APS Proposed Amendment 2,
15 which specifically requires APS to use proceeds issued pursuant to its general financing
16 authority for the purposes set forth in the Application. Such language puts the responsibility
17 squarely on the Company to use its funds for the purposes approved in the Application,
18 without an unintended effect of imposing that same responsibility on the Company's lenders.

19 III. CONCLUSION

20 For the foregoing reasons, the Company respectfully requests that the Commission adopt
21 amendments to the Recommended Order consistent with the Company's exceptions.

22 RESPECTFULLY SUBMITTED this 12th day of October, 2007.

23
24 By: 
25 Thomas L. McMaw
26 Meghan H. Grabel

27 Attorneys for Arizona Public Service Company and
28 Pinnacle West Capital Corporation

1 ORIGINAL and thirteen (13) copies
2 of the foregoing filed this 12th day of
3 October, 2007, with:

3 Docket Control
4 ARIZONA CORPORATION COMMISSION
5 1200 West Washington Street
6 Phoenix, Arizona 85007

6 AND copies of the foregoing mailed, faxed or
7 transmitted electronically this 12th day of
8 October, 2007 to:

9 All Parties of Record

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APS PROPOSED AMENDMENT # 1

Page 9 Line 18 to Page 10 Line 15: DELETE FINDINGS OF FACT 22 and 23

Page 15 Line 9 to Line 10: DELETE “, and such purposes” through “income”

Page 19 Line 12:

DELETE “are not.”

REPLACE WITH “may be”

Page 19 Line 13: INSERT “IT IS FURTHER ORDERED that, except as otherwise authorized herein, none of the purposes for which debt is to be issued pursuant to this authorization is reasonably chargeable to operating expense or income.”

MAKE ALL CONFORMING CHANGES.

APS PROPOSED AMENDMENT # 2

Page 19: DELETE last ordering paragraph.

REPLACE with "IT IS FURTHER ORDERED that Arizona Public Service Company shall use the proceeds from debt incurred pursuant to this authorization only for the purposes set forth in its application."

MAKE ALL CONFORMING CHANGES.

APS PROPOSED AMENDMENT # 3

Page 8 Line 22:

DELETE "55017" REPLACE WITH "55120"
DELETE "54230" REPLACE WITH "55320"

MAKE ALL CONFORMING CHANGES.