



0000078265

BEFORE THE ARIZONA CORPORATION CC

COMMISSIONERS

Arizona Corporation Commission

DOCKETED

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

OCT 30 2007

DOCKETED BY	nr
-------------	----

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.

DECISION NO. 69947

OPINION AND ORDER

DATE OF HEARING: July 23, 2007

PLACE OF HEARING: Phoenix, Arizona

ADMINISTRATIVE LAW JUDGE: Lyn Farmer

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.<sup>1</sup>

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 \$2,698,917,000<sup>2</sup> 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 <sup>1</sup> 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 <sup>2</sup> 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.<sup>3</sup> 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.<sup>4</sup> 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 <sup>3</sup> 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 <sup>4</sup> 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.<sup>5</sup>

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 <sup>5</sup> 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.<sup>6</sup>  
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 <sup>6</sup> 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.<sup>7</sup>

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.<sup>8</sup>

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

<sup>7</sup> Staff Exhibit No. 1, Staff Report, Attachment A p. 6.

<sup>8</sup> 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."<sup>9</sup> 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."<sup>10</sup> 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. 55120 and 55320.<sup>11</sup>

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."<sup>12</sup> In response to APS'  
25 comments, Staff agreed that only authorizations of new debt should terminate at December 31, 2012,

26 \_\_\_\_\_  
27 <sup>9</sup> Staff Exhibit No. 2, Fox Direct Testimony, p. 12.

<sup>10</sup> Ibid.

<sup>11</sup> TR pp. 155-156, 171, 174-175.

28 <sup>12</sup> 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.”<sup>13</sup> 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.”<sup>14</sup>  
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.”<sup>15</sup> 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 <sup>13</sup> APS Exhibit No. 2, APS Comments, p. 9.

28 <sup>14</sup> Ibid.

<sup>15</sup> 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 Continuing Long-Term Debt to pay its on-going  
12 operating expenses and to pay dividends. We decline to adopt such a "blanket exception" to this  
13 statutory language in a general financing authorization. While there may be purposes that would  
14 justify authorizing APS to use Continuing Long-Term Debt to pay operating expenses or to charge it  
15 to income, those purposes should be evaluated either by classification or as they occur on an  
16 individual basis.

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

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

27 **Declaratory Order**

28 26. APS further requested a declaratory order that confirms that only traditional

1 indebtedness for borrowed money constitutes an "evidence of indebtedness" under A.R.S. §§ 40-301  
 2 and 40-302 and that such other arrangements do not require prior Commission authorization and do  
 3 not count against the Continuing Long-Term Debt or Continuing Short-Term Debt authorizations  
 4 requested in the application.

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

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

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

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

<sup>16</sup> 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 reclassified as indebtedness, APS will notify the Commission of such GAAP Change  
2 within 30 days after APS files its Quarterly Report on Form 10-Q or its Annual Report  
3 on Form 10-K with the Securities and Exchange Commission following the end of the  
4 fiscal quarter in which such GAAP Change occurs (the "Notification Period");

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

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

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

<sup>17</sup> APS Exhibit No. 2, Comments pp. 7-8.

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

1 Decision, is a good solution and will adopt it.

2 **Mortgage/Security Interests**

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

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

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

25 **PWCC Guarantee**

26 35. APS witness Gomez testified that from time to time, it may be advantageous for  
27  
28

1 PWCC to guarantee debt issued, incurred or sold by APS.<sup>19</sup> The Joint Application requests either an  
 2 ongoing waiver of A.A.C. R14-2-803<sup>20</sup> or alternatively, that the Commission expressly grant to  
 3 PWCC the authority to guarantee APS' debt from time to time in indeterminate amounts. APS seeks  
 4 authorization to reimburse PWCC for any amounts that PWCC is required to pay under any such  
 5 guarantee, along with interest until the date of reimbursement, at a rate not greater than the rate of  
 6 interest payable on the debt guaranteed and paid by PWCC. According to the Joint Application, the  
 7 purpose of any guarantees by PWCC would be to allow APS to achieve greater access to the financial  
 8 markets.

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

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

#### CONCLUSIONS OF LAW

20  
 21 1. Arizona Public Service Company is a public service corporation within the meaning of  
 22 Article XV of the Arizona Constitution and A.R.S. §§ 40-285, 40-301, and 40-302 and A.A.C. R-14-  
 23 2-804.

24  
 25 <sup>19</sup> If APS were to be rated non-investment grade by at least one rating agency, the new Securities and Exchange rules  
 26 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.

27 <sup>20</sup> 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 Instruments, and establish and amend the terms and provisions of the Security Instruments, as may be  
2 deemed appropriate by Arizona Public Service Company in connection with the Continuing Long-  
3 Term Debt and the Continuing Short-Term Debt, and (iii) to pay all related expenses, all as  
4 contemplated in the Application and by the exhibits and testimony presented during the hearing in  
5 this matter.

6 IT IS FURTHER ORDERED that Arizona Public Service Company is authorized to issue  
7 short-term debt at any time and from time to time (excluding current maturities of long-term debt) in  
8 an amount not to exceed seven percent (7%) of Arizona Public Service Company's capitalization plus  
9 up to an additional \$500 million. The amount of the short-term debt issued in excess of seven percent  
10 (7%) of Arizona Public Service Company's capitalization shall be used for purchases of natural gas  
11 and power. (All short-term indebtedness outstanding on the date of this Order or hereafter issued or  
12 incurred pursuant to this paragraph is referred to as "Continuing Short-Term Debt.")

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

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

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

25 (a) Arizona Public Service Company must have a minimum common equity ratio  
26 of forty percent (40%) (the "Common Equity Test"). For purposes of this test, the  
27 common equity ratio is calculated as common equity divided by the sum of such  
28

1 common equity and Arizona Public Service Company's long-term debt (including  
2 current maturities of long-term debt). The Common Equity Test will be calculated  
3 using the most recent audited financial statements available prior to the date of  
4 calculation, adjusted to give effect to the issuance of any new indebtedness (including  
5 the proposed indebtedness for which the calculation is being made).

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

17 IT IS FURTHER ORDERED that changes in United States generally accepted accounting  
18 principles ("GAAP") or changes in the interpretation of GAAP (collectively, "GAAP Changes") shall  
19 be treated as follows: any contract or other legally-binding arrangement to which Arizona Public  
20 Service Company is or becomes a party (each, an "Obligation") will not be considered indebtedness  
21 for purposes of this Order, including the Continuing Long-Term Debt limit, the Continuing Short-  
22 Term Debt limit, the Common Equity Test, and the DSC, until further Commission action, if (a) the  
23 Obligation was not considered indebtedness under GAAP as of the date Arizona Public Service  
24 Company became a party to the Obligation; (b) a GAAP Change subsequently occurs that results in  
25 the Obligation being considered indebtedness for purposes of GAAP; (c) Arizona Public Service  
26 Company notifies the Commission of the GAAP Change that results in the Obligation being  
27 classified as indebtedness for GAAP purposes within 30 days after Arizona Public Service Company  
28

1 files its Quarterly Report on Form 10-Q or its Annual Report on Form 10-K with the Securities and  
2 Exchange Commission following the end of the fiscal quarter in which such GAAP Change occurs  
3 (the "Notification Period"); and (d) within the Notification Period, Arizona Public Service Company  
4 files an application with the Commission specifically requesting a decision regarding whether such  
5 reclassified Obligation should be included in, or excluded from, the Continuing Long-Term Debt  
6 limit, the Continuing Short-Term Debt limit, the Common Equity Test, and the DSC calculation.

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

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

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

28

1           IT IS FURTHER ORDERED that in the event that Arizona Public Service Company enters  
2 into a new mortgage and deed of trust, Arizona Public Service Company shall file documentation  
3 with Docket Control as a compliance filing in this docket within 60 days of entering into the  
4 mortgage or deed of trust.

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

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

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

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

27           IT IS FURTHER ORDERED that Arizona Public Service Company shall use the proceeds  
28 from debt incurred pursuant to this authorization only for the purposes set forth herein.

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 Lance H. Bloom William M. Wood  
 8 CHAIRMAN COMMISSIONER

9 Debra L. Hatcher Miller R. M. [Signature] Paul [Signature]  
 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 30<sup>th</sup> day of Oct., 2007.

18 Dean S. Miller  
19 DEAN S. MILLER  
20 INTERIM EXECUTIVE DIRECTOR

21  
22 DISSENT \_\_\_\_\_

23  
24 DISSENT \_\_\_\_\_

1 SERVICE LIST FOR:

ARIZONA PUBLIC SERVICE COMPANY

2 DOCKET NO.:

E-01345A-06-0779

3

Thomas L. Mumaw  
Barbara M. Gomez  
ARIZONA PUBLIC SERVICE CO.  
PINNACLE WEST CAPITAL CORP.  
400 N. 5<sup>th</sup> Street, Mail Station 8695  
Phoenix, AZ 85004-3992

7

Christopher Kempsey, Chief Counsel  
Legal Division  
ARIZONA CORPORATION COMMISSION  
1200 W. Washington Street  
Phoenix, Arizona 85007

8

9

10

Ernest Johnson, Director  
Utilities Division  
ARIZONA CORPORATION COMMISSION  
1200 W. Washington Street  
Phoenix, Arizona 85007

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

26

27

28