

ORIGINAL

OPEN MEETING



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MEMORANDUM RECEIVED

Arizona Corporation Commission

DOCKETED

JUL -2 2008

TO: THE COMMISSION

2008 JUL -2 P 4: 41

FROM: Utilities Division

AZ CORP COMMISSION DOCKET CONTROL

DATE: July 2, 2008

DOCKETED BY

RE: IN THE MATTER OF ARIZONA PUBLIC SERVICE COMPANY NOTICE OF INTENT TO INCREASE EQUITY (DOCKET NO. E-01345A-08-0228)

Arizona Public Service Company ("APS"), an Arizona Class "A" public service utility, provides electric distribution services to approximately 1.1 million customers. APS is a subsidiary of Pinnacle West Capital Corporation ("PNW"). APS' current rates were approved in Decision No. 69663, dated June 28, 2007.

On May 2, 2008, APS filed a notice of intent to increase equity with the Arizona Corporation Commission ("Commission"), as required by Arizona Administrative Code ("A.A.C.") R14-2-803.

APS expects to have an approximate \$400 million annual cash flow shortfall due to a difference between the funds received from operations and its capital needs. APS indicates that it is facing substantial capital needs that exceed one billion dollars in 2008 and will continue to be substantial in the foreseeable future. APS further states that the requested equity investment is necessary for the Company to maintain investment grade credit ratings and to improve financial stability.

PNW indicates that it intends to infuse a total of up to \$400 million into APS in the year 2008, from the proceeds of PNW common stock sales. APS does not anticipate that the \$400 million equity investment will impact APS' cost of service and cost of capital in the foreseeable future.¹

A.A.C. R14-2-803.A states that, "Any utility or affiliate intending to organize a public utility holding company or reorganize an existing public utility holding company will notify the Commission's Utility Division in writing at least 120 days prior thereto." Decision No. 58063, dated November 3, 1992, states that a public utility holding company increasing or decreasing its financial interest in an affiliate would be considered a reorganization and therefore would be subject to A.A.C. R14-2-803. Decision No. 58063 also exempts PNW or APS from the requirement of informing the Commission of any reorganization of an affiliate interest if the

¹ APS currently has a rate case in progress under Docket No. E-01345A-08-0172.

investment amount does not exceed \$150 million in one calendar year. A.A.C. R14-2-803.A directs the Company to include certain information related to the reorganization in its notice of intent. The information provided by APS in the application and supplemented by further discovery from Staff is satisfactory.

A.A.C. R14-2-803.C states that, “. . . the Commission may reject the proposal if it determines that it would impair the financial status of the public utility, otherwise prevent it from attracting capital at fair and reasonable terms, or impair the ability of the public utility to provide safe, reasonable and adequate service.”

Schedule PMC-1, attached, presents APS' capital structure as of March 31, 2008 (Column A), and a *pro forma* capital structure including the proposed \$400 million equity infusion (Column B). Column A shows that APS' existing capital structure consists of 3.0 percent short-term debt, 44.7 percent long-term debt and 52.3 percent equity. The *pro forma* capital structure reflecting the proposed \$400 million investment is composed of 2.8 percent short-term debt, 42.1 percent long-term debt and 55.1 percent equity.

For utilities with access to the capital markets, Staff typically recommends a capital structure within 40 to 60 percent equity of total capital (short-term debt plus long-term debt plus common equity) as appropriate to provide a balance of cost and financial risk.²

The appropriate capital structure for a particular utility at any specific time is dependent on various operational and general economic conditions. Providing APS authorization to issue equity capital combined with its existing authorization to issue debt would assist its efforts to maintain a capital structure that reflects its particular circumstances in recognition of the broader economic conditions.

Staff concludes that authorization to increase equity by up to \$400 million dollars would assist APS' efforts to maintain a balance of cost and financial risk in its capital structure while funding its capital expenditures.

Staff further concludes that there is no financial basis under A.A.C. R14-2-803.C. to reject APS' recapitalization plan.

² Decision No. 69947, dated October 30, 2007, ordered APS to have a minimum common equity ratio of 40.0 percent immediately subsequent to the issuance of any continuing long-term debt.

THE COMMISSION

July 2, 2008

Page 3

Staff further concludes that no determination of the ratemaking treatment of the equity infusion is necessary or appropriate in this docket.

Staff recommends approval of the reorganization.

for 

Ernest G. Johnson
Director
Utilities Division

EGJ:PMC:lhv\AH

ORIGINATOR: Pedro M. Chaves

FINANCIAL ANALYSIS

	[A] ¹ <u>3/31/2008</u> (000's)		[B] ² <u>Pro Forma</u> (000's)	
Short-term Debt ³	\$191,939	3.0%	\$191,939	2.8%
Long-term Debt	\$2,876,862	44.7%	\$2,876,862	41.8%
Common Equity	\$3,369,966	52.3%	\$3,819,966	55.5%
Total Capital	\$6,438,767	100.0%	\$6,888,767	100.0%

¹ Column [A] is based on APS' financial information for the quarter ended March 31, 2008, as portrayed on the form 10-Q filed with the SEC.

² Column [B] is Column [A] adjusted to reflect the proposed \$400 million equity infusion.

³ Short-term debt inclusive of commercial paper and current maturities of long-term debt.

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BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF PINNACLE WEST
CAPITAL CORPORATION TO PROVIDE
NOTIFICATION OF ITS INTENT TO
INCREASE ITS EQUITY INTEREST IN
ARIZONA PUBLIC SERVICE COMPANY
UNDER A.A.C. R14-2-803

DOCKET NO. E-01345A-08-0228
DECISION NO. _____
ORDER

Open Meeting
July 29 and 30, 2008
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. Arizona Public Service Company ("APS"), an Arizona class "A" public service utility that provides electric distribution services to approximately 1.1 million customers. APS is a subsidiary of Pinnacle West Capital Corporation ("PNW"). APS' current rates were approved in Decision No. 69663, dated June 28, 2007.
2. On May 2, 2008, APS filed a notice of intent to increase equity with the Arizona Corporation Commission ("Commission"), as required by Arizona Administrative Code ("A.A.C.") R14-2-803.
3. APS expects to have an approximate \$400 million annual cash flow shortfall due to a difference between the funds received from operations and its capital needs. APS indicates that it is facing substantial capital needs that exceed one billion dollars in 2008 and will continue to be substantial in the foreseeable future. APS further states that the requested equity investment is

...

1 necessary for the Company to maintain investment grade credit ratings and to improve financial
2 stability.

3 4. PNW indicates that it intends to infuse a total of up to \$400 million into APS in the
4 year 2008, from the proceeds of PNW common stock sales. APS does not anticipate that the \$400
5 million equity investment will impact APS' cost of service and cost of capital in the foreseeable
6 future.¹

7 5. A.A.C. R14-2-803.A states that, "Any utility or affiliate intending to organize a
8 public utility holding company or reorganize an existing public utility holding company will notify
9 the Commission's Utility Division in writing at least 120 days prior thereto." Decision No. 58063,
10 dated November 3, 1992, states that a public utility holding company increasing or decreasing its
11 financial interest in an affiliate would be considered a reorganization and therefore would be
12 subject to A.A.C. R14-2-803. Decision No. 58063 also exempts PNW or APS from the
13 requirement of informing the Commission of any reorganization of an affiliate interest if the
14 investment amount does not exceed \$150 million in one calendar year. A.A.C. R14-2-803.A
15 directs the Company to include certain information related to the reorganization in its notice of
16 intent. The information provided by the Company in the application and supplemented by further
17 discovery from Staff is satisfactory.

18 6. A.A.C. R14-2-803.B states that "The Commission will, within 60 days from the
19 receipt of the notice of intent, determine whether to hold a hearing on the matter or approve the
20 organization or reorganization without a hearing."

21 7. A.A.C. R14-2-803.C states that, ". . . the Commission may reject the proposal if it
22 determines that it would impair the financial status of the public utility, otherwise prevent it from
23 attracting capital at fair and reasonable terms, or impair the ability of the public utility to provide
24 safe, reasonable and adequate service."

25 8. APS' capital structure as of March 31, 2008, consists of 3.0 percent short-term debt,
26 44.7 percent long-term debt and 52.3 percent equity. A *pro forma* capital structure reflecting the

27

28 ¹ APS currently has a rate case in progress under Docket No. E-01345A-08-0172.

1 proposed \$400 million investment is composed of 2.8 percent short-term debt, 42.1 percent long-
2 term debt and 55.1 percent equity.

3 9. For utilities with access to the capital markets, Staff typically recommends a capital
4 structure within 40 to 60 percent equity of total capital (short-term debt plus long-term debt plus
5 common equity) as appropriate to provide a balance of cost and financial risk.²

6 10. The appropriate capital structure for a particular utility at any specific time is
7 dependent on various operational and general economic conditions. Providing APS authorization
8 to issue equity capital combined with its existing authorization to issue debt would assist its efforts
9 to maintain a capital structure that reflects its particular circumstances in recognition of the broader
10 economic conditions.

11 **CONCLUSIONS OF LAW**

12 1. APS is an Arizona public service corporation within the meaning of Article XV,
13 Section 2 of the Arizona Constitution.

14 2. The Commission has jurisdiction over APS and the subject matter of the
15 application.

16 3. Authorization to increase equity by up to \$400 million dollars would assist APS'
17 efforts to maintain a balance of cost and financial risk in its capital structure while funding its
18 capital expenditures.

19 4. There is no financial basis under A.A.C. R14-2-803.C. to reject APS'
20 recapitalization plan.

21 5. No determination of the ratemaking treatment of the equity infusion is necessary or
22 appropriate in this docket.

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27 ² Decision No. 69947, dated October 30, 2007, ordered APS to have a minimum common equity ratio of 40.0 percent
28 immediately subsequent to the issuance of any continuing long-term debt.

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ORDER

IT IS THEREFORE ORDERED that Pinnacle West Capital Corporation and Arizona Public Service Company's Notice of Intent to Increase Equity as set forth in the application and herein, is hereby approved.

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

BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN

COMMISSIONER

COMMISSIONER

COMMISSIONER

COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this _____ day of _____, 2008.

BRIAN C. McNEIL
EXECUTIVE DIRECTOR

DISSENT: _____

DISSENT: _____

EGJ:PMC:lh\AH

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