

ORIGINAL



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MEMORANDUM

TO: Docket Control

FROM: Ernest G. Johnson
Director
Utilities Division

DATE: November 3, 2008

RE: STAFF REPORT FOR THE SOUTHWEST TRANSMISSION COOPERATIVE, INC. APPLICATION FOR PERMISSION TO APPLY THE PROCEEDS OF PREVIOUSLY AUTHORIZED INDEBTEDNESS TO A DIFFERENT PURPOSE (DOCKET NO. E-04100A-08-0238)

Attached is the Staff Report for Southwest Transmission Cooperative, Inc.'s application for permission to apply the proceeds of previously authorized indebtedness to a different purpose. Staff recommends approval of the requested authorization.

Any party to this procedure who wishes may file comments to the Staff Report with the Commission's Docket Control by 4:00 p.m. on or before November 13, 2008.

EGJ:PMC:tdp

Originator: Pedro M. Chaves

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Arizona Corporation Commission
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Service List for: Southwest Transmission Cooperative, Inc.
Docket No. E-04100A-08-0238

Mr. Michael M. Grant
2575 East Camelback Road
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Phoenix, Arizona 85007

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Chief Administrative Law Judge, Hearing Division
Arizona Corporation Commission
1200 West Washington Street
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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

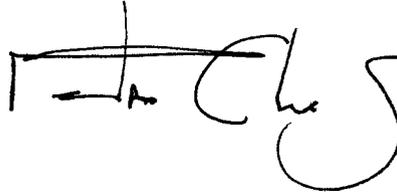
**SOUTHWEST TRANSMISSION COOPERATIVE, INC.
DOCKET NO. E-04100A-08-0238**

**APPLICATION FOR PERMISSION TO APPLY
THE PROCEEDS OF PREVIOUSLY AUTHORIZED
INDEBTEDNESS TO A DIFFERENT PURPOSE.**

NOVEMBER 3, 2008

STAFF ACKNOWLEDGMENT

The Staff Report for Southwest Transmission Cooperative, Inc., Docket No. E-04100A-08-0238 is the responsibility of the Staff members listed below: Pedro M. Chaves is responsible for the review and financial analysis of the Company's application.

A handwritten signature in black ink, appearing to read 'Pedro M. Chaves', with a large, stylized flourish at the end.

PEDRO M. CHAVES
PUBLIC UTILITIES ANALYST III

EXECUTIVE SUMMARY
SOUTHWEST TRANSMISSION COOPERATIVE, INC.
DOCKET NO. E-04100A-08-0238

Southwest Transmission Cooperative, Inc. ("SWTCO" or "Cooperative"), an Arizona class "A" public service corporation and non-profit, member-owned cooperative located in Benson Arizona, filed an application requesting to apply the proceeds of previously authorized indebtedness to a different purpose.

On December 19, 2002, the Commission issued Decision No. 65473 authorizing SWTCO to borrow an amount not to exceed \$30,853,000 from the Rural Utilities Service / Federal Financing Bank ("RUS/FFB") to finance its 2001-2004 construction work plan ("CWP"). SWTCO indicates that it was able to construct the projects in the 2001-2004 CWP at less cost than originally estimated, leaving \$2.7 million unused debt issuance authorization from Decision No. 65473. The application further asserts that "RUS has asked SWTCO to identify other projects which could be funded with these surplus B-8 Loan monies so that RUS will not have to go through another Congressional budget process to re-encumber those funds."

The Cooperative's application requests that the Commission approve the transfer of five projects from the 2005-2008 CWP (authorized by Decision No. 69239, dated January 19, 2007) to be financed by the unused \$2.7 million debt authorization from Decision No. 65473. The Commission previously authorized RUS/FFB borrowings not to exceed \$49,575,000 for the 2005-2008 CWP in Decision No. 69239.

SWTCO's existing capital structure is highly leveraged and consists of 8.0 percent short-term debt, 87.7 percent long-term debt, and 4.3 percent equity. Issuance of 30-year \$2,700,000 and \$49,575,000 amortizing loans at 5 percent per annum would further exacerbate SWTCO's overly leveraged financial position. Concerns about SWTCO's highly leveraged position lead the Commission to order the Cooperative to file an annual equity analysis (Decision No. 69239). The Commission further indicated that it may have SWTCO file a rate case if its equity position does not improve.

The Cooperative's existing times interest earned ("TIER") and debt service coverage ("DSC") are 1.35 and 1.05, respectively. Staff's pro forma TIER and DSC ratios that include annualized revenues from implementation of phase III of an authorized rate increase, direct assignment facilities revenues, and a reduced contractual wheeling obligation, are 1.34 and 1.04, respectively. These results suggest that projected operating results are sufficient to meet all obligations.

Staff concludes that issuance of the proposed debt financing for the purposes stated in the application is within SWTCO's corporate powers, is compatible with the public interest, is consistent with sound financial practices and will not impair its ability to provide services.

Staff further recommends that any authorization to incur debt granted in this proceeding terminate on December 31, 2011.

Staff further recommends authorizing SWTCO to engage in any transaction and to execute any documents necessary to effectuate the authorizations herein granted.

Staff further recommends that the Company file copies of the executed loan documents with Docket Control within 30 days of execution.

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INTRODUCTION

Southwest Transmission Cooperative, Inc. ("SWTCO" or "Cooperative") is an Arizona non-profit, member-owned cooperative located in Benson Arizona. SWTCO provides network and point-to-point transmission service to wholesale entities under various transmission service agreements. SWTCO provides wholesale firm network transmission service to Arizona Electric Power Cooperative, Inc. ("AEPCO") on behalf of Anza Electric Cooperative, Duncan Valley Electric Cooperative, Graham County Electric Cooperative, Sulphur Springs Valley Electric Cooperative and Trico Electric Cooperative. SWTCO also provides firm network transmission service to Mohave Electric Cooperative, Phelps Dodge Corporation and the City of Safford. SWTCO also provides firm point-to-point service to AEPCO, Mohave Electric Cooperative and the City of Thatcher.

On May 7, 2008, the Cooperative filed an application with the Arizona Corporation Commission ("Commission") requesting authorization to apply the proceeds of previously authorized indebtedness to a different purpose.

PUBLIC NOTICE

On May 30, 2008, the Cooperative filed an affidavit of publication verifying public notice of its financing application. The Cooperative published notice of its financing application in *The Kingman Daily Miner* on May 16, 2008, and in *The Arizona Daily Star/Tucson Citizen* on May 19, 2008. *The Kingman Daily Miner* is a newspaper of general circulation in the City of Kingman, County of Mohave, Arizona, and *The Arizona Daily Star/Tucson Citizen* is a newspaper of general circulation in the County of Pima, Arizona. The affidavit of publication is attached along with a copy of the Notice.

BACKGROUND

SWTCO was formed in August 2001 as part of the reorganization of AEPCO. SWTCO's current rates were approved in Decision No. 68072, dated August 17, 2005.¹

On December 19, 2002, the Commission issued Decision No. 65473 authorizing the Cooperative to borrow an amount not to exceed \$30,853,000 from the Rural Utilities Service / Federal Financing Bank ("RUS/FFB") to finance its 2001-2004 construction work plan ("CWP"). SWTCO indicates that it was able to construct the projects in the 2001-2004 CWP at less cost than originally estimated leaving \$2.7 million unused debt issuance authorization from Decision No. 65473.

On January 19, 2007, Commission's Decision No. 69239 authorized SWTCO to borrow from RUS/FFB an amount not to exceed \$49,575,000 to finance its 2005-2008 CWP.

¹ The authorized rate increase consisted of three phases. The third phase became effective on September 1, 2007.

PURPOSE AND DESCRIPTION OF THE PROPOSED FINANCING

SWTCO asserts in its application that "RUS has asked SWTC to identify other projects which could be funded with these surplus (i.e. unused) B-8 Loan monies so that RUS will not have to go through another Congressional budget process to re-encumber those funds."²

The Cooperative's application requests that the Commission approve the transfer of five projects from the 2005-2008 CWP (authorized by Decision No. 69239) for financing by the unused \$2.7 million debt authorization from Decision No. 65473 in order to comply with RUS' request.

The applicable interest rate on the RUS/FFB loan will be fixed at the time that each advance is made and SWTCO would be able to draw down on the loan as needed to proceed with the Cooperative's CWP. The current interest rate for a 30-year RUS/FFB loan is 4.14 percent.³

FINANCIAL ANALYSIS

Staff's analysis is illustrated in Schedule PMC-1. Column [A] reflects SWTCO's financial information for the year ended December 31, 2007. Column [B] presents pro forma financial information that modifies Column [A] to include annualized revenues from implementation of phase III of an authorized rate increase⁴, draw of \$2,700,000 amortized for 30 years at an interest rate of 5.0 percent per annum, previously authorized \$49.575 million (amortized for 30 years at 5 percent per annum) per Decision No. 69239, future direct assignment facilities revenues, and a reduced contractual wheeling obligation. Column [C] presents pro forma financial information that modifies Column [A] to include annualized revenues from implementation of phase III of the authorized rate increase and draw of \$2,700,000 amortized for 30 years at an interest rate of 5.0 percent per annum.

Capital Structure

The Cooperative's existing capital structure is highly leveraged and consists of 8.0 percent short-term debt, 87.7 percent long-term debt, and 4.3 percent equity. Issuance of 30-year \$2,700,000 and \$49,575,000 amortizing loans at 5 percent per annum would further exacerbate SWTCO's overly leveraged financial position resulting in a pro forma capital structure composed of 5.8 percent short-term debt, 91.3 percent long-term debt and 2.9 percent equity.

Concerns about SWTCO's highly leveraged position lead the Commission to order the Cooperative to file an annual equity analysis. The Commission further indicated that it may have SWTCO file a rate case if its equity position does not improve.⁵

² SWTCO's Application, page 1, lines 21 - 23.

³ <http://www.usda.gov/rus/electric/rates.shtml#ffb> (as of 9/22/2008)

⁴ Decision No. 68072.

⁵ Decision No. 69239, page 10, lines 7-9.

TIER and DSC

Times interest earned ratio ("TIER") represents the number of times earnings cover interest expense on short-term and long-term debt. A TIER greater than 1.0 means that operating income is greater than interest expense. A TIER less than 1.0 is not sustainable in the long-term but does not mean that debt obligations cannot be met in the short term.

Debt service coverage ratio ("DSC") represents the number of times internally generated cash will cover required principal and interest payments on short-term and long-term debt. A DSC greater than 1.0 indicates that operating cash flow is sufficient to cover debt obligations. A DSC less than 1.0 means that debt service obligations cannot be met by cash generated from operations and that another source of funds is needed to avoid default.

RUS has a coverage ratio requirement that requires SWTCO to achieve a minimum TIER of 1.05 and a DSC of 1.00 in two out of three years.

Schedule PMC-1, Column [A] shows that for the year ended December 30, 2007, SWTCO had a TIER and DSC of 1.35 and 1.05, respectively. The pro forma TIER and DSC for the Cooperative under the scenario described above for Column [B] are 1.34 and 1.04, respectively. The pro forma TIER and DSC for SWTCO under the scenario described above for Column [C] are 1.53 and 1.11, respectively. These results suggest that projected operating results are sufficient to meet all obligations and covenants.

COMPLIANCE

There are no compliance issues with Southwest Transmission Cooperative, Inc.

CONCLUSION AND RECOMMENDATIONS

Staff concludes that issuance of debt financing for the purposes stated in the application is within SWTCO's corporate powers, is compatible with the public interest, is consistent with sound financial practices and will not impair its ability to provide services.

Staff further recommends that the Commission approve the Cooperative's request to apply unused debt authorizations from Decision No. 65473 to a different purpose.

Staff further recommends that any authorization to incur debt granted in this proceeding terminate on December 31, 2011.

Staff further recommends authorizing SWTCO to engage in any transaction and to execute any documents necessary to effectuate the authorizations herein granted.

Staff further recommends that the Company file copies of the executed loan documents with Docket Control within 30 days of execution.

FINANCIAL ANALYSIS

	[A] ¹ <u>12/31/2007</u>		[B] ² <u>Pro forma</u>		[C] ³ <u>Pro forma (2)</u>	
1 Operating Income	\$ 6,277,926		\$ 9,711,886		\$ 7,339,201	
2 Depreciation & Amort.	7,317,126		7,317,126		7,317,126	
3 Income Tax Expense	0		0		0	
4						
5 Interest Expense	4,655,683		7,251,918		4,789,778	
6 Repayment of Principal	8,325,152		9,096,399		8,364,987	
7						
8						
9 TIER						
10 [1+3] ÷ [5]	1.35		1.34		1.53	
11						
12 DSC						
13 [1+2+3] ÷ [5+6]	1.05		1.04		1.11	
14						
15						
16						
17						
18 Short-term Debt	\$8,325,125	8.0%	\$ 9,096,372	5.8%	\$ 8,364,960	7.8%
19						
20 Long-term Debt	\$91,345,173	87.7%	\$142,848,926	91.3%	\$94,005,338	88.0%
21						
22 Common Equity	\$4,462,550	4.3%	\$4,462,550	2.9%	\$4,462,550	4.2%
23						
24 Total Capital	\$104,132,848	100.0%	\$156,407,848	100.0%	\$106,832,848	100.0%
25						
26						
27						

28 ¹ Column [A] is based on audited financial statements for the year ended December 31, 2007.

29 ² Column [B] is Column [A] modified to include issuance of \$2.7million debt financing, the previously authorized \$49.575 million per Decision No. 69239, dated January 19, 2007, future direct assignment facilities revenues, the full effect of phase II of authorized rates (effective on September 1, 2007, per Decision No. 68072, and a reduced contractual wheeling obligation.

30 ³ Column [C] is Column [A] modified to include the full effect of phase III of authorized rates (effective on September 1, 2007, per Decision No. 68072) and issuance of \$2.7million debt financing.

GALLAGHER & KENNEDY

P.A.

LAW OFFICES

MICHAEL M. GRANT
 DIRECT DIAL: (602) 530-8291
 E-MAIL: MMG@GKNET.COM

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**AZ CORP COMMISSION
 DOCKET CONTROL**

May 30, 2008

2575 EAST CAMELBACK ROAD
 PHOENIX, ARIZONA 85016-9225
 PHONE: (602) 530-8000
 FAX: (602) 530-8500
 WWW.GKNET.COM

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 Arizona Corporation Commission
DOCKETED

MAY 30 2008

HAND DELIVERED

Docket Control
 Arizona Corporation Commission
 1200 W. Washington St.
 Phoenix, AZ 85007

DOCKETED BY	
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Re: *Southwest Transmission Cooperative, Inc. ("SWTC") Finance Application;
 Docket No. E-04100A-08-0238; Affidavits of Publication*

Dear Sir or Madam:

Enclosed are the original and 13 copies of Affidavits of Publication from Tucson Newspapers and the *Kingman Daily Miner*. They confirm that notice of this matter was published in the *Kingman Daily Miner* on May 16, 2008 and in the *Arizona Daily Star* and *Tucson Citizen* on May 19, 2008. Your assistance in relation to this matter is appreciated.

Very truly yours,

GALLAGHER & KENNEDY, P.A.

By:

Michael M. Grant

MMG/plp
 15169-11/1838415
 Enclosures

Original and 13 copies filed with Docket
 Control this 30th day of May, 2008.

cc (w/enclosure): Pedro Chaves, Utilities Division (delivered)
 Prem Bahl, Utilities Division (delivered)
 Gary Pierson

TUCSON NEWSPAPERS

Tucson, Arizona

STATE OF ARIZONA)
COUNTY OF PIMA)

Debbie Capanear, being first duly sworn deposes and says: that she is the Legal Advertising Representative of TNI PARTNERS, DBA TUCSON NEWSPAPERS, a General Partnership organized and existing under the laws of the State of Arizona, and that it prints and publishes the Arizona Daily Star and Tucson Citizen, daily newspapers printed and published in the City of Tucson, Pima County, State of Arizona, and having a general circulation in said City, County, State and elsewhere, and that the attached

Legal Notice

was printed and published correctly in the entire issue of the said Arizona Daily Star and Tucson Citizen on each of the following dates, to-wit:

May 19, 2008

Debbie Capanear

Subscribed and sworn to before me this 23 day of May, 2008

Silvia H. Valdez
Notary Public



SILVIA H VALDEZ
Notary Public Arizona
Pima County
Expires 12/15/09

My commission expires

TNI AD NO. 6234/20

PUBLIC NOTICE OF AN APPLICATION FOR PERMISSION TO APPLY THE PROCEEDS OF PREVIOUSLY AUTHORIZED INDEBTEDNESS TO A DIFFERENT PURPOSE BY SOUTHWEST TRANSMISSION COOPERATIVE, INC. Docket No. E-04106A-08-0238

Southwest Transmission Cooperative, Inc. has filed an Application with the Arizona Corporation Commission for an order authorizing it to apply the proceeds of previously authorized indebtedness to a different purpose. The application is available for inspection during regular business hours at the office of the Commission in Phoenix, Arizona, and the Company's offices at 1000 South Highway 80, Benson, Arizona 85602. Intervention in the Commission's proceedings on the application shall be permitted to any person entitled by law to intervene and having a direct substantial interest in this matter. Persons desiring to intervene must file a Motion to Intervene with the Commission which must be served upon applicant and which, at a minimum, shall contain the following information:

- 1. The name, address and telephone number of the proposed intervenor and of any person upon whom service of documents is to be made if different than the intervenor.
2. A short statement of the proposed intervenor's interest in the proceeding.
3. Whether the proposed intervenor desires a formal evidentiary hearing on the application and the reasons for such a hearing.
4. A statement certifying that a copy of the Motion to Intervene has been mailed to Applicant.

The granting of Motions to Intervene shall be governed by A.A.C. R14-3-105.
Publish May 19, 2008
Arizona Daily Star
Tucson Citizen

AFFIDAVIT OF PUBLICATION

Kingman Daily Miner

3015 Stockton Hill Road, Kingman, AZ 86401

web: www.kingmandailyminer.com • e-mail: legals@kingmandailyminer.com

Phone (928) 753-6397, ext. 242 • Fax (928) 753-5661

"Serving Kingman since 1882"

STATE OF ARIZONA)
County of Mohave) ss.

I, **Melinda Mauser**, being first duly sworn on her oath says:
That she is the Legals Clerk of THE KINGMAN DAILY MINER
An Arizona corporation, which owns and publishes the Miner,
a Daily Newspaper published in the City of Kingman, County of Mohave,
Arizona, that the notice attached hereto, namely,

**Public Notice
Ad. No. 8644**

Has, to the personal knowledge of affiant, 16th day of May, 2008
to the 16th day of May, 2008 inclusive without change, interruption or
omission, amounting in 1 insertions, made on the following dates:
5/16/2008

By: *mm*
Legal Clerk, 19th Day of May, 2008

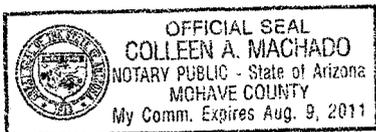
State of Arizona

County of Mohave

On this 23 day of May, 2008

Legal Clerk, whom I know personally to be
the person who signed the above document
and she proved she signed it.

Colleen A. Machado
Notary Public
My Commission Expires August 9, 2011



(8644)
PUBLIC NOTICE
OF
AN APPLICATION FOR PERMIS-
SION TO APPLY THE PROCEEDS OF
PREVIOUSLY AUTHORIZED
INDEBTEDNESS TO A DIFFER-
ENT PURPOSE
BY SOUTHWEST TRANSMIS-
SION COOPERATIVE, INC.
Docket No. E-04100A-08-0238

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2. A short statement of the proposed intervenor's interest in the proceeding.
3. Whether the proposed intervenor desires a formal evidentiary hearing on the application and the reasons for such a hearing.
4. A statement certifying that a copy of the Motion to Intervene has been mailed to Applicant.

The granting of Motions to Intervene shall be governed by A.A.C. R14-3-105.

Published: May 16, 2008
Ad. No. 8644