

ORIGINAL

OPEN MEETING ITEM



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COMMISSIONERS
KRISTIN K. MAYES - Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP



RECEIVED
Executive Director

ARIZONA CORPORATION COMMISSION

2010 OCT 29 P 1:46

DATE: OCTOBER 29, 2010

DOCKET NO.: E-04100A-09-0496

AZ CORP COMMISSION
DOCKET CONTROL

TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Jane L. Rodda. The recommendation has been filed in the form of an Opinion and Order on:

SOUTHWEST TRANSMISSION COOPERATIVE, INC.
(RATES)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by 4:00 p.m. on or before:

NOVEMBER 8, 2010

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Open Meeting to be held on:

NOVEMBER 22, 2010 and NOVEMBER 23, 2010

For more information, you may contact Docket Control at (602) 542-3477 or the Hearing Division at (602)542-4250. For information about the Open Meeting, contact the Executive Director's Office at (602) 542-3931.

Arizona Corporation Commission

DOCKETED

OCT 29 2010

DOCKETED BY

ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

KRISTIN K. MAYES - Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

IN THE MATTER OF THE APPLICATION OF
SOUTHWEST TRANSMISSION COOPERATIVE,
INC. FOR A HEARING TO DETERMINE THE
FAIR VALUE OF ITS PROPERTY FOR
RATEMAKING PURPOSES, TO FIX A JUST AND
REASONABLE RETURN THEREON AND TO
APPROVE RATES DESIGNED TO DEVELOP
SUCH RETURN.

DOCKET NO. E-04100A-09-0496

DECISION NO. _____

OPINION AND ORDER

DATE OF HEARING:	September 14, 2010
PLACE OF HEARING:	Tucson, Arizona
ADMINISTRATIVE LAW JUDGE:	Jane L. Rodda
APPEARANCES:	Mr. Michael M. Grant, GALLAGHER & KENNEDY, P.A., on behalf of Southwest Transmission Cooperative, Inc.;
	Mr. Michael Patten, ROSHKA DEWULF & PATTEN, P.L.C., on behalf of Trico Electric Cooperative, Inc.;
	Mr. Bradley S. Carroll, SNELL & WILMER, L.L.P., on behalf of Sulphur Springs Valley Electric Cooperative, Inc.;
	Mr. William P. Sullivan, CURTIS, GOODWIN, SULLIVAN, UDALL & SCHWAB, P.L.C., on behalf of Mohave Electric Cooperative, Inc.; and
	Ms. Maureen A. Scott, Ms. Ayesha Vohra, and Mr. Scott M. Helsa, Staff Attorneys, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

* * * * *

Having considered the entire record herein and being fully advised in the premises, the Arizona Corporation Commission ("Commission") finds, concludes, and orders that:

1 Mohave customers on March 18, 2010.

2 11. The Commission received three opinions from retail customers opposed to the
3 increase

4 12. On June 9, 2010, Staff filed a Motion for Extension of Time to File Staff Direct
5 Testimony and Staff Rate Design Direct Testimony. All parties consented, and the extension was
6 granted by Procedural Order dated June 10, 2010.

7 13. On June 18, 2010, Staff filed the Direct Testimony of Ralph C. Smith, Randall
8 Vickroy and Richard Mazzini.

9 14. On June 28, 2010, Staff filed the Direct Testimony of Dennis Kalbarczyk on Rate
10 Design and Cost of Capital.

11 15. On July 26, 2010, SWTC filed a Request to Extend the Filing Date for SWTC's
12 Rebuttal Testimony, from July 28, 2010, to July 30, 2010. No party objected, and the request was
13 granted by Procedural Order dated July 26, 2010.

14 16. On July 30, 2010, SWTC filed the Rebuttal Testimony of Gary C. Pierson and Dr. Jay
15 Zarnikau.

16 17. On August 12, 2010, Mohave filed the Surrebuttal Testimony of Carl N. Stover, Jr.

17 18. On August 16, 2010, Trico filed the Surrebuttal Testimony of Vincent Nitido.

18 19. On August 17, 2010, SSVEC filed a "Comment in Support of Testimonies" indicating
19 that after reviewing the Rebuttal Testimony of SWTC and Surrebuttal Testimonies of Mohave and
20 Trico, SSVEC supports the positions taken by SWTC, Mohave and Trico as expressed therein.

21 20. On August 18, 2010, Staff filed the Surrebuttal Testimony of Ralph C. Smith and
22 Dennis Kalbarczyk.

23 21. On September 1, 2010, SWTC filed the Rejoinder Testimony of Gary Pierson.

24 22. A Procedural Conference convened on September 7, 2010, for the purpose of
25 scheduling witnesses. At that time, the parties reported that they had reached agreement on many of
26 the rate case issues, including cost allocations and rate design concepts, and requested that the
27 testimonies of Mr. Kalbarczyk, Zarnikau and Mazzini be admitted upon stipulation. The only issue
28 remaining in dispute at that time was the difference in revenue requirement between Staff and

1 SWTC.

2 23. On September 9, 2010, Staff filed a Notice of Filing of Possible Stipulation in
3 Resolution of Issues.

4 24. The hearing convened on September 14, 2010, before a duly authorized
5 Administrative Law Judge. The parties reported at the commencement of the hearing that they had
6 reached agreement on the remaining revenue requirement issue. At the hearing, the following
7 witnesses appeared and gave testimony in support of the parties' final positions: Mr. Pierson for
8 SWTC, Ms. Barbara Keene for Staff, and Mr. Carl Stover for Mohave.

9 25. SWTC is a non-profit electric transmission cooperative, which primarily provides
10 transmission service to its Class A and B Members. In turn, the Class A Member distribution
11 cooperatives provide electricity to their retail member-owners.

12 26. SWTC has a thirteen member Board of Directors; twelve members of which represent
13 SWTC's six Class A member distribution cooperatives.¹ The remaining Board member represents
14 the Arizona Electric Power Cooperative, Inc. ("AEPSCO") and Sierra Southwest Cooperative
15 Services, Inc. ("Sierra") which are Class B members.

16 27. SWTC was formed in anticipation of the restructuring of AEPSCO, which the
17 Commission approved in Decision No. 63868 (July 25, 2001).

18 28. SWTC is a "transmitting utility" under Section 211 of the Federal Power Act, and as
19 such is subject to the jurisdiction of the Federal Energy Regulatory Commission ("FERC"). In order
20 to meet the requirements for reciprocity under FERC Order No. 888, SWTC maintains an Open
21 Access Transmission Tariff ("OATT"). As a borrower from the Rural Utilities Service ("RUS"), a
22 division of the United States Department of Agriculture, SWTC is subject to RUS' mortgage
23 requirements and regulations.

24 29. SWTC owns approximately 622 miles of transmission lines and 24 substations, some
25 of which are jointly owned with the Salt River Project ("SRP") and Tucson Electric Power ("TEP").
26 SWTC has contracts to receive transmission service from SRP, TEP, Arizona Public Service
27

28 ¹ SWTC's six Class A members are SSVEC, Trico, Mohave, Graham County Electric Cooperative, Inc., Duncan Valley Electric Cooperative, Inc. and Anza Electric Cooperative, Inc.

1 Company, the Western Area Power Administration and Southern California Edison.

2 30. SWTC's current rates were set in Decision No. 68072 (August 17, 2005).

3 31. In the Test Year ended March 31, 2009, SWTC experienced an adjusted Operating
4 Income (margin) of \$660,396, on Total Operating Revenue of \$27,777,277, which resulted in a 0.83
5 percent rate of return on an adjusted fair value rate base ("FVRB") of \$79,146,274.²

6 32. In its Rejoinder Position, SWTC proposed a revenue increase of \$6,823,195, an
7 increase of 24.56 percent, from \$27,777,277 to \$34,600,472. SWTC based its request on the revenue
8 necessary to produce a Debt Service Coverage ("DSC") ratio of 1.35.³ The Cooperative's request
9 would result in Operating Income of \$7,483,591, or 9.46 percent on a FVRB of \$79,146,274.⁴

10 33. In its Surrebuttal Testimony, Staff recommended a revenue increase of \$7,722,073, or
11 approximately 27.8 percent, for total Operating Revenues of \$35,499,350. Staff based its
12 recommendation on providing SWTC with sufficient revenue to yield a DSC of 1.45.⁵ Staff's
13 recommended revenue level produced Operating Income of \$8,382,519, a 10.59 percent rate of return
14 on FVRB of \$79,146,274.⁶

15 34. SWTC accepted all four of Staff's proposed adjustments to rate base, and four of
16 Staff's five adjustments to Operating Income.⁷ The Cooperative argued that its proposed treatment of
17 a \$73,000 gain from the sale of a 69 kV line to Mohave in 2009 had already been attributed to the
18 Class A member ratepayers, so that Staff's proposed adjustment to increase SWTC's test year income
19 would have had the effect of crediting ratepayers twice for the gain.⁸ Staff agreed with the
20 Cooperative's treatment of the gain.⁹

21 35. Thus, the parties agreed on all rate base and income adjustments for the test year, and
22 the only dispute between Staff, SWTC and the intervenors was the amount of the proposed increase,
23 with Staff recommending a revenue level \$898,878 greater than requested by the Cooperative in

24 ² Zarnikau Rebuttal, JWZ G-1.

25 ³ DSC represents the number of times internally generated cash will cover required principal and interest payments or
long-term debt.

26 ⁴ *Id.* at JWZ G-2.

27 ⁵ Summary of Ralph Smith's Direct Testimony.

28 ⁶ Pierson Rejoinder, GEP -3

⁷ Pierson Rebuttal at 1.

⁸ Pierson Rebuttal at 3.

⁹ Smith Surrebuttal at 3.

1 order to provide a DSC of 1.45, instead of the 1.35 advocated by the Cooperative.

2 36. SWTC believes that in this case, a DSC of 1.35 is adequate because SWTC has an
3 interim financing facility that helps manage the cash flow lags between cash expenditures for capital
4 projects and related loan draw replenishments. In addition, SWTC is confident that a new point-to-
5 point transmission agreement will be entered into with AEPCO commencing in January 2011, which
6 will provide a new revenue source for SWTC in 2011.¹⁰

7 37. Staff originally advocated for revenue sufficient to produce a DSC of 1.45 because
8 Staff was concerned that the Cooperative should have sufficient cash flow for debt service and
9 working capital needs.¹¹ Staff believed that the Cooperative's proposed DSC of 1.35 was at the low
10 end of the acceptable range, and that lags between having to make capital expenditures and being
11 able to draw on its long-term debt facility warranted greater cash flow than was being sought by
12 SWTC.¹²

13 38. Mohave's witness, Carl Stover, recommended adopting SWTC's position, and
14 provided a financial analysis which supports the position that a DSC of 1.35 would allow SWTC to
15 both increase cash reserves and its equity.¹³

16 39. Trico agreed with Mohave's position and believed that Staff's proposed increase based
17 on a DSC of 1.45, is unnecessary and results in increased burdens on Trico and its member-
18 customers.¹⁴

19 40. At the hearing, Staff agreed to accept the Cooperative's proposal for revenues
20 sufficient to produce a 1.35 DSC. Staff's witness, Barbara Keene testified that the proposed 1.35
21 DSC falls within Staff's acceptable range, and that Staff believes it will be sufficient to provide cash
22 flow for debt service and building equity as well as contingencies.¹⁵

23 41. In its application, SWTC proposed an Original Cost Rate Base ("OCRB") of
24 \$79,668,372. Staff recommended adjustments that decreased the proposed rate base by \$522,098, to
25

26 ¹⁰ Pierson Rebuttal at 1-2.

¹¹ Vickroy Direct at 9.

¹² *Id.*

¹³ Stover Surrebuttal.

¹⁴ Nitido Surrebuttal.

28 ¹⁵ Transcript of September 14, 2010 hearing ("Tr.") at 34 and 42.

1 \$79,146,274.¹⁶

2 42. The evidence supports a finding that an OCRB and FVRB of \$79,146,274, is
3 reasonable.

4 43. Because SWTC is a member-owned non-profit cooperative, return on FVRB is not a
5 meaningful basis to set the revenue requirement.¹⁷ Rates must be sufficient to allow SWTC to meet
6 its operating expenses and debt service obligations as measured by appropriate financial ratios.

7 44. The parties' recommended revenue increase of \$6,823,145, results in total Operating
8 Revenues of \$34,600,422, Operating Income of \$7,483,591, a DSC of 1.35, and a 9.46 percent rate of
9 return on FVRB. The parties' recommended revenue level and rates are just and reasonable and
10 should be approved.

11 45. It is difficult to calculate the effect of the requested rate increase on the customers of
12 the distribution cooperatives because each distribution cooperative has its own rate structure. SWTC
13 transmission charges flow through to the retail ratepayers by means of the distribution cooperatives'
14 fuel adjustor mechanisms.¹⁸ SWTC estimates that the average retail customer using 1,000 kWh a
15 month would see an increase in his or her bill of approximately \$4.20.¹⁹

16 46. Staff also recommends that SWTC work with Staff to develop forecasts that will allow
17 for careful and regular monitoring of emerging threats to SWTC's financial condition; and that
18 SWTC should report quarterly its most recent 12 months and forecasted (for the next 12 months)
19 DSC, Times Interest Earned Ratio ("TIER"), equity ratio, and cash and liquidity from credit
20 facilities.²⁰

21 47. SWTC does not object to meeting informally with Staff to discuss its financial
22 condition and does not object to providing periodic reports.²¹

23 48. In June 2010, SWTC's capital structure contained approximately 8 percent equity.
24 This represents an improvement since SWTC's last rate case when its equity comprised about 1.5

25 ¹⁶ Ralph Smith's Direct Testimony Summary at 1.

26 ¹⁷ Tr. at 38.

26 ¹⁸ Tr. at 36.

27 ¹⁹ Pierson Rejoinder at 3. Tr. at 26. Mohave's witness estimated the effect on its retail customer using 1,000 kWh per
month to be \$3.09. Tr. at 45.

27 ²⁰ Vickroy Direct at 11; Tr. at 39.

28 ²¹ Tr. at 24.

1 percent of total capital.²²

2 49. In Decision No. 69239 (January 19, 2007), the Commission approved SWTC's request
3 to borrow up to \$49.575 million from the RUS, and ordered SWTC to file an annual equity analysis
4 and forecast. SWTC filed its latest analysis in June 2010. Although SWTC has made progress in
5 increasing its equity, its current 8 percent equity position remains too low for a transmission
6 cooperative. The Cooperative believes that equity of about 15 percent of total capital is a reasonable
7 goal.²³

8 50. It is reasonable that SWTC be required to continue to file its annual equity analyses
9 and projections, and to provide Staff with quarterly updates on its financial metrics as recommended
10 by Staff. The Cooperative provides this information to its own Board of Directors and providing this
11 information to Staff should not be burdensome. If after reviewing the information provided by the
12 Cooperative, Staff believes that additional discussions are warranted, we trust that the Cooperative
13 will meet with Staff to address any concerns.

14 51. In Decision No. 68072, the Commission ordered that SWTC not make any patronage
15 refunds while its equity remains below 20 percent of total capitalization and that patronage refunds be
16 limited to 25 percent of net earnings if its equity is between 20 and 30 percent of its capitalization. It
17 is reasonable that this directive remain in force.

18 52. In the past, Staff has recommended a higher equity ratio than 15 percent. We make no
19 determination in this proceeding that any particular equity ratio should be a goal for SWTC, except
20 that SWTC should continue to build equity from its current position.

21 53. Staff did not identify any compliance issues or areas of operational concern. The Staff
22 consultant charged with the engineering analysis concluded that SWTC's technical performance and
23 facilities are sound. He found that facilities are in good condition and functioning as expected, that
24 maintenance conforms to industry standards, that reliability performance is good, but could be
25 improved by reducing outages due to errors, and that cost performance is good.²⁴

26
27 ²² Tr. at 17.

²³ Tr. at 16.

28 ²⁴ Mazzini Direct at 1-2.

CONCLUSIONS OF LAW

1
2 1. SWTC is a public service corporation pursuant to Article XV of the Arizona
3 Constitution and A.R.S. §§ 40-250 and 40-251.

4 2. The Commission has jurisdiction over SWTC's operations and the subject matter of
5 the application.

6 3. Notice of the proceeding was provided in conformance with law.

7 4. SWTC's FVRB is deemed to be \$79,146,274.

8 5. The rates, charges and conditions of service approved herein are just and reasonable
9 and in the public interest.

ORDER

10
11 IT IS THEREFORE ORDERED that Southwest Transmission Cooperative, Inc. is hereby
12 authorized and directed to file with the Commission, on or before November 30, 2010, revised
13 schedules of rates and charges consistent with the following:

<u>Transmission Services:</u>	
Firm Network Service - \$ Monthly Rev, Req.*	\$2,187,176
Firm Network Service - \$ Annual Rev. Req.*	\$26,246,111
Firm Network Service – Mohave Electric 2 \$ Monthly Rev. Req.*	\$2,056,562
Firm network Service – Mohave Electric 2 \$ Annual Rev. Req.*	\$24,678,748
Firm Point-to-Point Network Transmission (\$/kW)	\$3.608
Non-firm Point-to-Point network Transmission \$/kW	\$.3608
<u>Mandatory Ancillary Services:</u>	
Sch 1 – Network – System Control & Load Dispatch (\$/kW)	\$0.245
Sch. 1 – Point-to-Point- system control & Load dispatch (\$/kW)	\$0.245
Sch 2 – Network – Var Support/Voltage Control (\$/kW)	\$0.067
Sch. 2 – Point-to-Point- Var Support/voltage Control (\$/kW)	\$0.049

1		
2	<u>FERC Optional Ancillary Services - AEPCO</u>	
3	Sch 3 – Network – Req. & Freq. Resp (\$/kW)	\$0.5325
4	Sch 4– Network–Energy Imbalance–Eng In-Kind+/-1.5% (\$/MW)	\$36.68
5	Sch 5 – Network – Oper. Reserves – Spinning (\$/kW)	\$0.7060
6	Sch 6 – Network – Oper. Reserve – Supplemental (\$/kW)	\$0.4981
7		
8	<u>Direct Assignment Facilities</u>	
9	Trico Electric Only – (\$/mth)**	\$128,777

10 * Member Rate: \$ annual rev. req./12 x ratio of member’s current 12 month average
 11 load to that of same sum total members load.

12 ** Cost Allocation and associated charges for transmission construction by distribution
 13 cooperative – Trico Only.

14 IT IS FURTHER ORDERED that the revised rates and charges shall be effective for all
 15 service rendered on and after January 1, 2011.

16 IT IS FURTHER ORDERED that Southwest Transmission Cooperative, Inc. shall notify its
 17 members of the revised schedules of rates and charges authorized herein within 30 days of the
 18 effective date of this Decision.

19 IT IS FURTHER ORDERED that Southwest Transmission Cooperative, Inc. shall continue to
 20 file annual equity analyses and forecasts on June 30th of each year, and shall file the quarterly reports
 21 of financial metrics as discussed in Staff’s testimony, commencing April 30, 2011, for the period
 22 ended March 31, 2011, and continuing thereafter with reports due by the end of the month following
 23 the end of each quarter.

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IT IS FURTHER ORDERED that Southwest Transmission Cooperative, Inc. shall not make any patronage refunds while its equity remains below 20 percent of total capitalization and that patronage refunds shall be limited to 25 percent of net earnings if its equity is between 20 and 30 percent of its capitalization.

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

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN _____ COMMISSIONER _____

COMMISSIONER _____ COMMISSIONER _____ COMMISSIONER _____

IN WITNESS WHEREOF, I, ERNEST G. JOHNSON, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this ____ day of _____, 2010.

ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

DISSENT _____

DISSENT _____

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2 INC.
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