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BEFORE THE ARIZONA CORPORATION COMMISSION Arizona Corporation Commission

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**COMMISSIONERS**

GARY PIERCE, Chairman  
BOB STUMP  
SANDRA D. KENNEDY  
PAUL NEWMAN  
BRENDA BURNS

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FEB 4 2011

AZ CORP COMMISSION  
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IN THE MATTER OF THE APPLICATION OF )  
COMMUNITY WATER COMPANY OF GREEN )  
VALLEY FOR A DETERMINATION THAT )  
THE 'AGREEMENT FOR PAST CAP M&I )  
WATER SERVICE CAPITAL CHARGES )  
(INSTALLMENT)' WITH CENTRAL ARIZONA )  
WATER CONSERVATION DISTRICT IS NOT )  
AN EVIDENCE OF INDEBTEDNESS )  
REQUIRING COMMISSION APPROVAL )  
UNDER A.R.S §§ 40-301 AND 40-302; OR, IN )  
THE ALTERNATIVE, APPROVAL OF THAT )  
AGREEMENT. )

DOCKET NO. W-02304A-09-0575

**SUPPLEMENTAL  
RESPONSE BRIEF**

Community Water Company of Green Valley ("CWCGV") hereby provides its Supplemental Response Brief addressing Staff's reliance on Decision No. 69947 (October 30, 2007) in this matter. That decision essentially dealt with the request of Arizona Public Service Company ("APS") to increase the limitation of its general authorization to incur debt to \$4.2 billion. In fact, there are many aspects to this case that distinguish CWCGV's application from the facts and circumstances of Decision No. 69947.

First, CWCGV is not making a blanket request for a general authorization to incur long-term indebtedness up to a certain limit. Second, the request CWCGV makes here is regarding one specific agreement with Central Arizona Water Conservation District ("CAWCD") that is a condition precedent to receive an additional allocation of Colorado River water in accordance with Arizona water policy. CWCGV is not requesting that it be excused from seeking approval for any agreements that have typically been subject to Commission approval under A.R.S. §§ 40-301 and 40-302. Third, CWCGV's agreement with CAWCD is not a capital lease (unlike the agreements at issue in APS' request for declaratory order within its request for general financing authorization); even so, the Company is unaware of the Commission requiring approval under A.R.S. §§ 40-301

1 and 40-302 for every arrangement that may be classified as indebtedness under Generally Accepted  
2 Accounting Principles ("GAAP"). Fourth, to find this Agreement is an "evidence of indebtedness"  
3 under A.R.S. §§ 40-301 and 40-302 would mean *any* obligation over 12 months is subject to  
4 approval, inhibiting the Company's ability to conduct its day to day operations. Staff's concerns in  
5 Decision No. 69947 regarded APS incurring excessive debt and frustrating the establishment of a  
6 long-term debt limit; neither concern applies to CWCGV's request regarding one specific  
7 arrangement with CAWCD. Further, the Company believes the doctrine of *ejusdem generis*  
8 appropriately applies to define what constitutes an evidence of indebtedness requiring Commission  
9 approval under those statutes, since the legislative intent is not clear. Finally, the Commission  
10 decision cited in the Company's August 26, 2010 Response, Decision No. 69681 (June 28, 2007),  
11 is more applicable to this case. That decision dealt with an agreement between Avra Water Co-op  
12 ("Avra") for additional Colorado River water allocation, which is substantially the same as the  
13 agreement at issue here. The Commission did not require Avra to seek approval for its agreement  
14 with CAWCD under A.R.S. §§ 40-301 and 40-302.

15 The following memorandum of points and authorities details what the Company  
16 understands to be the facts and circumstances of Decision No. 69947 and why the Company  
17 believes that decision is not applicable to this matter.

## 18 MEMORANDUM ON POINTS AND AUTHORITIES

### 19 I. BACKGROUND: FACTUAL BASIS OF DECISION NO. 69947.

20 Decision No. 69947 increased the limitation on the level of indebtedness APS was  
21 authorized to incur. The Commission had established the previous limit for APS in Decision No.  
22 55017 (May 6, 1986). This decision authorized APS to have, at any one time outstanding, up to an  
23 aggregate principal amount of long-term indebtedness of \$4.2 billion, including the \$500 million  
24 authorized from Decision 65796 (April 4, 2003).

25 In Decision No. 69947, the Commission essentially concluded that: (1) APS had the  
26 technical and financial expertise to make decisions on an ongoing basis under a *general*  
27 *authorization* as requested in its application; and (2) that APS' management has shown the integrity

1 to manage its affairs.<sup>1</sup> The decision did not approve any specific agreements, but instead allowed  
2 APS the flexibility to take advantage of the market to secure debt on favorable and reasonable  
3 terms. By contrast, CWCGV does not have, and has not sought, any such general authorization in  
4 this or any other application.

5 Contained in APS' application was the request to confirm that only traditional indebtedness  
6 for borrowed money was subject to A.R.S. §§ 40-301 and 302, and other arrangements will not  
7 require prior Commission authorization *or count against the Continuing Long-Term Debt*  
8 *authorization* requested in its application.<sup>2</sup> APS cited the example of how changed circumstances  
9 in which a long-term power-purchase agreement, long-term fuel supply contract or similar  
10 agreements may be treated as indebtedness on its balance sheet in accordance with GAAP. There  
11 were actually two agreements in question: (1) a vehicle capital lease with a \$6-million balance; and  
12 (2) a trailer rental capital lease with a balance of approximately \$75,000.<sup>3</sup> Staff recommended  
13 denial of this request and the Commission agreed with Staff. In doing so, the Commission stated  
14 its belief that the purpose of debt limits would be frustrated if APS could structure the form of its  
15 debt to avoid those limits.<sup>4</sup> The Commission, however, addressed situations where GAAP  
16 subsequently reclassified certain arrangements as indebtedness. In doing so, the Commission did  
17 not automatically make those arrangements fall under the limits and conditions of Decision No.  
18 69947; instead, the Commission established a process to determine whether these "now GAAP"  
19 arrangements should count against the debt limit, understanding the unintended collateral effects of  
20

21  
22 <sup>1</sup> The Commission further explained that APS had demonstrated the ability to use its financial flexibility to benefit and  
23 lower its capital costs, and indicated that it also needs that flexibility to best manage its operating cash needs. See  
24 Decision 69947 at Finding of Fact No. 13.

25 <sup>2</sup> See APS' Verified Application in Docket No. E-01345-06-0779 (December 15, 2006) at paragraph 13 (the  
26 Application minus exhibits is attached as Exhibit 1; the entire Application is available at  
27 <http://images.edocket.azcc.gov/docketpdf/0000062501.pdf> (last visited on February 3, 2011).)

<sup>3</sup> See Staff Report in Docket No. E-01345-06-0779 (May 18, 2007) at 3 (the Staff Report minus Engineering  
Memorandum and exhibits is attached as Exhibit 2); the entire Staff Report is available at  
<http://images.edocket.azcc.gov/docketpdf/0000073226.pdf> (last visited on February 3, 2011).)

<sup>4</sup> Decision No. 69947 at Finding of Fact 31.

1 future GAAP changes on APS' ability to issue debt.<sup>5</sup> Importantly, the Commission's order focused  
2 on the debt ceiling it was authorizing for APS and did not make GAAP classification dispositive as  
3 to what arrangements constituted debt for APS.

4 This case involves different facts and circumstances than those in Decision No. 69947.  
5 Here, CWCGV is seeking a declaratory order regarding one specific arrangement necessary to  
6 obtain additional allocation of Colorado River water. The following section further explains why  
7 the Company believes Decision No. 69947 does not apply to this matter.

8 **II. ARGUMENT: SEVERAL FACTS AND CIRCUMSTANCES DISTINGUISH THIS**  
9 **CASE FROM THE FACTS AND CIRCUMSTANCES IN DECISION NO. 69947.**

10 **1. CWCGV is not asking for general authorization up to a certain debt limit.**

11 CWCGV seeks a declaratory order regarding one agreement CWCGV has with CAWCD.  
12 Decision No. 69947, however, is a general authorization. CWCGV, however, is not seeking a  
13 general authorization and it does not give CWCGV any blanket approval for issuing evidences of  
14 indebtedness. In other words, the Company would still have to seek specific approval for each  
15 agreement that would otherwise require approval under A.R.S. §§ 40-301 and 40-302. Because this  
16 is not a general authorization, the Commission still maintains more than adequate control over  
17 CWCGV to ensure its financial health without having to approve this agreement with CAWCD.  
18 Thus, finding in favor of the Company's request does not risk protection of the public.

19  
20 **2. CWCGV Is not requesting to exclude any other agreement from approval under**  
**A.R.S. §§ 40-301 And 40-302 with its request for a declaratory order in this case.**

21 The Company's request concerns the very limited arrangement involving it and CAWCD –  
22 which is a necessary condition precedent to obtaining 1,521 acre-feet of additional Colorado River  
23 water allocation. There is no dispute that this is consistent with Arizona water policy. But unlike  
24 the APS request, the Commission will have more stringent controls over the Company in that it  
25 will not have any general financing authority. The Company will be required to seek approval  
26

27  

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<sup>5</sup> Id. at Findings of Fact 29 through 31.

1 under A.R.S. §§ 40-301 and 40-302 to issue debt, such as the refinancing it sought and obtained  
2 approval for Decision No. 71259 (September 3, 2009). In other words, approving CWCGV's  
3 request will not unleash a mechanism for the Company to bypass regulatory controls. CWCGV  
4 must still seek approval for *any* agreement traditionally subject to approval under A.R.S. §§ 40-301  
5 and 40-302. Consequently, there is also no threat of the public good being sacrificed if the  
6 Company's declaratory order request is granted.

7  
8 **3. CWCGV's agreement with CAWCD is not a capital lease, and not every**  
9 **arrangement classified as debt under GAAP should require Commission approval**  
10 **under A.R.S. §§ 40-301 and 40-302.**

11 CWCGV's agreement with CAWCD is not equivalent to either a \$6 million vehicle capital  
12 lease or a \$75,000 trailer rental capital lease that APS sought to excuse from counting toward the  
13 debt limitation per a request for declaratory order. This is not a situation involving the eventual  
14 purchase of an asset or property at the end of a defined term.<sup>6</sup> Rather, the agreement involves five  
15 installment payments through December 2011 for the right to an additional allocation of Colorado  
16 River water. There is no purchase of a tangible asset such as a vehicle here. So, the agreement with  
17 CAWCD is not a capital lease – and the applicability of the capital lease arrangements implicated in  
18 APS' request for declaratory order as part of Decision No. 69947 to CWCGV in this matter is  
19 dubious.

20 Even so, it is not clear that the Commission has required *every* arrangement classified as  
21 long-term debt under GAAP to receive approval under A.R.S. §§ 40-301 and 40-302. For instance,  
22 the Company does not believe that the Commission has *required* approval for *every* long-term  
23 purchase power agreement or long-term fuel supply contract – or all such arrangements being  
24 subject to approval on a contract-by-contract basis under A.R.S. §§ 40-301 and 40-302. Staff also  
25 seemed to acknowledge the fluid nature of GAAP in Decision No. 69947 – by providing for  
26 conditions where arrangements and obligations subsequently classified as debt under GAAP would

27 <sup>6</sup> Blacks Law Dictionary defines capital lease as “a contract that transfers ownership of property to the lessee at the end of a lease term [or] a contract for the lease of property which possesses the characteristics of a purchase” (6<sup>th</sup> ed. 1990) at 209.

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1 not automatically be considered indebtedness for the purpose of calculating APS' debt limitations,  
2 common equity test, and debt service coverage.<sup>7</sup> Finally, the discussion in Decision No. 69947 had  
3 to with what counts under the new \$4.2 billion limitation for the general authorization awarded to  
4 APS. As discussed above, CWCGV is not requesting such general authorization here.

5  
6 **4. The Company's interpretation of what constitutes an evidence of indebtedness is reasonable and in accordance with applicable law.**

7 In Decision 69947, Staff appeared concerned with the idea that APS could frustrate the  
8 long-term debt limits if it could structure debt to avoid those limits; and Staff also appeared  
9 concerned about a utility incurring excessive debt.<sup>8</sup> But in this case, the Company has been careful  
10 to seek a very narrow declaratory order. Indeed, it is Staff's reading of A.R.S. §§ 40-301 and 40-  
11 302 that seems unworkably broad. Without providing any parameters as to what constitutes an  
12 evidence of indebtedness under these statutes, *any* obligation must then be subject to approval –  
13 including *any* arrangement involving payments over 12 months. This means a company entering  
14 into any credit arrangement to purchase office equipment involving payments over 12 months or  
15 more, for example, would have to seek Commission approval for that arrangement to be approved.  
16 This inhibits a Company's ability to conduct its day-to-day operations, and that cannot be the  
17 Legislature's intent.

18 To this point, Staff appears to imply that it is clear what the Legislature intended with the  
19 language in A.R.S. §§ 40-301 and 40-302 – in arguing that the doctrine of *ejusdem generis* does not  
20 apply here. The Company does not believe it is at all clear by what the Legislature meant by the  
21 term "other evidences of indebtedness." Further, Staff points to no such clear legislative intent in its  
22 September 10, 2010 Response. And rather than applying an overly narrow interpretation of the  
23

24  
25 <sup>7</sup> Decision No. 69947 at Finding of Fact 29 through 31. The Commission was addressing the Company's concerns  
26 where a contract previously not considered debt under GAAP is then considered debt under GAAP due to a future  
27 change in GAAP. The Commission established a process to address GAAP future changes. This is evidence justifying  
the position that GAAP classifications have not been dispositive to the Commission.

<sup>8</sup> Decision 69947 at Findings of Fact 27, 31.

1 statutes in question, the Company is using the doctrine of *ejusdem generis* as intended; that is, to  
2 provide a reasonable interpretation of what is meant by the term “other evidences of indebtedness.”  
3 within the context and meaning of the entire statute.<sup>9</sup> The agreement at issue in this case is not  
4 some example of a novel financing arrangement developed to circumvent regulatory controls. In  
5 fact, the circumstances mandating CWCGV entering into this agreement are rooted in Federal and  
6 State law. By excluding this agreement from requiring approval under A.R.S. §§ 40-301 and 40-  
7 302, the Commission does not render the phrase “other evidences of indebtedness” meaningless.<sup>10</sup>  
8 There are other financing instruments that are not bonds or notes, but that contain many of the same  
9 characteristics as bonds or notes to qualify as an evidence of indebtedness. But CWCGV’s  
10 agreement is CAWCD is not one of them.

11 **5. Decision No. 69681 is more applicable to this matter than Decision No. 69947.**

12 In Decision No. 69681 (June 28, 2007), the Commission did not require Avra to seek  
13 approval for its agreement for additional Colorado River water allocation. That decision notes that  
14 “Avra will make annual payments of \$115,000 for five years for the acquisition of its [Central  
15

---

16 <sup>9</sup> See *Wilderness World Inc. v. Dept. of Rev.*, 182 Ariz. 196, 199-200, 8595 P.2d 108, 111-12 (1995) (finding that river  
17 rafting is not an “amusement” under a taxing statute; the Department of Revenue had justified imposing a transaction  
18 privilege tax under what was A.R.S. 42-1314(A)(1). (which was amended and renumbered as A.R.S. § 42-1310.13, but  
19 is substantially the same) to river rafting per the language “and any business charging admission fees for exhibition,  
20 amusement or instruction”; the Arizona Supreme Court found that the tax did not apply to river rafting because it is not  
21 the same kind or nature as the specifically listed activities in former A.R.S. § 42-1314(A)(1); see also *Nielsen v. Hicks*,  
22 591 Ariz. Adv. Rep 19, 240 P.3d 276 (App. 2010) (reversing the trial court’s decision to change venue on defense  
23 motion; the Arizona Court of Appeals (Division 1) held that the language “all other actions concerning real property” in  
24 A.R.S. § 12-401 necessarily referred to actions where real property is the subject matter and not peripheral; because the  
25 allegations in the complaint were personal, sounded in tort and not of real property, the decision to change venue based  
26 on the quoted language above was in error.)

27 <sup>10</sup> By contrast, *United v. Alpers*, 338 U.S. 680, 70 S.Ct. 352 (1950), dealt with whether the shipment of obscene  
phonograph records in interstate commerce violated the statute prohibiting the depositing of obscene books, pictures  
and “other matter of indecent character” – where the U.S. Supreme Court rejected the argument that *ejusdem generis*  
limited the statute to only that matter comprehended through the sense of sight. 338 U.S. at 684, 70 S.Ct at 354-55.  
And *Arizona Superior Mining Co. v. Anderson*, 33 Ariz. 64, 262 P. 489 (1927) dealt with language in the old civil code  
regarding venue that the Arizona Supreme Court observed was “a complete departure from classification to  
generalization”; and that the specific words of the statute at issue were greatly different from one another. 33 Ariz. at  
71, 262 P. at 491-92. CWCGV believes approval of its request will not exclude a broad swath of arrangements  
equivalent to traditional financings, and that the language “other evidence of indebtedness” is not greatly different from  
bonds, notes and the remainder of what is described in A.R.S. § 40-301(A). And the Company believes providing some  
parameters as to what constitutes an “evidence of indebtedness” using *ejusdem generis* does not defeat the intent of the  
statute.

1 Arizona Project] allocation.”<sup>11</sup> CWCGV’s agreement with CAWCD for additional Colorado River  
2 water allocation is the same type of arrangement. CWCGV simply requests a declaratory order that  
3 its agreement with CAWCD (the type and kind to which the Company believes the Commission  
4 has never previously required approval for under A.R.S. §§ 40-301 and 40-302) is not an evidence  
5 of indebtedness that would now require approval. The Company believes the Commission is in no  
6 danger of sacrificing the protection of the public by approving this limited request.

7 **III. CONCLUSION.**

8 The Company has, in previous filings, provided ample documentation and support detailing  
9 the factual basis of the agreement and why it is consistent with the policy of this state. The  
10 Company further detailed the extensive Federal law and policy implicated within the agreement at  
11 issue – and also the nature of the agreement as not “an evidence of indebtedness” under A.R.S. §§  
12 40-301 and 40-302. Those arguments remain and the Company believes the agreement at issue is:  
13 (1) not an evidence of indebtedness requiring Commission approval; and (2) is implicitly  
14 preempted due to the agreement being directly related to the law of the Colorado River.

15 The facts and circumstances in Decision No. 69947 are significantly different than the facts  
16 and circumstances in this case. Still, the overarching policy question in both cases is whether  
17 approval of the Company’s request for declaratory order impairs the Commission’s ability to  
18 protect CWCGV ratepayers. The APS decision dealt with excluding two capital leases from  
19 counting against the debt limitation and approving a general financing authorization. The situation  
20 is not the same here. The Company’s request in this case for a declaratory order is only to  
21 determine that A.R.S. §§ 40-301 to 40-302 does not apply to CWCGV’s agreement for additional  
22 Colorado River water allocation by making five installment payments. It does not otherwise restrict  
23 the Commission’s ability to protect the public and ensure the financial health of the Company.  
24 Thus, protection of CWCGV ratepayers (who are also members of CWCGV) is not impaired. For  
25 these reasons, the Company believes approving its request – and declaring the agreement with  
26

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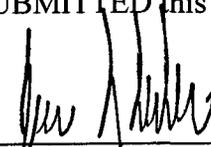
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<sup>11</sup> Decision No. 69681 at Finding of Fact 33.

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1 CAWCD does not require approval under A.R.S. §§ 40-301 and 40-302 – is consistent with the  
2 public interest.

3 RESPECTFULLY SUBMITTED this 4<sup>th</sup> day of February, 2011.

4  
5 By 

6 Jason D. Gellman  
7 ROSKA DEWULF & PATTEN, PLC.  
8 One Arizona Center  
9 400 East Van Buren Street, Suite 800  
10 Phoenix, Arizona 85004

11 Original and thirteen copies of the foregoing  
12 filed this 4<sup>th</sup> day of February, 2011, with:

13 Docket Control  
14 ARIZONA CORPORATION COMMISSION  
15 1200 West Washington Street  
16 Phoenix, Arizona 85007

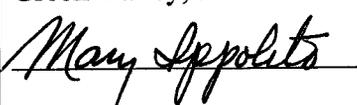
17 Copy of the foregoing hand-delivered  
18 this 4<sup>th</sup> day of February 2011, to:

19 Lyn A. Farmer, Esq.  
20 Chief Administrative Law Judge  
21 Hearing Division  
22 Arizona Corporation Commission  
23 1200 West Washington Street  
24 Phoenix, Arizona 85007

25 Janice Alward, Esq.  
26 Chief Counsel, Legal Division  
27 Arizona Corporation Commission  
1200 West Washington Street  
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Steve Olea  
Director, Utilities Division  
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1200 West Washington Street  
Phoenix, Arizona 85007

Arturo R. Gabaldon  
President  
Community Water Company of Green Valley  
1501 South La Canada  
Green Valley, AZ 85614-1600

27 

# Exhibit

"1"

# ORIGINAL NEW APPLICATION

BEFORE THE ARIZONA CORPORATIC

## COMMISSIONERS

JEFF HATCH-MILLER, Chairman  
WILLIAM A. MUNDELL  
MIKE GLEASON  
KRISTIN K. MAYES  
BARRY WONG

E-01345A-06-0779

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

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

DOCKET NO. E-01345A-06-

**VERIFIED APPLICATION**

Arizona Corporation Commission  
**DOCKETED**

DEC 15 2006

DOCKETED BY

*NW*

## **I. VERIFIED APPLICATION**

Pursuant to Sections 40-285, 40-301, and 40-302 of the Arizona Revised Statutes ("A.R.S."), Arizona Public Service Company (the "Company") hereby files this Application seeking one or more orders which, together, will authorize the Company to:

(i) incur the Continuing Long-Term Debt (as defined herein); (ii) redeem, refinance, refund, renew, reissue, roll-over, repay, and re-borrow from time to time such Continuing Long-Term Debt, and establish and amend the terms and provisions of Continuing Long-Term Debt from time to time; (iii) incur the Continuing Short-Term Debt (as defined herein); (iv) redeem, refinance, refund, renew, reissue, roll-over, repay, and re-borrow from time to time such Continuing Short-Term Debt, and establish and amend the terms

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1 and provisions of Continuing Short-Term Debt from time to time; (v) determine the form  
2 of security, if any, for the Continuing Long-Term Debt and the Continuing Short-Term  
3 Debt, execute and deliver one or more Security Instruments (as defined herein) in  
4 connection with the Continuing Long-Term Debt and the Continuing Short-Term Debt,  
5 and establish and amend the terms and provisions of any such Security Instruments from  
6 time to time; and (vi) reimburse any amounts paid by Pinnacle West Capital Corporation  
7 (“Pinnacle West”) under any Guarantee (as defined herein).

8 APS further requests a declaratory order that confirms that only traditional  
9 indebtedness for borrowed money (and not the other types of arrangements described in  
10 paragraph 13 of this Application) constitutes an “evidence of indebtedness” under A.R.S.  
11 Sections 301 and 302 and that, therefore, such other arrangements (of the type described  
12 in paragraph 13) neither require prior Commission authorization nor count against the  
13 Continuing Long-Term Debt or Continuing Short-Term Debt authorizations requested in  
14 this Application.

15 Pursuant to A.A.C. R14-2-806, Pinnacle West hereby files this Application seeking  
16 an ongoing waiver of or authorization under A.A.C. R14-2-803 to allow Pinnacle West to  
17 guarantee the indebtedness of the Company from time to time.

18 APS and Pinnacle West request issuance of the order or orders sought in this  
19 Application no later than June 30, 2007 so that APS will have sufficient financing  
20 authority to support its obligations without interruption. APS and Pinnacle West also  
21 request that the order or orders sought in this Application become effective immediately  
22 upon the issuance thereof.

## 23 II. SUPPORTING STATEMENTS

24 In support of this Application, the Company and Pinnacle West respectfully state  
25 as follows:

26 1. Both the Company and Pinnacle West are corporations duly organized and  
27 existing under the laws of the State of Arizona. Their principal place of business is 400  
28

1 North Fifth Street, Phoenix, Arizona, 85004, and their post office address is P.O. Box  
2 53999, Phoenix, Arizona 85072-3999.

3 2. The Company is a public service corporation principally engaged in serving  
4 electricity in the State of Arizona.

5 3. The Company is a wholly-owned subsidiary of Pinnacle West.

6 4. On October 18, 2006, each of the Company's and Pinnacle West's Board of  
7 Directors approved the filing of this Application with the Commission.

8 5. The attorney for the Company in this proceeding is Thomas L. Mumaw.  
9 The attorney for Pinnacle West in this proceeding Robert J. Metli of Snell & Wilmer LLP.

10 6. This Application is supported by the Affidavit of Barbara M. Gomez, the  
11 Vice President and Treasurer of both the Company and Pinnacle West (the "Affidavit"),  
12 which is attached hereto as Exhibit A.

13 **Financing Needs and Issues**

14 7. The Commission's Decision No. 55017, dated May 6, 1986 (the "1986  
15 Order"), allows the Company, among other things, to have, at any one time outstanding in  
16 1986 or thereafter, long-term indebtedness (including current maturities thereof) in an  
17 aggregate principal amount of up to \$2,698,917,000. Such authorization also permits any  
18 redemptions, refinancings, refundings, renewals, reissuances, and roll-overs of any such  
19 outstanding indebtedness, the incurrence or issuance of any long-term indebtedness, and  
20 the amendment or revision of any terms or provisions of or relating to any long-term  
21 indebtedness, as long as total long-term indebtedness at any one time outstanding does not  
22 exceed \$2,698,917,000 during any period of more than thirty days. The 1986 Order  
23 specifies that the nature and terms of all such issuances and sales of such long-term  
24 indebtedness may be determined by the Company by reference to conditions in the  
25 financial markets at the time or times of such issuances. A copy of the 1986 Order is  
26 attached to this Application as Exhibit B.

27 8. In Commission Decision No. 65796, dated April 4, 2003 (the "2003  
28 Financing Order"), the Commission authorized the Company to issue \$500 million of

1 long-term debt and to loan the proceeds thereof to Pinnacle West or Pinnacle West Energy  
2 Corporation ("PWEC") for the purpose of repaying Pinnacle West debt incurred to  
3 finance construction of the Arizona electric generating plants built to serve APS native  
4 load and owned by PWEC and that were later transferred to the Company. In May of  
5 2003, the Company issued \$300 million of its 4.650% Notes due 2015 and \$200 million  
6 of its 5.625% Notes due 2033 (the "2003 Financing Order Debt")<sup>1</sup>. The 2003 Financing  
7 Order specified that the 2003 Financing Order Debt would not be counted against the then  
8 existing continuing debt limits authorized by the Commission in the 1986 Order. The  
9 increased amount requested for the Continuing Long-Term Debt limit in this Application  
10 includes the 2003 Financing Order Debt. The 1986 Order and the 2003 Financing Order  
11 are referred to herein as the "Orders." The Affidavit describes the benefits to the  
12 Company and its customers that have derived from the Orders during the twenty years  
13 since the 1986 Order was issued. See "Benefits of Historical Financial Flexibility" in the  
14 Affidavit.

15 9. In view of the growth of the Company and its customer base during the 20  
16 year period following the issuance of the 1986 Order, as well as changes in financial  
17 market conditions, the Company requests Commission authorization to increase the long-  
18 term indebtedness limitation set forth in the 1986 Order, so that the Company may have,  
19 at any one time outstanding from the date of such authorization or thereafter, up to an  
20 aggregate principal amount of long-term indebtedness of \$4.2 billion. The Affidavit  
21 describes the Company's outstanding long-term indebtedness, the reasons for its request  
22 for additional financing authority, and the basis of the requested increase. See "APS'  
23 Long-Term Debt Financing Needs" in the Affidavit. The Company requests that such  
24 authorization permit any redemptions, refinancings, refundings, renewals, reissuances,  
25 roll-overs, repayments, and re-borrowings of any such outstanding indebtedness, the  
26 incurrence or issuance of any additional long-term indebtedness, and the establishment,

27  
28 <sup>1</sup> Although the loan from APS to PWEC has subsequently been repaid in full, the above APS debt issuances remain outstanding.

1 amendment, or revision of any terms or provisions of or relating to any long-term  
2 indebtedness, as long as total long-term indebtedness (including current maturities  
3 thereof) at any one time outstanding does not exceed \$4.2 billion for any period of more  
4 than thirty days. Such authorization will allow the Company to maintain its flexibility to  
5 refund and/or incur or issue long-term indebtedness as market conditions dictate. At no  
6 time, however, will the Company be able to exceed the proposed long-term indebtedness  
7 limitation for any period of more than thirty days without further Commission  
8 authorization. (All long-term indebtedness outstanding on the date of the order or orders  
9 of the Commission in this matter or thereafter issued or incurred pursuant to this  
10 paragraph being herein referred to as "Continuing Long-Term Debt.") The authorization  
11 sought in this paragraph 9 would supersede the long-term indebtedness limitation  
12 authorized by the 1986 Order and would be inclusive of the debt issued pursuant to the  
13 2003 Financing Order.

14       10. A.R.S. Section 40-302.D allows the Company to issue short-term debt in an  
15 amount not to exceed 7% of its capitalization without Commission approval. However,  
16 Section 40-302.D restricts the refunding or roll-over of any such notes. The  
17 Commission's Decision No. 54230, dated November 8, 1984 (the "1984 Order"), allows  
18 the Company to reissue, renew, and resell any such short-term indebtedness and to refund,  
19 refinance, and roll-over any such short-term indebtedness with or into additional short-  
20 term indebtedness, as long as such 7% limit is not exceeded. The Company requests  
21 authority to issue short-term debt at any time and from time to time (excluding current  
22 maturities of long-term debt) in an amount not to exceed the sum of: (i) 7% of the  
23 Company's capitalization and (ii) \$500 million. The Affidavit describes the Company's  
24 outstanding short-term indebtedness, the reason for its request for additional short-term  
25 financing authority, and the basis of the requested increase. See "APS' Short-Term Debt  
26 Financing Needs" in the Affidavit. The Company requests that such authorization permit  
27 any redemptions, refinancings, refundings, renewals, reissuances, roll-overs, repayments,  
28 and re-borrowings of any such outstanding indebtedness, the incurrence or issuance of any

1 additional short-term indebtedness, and the establishment, amendment, or revision of any  
2 terms or provisions of or relating to any short-term indebtedness, as long as total short-  
3 term indebtedness at any one time outstanding (excluding current maturity of long-term  
4 debt) does not exceed, for any period of more than thirty days, the sum of: (i) 7% of the  
5 Company's capitalization and (ii) \$500 million without further Commission authorization.  
6 (All short-term indebtedness outstanding on the date of the order or orders of the  
7 Commission in this matter or thereafter issued or incurred pursuant to this paragraph  
8 being herein referred to as "Continuing Short-Term Debt.")

9       11. The Company proposes to determine the nature of the *Continuing Long-*  
10 *Term Debt* and *Continuing Short-Term Debt* (or the individual components of each  
11 issuance of *Continuing Long-Term Debt* or *Continuing Short-Term Debt*), the maturities  
12 thereof, the interest and/or discount rates thereon, the necessity for and form of any  
13 security therefor, the applicable financial markets (e.g., whether domestic or foreign) or  
14 lenders, the nature (e.g., whether public or private) of the offerings or borrowings, and the  
15 type or types of transaction in which debt would be sold or incurred by reference to  
16 conditions in the financial markets at the time or times of commitment or sale. Terms  
17 would be negotiated with the intent of obtaining the most favorable results for the  
18 Company and its customers. The security, if any, for any such debt by the Company  
19 could consist of a mortgage or other lien as discussed in paragraph 12 below or a letter of  
20 credit of a third party, bond purchase agreement, or other security instrument.

21       12. In the event that the rating on the Company's long-term unsecured  
22 indebtedness is rated non-investment grade or if market conditions otherwise dictate, the  
23 Company may find it necessary or advantageous to secure all or any portion of the  
24 *Continuing Long-Term Debt* and the *Continuing Short-Term Debt*. The Company  
25 requests authority to enter into a new mortgage and deed of trust or similar instrument that  
26 establishes a lien on all or substantially all of the Company's property, including after-  
27 acquired property, as security for all or any part of the Company's indebtedness. The  
28 Company also requests authority to enter into separate security instruments of various

1 types that establish liens on separate properties or groups of properties of the Company to  
2 secure particular issues or groups of issues of indebtedness. (Any such mortgage and  
3 deed of trust or other security instrument to be entered into pursuant to this paragraph  
4 being herein referred to as a "Security Instrument.") Any such Security Instrument may  
5 be used to secure indebtedness previously issued as well as new indebtedness issued after  
6 the date of the financing order requested by this Application. The Affidavit describes the  
7 mortgage and deed of trust previously utilized by the Company and its termination in  
8 2004, and further describes the basis and rationale for the requests in this paragraph 12.  
9 See paragraphs 13 and 22 in the Affidavit.

10 13. The Affidavit describes recent changes in accounting rules and  
11 interpretations that have altered and may continue to alter the basis for treatment of  
12 various financial arrangements as indebtedness. For example, the Affidavit describes  
13 certain circumstances in which a long-term power purchase agreement, long-term fuel  
14 supply contract, or similar agreements may be treated as a capital lease or a substantive  
15 consolidation and thus be treated as indebtedness on the Company's balance sheet under  
16 Generally Accepted Accounting Principles. The Company requests that the Commission  
17 confirm that only traditional indebtedness for borrowed money (and not the types of  
18 arrangements described in the preceding sentence) is subject to A.R.S. Sections 301 and  
19 302 and that, therefore, such other arrangements will not require prior Commission  
20 authorization or count against the Continuing Long-Term Debt authorization requested in  
21 this Application. The Affidavit further describes the basis and rationale for APS' requests  
22 in this paragraph 13. See paragraph 21 in the Affidavit.

23 14. From time to time, it may be advantageous for Pinnacle West to guarantee  
24 debt issued, incurred, or sold by the Company. Pinnacle West requests either an ongoing  
25 waiver of A.A.C. Rule 14-2-803 in that respect or, alternatively, that the Commission  
26 expressly grant to Pinnacle West authority to guarantee the Company's debt from time to  
27 time in indeterminate amounts (the "Guarantees"). The Company also seeks authorization  
28 to reimburse Pinnacle West for any amounts that Pinnacle West is required to pay under

1 any such Guarantee, along with interest on such amounts until the date of reimbursement  
2 at a rate not greater than the rate of interest payable on the debt so Guaranteed and paid by  
3 Pinnacle West. The Affidavit describes certain of the circumstances in which such a  
4 Guarantee may be required or advantageous and further describes the basis and rationale  
5 for the requests in this paragraph 14. See paragraph 23 in the Affidavit.

6 **Purposes**

7 15. The Company proposes that the net proceeds from its issuance of  
8 Continuing Long-Term Debt and Continuing Short-Term Debt will be applied, directly or  
9 indirectly, to augment the funds available from all sources to finance its construction,  
10 resource acquisition and maintenance programs, to redeem or retire outstanding securities,  
11 to repay or refund other outstanding long-term or short-term debt, and to meet certain of  
12 the Company's working capital and other cash requirements.

13 16. The purpose of any Guarantees of Company debt by Pinnacle West would  
14 be to allow the Company to achieve greater access to the financial markets.

15 **General**

16 17. In the Company's opinion, the proposed issuance or incurrence of the  
17 Continuing Long-Term Debt and the Continuing Short-Term Debt, the establishment and  
18 amendment of any terms and provisions of any long-term or short-term indebtedness, the  
19 execution and delivery of the Security Instruments, and the establishment and amendment  
20 of any terms and provisions of the Security Instruments, all as contemplated herein, are  
21 for lawful purposes that are within its corporate powers and are compatible with the public  
22 interest, with sound financial practices, and with the proper performance by the Company  
23 of service as a public service corporation and will not impair its ability to perform that  
24 service. The Company is further of the opinion that the foregoing, all as contemplated  
25 herein, are reasonably necessary or appropriate for such purposes and that such purposes  
26 are not, wholly or in part, reasonably chargeable to the Company's operating expenses or  
27 to income, except to the extent required by generally accepted accounting principles or by  
28 other accounting requirements applicable to the Company, including regulatory

1 requirements. To the extent that the purposes set forth herein may be considered  
2 reasonably chargeable to operating expenses or to income, the Company requests that the  
3 order or orders of the Commission in this matter authorize such charge or charges.

4 18. A.A.C. R14-2-803 requires notice to the Commission of "reorganizations"  
5 by a public utility holding company such as Pinnacle West. A "reorganization" includes  
6 the "acquisition or divestiture of a financial interest in an affiliate or a [Class A] utility."  
7 A.A.C. R14-2-801(5). The Company is a Class A utility, and thus both it and Pinnacle  
8 West are subject to the provisions of Rule 803. In Decision No. 58063, dated November  
9 3, 1992, the Commission interpreted the aforementioned language to also include any  
10 increase or decrease of an existing "financial interest" in a utility in excess of a specified  
11 "exempt amount," which in the case of the Company and Pinnacle West, is \$100 million  
12 per year, even if the increase/decrease did not change the status of the utility as a wholly-  
13 owned subsidiary of the public utility holding company. The proposed Guarantees could  
14 result in an increase in Pinnacle West's existing financial interest in the Company in  
15 excess of \$100 million per year. The test for whether a "reorganization" can be rejected  
16 by the Commission under Rule 14-2 803 is whether the "reorganization" would: (1)  
17 impair the financial status of the public utility, (2) prevent the public utility from  
18 attracting capital on fair and reasonable terms, or (3) impair the ability of the public utility  
19 to provide safe, reasonable, and adequate service. The proposed Guarantees clearly will  
20 not have any of these negative impacts on the Company. Rather they will enhance the  
21 financial status of the Company, permit the Company to attract capital and access the  
22 capital markets on terms that are more favorable, and are essential to the Company's  
23 ability to provide safe, reasonable, and reliable service. The Company notes that pursuant  
24 to A.A.C. R14-2-806.C, if the Commission fails to approve, disapprove, or suspend for  
25 further consideration an application for waiver within thirty days following filing of a  
26 verified application for waiver, the waiver shall become effective on the 31st day  
27 following the filing of the application.

28

1           19.    The Company requests that notice of the filing of this Application be given  
2 in conformity with A.R.S. Section 40-302.

3           20.    The Company requests that the order or orders sought by this Application  
4 become effective immediately upon the issuance thereof.

5           21.    The most current public financial statements of the Company and Pinnacle  
6 West, which are included in their most recent combined Quarterly Report on Form 10-Q  
7 filed with the Securities Exchange Commission, are attached to this Application as  
8 Exhibit C.

9           WHEREFORE, the Company and Pinnacle West ask that the Commission cause  
10 notice of the filing of this Application to be given as above-requested; hold such a hearing  
11 or hearings as the Commission finds are necessary at a time or times to be specified,  
12 making such inquiry or investigation as the Commission may deem of assistance; and  
13 make any findings required by A.R.S. Sections 40-285, 40-301, and 40-302, or A.A.C.  
14 R14-2-803 and R14-2-806, as applicable, relative to the issuances and incurrences of  
15 Continuing Long-Term Debt and Continuing Short-Term Debt, the execution and delivery  
16 of the Security Instruments, the establishment and amendment of any terms and  
17 provisions of any long-term or short-term indebtedness or any such Security Instruments,  
18 the issuance of the Guarantees, and the reimbursement by the Company of amounts paid  
19 by Pinnacle West under the Guarantees, all as contemplated herein; and thereafter make  
20 one or more immediately effective orders which, together, (i) authorize the Company to  
21 issue, sell, and incur the Continuing Long-Term Debt and the Continuing Short-Term  
22 Debt, redeem, refinance, refund, renew, reissue, roll-over, repay, and re-borrow from time  
23 to time such Continuing Long-Term Debt and Continuing Short-Term Debt, and establish  
24 and amend the terms and provisions of long-term and short-term indebtedness from time  
25 to time, (ii) authorize the Company to determine the form of security, if any, for the  
26 Continuing Long-Term Debt and the Continuing Short-Term Debt, execute and deliver  
27 the Security Instruments, and establish and amend the terms and provisions of the Security  
28 Instruments, as may be deemed appropriate by the Company in connection with the

1 Continuing Long-Term Debt and the Continuing Short-Term Debt, (iii) state that the  
2 issuances and incurrences of the Continuing Long-Term Debt and the Continuing Short-  
3 Term Debt and the establishment and amendment of the terms and provisions of any  
4 outstanding long-term or short-term indebtedness are reasonably necessary or appropriate  
5 for the purposes set forth in this Application and that such purposes are within those  
6 permitted by A.R.S. Section 40-301, (iv) permit such purposes to the extent that they may  
7 be reasonably chargeable to operating expenses or to income, (v) authorize a continuing  
8 waiver of or authorization under R14-2-803 with respect to Pinnacle West Guarantees of  
9 Company indebtedness, (vi) authorize the Company to reimburse Pinnacle West for any  
10 payment on any such Guarantees, with interest as contemplated herein and (vii) confirm  
11 that only traditional indebtedness for borrowed money (and not the other types of  
12 arrangements described in paragraph 13 of this Application) are subject to A.R.S. Sections  
13 301 and 302 and that, therefore, such arrangements will not count against the Continuing  
14 Long-Term Debt or Continuing Short-Term Debt authorizations requested in this  
15 Application or require prior Commission approval.

16 Financing orders of the kind requested herein require very specific language to  
17 satisfy prospective lenders. Thus, proposed language for certain key paragraphs of the  
18 order requested in this matter is attached to this Application as Exhibit D.

19 Dated at Phoenix, Arizona this 15th day of December, 2006.

20 ARIZONA PUBLIC SERVICE COMPANY

21  
22 By: Barbara M. Gomez  
23 Barbara M. Gomez  
Vice President and Treasurer

24 ATTEST:  
25 Betsy Pregulman  
26 Betsy Pregulman  
Associate Secretary

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ATTORNEY FOR ARIZONA PUBLIC SERVICE COMPANY

By: Thomas L. Mumaw  
Thomas L. Mumaw  
Arizona Public Service Company

PINNACLE WEST CAPITAL CORPORATION

By: Barbara M. Gomez  
Barbara M. Gomez  
Vice President and Treasurer

ATTEST:

Betsy Pregulman  
Betsy Pregulman  
Associate Secretary

ATTORNEY FOR PINNACLE WEST CAPITAL CORPORATION

By: Robert J. Metli  
Robert J. Metli  
Snell & Wilmer LLP

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STATE OF ARIZONA        )  
                                  )ss.  
County of Maricopa

Barbara M. Gomez, being first duly sworn, deposes and says:

That she, Barbara M. Gomez, is the Vice President and Treasurer of Arizona Public Service Company; that she has read the foregoing Application and knows the contents thereof as it relates to Arizona Public Service Company; and that the same is true in substance and in fact, except as to matters therein stated on information and belief, and as to those she believes them to be true.

*Barbara M. Gomez*  
\_\_\_\_\_  
Barbara M. Gomez

SUBSCRIBED AND SWORN to before me this 15<sup>th</sup> day of December, 2006.

*Linda G. Redman*  
\_\_\_\_\_  
Notary Public

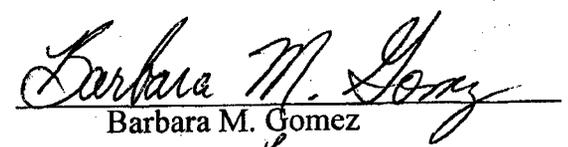
My commission expires:



1 STATE OF ARIZONA )  
2 )ss.  
3 County of Maricopa )

4 Barbara M. Gomez , being first duly sworn, deposes and says:

5 That she, Barbara M. Gomez, is the Vice President and Treasurer of Pinnacle  
6 West Capital Corporation; that she has read the foregoing Application and knows the  
7 contents thereof as it relates to Pinnacle West Capital Corporation; and that the same is  
8 true in substance and in fact, except as to matters therein stated on information and  
9 belief, and as to those she believes them to be true.

10   
Barbara M. Gomez

11 SUBSCRIBED AND SWORN to before me this 15<sup>th</sup> day of December, 2006.

12   
13 Notary Public



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# Exhibit

"2"

ORIGINAL

MEMORANDUM

TO: Docket Control

FROM: Ernest G. Johnson  
Director  
Utilities Division

DATE: May 18, 2007

RE: STAFF REPORT FOR ARIZONA PUBLIC SERVICE COMPANY AND  
PINNACLE WEST CAPITAL CORPORATION APPLICATION FOR A  
FINANCING ORDER AUTHORIZING VARIOUS FINANCING  
TRANSACTIONS DOCKET NO. E-01345A-06-0779

Attached is the Staff Report for Arizona Public Service Company and Pinnacle West Capital Corporation's joint application requesting authorization for various financing transactions and a declaratory order regarding long-term debt classifications.

Staff recommends conditional approval of the various financing transactions and denial of the request for a declaratory order.

Any party who wishes may file comments to the Staff Report with the Commission's Docket Control by 4:00 p.m. on or before May 28, 2007.

EGJ:DRR:tdp

Originator: Dennis Rogers

Attachment: Original and fourteen copies

Arizona Corporation Commission  
DOCKETED  
MAY 18 2007

DOCKETED BY NR

RECEIVED  
2007 MAY 18 A 9:22  
AZ CORP COMMISSION  
DOCKET CONTROL

Service List for: Arizona Public Service Company and Pinnacle West Capital Corporation  
Docket No. E-01345A-06-0779

Mr. Thomas Mumaw  
Post Office Box 53999 MS 8695  
Phoenix, Arizona 85702-3999

Mr. Christopher C. Kempley  
Chief Counsel, Legal Division  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

Mr. Ernest G. Johnson  
Director, Utilities Division  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

Ms. Lyn Farmer  
Chief Administrative Law Judge, Hearing Division  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

**STAFF REPORT  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION**

**ARIZONA PUBLIC SERVICE COMPANY AND PINNACLE WEST CAPITAL  
CORPORATION  
DOCKET NO. E-01345A-06-0779**

**APPLICATION FOR A FINANCING ORDER  
AUTHORIZING VARIOUS FINANCING TRANSACTIONS**

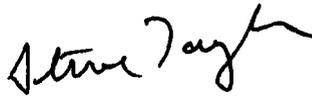
**MAY 18, 2007**

## STAFF ACKNOWLEDGMENT

The Staff Report for Arizona Public Service Company and Pinnacle West Capital Corporation, Docket No. E-01345A-06-0779, is the responsibility of the Staff members listed below. Dennis Rogers was responsible for the financial review and analysis. Steven Taylor was responsible for the engineering review and analysis.



Dennis Rogers  
Public Utilities Analyst V



Steven Taylor  
Utilities Engineer - Electrical

**EXECUTIVE SUMMARY**  
**ARIZONA PUBLIC SERVICE COMPANY AND**  
**PINNACLE WEST CAPITAL CORPORATION**  
**DOCKET NO. E-01345A-06-0779**

On December 15, 2006, Arizona Public Service Company ("APS") and Pinnacle West Capital Corporation ("Pinnacle West"), filed a joint application with the Arizona Corporation Commission ("Commission") requesting Commission authorization of various financing transactions.

APS is a wholly owned subsidiary of Pinnacle West. APS and Pinnacle West are requesting the following approvals:

First, an increase in APS' long-term indebtedness threshold from \$3,198,917,000 to \$4,200,000,000;

Second, an increase in APS' short-term indebtedness threshold from 7 percent of its total capitalization to the sum of 7 percent of total capitalization plus \$500 million;

Third, APS to determine the terms and types of both long-term and short-term debt instruments at the time(s) of commitment or sale without further Commission approval;

Fourth, APS to enter into new mortgages and deeds of trust or similar instrument that would establish a lien on all or substantially all of APS' property, as security for all or any part of APS' indebtedness;

Fifth, APS to enter into separate security instruments of various types that establish liens on separate APS properties or groups of APS properties to secure particular issues or groups of issues of indebtedness (properties constructed in the future);

Sixth, Pinnacle West asks the Commission to continue the waiver now in existence (per Decision Nos. 65796 and 55017) of A.A.C. R 14-2-803, or alternatively to authorize Pinnacle West to guarantee APS' debt from time to time in indeterminate amounts;

Seventh, APS seeks authorization to reimburse Pinnacle West for any amounts that Pinnacle West is required to pay under any such guarantee along with interest on such amounts at a rate not greater than the rate of interest payable on the debt so guaranteed and paid by Pinnacle West Capital Corporation;

Eighth, APS seeks a declaratory order confirming that only traditional indebtedness for borrowed money requires prior Commission authorization and that other arrangements would not be considered continuing long-term debt when considering the sum of total long-term debt in relation to the total debt threshold; and

Ninth, APS requests that it may use funds to the extent that the purposes set forth in the application may be considered reasonably chargeable to working capital requirements.

An increase in APS' long-term debt to \$4,200,000,000 would create a capital structure of 43.3 percent equity and 56.7 percent long-term debt. Staff concludes that incurrence of the short-term and long-term debt for which APS requests authorization, as modified by Staff, 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 financial practices if, subsequent to any debt issuance, APS can satisfy the following conditions:(1) common equity must represent at least 40 percent of total capital (common equity, preferred stock, long-term debt and short-term debt) and (2) the debt service coverage ratio ("DSC") must be equal to or greater than 1.0.

Staff recommends authorization of the long-term debt threshold proposed by APS subject to the condition that subsequent to any debt issuance common equity must represent at least 40 percent of total capital and the DSC must be equal to or greater than 1.0 (calculated using the most recent audited financial statements adjusted to reflect changes to outstanding debt).

Staff further recommends authorization for APS to incur short-term debt not to exceed \$500 million above 7 percent of total capital as long as the amount exceeding 7 percent of total capital is solely for costs relating to natural gas or power purchases.

Staff further recommends that all authorizations to incur long-term debt terminate on December 31, 2012.

Staff further recommends that the authorizations to incur short-term and long-term debt obligations provided in this proceeding should replace all existing authorizations and that all existing authorizations should terminate upon the effective date of the authorizations provided in this proceeding.

Staff further recommends denial of Pinnacle West's request for authorization of a waiver of A.A.C. R14-2-803 pursuant to A.A.C. R14-2-806. In the alternative, Staff recommends authorization for Pinnacle West to guarantee APS' debt from time to time in indeterminate amounts.

Staff further recommends authorization for APS to reimburse Pinnacle West for debt service costs paid by Pinnacle West on behalf of APS in conjunction with the provision of guarantees of APS debt and a cost of money on those payments at a rate not to exceed that of the underlying loan(s).

Staff further recommends authorization of the other financing requests made by APS in this application except as otherwise specified.

Staff further recommends that short-term debt in excess of 7 percent of total capital, that is used solely for costs relating to natural gas or power purchases not be applied toward APS' long-term debt threshold even when the amount remains outstanding for more than 12 months.

Staff further recommends denial of APS' broader request for a declaratory order confirming that only traditional indebtedness for borrowed money requires prior Commission authorization.

## **Introduction**

On December 15, 2006, Arizona Public Service Company ("APS") and Pinnacle West Capital Corporation ("Pinnacle West") filed a joint application with the Arizona Corporation Commission ("Commission"). In this application, APS requests Commission authorization of various financing transactions and a declaratory order regarding the classification of certain financial instruments. Pinnacle West requests Commission authorization to guarantee the indebtedness of APS.

## **Notice**

On March 6, 2007, APS and Pinnacle West filed affidavits of publication verifying public notice of the financing application. APS and Pinnacle West published notice of the financing application in *The Arizona Republic* on February 24, 2007. The affidavit of publication is attached along with a copy of the Notice.

## **Compliance**

There are no compliance issues outstanding for APS.

## **Background**

APS is a wholly owned subsidiary of the Pinnacle West. Both APS and Pinnacle West are Arizona corporations, and each has its principal place of business in Phoenix, Arizona. Decision No. 55017 ("1986 Order") of May 1986 established APS' long-term debt threshold at \$2,698,917,000. Decision No. 65796 of April 2003 authorized APS to issue an additional \$500 million in long-term debt to repay Pinnacle West for construction of utility plant. Decision No. 65796 also designated the \$500 million issuance as separate from the continuing debt used in the calculation of the total debt that is bound by the \$2,698,917,000 threshold. Thus, APS has \$2,698,917,000 of general debt authorization and \$500 million of specific debt authorization for a total of \$3,198,917,000.

## **Description and Terms of Proposed Financing**

### Long-Term Debt

APS now asks for authorization of up to \$4.2 billion in long-term indebtedness inclusive of the \$500 million debt issued pursuant to Decision No. 65796. APS asks that this threshold apply only to long-term debt that exists for more than thirty days.

APS also requests that the Commission's authorization of such debt permit APS, without further Commission approval, to redeem, refinance, refund, renew, reissue, roll-over, repay, or re-borrow any of its outstanding long-term debt, to incur or issue additional long-term debt, or to establish, amend, or revise any terms or provisions of or relating to any long-term debt as long as

total long-term indebtedness (including current maturities thereof) at any one time outstanding does not exceed \$4.2 billion for any period of more than thirty days. In other words, APS requests authorization to conduct a variety of activities enumerated in the application that are necessary to secure and maintain long-term debt, subject to certain conditions.

Short-Term Debt

APS also seeks authority to increase its short-term borrowing capacity. A.R.S. §40-302.D states that APS may issue short-term debt in amounts up to 7 percent of its total capitalization without Commission approval. The application seeks authorization to issue short-term debt up to a total of 7 percent of APS' total capitalization plus \$500 million.

APS also requests that the Commission's authorization of such debt permit APS, without further Commission approval, to redeem, refinance, refund, renew, reissue, roll-over, repay, or re-borrow any of its outstanding short-term debt, to incur or issue any additional short-term debt, and to the establish, amend, or revise any terms or provisions of or relating to any short-term debt as long as total short-term debt does not exceed the sum of: (1) 7 percent of APS' total capitalization and (2) an additional \$500 million. In other words, APS requests authorization to conduct a variety of activities enumerated in the application that are necessary to secure and maintain short-term debt, subject to certain conditions.

Terms and Conditions of Debt

APS seeks Commission authorization to determine the terms and types of both long-term and short-term debt instruments at the time(s) of commitment or sale without further Commission approval.

APS seeks authority to enter into new mortgages, deeds of trust, or similar instruments that would establish a lien on all or substantially all of APS' property, including after-acquired property, as security for all or any part of APS' indebtedness.

APS seeks authority to enter into separate security instruments of various types that establish liens on separate APS properties or groups of APS properties to secure particular issues or groups of issues of indebtedness. This language is written with the intent to include properties constructed in the future.

Pinnacle West asks the Commission to continue the waiver now in existence (per Decision Nos. 65796 and 55017) of A.A.C. R14-2-803, or alternatively, to authorize Pinnacle West to guarantee APS' debt from time to time in indeterminate amounts.

APS seeks authorization to reimburse Pinnacle West for any amounts that Pinnacle West is required to pay under any such guarantee along with interest on such amounts at a rate not greater than the rate of interest payable on the debt so guaranteed and paid by Pinnacle West.

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To the extent that the purposes set forth in the application may be considered reasonably chargeable to operating expenses or to income, APS requests that the order or orders from the Commission in this matter authorize such charge or charges and that they be deemed working capital requirements.

#### Declaratory Accounting Order

APS seeks a declaratory order confirming that only traditional indebtedness for borrowed money requires prior Commission authorization and that other obligations would not be considered continuing long-term debt when considering the sum of total long-term debt in relation to the total debt threshold. The application describes examples of these other obligations as long-term power purchase agreements, long-term fuel supply contracts, or similar agreements. In response to a Staff data request, APS stated that it currently has two agreements that are classified as long-term debt per generally accepted accounting principles ("GAAP"). APS seeks to exclude these two agreements from treatment as debt in relation to the debt threshold through the declaratory order. These agreements are a vehicle capital lease with a balance of approximately \$6 million and a trailer rental capital lease with a balance of approximately \$75,000.

#### **Purpose**

APS states in the application that the proceeds from the issuance of long-term and short-term debt will be used to finance construction, resource acquisition, and maintenance programs; to redeem or retire outstanding securities; to repay or refund other outstanding long-term or short-term debt; and to meet certain of APS' working capital and other cash requirements. The application also describes that the purpose of any guarantees of APS' debt by Pinnacle West would be to allow APS to achieve greater access to the financial markets.

#### **Engineering Analysis**

Staff concludes that (see Attachment A for details):

1. The load and customer growth rates of APS are reasonably projected based on past load and customer growth rates and overall population growth expected for Arizona.
2. The customer reliability measures for the last five years on an aggregate system basis indicate that APS is managing its distribution system on a comparable par with the better performing utilities in the nation with regard to reliability. APS is in a good position to continue this trend with continued emphasis on reliability and appropriate infrastructure investment.
3. APS is making investment in its capital plant over the next five years in a manner that indicates that new customers will be adequately and timely served and that all customers can expect a reasonable level of reliability. APS' Five Year Construction

Work Plan is appropriate, and associated cost estimates are reasonable. However, this does not imply a specific treatment or recommendation for rate base or ratemaking purposes in APS' future rate filings.

4. Staff finds that APS' growth, reliability, and capital investment plan are integrally related and dependent on access to capital.

## **Financial Analysis**

### Long-term and Short-term Debt Thresholds

In response to a Staff data request, APS stated that its capital structure as of December 31, 2006 consisted of 52.7 percent equity (\$3,204,700,000) and 47.3 percent long-term debt (\$2,878,500,000). There was no short-term debt outstanding at December 31, 2006.

A pro-forma capital structure reflecting issuance of long-term debt at the requested \$4.2 billion threshold consists of 43.3 percent equity and 56.7 percent long-term debt.

In its application, APS requests permission to increase its long-term and short-term debt thresholds. APS also asks for general authorization to take on new debt in unspecified amounts over time. The general nature of this request calls for financial parameters to place conditions on the borrowings to prevent APS from taking on an excessive amount of debt. As thresholds are ongoing in nature, the financial parameters employed by Staff to condition the future borrowings must also be ongoing in nature. Debt service coverage ratio ("DSC") is an effective parameter for this purpose as it indicates the ability to service debt in all aspects and is dynamic, i.e., reflects changes in operating results. Equity-to-total capitalization is also appropriate to show a balance sheet perspective of financial leverage and risk. Accordingly, Staff concludes that DSC and equity-to-total capitalization parameters are effective for placing conditions on debt issuances within a framework of threshold authorizations.

DSC represents the number of times internally generated cash will cover required principal and interest payment 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.

APS requests permission to take on short-term debt of 7 percent of total capitalization plus \$500 million. At present, APS may obtain short-term debt in an amount up to 7 percent of total capitalization without authorization from the Commission. APS uses short-term borrowings to finance the purchase of natural gas for generation of electricity and for the purchase of power from other providers. Fuel and power purchases are critical activities for meeting electric load requirements. Prudent procurement practices may be accompanied by large short-term capital requirements. Accordingly, Staff has determined that short-term borrowing in excess of 7 percent of APS' total capitalization is appropriate to facilitate APS' purchase of natural gas or

power since it has an adjuster mechanism providing for recovery of those costs in what is anticipated to be a short-term.

Approval of the requested new debt limits would eliminate the necessity for APS to file financial applications whenever it has the need to enter into any new debt agreements. Approval of these new debt limits would provide APS with the flexibility to take advantage of any favorable conditions in the financial markets when capital needs arise. Approval to exceed the short-term debt limitation of 7 percent of capitalization for purposes related to the purchase of natural gas or power would facilitate APS' effective management of purchases necessary to meet electric load requirements. Accordingly, authorization to increase the long-term debt and the short-term debt is appropriate but should include a specific termination date to maintain reasonable oversight of APS' capital financing by compelling it to seek reauthorization. Additionally, an increase in the short-term borrowing capacity is appropriate only when short-term borrowing above 7 percent of capitalization is limited to purchases of natural gas and power and does not exceed \$500 million above 7 percent of capitalization.

#### Declaratory Accounting Order

APS has requested a declaratory order confirming that only traditional indebtedness for borrowed money requires prior Commission authorization and that other obligations would not be considered continuing long-term debt when considering the sum of the total of long-term debt in relation to the total debt threshold. Concerns regarding incurrence of excessive debt exist regardless of the form it takes. Issuance of a declaratory order as requested by APS would exempt certain financing activities from appropriate controls established by the long-term debt limitations established by the Commission. Providing APS a mechanism for circumventing these controls has no merit.

#### **Conclusions and Recommendations**

Staff concludes that incurrence of the short-term and long-term debt for which APS requests authorization, as modified by Staff, 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 financial practices if, subsequent to any debt issuance, APS can satisfy the following conditions: (1) common equity must represent at least 40 percent of total equity (common equity, preferred stock, long-term debt and short-term debt) and (2) the debt service coverage ratio ("DSC") is equal to or greater than 1.0.<sup>1</sup>

Staff further concludes that:

1. APS should be authorized to incur up to \$4.2 billion in long-term indebtedness.

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<sup>1</sup> DSC for this purpose is calculated as operating income plus depreciation and amortization and income tax divided by interest and principle on short-term and long-term debt less short-term debt and interest related to purchased power and natural gas and using the most recent audited financial statements adjusted to reflect changes to outstanding debt.

2. APS should be authorized to incur short-term debt of 7 percent of total capital plus \$500 million exclusively for the purpose of financing natural gas and power acquisitions.
3. APS should be authorized to conduct the activities enumerated in the application that are necessary to secure and maintain debt.
4. The short-term and long-term debt levels authorized in this proceeding should terminate on December 31, 2012.
5. The authorizations to incur short-term and long-term debt obligations provided in this proceeding should replace all existing authorizations, and all existing authorizations should terminate upon the effective date of the authorizations provided in this proceeding.
6. APS' levels of long-term debt should be calculated according to generally accepted accounting principles.

Staff recommends increasing APS' authorized long-term debt threshold to \$4.2 billion subject to the following conditions: (1) common equity must represent at least 40 percent of total capital (common equity, preferred stock, long-term debt and short-term debt) and (2) the debt service coverage ratio ("DSC") must be equal to or greater than 1.0.

Staff further recommends that the short-term and long-term debt levels authorized in this proceeding terminate on December 31, 2012.

Staff further recommends that the authorizations to incur short-term and long-term debt obligations provided in this proceeding should replace all existing authorizations and that all existing authorizations should terminate upon the effective date of the authorizations provided in this proceeding.

Staff further recommends authorization for APS to incur short-term debt not to exceed \$500 million above 7 percent of total capital as long as 1) the excess over 7 percent of total capital shall be used solely for costs relating to natural gas or power purchases and 2) APS has a Commission authorized adjustor mechanism for recovery of these costs.

Staff further recommends that short-term debt in excess of 7 percent of total capital that is used solely for costs relating to natural gas or power purchases not be applied toward APS' long-term debt threshold even when the amount remains outstanding for more than 12 months. Staff recommends denial of APS' broader request for a declaratory order confirming that only traditional indebtedness for borrowed money requires prior Commission authorization.

Staff further recommends authorization for APS to (1) conduct the activities enumerated in the application that are necessary to secure and maintain debt, (2) to determine the form of

security, if any, for the continuing long-term debt and the continuing short-term debt, execute and deliver the security instruments, and establish and amend the terms and provisions of the security instruments, as may be deemed appropriate by APS in connection with the long-term debt and the short-term debt, and (3) to reimburse Pinnacle West for debt service costs paid by Pinnacle West on behalf of APS and a cost of money on those payments at a rate not to exceed the rate in the underlying loan(s).

Staff further recommends that, on each occasion when APS enters into a new long-term debt agreement, APS file with Docket Control a description of the transaction and a demonstration that the rates and terms are consistent with those generally available to comparable entities at the time.

Staff further recommends denial of Pinnacle West's request for authorization of a waiver of A.A.C. R14-2-803 pursuant to A.A.C. R14-2-806. In the alternative, Staff recommends authorization for Pinnacle West to guarantee APS' debt from time to time in indeterminate amounts.