OPEN MEETING ITEM

ORIGINAL

ERNEST G. JOHNSON
Executive Director

ARIZONA CORPORATION COMMISSION

DATE: AUGUST 1, 2011

DOCKET NO.: E-01787A-11-0165

TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Dwight D. Nodes. The recommendation has been filed in the form of an Order on:

NAVOPACHE ELECTRIC COOPERATIVE, INC.
(FINANCE)

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:

AUGUST 10, 2011

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:

AUGUST 16, 2011 and AUGUST 17, 2011

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.

ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF THE APPLICATION OF NAVOPACHE ELECTRIC COOPERATIVE, INC., AN ELECTRIC COOPERATIVE NONPROFIT MEMBERSHIP CORPORATION, FOR AUTHORIZATION TO SECURE A $49,329,000 RUS GUARANTEED FEDERAL FINANCING BANK LOAN AND TO PLEDGE, MORTGAGE, LIEN AND/OR ENCUMBER UTILITY ASSETS IN RELATION THERETO.	DOCKET NO. E-01787A-11-0165 DECISION NO. ____________ **ORDER**

Open Meeting
August 16 and 17, 2011
Phoenix, Arizona

BY THE COMMISSION:

Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

Background and Procedural History

1. Navopache Electric Cooperative, Inc. ("Navopache" or "Company") is a nonprofit, member-owned Class A public service corporation that provides electric distribution service to approximately 39,000 member/customers in Apache, Navajo, Greenlee, and Gila counties in Arizona, and in Catron County, New Mexico. (Application, at 2.) The Company's service area contains more than 3,480 miles of distribution and sub-transmission lines within its approximately 10,000 square mile service area. (*Id.*) Navopache has no generation facilities and receives all of its power requirements from Public Service Company of New Mexico. (Staff Engineering Report, at 1.)

2. On April 15, 2011, Navopache filed with the Arizona Corporation Commission ("Commission") an application requesting an Order authorizing Navopache to: (a) borrow up to $49,329,000 from the Federal Financing Bank ("FFB"), guaranteed by the Rural Utilities Service

("RUS"), to finance Navopache's Four Year Construction Work Plan for 2010-2013 period ("Work Plan"), (b) execute related loan documents and (c) grant liens and encumbrances on Navopache's utility assets.

3. By its application, Navopache seeks authorization to incur up to $49,329,000 in long-term debt through a 35-year amortizing loan, with an interest rate of approximately 5.0 percent per annum, from the FFB and guaranteed by the RUS. (Staff Report, at 1.) The Company intends to use the loan proceeds to finance capital expenditures for transmission and distribution system upgrades and new infrastructure pursuant to its Work Plan. (*Id.* at 2.)

4. On June 30, 2011, Navopache filed Affidavits of Publication attesting that notice of the application had been published in the *White Mountain Independent* and the *Fort Apache Scout*, newspapers distributed in Navopache's service area.

5. On July 20, 2011, the Commission's Utilities Division ("Staff") filed a Staff Report recommending approval of the requested loan amount subject to certain conditions.

6. On July 26, 2011, Navopache filed Comments in Support of Staff Report. The Company stated that recent fires within its service area have increased the need for several of the improvements set forth in the Company's Work Plan. Navopache requested that the Commission issue an Order in accordance with Staff's recommendations.

Engineering Analysis

7. Staff stated that the number of meters on Navopache's system increased from 36,974 in 2005 to 39,123 at the end of 2010, an average growth rate of 1.16 percent per year. (Staff Engineering Report, at 1.) Staff indicated that the Company's distribution system coincident peak load experienced unusual fluctuations between 2005 and 2010 due to the economic downturn and colder than normal winters in 2007 and 2009. (*Id.*) During this period, Navopache's coincident peak load varied from a low of 72.9 MW in 2005 to a high of 88.6 MW in 2007, 80.8 MW in 2008, and 86.1 MW in 2009, before decreasing to 75.5 MW in 2010. Staff claims that the Company's peak load is now expected to grow at a more moderate annual rate of approximately 3 percent until economic conditions improve. (*Id.*)

8. According to the Staff Engineering Report, the anticipated capital projects contained

in Navopache's four-year Work Plan include: new underground and overhead distribution lines for line extensions, subdivisions and other new services; new feeders and line ties; replacement of old wooden poles; and miscellaneous distribution system upgrades, including pole mounted transformers, voltage regulators, and metering equipment. (*Id.* at 2.) Staff indicates that the Work Plan also includes capital expenditures for transmission switch replacements; supervisory control and data acquisition upgrades; microwave communication system improvements; and replacement of line reclosers, voltage regulators, and primary conductors. (*Id.* at 3.)

9. As set forth in its application, Navopache's 2010-2013 Work Plan budget is $56,329,000. The Work Plan budget includes $7,000,000 for construction of a warehouse facility in 2010, that will be secured by a loan previously approved by the Commission.[1] After subtracting the $7,000,000 from the prior loan authority, Navopache requested approval for financing of $49,329,000 to fund the balance of its four-year Work Plan. (*Id.*) A summary of Navopache's 2010-2013 Work Plan budget is set forth below.[2]

SUMMARY OF NAVOPACHE CONSTRUCTION WORK PLAN 2010-2013 BUDGET
(Dollars)

Description	2010	2011	2012	2013	TOTALS
New Services, Tie Lines and Line Conversions	4,701,000	3,391,000	2,801,000	3,178,000	14,071,000
New Substations & Substation Changes	417,000	2,322,000	1,904,000	161,000	4,804,000
Misc & Other Distribution	3,988,000	4,359,000	4,529,000	4,584,000	17,460,000
Line& Station Changes and Other Transmission Lines	1,479,000	122,000	1,829,000	91,000	3,521,000
Warehouse/Headquarter Facilities	7,000,000	0	0	5,000,000	12,000,000
TOTAL					**51,856,000**

10. Staff's Engineering Report concluded that the new and upgraded infrastructure proposed in the Company's Work Plan "will result in improvement of system reliability and in

[1] Decision No. 68691 (May 5, 2006), as amended by Decision Nos. 71859 (September 1, 2010) and 72010 (December 10, 2010).

[2] The difference between the Work Plan budget ($56,329,000) and the total amount shown on this Table ($51,856,000) is due to $4,473,000 of capital projects completed in Navopache's previous construction work plan with internal Company funds. (*Id.* at 3-4.)

meeting projected system load in a reliable and cost effective manner." (*Id.* at 4.) Staff believes Navopache's Work Plan projects are appropriate to meet projected demand by new customers and to enhance system reliability through the planned equipment upgrades, replacement of old underground cables, and the addition of new sub-transmission and distribution facilities. (*Id.*) Based on its analysis, Staff concluded that the costs associated with the projects appear to be reasonable, but that Staff's recommendation does not imply a specific rate base or ratemaking treatment for the projects. (*Id.* at 4.)

Capital Structure

11. Staff indicated that Navopache's capital structure, as of December 31, 2010, consisted of 3.0 percent short-term debt, 69.5 percent long-term debt, and 27.5 percent equity. Staff calculated a pro forma capital structure of 2.2 percent short-term debt, 81.3 percent long-term debt, and 16.5 percent equity, assuming issuance of a $49,329,000 35-year amortizing loan plus the remaining $7,000,000 financing authorization from a prior Commission Decision. (*Id.*)

12. In Decision No. 68691 (May 5, 2006), Navopache was authorized to obtain a loan in the amount of $33,231,000, but, due to concerns expressed by Staff regarding the high level of debt in the Company's capital structure, Navopache was directed "to file a capital plan that is satisfactory to Staff, to achieve and maintain equity at no less than 30 percent of total capital." (Decision No. 68691, at 4.) The Company was also ordered to file "a plan that is satisfactory to Staff, to increase its TIER and DSC[3] ratio to a minimum of 1.25." (*Id.* at 4-5.)

13. Because Navopache's capital structure will be comprised of a high percentage of debt following receipt of the financing proposed in this case, we believe it is appropriate to require the Company to file in this docket the same types of plans that were required in Decision No. 68691.

Financial Analysis

14. Staff analyzed the financial effect of the proposed financing on Navopache's operations under a number of assumptions.[4] Staff evaluated: (1) the Company's historical financial information for year end 2010; (2) a pro forma scenario that includes a 35-year, $7,000,000 loan at

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[3] See discussion below regarding TIER and DSC.
[4] Staff's analysis is set forth on Schedule JCM-1 to the Staff Report. Schedule JCM-1 is attached hereto as Exhibit A.

5.25 percent (representing the unused portion of the prior loan authorization); (3) addition of the requested $49.33 million 35-year amortizing loan with an interest rate of 5.0 percent per annum; (4) alternatively, addition of a $28 million 35-year amortizing loan with an interest rate of 5.0 percent per annum; and (5) addition of the requested $49.33 million 35-year amortizing loan with an interest rate of 5.0 percent per annum, plus the minimum additional operating income that would be needed for the Company to achieve a 1.0 Debt Service Coverage ("DSC") ratio.[5] (Staff Report, at 2.)

15. According to Staff, under the first scenario analyzed (historical year-end 2010), Navopache's Times Interest Earned Ratio ("TIER")[6] and DSC were 1.54 and 1.46, respectively. (*Id.*) Under the second assumption (historical plus existing $7 million loan), the Company's TIER was 1.31 and its DSC was 1.33. Under the third scenario (existing $7 million loan plus requested $49.33 million loan), Staff calculated a TIER and DSC of 0.65 and 0.84, respectively. The fourth analysis (existing $7 million loan plus an alternative $28 million loan amount) resulted in TIER and DSC ratios of 0.83 and 1.00, respectively. The fifth scenario (requested $49.33 million loan plus minimum operating income needed to produce a 1.0 DSC) produced a TIER of 0.92 and DSC of 1.0. (*Id.*)

16. Staff states that the pro forma DSC results show that the maximum amortizing long-term debt that Navopache can incur under its current rates is $28.0 million (while maintaining a 1.0 DSC), which Staff recommends should be the maximum authorization granted by the Commission while the Company's current rates are in effect. (*Id.* at 3.)[7]

17. Staff points out that Navopache has filed a rate application seeking a revenue increase of $3,413,663.[8] Based on its analysis, Staff determined that an increase to the Company's test year revenues in that case, with a corresponding increase in operating income, would produce

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[5] DSC represents the number of times internally generated cash will cover required principal and interest payments on short-term and long-term debt. A DSC greater than 1.0 indicates that cash flow from operations 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.

[6] TIER represents the number of times earnings cover interest expense on short-term and long-term debt. A TIER greater than 1.0 means that operating income is greater than interest expense. A TIER less than 1.0 is not sustainable in the long term but does not mean that obligations can not be met in the short term.

[7] Staff noted that adding $28.0 million in long-term debt results in TIER and DSC ratios of 1.31 and 1.26, respectively, under the methodology used by RUS. The RUS methodology also produces an operating TIER ("OTIER") of 1.24 and an operating DSC ("ODSC") of 1.12, which Staff states would satisfy the loan covenants required for the RUS loan as well as Staff's recommendation for a 1.0 DSC. (*Id.*, note 5.)

[8] Docket No. E-01787A-11-0186 (Application filed April 27, 2011). To date, Staff has not found Navopache's rate application to be sufficient under the Arizona Administrative Code requirements.

sufficient cash flow from operations to cover all obligations, including the full $49,329,000 loan proposed by Navopache. Staff also indicated that in the event the Commission authorizes a revenue increase less than $1,323,913 in the Company's pending rate case, Navopache could service $16,000 of additional debt for each $1,000 increase in revenue. (*Id.*)

Staff Recommendations

18. As discussed above, Staff found that Navopache's 2010-2013 Work Plan capital projects are appropriate and that the cost estimates for those projects are reasonable. However, Staff made no used or useful determination for the proposed projects; nor did Staff reach any conclusions about the projects for rate base or ratemaking purposes. (*Id.*)

19. Staff concluded that issuance of the Company's proposed debt financing, for the purposes stated in the application, is within Navopache's corporate powers and, under Staff's recommendations, is compatible with the public interest, is consistent with sound financial practices and will not impair the Company's ability to provide service to customers. (*Id.* at 4.)

20. Staff recommends approval of Navopache's requested financing under the following terms and conditions:

a. Navopache should be authorized to execute agreements to incur an amortizing debt in an amount not to exceed $49,329,000, for a period of 33 to 37 years, at prevailing interest rates from the RUS/FFB.

b. The amount of draws on the debt authorizations granted should be restricted to $28,000,000 until the effective date of rates authorized by the Commission that increase the Company's revenues, with additional draws of $16,000 for each $1,000 of authorized increase in revenues, effective as of the date of the new rates. As an example, Staff indicated that a revenue increase of $1,333,000 or greater would allow Navopache to make additional draws of approximately $21,329,000 ($1,333,000 /$1,000 x $16,000) to achieve the full $49,329,000 amount requested in the application ($28,000,000 + $21,329,000).

c. Navopache should be authorized to pledge, mortgage, lien and/or encumber its assets in the State of Arizona pursuant to A.R.S. § 40-285 in connection with the proposed RUS/FFB loan.

d. Navopache should be authorized to engage in any transaction, and to execute any documents necessary, to effectuate the authorizations granted.

e. Navopache should be required to file with Docket Control, as a compliance item in this docket, copies of the loan documents executed for the financing authorized herein, within 60 days of the execution of such documents.

f. The authorization to incur debt under this Decision should terminate as of December 31, 2015.

Conclusion

21. We find Staff's recommendations, as described and modified herein, to be reasonable and appropriate, and we will therefore approve Navopache's financing application, as amended by the Staff Report recommendations and discussion.

CONCLUSIONS OF LAW

1. Navopache is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. §§ 40-285, 40-301, 40-302, and 40-303.

2. The Commission has jurisdiction over Navopache and the subject matter of the financing application.

3. Notice of the financing application was provided in accordance with the law.

4. The financing approved herein is for lawful purposes within Navopache's corporate powers, is compatible with the public interest, with sound financial practices, and with the proper performance by Navopache of service as a public service corporation and will not impair Navopache's ability to perform the service.

5. The financing approved herein is for the purposes stated in the application and is reasonably necessary for those purposes, and such purposes are not, wholly or in part, reasonably chargeable to operating expenses or to income.

6. Approval of the proposed financing is not intended to, and should not be interpreted to, guarantee or imply any specific treatment of any capital additions for rate base or ratemaking purposes.

7. Staff's recommendations, as described and modified herein, are reasonable and appropriate and should be adopted.

ORDER

IT IS THEREFORE ORDERED that Navopache Electric Cooperative, Inc., is hereby authorized to execute agreements to incur an amortizing debt in an amount not to exceed

$49,329,000, for a period of 33 to 37 years, at prevailing interest rates from the RUS/FFB, conditioned on compliance with the requirements set forth in the following ordering paragraphs.

IT IS FURTHER ORDERED that the amount of draws on the debt authorizations granted should be restricted to $28,000,000 until the effective date of any rates authorized by the Commission that increase the Company's revenues, with additional draws of $16,000 for each $1,000 of authorized increase in revenues, effective as of the date of the new rates.

IT IS FURTHER ORDERED that Navopache Electric Cooperative, Inc., shall file within 90 days, as a compliance item with Docket Control, a capital plan that is satisfactory to Staff, to achieve and maintain equity at no less than 30 percent of total capital.

IT IS FURTHER ORDERED that Navopache Electric Cooperative, Inc., shall file within 90 days, as a compliance item with Docket Control, a plan that is satisfactory to Staff, to increase the Company's TIER and DSC ratio to a minimum of 1.25, and shall adhere to that plan.

IT IS FURTHER ORDERED that any unused authorization to incur long-term debt granted in this proceeding shall terminate on December 31, 2015.

IT IS FURTHER ORDERED that Navopache Electric Cooperative, Inc., is hereby authorized to engage in any transaction and to execute any documents necessary to effectuate the authorizations granted herein.

IT IS FURTHER ORDERED that Navopache Electric Cooperative, Inc., is hereby authorized to pledge, mortgage, lien and/or encumber its assets in the State of Arizona pursuant to A.R.S. § 40-285 in connection with the proposed RUS/FFB loan.

IT IS FURTHER ORDERED that Navopache Electric Cooperative, Inc., shall, within 60 days of the execution of any financing transaction authorized herein, file with Docket Control, as a compliance item in this docket, copies of all executed financing documents related to the authorizations granted herein.

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IT IS FURTHER ORDERED that approval of the financing set forth herein does not constitute or imply approval or disapproval by the Commission of any particular expenditure of the proceeds derived thereby for purposes of establishing just and reasonable rates.

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 ___________, 2011.

ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

DISSENT ____________________________

DISSENT ____________________________

SERVICE LIST FOR: NAVOPACHE ELECTRIC COOPERATIVE, INC.

DOCKET NO.: E-01787A-11-0165

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EXHIBIT A

FINANCIAL ANALYSIS

Line		[A][1] 12/31/2010		[B][2] Pro forma		[C][3] Pro forma		[D][4] Pro forma		[E][5] Pro forma	
1	Operating Income	$3,176,087		$3,176,087		$3,176,087		$3,176,087		$4,500,000	
2	Depreciation & Amort.	$3,532,302		$3,532,302		$3,532,302		$3,532,302		$3,532,302	
3	Income Tax Expense	$0		$0		$0		$0		$0	
4											
5	Interest Expense	$2,058,336		$2,424,129		$4,878,471		$3,817,256		$4,878,471	
6	Repayment of Principal	$2,547,012		$2,618,643		$3,151,790		$2,921,267		$3,151,790	
7											
8											
9	**TIER**										
10	[1+3] ÷ [5]	1.54		1.31		0.65		0.83		0.92	
11											
12	**DSC**										
13	[1+2+3] ÷ [5+6]	1.46		1.33		0.84		1.00		1.00	
14											
15											
16											
17											
18	**Capital Structure**										
19											
20	Short-term Debt	$2,547,012	3.0%	$2,618,643	2.9%	$3,151,790	2.2%	$ 2,921,267	2.4%	$3,151,790	2.2%
21											
22	Long-term Debt	$58,968,678	69.5%	$65,897,047	71.8%	$114,692,900	81.3%	$93,594,423	78.1%	$114,692,900	81.3%
23											
24	Common Equity	$23,276,322	27.5%	$23,276,322	25.4%	$23,276,322	16.5%	$23,276,322	19.4%	$23,276,322	16.5%
25											
26	Total Capital	$84,792,012	100.0%	$91,792,012	100.0%	$141,121,012	100.0%	$ 119,792,012	100.0%	$141,121,012	100.0%

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28
29
30
31 [1] Column [A] is based on the Company's Financial Statements for the year ended December 31, 2010.
32 [2] Column [B] is Column [A] modified to reflect issuance of 7.0 million of outstanding debt authorizations amortized for 35 years at 5.25 percent.
33 [3] Column [C] is Column [B] modified to reflect issuance of the proposed $49.33 million long term debt financing amortized for 35 years at 5.00 percent.
34 [4] Column [D] is Column [B] modified to reflect issuance of a $28.0 long term debt financing amortized over 35 years at 5.00 percent
35 [5] Column [E] reflects issuance of the proposed $49.33 million long term debt financing amortized for 35 years at 5.00 percent and the minimum Operating Income that would achieve a 1.00 DSC.