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9 **BEFORE THE ARIZONA CORPORATION COMMISSION**

10 COMMISSIONERS

11 GARY PIERCE, Chairman
12 BOB STUMP
13 SANDRA D. KENNEDY
14 PAUL NEWMAN
15 BRENDA BURNS

16 IN THE MATTER OF THE APPLICATION
17 OF ARIZONA PUBLIC SERVICE
18 COMPANY FOR AN ORDER OR
19 ORDERS AUTHORIZING IT TO ISSUE,
20 INCUR, AND AMEND EVIDENCES OF
21 LONG-TERM INDEBTEDNESS, SHORT-
22 TERM INDEBTEDNESS, AND OTHER
23 LONG-TERM SECURITIES, TO MANAGE
24 INTEREST RATE RISK, TO EXECUTE
25 NEW SECURITY INSTRUMENTS TO
26 SECURE ANY SUCH INDEBTEDNESS
27 OR OTHER LONG-TERM SECURITIES,
28 AND FOR DECLARATORY ORDER
CONCERNING VARIABLE INTEREST
ENTITIES

DOCKET NO. E-01345A-11-0423

**APS COMMENTS ON
STAFF REPORT**

22 **INTRODUCTION**

23 On November 22, 2011, Arizona Public Service Company (“APS” or
24 “Company”) filed the above Application pursuant to Sections 40-285, 40-301, and 40-
25 302 of the Arizona Revised Statutes, and the Arizona Corporation Commission’s
26 (“Commission”) Decision No. 69947 (October 30, 2007) (the “2007 Order”). On
27 November 2, 2012, Utilities Division Staff (“Staff”) filed its Report on the Application,
28 requesting Comments by November 9, 2012.

1 **APS COMMENTS**

2 Below is a listing of Staff's 19 recommendations and the Company's Comments
3 thereto. APS has attempted to limit its Comments because of the critical need for this
4 matter to be determined by the Commission before year's end. Under terms of the 2007
5 Order, APS's long-term debt authorization from that Order automatically expires after
6 December 31, 2012.

7 *Staff Recommendation:*

8 1. Increasing APS' authorized long-term debt threshold to \$5.1 billion subject to
9 the following conditions:

10 (a) common equity represents at least 40 percent of total capital (common
11 equity, preferred stock, long-term debt and short-term debt);

12 (b) debt service coverage ratio ("DSC") is equal to or greater than 2.0;

13 (c) variable interest debt should not exceed \$750 million; and

14 (d) APS not having entered into any agreement/contract for an financial
15 derivative security or similar instrument other than those authorized by the
16 Commission, and establishing that violation of this condition shall result in
17 immediate expiration of this general authorization to issue long-term
18 indebtedness (This provision is not intended to place any restoration on
hedging activities pertaining to energy procurement);

19 **APS position:**

20 APS can accept the \$5.1 billion limitation for purposes of this proceeding.
21 However, some of the conditions imposed on such a grant of expanded long-term debt
22 authority have been subtly but substantively changed from prior Commission decisions,
23 including the 2007 Order.

24 The 40% common equity test has seemingly been modified without explanation
25 from that first approved in Decision No. 65976 (April 4, 2003) and reaffirmed in the
26 2007 Order. See 2007 Order at 16-17. Specifically, short-term debt was excluded from
27 the definition of "total capital" in both prior instances. Unless Staff can identify a
28

1 reason for changing a proven and well-vetted calculation of this test, APS would ask
2 that short-term debt continue to be excluded.

3 Similarly, the DSC test of 2.0 apparently includes principal amounts excluded
4 from the calculation agreed to by Staff and approved in the 2007 Order (*Id.*), again
5 without explanation. For entities that use sinking fund financing, such inclusion would
6 be of little consequence. For entities such as investor-owned electric utilities (including
7 APS) that use so-called “bullet-maturity” financing (i.e., the entire principal amount is
8 due at one time), such an inclusion of principal would make it difficult if not impossible
9 to meet the DSC test, thus eviscerating the authorization of additional long-term debt
10 recommended by Staff.

11 The proposed \$750 million cap on variable rate long-term debt is sufficient for
12 the term of this financing authority. APS may ask the Commission to revisit this issue
13 in future financing proceedings.

14 Part (d) of this Staff recommendation is somewhat vague. It appears to authorize
15 the use of the interest rate management instruments referenced in Recommendation 15
16 (forward-starting swaps based on LIBOR or U.S. Treasuries and U.S. Treasury rate-
17 locks) but does not actually say that. APS is satisfied with the limitations set forth
18 within Staff Recommendation 15, but believes any final order should be clear and
19 specific on this important point.

20 Also, APS urges that the language in (d) requiring “immediate expiration of this
21 general authorization to issue long-term indebtedness” should APS issue a “derivative”
22 other than the types identified in Staff Recommendation 15 be modified to make such
23 an issuance *grounds* for summary revocation by the Commission. Creating *automatic*
24 penalties for the occurrence of future events is seldom a good idea, and especially so
25 when the consequences of the penalty are so severe. APS has no control over what may
26 at some future time be labeled by the accounting community as a “derivative” when it
27 had not previously been so described and would like at least to be able to explain the
28 situation to the Commission before such drastic action is taken.

1 *Staff Recommendation:*

- 2 2. That the authorizations to incur long-term debt, and short-term debt
3 obligations provided in this proceeding replace all existing authorizations and
4 that all existing authorizations expire upon the effective date of the
5 authorizations provided in this proceeding;

6 **APS Position:**

7 As in the 2007 Order, APS requests that Decision Nos. 55120 (July 24, 1986) and
8 55320 (December 5, 1986) be expressly exempted from this replacement of “all existing
9 authorizations” language. *See* 2007 Order at 18. These two Palo Verde sale/leaseback
10 Decisions have always stood on their own, distinct from general financing authorizations
11 of the type at issue herein and contain numerous provisions critical to the continued
12 validity of these transactions.

13 Also, APS presumes that Staff means only to supplant the relevant long-term and
14 short-term debt authorizations from the 2007 Order and not to revoke that Decision in its
15 entirety. There are portions of that Decision that remain viable and necessary today,
16 such as the process for addressing unanticipated changes in Generally Accepted
17 Accounting Principles (“GAAP”) – a provision of the 2007 Order exercised by both the
18 Company and Staff in this very proceeding with regard to Variable Interest Entities
19 (discussed in Staff Recommendation 19).¹

20 *Staff Recommendation:*

- 21 3. Authorization for APS to incur short-term debt not to exceed \$500 million
22 above 7 percent of total capital provided that the excess over 7 percent of total
23 capital shall be used solely for costs relating to natural gas or power purchases
24 and as long as APS has an authorized adjustor mechanism for recovery of
25 these kinds of costs;

26 **APS Position:**

27 APS agrees.

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¹ APS and other public companies are required to follow GAAP by federal law.

1 *Staff Recommendation:*

- 2 4. That short-term debt in excess of 7 percent of total capital, used solely for
3 costs relating to natural gas or power purchases, not be applied toward APS'
4 long-term debt threshold even when the amount remains outstanding for more
5 than 12 months;

6 **APS Position:**

7 APS agrees.

8 *Staff Recommendation:*

- 9 5. Authorization for APS to redeem, refinance, refund, renew, reissue, roll-over,
10 repay, and re-borrow from time to time the long-term debt and short-term debt
11 in (1) and (3) above;

12 **APS Position:**

13 Although this language is right from the 2007 Order, in its Application, APS had
14 added the term "reprice" to the litany of "re's" for which it sought authorization. Unless
15 there was some reason for omitting the term "reprice" that is not addressed in the Staff
16 Report, APS would urge its re-inclusion.

17 *Staff Recommendation:*

- 18 6. That the short-term and long-term debt levels authorized in this proceeding
19 expire on December 31, 2016;

20 **APS Position:**

21 APS strongly urges that language similar to that adopted in the 2007 Order at
22 page 18 be used with regard to all the authorizations approved in this proceeding. It is
23 the failure to include long-term debt within the scope of the 2007 Order's language that
24 has brought us to the current situation of having to get this matter decided by year's end.
25 Specifically, the authorizations granted in this proceeding should remain in effect until
26 further order of the Commission *if and only if* the Company files an application to
27 continue or expand such authorizations prior to January 1, 2016. Otherwise, they would
28 expire after December 31, 2016, as recommended in the Staff Report. In either instance,
 the Commission should make it clear that debt properly issued by APS prior to that date
 will remain valid in accordance with its terms.

1 *Staff Recommendation:*

2 7. Authorization for APS to (1) conduct the activities enumerated in the
3 application that are necessary to secure and maintain debt, (2) to determine
4 the form of security (except as otherwise established in the Order), if any, for
5 the continuing long-term debt and continuing short-term debt, execute and
6 deliver the security instruments, and establish and amend the terms and
7 provisions of the security instruments, as may be deemed appropriate by APS
8 in connection with the continuing long-term debt and continuing short-term
9 debt;

10 **APS Position:**

11 APS agrees.

12 *Staff Recommendation:*

13 8. Denial of APS' request to issue Other Long-Term Securities;

14 **APS Position:**

15 Because Staff's proposed denial of this portion of the Company's request is
16 expressly without prejudice to APS's ability to raise the issue in a future application,
17 APS can accept this Staff Recommendation for purposes of this proceeding.

18 *Staff Recommendation:*

19 9. Direct APS not to enter into any derivative financial instrument that
20 effectively converts fixed cost long-term debt in (1) above to floating/variable
21 cost debt;

22 **APS Position:**

23 APS can accept Staff's Recommendation for purposes of this proceeding.

24 *Staff Recommendation:*

25 10. Direct that for purposes of calculation the \$750 million aggregate limit on the
26 outstanding balance of floating/variable cost rate long-term debt, in the event
27 that the Commission authorizes issuance of derivative financial instruments
28 that effectively convert fixed cost rate debt to floating cost rate debt, the
 converted debt shall be considered floating cost rate debt;

APS Position:

 APS can accept Staff's Recommendation for purposes of this proceeding.

1 *Staff Recommendation:*

2 11. Authorize APS to enter into derivative financial instruments that convert
3 floating cost long-term securities to long-term fixed cost securities. For
4 purposes of calculating the \$750 million aggregate limit on the outstanding
5 balance of floating/variable cost rate debt, any floating cost security
6 effectively converted to a fixed cost security by issuance of a financial
7 derivative instrument or any other means shall be deemed a fixed cost
8 security;

9 **APS Position:**

10 APS can accept Staff's Recommendation for purposes of this proceeding.

11 *Staff Recommendation:*

12 12. Find that it is in the public interest for the Commission to control the use by
13 APS of interest rate swap agreements, US. Treasury rate-lock agreements,
14 derivative financial securities and similar instruments;

15 **APS Position:**

16 APS agrees.

17 *Staff Recommendation:*

18 13. Require APS to file confirmation with the Commission Docket Control Center
19 certifying that it has established an appropriate management policy/system of
20 internal controls formally approved by APS' Board of Directors designed to
21 govern such trading within the organization prior to initiation of trading
22 activity in financial derivative securities or similar contracts to manage
23 interest rate risk and/or exposure;

24 **APS Position:**

25 APS agrees.

26 *Staff Recommendation:*

27 14. Find that any authorization granted APS to engage in financial derivative
28 securities or similar contracts to manage interest rate risk and or exposure
 should specifically exclude use of such authorization for speculative purposes;

APS Position:

 Recognizing that what is or is not "speculative" is, like beauty, somewhat in the
 eye of the beholder, APS can accept Staff's Recommendation for purposes of this
 proceeding. Both the Application and the Staff Report identify the business purpose

1 behind the Company's proposals in this regard, and APS has no intent to deviate from
2 such purpose.

3 *Staff Recommendation:*

4 15. Authorize APS to issue forward-starting swaps based on LIBOR or U.S.
5 Treasuries and U.S. Treasury rate-locks for the purpose of hedging changes in
6 interest rates up to 18 months in advance of planned issuances of fixed-rate
taxable long-term debt having final maturity of five years or longer;

7 **APS Position:**

8 APS can accept Staff's Recommendation for purposes of this proceeding.

9 *Staff Recommendation:*

10 16. Deny APS' request to amortize gains or losses associated with pre-issuance
11 interest rate hedging transactions over the life of the new debt issuance to
12 which they relate;

13 **APS Position:**

14 Reading the text of the Staff Report at page 9, it is clear that Staff is declining to
15 endorse a particular ratemaking treatment of these gains or losses rather than attempting
16 to determine how they should be accounted for under GAAP. GAAP requires
17 amortization of these types of gains and losses, and APS will follow GAAP's
18 instructions in this regard. APS agrees that the ratemaking treatment of any gains or
19 losses can be addressed in its next rate case, although notes that amortization is
20 consistent with Commission ratemaking practices since at least 1983. *See* Decision No.
53761 (September 30, 1983).

21 *Staff Recommendation:*

22 17. Order that the authorizations to incur short-term and long-term debt
23 obligations in this case shall replace all existing authorizations for the
24 incurrence of short-term and long-term debt provided for in Decision No.
25 69947. That those authorizations expire upon the effective date of an Order in
26 this case, and that all existing obligations incurred under lawful authorizations
shall remain valid;

27 **APS Position:**

28 See the Company's Comments on Staff Recommendation 2.

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RESPECTFULLY SUBMITTED this 8th day of November, 2012.



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Company

ORIGINAL and thirteen (13) copies
of the foregoing filed this 8th day of
November, 2012, with:

The Arizona Corporation Commission
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