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ORIGINAL

MEMORANDUM

TO: Docket Control Center

FROM: Steven M. Olea
Director
Utilities Division

EA for SMD

Arizona Corporation Commission

DOCKETED

MAR 14 2014

DATE: March 14, 2014

DOCKETED BY 

RE: STAFF REPORT FOR ARIZONA ELECTRIC POWER COOPERATIVE, INC.
FOR AUTHORIZATION TO OBTAIN TWO COMMITTED REVOLVING LINES
OF CREDIT (DOCKET NO. E-01773A-14-0019)

Attached is the Staff Report for Arizona Electric Power Cooperative's application for authorization to obtain two committed revolving lines of credit in the combined amount of \$100 million. Staff recommends approval of the requested authorization.

Any party to this procedure who wishes may file comments to the Staff Report with the Commission's Docket Control by 4:00 p.m. on or before March 24, 2014.

SMO:PNT:tdp\WVC

Originator: Phan Tsan

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AZ CORP COMMISSION
DOCKET CONTROL

Service List for: Arizona Electric Power Cooperative, Inc.
Docket No. E-01773A-14-0019

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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

ARIZONA ELECTRIC POWER COOPERATIVE, INC.

DOCKET NO. E-01773A-14-0019

**APPLICATION FOR AN AUTHORIZATION TO OBTAIN
TWO COMMITTED LINES OF CREDIT
IN THE COMBINED AMOUNT OF \$100 MILLION.**

MARCH 14, 2014

STAFF ACKNOWLEDGMENT

The Staff Report for Arizona Electric Power Cooperative, Inc., Docket No. E-01773A-14-0019 is the responsibility of the Staff members listed below. Phan Tsan is responsible for the financial review and analysis of the Cooperative's application.

A handwritten signature in black ink, appearing to read 'Phan Tsan', with a long horizontal flourish extending to the right.

PHAN TSAN
PUBLIC UTILITIES ANALYST I

EXECUTIVE SUMMARY
ARIZONA ELECTRIC POWER COOPERATIVE, INC.
DOCKET NO. E-01773A-14-0019

On January 21, 2014, Arizona Electric Power Cooperative, Inc. (“AEPCO”), a not-for-profit, member-owned electric generation cooperative located in Benson, Arizona, filed an application with the Arizona Corporation Commission (“Commission”) requesting authorization to obtain two unsecured committed revolving lines of credit (“LOCs”) in the combined amount of \$100 million.

In a related Docket, AEPCO and Southwest Transmission Cooperative, Inc. (“SWTC”)(collectively, the “Cooperatives”) simultaneously filed a Joint Application seeking (i) Commission authorization for a merger, with AEPCO as the surviving generation and transmission cooperative, and (ii) replacement of the Cooperatives’ current mortgages with an Indenture. The requested revolving LOCs are intended to improve AEPCO’s and the Cooperatives’ post-merger credit profiles by increasing liquidity and providing access to committed funds that will afford greater short-term financial flexibility.

Given the connection between the committed revolving LOCs in this docket and the Indenture sought in the separate joint application, AEPCO requests that the Commission approve this Application prior to, or simultaneous with, the Joint Application.

Staff recommends authorization of AEPCO’s request to enter into two unsecured committed lines of credit in an amount not to exceed \$100 million in the aggregate.

Staff further recommends the following:

- Authorizing AEPCO to engage in any transaction and to execute any documents necessary to effectuate the authorization herein granted.
- That AEPCO provide to the Utilities Division Director, a copy of the loan documents executed pursuant to the authorizations granted herein, within 30 days of the execution of the loan, and also file a letter in Docket Control verifying that such documents have been provided to the Utilities Division.
- That any unused authorizations to issue debt granted in this proceeding terminate within five and a half years of a decision in this docket.

TABLE OF CONTENTS

	<u>PAGE</u>
INTRODUCTION	1
NOTICE	1
COMPLIANCE	1
BACKGROUND	1
PURPOSE OF THE FINANCING	2
DESCRIPTION OF PROPOSED FINANCING	3
FINANCIAL ANALYSIS	3
CAPITAL STRUCTURE	3
DEBT SERVICE COVERAGE RATIO (“DSC”).....	3
TIMES INTEREST EARNED RATIO (“TIER”).....	4
ENCUMBRANCE	4
CONCLUSION AND RECOMMENDATIONS	4

SCHEDULES

FINANCIAL ANALYSIS	Schedule PNT-1
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ATTACHMENT

NOTICE	Attachment A
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INTRODUCTION

On January 21, 2014, Arizona Electric Power Cooperative, Inc. (“AEPCO”) filed an application with the Arizona Corporation Commission (“Commission”) requesting authorization to obtain two unsecured committed revolving lines of credit (“LOCs”) in a combined amount of \$100 million.

In a related Docket, AEPCO and Southwest Transmission Cooperative, Inc. (“SWTC”) (collectively, the “Cooperatives”) simultaneously filed a Joint Application seeking (i) Commission authorization for a merger, with AEPCO as the surviving generation and transmission cooperative, and (ii) replacement of the Cooperatives’ current mortgages with an Indenture. The requested revolving LOCs are intended to improve AEPCO’s and the Cooperatives’ post-merger credit profiles by increasing liquidity and providing access to committed funds that will afford greater short-term financial flexibility.

NOTICE

On February 28, 2014, AEPCO filed an affidavit of publication verifying public notice of its financing application. The Cooperative published notice of its financing application in *The Arizona Daily Star* and *The Kingman Daily Miner* on February 25, 2014. *The Arizona Daily Star* is a newspaper of general circulation in the county of Pima, Arizona, and *The Kingman Daily Miner* is a newspaper of general circulation in the City of Kingman, County of Mohave, Arizona. The affidavit of publication is attached along with a copy of Notice.

COMPLIANCE

As of March 10, 2014, a check of the Compliance Database indicates that there are currently no delinquencies for AEPCO. Therefore, AEPCO is currently in Compliance.

BACKGROUND

AEPCO is an Arizona public service corporation and a Class “A” not-for-profit, electric generation cooperative located in Benson, Arizona. AEPCO provides power and wholesale energy primarily to six Class “A” member distribution cooperatives-Anza Electric Cooperative¹, Duncan Valley Electric Cooperative, Graham County Electric Cooperative, Mohave Electric Cooperative, Sulphur Springs Valley Electric Cooperative and Trico Electric Cooperative, under the terms of all-requirements or partial-requirements capacity and energy agreements. Also, Valley Electric Association (“VEA”) is a Class “D” member. VEA does not have either a partial or all-requirements contract with AEPCO, but has an agreement with AEPCO whereby AEPCO provides scheduling and trading services as well as economy energy purchases.

¹ Anza Electric Cooperative is a distribution cooperative located in California.

AEPCO's current rates were approved in Decision No.74173, dated October 25, 2013².

SWTC was formed as a not-for-profit, transmission-only cooperative as part of restructuring undertaken by AEPCO in the late 1990s and the early 2000s. The Commission approved the restructuring in Decision No. 63868 (dated July 25, 2001)³. Among other approvals, Decision No. 63868 authorized the transfer of AEPCO's transmission assets and the transmission portion of its CC&N to SWTC. As noted, simultaneous to the filing in this docket, AEPCO and SWTC filed a joint application seeking Commission authorization for a merger. That docket remains pending.

PURPOSE OF THE FINANCING

As stated in the Application, AEPCO and SWTC are seeking to enhance and expedite their access to a broader base of private and public loan funds, at the lowest available cost, and to meet future electricity supply/delivery challenges. Accordingly, the purpose of the revolving LOCs are to further that goal by (1) improving AEPCO's and the Cooperatives' post-merger combined credit profiles by increasing liquidity, (2) establishing broader/more diversified banking relationships, and (3) providing access to committed funds that will afford greater short-term financial flexibility.

As noted in the joint application for merger filed by AEPCO and SWTC, the Cooperatives are seeking to transition from an historical reliance on mortgage-based, federally-funded financing provided by the Rural Utilities Service ("RUS"), to a broader base of financing secured under an Indenture.⁴ In making this transition, the Cooperatives must obtain an investment grade credit rating from two credit rating agencies, with liquidity being one factor considered by the rating agencies.⁵

Liquidity is measured by comparing operating expenses to cash and cash equivalents, plus available committed lines of credit and commercial paper. For a rated generation and transmission cooperative, the median liquidity coverage ratio is more than 200 days. Although AEPCO currently maintains a short-term, uncommitted LOC, that uncommitted LOC does not count towards meeting this liquidity calculation. Consequently, AEPCO's current liquidity is estimated at only 65 days, far short of the target 200-day mark needed to obtain an investment grade credit rating. The committed revolving LOCs requested in the Application will, however, count towards this liquidity calculation, thus assisting AEPCO to qualify for an investment grade credit rating. In turn, the credit rating is essential to obtaining the Indenture and to the pricing of AEPCO's future short-term and long-term debt financings.

² Docket No.E-01773A-12-0305.

³ Docket No.E-01773A-00-0826.

⁴ See AEPCO and SWTC Joint Application (Docket Nos. E-01773A-14-0018 and E-04100A-14-0018), pp. 4-5.

⁵ *Ibid*, p. 5, footnote 2.

The requested, combined \$100 million committed LOC amount is based on AEPCO's analysis of its post-merger credit and interim financing needs. Upon closing these LOCs, AEPCO will immediately terminate its current short-term, uncommitted line of credit. Going forward, AEPCO plans to use the committed LOCs to provide interim financing until permanent long-term financing can be obtained for future capital projects.

DESCRIPTION OF PROPOSED FINANCING

The application requests authorization to obtain two unsecured committed revolving LOCs in the combined amount of \$100 million. The LOCs will be provided by the National Rural utilities Cooperative Finance Corporation ("CFC") and CoBank, each with a \$50 million commitment. The facilities will terminate five years from closing and draws made under the facilities may be voluntarily prepaid and redrawn at any time prior to the termination date. The facility from CFC includes a renewal option for up to two one-year extensions, subject to the consent of CFC. CFC requires that AEPCO maintain a times interest ratio ("TIER") of 1.10. Both CFC and CoBank assess an annual facility fee based on their respective \$50 million credit facility commitment to AEPCO.

The interest rate on LOCs borrowings and the facility fee to be assessed by CFC and CoBank will depend on the credit rating assigned AEPCO by the rating agencies (i.e., S&P, Fitch or Moody's), with interest rates to be calculated based on London Interbank Offered Rate ("LIBOR") plus a margin. Based upon the credit ratings that AEPCO received and the maturity length of the LIBOR loan draw (i.e., 3-month, 6-month or 12 month), interest rates could range from 1.08 percent to 1.81 percent per annum based upon current LIBOR rates.

FINANCIAL ANALYSIS

Staff's analysis is illustrated on Schedule PNT-1. Column [A] reflects the Cooperative's historical financial information for the year ended December 31, 2012. Column [B] represents pro forma financial information that modifies Column [A] to reflect the repayment of principal associated with a capital lease obligation.

Capital Structure

As of December 31, 2012, AEPCO's capital structure consisted of 5.5 percent short-term debt, 60.4 percent long-term debt, and 34.1 percent equity. Authorization of the proposed unsecured committed revolving LOCs will not affect AEPCO's capital structure until the Cooperative makes a draw upon the facilities.

Debt Service Coverage ratio ("DSC")

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 may be needed to avoid default under certain conditions.

Schedule PNT-1, column [A] shows that for the year ended December 31, 2012, AEPCO's DSC was 1.39. The pro forma DSC for the Cooperative under the scenario described above for Column [B] is 1.29. The pro forma DSC results show AEPCO has sufficient funds to meet all debt obligations and meets the minimum 1.0 DSC covenant required by CFC.

Times Interest Earned Ratio ("TIER")

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

Schedule PNT-1, column [A] shows that for the year ended December 31, 2012, AEPCO's TIER was 1.71. The pro forma TIER for the Cooperative under the scenario described above for Column [B] is 1.71. The pro forma TIER results show the Cooperative has sufficient funds to meet all debt obligations, and meets the minimum 1.1 TIER covenant required by CoBank.

Encumbrance

A.R.S. § 40-285 requires public service corporations to obtain Commission authorization to encumber certain utility assets. The statute serves to protect captive customers from a utility's act to dispose of any of its assets that are necessary for the provision of service, thus, it serves to preempt any service impairment due to disposal of assets essential for providing service. Pledging assets as security typically provides benefits to the borrower in the way of increased access to capital funds or preferable interest rates, and it is often an unavoidable condition for procurement of funds for small or financially stressed entities. In the instant docket, the proposed committed revolving LOCs are *unsecured*; thus, encumbrance of AEPCO's assets and revenues is not required.

CONCLUSION AND RECOMMENDATIONS

Staff concludes that issuance of the two proposed unsecured, committed revolving lines of credit for the purposes stated in the application is within AEPCO's corporate powers, is compatible with the public interest, is consistent with sound financial practices and will not impair its ability to provide services.

Staff recommends authorization of AEPCO's request to enter into two unsecured committed lines of credit in an amount not to exceed \$100 million in the aggregate.

Staff further recommends the following:

- Authorizing AEPCO to engage in any transaction and to execute any documents necessary to effectuate the authorization herein granted.
- That AEPCO provide to the Utilities Division Director, a copy of the loan documents executed pursuant to the authorizations granted herein, within 30 days of the execution of the loan, and also file a letter in Docket Control verifying that such documents have been provided to the Utilities Division.
- That any unused authorizations to issue debt granted in this proceeding terminate within five and a half years of a decision in this docket.

FINANCIAL ANALYSIS

Selected Financial Information

	[A] ¹ <u>12/31/2012</u>		[B] ² <u>Pro Forma</u>	
1	Operating Income	\$ 16,295,960	\$ 16,295,960	
2	Depreciation & Amort.	10,345,165	10,345,165	
3	Income Tax Expense	0	0	
4				
5	Interest Expense	9,514,518	9,514,518	
6	Repayment of Principal	9,589,123	11,077,233	
7				
8				
9	TIER			
10	[1] ÷ [5]	1.71	1.71	
11				
12				
13	DSC			
14	[1+2+3] ÷ [5+6]	1.39	1.29	
15				
16				
17	Capital Structure			
18				
19	Short-term Debt	16,146,221 ³	16,146,221	5.5%
20				
21	Long-term Debt	177,652,240	177,652,240	60.4%
22				
23	Common Equity	100,376,057	100,376,057	34.1%
24				
25	Total Capital	\$ 294,174,518	\$ 294,174,518	100.0%
26				

¹ Column [A] is based on audited financial information for the year ended December 31, 2012.

² Column [B] is column [A] modified to reflect the repayment of principal associated with capital lease obligation.

³ Member advances and other investments, current maturities of long-term debt and capital lease obligation.



Email: mmg@gknet.com

G|K
Gallagher&Kennedy

February 28, 2014

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AZ CORP COMMISSION
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HAND DELIVERED

ORIGINAL

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

Re: *Affidavits of Publication; AEPSCO Lines of Credit Application;*
Docket No. E-01773A-14-0019

Dear Sir or Madam:

Enclosed are the original and 13 copies of the Affidavits of Publication confirming published notice in this matter in the *Arizona Daily Star* and the *Kingman Daily Miner*. Your assistance in relation to this matter is appreciated.

Arizona Corporation Commission

DOCKETED

FEB 28 2014

DOCKETED BY

Very truly yours,

GALLAGHER & KENNEDY, P.A.

By: Michael M. Grant

MMG/plp
10421-69/4037033
Enclosures

cc w/enclosures (delivered): Phan Tsan, Utilities Division
Margaret "Toby" Little, Utilities Division
Wes Van Cleve, Legal Division

Original and 13 copies filed with Docket Control this 28th day of February, 2014.

ARIZONA DAILY STAR

Tucson, Arizona

STATE OF ARIZONA)
COUNTY OF PIMA)

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

Legal Notice

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

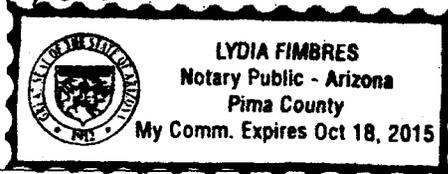
FEBRUARY 25, 2014

Debbie Capanear

Subscribed and sworn to before me this 26 day of

February, 2014

Lydia Fimbres
Notary Public



My commission expires _____

AD NO. 8174053

**PUBLIC NOTICE
OF AN APPLICATION FOR AN
ORDER AUTHORIZING THE
ARIZONA ELECTRIC POWER
COOPERATIVE, INC.
TO OBTAIN TWO COMMITTED
REVOLVING LINES OF CREDIT**

The Arizona Electric Power Cooperative, Inc. ("AEP CO") has filed an Application with the Arizona Corporation Commission for an order authorizing it to obtain two committed revolving lines of credit in the combined amount of \$100 million (Docket No. E-01773A-14-0019). The application is available for inspection during regular business hours at the office of the Commission in Phoenix, Arizona, and AEP CO's offices at 1099 South Highway 80, Benson, Arizona 85602. It may also be viewed on the Commission's website at www.azcc.gov using the e-Docket function, located at the bottom of the website home page.

Intervention in the Commission's proceedings on the application shall be permitted to any person entitled by law to intervene and having a direct substantial interest in this matter. Persons desiring to intervene with the Commission which must be served upon AEP CO and which, at a minimum, shall contain the following information:

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

The granting of Motions to Intervene shall be governed by A.A.C. R14-3-105, except that all Motions to Intervene must be filed on, or before, the 15th day after publication of this Notice.

Publish February 25, 2014
Arizona Daily Star

AFFIDAVIT OF PUBLICATION

Kingman Daily Miner

3015 Stockton Hill Road, Kingman, AZ 86401

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

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

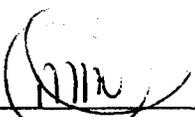
"Serving Kingman since 1882"

STATE OF ARIZONA)
County of Mohave) ss.

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

Public Notice
Ad. No. 358289

Has, to the personal knowledge of affiant, **25th day of February, 2014**
to the **25th day of February, 2014** inclusive without change, interruption or
omission, amounting in **1** insertions, made on the following dates:
2/25/2014

By: 
Legal Clerk, 25th Day of February, 2014

State of Arizona

County of Mohave

On this 25 day of February, 2014

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



Notary Public
My Commission Expires May 24, 2014

PUBLIC NOTICE
OF
AN APPLICATION FOR AN ORDER
AUTHORIZING THE ARIZONA ELECTRIC
POWER COOPERATIVE, INC.
TO OBTAIN TWO COMMITTED REVOLVING
LINES OF CREDIT

The Arizona Electric Power Cooperative, Inc. ("AEPCCO") has filed an Application with the Arizona Corporation Commission for an order authorizing it to obtain two committed revolving lines of credit in the combined amount of \$100 million (Docket No. E-01773A-14-0018). The application is available for inspection during regular business hours at the office of the Commission in Phoenix, Arizona, and AEPCCO's offices at 1000 South Highway 80, Benson, Arizona 85802. It may also be viewed on the Commission's website at www.azcc.gov using the e-Docket function, located at the bottom of the website home page.

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

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Published: 2/25/2014
Ad. No.

