BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

BOB STUMP - Chairman
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH

IN THE MATTER OF THE APPLICATION OF ARIZONA ELECTRIC POWER COOPERATIVE, INC. FOR AUTHORIZATION TO OBTAIN TWO COMMITTED REVOLVING LINES OF CREDIT.

DOCKET NO. E-01773A-14-0019

DECISION NO. 74447

ORDER

Open Meeting
April 8 and 9, 2014
Phoenix, Arizona

BY THE COMMISSION:

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

FINDINGS OF FACT

Procedural History

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

2. Simultaneously, in a related Docket, AEPCO and Southwest Transmission Cooperative, Inc. ("SWTC") (collectively "Cooperatives") 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.[1]

[1] Docket Nos. E-01773A-14-0018 and E-04100A-14-0018 ("Merger Docket").

3. On February 12, 2014, AEPCO filed a Request for Expedited Processing, in which AEPCO states that it learned after filing its Application that the rating agencies are unlikely to consider the proposed LOCs in calculating the Cooperatives' liquidity unless the Commission approves the Application. Thus, AEPCO requests that the Commission expedite the instant docket so that the LOCs can be considered in advance of the Merger Docket, at the Commission's April 2014 Open Meeting. Given its request, AEPCO agreed to waive the 10-day period for filing exceptions to a Recommended Order in this matter.

4. On February 28, 2014, AEPCO filed an affidavit of publication verifying public notice of its Application was published in *The Arizona Daily Star* and *The Kingman Daily Miner* on February 25, 2014.[2]

5. On March 14, 2014, the Commission's Utilities Division ("Staff") filed its Staff Report recommending approval of the requested authorization.

6. On March 21, 2014, AEPCO filed Comments on Staff Report, noting three clarifications to Staff's observations and recommendations.

Background

7. AEPCO is an Arizona public service corporation and 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 Cooperative, 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. In addition, 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 under which AEPCO provides scheduling and trading services as well as economy energy purchases.

8. AEPCO's current rates were approved in Decision No. 74173 (October 25, 2013).

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[2] *The Arizona Daily Star* is a newspaper of general circulation in Pima County, Arizona, and *The Kingman Daily Miner* is a newspaper of general circulation in the City of Kingman, Mohave County, Arizona.

9. SWTC was formed as a not-for-profit transmission-only cooperative as part of a restructuring undertaken by AEPCO in the late 1990s and the early 2000s. The Commission approved the restructuring in Decision No. 63868 (July 25, 2001), and authorized the transfer of AEPCO's transmission assets and the transmission portion of AEPCO's Certificate of Convenience and Necessity ("CC&N") to SWTC. In the Merger Docket, the Cooperatives would be re-united with AEPCO as the surviving entity.

10. The Staff Report indicates that AEPCO is currently in compliance with Commission Rules and Orders.[3]

The Application

11. This 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 on the facilities may be voluntarily prepaid and redrawn at any time prior to the termination date.

12. The facility from CFC includes a renewal option for up to two one-year extensions, subject to the consent of CFC. CoBank requires that AEPCO maintain a times interest earned ratio ("TIER") of 1.10, and CFC requires a Debt Service Coverage ("DSC") ratio of at least 1.0. Both the CFC and CoBank assess an annual facility fee based on their respective $50 million credit facility commitment.

13. The interest rate on the 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. Interest rates are to be calculated based on London Interbank Offered Rate ("LIBOR") plus a margin. According to the Staff Report, based upon the credit ratings that AEPCO receives 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.

14. In the Application, AEPCO states that the Cooperatives are seeking to enhance and

[3] Staff Report at 1.

expedite their access to a broader base of private and public loan funds, at the lowest available cost, in order to finance necessary generation and transmission projects as well as to improve their ability to meet future electricity supply and delivery challenges.[4] AEPCO asserts that the proposed LOCs further those goals by (1) improving AEPCO's and the Cooperatives' post-merger combined credit profiles, (2) establishing broader, more diversified banking relationships, and (3) providing access to committed funds that will afford greater short-term financial flexibility. AEPCO anticipates that the interest rates under these LOCs will be lower than AEPCO's current financing rates.

15. In the Merger Docket, AEPCO and SWTC seek to transition from an historic reliance on mortgage-based, federally-funded financing provided by the Rural Utilities Service ("RUS") to a broader base of financing secured under an Indenture.[5] To make this transition, the Cooperatives assert that they must obtain an investment grade credit rating from two credit rating agencies, with liquidity being one factor to be considered in that process.[6]

16. AEPCO asserts that the LOCs will help improve AEPCO's credit profile by increasing its liquidity. According to AEPCO, the median liquidity coverage ratio for a rated generation and transmission cooperative is more than 200 days.[7] AEPCO states that the short-term uncommitted line of credit which AEPCO currently maintains does not count toward meeting this liquidity calculation, and as a result, AEPCO's current liquidity is estimated at only 65 days. AEPCO states that because the committed LOCs will count towards the liquidity calculation, these facilities will help qualify AEPCO for an investment grade credit rating. AEPCO further states that having an investment grade credit rating is essential to obtaining the Indenture it seeks and to the pricing of AEPCO's future short-term and long-term debt financings.

17. In its Application, AEPCO states that in addition to addressing liquidity, the combined amount of the LOCs is based on AEPCO's analysis of its post-merger credit and interim financing needs. Upon closing these LOCs, AEPCO states that it will immediately terminate its current short-term, uncommitted line of credit, and in the future will use the committed LOCs to provide interim

[4] Application at 2.
[5] Docket Nos. E-01773A-14-0018 and E-04100A-14-0018, at 4-5.
[6] Staff Report at 2.
[7] Liquidity is measured by comparing operating expenses to cash and cash equivalents plus available committed lines of credit and commercial paper.

financing until permanent long-term financing for future capital projects is obtained.

18. Given the connection between the LOCs and the Indenture sought in the Merger Docket, AEPCO requests that the Commission approve the LOC Application prior to considering the Merger Docket. AEPCO anticipates that early approval of the instant Application will result in more favorable financing terms, and thus, requested approval as soon as possible.[8]

Staff Analysis and Recommendations

19. Staff performed a financial analysis based on financial information for the year ended December 31, 2012.

20. 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. Staff notes that authorization of the proposed unsecured committed revolving LOCs will not affect AEPCO's capital structure until the Cooperative draws upon the facilities.

21. Staff's analysis indicates that for the year ended December 31, 2012, AEPCO's DSC was 1.39.[9] The pro forma DSC, assuming the repayment of principal associated with a capital lease obligation, indicates a DSC of 1.29.[10] Staff concludes that the pro forma DSC analysis shows that AEPCO has sufficient funds to meet all debt obligations and meets the minimum 1.0 DSC covenant required by CFC.

22. Staff's analysis shows that for the year ended December 31, 2012, AEPCO's TIER was 1.71.[11] The pro forma TIER, assuming the repayment of the principal on a capital lease, shows a TIER of 1.71. Staff concludes that the pro forma TIER analysis shows that AEPCO has sufficient funds to meet all debt obligations and meets the minimum 1.1 TIER covenant required by CoBank.

23. The proposed LOCs are unsecured, and as such do not require the encumbrance of AEPCO's assets or revenues.

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[8] Application at 3.

[9] 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.

[10] Staff Report at 4.

[11] TIER represents the number of times operating earnings over 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.

24. Staff concludes that the issuance of the two proposed unsecured, committed revolving LOCs 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.[12]

25. Staff recommends authorizing AEPCO's request to enter into two unsecured committed LOCs in an amount not to exceed $100 million in the aggregate. Staff further recommends:

(a) Authorizing AEPCO to engage in any transactions and to execute any documents necessary to effectuate the authorization granted in this proceeding;

(b) That AEPCO provide to the Utilities Division Director, a copy of the loan documents executed pursuant to the authorizations granted in this proceeding, 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; and

(c) That any unused authorizations to issue debt granted in this proceeding terminate within five and a half years of a Decision in this docket.

26. In its March 21, 2014 Comments to the Staff Report, AEPCO notes that the CFC line of credit terminates five years from closing, but also includes a renewal option for up to two one-year terms, as Staff recognizes in the Staff Report. With respect to Staff's recommendation that any unused authority terminate within five-and-a-half years, AEPCO states its understanding that approval of the LOCs would include use of the renewal option, such that the 5.5 year termination recommendation would not preclude exercise of the CFC option to renew. AEPCO request clarification of that point in the Order.[13]

Conclusion

27. The proposed LOCs are necessary to augment AEPCO's liquidity which will place it in a position to obtain an investment grade rating and allow it a better opportunity to take advantage of other diverse and fiscally-attractive financing opportunities. Based on AEPCO's and Staff's

[12] Staff Report at 4.
[13] AEPCO Comments at 2.

analyses, and the lenders' loan covenants requiring a minimum DSC and TIER, we find that AEPCO's request, and Staff's recommendations to be reasonable, and we approve them.

CONCLUSIONS OF LAW

1. AEPCO 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 AEPCO and of the subject matter of the Application.

3. Notice of the Application was given in accordance with the law.

4. The authorizations granted herein are for lawful purposes which are within the corporate powers of AEPCO, are compatible with the public interest, with sound financial practices, and with the proper performance by AEPCO of service as a public service corporation, and will not impair AEPCO's ability to perform that service.

5. The financing approved herein is for the purposes stated in the Application, and is reasonably necessary for those purposes.

ORDER

IT IS THEREFORE ORDERED that Arizona Electric Power Cooperative, Inc. is hereby authorized to borrow up to a combined amount of $100,000,000, from the National Rural Utilities Cooperative Finance Corporation and CoBank in the form of unsecured committed revolving lines of credit.

IT IS FURTHER ORDERED that such finance authority shall be expressly contingent upon Arizona Electric Power Cooperative, Inc.'s use of the proceeds for the purposes stated in its Application and approved herein.

IT IS FURTHER ODRERED that any unused authority granted herein shall expire five and one half years from the effective date of this Decision, except that this condition shall not prevent Arizona Electric Power Cooperative, Inc. from exercising the two one-year renewal options offered pursuant to the terms of the National Rural Utilities Cooperative Finance Corporation line of credit.

IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. may engage in any transaction and to execute any documents necessary to effectuate the authorizations granted herein.

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 Arizona Electric Power Cooperative, Inc. shall provide the Utilities Division Director a copy of any loan documents executed pursuant to the authorizations granted herein, within 30 days of the execution of the loan, and shall file with Docket Control, as a compliance item in this Docket, a letter verifying that such documents have been provided to the Utilities Division.

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, JODI JERICH, 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 18th day of April 2014.

JODI JERICH
EXECUTIVE DIRECTOR

DISSENT ____________________

DISSENT ____________________

JR:ru

DECISION NO. 74447

SERVICE LIST FOR: ARIZONA ELECTRIC POWER COOPERATIVE, INC.

DOCKET NO.: E-01773A-14-0019

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