

RENZ D. JENNINGS
CHAIRMAN

MARCIA WEEKS
COMMISSIONER

CARL J. KUNASEK
COMMISSIONER



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JAMES MATTHEWS
EXECUTIVE SECRETARY

ARIZONA CORPORATION COMMISSION

DATE: June 14, 1996

DOCKET NO: U-2044-96-259

TO ALL PARTIES:

Enclosed please find the recommendation of Hearing Officer Jane L. Rodda. The recommendation has been filed in the form of an Order on:

Dixie-Escalante Rural Electric Association (Financing)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Hearing Officer by filing an original and ten (10) copies of the exceptions with the Commission's Docket Control at the address listed below by 5:00 p.m. on or before:

June 24, 1996

The enclosed is NOT an order of the Commission, but a recommendation of the Hearing Officer to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Working Session and Open Meeting to be held on:

June 25, 1996 and June 26, 1996

For more information, you may contact Docket Control at (602)542-3477 or the Hearing Division at (602)542-4250.


James Matthews
EXECUTIVE SECRETARY

JM
Enc.
cc: ALL PARTIES

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 RENZ D. JENNINGS
CHAIRMAN
3 MARCIA WEEKS
COMMISSIONER
4 CARL J. KUNASEK
COMMISSIONER

5 IN THE MATTER OF THE APPLICATION OF)
6 DIXIE-ESCALANTE RURAL ELECTRIC)
7 ASSOCIATION FOR APPROVAL TO BORROW)
FUNDS AND GRANT LIENS IN ITS)
PROPERTY.)
8 _____)

DOCKET NO. U-2044-96-259
DECISION NO. _____

ORDER

9 Open Meeting
June 26, 1995
10 Phoenix, Arizona

11 **BY THE COMMISSION:**

12 On April 30, 1996, Dixie-Escalante Rural Electric Association, Inc. ("Dixie," "Cooperative" or
13 "Applicant") filed an application with the Arizona Corporation Commission ("Commission") for
14 approval to borrow funds and grant liens on its property. Dixie seeks approval to borrow \$2,500,000
15 from the National Rural Utilities Cooperative Finance Corporation ("CFC") to refinance a loan from the
16 Rural Utility Services of the United States Department of Agriculture ("RUS"); to borrow \$12,500,000
17 from CFC to loan to Deseret Generation & Transmission Co-operative, Inc. ("Deseret") to support a
18 restructuring of Deseret's debt; and approval of a \$2.0 million line of credit from CFC to replace a line
19 of credit from a local bank. The Arizona Corporation Commission ("Commission") Utilities Division
20 Staff ("Staff") filed its Staff Report on June 7, 1996 and recommended approval of the application
21 without a hearing.¹

22 Dixie is a Utah, non-profit cooperative association which supplies electric power to its members
23 in Utah and Arizona. Dixie has approximately 5,200 members of which about 600 reside in the extreme
24 northwest corner of Arizona in and around the town of Littlefield. Dixie is managed by a Board of
25 _____

26 ¹ Dixie has requested expedited handling of this application and a final decision before the
27 end of June, 1996 because of a purported July 1, 1996 deadline associated with the proposed
28 restructuring. The proposed restructuring requires that all of Deseret's members participate. Thus, in
addition to the current application, we consider at the same time the application of Garkane Power
Association Inc. to approve financing associated with the same transaction (Docket No. U-1891-96-258).

1 Directors which is elected by its member-owners.

2 Dixie is a member of Deseret, a Utah nonprofit cooperative corporation which supplies power to
3 Dixie and five other rural distribution cooperatives. Through its member cooperatives, Deseret supplies
4 power to approximately 36,000 customers, the vast majority of which reside in Utah. In 1995, Dixie
5 purchased approximately 16.0 percent of its power from Deseret.

6 For several years Deseret has encountered severe financial difficulties. In 1985, Deseret
7 constructed its 400 MW Bonanza power plant at Vernal, Utah. Deseret sold the plant and leased it back
8 from Shell Oil Leasing. When the plant first came into service it had approximately 75 percent excess
9 capacity and a substantial portion remains excess capacity to this day. In 1990 Deseret was forced to
10 restructure its debt obligations, but the restructuring was not successful and Deseret continues to suffer
11 large financial losses. In 1995, Deseret experienced a net margin of a negative \$73.0 million. As of
12 December 31, 1995, Deseret had long-term debt obligations of \$1.3 billion of which approximately
13 \$650.0 million was owed to RUS.

14 RUS and CFC have agreed in concept to a general restructuring of Deseret's obligations,
15 predicated in part upon willingness of Deseret's members, including Dixie, to become directly involved
16 in a long-term solution to Deseret's financial problems. Under the proposed restructuring, RUS is willing
17 to accept \$250 million to compromise more than \$650 million owed to it by Deseret. CFC will lend
18 Deseret \$195 million of the \$250 million it needs to buy down the RUS debt. Deseret's members,
19 including Dixie, will lend Deseret the remaining \$55 million. Dixie's share of the \$55 million is \$12.5
20 million, which funds it will obtain from the proceeds of a loan from the CFC ("Member Compromise
21 Loan"). Dixie and the other members will receive an assignment of Deseret's existing wholesale power
22 contracts and security interests in Deseret's assets.² The Member Compromise Loan will be amortized
23 over a period not to exceed 30 years, will bear interest at a competitive interest rate to be established at
24 closing and will be secured by a lien and security interest in Dixie's assets.

25 As another condition of the restructuring plan, RUS is requiring each Deseret member to pay off
26

27 ² It is the intent of the parties that Dixie receive sufficient cash flow from Deseret to service
28 the Member Compromise Loan and the effect of the Member Compromise Loan will be revenue neutral
for Dixie.

1 its existing RUS debt. Consequently, Dixie seeks authority to borrow \$2.5 million from CFC to
2 refinance its existing RUS debt of approximately \$2.85 million ("Refinance Loan"). Dixie will refinance
3 its RUS debt over the course of approximately one year in a manner that will enable Dixie to preserve
4 its tax-exempt status and to take advantage of RUS regulations that offer pre-payment discounts. Dixie
5 must, however, commit not to seek RUS loans in the future and as a result will be losing a low cost
6 lender. The Refinance Loan likely will have a higher interest rate than the existing RUS debt which
7 currently bears interest rates of 2 and 5 percent. The interest rate on the Refinance Loan will be set at
8 a market rate of interest at the time of closing and will depend on whether Dixie chooses a fixed or
9 variable interest rate.³ Based upon an estimated interest rate of 7 percent, Staff estimated Dixie's annual
10 interest expense would increase by \$55,938, from \$154,920 to \$210,858 as a result of the Refinance
11 Loan.

12 As of the date of the Staff Report none of the agreements between and among the parties included
13 in the restructuring had been finalized. The CFC loans to Deseret and its members are contingent upon
14 the completion of three other transactions: 1) Deseret must have a new coal contract with Western Fuels-
15 Utah Inc. ("WFU") at market rates; 2) it must have a marketing agreement with a third party; and 3) all
16 regulatory approvals must be received. Deseret expects all conditions to be met by the end of June. As
17 of the filing of the Staff Report, Wyoming and Utah had held informal hearings but had not produced a
18 final decision⁴. Neither had an agreement with WFU been finalized.

19 If the restructuring is successful, Dixie and the other Deseret members will be subject to a new
20 power contract with Deseret. Currently, Deseret's power contract with its members includes a premium
21 for new load which has served as a disincentive for the members to pursue or acquire new loads. The
22 contract also specifies that the members must pay rates to Deseret set at a level that allows Deseret to pay
23 all of its expenses and meet its debt service obligations (although Deseret has not strictly enforced the
24 latter provision). The new contract will institute reduced rates for load growth and will set rates based
25

26 ³ As of June 11, 1996, the fixed interest rate was 8.2 percent per annum and the variable
27 interest rate was 6.2 percent per annum.

28 ⁴ On June 14, 1996, the Utah Division of Public Utilities filed a Staff Memorandum
recommending approval of the agreements.

1 on Deseret's costs of production, eliminating the provision that requires members to pay rates sufficient
2 to meet Deseret's debt service costs. The new contract also includes new lower rates to members who
3 agree to pool their power resources with Deseret. Dixie estimates that its average cost of power (from
4 all sources, including Deseret) will increase after the restructuring and new power contract from \$0.0312
5 per kWh to \$0.0318 per kWh. Dixie and the other members will receive, however, the advantage of a
6 \$0.026 per kWh incremental rate for new loads. We note that the benefit of the reduced rate for new load
7 is only a benefit if Dixie is able to acquire new members.

8 As of December 31, 1995, Dixie's capital structure consisted of 33.0 percent long-term debt. The
9 effect of the Member Compromise Loan and Refinance Loan is to increase Dixie's long-term debt to 69.1
10 percent of total capital as of December 31, 1995. Although it is a significant increase, it is not uncommon
11 for electric distribution cooperatives to be highly leveraged.

12 The effect on Dixie's cash flow of the Refinance Loan's higher interest rate is substantial, but
13 would still leave Dixie with a Time Interest Earned Ratio ("TIER") and Debt Service Coverage ("DSC")
14 of 3.28 and 4.56, respectively. If the restructuring is successful, Deseret will make payments of Dixie
15 on account of the Member Compromise Loan in amounts sufficient to cover Dixie's debt service to the
16 CFC. If, however, Deseret is not able to make anticipated interest and principal payments, Dixie's TIER
17 and DSC drop to 0.64 and 0.93, respectively.

18 We recognize and are concerned that under the proposed financing Dixie will be taking financial
19 risks to facilitate the survival of Deseret. If Deseret is unable to make the anticipated debt service
20 payments to Dixie, Dixie will have to shoulder the costs of the \$12.5 million loan. Further, Dixie will
21 be paying a higher interest rate on account of the Refinance Loan and a higher rate for its power. The
22 benefits of the restructuring are that Dixie will receive lower rates for new loads, will be relieved of a
23 potentially onerous provision in the current supply contract and the likelihood of a Deseret bankruptcy
24 would be reduced. The probable impact of Deseret's bankruptcy on Dixie and its members is not known
25 with certainty but is potentially far more severe than the risks associated with our approving Dixie's
26 increased debt, especially if a bankruptcy court were to enforce the provision of the current power supply
27 contract that requires Deseret's members to pay rates that cover all of Deseret's debt costs. It is with
28 these unknown and potentially severe risks in mind that we approve Dixie's application subject to several

1 conditions.

2 Dixie has requested expedited handling of this application because it purports that RUS' offer to
3 compromise is open only until July 1, 1996. As of the date of the Staff Report many of the terms of the
4 restructuring had not been finalized. Further, although Dixie did meet with Staff prior to filing its
5 application on April 30, 1996, Staff's opportunity to analyze the financial projections Dixie provided has
6 been limited because many of the terms of the restructuring are not yet finalized and they could change
7 significantly before closing. Consequently, Staff recommended that we rescind our approval if
8 restructuring is not finalized within 120 days from the date of this Decision. We agree with Staff, except
9 that we believe that based on the July 1, 1996 deadline, the final terms of the restructuring should be
10 known by July 31, 1996. Consequently, we will condition our approval upon Dixie filing a letter or other
11 statement with the Commission providing the details of the final restructuring no later than July 31, 1996.

12 As previously noted, we do have some reservations regarding what appears to be a "bail out" of
13 Deseret by its members. However, those concerns are somewhat ameliorated by the assertions that
14 Deseret would provide the monies to service the Member Compromise Loans. With that understanding,
15 we want the Applicant to be aware that if there is any request for a rate increase as a result of the loans
16 approved here, the burden will be on the Applicant to clearly demonstrate that the overall benefits are
17 greater than the overall costs. As a result, Dixie may have to reduce other costs in order to maintain its
18 own financial viability.

19 FINDINGS OF FACT

20 1. Dixie is an Utah nonprofit cooperative association providing electric utility service to the
21 public in Mohave County, Arizona, pursuant to authority granted by the Commission.

22 2. Dixie is a member of Deseret, a Utah nonprofit cooperative corporation which supplies
23 power to Dixie and five other rural distribution cooperatives. Through its member cooperatives, Deseret
24 supplies power to approximately 36,000 customers, the vast majority of which reside in Utah.

25 3. For several years Deseret has faced severe financial difficulties. Since late 1994, Deseret
26 and its members, including Garkane, have engaged in extensive negotiations regarding debt restructuring
27 with RUS and CFC, Deseret's major creditors. The RUS and CFC have agreed in concept to a general
28 restructuring of Deseret's obligations, which requires Deseret's members, including Dixie to refinance

1 their RUS debt and to participate with CFC in compromising Deseret's RUS debt.

2 4. On April 30, 1996, Dixie filed with the Commission an application requesting approval
3 to borrow funds and to grant liens in its assets in order to participate in the financial restructuring of
4 Deseret. Dixie seeks to borrow \$2.5 million from CFC to refinance its existing debt with RUS of
5 approximately \$2.86 million; to borrow an additional \$12.5 million from the CFC which Dixie would
6 then reloan to Deseret as Dixie's share of the restructuring of Deseret's debt; and to replace a \$2.0 million
7 revolving line of credit from a local bank with a line of credit for the same amount from the CFC.

8 5. On May 15, 1996, Dixie provided notice of the application to its customers.

9 6. Pursuant to the terms of the financing, Dixie's loans from the CFC will be amortized over
10 a period not to exceed 30 years and will bear interest at rates equal to CFC's standard loan program rates
11 established at the time of closing. Dixie will grant CFC a lien and security interest against substantially
12 all of its assets to secure the loans.

13 7. The proceeds of the financing will be utilized to effectuate a restructuring of Deseret's
14 debt pursuant to conditions established by RUS and CFC. Under the terms of the restructuring Dixie
15 would loan the \$12.5 million it borrowed from the CFC to Deseret and would receive periodic payments
16 from Deseret in amounts sufficient to cover Dixie's interest and principal repayment obligations to the
17 CFC. Deseret would also assign to Dixie an interest in its existing wholesale power contracts and grant
18 Dixie a lien and security interest in certain Deseret assets.

19 8. On June 7, 1996, Staff filed its Staff Report in this matter recommending that the
20 application be approved without a hearing.

21 9. Staff has reviewed the intended uses of the proceeds of the financing, and found them to
22 be appropriate.

23 10. In addition to recommending approval of the application, Staff recommends that: (a) the
24 Commission rescind approval granted herein in the event the Deseret restructuring is not finalized within
25 120 days of the date of this Decision; and (b) that the Commission notify Dixie that approval of the
26 proposed financing does not obligate the Commission to pass on any of the costs related to the
27 restructuring or the new power contract to Dixie's Arizona rate payers in a future rate case.

28 11. Staff's recommendations, as set forth in Finding of Fact No. 10, are reasonable.

CONCLUSIONS OF LAW

1
2 1. Applicant is a public service corporation within the meaning of Article XV of the Arizona
3 Constitution and A.R.S. §§40-301 and 40-302.

4 2. The Commission has jurisdiction over Applicant and the subject matter of the application.

5 3. Applicant caused notice of its application in this matter to be duly published.

6 4. Staff's recommendations, as set forth in Finding of Fact No. 10 as well as those delineated
7 below, should be adopted.

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

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

15 **ORDER**

16 IT IS THEREFORE ORDERED that Dixie-Escalante Rural Electric Association Inc. is hereby
17 authorized to refinance through the National Rural Utilities Cooperative Finance Corporation its
18 outstanding Rural Utilities Service's debt in the amount of \$2.85 million on the terms and conditions set
19 forth in Finding of Fact No. 6, borrow an additional \$12.5 million from the National Rural Utilities
20 Cooperative Finance Corporation on the terms and conditions set forth in Finding of Fact No. 6, and to
21 obtain a \$2.0 million line of credit from the National Rural Utilities Cooperative Finance Corporation.

22 IT IS FURTHER ORDERED that Dixie-Escalante Rural Electric Association Inc. is authorized
23 to grant liens in its asset and enter into one or more security agreements as part of the issuance of the
24 debt.

25 IT IS FURTHER ORDERED that Dixie-Escalante Rural Electric Association Inc. is hereby
26 authorized to engage in any transactions and to execute any documents necessary to effectuate the
27 authorization granted hereinabove.

28 IT IS FURTHER ORDERED that such authority shall be expressly contingent upon Dixie-

1 Escalante Rural Electric Association Inc.'s use of the proceeds for the purposes set forth in the
2 application.

3 IT IS FURTHER ORDERED that such authority is expressly conditioned upon Dixie-Escalante
4 Rural Electric Association Inc. submitting the final terms of the restructure agreement to the Commission
5 no later than July 31, 1996 and Deseret Generation & Transmission Co-operative, Inc. completing the
6 proposed debt restructure no later than 120 days from the date of this Decision.

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

10 IT IS FURTHER ORDERED that at its next rate case, Dixie-Escalante Rural Electric Association
11 Inc. shall have the burden to clearly demonstrate that the overall benefits of the loans approved herein
12 are greater than the overall costs.

13 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

14 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

15
16 CHAIRMAN

COMMISSIONER

COMMISSIONER

17
18 IN WITNESS WHEREOF, I, JAMES MATTHEWS, Executive Secretary of the
19 Arizona Corporation Commission, have hereunto set my hand and caused the
20 official seal of the Commission to be affixed at the Capitol, in the City of
Phoenix, this ____ day of _____, 1996.

21 _____
22 JAMES MATTHEWS
EXECUTIVE SECRETARY

23 DISSENT _____
24 JR/kjh

1 SERVICE LIST FOR: DIXIE-ESCALANTE RURAL ELECTRIC ASSOCIATION, INC.

2 DOCKET NO.: U-2044-96-259

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