

ORIGINAL

OPEN MEETING



MEMORANDUM

Arizona Corporation Commission

DOCKETED

NOV 30 2016

**AZ CORP COMMISSION
DOCKET CONTROL**

2016 NOV 30 A 9 35

TO: THE COMMISSION

FROM: Utilities Division

DATE: November 29, 2016

DOCKETED BY

RE: IN THE MATTER OF THE APPLICATION OF ARIZONA ELECTRIC POWER COOPERATIVE, INC., FOR APPROVAL OF THE SALE OF DIRECT ASSIGNMENT FACILITIES TO TRICO ELECTRIC COOPERATIVE, INC. (DOCKET NOS. E-01461A-16-0363 AND E-01773A-16-0363).

INTRODUCTION

Enclosed are the Commission Staff's memorandum and proposed order for the Application of Arizona Electric Power Cooperative, Inc., for Approval of the Sale of Direct Assignment Facilities to Trico Electric Cooperative, Inc. (Docket Nos. E-01461A-16-0363 and E-01773A-16-0363). This is only a Staff recommendation to the Commission; it has not yet become an order of the Commission. The Commission can decide to accept, amend or reject Staff's proposed order.

You may file comments to the recommendation(s) of the proposed order by filing an original and thirteen (13) copies of the comments with the Commission's Docket Control Center at 1200 W. Washington St., Phoenix, AZ 85007 by 4:00 p.m. on or before **December 7, 2016**.

This matter may be scheduled for Commission deliberation at its Open Meetings scheduled **December 19, 2016**, at 10:00 a.m. and **December 20, 2016**, at 10:00 a.m.

If you have any questions about this matter, please contact Julie McNeely-Kirwan of our Staff at (602) 542-0833, or Jeffrey Hatch-Miller, Interim Director, at (602) 542-7270.

BACKGROUND

On October 7, 2016, Arizona Electric Power Cooperative, Inc. ("AEPSCO") filed an application requesting the Arizona Corporation Commission's ("Commission") approval for the sale and transfer of eight Direct Assignment Facilities ("DAFs") to Trico Electric Cooperative, Inc. ("Trico").

In 2015, prior to the completion of the merger between AEPSCO and Southwest Transmission Cooperative ("SWTC"), SWTC and Trico agreed that Trico would purchase eight DAFs from SWTC. The agreement between Trico and SWTC was memorialized in a letter agreement dated December 14, 2015. The Commission approved the merger between SWTC and

AEPCO in Decision No. 74591. As a result of the merger AEPCO, as the surviving cooperative, acquired all of SWTC's obligations, including the agreement to sell the DAFs to Trico.

The December 14, 2015, letter agreement states that the estimated depreciated net book value of the DAFs will be approximately \$7,825,000 as of January 1, 2017, but that this amount will be modified based on the final accounting true-up. The application estimates a final purchase price of approximately \$8.4 million, based on a closing date of January 1, 2017, and calculated in accordance with 2(b)(i) of the December 14, 2015, letter agreement.

The DAFs consist of all or part of eight transmission substation delivery point facilities now owned by AEPCO, but which are not part of its system facilities. These DAFs are used to provide transmission services only to Trico.

In Trico's pending rate case (Docket No. E-01461A-15-0363), Trico proposed to include the DAFs in its rate base as post-test year plant. In testimony, Staff noted that "the DAFs are already in use by the current rate-payers, but Trico does not own the facilities." Trico and Staff entered into a settlement agreement in Trico's recent rate case which included the DAFs in Trico's fair value rate base.

Benefits of the Transaction

Benefits for Trico. In rate case testimony, Trico included the following benefits of the sale: (i) acquiring the DAFs concurrently with a rate case means carrying costs associated with the DAFs can be recovered through base rates rather than through its adjustor mechanism; (ii) owning the DAFs provides Trico with control of costs and cost allocation for the facilities it is using; (iii) tracking and administering the costs and billing associated with DAFs is currently a "very complex and difficult" process, and (iv) an approximate \$164,000 benefit to Trico ratepayers per year, through a reduction in its operating expenses. Acquiring ownership of the DAFs will ease this administrative burden.

Based on the transaction, Trico will experience savings and be vested with ownership of assets used only for its own transmission service. Accounting for the costs associated with service will be simplified for Trico and will save administrative time and efforts.

Benefits for AEPCO. AEPCO will continue to operate and maintain most of the DAFs, thereby retaining the O&M revenues (which might have otherwise gone to other utilities or contractors). The O&M revenue retained by AEPCO will contribute to patronage capital or be used to reduce Member rates as a credit to the transmission revenue requirement in future rate cases.

In addition, the sale will provide financial flexibility to AEPCO, with additional up-front capital being made available for the following: (i) potential retirement of higher cost debt; (ii) avoiding new debt draws; and (iii) generating potential investment invest, which would flow to Members via patronage capital.

Timing

AEPCO has requested that the Commission approve this application prior to, or simultaneously with, its approval of Trico's revised rates. AEPCO has also requested that this application be processed as soon as possible, because AEPCO's ability to close on the sale is contingent upon receiving the necessary releases from its Indenture Trustee.

Staff Engineering Report

The Staff engineering report regarding the sale of the eight DAFs to Trico states concludes that the DAFs are "used and useful" with respect to Trico's provision of service. The Staff engineering report also concludes that transfer of the DAFs will not negatively impact system reliability. The Staff engineering report is attached to this Proposed Order as Exhibit A.

STAFF ANALYSIS AND RECOMMENDATIONS

The sale of eight DAFs by AEPCO to Trico will provide financial and administrative benefits to both cooperatives. Staff recommends that the sale and transfer of the eight DAFs be approved as herein described.



Jeffrey M. Hatch-Miller
Interim Director
Utilities Division

JHM:JMK:red\MAS

ORIGINATOR: Julie McNeely-Kirwan

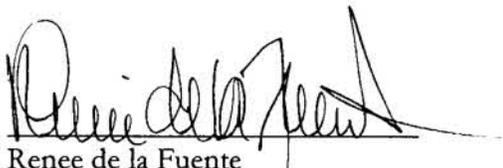
Arizona Electric Power Cooperative, Inc.
Docket Nos. E-01773A-16-0363 et al.

On this 29th day of November, 2016, the foregoing document was filed with Docket Control as a **Utilities Division Memorandum & Proposed Order**, and copies of the foregoing were mailed on behalf of the Utilities Division to the following who have not consented to email service. On this date or as soon as possible thereafter, the Commission's eDocket program will automatically email a link to the foregoing to the following who have consented to email service.

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By: 
Renee de la Fuente
Administrative Support Specialist

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BEFORE THE ARIZONA CORPORATION COMMISSION

DOUG LITTLE
Chairman
BOB STUMP
Commissioner
BOB BURNS
Commissioner
TOM FORESE
Commissioner
ANDY TOBIN
Commissioner

IN THE MATTER OF THE APPLICATION)
OF ARIZONA ELECTRIC POWER)
COOPERATIVE, INC. FOR APPROVAL OF)
THE SALE OF DIRECT ASSIGNMENT)
FACILITIES TO TRICO ELECTRIC)
COOPERATIVE, INC.)

DOCKET NO. E-01461A-16-0363
E-01773A-16-0363

DECISION NO. _____

ORDER

Open Meeting
December 19 and 20, 2016
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. Arizona Electric Power Cooperative, Inc. ("AEPCO") is certificated to provide electric service as a public service corporation in the State of Arizona. AEPCO is a not-for-profit generation and transmission cooperative which supplies all or most of the power and energy requirements for six member cooperatives.

2. Trico Electric Cooperative, Inc. ("Trico") is certificated to provide electric service as a public service corporation in the State of Arizona. Trico provides service in Santa Cruz, Pima, and Pinal counties, and has approximately 44,000 primarily Residential and Commercial customers. Trico also has a small number of Industrial, Public Street and Highway Lighting, and Irrigation customers.

3. On October 7, 2016, AEPCO filed an application requesting the Commission's approval for the sale and transfer of eight Direct Assignment Facilities ("DAFs") to Trico.

...
...

1 Background

2 4. In 2015, prior to the completion of the merger between AEPCO and Southwest
3 Transmission Cooperative (“SWTC”), SWTC and Trico agreed that Trico would purchase eight DAFs
4 from SWTC. The agreement between Trico and SWTC was memorialized in a letter agreement dated
5 December 14, 2015. The Commission approved the merger between AEPCO and SWTC in Decision
6 No. 74591. As a result of the merger AEPCO, as the surviving cooperative, acquired all of SWTC’s
7 obligations, including the agreement to sell the DAFs to Trico.

8 5. The December 14, 2015, letter agreement states that the estimated depreciated net
9 book value of the DAFs will be approximately \$7,825,000 as of January 1, 2017, but that this amount
10 will be modified based on the final accounting true-up. The application estimates a final purchase
11 price of approximately \$8.4 million, based on a closing date of January 1, 2017, and calculated in
12 accordance with 2(b)(i) of the December 14, 2015, letter agreement.

13 6. The DAFs consist of all or part of eight transmission substation delivery point facilities
14 now owned by AEPCO, but which are not part of its system facilities. These DAFs are used to
15 provide transmission services only to Trico.

16 7. In Trico’s pending rate case (Docket No. E-01461A-15-0363), Trico proposed to
17 include the DAFs in its rate base as post-test year plant. In testimony, Staff noted that “the DAFS are
18 already in use by the current rate-payers, but Trico does not own the facilities.” Trico and Staff
19 entered into a settlement agreement which included the DAFs in Trico’s fair value rate base..

20 Benefits of the Transaction

21 8. Benefits for Trico. In rate case testimony, Trico included the following benefits of the
22 sale: (i) acquiring the DAFs concurrently with a rate case means carrying costs associated with the
23 DAFs can be recovered through base rates rather than through its adjustor mechanism; (ii) owning the
24 DAFs provides Trico with control of costs and cost allocation for the facilities it is using; (iii) tracking
25 and administering the costs and billing associated with DAFs is currently a “very complex and
26 difficult” process, and (iv) an approximate \$164,000 benefit to Trico ratepayers per year, through a
27 reduction in its operating expenses. Acquiring ownership of the DAFs will ease this administrative
28 burden.

1 9. Based on the transaction, Trico will experience savings and be vested with ownership
2 of assets used only for its own transmission service. Accounting for the costs associated with service
3 will be simplified for Trico and will save administrative time and efforts.

4 10. Benefits for AEPCO. AEPCO will continue to operate and maintain most of the
5 DAFs, thereby retaining the O&M revenues (which might have otherwise gone to other utilities or
6 contractors). The O&M revenue retained by AEPCO will contribute to patronage capital or be used
7 to reduce Member rates as a credit to the transmission revenue requirement in future rate cases.

8 11. In addition, the sale will provide financial flexibility to AEPCO, with additional up-
9 front capital being made available for the following: (i) potential retirement of higher cost debt; (ii)
10 avoiding new debt draws; and (iii) generating potential investment invest, which would flow to
11 Members via patronage capital.

12 *Timing*

13 12. AEPCO has requested that the Commission approve this application prior to, or
14 simultaneously with, its approval of Trico's revised rates. AEPCO has also requested that this
15 application be processed as soon as possible, because AEPCO's ability to close on the sale is
16 contingent upon receiving the necessary releases from its Indenture Trustee.

17 *Staff Engineering Report*

18 13. The Staff Engineering Report regarding the sale of the eight DAFs to Trico states
19 concludes that the DAFs are "used and useful" with respect to Trico's provision of service. The Staff
20 Engineering Report also concludes that transfer of the DAFs will not negatively impact system
21 reliability. The Staff Engineering Report is attached to this Proposed Order as Exhibit A.

22 **Recommendations**

23 14. The sale of eight DAFs by AEPCO to Trico will provide financial and administrative
24 benefits to both cooperatives. Staff has recommended that the sale and transfer of the eight DAFs be
25 approved as herein described.

26 CONCLUSIONS OF LAW

27 1. AEPCO and Trico are Arizona public service corporations within the meaning of
28 Article XV, Section 2, of the Arizona Constitution.

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IT IS FURTHER ORDERED that AEPCO shall file a notice in this docket when all steps to effectuate the transfer have been completed and the transfer has been consummated.

IT IS FURTHER ORDERED that this Order shall take effect immediately.

BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN LITTLE

COMMISSIONER STUMP

COMMISSIONER FORESE

COMMISSIONER TOBIN

COMMISSIONER BURNS

IN WITNESS WHEREOF, I, JODI A. JERICH, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this _____ day of _____, 2016.

JODI A. JERICH
EXECUTIVE DIRECTOR

DISSENT: _____

DISSENT: _____

JMH:JMK:red/MAS

1 Arizona Electric Power Cooperative, Inc.
2 Docket Nos. E-01461A-16-0363 and E-01773A-16-0363

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EXHIBIT A

MEMORANDUM

TO: Julie McNeely-Kirwan
Public Utilities Analyst
Utilities Division

FROM: Margaret (Toby) Little
Electric Utilities Engineer
Utilities Division

THRU: Del Smith
Engineering Supervisor
Utilities Division

DATE: October 28, 2016

RE: STAFF ENGINEERING REPORT FOR THE APPLICATION OF ARIZONA ELECTRIC POWER COOPERATIVE, INC. FOR APPROVAL OF THE SALE OF DIRECT ASSIGNMENT FACILITIES TO TRICO ELECTRIC COOPERATIVE, INC. (DOCKET NOS. E-01773A-16-0363 AND E-01461A-16-0363)

GENERAL

On October 7, 2016, Arizona Electric Power Cooperative, Inc. ("AEPCO") filed an application ("Application") with the Arizona Corporation Commission ("Commission") for (1) approval of the sale and transfer of Direct Assignment Facilities ("DAFs") to Trico Electric Cooperative, Inc. ("Trico" or "Cooperative") and (2) such other and further relief as the Commission deems just and reasonable under the circumstances.

Trico submitted an application on October 23, 2015 to the Commission for a determination of the fair value of its utility plant and property and for increases in its rates and charges for utility service ("Trico Rate Case Application"). As a part of that application, Trico asked for authorization to include DAFs to be acquired from Arizona Electric Power Cooperative, Inc. ("AEPCO") in rate base as post-test year plant and for ratemaking purposes.

It is anticipated that the sale will close and the assets will transfer to Trico concurrent with the effective date of Trico's new rates, presumably January 1, 2017.

ENGINEERING EVALUATION

History

Trico is a member-owned, non-profit, rural electric distribution cooperative headquartered in Marana, Arizona. Trico serves primarily rural areas in Pima, Pinal and Santa Cruz Counties and provides electric service to approximately 38,000 members, most of whom are residential customers.

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Arizona Electric Power Cooperative, Inc.
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Page 2

Trico is a Class A Partial Requirements Member of AEPCO as well as a Class A Member and network transmission customer of AEPCO.

AEPCO is an Arizona not-for-profit electric generation and transmission cooperative which supplies all or most of the power and energy requirements of its six Class A member distribution cooperatives. AEPCO was originally formed and certificated as a generation and transmission cooperative in 1962. In the early 2000s, AEPCO restructured to create a separate, affiliated entity, Southwest Transmission Cooperative, Inc. ("SWTC"); SWTC assumed ownership and operational control of the Cooperative's transmission assets. However, in response to certain market conditions and changes in available financing, AEPCO and SWTC merged back into a single entity with AEPCO as the surviving generation and transmission cooperative in 2016. The merger was approved by the Commission in Decision No. 74591.

In 2015, prior to the completion of the AEPCO/SWTC merger, SWTC and Trico reached an agreement for Trico's purchase of certain DAFs from SWTC. The parties' arrangement was memorialized in a letter agreement (the "Letter Agreement"), which describes the terms and conditions under which the purchase will take place. The DAFs consist of all or part¹ of eight transmission substation delivery point facilities that are owned by AEPCO but are not a part of AEPCO system facilities and are used to provide transmission services only to Trico. As a result of the AEPCO/SWTC merger, all of SWTC's obligations became AEPCO's obligations, including the agreement to sell the DAFs to Trico.

Trico Site Visit and Facilities Inspection

As a part of its Engineering Evaluation for the Trico Rate Case, Utilities Division Staff ("Staff") met with Trico Staff at its headquarters in Marana on March 1, 2016. During the visit, the history of the Cooperative's operations and their organization related to customer service, planning, engineering, construction, system operations, meters, rates and maintenance were discussed.

Staff inspected two of the major substations and portions of the transmission, sub-transmission and distribution systems, as well as facilities at Trico Headquarters. Of particular interest to Staff were the DAFs in the substations inspected. Sandario Substation and Thornydale Substation were inspected during the site visit; both include DAFs and are delivery points. It was noted that the substations and all equipment are extremely well maintained, with safety related equipment installed.

In general, the Trico electric system appears to be well planned and maintained. No deficiencies or obvious problems were observed during the inspection tour.

Direct Assignment Facilities

¹ DAFs to be transferred do not include parts of delivery point facilities either presently owned by Trico or parts of facilities used to deliver power to AEPCO customers in addition to Trico.

Under AEPCO's policies, the carrying costs associated with transmission facilities constructed and owned by AEPCO that are utilized to provide transmission service only to Trico (Direct Assignment Facilities or DAFs) are assigned to and paid by Trico. These costs are passed through directly to Trico's Members. The AEPCO DAFs assigned to Trico include all or part of eight transmission substation delivery point facilities.

The Letter Agreement specifies that Trico will purchase its DAFs from SWTC (now AEPCO) effective as of the date of Commission approval of the Trico Rate Case Application. Trico seeks to include the DAFs it is acquiring from SWTC into rate base as post-test year plant, which will reduce the purchased power costs associated with energy losses on the DAF facilities.

Based on an inspection of the DAFs at Sandario and Thornydale Substations and a review of one-line diagrams for the remaining substations containing DAFs, Staff concludes that the facilities are "used and useful," to the Cooperative's provision of service. Trico stated in its application that "[a]cquiring the DAFs provides Trico with better control over the operation and maintenance expenses of those DAFs, and benefits Trico's Members because Trico will no longer pay a margin to SWTC."

In responses to Staff Data Requests, AEPCO has stated that "the sale will provide financial flexibility to AEPCO, with additional up-front capital being made available..." In addition they have stated that "...the revenue retained by AEPCO (for continued operation and maintenance of most of the DAFs) will contribute to patronage capital or be used to reduce Member rates as a credit to the transmission revenue requirement in future rate cases."

Under terms of the Letter Agreement, AEPCO will continue to operate and maintain most of the DAFs and it is expected that transfer of ownership will not affect the operation of either AEPCO's or Trico's electric system. The transfer is therefore not expected to impact system reliability.

CONCLUSIONS

Based on its review of AEPCO's Application, Trico's Rate Case Application, inspection of the Cooperative's electric system, discussions with the Cooperative's staff, and responses to data requests from both Trico and AEPCO, Staff's conclusions are as follows:

- a. Staff has concluded that the DAFs are "used and useful" to Trico's provision of service.
- b. Transfer of the DAFs will not negatively impact system reliability.