COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF BIG SANDY RURAL ELECTRIC COOPERATIVE CORPORATION FOR AUTHORITY TO ISSUE INDEBTEDNESS	))))	CASE NO. 98-588

<u>O R D E R</u>

Big Sandy Rural Electric Cooperative Corporation (Big Sandy) filed its application on January 4, 1999 for approval to issue indebtedness to the National Rural Utilities Cooperative Finance Corporation (CFC) and to execute a note in the amount of $6,100,000 according to CFC s PowerVision™ financing program. The proceeds of this loan will be used only to finance eligible property additions.[1] This financing is a shelf loan agreement and promissory note, whereby Big Sandy has up to five years to withdraw any funds which will then be payable at terms up to 35 years from the date of the advance. Each advance will bear interest at CFC s standard fixed rate or variable rate at the time of advance, depending on Big Sandy s selection at that time. PowerVision™ financing is available only to qualifying rural electric cooperative corporations that are concurrent borrowers with CFC and Rural Utilities Service (RUS).

[1] 7 Code of Federal Regulations, Part 1718, Subpart B, Mortgage for Distribution Borrowers.

Big Sandy filed a copy of the correspondence from CFC approving the PowerVision™ loan based upon financial statements for the calendar year ended December 31, 1997. Although the CFC approval was obtained in August 1998, Big Sandy did not submit its application to the Commission for approval of the financing until November 12, 1998. The application did not initially satisfy the minimum filing requirements, but the initial filing deficiencies were cured and the application was considered filed on January 4, 1999.

Big Sandy has responded to the Commission s January 27, 1999 and April 16, 1999 Orders, providing information about the loan program. An informal conference was held at the Commission s offices on August 24, 1999, with Big Sandy, CFC representatives and other interested parties. The conference provided CFC s representatives an opportunity to explain this new financing alternative, PowerVision™, and answer questions of Commission Staff and others in attendance.

The primary difference between CFC s new PowerVision™ financing program, and conventional CFC, or conventional RUS and CFC concurrent financing programs, is that PowerVision™ is a shelf loan, not referenced to a previously approved work plan. Under conventional financing programs, Big Sandy would establish a construction work plan for a specified period, usually two or three years, then obtain Commission approval for the work plan and the related financing. According to the PowerVision™ financing program, the only description of assets that may be acquired or constructed is that they are eligible property additions. Eligible property additions are defined as the cooperative s utility system. The electric system is defined as property used for electric production, transmission, distribution, conservation, load management, general plant and other related facilities that are acceptable to RUS.[2] PowerVision™ withdrawals may not be used to finance operating costs.[3] Although this is the same as for conventional financing, no construction work plan has to be formalized and approved in connection with the financing. The PowerVision™ credit facility does not preclude Big Sandy from obtaining conventional RUS and CFC financing.

Although PowerVision™ is a shelf loan, it is not a line of credit. Generally, a CFC line of credit is unsecured, has a one-year term limitation and bears interest according to CFC short-term, line of credit rate schedules. A line of credit withdrawal may be made, repaid, then withdrawn again. This differs from PowerVision™ in that when a PowerVision™ withdrawal is made, a note and amortization period is established for that withdrawal and the shelf loan amount is reduced by the withdrawal. In addition, penalties are imposed if PowerVision™ funds are repaid early.

The sample PowerVision™ loan agreement filed with the application includes the same requirements as the RUS mortgage agreement for issuing notes to other lenders. The loan agreement also permits a lien accommodation without the prior consent of RUS or CFC if certain financial criteria are met.[4] One of the criteria is that a Times Interest Earned Ratio (TIER) of not less than 1.5x and a Debt Service Coverage (DSC) of 1.25x, must be achieved for the two calendar years immediately preceding the issuance of such additional notes. Other criteria include requirements that the ratio

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[2] Restated Mortgage and Security Agreement between Big Sandy, RUS and CFC, Authorized by RUS (primary mortgagor) December 30, 1998, at page 6.

[3] Id., at Page 10, Article I, Definitions, Section 1.01.

[4] Id., at Page 14, Article II., Additional Notes, Section 2.01.

of Net Utility Plant to Total Long-Term Debt cannot be less than 1.0; Equity must be greater than or equal to 27 percent of Total Assets on a pro forma basis; and the additional notes when added to all outstanding principal for loans not related to the electric system cannot exceed 30 percent of total Equity on a pro forma basis. Once the PowerVision™ financing is approved by the CFC, the borrower must meet the financial criteria on an ongoing basis to be eligible to withdraw funds under the program.

At the time Big Sandy applied to CFC for this financing it met the financial criteria based on the calendar years 1996 and 1997. However, for calendar year 1998 Big Sandy s TIER was less than 1.5. Thus, while Big Sandy is eligible to participate in the PowerVision™ program, it is not presently eligible to withdraw funds. Consequently, Big Sandy must obtain RUS s prior consent, or achieve the qualifying TIER, DSC and other financial ratio requirements prior to making any withdrawal on this loan.[5]

Based on the evidence of record and being sufficiently advised, the Commission finds that the concept of shelf financing is reasonable, and financings of this nature have been approved for other utilities. However, in all prior instances of shelf financing, the specific uses of the proceeds were known at the time the financing was approved. This is not true for PowerVision™. Here, the specific uses will not be known until Big Sandy files a withdrawal request with CFC.

Big Sandy stated in response to the data request that the financing could potentially be used for uninsured storm damage and catastrophic events.[6] While some

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[5] Id.

[6] Response to Commission s Order, dated January 27, 1999, Item 4.

of the costs related to these uses may be of a capital nature, other costs may be extraordinary expenses. Thus, there is a need to monitor the actual purposes and uses of the loan funds. The potential also exists, under the provisions of the restated mortgage and security agreement, that Big Sandy could use a portion of the proceeds to fund non-electric system assets such as natural gas, telecommunications and water/wastewater projects. While these may be acceptable functions of the cooperative, the Commission must consider whether the investment will adversely affect the financial condition of the utility in approving long-term financing. Consequently, Big Sandy should provide certain information related to the request to withdraw funds.

At the time of requesting a withdrawal, Big Sandy must meet the previously discussed RUS mortgage requirements to permit CFC a lien accomodation. The process of requesting a withdrawal under PowerVision™ requires two supporting documents: (1) an independent auditor s certificate attesting that Big Sandy complies with the financial covenants of the mortgage; and (2) a complete PowerVision™ Requisition Form with an attestation from Big Sandy s manager that it is in compliance with the loan agreement and that the funds will be used for eligible property additions. These documents must be filed with both CFC and RUS.

In addition to the auditor s certificate and the PowerVision™ requisition form, CFC s analysts are provided detailed explanations of the property or construction to be financed with each PowerVision™ loan withdrawal. Any questions CFC has about the property or construction qualifying as eligible property additions are communicated to RUS for its approval. CFC indicated that PowerVision™ withdrawals will be used primarily to fund the CFC portion of concurrent RUS and CFC financing programs. In these instances the Commission will already have approved the work plan, and the benefits of using PowerVision™ funding will result from reduced administrative burden, and the ability to obtain these PowerVision™ withdrawals prior to receipt of RUS funding. This may decrease the need to borrow higher cost short-term debt for interim financing pending the availability of RUS funds.

The Commission s concern is in instances when withdrawals are not referenced to an approved work plan. The reduced level of oversight into the purpose and use of the financing in these circumstances necessitates the Commission to require a cooperative to explain why any particular construction project did not require a Certificate of Public Convenience and Necessity, and describe the property being constructed or replaced with the loan funds.

In summary, the Commission finds that:

1. The proposed PowerVision™ loan from CFC, if limited to financing of the cooperative s electric system assets, is for lawful objects within the corporate purposes of Big Sandy, is necessary and appropriate for and consistent with the proper performance by the utility of its service to the public and will not impair its ability to perform that service, and is reasonably necessary and appropriate for such purposes.

2. Big Sandy is capable of executing its notes as security for the loan as stated herein.

3. Within 10 days of the receipt of finalized PowerVision™ loan documents, Big Sandy should file a copy of said documents with the Commission for the case record.

4. Big Sandy shall notify the Commission within 10 days of either: (1) achieving the industry financial ratio requirements for two consecutive years, or (2) its obtaining RUS and other noteholders prior consents, if it decides to obtain waiver of the TIER requirement for a PowerVision™ withdrawal.

5. Big Sandy should file with the Commission a copy of the same documents to be submitted to CFC and RUS for a withdrawal of PowerVision™ funds. In addition, Big Sandy should include a statement to cross-reference all construction funded by the PowerVision™ withdrawals to the Commission case approving the work plan(s). If the financing is not related to a work plan, Big Sandy should describe the property being constructed or replaced, and explain why the property did not require a Certificate of Public Convenience and Necessity. Big Sandy should not withdraw any PowerVision™ funds until at least 10 days after filing the loan withdrawal documents. If the Commission does not issue an Order questioning the purpose or use of the proceeds within that 10-day period, the withdrawal will be deemed approved.

6. At the time discussion is initiated with CFC regarding loan withdrawals, Big Sandy shall inform the Commission s Financial Analysis Division of the plans regarding the Cooperative s intended loan fund withdrawals.

7. Big Sandy should select the interest rate program that will result in the net lowest cost of money to it over the term of the financing, bearing either a fixed or variable rate, as chosen by Big Sandy at the time each advance is drawn from CFC, subject to the provisions and terms of the application with respect to the renegotiations of the interest rate.

8. Upon receipt of the PowerVision™ withdrawal, Big Sandy should include in its next monthly report filed with the Commission, the amount and date of the withdrawal, the interest rate program selected, and the remaining amount of the PowerVision™ credit facility.

9. The proceeds from the proposed loans should be used only for the lawful purposes set out in Big Sandy s application and the documents supporting the specific fund withdrawals.

IT IS THEREFORE ORDERED that:

1. Big Sandy is authorized to issue indebtedness to CFC in the amount of $6,100,000 for a shelf loan according to its PowerVision™ financing program, bearing either a fixed or variable interest rate, as chosen by Big Sandy at the time each advance is drawn from CFC, subject to the provisions and terms of the application with respect to the renegotiation of the interest rate.

2. Big Sandy is authorized to execute its notes as security for the loan herein authorized.

3. Big Sandy shall comply with all matters set out in Findings No. 3 through 9 as if they were individually so ordered.

Nothing contained herein shall be deemed a warranty or finding of value of securities or financing authorized herein on the part of the Commonwealth of Kentucky or any agency thereof.

Done at Frankfort, Kentucky, this 2nd day of November, 1999.

By the Commission

ATTEST:

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Executive Director