ACTION REQUEST RESPONSE

To: Utah Public Service Commission

From: Division of Public Utilities

Chris Parker, Director
Artie Powell, Manager, Energy Section
Charles Peterson, Technical Consultant
Doug Wheelwright, Utility Analyst

Subject: Docket No. 10-506-01, Application of Deseret Generation & Transmission Co-Operative for Authority to Issue Securities in the Form of Secured Promissory Note to National Rural Utilities Cooperative Finance Corporation,.

Date: January 27, 2010

RECOMMENDATION (APPROVAL)

The Division recommends that the Commission authorize Deseret G&T to issue securities in the form of a promissory note to the CFC for approximately $20 million dollars.

ISSUE

Deseret Generation & Transmission Co-Operative (Deseret G&T, Deseret, or the Company) requests authorization for authority to issue securities in the form of a promissory note to the National Rural Utilities Cooperative Finance Corporation (CFC) for approximately $20 million for a supplemental credit line. This is an interim financing measure and is primarily related to the overhaul of the Hunter Unit II facility. While the total Hunter facility is operated by PacifiCorp, Deseret has a 25.1% ownership interest in the Hunter II generating unit. In addition to the routine repair and replacement, PacifiCorp is proposing substantial capital improvements and has demanded that the Company pay a portion of those charges. Deseret has disputed some of the charges and at the present time it is unclear what amount the Company will be required to pay. Other capital needs include the ongoing replacement of aging equipment used to operate and maintain the 345kV transmission system and safety related equipment at the Deserado coal mine operated by Blue Mountain Energy. This loan application will create an interim financing mechanism for the operational needs. It is anticipated that once the disputed charges are resolved, the Company will apply for long term financing of up to $40 million in the spring of 2011.

DISCUSSION

Information used in the Division's analysis included: the Company's Application; Resolution of the Board of Trustees dated November 18, 2010; Revolving Line of Credit Agreement with CFC; FERC Form 1 Annual Reports for years ending December 31, 2005 through December 31, 2009; FERC Form 1 financial statements of the Company for the nine months ending September 30, 2010. In addition, the Division has had discussions with David Crabtree, Vice President and General Counsel concerning questions relating to the application and the financial information.

BACKGROUND

Deseret Generation and Transmission Cooperative (DG&T) was formed in 1978 and supplies wholesale electricity to its members and other bulk energy customers in Arizona, Colorado, Nevada, Utah, and Wyoming. The member-owned utility operates 223 miles of transmission lines, and it has interests in two power generation facilities in Utah with approximately 550 MW of capacity. The primary generating resource, the Bonanza Power Plant is consistently ranked in the top environmentally clean coal fired plants in the United States. Deseret has an 88.13% ownership interest in this facility with the 11.87% owned by Utah Municipal Power Agency (UMPA). In addition, the Company has a 25.10% ownership interest in the Hunter II power generation unit. Deseret owns and operates its own coal mine under Blue Mountain Energy (BME), which fuels the Bonanza power plant. Deseret is owned by its six members: Bridger

Valley Electric, Dixie Escalante Rural Electric, Flowell Electric, Garkane Energy, Moon Lake Electric, and Mt. Wheeler Power.

Deseret has faced financial difficulties in the past leading to a series of arrangements for restructuring and recapitalizing the Company's indebtedness. The last such restructuring occurred within the 1996 to 1998 time frame and resulted in an agreement with CFC known as the Obligations Restructuring Agreement (ORA) and the 1998 Recapitalization Agreement. The renegotiated payment terms provided for stipulated quarterly minimum payments and an additional contingent payment based on a percentage of the year-end cash balances, less working capital reserves.

As of September 2010, the Company had $278 million in long term debt of various maturities and a $20 million line of credit with CFC which matures October 16, 2011. The existing line of credit has not been used since it was approved October 12, 2007. Deseret depends on CFC as a primary source of financial support. CFC is structured as a co-op and Deseret is one of several hundred members.

Historical Financial Results

Exhibit 1 sets forth the historical financial results for year-end 2005 through September 2010 and includes the balance sheet, income statement, cash flow statement, common size statements and a ratio analysis statement. The income statement shows revenues on average increased by 1.45% from $215 million in 2005 to $228 million in 2009. Revenue in 2009 was down from a high of $270 million in 2008. Operating expenses grew from $192 million in 2005 to $215 million in 2009, which results in 2.83% annual increase. By comparison, operating expenses grew at a faster rate than revenue for the period under review. Interest expense was down slightly from $32 million in 2005 to $31 million in 2009. Net income had a fluctuating trend that resulted from the 2-year cycle of maintenance expense. Net income fluctuates from a loss of $5.0 million in 2005 to $10.8 million gain in 2006, a $9.7 million loss in 2007, a $7.8 million gain in 2008 and an $8.7 million loss in 2009. For the first 9 months of 2010, the Company is showing an $8.2 million gain.

The balance sheet information shows that unrestricted cash has increased 5.82% from $14.3 million in 2005 to $18.2 million in 2009. Through September 2010, unrestricted cash increased to $22.3 million. Restricted deposits had a large average annual increase of 49.16% from $9.4 million in 2005 to $46.9 million in 2009. As of September 2010, the balance had increased further to $52.7 million. Restricted deposits are designated as funds paid for future service or for transmission studies. In addition, included in the total amount is $22.8 million from the sale of SO_2 environmental allowances.

There was a significant increase in the fuel stock from $12.4 million in 2008 to $23.5 million in 2009. This increase was due to an adjustment and recalculation of the shrinkage in the coal inventory. Total current assets have increased by 9.19% annually from 2005 to 2009. The increase in cash was partially offset by a reduction in accounts receivable which decreased from $30.4 million in 2005 to $24.3 million in 2009. For the first 9 months in 2010, receivables have increased to $30.6 million. Net plant and equipment decreased at 3.58% annually from $236.9 million in 2005 to $204.7 in 2009 and total assets decreased 2.46% annually from 2005 to 2009.

Current liabilities increased 2.66% with the primary change coming from an increase in Accounts Payable. For the period under review, Accounts Payable increased from $16.2 million in 2005 to $19.6 million in 2009. Through September 2010, accounts payable have increased to $32.1 million. Approximately $10.8 million of the increase in 2010 is due to the disputed and unpaid invoices involved in the Hunter II facility.

Long-term debt has been reduced from $326.3 million in 2005 to $285.1 million in 2009 for a 3.25% annual decrease. Total liabilities declined at an average rate of 2.78% for 2005 through 2009. Total Patronage Equity is down .90% from $86.1 million to $83.1. While this is a slight decrease in the dollar value, equity as a percentage of total assets has increased from 16.95% in 2005 to 18.06% in 2009.

The calculated ratio report indicates the Company's current ratio[1] has varied annually, but has shown an increased from 2.84 in 2005 to 3.63 in 2009. The Company's quick ratio[2] averaged 1.42 for the period under review and does not include restricted deposits. Long-term solvency ratios appear to have generally been flat or slightly improving throughout the time period examined. Times interest earned alternated during the 2005 to 2009 period starting at 0.65, increasing to 1.40, declining to 0.54, increasing to 1.56 and then declining to .76 in 2009. For the 9 month period of 2010 the ratio has increased to 1.35. The capital structure has shown a slight improvement for the period under review, however it should be noted that the Company is highly leveraged. Long term debt totaled 79.12% in 2005. This has been reduced to 77.48% in 2009 and 75.45% for year-to-date 2010.

Forecast 2010 to 2014

The Division prepared forecasts based on historical data from 2005 through 2009 and the September 2010 interim financial statements. While this request is for short term interim financing, the proceeds will be used to finance long term capital expenditures. The projections have been prepared to include the capital expenditures and additional debt. The Company has indicated that the next major overhaul of the Bonanza facility is scheduled for 2012 and adjustments to the revenue and earnings have been included. Plant in service was adjusted in 2011 for the prospective Hunter II upgrade.

Historically, Deseret has had limited profitability and is highly leveraged. By structure, DG&T is a not-for-profit co-op and is "upstream" from its six owner/members, which are also not-for-profit co-op electric power retailers. The revenues received from its member co-ops can be

---

[1] Current ratio is current assets divided by current liabilities. It is a measure of a company's ability to satisfy its cash needs over the coming twelve months.

[2] Quick ratio is cash plus accounts receivable divided by current liabilities. It is a more stringent measure of a company's ability to satisfy its cash needs over the coming twelve months.

controlled according to Deseret's cash flow needs, therefore it is likely that over a period of several years, the Company will cover its operating and debt service cash flow needs and show little net profit. It is anticipated that the Company will continue to show the cycle of profitable and unprofitable years along with variation in the return of patron's capital. With uncertain expenditures for Hunter II in 2011 and required maintenance at the Bonanza facility in 2012, the projections indicate possible losses in both years.

The Division believes that Deseret will be able to maintain the cash flow and minimal profitability it needs, and should be able to service additional debt. Based on the assumptions, the forecast indicates that Deseret should be able to service the additional debt. Profitability ratios are positive, fairly stable, and are close to the historical averages.

The Division has not attempted to evaluate the reasonableness of the terms and conditions of the financial transaction and has based its recommendation for approval on the following factors:

A. This loan request is an interim funding requirement that will be replaced with a new long term loan likely in the spring of 2011.

B. The Company, which has total access to financial information about its operations and budgets and has conducted an evaluation.

C. The board of trustees approved the transaction in the board meeting on November 18, 2010.

D. Attached as Exhibit 1, in 5 pages, are financial statements of the Company for the years 2005 through September 2010. This information has been compiled from the Company's FERC Form 1 filings and not audited financial statements.

E. The forecast prepared by the Division suggests that the Company should be able to service the additional debt from this loan request.

Based upon these considerations, the Division recommends that the Commission approve the Application of Deseret Power for authority to issue securities in the form of a secured promissory note to CFC for $20 million in Docket No. 10-506-01. The Division would recommend that the Company prepare a detailed financial forecast to be submitted with the application for long term financing. The projection should include anticipated capital expenditures and debt obligations along with any forecasted refund of patron's capital. Since the existing revolving line will mature in October 2011, the Company may want to submit an application for that portion of the financing along with the term request in the spring of 2011.

cc: David F. Crabtree, General Counsel, Deseret Generation & Transmission
Michele Beck, Director, Office of Consumer Services