State of Utah
Department of Commerce
Division of Public Utilities

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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. 11-506-01, 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: September 15, 2011

RECOMMENDATION (APPROVAL)

The Division recommends that the Commission authorize Deseret Generation & Transmission Co-Operative (DG&T, or the Company) to issue securities in the form of two promissory notes with National Rural Utilities Cooperative Finance Corporation (CFC) in connection with two financing transactions. The first transaction is an extension of an existing $20 million revolving line of credit. The second transaction is a $40 million term loan facility which will be used to finance anticipated capital projects over the next 5 years.

ISSUE

DG&T requests authorization for authority to issue securities in the form of two financial transactions to the National Rural Utilities Cooperative Finance Corporation (CFC).

The first transaction is an extension of the existing $20 million revolving line of credit which will mature October 16, 2011. The current credit line was approved by the Commission on October 12, 2007 under Docket No. 07-506-01. To date, the Company has not drawn on this line of credit and there is no outstanding balance. The revolving line is secured by an existing mortgage on all of the Company's property excluding the office building located in South Jordan, Utah. In addition to the Company assets, the loan agreement includes a guarantee from the Company's wholly owned subsidiary, Blue Mountain Energy, Inc. ("BME"). If approved, the maturity date for the revolving line of will be extended to October 2016.

The second transaction is for a $40 million long-term financing facility that will be used to fund anticipated capital projects. Advances against the total commitment amount will be structured as individual notes with repayment terms that correspond with the specific project. For each advance, the Company can request either a fixed or variable interest rate with a maximum maturity date of December 31, 2025. This credit facility will remain in place for the five year draw period or until the commitment amount has been reached. This credit facility will also be secured by an existing mortgage on all of the Company's property excluding the office building located in South Jordan, Utah. The loan agreement includes a guarantee from the Company's wholly owned subsidiary, Blue Mountain Energy, Inc. ("BME"). A portion of this commitment will be used to fund the expenses related to the recent overhaul of the Hunter Unit II facility and for an overhaul of the Bonanza plant scheduled for 2012. Other capital projects 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.

The Company has contested a portion of the costs associated with the upgrade of the emission control modifications made to the Hunter II generating unit. While the Hunter generating facility is operated by PacifiCorp, Deseret has a 25.1% ownership interest in the Hunter II generating unit. This dispute has been in arbitration since April 2010 and the final award has been included as appendix "C" of the Company's application. Even though the final award has been issued by the arbitrator, this issue has not been resolved. At the present time it is unclear what amount the Company will be required to pay to PacifiCorp.

DISCUSSION

Information used in the Division's analysis included: the Company's Application; Resolution of the Board of Directors dated July 21, 2011; Revolving Line of Credit Agreement with CFC; Term Loan Credit Agreement with CFC; FERC Form 1 Annual Reports for years ending December 31, 2005 through December 31, 2010 and the Consolidated and audited financial statements for Deseret Generation and Transmission Cooperative and Subsidiary for years ending December 31, 2007 through December 31, 2010. In addition, the Division has had discussions with David Crabtree, Vice President and General Counsel and Bob Dalley, CFO 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 Company is owned by its six members: Bridger Valley Electric, Dixie Escalante Rural Electric, Flowell Electric, Garkane Energy, Moon Lake Electric, and Mt. Wheeler Power. The member-owned utility operates 223 miles of transmission lines, and 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 among the top environmentally clean coal fired plants in the United States. Deseret has an 88.13% ownership interest in this facility with the remaining 11.87% owned by Utah Municipal Power Agency (UMPA). Deseret owns and operates its own coal mine under Blue Mountain Energy (BME), which fuels the Bonanza power plant. In addition, the Company has a 25.10% ownership interest in the Hunter II power generation unit which is operated by PacifiCorp.

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. CFC is the primary lender and as of December 2010, the Company had $306 million in outstanding debt of various maturities.

Historical Financial Results

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 controlled according to Deseret's cash flow needs and has historically shown little net profit. Exhibit 1 is a review of the historical financial results for year-end 2005 through 2010. This information 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 1.63% from $215 million in 2005 to $233 million in 2010. Operating expenses grew from $186 million in 2005 to $213 million in 2010, which calculates to a 2.76% annual increase. By comparison, operating expenses grew at a faster rate than revenue for the period under review. Interest expense increased slightly from $32.0 million in 2005 to $32.3 million in 2010. Net income fluctuates between positive and negative every other year due primarily to a 2-year maintenance cycle. Net income was positive in 2008 with a gain of $7.8 million followed by a loss of $8.7 million in 2009 and a $5.1 million gain in 2010.

The balance sheet information shows that unrestricted cash has remained fairly stable and is currently $14.2 million. Restricted deposits showed a 43.1% increase from $9.4 million in 2005 to $56.8 million in 2010. Restricted deposits are designated as funds reserved for future service or transmission studies and includes $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 9.05% annually from 2005 to 2009 due to the increase in restricted deposits. Net plant and equipment decreased 3.15% annually from $236.9 million in 2005 to $201.9 in 2010. Total assets decreased 1.96% annually from 2005 to 2010.

Current liabilities increased 6.76% with the primary change coming from a temporary increase in Accounts Payable. Payables increased from $16.2 million in 2005 to $30.5 million in 2010. 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 $275.5 million in 2010 for a 3.33% annual decrease and total liabilities declined at an average rate of 2.44% for 2005 through 2010. Total Patronage Equity has shown little change from $86.1 million in 2005 to $87.2 million in 2010. While there is only a slight increase in the dollar value, equity as a percentage of total assets has increased from 16.95% in 2005 to 18.93% in 2010.

Page 4 of Exhibit 1calculates the Company's financial ratios. The current ratio[1] has varied annually, but has shown an increased from 2.84 in 2005 to 3.16 in 2010. The Company's quick ratio[2] stands at 1.0 for 2010 which is down from the 5 year average of 1.35 and has been calculated excluding the restricted deposit balances. The long-term solvency ratios appear to

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[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.

have generally been flat or slightly improving throughout the time period examined and are close to historical averages. 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 and has been reduced to 75.97% in 2010. Patron's Capital has increased from 20.88% in 2005 to 24.03% in 2010.

Forecast 2010 to 2014

The Division has prepared forecasts based on historical information from 2005 through 2010. The projections have been prepared to include both the anticipated capital expenditures and additional long term 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.

Historically, Deseret has had limited profitability and is highly leveraged. 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 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, it is possible that the Company could incur losses in both 2011 and 2012.

Based in the projections included as Exhibit 2, the Division believes that Deseret will be able to maintain the cash flow and minimal profitability it needs, and should be able to service the additional debt. Forecast profitability ratios remain 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. The first loan requests are for an extension of the existing $20 million revolving credit facility which has not been used by the Company. The second request for a $40 million long term credit facility appears to be needed to meet future capital requirements.

B. The Company, which has total access to financial information about its operations and budgets and has conducted an evaluation of the terms offered by CFC.

C. The board of directors approved the transactions in the board meeting held on July 21, 2011.

D. Attached as Exhibit 1, are financial statements of the Company for the years 2005 through 2010. This information has been compiled from the Company's FERC Form 1 filings.

E. Attached as Exhibit 2, is a forecast prepared by the Division which 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 Generation and Transmission for authority to issue securities in the form of a secured promissory note to CFC for a $20 million revolving credit facility and a secured promissory note for $40 million for a term credit facility.

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