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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF  
ARIZONA ELECTRIC POWER COOPERATIVE,  
INC. FOR A RATE INCREASE.

DOCKET NO. E-01773A-04-0528

IN THE MATTER OF THE APPLICATION OF  
SOUTHWEST TRANSMISSION COOPERATIVE,  
INC. FOR A RATE INCREASE.

DOCKET NO. E-04100A-04-0527

**AEPCO'S EXCEPTIONS TO  
RECOMMENDED OPINION  
AND ORDER**

GALLAGHER & KENNEDY, P.A.  
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The Arizona Electric Power Cooperative, Inc. ("AEPCO") submits these exceptions to the Recommended Opinion and Order ("ROO") dated June 27, 2005 pertaining to its case in this consolidated matter. The Southwest Transmission Cooperative, Inc. ("SWTC") has also filed exceptions pertaining to its case.

This is the first general rate increase on the AEPCO system in more than 20 years. Instead, since 1985, while the overall cost of living has increased 90%, AEPCO has reduced Class A member distribution cooperative rates by approximately 22%. In addition, over that same time frame, more than \$27 million in fuel and purchased power costs have either been refunded or forgiven.

However, as the ROO states, higher delivered coal and natural gas costs, increased maintenance costs associated with aging generation plant and necessary capital additions for efficiencies and load growth produced a net margin loss in the 2003 test year and another operating loss in 2004. As a result, AEPCO is no longer in financial compliance under the terms of its mortgage and Rural Utilities Service rules. Commission approval of the rates

1 recommended in the ROO, together with implementation of the Fuel and Purchased Power Cost  
2 Adjustor, will allow AEPCO to return to mortgage compliance, build equity and stabilize its  
3 financial position. The phasing of the rate increases described at Finding 23 of the ROO  
4 minimizes to the maximum extent possible ratepayer impact, while allowing AEPCO to continue  
5 to provide safe, reliable and adequate service to its Class A member distribution cooperatives  
6 and the retail member consumers they serve.

7 AEPCO supports the ROO and appreciates the efforts of both the Administrative Law  
8 Judge and the Utilities Division Staff in processing these consolidated cases. These exceptions  
9 are directed to clarification or amendment of a few issues.

#### 10 **Phases 2 and 3 Implementation**

11 As discussed at Findings 24-29, the AEPCO Board of Directors, which is comprised of  
12 representatives of AEPCO's member owners, did not have an opportunity to approve the  
13 Phases 2 and 3, 1.5% step increases (the "step increases") prior to the hearing on this matter.  
14 The Board subsequently approved them, but also requested the opportunity to review their  
15 impact on AEPCO's financial results closer to the time of implementation in 2006 and 2007.  
16 AEPCO would ask that the Commission allow AEPCO and its Board this opportunity to submit  
17 information prior to the step increases actually taking effect.

18 AEPCO is a member owned and controlled non-profit generation cooperative. As to rate  
19 matters, its Board's role is very similar to the one performed by the Commission. The Board  
20 attempts to balance AEPCO's need for adequate revenues so it can continue to deliver service at  
21 the lowest, reasonable cost with the impact of rates at the distribution cooperative and retail  
22 level.

1 In this case, the Board agrees that, based on information currently available, the step  
2 increases will be necessary to maintain AEPCO's financial health and also will minimize rate  
3 payer impact. It is possible, however, that conditions might change over the next two years. For  
4 example, Staff has used an operating DSC in this case. If non-operating margins from sources  
5 like interest income or patronage allocations from other organizations were to be higher than  
6 expected, this would improve AEPCO's financial results and build equity—possibly without the  
7 need for one of the step increases.<sup>1</sup>

8 At Finding 29, the ROO rejects the Board's request that AEPCO be allowed to submit  
9 additional information prior to the scheduled implementation date of the step increases because  
10 the process appears "unnecessarily complicated and could delay the implementation of the rates  
11 we find necessary to restore AEPCO's financial health." The following substitute Finding 29  
12 which AEPCO asks that the Commission adopt addresses both issues:

13 29. A total revenue level of \$152,279,203 is fair and reasonable and fully  
14 supported by the record. We adopt the phased in approach to minimize the  
15 immediate impact on rate payers and will instruct AEPCO to file a tariff stating  
16 the rates and charges authorized in Exhibit A including the step increases.  
17 However, AEPCO may file by May 15 of 2006 and 2007 financial information  
18 for the previous year which takes into account the 1.5% scheduled step increase  
19 and its impact on AEPCO's achieved operating DSC together with any  
20 recommendation concerning the scheduled step increase. The Commission will  
21 evaluate such information and recommendation and take action as it deems  
22 appropriate.

23 This process will assure timely implementation of the rates recommended in the ROO.  
24 However, it will also allow AEPCO's Board to assess the impact of the step increases at a time

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23 <sup>1</sup> Given the large margin losses which have already occurred prior to implementation of new  
24 rates, it is unlikely that AEPCO will achieve a 1.0 DSC on either standard in 2005. The  
situation, however, might be different in 2006.

1 closer to their implementation and communicate its conclusions and recommendations  
2 concerning them to the Commission.

### 3 Next Rate Case

4 At Findings 31-32 and the Ordering Paragraph at p. 15, l. 28-p. 16, l. 3, the ROO orders  
5 the filing of a rate case “six months after Sulphur Springs Valley Electric Cooperative, Inc. has  
6 completed a full year as a partial requirements member, or not later than five years after the  
7 effective date of this Decision, whichever is earlier.” AEPCO suggests the Order be clarified to  
8 state the filing will be made a full calendar year after SSVEC’s conversion. Consistent with  
9 normal practice, this will allow the test year to match AEPCO’s fiscal year and to take into  
10 account any adjustments and other matters covered in its audited financial statements.

11 The word “calendar” should be added after “full” at p. 8, l. 7 and p. 8, l. 8. “Calendar”  
12 should also be inserted after “full” in the Ordering paragraph at p. 16, l. 1.

### 13 Equity Improvement Analysis

14 Findings 43-54 discuss equity issues and the Ordering paragraph at p. 16, ll. 8-12  
15 instructs AEPCO to file an equity improvement analysis by March 31, 2006. AEPCO will  
16 perform that analysis and supports the ROO’s conclusion that no specific equity goal be  
17 established in this case. As discussed in the SWTC exceptions, the analysis will provide  
18 important information for the Cooperative, Staff and the Commission to further assess this issue.

19 As the ROO states at Finding 54, the Mohave Electric Cooperative, Inc. (“Mohave”)  
20 raised arguments regarding possible differences between partial- and full-requirements members  
21 on this issue for the first time in its Closing Brief. AEPCO does not agree with Mohave’s  
22 assertions that equity improvement impacts or benefits members differently. For example, much  
23 of the borrowing which AEPCO undertakes has nothing to do with capacity resource expansion,  
24

1 but instead is directed at maintaining or improving the operating efficiency of the existing plant  
2 which serves equally both partial- and full-requirements members. Mohave, together with all  
3 other AEPCO members, will participate over the next several months in the equity analysis  
4 process and will have the opportunity to raise any issues it considers relevant. No amendment of  
5 the ROO is necessary on this issue. However, for record purposes, AEPCO wanted to advise the  
6 Commission of its position on this issue which Mohave raised for the first time after the hearing  
7 record had closed.

#### 8 Anza Cost of Service Study

9 Findings 55-60 of the ROO discuss Staff's recommendation that the Commission should  
10 order AEPCO to file jurisdictionally separated information for the Anza Electric Cooperative,  
11 Inc. ("Anza") in its next rate case. Anza is a small distribution cooperative in south central  
12 California which has been an AEPCO member for 25 years. In the four rate cases since that  
13 time, AEPCO has never filed such information. Finding 60 does not grant Staff's request, but  
14 instead allows AEPCO to request a waiver of the separation requirement in R14-2-103.B.6 in  
15 conjunction with its next rate case.

16 Although AEPCO appreciates that allowance, it would ask that the Commission settle the  
17 issue in this Decision. Anza is and always has been a small distribution cooperative on the  
18 AEPCO system. As Mr. Minson testified at hearing, there is no reason to expect that the cost of  
19 service to Anza would be different than the cost to serve other Class A members. Rate case  
20 filings take several months to prepare and uncertainties over what information they must contain  
21 simply add to AEPCO, Staff and the Commission's time and expense in processing them.

22 In Decision No. 67220, the Commission granted AEPCO's request for a sufficiency  
23 determination as to its cost of service study requirements in this case. The Decision notes at  
24

1 Finding 9 that while Staff did not need cost of service information by distribution cooperative  
2 including Anza, it did need cost information separating costs to serve Class A members from  
3 other classes, categorization of costs by demand, energy and customer-related costs and a  
4 breakdown of costs for ancillary services by cost component with firm and variable costs  
5 separated. AEPCO supplied that information in relation to this filing and is willing to do so in  
6 future filings.

7 To bring this matter to a close, AEPCO would request that the Commission delete  
8 Finding 60 in the ROO and insert the following:

9 60. Given the circumstances of this case, we will not require AEPCO to  
10 prepare and file jurisdictionally separated schedules for Anza. However, AEPCO  
11 shall submit with its next rate case the information specified in Finding 9 of  
12 Decision No. 67220.

13 **Conclusion**

14 AEPCO requests that the Commission approve the ROO with the amendments requested  
15 in these exceptions.

16 DATED this 6<sup>th</sup> day of July, 2005.

17 GALLAGHER & KENNEDY, P.A.

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1 **Original and fifteen copies** of the foregoing  
filed this 6<sup>th</sup> day of July, 2005, with:

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5 **Two copies** of the foregoing delivered  
this 6<sup>th</sup> day of July, 2005, to:

6 Chairman Jeff Hatch-Miller  
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19 **Copy** of the foregoing delivered  
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