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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission
DOCKETED
MAR 27 2002
DOCKETED BY

WILLIAM A. MUNDELL
Chairman
JIM IRVIN
Commissioner
MARC SPITZER
Commissioner

IN THE MATTER OF THE EXAMINATION OF ARIZONA ELECTRIC POWER COOPERATIVE, INC.'S PURCHASED POWER AND FUEL ADJUSTOR CLAUSE	DOCKET NO. E-01773A-01-0833 DECISION NO. 64677 ORDER

Open Meeting
March 19 and 20, 2002
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. On October 11, 2000, Arizona Electric Power Cooperative, Inc. ("AEPCO" or "the Cooperative") filed an application for approval and confirmation of various transactions enabling the Cooperative to restructure into three affiliated entities. As part of the application, AEPCO also requested Commission authorization to forgive the under-collected purchased power and fuel adjustor clause ("PPFAC") bank balance as of the effective date of the restructuring and to eliminate its PPFAC on an on-going basis.

2. On July 31, 2001, AEPCO's restructuring transactions closed.

3. In Decision No 63868, dated July 25, 2001, the Commission approved AEPCO's restructuring. The Commission also approved forgiveness of the December 31, 2000 under-collected PPFAC balance of approximately $6.0 million.

4. The Commission also authorized Staff "to open a docket and request a procedural order be issued within 90 days from the decision in this docket. The purpose of the docket would be to examine AEPCO's PPFAC. Staff would perform an audit of AEPCO's PPFAC filings and balance to verify the balance and verify AEPCO's compliance with previous Commission orders. At that time, Staff will also make a recommendation regarding the continuation or discontinuation of the PPFAC and a recommendation regarding the balance forgiven."

5. On October 23, 2001, Staff filed a Notice of Opening Docket and Request for Procedural Order requesting that Docket Control open a docket to examine AEPCO's PPFAC and requesting Hearing Division to issue a procedural order directing Staff to file its preliminary report on its examination of AEPCO's PPFAC by January 31, 2002.

6. On January 24, 2002 AEPCO sent a letter to Chief Administrative Law Judge Lyn Farmer setting forth certain requests. AEPCO requested cancellation of the current PPFAC, authorization to explore a revised PPFAC with Staff to be implemented at a future date, and authorization of a surcharge to recover the $8.3 million under-collection in the PPFAC balance as of July 31, 2001 (the day before the reorganization of AEPCO).

7. AEPCO also requested that the Hearing Division extend the due date of Staff's recommendations from January 31, 2002 to March 5, 2002.

8. Each month, AEPCO makes a PPFAC filing with the Utilities Division on "Form A2". Form A2 distills monthly information regarding AEPCO's customers, generating units, revenues and costs of wheeling, fuel and purchased power into eight pages and computes a monthly over- or under-collected "bank balance".

9. Form A2, and the Commission's requirement that AEPCO use it, originated in Decision No. 53034, dated May 21, 1982.

10. Although the adjustor mechanism originated in the 1982 Decision, a new energy charge, base rate and adjustor was established in the Commission's last full rate case decision for AEPCO, Decision No. 58405, dated September 3, 1993. At that time, the adjustor was set at zero and the base cost of fuel and purchased power was set at $0.01714.

11. A second decision on outstanding rate case issues in the same case, Decision No. 58792, dated September 21, 1994, ordered AEPCO to file testimony in its next rate case discussing retention or elimination of the PPFAC. AEPCO has not filed a rate case since then.

12. Decision No. 58405 required AEPCO to determine the amount of fuel and purchased power expenses that should be allocated to the Class A members in a manner suitable to AEPCO's rates, contracts and operations at that time.

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13. AEPCO determines the various costs of fuel (coal and gas) used by each generator and the costs of purchased power. The most expensive fuel and purchased power are allocated to non-firm, non-jurisdictional customers, then to firm-non-jurisdictional customers with some specified exceptions. Then, the total costs allocated to the firm and non-firm non-jurisdictional customers is subtracted from total fuel and purchased power expense, leaving the remainder to be recovered from the Class A members.

14. In 1994 through 1996, Commission Staff members and AEPCO representatives held meetings and exchanged correspondence regarding AEPCO's method of calculating its PPFAC. Staff's concerns at that time centered on whether AEPCO's Class A members were receiving their fair allocation of the least-cost generation.

15. AEPCO had been determining the average cost of fuel and purchased power allocated to firm, non-jurisdictional customers differently from that allocated to non-firm non-jurisdictional customers, a process that AEPCO termed "illogical".

16. On February 14, 1994, AEPCO notified the Commission's Chief of Accounting and Rates that it was correcting "inconsistencies" in the logic used to develop the pools of marginal costs applicable to non-firm and firm non-jurisdictional sales and from that day forward would continue the new calculation.

17. Staff reviewed the surviving memos, letters and workpapers of both Staff and AEPCO to determined the source of the controversy. When AEPCO made the allocation methods conform under the new calculation, the result was a significant increase in costs allocated to Class A customers.

18. Staff also reviewed the Decision that created the PPFAC mechanism in 1982 along with other Commission Decisions that addressed the PPFAC and the adjustor and can find no specific references to or directions for determining or allocating the fuel and purchased power expenses among the Class A and non-Class A customers that AEPCO may have violated.

19. Staff believes that although the change in the calculation method instituted by AEPCO in 1994 may not have benefited the Class A members, it is a method of computing and allocating costs that is not prohibited by any Commission Decision. Thus, Staff believes that the change made in 1994 was within the purview of AEPCO to make.

20. Furthermore, none of AEPCO's Class A members have objected to the change in the method used.

21. Staff focused its attention on auditing the January, 2001 adjustor filing. January was chosen because it began with zero balance as it was the first filing after the forgiveness of the under-collected balance, making it the most straightforward monthly PPFAC filing to audit and verify. Previous to Staff's visit, AEPCO was not aware of the month Staff selected to audit.

22. Staff began with January 31st calculated bank balance, traced it back through the PPFAC calculations to randomly selected general ledger entries and, finally, to randomly selected invoices. No discrepancies were found. Staff's audit was particularly efficient given AEPCO's cooperation. Staff interviewed finance, accounting, marketing, and energy procurement employees of the company in the course of the audit.

23. Staff's audit revealed no unreasonable or imprudent accounting practices related to the PPFAC. Staff concluded that problems with the PPFAC lie not with the application of the existing structure, but rather the problems are within the structure of the mechanism itself.

24. At the time of the 1982 Decision, AEPCO was a much different cooperative than it is today. AEPCO's 1982 revenues of $125.9 million were derived from the sale of 2.5 billion kWhs. In contrast, for the year ending December 31, 2000, AEPCO's revenues were $229.0 million and kWh sales totaled 4.6 billion. Currently, AEPCO has more members and its revenues are comprised of a significantly greater proportion of contract and non-member sales than in 1982.

25. The most significant event since the 1982 adoption of Form A2 is the recent restructuring of AEPCO and the transfer of its transmission assets to Sierra Southwest.

26. Included in Form A2 is a section entitled Supplement B-Purchased Power and Wheeling Costs that computes the difference between wheeling costs included in base rates with wheeling costs incurred during the reporting period. Since the restructuring and the transfer of the transmission assets, AEPCO no longer pays wheeling costs. Thus, the restructuring created an inconsistency between Form A2 and AEPCO's actual operations.

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27. The decision from AEPCO's last rate case set rates to AEPCO's Class A members at $15.25 per kW of billing demand and $0.02228 per kWh. The Decision also determined that the base cost of fuel and purchased power included within the revenue requirements to be $0.01714. The adjustor was set at zero. Since then, AEPCO's adjustor has remained unchanged.

28. In the recent restructuring docket, the Commission authorized AEPCO to change its rates to $12.44 per kW of billing demand plus $0.01989 per kWh. Unfortunately, the new rates were adopted without consideration of a new base rate for the PPFAC. It is highly unlikely that AEPCO's base cost of fuel and purchased power is still the same $0.01714 it was in 1993.

29. Further drawing the accuracy of the base rate and the adjustor mechanism into question is the lack of a fully-allocated cost-of-service study supporting AEPCO's rate design when the base rate and energy charge were set in 1993. The incompatibility of the PPFAC and AEPCO's current rate structure and operations is further emphasized by the lack of a relevant cost of service study.

30. On the December 31, 2000 financial statements, AEPCO wrote-off the $6.7 million under-collection of its PPFAC bank balance and forgave repayment of that amount by its members.

31. Since that time until August 1, 2001, AEPCO has tracked PPFAC bank balance but has not "booked" the PPFAC deferred revenues in anticipation of the adjustor's elimination.

32. Between January 31, 2001, and July 31, 2001, the day before the restructuring was effectuated, a new bank balance of $8,294,176 accumulated.

33. AEPCO asserts that unexpected generating unit outages in the spring of 2001 forced AEPCO to buy replacement power at the higher prices prevailing at that time.

34. AEPCO requested authorization of a "surcharge" of $0.02 per kWh, through the docketed letter to the Chief Administrative Law Judge. AEPCO also submitted a resolution from its Board of Directors, that gave AEPCO authority to request termination of the PPFAC and to seek collection of the "$8,294,176 million under-collected balance as of July 31, 2001 at a rate not to exceed 2 mills per kWh".

35. Because AEPCO's Board is primarily composed of Directors of the Class A member cooperatives, Staff believes that the Board Resolution constitutes notice to AEPCO's Class A members.

36. AEPCO also requested in its letter authorization to "explore a revised PPFAC with Staff that could be implemented at a future date".

37. Staff believes that an order from the Commission is not necessary for AEPCO to "explore a revised PPFAC with Staff which could be implemented at a future date." AEPCO and Staff are free to meet about the new adjustor at any time, without an order of the Commission.

38. As an attachment to its letter, AEPCO filed the analysis that computed the July 31, 2001 under-collection of $8,294,176.

39. Staff believes that what AEPCO refers to as the "surcharge" is more appropriately called an adjustor within the construct of the mechanism.

40. The proposed 2-mill adjustor would collect the $8,294,176 million over approximately 27 months, a period much longer than the seven-month period over which it accumulated. The charge would be passed through to the Class A members' customers through the Class A members individual purchased power adjustors.

41. The Cooperative indicated that the under-collection accumulated primarily from an unusual generator outage.

42. This further highlights another area for improvement in the existing adjustor mechanism. A mechanism should contain some element that only passes normalized costs on to customers rather than costs incurred on an irregular basis. AEPCO's adjustor mechanism has no such normalization feature.

43. Staff believes that the intrinsic weaknesses of AEPCO's adjustor mechanism along with AEPCO's restructuring require the abolition of the existing mechanism. The continuation of the adjustor mechanism would only exacerbate the inconsistency between the adjustor and AEPCO's operations.

44. Staff recommends the discontinuation of the mechanism as of August 1, 2001 without a hearing.

45. Staff also recommends that AEPCO be allowed to recover $8,294,176 million of the remaining under-collected bank balance as of August 1, 2001, as authorized by its Board of Directors through a $0.002 per kWh adjustor from its Class A members until the balance is zero.

46. Staff further recommends that AEPCO file a quarterly report with the Director of the Utilities Division until the full $8,294,176 million is collected. The report should indicate the kWhs sold to the Class A members, the amount collected by the adjustor and the remaining balance for the quarter. The first quarterly report should be filed by July 31, 2002 for the period ending June 30, 2002. Subsequent reports should be filed within 30 days following the calendar quarter.

CONCLUSIONS OF LAW

1. AEPCO is a public service corporation within the meaning of Article XV of the Arizona Constitution.

2. The Commission has jurisdiction over AEPCO and the subject matter of this filing.

3. The Commission, having reviewed the filing and Staff's Memorandum dated February 27, 2002, concludes that it is in the public interest to approve the filing.

ORDER

IT IS THEREFORE ORDERED that AEPCO recover $8,294,176 million of the under-collected bank balance as authorized by its Board of Directors through a $0.002 per kWh adjustor from its Class A members until the balance is zero.

IT IS FURTHER ORDERED that although AEPCO may collect the July 31, 2001 adjustor bank balance through an adjustor, the adjustor mechanism and tracking of the bank balance is discontinued as of July 31, 2001.

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IT IS FURTHER ORDERED that AEPCO file a quarterly report with the Director of the Utilities Division until the full $8,294,176 million is collected. The report should indicate the kWhs sold to the Class A members, the amount collected by the adjustor and the remaining balance for the quarter. The first quarterly report should be filed by July 31, 2002 for the period ending June 30, 2002. Subsequent reports should be filed within 30 days following the calendar quarter.

IT IS FURTHER ORDERED that this Order shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION

William A. Mundell

CHAIRMAN COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary 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 27TH day of MARCH, 2002.

for BCM

BRIAN C. McNEIL
Executive Secretary

DISSENT: ____________________

EGJ:LAJ:JST:nms/JMA

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