

NEW APPLICATION



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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

- JEFF HATCH-MILLER, Chairman
- WILLIAM A. MUNDELL
- MARC SPITZER
- MIKE GLEASON
- KRISTIN K. MAYES

AZ CORP COMMISSION  
DOCUMENT CONTROL

E-01773A-06-0047

IN THE MATTER OF THE APPLICATION OF THE  
ARIZONA ELECTRIC POWER COOPERATIVE,  
INC. FOR PERMISSION TO IMPLEMENT AN  
FPPCA ADJUSTOR RATE ON APRIL 1, 2006.

DOCKET NO. E-01773A- - -

**APPLICATION**

The Arizona Electric Power Cooperative, Inc. ("AEPCO" or "the Cooperative")  
in support of its Application states as follows:

1. AEPCO is a non-profit, member-owned generation cooperative which supplies all or most of the power and energy requirements of its five Arizona and one California Class A member distribution cooperatives. For the reasons discussed below, AEPCO seeks Commission authorization to implement Fuel and Purchased Power Cost Adjustor ("FPPCA") Rates of 7.28 mills per kWh for its partial-requirements member and 8.82 mills per kWh for its all-requirements members on April 1, 2006.

2. Approval will allow the Cooperative to (a) begin to recover substantial undercollections in its fuel and purchased power expense, (b) stabilize its financial condition by beginning to reverse its severe shortage of cash working capital, (c) provide a source of funds to repay past and lessen future borrowings and therefore reduce its interest expense, (d) allow AEPCO to continue its physical hedging program which aim is to limit the impact of increased natural gas costs and, as importantly, (e) mitigate the impact of implementation of the Adjustor Rate on its members and their retail members.

GALLAGHER & KENNEDY, P.A.  
2575 E. CAMELBACK ROAD  
PHOENIX, ARIZONA 85016-9225  
(602) 530-8000

1           3.       AEPCO's Board of Directors is comprised of representatives of its members.  
2 Attached as Exhibit A is a Board resolution authorizing AEPCO to seek permission to implement  
3 the FPPCA Rate on April 1, 2006.

4           4.       In AEPCO's last rate case (Decision No. 68701 dated August 17, 2005, the  
5 "Decision"), the Commission authorized the Cooperative to implement an FPPCA clause.  
6 Finding that AEPCO's fuel and purchased power expenses amounted to almost half of its total  
7 expenses for the 2003 test year and no party had objected to the FPPCA, an FPPCA Adjustor  
8 Rate process was approved to begin with implementation on October 1, 2006 and to continue on  
9 April 1 and October 1 thereafter (Decision, Findings 34-36).

10          5.       During the Open Meeting discussion, however, the Commission also expressed  
11 concern that AEPCO's recovery of costs under the FPPCA might be "outpaced by the rate of  
12 future fuel and purchased power cost increases." Because of that concern, the Commission  
13 approved an amendment to the proposed opinion authorizing the Cooperative to file a request for  
14 review of the terms of the FPPCA should that occur (Decision, Finding 36 and Ordering  
15 Paragraph at ll. 16-18, p. 16). Although the Decision contemplated such a request at the time  
16 semi-annual reports were filed, AEPCO believes the intent of the amendment was to authorize a  
17 request to change FPPCA procedures, if necessary, at any time after the Decision took effect.

18          6.       The Commission is well aware of the unprecedented increases in fuel and  
19 purchased power costs which have occurred primarily over the past six months—led by  
20 astronomical volatility in the price of natural gas. In AEPCO's case, its FPPCA base rates were  
21 set using 2003 test year experience, including natural gas costs of \$4.50 per Dth. In October and  
22 November, the average cost of natural gas was more than double the amount recovered by the  
23 tariff. Prices for coal and purchased power have also risen dramatically. In November,

1 purchased power prices were 90% greater than tariff levels and coal costs had gone up about  
2 11%. Although about 60% of AEPCO's generation resources are coal fired, growth on the  
3 members' systems is forcing increased reliance on natural gas and purchased power. Last  
4 summer's record peak was 17% higher than 2004's and AEPCO anticipates it will have to meet  
5 about 20% of this year's demands with higher cost natural gas and purchased power.

6 7. AEPCO has taken several steps to control costs and improve its cash position  
7 where possible. This month, it sold approximately \$1.5 million in SO2 allowances to generate  
8 additional cash working capital. It has applied to the RUS under a new program to extend the  
9 maturity of certain FFB debt so as to lower its quarterly principal payments. Under its natural  
10 gas physical hedging program, supplies purchased last year at \$4.50 were used to mitigate some  
11 of this fall's large price increases. In April of 2005, AEPCO's Board approved a gas storage  
12 contract for this winter's gas needs and this strategy saved more than \$92,000 in December  
13 compared to market prices. Natural gas prices currently are at comparatively low levels, but  
14 AEPCO does not have the funds to take advantage of them. Assuming the Commission approves  
15 the cash and credit resources to do so, the Cooperative will continue the hedging program to  
16 attempt to control costs for this summer's peaking season. Finally, as the Commission is aware,  
17 AEPCO has also been very aggressive in attempting to control both its coal and coal  
18 transportation costs.

19 8. Notwithstanding these and other efforts, recent extraordinary fuel and purchased  
20 power increases have strained the Cooperative's financial resources to the breaking point. As of  
21 December 31, 2005, for the period September through December, under-collected fuel and  
22 purchased power expenses totaled approximately \$7.44 million and were more than \$11 million  
23 under-collected compared against base costs for calendar 2005. Combined with unexpectedly

1 high maintenance expenses on Steam Unit 2 in November, AEPCO has almost completely  
2 exhausted its CFC line of credit and short-term debt capacity. As the Commission knows, no  
3 substantial price relief is expected in the near term. Fuel and purchased power undercollections  
4 alone are expected to total almost \$17 million through the remainder of 2006. AEPCO does not  
5 have credit or cash resources to continue to carry these expenses. As well, it has no ability to  
6 continue its physical hedging program to attempt to control gas costs for this summer's peaking  
7 season.

8           9.       The Cooperative has devised a two-step process to address this situation. On  
9 January 6, it filed an Emergency Application for permission to temporarily exceed the seven  
10 percent (7%) short-term debt limitation (Docket No. E-01773A-06-0007) so it can increase its  
11 CFC line of credit. AEPCO has been working with Staff to process that Application and  
12 requests that the Commission enter its Order approving it as soon as possible. While prompt  
13 favorable action on this credit request is a critical first step, AEPCO also needs a source of cash  
14 to continue to fund future undercollections and its hedging program, repay credit advances and  
15 meet its other working capital needs as they come due.

16           10.       As the necessary second step, AEPCO requests that the Commission authorize  
17 FPPCA Adjustor Rates of 7.28 mills per kWh for its partial-requirements member and 8.82 mills  
18 per kWh for its all-requirements members effective April 1, 2006. Attached as Exhibit B is a  
19 schedule which shows the calculation of these rates. It follows the method approved in the  
20 Decision and uses the 12-month rolling average of fuel and purchased power expenses in  
21 calendar 2005, combined with undercollections in the FPPCA for the period September to  
22 December 2005. The calculation method followed on Exhibit B produced the lowest Adjustor  
23 Rates for the members. Other historic and projected methods would require Adjustor Rates on

1 April 1 two to three mills higher than the ones requested. A revised tariff and a partial-  
2 requirements member schedule, effective with April 1 usage, are attached as Exhibits C and D.

3 11. In addition to stabilizing the Cooperative's financial condition and providing a  
4 source of funds to continue to carry these large under-collected balances as well as to continue its  
5 physical hedging program, implementation of these Adjustor Rates will also mitigate  
6 implementation impact if they were to be deferred until October 1. Although AEPCO cannot  
7 cash flow its operations without prompt adjustor relief, assuming FPPCA implementation was  
8 postponed, the Cooperative estimates that the amount of the adjustors required at that time would  
9 be approximately 14 and 17 mills per kWh instead of the 7.28 and 8.82 mills currently requested.

10 12. It's difficult to estimate precisely the impact at retail of the wholesale Adjustor  
11 Rates because AEPCO's member distribution cooperatives have different rate designs, customer  
12 usage patterns and other factors which impact the total delivered rate from system to system.  
13 However, for an average residential customer on an all-requirements system using 750 kWh per  
14 month, the estimated impact of the Adjustor Rate implemented on April 1 would be about \$6.60  
15 per month.

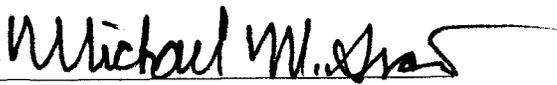
16 13. AEPCO has undertaken several communication efforts to keep its members and  
17 their retail members informed of these developments. It distributes monthly to its Board  
18 members as well as the distribution cooperatives for their use summaries of gas, coal and  
19 purchased power prices and impacts. In addition to coverage by the mass media of these  
20 developments, it also published in the November and January editions of the statewide Currents,  
21 stories on projected national higher energy bills, a summary of this Commission's September  
22 forum on the subject, energy savings tips from the Commission's website and an article  
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1 describing the reasons for AEPCO's rising costs of production as well as a description of the  
2 FPPCA mechanism.

3 WHEREFORE, having fully stated its Application, AEPCO requests that the  
4 Commission enter its Order approving FPPCA Adjustor Rates of 7.28 and 8.82 mills per kWh  
5 and approving the tariff and schedule attached as Exhibits C and D effective April 1, 2006.

6 RESPECTFULLY SUBMITTED this 30<sup>th</sup> day of January, 2006.

7 GALLAGHER & KENNEDY, P.A.

8  
9 By   
10 Michael M. Grant  
11 Todd C. Wiley  
12 2575 East Camelback Road  
Phoenix, Arizona 85016-9225  
Attorneys for Arizona Electric Power  
Cooperative, Inc.

13 **Original and thirteen copies** filed this  
14 30<sup>th</sup> day of January, 2006, with:

15 Docket Control  
16 Arizona Corporation Commission  
1200 West Washington  
Phoenix, Arizona 85007

17 **Copies** of the foregoing delivered  
18 this 30<sup>th</sup> day of January, 2006, to:

19 Commissioner Jeff Hatch-Miller, Chairman  
Arizona Corporation Commission  
1200 West Washington  
20 Phoenix, Arizona 85007

21 Commissioner William A. Mundell  
Arizona Corporation Commission  
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6 Attorneys for Mohave Electric Cooperative, Inc.

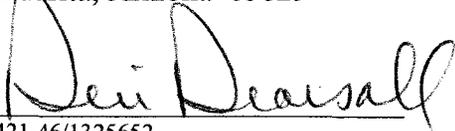
7 **Copies** of the foregoing mailed  
this 30<sup>th</sup> day of January, 2006, to:

8  
9 Christopher Hitchcock  
Law Offices of Christopher Hitchcock, P.L.C.  
One Copper Queen Plaza  
10 Post Office Box AT  
Bisbee, Arizona 85603-0115  
11 Attorneys for Sulphur Springs Valley Electric Cooperative, Inc.

12 John T. Leonetti  
HC 70, Box 4003  
13 Sahuarita, Arizona 85629

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**EXHIBIT A**

**ARIZONA ELECTRIC POWER COOPERATIVE, INC.**

The following resolution was adopted at a **regular meeting** of the Board of Directors of Arizona Electric Power Cooperative, Inc. (AEPCO), held in Benson, Arizona on January 11, 2006.

**RESOLUTION**

*WHEREAS, Management has reviewed the current status of the Cooperative's general fund and working capital accounts; and*

*WHEREAS, as a result of significant increases in the cost of natural gas and the cost of purchased power, under-collected fuel and purchased power costs totaling \$7.43 million have resulted from September 1, 2005 through November 30, 2005; and*

*WHEREAS, the 2006 Operating Budget projects that the fuel and purchased power costs will be under-collected by \$16.8 million; and*

*WHEREAS, the actual costs associated with the most recent ST2 maintenance overhaul exceeded planned budget by \$3.6 million; and*

*WHEREAS, the above circumstances have substantially and negatively impacted the level of the Cooperative's general funds; and*

*WHEREAS, due to the above circumstances the Cooperative has found it necessary to rely on the Operating Line of Credit in the amount of \$10.0 million of the total currently available \$12.0 million; and*

*WHEREAS, Management has discussed the available options of recovering current and projected under-collected fuel and purchased power expenses and ensuring the adequacy of the Cooperative's general funds;*

**NOW THEREFORE BE IT RESOLVED**, that in an effort to address the current outstanding and expected increasing under-collected balances associated with the fuel and purchased power expenses, Management is authorized to immediately apply to the Arizona Corporation Commission for permission to implement a Power Cost Adjustor Rate on April 1, 2006; and

**BE IT FURTHER RESOLVED**, that in an effort to ensure adequate working capital resources, Management is hereby authorized to immediately petition the ACC for permission to exceed the seven percent of total capitalization limitation on short-term debt; and

**BE IT FURTHER RESOLVED**, that Management is hereby directed and authorized to submit an application to the National Rural Utilities Cooperative Finance Corporation requesting that the Cooperative's Operating Line of Credit be increased from \$12 million to \$25 million; and

**BE IT FURTHER RESOLVED**, that Management is hereby authorized to execute an Incumbency Resolution as may be required by the CFC for the purposes of increasing the amount of credit available to the Cooperative under certain lines of credit; and

**BE IT FURTHER RESOLVED**, that Management in the form of the Executive Vice President and Chief Executive Officer, Senior Vice President and Chief Operating Officer, and Chief Financial Officer is and are hereby authorized, either individually or collectively, to execute, deliver and perform all other reasonable and necessary actions and functions necessary to achieve the intended purpose of this resolution.

I, Harold L. Hinkley, do hereby certify that I am Secretary of AEPCO, and that the foregoing is a true and correct copy of the Resolution adopted by the Board of Directors at a **regular meeting** held on January 11, 2006.

(seal)

  
Secretary

**EXHIBIT B**

# Arizona Electric Power Cooperative Inc.

## Computation of Power Cost Adjustor Rate Twelve Months Ended December 31, 2005

	Partial Requirements	All Requirements	Total
FPPCA 12 month rolling average (1) (Positive) Negative			
January	\$ (297,957.53)	\$ (579,970.99)	\$ (877,928.52)
February	(219,827.12)	(433,394.19)	(653,221.31)
March	(79,378.89)	(211,797.49)	(291,176.38)
April	(375,145.63)	(704,999.88)	(1,080,145.51)
May	30,562.51	283,843.12	314,405.63
June	294,144.81	850,675.93	1,144,820.74
July	970,264.93	2,434,513.79	3,404,778.72
August	519,971.88	1,212,219.86	1,732,191.74
September	497,066.61	1,279,315.82	1,776,382.43
October	713,730.84	1,329,282.19	2,043,013.03
November	1,266,728.64	2,716,624.61	3,983,353.25
December	(97,115.55)	(265,829.08)	(382,241.63)
<b>Total</b>	<b>\$ 3,223,045.50</b>	<b>\$ 7,910,483.69</b>	<b>\$ 11,114,232.19</b>
<b>Total 2005 MWh</b>	<b>769,705.00</b>	<b>1,471,354.5</b>	<b>2,241,059.5</b>
Increase in base rate required for 12 month average- \$/kWh	\$ 0.00419	\$ 0.00538	\$ 0.00496
Sept. - Dec. Under (Over) Collected Balance- (As of December 31, 2005)	\$ 2,380,410.54	\$ 5,059,393.54	\$ 7,439,804.08
<b>Total 2005 MWh</b>	<b>769,705.00</b>	<b>1,471,354.5</b>	<b>2,241,059.5</b>
Increase required to collect undercollection	\$ 0.00309	\$ 0.00344	\$ 0.00332
<b>Power Cost Adjustor Rate - \$/kWh</b>	<b><u>0.00728</u></b>	<b><u>0.00882</u></b>	<b><u>0.00828</u></b>

(1) Calculations are based upon Commission allowed fuel, purchased power and wheeling costs under Decision # 68071 compared against the base costs for the partial and all requirements members for calendar 2005.

**EXHIBIT C**

## ARIZONA ELECTRIC POWER COOPERATIVE, INC.

### TARIFF

#### PERMANENT

Effective Date: April 1, 2006

#### AVAILABILITY

Available to all cooperative associations which are or shall be all-requirements Class A members of the Arizona Electric Power Cooperative, Inc. ("AEPCO").

#### MONTHLY RATE (BILLING PERIOD)

Electric power and energy furnished under this Tariff will be subject to the rates set forth in the attached Exhibit A and the terms set forth herein.

Billing Demand – The billing demand shall be that thirty minute integrated Class A member metered demand coincident at the hour of the AEPCO monthly peak. Contracts specifying demand levels and billing parameters are not included in this Class A member definition of billing demand and are billed separately.

Billing Month – The first calendar month preceding the month the bill is rendered.

Additional Charges – Service is also subject to the rates and charges stated in AEPCO's Regulatory Assets and Competition Transition Charge Supplemental Tariff. The demand and energy rates stated herein include no allowance for recovery of regulatory assets. Pursuant to Decision No. 62758, the regulatory assets and RAC have been assigned to Southwest Transmission Cooperative, Inc. AEPCO will pass through to its Class A members the RAC assessed by Southwest Transmission Cooperative, Inc.

Power Factor – Each member shall maintain power factor at the time of maximum demand as close to unity as possible. In the event the power factor measured at the time of the maximum demand is less than 95% lagging or leading, the maximum demand shall be adjusted for billing purposes by dividing the maximum measured demand by the measured power factor multiplied by .95. The provisions of the power factor adjustment will be waived if power factor is detrimentally impacted as a direct result of system improvements or a change in operational procedure by AEPCO to reduce transmission losses and/or improve system reliability.

Taxes – Bills rendered are also subject to adjustment for all federal, state and local government taxes or levies on such sales and any assessments that are or may be imposed by federal or state regulatory agencies on electric utility gross revenues.

Transmission and Ancillary Service Charges – Each Class A member will also be billed by AEPCO for charges it incurs for the transmission of energy to the Class A member’s delivery point(s). Such charges will be assessed to the Class A member at the rates actually charged AEPCO by the transmission provider and others for transmission service and the provision of ancillary services.

Power Cost Adjustor Rate – The monthly bill computed under this Tariff will, on the procedures stated herein, be increased or decreased by an amount equal to the result of multiplying the kWh used by the Power Cost Adjustor Rate where:

$$F = (PC + BA) - \$0.01687$$

F = Power Cost Adjustor Rate in dollars per kWh, rounded to the nearest one-thousandth of a cent (\$0.00001).

PC = The Commission allowed pro forma fuel, purchased power and wheeling costs in dollars per kWh, rounded to the nearest one-thousandth of a cent (\$0.00001).

BA = The “Bank Account” represents allowable accumulated fuel and purchased energy costs in dollars per kWh, rounded to the nearest one-thousandth of a cent (\$0.00001) over or under collected in the past.

Allowable fuel, purchased power and wheeling costs include:

- A. The costs of fossil fuel and natural gas consumed in AEPCO’s own plants as recorded in RUS Accounts 501 and 547, plus
- B. The actual costs associated with power purchased for reasons other than identified in paragraph (C) below as recorded in RUS Account 555, plus
- C. The cost of energy purchased when such energy is purchased on an economic dispatch basis. Included therein may be such costs as that charged for economy energy purchases and the charges as a result of scheduled outage. All such kinds of energy being purchased by AEPCO to substitute for its own higher cost energy as recorded in RUS Account 555, plus
- D. The firm and non-firm wheeling expenses associated with the delivery of energy as recorded in RUS Account 565, excepting network service transmission payments made by AEPCO to Southwest Transmission Cooperative, Inc for electric power and energy furnished to the all-requirements Class A members and less
- E. The demand and energy costs recovered through non-tariff contractual firm sales of power and energy as recorded in RUS Account 447, less

- F. The demand and energy costs recovered through inter-system sales including the incremental fuel and/or purchased energy costs related to economy energy sales and other energy sold on an economic dispatch basis as recorded in RUS Account 447.

On a calendar semi-annual basis, AEPCO shall compute the Power Cost Adjustor Rate as specified herein based upon a rolling twelve-month average and file on September 1 or March 1 of the month preceding the effective date of the revised Power Cost Adjustor Rate (i.e., October 1 or April 1): (1) calculations supporting the revised Adjustor Rate with the Director, Utilities Division and (2) a Tariff reflecting the revised Adjustor Rate with the Commission which shall be effective for billings after the 1<sup>st</sup> day of the following month and which shall continue in effect until revised pursuant to the procedures specified herein.

DSM Adjustor Rate – Monthly bills for service provided hereunder will also include an amount for recovery of costs associated with pre-approved DSM programs. The DSM Adjustor Rate will be calculated by dividing the account balance of any costs incurred by AEPCO for pre-approved DSM programs less revenues received through the DSM Adjustor Rate by the total number of kWh sold to Class A members in the previous calendar year. AEPCO will file a request for the initial or revised DSM Adjustor Rate and supporting documentation with Utilities Division Staff by February 1 for a DSM Adjustor Rate to be effective on March 1.



**EXHIBIT D**

## Arizona Electric Power Cooperative, Inc.

### Partial-Requirements Member Rates and Fixed Charge (Effective April 1, 2006)

Service provided to Mohave Electric Cooperative, Inc. by the Arizona Electric Power Cooperative, Inc. under the Partial Requirement Capacity and Energy Agreement shall be at the rates set forth in the attached Exhibit A.

Power Cost Adjustor Rate – The monthly bill computed under this Schedule will, on the procedures stated herein, be increased or decreased by an amount equal to the result of multiplying the kWh used by the Power Cost Adjustor Rate where:

$$F = (PC + BA) - \$0.01603$$

F = Power Cost Adjustor Rate in dollars per kWh, rounded to the nearest one-thousandth of a cent (\$0.00001).

PC = The Commission allowed pro forma fuel, purchased power and wheeling costs in dollars per kWh, rounded to the nearest one-thousandth of a cent (\$0.00001).

BA = The "Bank Account" represents allowable accumulated fuel and purchased energy costs in dollars per kWh, rounded to the nearest one-thousandth of a cent (\$0.00001) over or under collected in the past.

Allowable fuel, purchased power and wheeling costs include:

- A. The costs of fossil fuel and natural gas consumed in AEPCO's own plants as recorded in RUS Accounts 501 and 547, plus
- B. The actual costs associated with power purchased for reasons other than identified in paragraph (C) below as recorded in RUS Account 555, plus
- C. The cost of energy purchased when such energy is purchased on an economic dispatch basis. Included therein may be such costs as that charged for economy energy purchases and the charges as a result of scheduled outage. All such kinds of energy being purchased by AEPCO to substitute for its own higher cost energy as recorded in RUS Account 555, plus
- D. The firm and non-firm wheeling expenses associated with the delivery of energy as recorded in RUS Account 565, excepting network service transmission payments made by AEPCO to Southwest Transmission Cooperative, Inc for electric power and energy furnished to the all-requirements Class A members and less

- E. The demand and energy costs recovered through non-tariff contractual firm sales of power and energy as recorded in RUS Account 447, less
- F. The demand and energy costs recovered through inter-system sales including the incremental fuel and/or purchased energy costs related to economy energy sales and other energy sold on an economic dispatch basis as recorded in RUS Account 447.

On a calendar semi-annual basis, AEPCO shall compute the Power Cost Adjustor Rate as specified herein based upon a rolling twelve-month average and file on September 1 or March 1 of the month preceding the effective date of the revised Power Cost Adjustor Rate (i.e., October 1 or April 1): (1) calculations supporting the revised Adjustor Rate with the Director, Utilities Division and (2) a Schedule reflecting the revised Adjustor Rate with the Commission which shall be effective for billings after the 1<sup>st</sup> day of the following month and which shall continue in effect until revised pursuant to the procedures specified herein.

DSM Adjustor Rate – Monthly bills for service provided hereunder will also include an amount for recovery of costs associated with pre-approved DSM programs. The DSM Adjustor Rate will be calculated by dividing the account balance of any costs incurred by AEPCO for pre-approved DSM programs less revenues received through the DSM Adjustor Rate by the total number of kWh sold to Class A members in the previous calendar year. AEPCO will file a request for the initial or revised DSM Adjustor Rate and supporting documentation with Utilities Division Staff by February 1 for a DSM Adjustor Rate to be effective on March 1.

