

ORIGINAL

OPEN MEETING



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MEMORANDUM

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2006 MAR -11 A 9:28

TO: THE COMMISSION

FROM: Utilities Division

AZ CORP COMMISSION
DOCUMENT CONTROL

DATE: March 1, 2006

RE: IN THE MATTER OF THE APPLICATION OF THE ARIZONA ELECTRIC POWER COOPERATIVE, INC. FOR PERMISSION TO IMPLEMENT A FUEL AND PURCHASED POWER COST ADJUSTOR RATE ON APRIL 1, 2006 (DOCKET NO. E-01773A-06-0047)

This application, filed January 31, 2006, is a request by the Arizona Electric Power Cooperative, Inc. ("AEPCO" or "the Cooperative") to accelerate the date of the initial reset of its new Fuel and Purchased Power Cost Adjustor ("FPPCA" or "adjustor") from October 1, 2006, to April 1, 2006. In Decision No. 68071 (August 17, 2005), the Commission approved new rates for AEPCO. In that Decision, the Commission also ordered other provisions including a provision directing AEPCO to amend its tariffs to include a FPPCA rate component. Under the terms set forth in the Order, the adjustor rate, initially set to zero, would be reset semi-annually on October 1, 2006, and April 1, 2007, and thereafter on October 1 and April 1 of each subsequent year. AEPCO indicated that its current financial situation has made the application to accelerate the date for the initial reset of the new FPPCA from October 1, 2006, to April 1, 2006, necessary.

AEPCO is a non-profit, member-owned generation cooperative that supplies all or most of the power and energy requirements of its five Arizona and one California member distribution cooperatives. AEPCO supplies all requirements to the following members: Anza Electric Cooperative, Inc. (California); Duncan Valley Electric Cooperative, Inc.; Graham County Electric Cooperative, Inc.; Trico Electric Cooperative, Inc.; and Sulphur Springs Valley Electric Cooperative, Inc. Its only partial-requirements member is currently Mohave Electric Cooperative, Inc., although AEPCO states that Sulphur Springs Valley Electric Cooperative, Inc. may become a partial-requirements member in the future.

Prior to Commission Decision No. 68071, AEPCO did not have an FPPCA. This Decision provided that AEPCO begin reporting its fuel and purchased power costs to the Commission on a monthly basis beginning with September 2005 data, and the actual adjustor component be added to AEPCO's rates beginning October 1, 2006.

AEPCO stated that the acceleration of FPPCA implementation to April 1, 2006, is needed to mitigate its strained financial resources caused by extraordinary fuel and purchased power cost increases. It stated that the accelerated implementation date would allow AEPCO to: 1.) begin to recover substantial under-collections in its fuel and purchased power costs; 2.) stabilize its financial condition by beginning to reverse its severe shortage of working capital; 3.) provide a source of funds to repay past and lessen future borrowings and, therefore, reduce interest

THE COMMISSION

March 1, 2006

Page 2

expenses; 4.) allow it to continue its physical hedging program; and 5.) more gradually phase in the impact of the implementation of the Adjustor rate on its members and their retail customers.

The Cooperative states that its increase in fuel and purchased power costs over the past six months were driven primarily by volatility in the price of natural gas. AEPCO's current rates, set by Decision No. 68071 and implemented on September 1, 2005, were based on a test year of 2003, including natural gas costs of \$4.50 per Dth. AEPCO states that the average cost of natural gas in October and November 2005 were more than double the amount recovered by the current tariff. Although about 60 percent of AEPCO's generation is coal-fired, AEPCO states that coal and purchased power prices have also escalated. Additionally, AEPCO indicated it had to rely increasingly on burning natural gas and purchasing power to meet growth on the members' systems and to meet significantly higher system peak demands. Staff determined through discovery that an 11-day extension of a minor overhaul of Steam Turbine Unit 2 resulted in additional gas generation and purchased power to supply power that was not generated by Steam Turbine Unit 2 during that time period. The incremental costs associated with this outage, however, have not yet been quantified. Staff will investigate this at the time that a prudence review is performed on AEPCO's fuel and purchased power practices.

Strained financial resources caused by escalating fuel and purchased power costs were accentuated by unexpectedly high maintenance expenses on Steam Unit 2 in November 2005. To help mitigate its situation, AEPCO states that it has taken a number of steps to improve its cash position including selling SO₂ allowances, applying to extend debt to lower quarterly payments, engaging in natural gas physical hedging activities, entering into a new gas storage contract, and aggressively attempting to control coal and coal transportation costs. However, AEPCO states that it had almost completely exhausted its credit line and short-term debt capacity by November 2005.

As part of a two-step process to address its financial situation, AEPCO filed an application with the Commission to request approval to temporarily exceed its statutory short-term borrowing limit of seven percent of total capital through 2006. In Decision No. 68481, February 15, 2006, the Commission granted approval for AEPCO to increase its borrowing to \$30 million. The second step of AEPCO's two-step process was to request that the Commission allow the first reset of the FPCCA to occur in April instead of October, the subject of this application.

According to AEPCO's analysis, requested by Staff, the proposed FPCCA rates would result in an overall increase for all-requirements members of 18.1 percent and for Mohave Electric Cooperative, Inc., the only partial-requirements member, 16.4 percent. The proposed FPCCA rates would result in an overall increase to all six distribution cooperatives of 17.5 percent. AEPCO states that for an average retail customer (using 750 kWh per month) of an all-requirements distribution cooperative, the estimated impact of the Adjustor Rate would be about \$6.60 per month.

Staff has analyzed AEPCO's application and the associated workpapers requested from the Cooperative as well as the monthly FPCCA reports which AEPCO began filing in September

THE COMMISSION

March 1, 2006

Page 3

2005. The calculation of the adjustor rates at \$0.00881 per kWh for all-requirements members and \$0.00728 per kWh for partial-requirements members appears to be in conformance with the provisions set forth in Decision No. 68071. (The rates included in the application are slightly different because they were based on preliminary December 2005 numbers which have subsequently been revised.) Bank balance information shown in Table 1 has been filed with the Commission reflecting only the months of September 2005 through December 2005, in conformance with Decision No. 68071. AEPCO, however, has gone back and calculated fuel and purchased power cost data beginning January 2005 for the purposes of calculating these adjustor rates on a full year of experience January 2005 through December 2005.

Table 1: AEPCO Under-collected (Over-collected) Bank Balance - Actual

2005	Partial Requirements	All Requirements	Total	Cumulative Balance
September	\$497,066.61	\$1,279,315.82	\$1,776,382.43	\$1,776,382.43
October	\$713,730.84	\$1,329,282.19	\$2,043,013.03	\$3,819,395.46
November	\$1,266,728.64	\$2,716,624.61	\$3,983,353.25	\$7,802,748.71
December	(\$98,268.20)	(\$267,864.53)	(\$366,132.73)	\$7,436,615.98
Total	\$2,379,257.89	\$5,057,358.09	\$7,436,615.98	\$7,436,615.98

The table above shows the rapid accumulation of the under-collected bank balance during the short time we have been receiving monthly reports. Following is Staffs forecast of where that bank balance would be in July 2006, based upon numbers supplied by AEPCO. We are focusing on July 2006 because there is a lag in the data, and at the October 1, 2006, reset, we would be looking at July 2006 actual numbers.

Table 2: Forecast of AEPCO Under-collected (Over-collected) Bank Balance - Projected

2006	All Requirements (\$)	Partial Requirements (\$)	Total (\$)
Actual through 2005	\$2,379,258	\$5,057,358	\$7,436,616
January	\$310,000	\$768,000	\$1,078,000
February	\$24,000	\$142,000	\$166,000
March	(\$431,000)	(\$872,000)	(\$1,303,000)
April	(\$264,000)	(\$501,000)	(\$765,000)
May	\$669,000	\$592,000	\$1,261,000
June	\$1,113,000	\$1,339,000	\$2,452,000
July	\$1,345,000	\$1,719,000	\$3,064,000
Total	\$5,145,258	\$8,244,358	\$13,389,616

According to a Staff analysis, the proposed adjustor rates if implemented April 1, 2006, would generate the following incremental revenues:

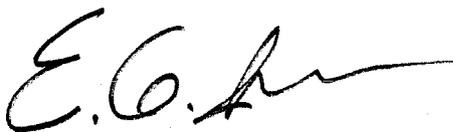
Table 3: Incremental Revenue to be Received by AEPCO as a Result of Adding Proposed Adjustor Rates 6 Months Early

2006	All Requirements (\$)	Partial Requirements (\$)	Total (\$)
April	\$986,534.99	\$462,010.64	\$1,448,545.63
May	\$1,152,453.72	\$487,337.76	\$1,639,791.48
June	\$1,380,077.69	\$498,461.60	\$1,878,539.29
July	\$1,538,358.15	\$562,219.84	\$2,100,577.99
August	\$1,488,431.88	\$562,532.88	\$2,050,964.76
September	\$1,299,122.60	\$496,030.08	\$1,795,152.68

Staff finds no reason to believe that AEPCO's financial situation is not as represented by the Cooperative in its application in this matter, and as established in Decision No. 68481 (the matter of AEPCO's request for permission to temporarily exceed the seven percent short-term debt limitation).

In consideration of the analysis above and the findings in the earlier case, Staff, recommends that the new adjustor rates be reset from zero to \$0.00881 per kWh for all-requirements members and \$0.00728 per kWh for partial-requirements members and implemented on April 1, 2006, six months earlier than the schedule originally contemplated to occur on October 1, 2006.

Staff also recommends that AEPCO work with its member Cooperatives to calculate the impact of the AEPCO adjustor rates on the average residential customer for each distribution cooperative and to ensure that proper notice be provided to the distribution cooperative's retail customers by no later than May 1, 2006, in a form acceptable to Staff.



Ernest G. Johnson
Director
Utilities Division

EGJ:JDA:lhmvJG

ORIGINATOR: Jerry D. Anderson

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 JEFF HATCH-MILLER

Chairman

3 WILLIAM A. MUNDELL

Commissioner

4 MARC SPITZER

Commissioner

5 MIKE GLEASON

Commissioner

6 KRISTIN K. MAYES

Commissioner

7

8 IN THE MATTER OF THE APPLICATION
9 OF THE ARIZONA ELECTRIC POWER }
10 COOPERATIVE, INC. FOR APPROVAL, }
11 TO IMPLEMENT A FUEL AND }
PURCHASED POWER COST ADJUSTOR }
RATE ON APRIL, 1,2006 }

DOCKET NO. E-01773A-06-0047

DECISION NO. _____

ORDER

12 Open Meeting
13 March 15 and 16,2006
14 Phoenix, Arizona

15 BY THE COMMISSION:

16 FINDINGS OF FACT

17 1. Arizona Electric Power Cooperative, Inc. ("AEPCO") is certificated to provide
18 electric service as a public service corporation in the State of Arizona.

19 2. This application, filed January 31, 2006, is a request by the AEPCO to accelerate
20 the date of the initial reset of its new Fuel and Purchased Power Cost Adjustor ("FPPCA" or
21 "adjustor") from October 1,2006, to April 1,2006. In Decision No. 68071 (August 17, 2005), the
22 Commission approved new rates for AEPCO. In that Decision, the Commission also ordered other
23 provisions including a provision directing AEPCO to amend its tariffs to include a FPPCA rate
24 component. Under the terms set forth in the Order, the adjustor rate, initially set to zero, would be
25 reset semi-annually on October 1,2006, and April 1, 2007, and thereafter on October 1 and April 1
26 of each subsequent year. AEPCO indicated that its current financial situation has made the
27 application to accelerate the date for the initial reset of the new FPPCA from October 1, 2006, to
28 April 1,2006,necessary.

1 3. AEPCO is a non-profit, member-owned generation cooperative that supplies all or
2 most of the power and energy requirements of its five Arizona and one California member
3 distribution cooperatives. AEPCO supplies all requirements to the following members: Anza
4 Electric Cooperative, Inc. (California); Duncan Valley Electric Cooperative, Inc.; Graham County
5 Electric Cooperative, Inc.; Trico Electric Cooperative, Inc.; and Sulphur Springs Valley Electric
6 Cooperative, Inc. Its only partial-requirements member is currently Mohave Electric Cooperative,
7 Inc., although AEPCO states that Sulphur Springs Valley Electric Cooperative, Inc. may become a
8 partial- requirements member in the future.

9 4. Prior to Commission Decision No. 68071, AEPCO did not have an FPPCA. This
10 Decision provided that AEPCO begin reporting its fuel and purchased power costs to the
11 Commission on a monthly basis beginning with September 2005 data, and the actual adjustor
12 component be added to AEPCO's rates beginning October 1, 2006.

13 5. AEPCO stated that the acceleration of FPPCA implementation to April 1, 2006, is
14 needed to mitigate its strained financial resources caused by extraordinary fuel and purchased
15 power cost increases. It stated that the accelerated implementation date would allow AEPCO to:
16 1.) begin to recover substantial under-collections in its fuel and purchased power costs; 2.)
17 stabilize its financial condition by beginning to reverse its severe shortage of working capital; 3.)
18 provide a source of funds to repay past and lessen future borrowings and, therefore, reduce interest
19 expenses; 4.) allow it to continue its physical hedging program; and 5.) more gradually phase in
20 the impact of the implementation of the Adjustor rate on its members and their retail customers.

21 6. The Cooperative states that the increase in fuel and purchased power costs over the
22 past six months were driven primarily by volatility in the price of natural gas. AEPCO's current
23 rates, set by Decision No. 68071 and implemented on September 1, 2005, were based on a test
24 year of 2003, including natural gas costs of \$4.50 per Dth. AEPCO states that the average cost of
25 natural gas in October and November 2005 were more than double the amount recovered by the
26 current tariff. Although about 60 percent of AEPCO's generation is coal-fired, AEPCO states that
27 coal and purchased power prices have also escalated. Additionally, AEPCO indicated it had to
28 rely increasingly on burning natural gas and purchasing power to meet growth on the members'

1 systems and to meet significantly higher system peak demands. Staff determined through
2 discovery that **an** 11-day extension of a minor overhaul of Steam Turbine Unit 2 resulted in
3 additional gas generation and purchased power to supply power that was not generated by Steam
4 Turbine Unit 2 during that time period. The incremental costs associated with this outage,
5 however, have not yet been quantified. Staff will investigate this at the time that a prudence
6 review is performed on AEPCO's fuel and purchased power practices.

7 7. Strained financial resources caused by escalating fuel and purchased power costs
8 were accentuated by unexpectedly high maintenance expenses on Steam Unit 2 in November 2005.
9 To help mitigate its situation, AEPCO states that it has taken a number of steps to improve its cash
10 position including selling SO2 allowances, applying to extend debt to lower quarterly payments,
11 engaging in natural gas physical hedging activities, entering into a new gas storage contract, and
12 aggressively attempting to control coal and coal transportation costs. However, AEPCO states that
13 it had almost completely exhausted its credit line and short-term debt capacity by November 2005.

14 8. As part of a two-step process to address its financial situation, AEPCO filed an
15 application with the Commission to request approval to temporarily exceed its statutory short-term
16 borrowing limit of seven percent of total capital through 2006. In Decision No. 68481, February
17 15, 2006, the Commission granted approval for AEPCO to increase its borrowing to \$30 million.
18 The second step of AEPCO's two-step process was to request that the Commission allow the first
19 reset of the FPCCA to occur in April instead of October, the subject of this application.

20 9. According to AEPCO's analysis, requested by Staff, the proposed FPCCA rates
21 would result in an overall increase for all-requirements members of 18.1 percent and for Mohave
22 Electric Cooperative, Inc., the only partial-requirements member, 16.4 percent. The proposed
23 FPCCA rates would result in **an** overall increase to all **six** distribution cooperatives of 17.5 percent.
24 AEPCO states that for an average retail customer (using 750 kWh per month) of an all-
25 requirements distribution cooperative, the estimated impact of the Adjustor Rate would be about
26 \$6.60 per month.

27 10. Staff has analyzed AEPCO's application and the associated workpapers requested
28 from the Cooperative as well as the monthly FPCCA reports which AEPCO began filing in

1 September 2005. The calculation of the adjustor rates at \$0.00881 per kWh for all-requirements
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 18 12. The table above shows the rapid accumulation of the under-collected bank balance
 19 during the short time we have been receiving monthly reports. Following is Staff's forecast of
 20 where that bank balance would be in July 2006, based upon numbers^{*} supplied by AEPCO. We are
 21 focusing on July 2006 because there is a lag in the data, and at the October 1, 2006 reset, we would
 22 be looking at July 2006 actual numbers.

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13. According to a Staff analysis, the proposed adjustor rates if implemented April 1, 2006, would generate the following incremental revenues:

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August	\$1,488,431.88	\$562,532.88	\$2,050,964.76
September	\$1,299,122.60	\$496,030.08	\$1,795,152.68
Total	\$7,844,979.03	\$3,068,592.80	\$10,913,571.83

14. Staff has found no reason to believe that AEPCO’s financial situation is not as represented by the Cooperative in its application in this matter, and as established in Decision No. 68481 (the matter of AEPCO’s request for permission to temporarily exceed the seven percent short-term debt limitation).

15. In consideration of the analysis above and the findings in the earlier case, Staff has recommended that the new adjustor rates be reset from zero to \$0.00881 per kWh for all-requirements members and \$0.00728 per kWh for partial-requirements members and implemented

1 on April 1, 2006, six months earlier than the schedule originally contemplated to occur on
2 October 1, 2006.

3 16. Staff has also recommended that AEPCO work with its member Cooperatives to
4 calculate the impact of the AEPCO adjustor rates on the average residential customer for each
5 distribution cooperative and to ensure that proper notice be provided to the distribution
6 cooperative's retail customers by no later than May 1, 2006, in a form acceptable to Staff.

7 CONCLUSIONS OF LAW

8 1. AEPCO is certificated to provide electric service as a public service corporation in
9 the State of Arizona.

10 2. The Commission has jurisdiction over AEPCO and over the subject matter of the
11 application.

12 3. The Commission, having reviewed the application and Staff's Memorandum dated
13 March 1, 2006, concludes that it is in the public interest to approve the acceleration of the first
14 reset of AEPCO's FPPCA from October 1, 2006 to April 1, 2006.

15 ORDER

16 IT IS THEREFORE ORDERED that the acceleration of the first reset of AEPCO's FPPCA
17 from October 1, 2006 to April 1, 2006, be and hereby is approved as discussed herein.

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IT IS FURTHER ORDERED that AEPCO work with its member Cooperatives to calculate the impact of the AEPCO adjustor rates on the average residential customer for each distribution cooperative and ensure that proper notice is provided to the distribution cooperative's retail customers by no later than May 1,2006, in a form acceptable to Staff.

IT IS FURTHER ORDERED that this decision should become effective immediately.

BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN	COMMISSIONER	
COMMISSIONER	COMMISSIONER	COMMISSIONER

IN WITNESS WHEREOF, I BRIAN C. McNEIL, Executive Director 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 ____ day of _____, 2006.

BRIAN C. McNEIL
Executive Director

DISSENT: _____

DISSENT: _____

EGJ:JDA:lhmvjg

1 SERVICE LIST FOR: Arizona Electric Power Cooperative, Inc.
2 DOCKET NO. E-01773A-06-0047

3 Mr. John Leonetti
4 -IC 70, Box 4003
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10 Bisbee, Arizona 85603-0115

11 Mr. Michael Curtis
12 Mr. William P. Sullivan
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