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MEMORANDUM

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TO: Docket Control  
Arizona Corporation Commission  
FROM: Ernest Johnson  
Director  
Utilities Division

ARIZONA CORPORATION COMMISSION  
DOCUMENT CONTROL  
EA for EGS

Arizona Corporation Commission  
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DATE: March 30, 2007

RE: ARIZONA ELECTRIC POWER COOPERATIVE, INC. DOCKET NOS. E-01773A-04-0528 AND E-04100A-04-0527. REQUEST FOR REVIEW OF FPPCA EFFICACY AND IMPLEMENTATION OF ALTERNATE ADJUSTOR RATES

**Issue**

On February 27, 2007, Arizona Electric Power Cooperative, Inc. ("AEP" or "the Cooperative") filed a Request for Review of its Fuel and Purchased Power Cost Adjustor ("FPPCA") Efficacy and Implementation of Alternate Adjustor Rates. AEP's request was filed in Docket Nos. E-01773A-04-0528 and E-04100A-04-0527 (Decision No. 68071).

**Background**

Pursuant to Commission's Decision No. 68071, issued August 18, 2005, established a FPPCA for AEP, initially set it at zero, and scheduled it to reset semi-annually on October 1, 2006, and April 1, 2007, and thereafter on October 1 and April 1 of each subsequent year. On January 31, 2006, AEP filed an application with the Commission in Docket No. E-01773A-06-0047 to accelerate implementation of its FPPCA from October 1, 2006, to April 1, 2006. The Commission granted AEP approval to accelerate the FPPCA start date to April 1, 2006, in Decision No. 68594, March 23, 2006.

AEP's FPPCA is a two-part adjustor mechanism, without bands or limitations. The mechanism considers a 12-month rolling average of actual fuel and purchased power costs calculated once each six (6) months, and a second component takes the bank balance amount at the time of each 6-month re-calculation into consideration. Once set, the adjustors for both all-requirements members and partial-requirements members remain unchanged for six months. The FPPCA has been in effect for almost one year, having been initially reset from zero on April 1, 2006, and reset a second time on October 1, 2006. AEP is required to submit relevant FPPCA reset information to the Commission on or before March 1 for the April 1 reset and on or before September 1 for the October 1 reset.

AEPCO's filing is a request for the Commission to review the efficacy of AEPCO's FPPCA mechanism and to implement alternate (higher) adjustor rates for the six-month period beginning April 1, 2007. AEPCO made this additional filing because it believes the adjustors generated by the Commission-approved FPPCA rates will not allow AEPCO to make substantial progress in reducing its bank balance. AEPCO cited Decision No. 68071 in making its request. The sixth Ordering Paragraph in Decision No. 68071 states:

"IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. may file a request that the Commission review the efficacy of the FPPCA with the Arizona Electric Cooperative, Inc.'s submission of any semi-annual FPPCA report required by this Decision."

AEPCO submitted two alternative FPPCA mechanism proposals based on 9-month and 6-month rolling averages to accelerate the recovery of its under-collected bank balance. AEPCO recommended that the Commission authorize the 9-month rolling average adjustors on April 1, 2007, and authorize it to implement the six-month rolling average adjustors on October 1, 2007, if the nine-month based adjustors do not allow the Cooperative to make substantial progress in reducing its bank balance and paying down its short-term debt.

AEPCO suggested Staff might review its proposal in time to get it on the March Open meeting agenda or a March 29 Securities agenda such that the higher adjustors could still become effective on the reset date, April 1, 2007. If that timeframe is not possible, the Cooperative suggested implementation of its proposed adjustors, based on the approved 12-month rolling average Commission-approved FPPCA, on April 1, 2007, and the higher adjustors be authorized for May 1, 2007, implementation.

### **Analysis**

Staff is aware of the magnitude of AEPCO's Bank Balance which is near its peak on AEPCO's most recent Monthly FPPCA Report for December 2006, at \$10.8 million. Staff is also aware that AEPCO is in need to build equity and has an equity goal of 30 percent of total capitalization, and that the FPPCA bank balance has exerted an influence over the past year in keeping the Cooperative from reaching that goal and reducing its short-term debt.

However, Staff is also concerned about the effect of the potential adjustor increases to member cooperatives, and to the ultimate electricity consumers. It is clear to Staff that AEPCO's proposal needs to be analyzed fully from all perspectives. Staff has been reviewing the data submitted by AEPCO with its February 27, 2007, filings, but will need to issue data requests for additional information and analysis well beyond that which AEPCO filed. Staff, indeed, has more work to do before it will be able to make informed recommendations to the Commission regarding the efficacy of AEPCO's FPPCA.

At the current stage of Staff's analysis, it appears that the Commission-approved FPPCA 12-month rolling average adjustors may be doing what they were designed to do; to smooth out

wide variations in fuel and purchased power costs for customers while continuing to track costs. By AEPCO's own analysis, the current 12-month rolling average based FPPCA will reduce the Cooperative's bank balance from its current level of \$10.8 million in December 2006, the most recently available monthly report, to \$5.8 million in September 2007, the final month of the six-month period during which the April 1, 2007, reset adjustor rates will be in effect. Indeed, the bank balance projected by AEPCO for each month of that period, April 2007 through September 2007, is lower than the corresponding month in 2006.

Staff may like to see the FPPCA recover AEPCO's under-collected bank balance more rapidly, but Staff is cautious about recommending higher increases for ratepayers unless absolutely necessary. The fuel and purchased power costs taken into consideration in AEPCO's FPPCA calculations, to date, span from January 2005 through December 2006, a period of abnormal and extraordinary fuel and purchased power cost fluctuations. Staff believes that the question is whether these extraordinary conditions justify modifying the FPPCA methodology. This depends on the results of additional analysis regarding how much of the under-collected balance will be recovered longer term by the current adjustor, and the effect on AEPCO's financial health of carrying the bank balance over the time necessary to make significant progress in reducing it.

### **Conclusion**

Staff is actively pursuing additional data and continuing its analysis of AEPCO's proposal of altering the FPPCA to accelerate recovery of AEPCO's under-collected bank balance.

EGJ:JDA:tdp

Originator: Jerry D. Anderson