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OPEN MEETING AGENDA ITEM

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**BEFORE THE ARIZONA CORPORATION COMMISSION**

**In the Matter of the Application of Arizona Public Service Company for A Hearing to Determine the Fair Value of the Utility Property of the Company for Ratemaking Purposes, to Fix a Just and Reasonable Rate of Return Thereon, To Approve Rate Schedules Designed to Develop Such Return and to Amend Decision No. 67744**

**Docket No. E-01345A-05-0816**

Arizona Corporation Commission  
**DOCKETED**

**MAY 15 2007**

DOCKETED BY *SM*

**In The Matter Of The Inquiry Into The Frequency Of Unplanned Outages During 2005 At Palo Verde Nuclear Generating Station, The Causes Of The Outages, The Procurement Of Replacement Power And The Impact Of The Outages On Arizona Public Service Company's Customers.**

**Docket no. E-01345A-05-0826**

**In The Matter Of The Audit Of The Fuel And Purchased Power Practices And Costs Of The Arizona Public Service Company**

**Docket No. E-01345A-05-0827**

AZ CORP COMMISSION  
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**EXCEPTIONS OF THE KROGER CO.**

On April 27, 2007, Administrative Law Judge Lyn Farmer submitted her recommendation in the form of an Opinion and Order (referenced herein as the "Recommendation") in the above-captioned matter. The Kroger Co. ("Kroger") respectfully files the below Exceptions to the ALJ's Recommendation on the issues of cost allocation and the rate design of the E-32 customers class.

**1. Cost Allocation.**

The fact that there are significant interclass subsidies in rates is not disputed by any of the cost of service studies/methodologies proposed in this proceeding. However, there is no attempt in the Recommendation to remedy this problem by reducing interclass subsidies.<sup>1</sup> The parties that have recommended a subsidy reduction have made compelling arguments evidencing the inequity of interclass subsidies from the perspective of proper rate making theory and simple fairness. Some movement toward cost of service must be made in such a major rate case. Kroger's recommendation of a 25 percent subsidy reduction is a reasonable and gradual approach toward a more equitable allocation of rates. Kroger would also support the adoption of AECC rate allocation proposal which achieves the same goal of moving the respective customer classes a step toward cost of service while recognizing the concept of gradualism.

**2. Rate Design Of The E-32 Schedule.**

The ALJ expressed concern with the recommendations of several intervenors that rates should be designed in order to make a move toward reducing intraclass subsidies between high and low load factor customers within a given rate schedule. The ALJ believes that movement toward costs of service in rate design is appropriate but because such movement was made in a recent rate case more movement toward cost of service is premature. The ALJ states:

*"It is clear from the results of all cost-of-service studies that there are subsidies in APS' current rate structure. This means that some classes of customers are providing a subsidy to others and that some customers in a class subsidize others in the same class. Several parties have recommended that the Commission begin to close that gap, and move rates closer to the class' cost-of-service now. We agree that some movement should be made in that direction, but given the fact that current rates have been in effect*

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<sup>1</sup> Recommendation of Administrative Law Judge Lyn Farmer pp. 68-73.

*for only two years and they were designed to move rates closer to cost-of-service we do not want to modify the current rate structure dramatically. Accordingly, given the level of revenues that we authorize herein, we will generally adopt the Company's rate design as modified by Staff and with the AECC proposal for transmission rate design as agreed to by APS, and the voltage discounts as proposed by the FEA." (ALJ Recommendation pp. 75-76) (emphasis added)*

At least with respect to the E-32 class, the ALJ's position misses the mark because the Company's proposed rate design does not preserve the movement toward the reduction of intraclass subsidies made in the prior proceeding as the ALJ contends, but rather the Company's proposal reverses the previous movement toward cost of service by allocating a larger portion of the proposed increase to high load factor customers than to lower load factor customers.<sup>2</sup> Kroger's recommendation merely seeks to maintain the status quo for the high-load factor E-32 customers that are subsidizing lower-load factor E-32 customers by increasing allocating an equal percentage increase to all delivery and generation charges for all E-32 customers.<sup>3</sup>

As explained in the testimony of Kroger witness Stephen Baron<sup>4</sup> and in Kroger's Initial Brief,<sup>5</sup> the Company proposed rate design would result in an increase to some E-32 customers significantly above the average increase proposed for the rate. APS is proposing much larger increases to high-load factor customers taking service on rate E-32, than for lower load factor customers. In addition to the fact that all E-32 customers are paying millions of dollars in subsidies to the Residential class at both present and proposed rates, high load factor E-32 customers have the additional burden of also subsidizing lower load factor customers within their own rate class. Although the ALJ contends that the intraclass subsidy paid by high load factor customers to lower load factor customers will not change from current rates, the ALJ's recommendation would actually increase the intraclass subsidies paid by high load factor E-32 customers.

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<sup>2</sup> Direct Testimony of Stephen Baron p. 21.

<sup>3</sup> Id. p. 26.

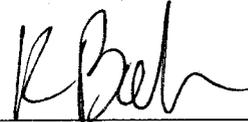
<sup>4</sup> Id. pp. 20-21.

<sup>5</sup> Initial Brief of Kroger pp. 10-11.

High load factor customers, who use a greater percentage of the energy use in off-peak periods, are being unreasonably penalized by the APS and ALJ proposals in this case. The Commission should encourage the type of efficient energy usage that high-load factor customers practice, not punish customers for using energy efficiently.

As stated above and in its Initial Brief, Kroger's recommendation only asks for E-32 intraclass subsidies to not increase. This could be achieved by allocating the same percentage increase to all delivery and all generation charges paid by E-32 customers.

Respectfully submitted,



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Michael L. Kurtz, Esq.

Kurt J. Boehm, Esq.

**BOEHM, KURTZ & LOWRY**

36 East Seventh Street, Suite 1510

Cincinnati, Ohio 45202

Ph: (513) 421-2255 Fax: (513) 421-2764

[mkurtz@BKLawfirm.com](mailto:mkurtz@BKLawfirm.com)

[kboehm@BKLawfirm.com](mailto:kboehm@BKLawfirm.com)

**COUNSEL FOR THE KROGER CO.**