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BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF ARIZONA ELECTRIC POWER COOPERATIVE, INC. FOR HEARING TO DETERMINE THE FAIR VALUE OF ITS PROPERTY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RETURN THEREON AND TO APPROVE RATES DESIGNED TO DEVELOP SUCH RETURN	DOCKET NO. E-01773A-09-0472 **STAFF'S NOTICE OF FILING TESTIMONY SUMMARIES**

Staff of the Arizona Corporation Commission ("Staff") hereby files the Testimony Summaries of Ralph C. Smith; Randall E. Vickroy; John Antonuk; Dennis M. Kalbarczyk and Richard Mazzini in the above-referenced matter.

RESPECTFULLY SUBMITTED this 22nd day of October 2010.

Arizona Corporation Commission
DOCKETED
OCT 22 2010
DOCKETED BY

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EXECUTIVE SUMMARY
STAFF WITNESS
RALPH C. SMITH DIRECT TESTIMONY
ARIZONA ELECTRIC POWER COOPERATIVE, INC.
DOCKET NO. E-01773A-09-0472

My testimony and Attachment RCS-2 present Staff's recommended rate base, net income (margin) and revenue increase for The Arizona Electric Power Cooperative, Inc.'s ("AEPCO"). In computing Staff's recommended revenue increase, I used the debt service coverage ("DSC") method and applied the DSC ratio of 1.40 recommended by Staff witness Vickroy.

Staff's recommended rate base is $211.8 million versus the $231.8 million requested by AEPCO. The following table summarizes Staff's recommended rate base adjustments:

Summary of Staff Adjustments to Rate Base

Adj. No.	Description		Increase (Decrease)
B-1	Plant Held for Future Use	$	(2,551,631)
B-2	Acquisition Adjustment	$	-
B-3	Accumulated Depreciation - Retirement Work in Progress	$	(3,547,307)
B-4	Fuel Stock	$	-
B-5	Deferred Debits	$	(12,850,764)
B-6	Asset Retirement Obligation	$	(1,092,679)
	Total of Staff Adjustments	**$**	**(20,042,381)**
	AEPCO Proposed Rate Base (Original Cost)	$	231,844,975
	Staff Proposed Rate Base (Original Cost)	**$**	**211,802,594**

Both AEPCO and Staff have used original cost information to derive the fair value rate base. Because AEPCO is a cooperative, a DSC method is being used to derive the recommended revenue requirement, and the revenue requirement does not vary with the amount of rate base.

Staff's adjustments produce an adjusted net income (margin) of $5.232 million versus the $3.333 million proposed by AEPCO. Staff's recommended adjustments to income are summarized in the following table:

Summary of Staff Adjustments to Net Income (Margin)			
			Net Income (Margin)
Adj. No.	Description		Increase (Decrease)
C-1	Work Force Reduction	$	898,760
C-2	Incentive Compensation	$	681,900
C-3	Donations	$	79,926
C-4	Lobbying Expense in Association Dues	$	112,240
C-5	Asset Retirement Obligation - Depreciation and Accretion Expense	$	125,720
Total of Staff's Adjustments to Net Operating Income		**$**	**1,898,546**
	Adjusted Net Income per AEPCO	$	3,333,347
	Adjusted Net Income per Staff	$	5,231,893

On Attachment RCS-2, Schedule A, page 1, I present Staff's calculation of the revenue deficiency for AEPCO. As shown on Schedule A, page 1, column D, lines 16-26, using the DSC ratio of 1.40 recommended by Staff witness Vickroy, my calculations show a revenue deficiency of approximately $231,000. As shown on Attachment RCS-2, Schedule C, line 20, this represents an increase of approximately 0.14 percent over adjusted total operating revenues at AEPCO's current rates.

EXECUTIVE SUMMARY
STAFF WITNESS
RALPH C. SMITH SURREBUTTAL TESTIMONY
ARIZONA ELECTRIC POWER COOPERATIVE, INC.
DOCKET NO. E-01773A-09-0472

My surrebuttal testimony acknowledges the acceptance of Staff's recommended rate base, and adjusted net income by The Arizona Electric Power Cooperative, Inc.'s ("AEPCO"). A difference remains in Staff's recommended revenue increase and AEPCO's request, which is due to Staff using the debt service coverage ("DSC") method and applied the DSC ratio of 1.40 recommended by Staff witnesses Vickroy (direct) and Antonuk (surrebuttal), whereas AEPCO, in its rebuttal testimony is requesting a DSC ratio of 1.32 (increased from AEPCO's previously recommended DSC of 1.275).

I also address AEPCO's updated information concerning rate case expense and conclude that the annual allowance of $160,000 used in AEPCO's direct and rebuttal filings and in Staff's calculation of the AEPCO's operating expenses represents a reasonable normalized amount.

EXECUTIVE SUMMARY
STAFF WITNESS
RANDALL E. VICKROY
ARIZONA ELECTRIC POWER COOPERATIVE, INC.
DOCKET NO. E-01773A-09-0472

AEPCO has requested a slight decrease in its overall revenue requirement of about $97,000 annually, or a decrease of 0.06%. AEPCO has based its revenue requirement request on targeting a Debt Service Coverage ("DSC") of 1.275 times and a Times Interest Earned Ratio ("TIER") of 1.30 times, along with a composite cost of debt of 5.92% for the test period ended March 31, 2009. AEPCO's actual net margins during the test period were $15.8 million. However, the loss of three major wholesale sales contracts and increases in coal costs and other operating expenses have caused the cooperative to make $12.5 million in pro forma reductions in margins by December 31, 2010. AEPCO is not proposing to increase its rates to recover these lost margins; the expected net margin level with proposed rates drops to only $3.2 million.

Mr. Vickroy, representing the ACC staff, has determined a target range for DSC on which rates should be set of 1.25 times to 1.45 times. Mr. Vickroy's analysis applies credit rating agency financial targets and business risk evaluations for G&T cooperatives, and applies them to AEPCO. Mr. Vickroy recommends that AEPCO should fall at the upper end of the range, or a 1.40 times DSC, due to the cooperative's overall risk profile and its specific business risks.

Mr. Vickroy also believes that AEPCO's proposed debt service coverage, net margins, and cash flow are insufficient due to the higher than normal business risks for the company, likely earnings attrition due to a historical test period and a larger capital expenditures budget, and potential operating expense increases. Mr. Vickroy's overall recommendation is that rates be set on a DSC ratio of 1.40 times, which would also produce a TIER of 1.51 times and net margins of about $5.5 million annually for the test period.

EXECUTIVE SUMMARY
STAFF WITNESS
JOHN ANTONUK
ARIZONA ELECTRIC POWER COOPERATIVE, INC.
DOCKET NO. E-01773A-09-0472

Mr. Antonuk's testimony summarizes the results of an examination that The Liberty Consulting Group performed of Arizona Electric Cooperative, Inc. ("AEPCO") fuel, purchased power, and plant operations policies, activities, and costs. That examination produced a report making a series of recommendations for improvement in management and operations in these areas. He recommends a formal process for AEPCO's plans to implement the recommendations, which AEPCO has largely accepted. Mr. Antonuk's testimony also supports the continued operation of an FPPAC by AEPCO. Mr. Antonuk's testimony recommends, however, that AEPCO and its members address through focused discussions methods to provide for more current recovery of fuel and purchased power costs, and to construct a specific method for addressing the transition from AEPCO's current FPPAC to the FPPAC proposed by the cooperative.

EXECUTIVE SUMMARY
STAFF WITNESS
DENNIS M. KALBARCZYK
ARIZONA ELECTRIC POWER COOPERATIVE, INC.
DOCKET NO. E-01773A-09-0472

Dennis M. Kalbarczyk addressed for Staff the fully allocated cost of service study and proposed rate design as submitted by Arizona electric Power Cooperative, Inc. ("AEPCO") witness Gary L. Goble. He found AEPCO's study, based upon the as-filed revenue requirements and proposed rate design methods, to be reasonable. He then applied the adjustments of Staff witness Smith and Vickroy to AEPCO's pro forma test year revenue requirement claim, updating the AEPCO fully allocated cost of service study methods in light of them. He presented a proposed rate design necessary to produce Staff's proposed revenue requirement. After reviewing AEPCO's rebuttal testimony, Mr. Kalbarczyk accepted witness Gable's changes in allocation factors due to Trico Electric Cooperative's ("Trico") decision to move from an all-requirement member ("ARM") to a partial-requirements member ("PRM"), and made adjustments to his direct testimony to reflect Staff's overall revenue requirement, as provided in Staff witnesses Smith's and Vickroy's testimony. Mr. Kalbarczyk's surrebuttal testimony provided an updated fully allocated cost of service study and rate design schedules to reflect these changes based upon Staff's proposed revenue requirement.

EXECUTIVE SUMMARY
STAFF WITNESS
RICHARD MAZZINI
ARIZONA ELECTRIC POWER COOPERATIVE, INC.
DOCKET NO. E-01773A-09-0472

My testimony relates to my engineering analysis of the filing, with particular note of AEPCO's maintenance practices and the performance of its Apache Station. In addition, my testimony addresses facilities being added to the rate base and the degree to which such facilities are "used and useful".

I found that the plant was generally well managed, maintenance work was appropriate, capital additions were justified and useful, expenditures were reasonable and staff had a handle on most current issues. I therefore did not observe anything from an engineering perspective that would take issue with the rate filing.

I express concern, however, that the operating problems of 2009 may not have resulted simply from a run of bad luck. To the contrary, there is reason to suspect that 2009 was a warning that fundamental forces are at work, and those forces may be changing the role and future of the station, and perhaps AEPCO as well. This is manifest in less competitive dispatch costs leading to a much reduced output for the station. This is a matter of future concern, but may also be a contributor, through increased cycling of the units, to the 2009 operating problems.