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COMMISSIONERS
GARY PIERCE, Chairman
BOB STUMP
SANDRA D. KENNEDY
PAUL NEWMAN
BRENDA BURNS

IN THE MATTER OF THE APPLICATION OF AEPCO THAT THE COMMISSION, PURSUANT TO A.R.S. § 40-252, REOPEN ITS JANUARY 6, 2011 RATE DECISION NO. 72055 FOR THE LIMITED PURPOSE OF AUTHORIZING AMENDMENTS TO ADDRESS THE RATE DESIGN AND COST RECOVERY ISSUES DESCRIBED HEREIN	Docket No. E-01773A-09-0472 **APPLICATION**

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

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

1. AEPCO is a non-profit electric generation cooperative which serves the power needs of its three all-requirements ("CARMs") and three partial-requirements ("PRMs") Class A member distribution cooperatives. Those distribution cooperatives, in turn, use the power supplied by AEPCO to meet the electricity needs of their retail members who are located primarily in Arizona's rural areas.

2. AEPCO's 13-member Board of Directors oversees all aspects of its operations. Twelve members of the Board are elected by AEPCO's six Class A member distribution cooperatives. Those distribution cooperatives' Boards are elected annually by their retail member/customers. At its September 14, 2011 meeting, AEPCO's Board unanimously authorized the filing of this Application.

3. On January 6, 2011, the Commission issued Decision No. 72055 which, *inter alia*, authorized new rates and charges for AEPCO's Class A member distribution cooperatives (the "Rate Decision"). The Rate Decision also authorized continuation of a Purchased Power and Fuel Adjustment Clause ("PPFAC") for the CARMs and PRMs, as well as its "Efficacy Provision" which was first authorized in AEPCO's 2005 rate case (Decision No. 68071). The Efficacy Provision allows the Cooperative to request Commission revision of the PPFAC should problems with cost recovery develop. (Rate Decision, First Ordering Paragraph; Decision No. 68071, Finding 36 and its Sixth Ordering Paragraph.)

4. By this Application, AEPCO requests that the Commission exercise its authority pursuant to A.R.S. § 40-252 to reopen the Rate Decision for the limited purpose of amending it as follows:

(a) Authorizing the Cooperative to shift recovery of the approximately $3.6 million in test year fixed gas costs—which are currently assigned for recovery through the CARMs and PRMs' Base Resources and Other Resources <u>energy rates</u>—to recovery instead through the Class A members' <u>fixed monthly charges</u>. AEPCO also requests that the Commission authorize it to recover or refund any increase or decrease in the test year fixed gas costs' amount through the PPFAC on a member Allocated Capacity Percentage ("ACP") basis;

(b) As of the effective date of the revised tariffs which shift recovery of the fixed gas costs to the Class A members' fixed monthly charges, authorizing AEPCO to collect a surcharge to recover any further under-collection of fixed gas costs through the PPFAC which occurs from July 1, 2011 to the Effective Date of those revised tariffs; and

(c) In order to mitigate the current rate impact on its members of the approximately $1.43 million in fixed gas costs incurred by AEPCO from January 1 to July 1, 2011, authorizing the Cooperative not to recover that $1.43 million cost amount through the PPFAC.

Background

5. In late July, as AEPCO personnel began to develop the data needed to make its initial adjustor filing under the revised PPFAC approved in the Rate Decision, a serious problem was detected with the allocation method used in relation to, and consequently AEPCO's recovery of, fixed gas costs through the CARMs and PRMs' energy rates and the PPFAC. AEPCO's September 1, 2011 Efficacy Filing described the nature of the problem and summarized its three major consequences: (1) the allocation of these fixed gas costs to the Base and Other Resources energy rates is artificially disadvantaging AEPCO's units against the purchased power market; (2) the allocation method results in an inequitable assignment of these fixed costs to the Cooperative's members; and (3) if the issue is not promptly addressed, the Cooperative will suffer an approximate $4.6 million dollar annual loss—about $1.5 million more than the <u>total</u> operating margins of $2.95 million authorized for AEPCO in the Rate Decision (the Efficacy Filing's transmittal letter is attached hereto as Exhibit A). AEPCO proposed a different allocation method in the Efficacy Filing with revised adjustors to address this cost allocation issue.

6. AEPCO is working with the Commission's Utilities Division Staff to bring those revised Efficacy Filing adjustors to Open Meeting as soon as possible. Their implementation will address the cost recovery problem and mitigate AEPCO's financial losses which are occurring as a result. However, as mentioned in that filing, the correct <u>permanent</u> solution to the

problem lies in assigning these <u>fixed</u> gas costs to the members' <u>fixed</u> monthly charges, not their energy rates. That is this Application's primary request.

7. During the test year ended March 31, 2009, AEPCO incurred about $3.6 million in fixed gas cost charges from El Paso and Unocal. The Cooperative pays these fixed gas costs to assure a constant amount of natural gas is available when Apache Station resources need it. For example, they assure (a) flame stabilization gas is available for the operation of the coal-fired units and (b) the gas-fired units have fuel to operate as and when they are called upon by any of the PRMs or by AEPCO on behalf of the CARMs. Thus, the fixed gas costs are most logically and fairly assigned to the fixed monthly charges which each member must pay, regardless of how much energy, or from what AEPCO resource that energy, is taken.[1]

8. Allocating these costs to the fixed monthly charges instead of the energy rates will also correct another problem. Both AEPCO's coal- and gas-fired units are being unfairly disadvantaged against the rest of the purchased power market, because these fixed costs are assigned for recovery through those units' energy cost. This impacts AEPCO and its members in two ways. First, third parties are less likely to purchase the units' output. Therefore, the additional margins (profit) which would result from those sales to others are not available to benefit the PRMs and CARMs and, in turn, to benefit their retail customers. Second, because of this pricing disadvantage, the PRMs are also less likely to use these units instead of the purchased power market as is AEPCO in selecting the most cost efficient resources to serve its ARMs. Therefore, the current energy rate cost allocation method artificially interferes with the selection of the most cost-beneficial resource.

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[1] Allocating these costs to the fixed monthly charges is also consistent with the members' contracts which the Commission approved in the Rate Decision (Finding 67; First Ordering Paragraph, page 17).

9. To address and resolve these issues, AEPCO requests that the Commission approve revised rates which move the fixed gas costs from the PRMs and CARMs' Base Resources and Other Resources energy rates, where cost recovery is currently assigned, to the Class A members' Fixed Monthly Charges.

10. Attached as Exhibit B is a summary of the revised rates requested and a comparison of the effects of this shift on the Energy Rates and Fixed Charges for the PRMs and CARMs. The data at lines 29-40 of Exhibit B shows, on a test year basis, the expected difference in fixed gas cost recovery among Class A members which the requested rate redesign would produce. Line 40 of Exhibit B also shows that the cost reallocation is designed only to allow AEPCO to recover its test year fixed gas and other costs. It does not result in an increase in AEPCO's approved test year revenue requirement.

11. Because AEPCO will continue to under-recover its fixed gas costs from July 1 to the Effective Date of revised tariffs which authorize recovery of these fixed gas costs through the members' fixed monthly charges, the Cooperative also requests that the Commission approve a surcharge to collect that difference. Finally, in order to reduce the current rate impact of the fixed gas cost realignment, AEPCO has agreed to write off approximately $1.43 million of these costs which were unrecovered from January 1 to July 1 of this year. Therefore, the Cooperative also asks that the Commission approve its non-recovery of those costs through the PPFAC.

Conclusion

12. AEPCO requests that the Commission reopen the Rate Decision for the limited purposes as described herein; grant the relief described in paragraph 4 of this Application; and approve the revised rates stated in Exhibit B.

RESPECTFULLY SUBMITTED this 20th day of October, 2011.

GALLAGHER & KENNEDY, P.A.

By [signature]
Michael M. Grant
Jennifer A. Cranston
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Attorneys for Arizona Electric Power Cooperative, Inc.

Original and 13 copies filed this 20th day of October, 2011, with:

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EXHIBIT A

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September 1, 2011

HAND DELIVERED

Commissioner Gary Pierce, Chairman
Commissioner Bob Stump
Commissioner Sandra D. Kennedy
Commissioner Paul Newman
Commissioner Brenda Burns
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

Re: *Arizona Electric Power Cooperative, Inc. ("AEPCO") Request for Review of PPFAC Efficacy and Approval of Alternate Adjustor Rates ("Efficacy Filing"); Decision No. 72055 dated January 6, 2011 (the "Rate Case Decision"); Docket No. E-01773A-09-0472*

Dear Commissioners:

In AEPCO's Rate Case Decision approved earlier this year, the Commission authorized continuation of the Purchased Power and Fuel Adjustment Clause ("PPFAC") and, as well, continued AEPCO's ability to request modifications to the PPFAC should problems with cost recovery develop:

> [AEPCO] may file a request that the Commission review the efficacy of the [PPFAC] with Arizona Electric Cooperative Inc.'s submission of any semi-annual report required by the tariff and this Decision. (The Rate Case Decision, p. 17, Third Full Ordering Paragraph.)[1]

This filing requests that efficacy review to correct a substantial problem which has arisen with recovery of certain fixed costs in the PPFAC.

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[1] Simultaneous with this Efficacy Filing, AEPCO has submitted revised adjustors using the PPFAC's current structure for October 1 implementation if the Commission cannot act on this request by that date. However, AEPCO asks that the Commission approve the adjustors requested here as soon as possible.

A month ago, when AEPCO personnel began developing the data and schedules necessary to make its initial adjustor filing, a serious problem was detected with the allocation method used to assign certain fixed-gas costs within, and recover those costs through, the PPFAC. The problem has three major, negative consequences for AEPCO and its members: (1) the allocation of a majority of these costs through the Other Resources energy rate artificially disadvantages AEPCO's gas-fired units against the purchased power market; (2) it results in an inequitable allocation of these fixed costs to certain of AEPCO's member distribution cooperatives; and (3) ultimately, because of this allocation problem, AEPCO likely will not be able to recover these costs, because AEPCO's gas-fired units will not be selected as a power source by any of AEPCO's members or, in the case of the collective all-requirements members ("CARMs"), by AEPCO on their behalf. If that occurs, AEPCO would take an approximate $4.6 million dollar loss to its bottom line. To place that loss in context, the rates the Commission authorized earlier this year were only designed to produce an operating margin of $2.95 million.[2]

As a first step to address this issue, this Efficacy Filing requests a change in the PPFAC allocation method used in relation to these costs. In that regard, attached are a revised all-requirements tariff and partial-requirements schedule, as well as schedules supporting the revised adjustors and PPFAC allocation methodology which AEPCO asks that you approve.[3] This will temporarily address and partially resolve the problem.

On a longer-term basis, AEPCO believes these fixed-gas costs should instead be allocated to the fixed monthly charges which each member pays rather than being assigned to the energy rates. After discussing further this issue internally and with its members, AEPCO anticipates filing soon a request under A.R.S. § 40-252 to amend the Rate Case Decision to accomplish that result.

Background

As background, about $3.8 million of fixed-gas costs from El Paso and Unocal were incurred in the test year ending March 31, 2009. These fixed costs are paid to assure flame stabilization gas for the coal-fired units, as well as to assure the gas-fired units will have fuel to generate anytime they are called upon for use by any of the partial-requirements members ("PRMs") and CARMs.

In the rate case, most of these expenses were assigned for cost recovery through the energy rate. A flame stabilization estimate of approximately $545,000 was included in developing the Base Resources energy rate. That was allocated between the members premised upon their anticipated use of the coal units.

[2] Decision No. 72055, Finding 50.
[3] AEPCO will shortly file revised monthly reports for January through June of this year in support of these adjustors.

$3.1 million of these fixed-gas costs were included in the Other Resources energy rate. These costs were allocated generally between the members based upon their anticipated use of the gas-fired units.

The allocations were developed based on assumed levels of gas-fired generation using a billing unit model applied against the adjusted test year. The model predicted anticipated Base and Other Resource kWh usages under the new rate structure, which consists of fixed monthly charges, fixed monthly O&M charges, Base Resources and Other Resources energy rates.

The Problem

In preparing the required semi-annual adjustor filing, AEPCO realized, based on actual operating experience, that actual use was significantly different than what the billing unit model had predicted. As a result, the allocation method is producing an inequitable allocation of costs to certain of AEPCO's members. Also, including the fixed-gas costs in the Other Resources energy rate has resulted in a price signal which is artificially disadvantaging AEPCO's gas-fired units against the rest of the purchased power market. As a result of that cost disadvantage, two of AEPCO's PRMs have elected almost exclusively to purchase in that market rather than use AEPCO gas-fired resources. Therefore, the remaining members have been, under this system, allocated the vast majority of these fixed-gas costs. The result is a substantial under-collection which AEPCO, absent a change, will need to collect from Anza, Duncan, Graham, Trico and their retail members.

Mohave and SSVEC will only contribute in a small way towards the recovery of these fixed-gas costs—even though these costs provide them reserves and enable them to call upon AEPCO's gas-fired generation at any time when and if needed. If the remaining members were also to stop using these gas-fired resources, then AEPCO would not be able to collect any of the $3.1 million in fixed costs built into the Other Resource energy rate and base, nor collect any of the approximately $1.5 million increase in costs which AEPCO is incurring annually as a result of an El Paso rate increase that became effective April 1, 2011. If AEPCO cannot recover these fixed-gas costs through its rates, the result is margin losses of approximately $4.6 million—a loss substantially greater than the $2.95 million of operating margins allowed in the rate case.

The Solution

In order to address and resolve these issues, AEPCO proposes a two-step solution. As a temporary first step, AEPCO proposes that fixed-gas costs be allocated to the CARMs and each PRM on an Allocated Capacity Percentage ("ACP") basis. The ACPs for each are as follows: CARMs – 11.4%, Mohave – 35.8%, Sulphur – 31.7% and Trico – 21.1%. This ACP cost assignment will then be split between Base and total Other Resources energy for the CARMs and each of the PRMs. The total Other Resources energy category includes not only AEPCO's gas resources, but also power purchased on behalf of the CARMs and/or Trico.

Attached to this Efficacy Filing are: (1) a revised tariff for the CARMs; (2) a revised partial-requirements Schedule; and (3) a nine-page schedule providing supporting information in relation to the revised adjustors. AEPCO requests the Commission authorize these adjustors for October 1 implementation or as soon as possible thereafter.

The PPFAC bases for the CARMs and each of the PRMs also have been re-designed to reflect the new allocation methodology associated with the fixed-gas costs. The under/(over) collected PPFAC balances have been recalculated for the period January 2011 thru June 2011 using the new PPFAC bases and AEPCO's proposed allocation methodology in order to derive revised under/(over) collected PPFAC balances.

While approval of these adjustors will solve the immediate allocation and revenue problems created by the current allocation methodology on a short-term basis, a better and more permanent resolution of these issues is to instead assign these fixed-gas costs to the CARMs and PRMs' respective fixed charges. In that regard, after further consultation with its members, AEPCO anticipates filing soon a request under A.R.S. § 40-252 to amend the Rate Case Decision to adjust the fixed monthly charges accordingly.

Conclusion

AEPCO requests that the Commission enter its Order approving the revised adjustors in the CARM Tariff and the PRM Schedule attached hereto.

Very truly yours,

GALLAGHER & KENNEDY, P.A.

By: Michael M. Grant

Michael M. Grant

MMG/plp
10421-59/2848117
Attachments

cc w/attachments (delivered): Commissioners (2 copies)
Terri Ford, Utilities Division
Barbara Keene, Utilities Division
Candrea Allen, Utilities Division

Original and 13 copies filed with Docket Control this 1st day of September, 2011.

EXHIBIT B

Arizona Electric Power Cooperative, Inc.
Comparison of 40-252 Proposed Rates and Current Rates
Test Year Ended March 31, 2009

Line No.	Description	Col. 1 CARM Rate Tariffs	Col. 2 MEC Rate Tariffs	Col. 3 SSVEC Rate Tariffs	Col. 4 TEC Rate Tariffs
1	40-252 Proposed Rate Tariffs:				
2	Total Fixed Charges - $/Month	$273,334	$835,756	$740,041	$710,367
3	Total O&M Charges - $/Month	$414,019	$1,274,882	$1,128,876	$764,465
4	Base Resources Energy Charge - $/kWh	$0.03132	$0.03191	$0.03205	$0.03214
5	Other Resources Energy Charge - $/kWh	$0.05300	$0.05852	$0.05742	$0.05747
6					
7	Base Resources PPFAC Base	$0.03513	$0.03454	$0.03449	$0.03431
8	Other Resources PPFAC Base	$0.07188	$0.06191	$0.06449	$0.08274
9					
10	Decision No. 72055 Authorized Rates:				
11	Total Fixed Charges - $/Month	$238,793	$727,283	$643,991	$646,435
12	Total O&M Charges - $/Month	$414,019	$1,274,882	$1,128,876	$764,465
13	Base Resources Energy Charge - $/kWh	$0.03156	$0.03215	$0.03229	$0.03238
14	Other Resources Energy Charge - $/kWh	$0.06170	$0.06879	$0.06676	$0.06604
15					
16	Base Resources PPFAC Base	$0.03361	$0.03330	$0.03337	$0.03336
17	Other Resources PPFAC Base	$0.07941	$0.06971	$0.07241	$0.09084
18					
19	Difference from Decision No. 72055 Rates:				
20	Total Fixed Charges - $/Month	$34,542	$108,473	$96,050	$63,932
21	Total O&M Charges - $/Month	$0	$0	$0	$0
22	Base Resources Energy Charge - $/kWh	($0.00024)	($0.00024)	($0.00024)	($0.00024)
23	Other Resources Energy Charge - $/kWh	($0.00870)	($0.01026)	($0.00934)	($0.00857)
24					
25	Base Resources PPFAC Base	$0.00152	$0.00125	$0.00112	$0.00095
26	Other Resources PPFAC Base	($0.00753)	($0.00780)	($0.00793)	($0.00810)
27					
28					

29	Revenues Generated by 40-252 Proposed Rates and Decision No. 72055 Authorized Rates			
30	Test Year Ended March 31, 2009			
31		40-252	Decision 72055	
32	*Description*	Proposed Rates	Rates	Difference
33	Test Year Revenues Generated:			
34	Anza	$3,314,354	$3,260,032	$54,322
35	Duncan	1,891,392	1,858,063	33,328
36	Graham	10,634,566	10,446,493	188,073
37	Mohave	55,673,264	55,489,632	183,632
38	Sulphur Springs	52,330,518	52,370,038	(39,520)
39	Trico	41,602,227	42,022,063	(419,835)
40	Total	$165,446,321	$165,446,321	$0