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BEFORE THE ARIZONA CORPORATION COMMISSION

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**COMMISSIONERS**

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

2012 JAN 18 P 3:00

AZ CORP COMMISSION  
DOCKET CONTROL

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.

DOCKET NO. E-01345A-11-0224

**STAFF'S NOTICE OF FILING  
TESTIMONY IN SUPPORT OF  
SETTLEMENT AGREEMENT**

Staff of the Arizona Corporation Commission ("Staff") hereby files the Testimony of Steven M. Olea and Howard Solganick in Support of the Settlement Agreement in the above docket.

RESPECTFULLY SUBMITTED this 18<sup>th</sup> day of January 2012.

Arizona Corporation Commission  
**DOCKETED**

JAN 18 2012

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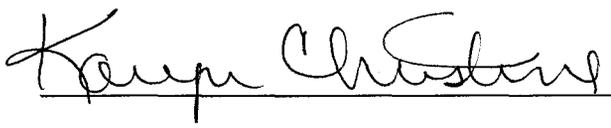
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**BEFORE THE ARIZONA CORPORATION COMMISSION**

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

IN THE MATTER OF THE APPLICATION OF )  
ARIZONA PUBLIC SERVICE COMPANY FOR )  
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\_\_\_\_\_ )

DOCKET NO. E-01345A-11-0224

TESTIMONY  
IN SUPPORT OF  
THE SETTLEMENT AGREEMENT  
STEVEN M. OLEA  
DIRECTOR  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION

JANUARY 18, 2012

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**EXECUTIVE SUMMARY**  
**ARIZONA PUBLIC SERVICE COMPANY**  
**DOCKET NO. E-01345A-11-0224**

Mr. Olea's testimony supports the adoption of the Settlement Agreement ("Agreement") as proposed by the Signatories in this case. This testimony describes the settlement process as open, candid, transparent and inclusive of all parties to this case. Mr. Olea explains why Staff believes this Agreement is in the public interest.

Mr. Olea's testimony recommends that the Commission adopt the Agreement as proposed.

1 **SECTION I - INTRODUCTION**

2 **Q. Please state your name and business address.**

3 A. Steven M. Olea, 1200 West Washington, Phoenix, Arizona, 85007.  
4

5 **Q. By whom and in what capacity are you employed?**

6 A. I am employed by the Arizona Corporation Commission ("Commission") as the Director of  
7 the Utilities Division ("Division").  
8

9 **Q. Please state your educational background.**

10 A. I graduated from Arizona State University ("ASU") in 1976 with a Bachelors Degree in Civil  
11 Engineering. From 1976 to 1978 I obtained 47 graduate hours of credit in Environmental  
12 Engineering at ASU.  
13

14 **Q. Please state your pertinent work experience.**

15 A. From April 1978 to October 1978 I worked for the Engineering Services Section of the  
16 Bureau of Air Quality Control in the Arizona Department of Health Services ("ADHS"). My  
17 responsibilities were to inspect air pollution sources to determine compliance with ADHS  
18 rules and regulations.  
19

20 From November 1978 to July 1982 I was with the Technical Review Unit of the Bureau of  
21 Water Quality Control ("BWQC") in ADHS (this is now part of the Arizona Department of  
22 Environmental Quality ["ADEQ"]). My responsibilities were to review water and  
23 wastewater construction plans for compliance with ADHS rules, regulations, and  
24 Engineering Bulletins.  
25

1 From July 1982 to August 1983 I was with the Central Regional Office, BWQC, ADHS. My  
2 responsibilities were to conduct construction inspections of water and wastewater facilities to  
3 determine compliance with plans approved by the Technical Review Unit. I also performed  
4 routine operation and maintenance inspections to determine compliance with ADHS rules  
5 and regulations, and compliance with United States Environmental Protection Agency  
6 requirements.

7  
8 From August 1983 to August 1986 I was a Utilities Consultant/Water-Wastewater Engineer  
9 with the Division. My responsibilities were to provide engineering analyses of Commission  
10 regulated water and wastewater utilities for rate cases, financing cases, and consumer  
11 complaint cases. I also provided testimony at hearings for those cases.

12  
13 From August 1986 to August 1990 I was the Engineering Supervisor for the Division. My  
14 primary responsibility was to oversee the activities of the Engineering Section, which  
15 included one technician and eight Utilities Consultants. The Utilities Consultants included  
16 one Telecommunications Engineer, three Electrical Engineers, and four Water-Wastewater  
17 Engineers. I also assisted the Chief Engineer and performed some of the same tasks as I did  
18 as a Utilities Consultant.

19  
20 In August 1990 I was promoted to the position of Chief Engineer. My duties were somewhat  
21 the same as when I was the Engineering Supervisor, except that now I was less involved with  
22 the day-to-day supervision of the Engineering Staff and more involved with the  
23 administrative and policy aspects of the Engineering Section.

24

1 In April 2000 I was promoted to the position of one of two Assistant Directors of the  
2 Division. In this position I assisted the Division Director in the policy aspects of the  
3 Division. I was primarily responsible for matters dealing with water and energy.  
4

5 In August 2009 I was promoted to my present position as Director of the Utilities Division.  
6 In this position I manage the day-to-day operations of the Utilities Division with the  
7 assistance of the Utilities Division Assistant Director and oversee the management of the  
8 Division's Telecom & Energy Section, the Financial & Regulatory Analysis Section, the  
9 Consumer Services Section, the Engineering Section and the Administrative Section. In  
10 addition, I am responsible for making policy decisions for the Division.  
11

12 In early 2010 I was given the task of being the Interim Director for the Commission's Safety  
13 Division (Railroad and Pipeline). The day-to-day activities of the Safety Division are  
14 overseen by the managers of the Railroad Safety Section and the Pipeline Safety Section with  
15 input from me. Together with the Commission's Executive Director, I am responsible for the  
16 policy decisions for the Safety Division.  
17

18 **Q. What is the purpose of your testimony in this case?**

19 A. The purpose of my testimony is to support the Proposed Settlement Agreement  
20 ("Agreement"). I will also provide testimony which addresses the settlement process,  
21 public interest benefits and general policy considerations.  
22

23 **Q. Did you participate in the negotiations that led to the execution of the Agreement?**

24 A. Yes, I did.  
25

1 **Q. How is your testimony being presented?**

2 A. My testimony is organized into five sections. Section I is this introduction, Section II  
3 provides discussion of the settlement process, Section III discusses the various parts of the  
4 Agreement, Section IV identifies and discusses the reasons why the Agreement is in the  
5 public interest and Section V addresses general policy considerations.

6  
7 **Q. Will there be other Staff witnesses providing testimony in this case?**

8 A. Yes. Mr. Howard Solganick will be providing testimony to explain the Lost Fixed Cost  
9 Recovery ("LFCR") mechanism. In addition, all Division Staff ("Staff") witnesses that  
10 filed Direct Testimony prior to the Agreement will be available if the Commission has  
11 questions for them.

12

13 **SECTION II – SETTLEMENT PROCESS**

14 **Q. Please discuss the settlement process.**

15 A. The settlement process was open, transparent and inclusive. All parties received notice of  
16 the settlement meetings and were accorded an opportunity to raise, discuss, and propose  
17 resolution to any issue that they desired.

18

19 **Q. Over what period did the Settlement meetings take place?**

20 A. Large group Settlement meetings relating to revenue requirement, decoupling, LFCR  
21 mechanism, energy efficiency programs and rate design, began in late November, 2011  
22 and continued until the Settlement Agreement was filed on January 6, 2012. In addition,  
23 there were numerous other discussions involving individual parties and/or groups.

24

1 **Q. Who participated in those meetings?**

2 A. The following parties were participants in some or all of the meetings: Arizona Public  
3 Service Company ("APS" or "Company"); the Residential Utility Consumer Office  
4 ("RUCO"); the Arizona Investment Council ("AIC"); the Southwest Energy Efficiency  
5 Project ("SWEEP"), Cynthia Zwick, Tucson Electric Power Company ("TEP"), the  
6 Natural Resources Defense Council ("NRDC"), Federal Executive Agencies ("FEA"),  
7 Kroger Co. ("Kroger"), Freeport-McMoRan Copper & Gold Inc. ("Freeport-McMoRan"),  
8 Arizonans for Electric Choice and Competition ("AECC"), Wal-Mart Stores, Inc. and  
9 Sam's West, Inc. ("Wal-Mart"), IBEW Locals 387, 640, 769 ("IBEW"), AzAg Group  
10 ("AzAG"), Arizona Competitive Power Alliance ("AzCPA"), American Association of  
11 Retired Persons ("AARP"), Arizona Association of Realtors ("AAR"), Southwestern  
12 Power Group II, LLC ("SWPG"), Bowie Power Station, LLC ("Bowie"), Noble Americas  
13 Energy Solutions, LLC ("Noble"), Constellation NewEnergy, Inc. ("Constellation"),  
14 Direct Energy, LLC ("Direct"), Shell Energy North America (US), L.P. ("Shell"), Western  
15 Resource Advocates ("WRA"), Interwest Energy Alliance, the Gilbert and Wickenburg  
16 municipalities, the Arizona School Board Association ("ASBA"), Arizona Association of  
17 School Board Officials ("AASBO") and Staff.

18

19 **Q. Could you identify some of the diverse interests that were involved in this process?**

20 A. Yes. The diverse interests included Staff, RUCO, APS, an investment council, consumer  
21 representatives including AARP, demand-side management ("DSM")/energy efficiency  
22 advocates, low-income consumer advocates, renewable energy advocates, realtors, labor  
23 unions, large/industrial users, competitive power producers and the mines.

24

1 **Q. How many of these parties executed the Agreement?**

2 A. The Agreement was signed by all participants with the exception of WRA, SWEEP,  
3 NRDC, Interwest Energy Alliance, the municipalities of Gilbert and Wickenburg, ASBA  
4 and AASBO. In addition, Ms. Barbara Wyllie-Pecora ("Wyllie-Pecora") signed the  
5 Agreement.

6  
7 **Q. Was there an opportunity for all issues to be discussed and considered?**

8 A. Yes, each party had the opportunity to raise and have its issues considered.

9  
10 **Q. Were the Signatories able to resolve all issues?**

11 A. Yes, the Signatories were able to resolve and reach agreement on all issues.

12  
13 **Q. How would you describe the negotiations?**

14 A. I believe that all participants zealously advocated and represented their interests. I would  
15 characterize the discussions as candid but professional. While acknowledging that not all  
16 parties executed the Agreement, I must re-emphasize that all parties had the opportunity to  
17 be heard and to have their issues fairly considered.

18  
19 **Q. Would you describe the process as requiring give and take?**

20 A. Yes, I would. As a result of the varied interests represented in the settlement process, a  
21 willingness to compromise was necessary. As evidenced in the Agreement, the  
22 Signatories compromised on what could be described as vastly different litigation  
23 positions.

24

1 **Q. Because of such compromising, do you believe the public interest was compromised?**

2 A. No. As I will discuss later in this testimony, I believe that the compromises made by the  
3 Signatories further the public interest.

4  
5 **Q. Mr. Olea, you have indicated that the Agreement incorporates diverse interests**  
6 **including those of low-income customers, residential customers, large**  
7 **commercial/industrial customers, energy efficiency advocates, renewable energy**  
8 **advocates, the Company and the investment community. Please discuss how the**  
9 **Agreement addresses the diverse interests of these entities.**

10 A. In the Agreement, there are specific provisions which address many of the concerns  
11 expressed by the various interests. For example, the low-income customer issues are  
12 addressed in Section XIV. Another example is Section IX, which addresses the interests  
13 of those concerned about promoting energy efficiency and the LFCR/opt-out provision.  
14 Section VIII addresses renewable energy. Section X of the Settlement Agreement  
15 addresses the rate treatment related to any acquisition by APS of Southern California  
16 Edison's share of Four Corners units 4 and 5. Section XI addresses the environmental  
17 improvement surcharge. Section XII provides a cost recovery methodology for APS on  
18 the issue of property tax. Section XV addresses APS's Schedule 3 (line extensions).  
19 Section XVI deals with the bill format, and Section XVII addresses issues pertinent to  
20 large customers.

21  
22 **Q. What is the revenue increase and cost of equity requested by the Company?**

23 A. APS requested a net increase in base rates of \$95.5 million, which included a requested  
24 cost of equity of 11.0 percent.<sup>1</sup>

25  

---

<sup>1</sup> See, e.g., APS' Application filed June 1, 2011, Schedules A-1 and D-1, respectively.

1 **Q. What is the revenue increase and cost of equity recommended by the settling parties?**

2 A. The settling parties recommend an overall zero net base rate increase, which includes a  
3 10.0 percent cost of equity.<sup>2</sup>  
4

5 **SECTION III – SETTLEMENT AGREEMENT**

6 **Q. Please describe Part I of the Agreement.**

7 A. Part 1 is a general description of the settlement process and the Agreement itself, which  
8 also includes a brief description about why Staff believes that the terms of the Settlement  
9 Agreement are just, reasonable, fair and in the public interest.  
10

11 **Q. Please describe Part II of the Agreement.**

12 A. In Part II of the Agreement APS agrees not to file its next general rate case prior to May  
13 31, 2015. APS further agrees that no new base rates resulting from APS's next general  
14 rate case will be effective before July 1, 2016. This provision of the Agreement is to  
15 ensure rate stability for APS's customers while providing adequate revenue to the  
16 Company that is fair, just and reasonable and that will allow APS to provide safe and  
17 reliable electric services.  
18

19 **Q. Please describe Part III of the Agreement.**

20 A. This section of the Agreement addresses the base rate increase to APS's customers. The  
21 Signatories agreed that APS should receive a base rate increase of zero dollars ("revenue  
22 requirement"). This is comprised of (1) a non-fuel base rate increase of \$116.3 million,  
23 which includes providing for a return on and of plant that is in service as of March 31,  
24 2012 ("Post-Test Year Plant"); (2) a fuel base rate decrease of \$153.1 million; and (3) a

---

<sup>2</sup> See, e.g., the Proposed Settlement Agreement filed January 5, 2012, at paragraphs 1.5, 3.1 and 5.2.

1 transfer of cost recovery from the Renewable Energy Surcharge ("RES") to base rates  
2 described in Paragraph VIII of the Settlement Agreement.

3  
4 **Q. Please discuss Part IV of the Agreement.**

5 A. When new rates become effective, customers will have, on average, a zero percent bill  
6 impact or less. This zero percent or slightly negative bill impact will be achieved by  
7 allowing the negative credit that exists in the Company's Power Supply Adjustor ("PSA")  
8 to continue until February 1, 2013, at which time it will reset. The annual 4 mill cap will  
9 be applied after the impact of the expiration of the then-current PSA credit. The zero  
10 percent bill impact will continue for the remainder of 2012. Commission-approved  
11 adjustors (including the possibility of a Four Corners rider pursuant to paragraph 10.3)  
12 may increase customer bills after December 31, 2012.

13  
14 **Q. Please describe Part V of the Agreement.**

15 A. A capital structure comprised of 46.06 percent debt and 53.94 percent common equity is  
16 proposed.

17  
18 A return on common equity of 10.0 percent and an embedded cost of debt of 6.38 percent  
19 are proposed.

20  
21 A fair value rate of return of 6.09 percent, which includes a return on the fair value  
22 increment of 1.0 percent, is proposed.

23  
24 **Q. Please describe Part VI of the Agreement.**

25 A. This section deals with depreciation and nuclear decommissioning. APS's proposed  
26 depreciation rates are adopted, except for metering. This section also calls for APS to

1 make a filing to reduce its Systems Benefit charge once Palo Verde Unit 2  
2 decommissioning is fully funded, which should occur prior to 2016.

3  
4 **Q. Please describe Part VII of the Agreement.**

5 A. Part VII addresses the Power Supply Adjustor ("PSA"). The Signatories agree that the  
6 base fuel rate shall be lowered from \$0.037571 per kWh, as set in Commission Decision  
7 No. 71448, to \$0.032071 per kWh. This change shall take effect on the effective date of  
8 the new rates contained in this Agreement, in accordance with the current approved Plan  
9 of Administration for the PSA.

10  
11 The Signatories further agree that, for purposes of this case, APS will withdraw its request  
12 to recover through the PSA the cost of chemicals required for environmental compliance  
13 at APS's power plants, and APS shall not raise this request before its next general rate  
14 case.

15  
16 Also, the Signatories agree that the 90/10 sharing provision in APS's PSA should be  
17 eliminated. The Signatories further agree that the PSA should be modified to require APS  
18 to apply interest on the PSA balance annually, rather than monthly, at the following rates:  
19 any over-collection existing at the end of the PSA year will accrue interest at a rate equal  
20 to the Company's authorized ROE or APS's then-existing short term borrowing rate,  
21 whichever is greater, and will be refunded to customers over the following 12 months; any  
22 under-collection existing at the end of the PSA year will accrue interest at a rate equal to  
23 the Company's authorized ROE or APS's then-existing short term borrowing rate,  
24 whichever is less, and will be recovered from customers over the following 12 months.  
25 APS may, at any time during the PSA year, request to reduce the PSA rate through the  
26 Transition Component.

1 To incent prudent fuel and power procurement and use, APS shall be subject to periodic  
2 audits. The first audit shall be for calendar year 2014. Commission Staff shall select a  
3 consultant to perform this audit and subsequent audits. Each audit shall be funded by APS  
4 in an amount not to exceed \$100,000 per audit. APS's PSA has been modified to reflect  
5 these changes. (Attachment C of the Agreement)

6  
7 **Q. Please describe Part VIII of the Agreement.**

8 A. This section of the Settlement Agreement addresses on an ongoing basis how and when  
9 APS will collect the costs associated with certain APS-owned renewable energy projects  
10 through the RES.

11  
12 APS currently collects the costs associated with certain APS-owned renewable energy  
13 projects through the RES. Consistent with the treatment of other Post-Test Year Plant  
14 adopted in this Agreement, the portion of those renewable projects that have been closed  
15 to plant in service as of March 31, 2012, shall be rate based and recovery of those costs  
16 shall be accomplished through base rates.

17  
18 The Signatories also agree that, effective with the date of the Commission's order in this  
19 matter, the capital carrying costs for any APS renewable energy-related capital  
20 investments shall not be recovered through the RES adjustor, except that capital carrying  
21 costs for renewable energy-related capital investments that APS makes in compliance with  
22 Commission Decision No. 71448 shall be recovered in the RES adjustor unless and until  
23 specifically authorized for recovery in another adjustor or in base rates.

24  
25 The Signatories believe that this provision of the Agreement will provide the Commission  
26 with greater flexibility in setting RES adjustor rates and related caps by eliminating the

1 requirement established in Decision No. 67744 that any changes to RES charges and caps  
2 must be allocated between customer classes according to certain set proportions.  
3

4 **Q. Please describe Part IX of the Agreement.**

5 A. This section of the Agreement addresses the energy efficiency/LFCR/opt-out residential  
6 rate/large general service customer exclusion. In general, the LFCR provides for APS to  
7 recover certain fixed costs that it would not otherwise recover due to Commission  
8 mandates regarding energy efficiency and renewable energy. As stated earlier in my  
9 testimony, Mr. Howard Solganick will be Staff's witness on this issue. The LFCR Plan of  
10 Administration is appended to the Agreement as Attachment F.  
11

12 Part IX of the Agreement also addresses changes to the DSM Adjustment Clause,  
13 modifications to APS's Energy Efficiency Performance Incentive Structure and an  
14 independent evaluation to be paid for by APS up to \$100,000 to analyze APS's DSM  
15 programs and energy savings. The DSM Adjustment Clause Plan of Administration shall  
16 be modified to reflect the terms of this Agreement as set forth in Attachment G.  
17

18 **Q. Please describe Part X of the Agreement.**

19 A. This section of the Settlement Agreement is meant to address the process and timing of  
20 how the Commission may treat APS's acquisition of Southern California Edison's  
21 ("SCE") units 4 and 5. In Docket No. E-01345A-10-0474, APS has sought Commission  
22 permission to pursue acquisition of SCE's current ownership interest in Four Corners  
23 Units 4 and 5 and to retire Four Corners Units 1-3 (the "proposed Four Corners  
24 transaction").  
25

1 The Agreement provides for this rate case docket to remain open for the purpose of  
2 allowing APS to file a request, no later than December 31, 2013, to adjust its rates to  
3 reflect the proposed Four Corners transaction, should the Commission allow APS to  
4 pursue the acquisition and should the transaction thereafter close. Specifically, APS may  
5 file an application with the Commission seeking to reflect in rates the rate base and  
6 expense effects associated with the acquisition of SCE's share of Units 4 and 5, the rate  
7 base and expense effects associated with the retirement of Units 1-3, and any cost deferral  
8 authorized in Docket No. E-01345A-10-0474. APS shall also be permitted to seek  
9 authorization to amend the PSA Plan of Administration to include in the PSA the post-  
10 acquisition Operations and Maintenance expense associated with Four Corners Units 1-3  
11 as a cost of producing off-system sales until closure of Units 1-3, provided that such costs  
12 do not exceed off-system sales revenue in any given year. APS's rates shall be adjusted  
13 only if the Commission finds the Four Corners transaction to be prudent.

14  
15 The Signatories have agreed not to raise any issues in the rate adjustment proceeding other  
16 than those specifically described in Section 10.2. The Signatories have further agreed to  
17 use good faith efforts to process this rate adjustment request within a reasonable time.

18  
19 If, at any time, APS determines that the Four Corners Transaction will not close, it shall  
20 inform the Commission and the Signatories by filing a Notice to that effect in this Docket.

21  
22 **Q. Please describe Part XI of the Agreement.**

23 A. In this section, APS agrees to withdraw its request for approval of its proposed  
24 Environmental and Reliability Account ("ERA") mechanism, and further agrees not to  
25 raise this request before its next general rate case.  
26

1 This section also provides that APS shall implement a revised version of the existing  
2 Environmental Improvement Surcharge ("EIS"). As amended, APS shall no longer receive  
3 customer dollars through the EIS to pay for government-mandated environmental controls.  
4 However, when APS invests capital to fund any government-mandated environmental  
5 controls, the EIS will recover the associated capital carrying costs, subject to a cap equal  
6 to the charge currently in place for the EIS. Adjustments to the EIS shall become effective  
7 each April 1st unless Staff requests Commission review or unless otherwise ordered by the  
8 Commission. APS will not request a change in the rate cap prior to its next general rate  
9 case.

10  
11 APS will be held responsible for demonstrating that the environmental controls were  
12 government-mandated and represented a reasonable and prudent option available to the  
13 Company at that time sufficient to meet the environmental requirements.

14  
15 The existing EIS will be reset to zero on the effective date of the new rates contained in  
16 this Agreement.

17  
18 **Q. Please describe Part XII of the Agreement.**

19 A. This section of the Agreement provides that APS shall be allowed to defer for future  
20 recovery, in accordance with the provisions of Accounting Standards Codification  
21 ("ASC") 980 (formerly SFAS No. 71), the following portions of Arizona property tax  
22 expense above or below the test year level of \$141.5 million caused by changes to the  
23 applicable Arizona composite property tax rate (not changes in the assessed value of  
24 property):

25  
26 (a) When the property tax rate increases:

- 1                   • For 2012: 25 percent (prorated with an assumed July 1 rate effective date);
- 2                   • For 2013: 50 percent; and
- 3                   • For 2014 and all subsequent years: 75 percent.

4                   (b) When the property tax rate decreases: 100 percent in all years.

5                   No interest shall be applied to the deferred balance.

6

7                   Beginning with the effective date of the Commission decision resulting from APS's next  
8                   general rate case, any final property tax rate deferral that has a positive balance will be  
9                   recovered from customers over 10 years and any deferral that has a negative balance will  
10                  be refunded to customers over 3 years.

11

12                  The Signatories reserve the right to review APS's property tax deferrals for  
13                  reasonableness and prudence such that the deferrals can be recognized in accordance with  
14                  the provisions of ASC-980.

15

16                  **Q. Please describe Part XIII of the Agreement.**

17                  A. Part XIII of the Agreement provides that the level of transmission costs presently in APS's  
18                  base rates will remain in base rates until further order of the Commission.

19

20                  The annual TCA adjustment will become effective June 1 of each year without the need  
21                  for affirmative Commission approval, unless Staff requests Commission review or unless  
22                  otherwise ordered by the Commission.

23

24                  APS shall file a notice with Docket Control that includes its revised TCA tariff, along with  
25                  a copy of its FERC information filing of its annual update of transmission service rates

1           pursuant to its Open Access Transmission tariff ("OATT"). This notice shall be filed with  
2           the Commission by May 15 of each year.

3  
4       **Q.    Please describe Part XIV of the Agreement.**

5       A.    In Section 16.3 of the 2009 Settlement, APS committed to augment the bill assistance  
6           program approved in Decision No. 69663 by funding \$5 million to assist customers whose  
7           incomes exceed 150 percent of the Federal Poverty Income Guidelines but are less than or  
8           equal to 200 percent of the Federal Poverty Income Guidelines. This section of the  
9           Agreement provides that any funds remaining of that \$5 million funding requirement may  
10          be used to assist customers whose incomes are less than or equal to 200 percent of the  
11          Federal Poverty Income Guidelines.

12  
13          The Agreement also provides that the PSA and DSMAC adjustor rates shall apply to low-  
14          income customers. The billing method for low income customers shall be simplified by  
15          transferring customers to their corresponding non-low income rate schedule and applying  
16          the PSA and DSMAC rate schedules to those bills, but then applying a discount to the  
17          total bill.

18  
19       **Q.    Please describe Part XV of the Agreement.**

20       A.    This section of the Agreement addresses the line extension issue. Version 12 of Service  
21           Schedule 3, as approved in Decision No. 72684 (November 18, 2011), shall become  
22           effective on the date that rates from this case become effective.

23  
24       **Q.    Please describe Part XVI of the Agreement.**

25       A.    This section of the Agreement provides that within 90 days following approval of the  
26           Agreement, APS will initiate stakeholder meetings to address issues related to the APS

1 bill presentation with a goal of making the bill easier for customers to understand. APS  
2 shall thereafter file an application with the Commission for any authorization needed to  
3 modify its bill presentation. Such application shall explain how the APS bill presentation  
4 proposal reflects the input of stakeholders during the stakeholder meeting process.

5  
6 **Q. Please describe Part XVII of the Agreement.**

7 A. This section of the Agreement describes the Company's proposed Experimental Rate  
8 Schedule AG-1, (as modified through negotiations) a buy-through rate for large  
9 commercial and industrial customers, which is capped at 200 MW under the Agreement.  
10 Proposed Experimental Rate Schedule AG-1 does not address the subject of retail electric  
11 competition.

12  
13 APS shall make commercially reasonable efforts to eliminate or mitigate all unrecovered  
14 costs resulting from the AG-1 experimental program established in this docket. If there are  
15 any lost fixed generation costs related to the AG-1 experimental rate, in its next general  
16 rate case, APS shall provide testimony that explains why it was unable to eliminate all lost  
17 fixed generation costs. Because AG-1 is an experimental program that may benefit certain  
18 General Service customers, and because residential customers cannot participate in the  
19 program, any APS proposal in APS's next general rate case that seeks to collect lost fixed  
20 generation costs related to the AG-1 experimental rate shall not propose to recover such  
21 costs from residential customers.

22  
23 APS shall withdraw its request to establish Service Schedule 9, an economic development  
24 service schedule. In its place, APS is authorized to pursue economic development  
25 opportunities through the use of Commission-approved special contracts.  
26

1           The remaining rate design issues presented by this case should be resolved as set forth in  
2           Attachment K to the Agreement.

3  
4       **SECTION IV - PUBLIC INTEREST**

5       **Q.     Mr. Olea, is the Agreement in the public interest?**

6       A.     Yes, in Staff's opinion, the Agreement is fair, balanced, and in the public interest.

7  
8       **Q.     Would you summarize the reasons that lead Staff to conclude that the Agreement is**  
9       **fair, balanced, and in the public interest?**

10      A.     This Agreement results in a settlement package that addresses APS's needs while  
11      balancing those needs with terms and conditions that provide customer benefits, such as:

- 12           • an overall zero dollar base rate increase;
  - 13           • a zero percent bill impact for the remainder of 2012 (Commission-approved  
14           adjustors, including the possibility of a Four Corners rider pursuant to paragraph  
15           10.3 of the Agreement, may increase customer bills after December 31, 2012);
  - 16           • a four-year rate case stay out, in which APS agrees not to raise base rates as a result  
17           of any new general rate case filing prior to July 1, 2016;
  - 18           • a buy-through rate for industrial and large commercial customers;
  - 19           • a narrowly-tailored Lost Fixed Cost Recovery ("LFCR") mechanism that supports  
20           energy efficiency ("EE") and distributed generation ("DG") at any level or pace set  
21           by this Commission;
  - 22           • an opt-out rate design for residential customers who choose not to participate in the  
23           LFCR;
  - 24           • a process for simplifying customers' bill format; and
  - 25           • bill assistance for additional low income customers, at shareholder expense.
- 26

1 **Q. Mr. Olea, do you believe that the Agreement results in just and reasonable rates for**  
2 **consumers?**

3 A. Yes. In its rate application, customers will experience an average zero percent bill impact  
4 or a slight rate decrease when new rates become effective.

5  
6 **Q. Please discuss how the Agreement is fair to the utility.**

7 A. The revenue recommended will provide APS with adequate funds to provide reliable and  
8 safe service, while at the same time ensuring the financial health of the Company. The  
9 LFCR mechanism will also improve APS's revenue stability, which will have a positive  
10 impact on its financial profile and credit ratings.

11  
12 **Q. Mr. Olea, what was Staff's goal when it agreed to be a Signatory to the Agreement?**

13 A. The primary goal of Staff in this matter, as in all rate proceedings before the Commission,  
14 is to protect the public interest by recommending rates that are just, fair and reasonable for  
15 both the ratepayers and the Company. Staff believes it has accomplished this by  
16 reviewing the facts presented and making the appropriate recommendations to the  
17 Commission for its consideration, which will balance the interests of the Company and the  
18 ratepayers, by promoting the Commission's desire to ensure that the Company has the  
19 tools and financial health to provide safe, adequate and reliable service, while complying  
20 with Commission requirements at just and reasonable rates.

21  
22 **SECTION V – POLICY CONSIDERATIONS**

23 **Q. Mr. Olea, what were the major policy considerations the parties had to deal with in**  
24 **this Docket?**

25 A. I believe there was one major policy consideration that Staff and other Signatories had to  
26 address in order to balance the interests of all parties. The Commission, in Docket Nos. E-

1           00000J-08-0314 and G-00000C-08-0314, issued its Policy Statement Regarding Utility  
2           Disincentives to Energy Efficiency and Decoupled Rate Structures (“Policy Statement”).  
3           The Policy Statement did not adopt a requirement or mandate a specific revenue  
4           decoupling mechanism, but noted that utilities may file a proposal for decoupling or an  
5           alternative mechanism for addressing disincentives, in their next general rate case.

6  
7           **Q.    Please describe the Company’s decoupling proposal.**

8           A.    In its rate application, the Company’s proposed to establish an Efficiency and  
9           Infrastructure Account (“EIA”) mechanism that focused on recovering fixed revenue per  
10           customer on an annual basis. APS’s proposed EIA excluded fuel and transmission  
11           charges because those areas are already subject to an adjustment mechanism or annual  
12           formula. The Company’s proposed EIA would have to include all customer classes except  
13           for street lighting, unmetered accounts and merchant generation station power. For  
14           calculation purposes, the EIA proposal used two classes, residential and the applicable  
15           remaining non-residential customers, or “super” classes for identification.

16  
17           **Q.    What was Staff’s recommendation on this issue in its Direct Testimony?**

18           A.    In lieu of the Company’s proposal, Staff recommended that a LFCR mechanism be  
19           adopted which in general provides for APS to recover certain fixed costs that it would not  
20           otherwise recover due to Commission mandates regarding energy efficiency and  
21           renewable energy. The LFCR mechanism Staff recommended focuses specifically on the  
22           portion of the distribution revenue affected by the Company’s compliance with its EE and  
23           DG plans. In addition, the LFCR mechanism is based upon information readily available  
24           within the Company’s Test Year filing, updated to reflect the results of this case. The  
25           mechanism recognizes the impact on the Company due to energy efficiency and  
26           distributed generation and recovers only the fixed costs that the Company actually loses

1 (distribution) as opposed to all of the Company's non-variable costs. The Company  
2 continues to retain its weather and economic risks.

3  
4 **Q. How does the Settlement Agreement address these issues?**

5 A. The Settlement Agreement proposes an LFCR mechanism similar to that proposed by  
6 Staff. The Agreement also provides an opt-out rate for residential customers who choose  
7 to opt-out of the LFCR mechanism.

8  
9 **Q. Is there anything else you would like to add regarding the Agreement?**

10 A. I would like to reiterate that the settlement discussions were transparent, candid,  
11 professional and open to all parties in this docket. All parties were allowed to openly  
12 express their views and opinions on all issues. I believe the Settlement Agreement is in  
13 the public interest.

14  
15 **Q. Does this conclude your testimony?**

16 A. Yes.

**BEFORE THE ARIZONA CORPORATION COMMISSION**

GARY PIERCE  
Chairman

BOB STUMP  
Commissioner

SANDRA D. KENNEDY  
Commissioner

PAUL NEWMAN  
Commissioner

BRENDA BURNS  
Commissioner

IN THE MATTER OF THE APPLICATION OF ) DOCKET NO. E-01345A-11-0224  
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 )  
\_\_\_\_\_ )

TESTIMONY

IN SUPPORT OF

THE SETTLEMENT AGREEMENT

HOWARD S. SOLGANICK

CONSULTANT

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

JANUARY 18, 2012

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**EXECUTIVE SUMMARY  
ARIZONA PUBLIC SERVICE COMPANY  
DOCKET NO. E-01345A-11-0224**

My testimony reviews the details and implementation of the Lost Fixed Cost Recovery (“LFCR”) mechanism proposed in the Settlement Agreement and defined by the proposed Plan of Administration.

I provide details of the LFCR mechanism; the sources of required data; how the initial year is recognized; that the sales reductions are documented by an existing process; how the annual calculations are made; the customer protections included; and the opportunity for review and compliance reporting.

I also compare the LFCR mechanism to revenue decoupling, highlighting that weather, business and other risks are not transferred to customers.

Staff recommends that the Lost Fixed Cost Recovery mechanism be adopted as proposed.

1 **INTRODUCTION**

2 **Q. Please state your name, position and business address.**

3 A. My name is Howard Solganick. I am a Principal at Energy Tactics & Services, Inc. My  
4 business address is 810 Persimmon Lane, Langhorne, Pennsylvania 19047. I am  
5 performing this assignment under subcontract to Blue Ridge Consulting Services, Inc.

6  
7 **Q. Have you previously submitted testimony in this case?**

8 A. Yes. In this proceeding I submitted testimony in regard to APS' proposed decoupling  
9 mechanism and Staff's proposed Lost Fixed Cost Recovery ("LFCR") mechanism on  
10 November 18, 2011 and rate design on December 2, 2011.

11  
12 **Q. For whom are you appearing in this proceeding?**

13 A. I am appearing on behalf of the Staff of the Arizona Corporation Commission ("Staff").  
14

15 **Q. What is the purpose of your testimony?**

16 A. My testimony describes the operation of the LFCR mechanism adopted by the Signatories  
17 to the Settlement Agreement filed by Staff on January 6, 2012, which is similar to the  
18 LFCR mechanism proposed by Staff. I compare the LFCR mechanism to the generic  
19 concept of revenue decoupling; compare the risks transferred to customers and other  
20 aspects of decoupling a utility's revenues.

21  
22 **Q. Have you reviewed specific decoupled rate design proposals in other jurisdictions?**

23 A. I have reviewed proposals for decoupled electric and gas rate designs in Delaware for the  
24 Staff of the Delaware Public Service Commission where I also assisted in the pre-  
25 implementation education process. I have also reviewed decoupling proposals by gas  
26 utilities and offered testimony in Maryland for the People's Counsel and in Michigan for

1 the Attorney General. In addition, I assisted the Staff of the District of Columbia Public  
2 Service Commission in the evaluation and implementation of a decoupled rate design for  
3 delivery of electricity.  
4

5 **LOST FIXED COST RECOVERY MECHANISM**

6 **Q. What is the purpose of the Lost Fixed Cost Recovery (“LFCR”) mechanism?**

7 A. The LFCR mechanism is designed to recover for Arizona Public Service Company  
8 (“Company”) only the Test Year fixed costs that have been documented to be lost as a  
9 result of the Arizona Corporation Commission (“Commission”) approved energy  
10 efficiency (“EE”) and distributed generation (“DG”) programs.  
11

12 **Q. Please describe how the LFCR mechanism works.**

13 A. After the Commission’s decision in this case, the Company’s compliance filing will  
14 include the various values for the LFCR mechanism. For each applicable rate schedule,  
15 the LFCR includes the allowed Test Year Distribution Revenue and Transmission  
16 Revenue divided by the Test Year billing determinants, reduced by 50 percent of any  
17 demand revenue.  
18

19 The LFCR mechanism is an annual process that is initiated by the Company’s  
20 Measurement, Evaluation and Research (“MER”) of its EE program results. The outside  
21 MER consultant studies each EE program and determines the level of energy sales that  
22 were reduced by each program during a year. The Company uses the MER report to  
23 determine the sales reduction for the applicable rate schedules by excluding any sales  
24 reduction for the Excluded Rate Schedules. The sales reduction for the applicable DG is  
25 added to EE sales reduction and is called the Total Recoverable MWh Savings.  
26

1           The Company will file its Annual LFCR Adjustment for the previous year by January 15<sup>th</sup>.  
2           This adjustment is the product of the Total Recoverable MWh Savings times the  
3           applicable Lost Fixed Cost Rate. That product is divided by the Applicable Company  
4           revenues to determine the LFCR Adjustment. Under the Settlement Agreement Staff will  
5           use its best efforts to process the matter by March 1<sup>st</sup> of each year. The LFCR adjustment  
6           is subject to Commission approval. If the Settlement Agreement is adopted by the  
7           Commission, the first LFCR adjustment would occur in 2013.

8  
9           **Q.    What customer (rate) classes will not be subject to the LFCR mechanism?**

10          A.    Residential customers that do not wish to be subject to the LFCR mechanism can “Opt-  
11          Out” by selecting an alternate Basic Service Charge within their existing rate schedule.  
12          During the calculation of the LFCR Adjustment, the associated sales and revenues are  
13          excluded.

14  
15          General customers served under rate schedules E-32 L, E-32 L TOU, E-34, E-35, E-36  
16          XL, unmetered general service customers served under rate schedule E-30 and lighting  
17          customers are excluded from the LFCR mechanism because these rate schedules have  
18          fixed charges that are not expected to be impacted by EE and DG programs. The demand  
19          charge in some of these rate schedules was increased to allow them to be excluded from  
20          the LFCR mechanism.

21  
22          **Q.    Why are the other rate schedules subject to the LFCR mechanism?**

23          A.    The included rate schedules are expected to be impacted by EE and DG programs and  
24          have some or all of the fixed costs collected by a volumetric rate.

1 **Q. Why does the LFCR mechanism not include generation costs?**

2 A. The Company's sales forecast demonstrated that total sales are still expected to rise in the  
3 near future. The Company also has off-system and/or non-AZCC jurisdictional  
4 opportunities to sell any excess energy, therefore, there is no need to include generation  
5 costs in the LFCR mechanism.

6

7 **Q. Why does the LFCR mechanism not include the Basic Service Charge ("BSC")?**

8 A. If a customer reduces its energy consumption in response to an EE or DG program, the  
9 customer is still responsible for paying the applicable BSC, therefore, there is no need to  
10 include the BSC in the LFCR mechanism.

11

12 **Q. Why does the LFCR mechanism not recover 100 percent of the demand charge  
13 revenue?**

14 A. If a customer reduces its energy consumption in response to an EE or DG program it is  
15 unlikely that there will be a proportional reduction in the demand level. To recognize that  
16 there may be some demand reduction a 50 percent Demand Stability Factor is applied,  
17 which reduces the magnitude of the LFCR Adjustment.

18

19 **Q. Is there an option for a residential customer to opt out from the LFCR mechanism?**

20 A. Yes. For residential customers that decide not to be subject to the LFCR mechanism, each  
21 residential rate schedule would contain an alternate BSC applicable to customers choosing  
22 to Opt-Out.

23

24 **Q. Is there a limit on the increase for the LFCR mechanism?**

25 A. Annual adjustments are limited to 1 percent of APS' applicable revenue and are estimated  
26 to be below that level for the next four years based on the expected EE and DG programs.

1           The EE and DG programs are subject to the Commission's annual review and approval  
2           process.

3  
4           **Q.    Does the LFCR mechanism require any additional implementation costs?**

5           A.    No. The MER process is integral to the continuing review of a well-designed EE program  
6           and was in place for the Company's program before the LFCR mechanism was developed.  
7           Therefore, there is no additional cost imposed for the LFCR mechanism.

8  
9           **Q.    Does the LFCR mechanism increase the Company's revenue over the 2010 Test**  
10           **Year?**

11          A.    No. The Lost Fixed Cost Revenue is limited to only the documented reduction of sales  
12          that occur after the rate effective date of this case. The Plan of Administration prorates the  
13          2012 adjustment to reflect the rate effective date. Also any sales reduction for the period  
14          from the end of the Test Year through the rate effective date are not included in the LFCR  
15          mechanism.

16  
17          **Q.    Does the LFCR mechanism provide additional revenue if the Company's sales**  
18          **decline due to weather?**

19          A.    No. Weather risk remains with the Company and its shareholders as it is now. The LFCR  
20          mechanism is focused on the measured sales reduction due to the EE and DG programs.  
21          These programs are those determined by the Commission to be cost effective and  
22          appropriate.

23

1 **Q. Does the LFCR mechanism provide additional revenue if the Company's sales**  
2 **decline due to economic conditions?**

3 A. No. Should economic conditions worsen, any sales reductions are not included in the  
4 LFCR mechanism. Business risk remains with the Company and its shareholders as it is  
5 now.

6  
7 **Q. Does the LFCR mechanism require a change in the Company's allowed rate of**  
8 **return?**

9 A. The LFCR mechanism does not transfer weather or business risk from the Company and  
10 its stockholders to customers, therefore a risk-based change in the Company's allowed rate  
11 of return is not necessary.

12  
13 **Q. Does the LFCR remove the disincentive to the Company to engage in EE and DG**  
14 **programs and activities?**

15 A. Yes. The LFCR mechanism provides a means to recover lost fixed costs that result from  
16 documented sales reductions due to EE and DG programs. From a revenue perspective,  
17 the Company is neutral. The EE program provides for recovery of program costs and a  
18 possible performance incentive, so there is no need to augment the LFCR mechanism.

19  
20 **Q. If the Company failed to achieve documented results from its EE and DG programs,**  
21 **what is the effect on the LFCR mechanism?**

22 A. If the Company is unable to document sales reductions from its EE and DG programs,  
23 then the LFCR mechanism would remain at zero and customers would see no impact.

24  
25 **Q. How is revenue decoupling different from the LFCR mechanism?**

26 A. As applied in some jurisdictions (and as the Company proposed in its application) generic  
27 revenue decoupling looks at a gross measure of sales reduction per customer and adjusts

1 revenue levels to compensate for any changes. The sales reduction could be the result of  
2 weather, economic conditions, outages, price elasticity or the result of EE and DG  
3 programs.

4  
5 **Q. What risks are shifted from the utility to the customer if revenue decoupling is**  
6 **implemented?**

7 A. The implementation of generic revenue decoupling usually transfers weather and business  
8 risks to customers.

9  
10 **Q. Is shifting these risks to customers necessary to encourage a utility to pursue EE**  
11 **and/or DG programs?**

12 A. No. While generic revenue decoupling will remove the perceived disincentives of EE and  
13 DG programs, the shift of other risks to customers is not necessary.

14  
15 **Q. Is the administration of revenue decoupling less costly than an LFCR mechanism?**

16 A. No. There is no additional cost for the MER. The LFCR calculations use compliance  
17 filing values and annual sales data and are made once per year by the Company and  
18 reviewed by Staff.

19  
20 Revenue decoupling requires similar sales data for its calculation. In some jurisdictions  
21 the concern over the impact of weather has led to revenue decoupling implemented on a  
22 monthly basis, requiring additional calculations and reviews. If weather is excluded, then  
23 a weather normalization process must be applied to the sales data on a monthly basis,  
24 requiring additional algorithms, calculations and reviews. If outages are a concern then a  
25 process has to be developed to reflect lost sales due to each applicable outage, which must  
26 be tracked and analyzed.  
27

1 **Q. What is your recommendation?**

2 A. The proposed LFCR mechanism is the result of the input of a number of parties to this  
3 Settlement Agreement. It is designed to remove the Company's disincentive to pursue EE  
4 and DG programs due to sales reductions.

5  
6 The lost fixed costs are determined as a result of the rate case and are part of the  
7 compliance filing.

8  
9 The existing MER evaluation process documents the sales reduction.

10  
11 There is an option for residential customers that wish to Opt-Out of the LFCR mechanism.  
12 To further stabilize revenues, the demand rates of some of the excluded rate schedules  
13 have been increased.

14  
15 The mechanism does not shift weather or business risks to customers; those risks remain  
16 with the Company and its shareholders. A rate of return adjustment is not necessary.

17  
18 The implementation details recognize the initial, partial year. There is a 1 percent annual  
19 cap on any increases resulting from the LFCR mechanism.

20  
21 Reporting requirements have been defined. The calculations are defined and performed  
22 annually. There is a process to provide Staff with adequate time for the annual review.

23 For all of these reasons, Staff recommends the Commission adopt the LFCR mechanism.  
24

25 **Q. Does this conclude your testimony?**

26 A. Yes.