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BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION  
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Arizona Corporation Commission

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FEB 29 2012

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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

**JOINT INITIAL POST-HEARING BRIEF  
 OF  
 PARTIES SUPPORTING SETTLEMENT (EXCEPT COMMISSION STAFF)**

February 29, 2012

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1           **I.       INTRODUCTION**

2       ***“At the most fundamental level, the settlement satisfies the public interest . . . in***  
3       ***that it provides a framework that provides a zero dollar base rate increase, a zero***  
4       ***dollar overall bill impact in 2012 while allowing the Company to maintain its***  
5       ***financial health . . . .”***

6                       - Testimony of Jodi A. Jerich in Support of Settlement Agreement, RUCO  
7                       Exhibit 6, at 11.

8           The Proposed Settlement Agreement (“Agreement”) presented to the Arizona  
9       Corporation Commission (“Commission”) for approval is a broadly-supported document  
10      with a litany of customer and stakeholder benefits that will allow Arizona Public Service  
11      Company (“APS” or “Company”) to continue to provide high quality service and reliability  
12      during a four year rate case stay out. Among the Agreement’s 22 signatories are the  
13      Commission’s Utilities Division Staff and various representatives of APS customers,  
14      including the Residential Utility Consumer Office (“RUCO”), AARP, Freeport-McMoRan  
15      Copper & Gold Inc., Arizonans for Electric Choice and Competition (“AECC”),<sup>1</sup> Kroger  
16      Co., Wal-Mart and Sam’s Club, and the Federal Executive Agencies (“FEA”). The  
17      Agreement is also signed by representatives of landowners and realtors, merchant power  
18      plant owners and competitive suppliers, investors, low income customers, and union  
19      workers.

20           Each of these various parties (“Signatories”) determined after many weeks of  
21      extensive, detailed, and often-times contentious negotiations that the final Agreement serves  
22      their individual interests and, more importantly, the public interest. *See* Settlement  
23      Agreement (“Agreement”) at § 1.4. The only parties to express even partial dissatisfaction  
24      with the Agreement, Southwest Energy Efficiency Project (“SWEEP”) and the Natural  
25      Resources Defense Council (“NRDC”), object primarily to just one specific aspect– that it  
26      does not propose an option for the Commission to adopt revenue per customer decoupling  
27      and chooses instead to promote a narrowly-tailored Lost Fixed Cost Recovery mechanism  
28      as the preferred ratemaking means of enabling APS to meet the Commission’s energy

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<sup>1</sup> AECC is a coalition of a broad range of commercial and industrial interests.

1 efficiency (“EE”) and distributed generation (“DG”) rules. Yet even these objecting parties  
2 agree that their input was reflected elsewhere in the Settlement and that addressing the lost  
3 fixed cost recovery phenomenon associated with EE and DG generally is in the public  
4 interest, even if the Agreement would not do so specifically by way of revenue per  
5 customer decoupling. *See, e.g.*, Hearing Testimony of SWEEP Witness Jeff Schlegel  
6 (“Schlegel Testimony”), Hearing Transcript (“Tr.”) at 665-66.

7 Support of this magnitude is unsurprising, for the Agreement results in significant  
8 benefits that collectively serve the public interest. From a customer standpoint, the  
9 Agreement gives APS a **zero dollar base rate increase** and requires APS to keep base rates  
10 at the current level during a **four year rate moratorium** - until July of 2016. The  
11 Agreement also takes steps to **decrease the average customer bill** on the rate effective  
12 date. If this Agreement is approved, the average residential bill will go down by about one  
13 percent in July and continue at that reduced level throughout 2012 – a welcome discount at  
14 a time when summer heat naturally causes electric bills to rise. As one witness – the former  
15 Chairman of the Michigan Public Service Commission with decades of national experience  
16 in the electric utility industry testified—a settlement that results in such extraordinary  
17 customer benefits is “quite rare.” *See* Testimony of Arizona Investment Council (“AIC”)   
18 Witness Steven Fetter in Support of Settlement Agreement, AIC Exhibit 5, at 4.

19 Although adjustment mechanisms will impact bills over time, many of those changes  
20 would occur irrespective of this rate case and the Settlement-related bill impacts will be  
21 more gradual and predictable than they otherwise would be. *See, e.g.*, APS Exhibit 17. The  
22 Agreement also specifically requires APS to apply to **reduce** rates once prior to its next rate  
23 case. *See* Agreement at § 6.3. In addition, the Agreement gives APS customers several  
24 opportunities to better manage their energy bills and offers additional low income  
25 customers shareholder-funded bill assistance.

26 From a regulator’s perspective, the Agreement affords the Commission considerable  
27 flexibility in setting energy policy. It does so by addressing cost-recovery issues associated  
28 with EE and DG in a manner that can accommodate the Commission’s policy direction

1 outside of a rate case and by freeing the Commission from existing restraints on how to  
2 allocate Renewable Energy Standard (“RES”) costs to customers. The Agreement also  
3 maintains APS’s financial health from the proposed rate-effective date through 2016 by  
4 including several economic provisions designed to support APS during the moratorium  
5 without adding to its proposed zero dollar base rate increase.

6 In short, the proposed Agreement is the result of many weeks of give and take by its  
7 22 diverse supporters. It resolves a complex dispute in a manner that, among other things  
8 described in Section 1.5 of the Agreement:

- 9 • Provides base rate stability for customers;
- 10 • Provides customers with additional rate options;
- 11 • Creatively resolves significant customer and stakeholder concerns regarding  
12 how to recover lost fixed costs that result from Commission-authorized  
13 energy efficiency and distributed generation;
- 14 • Protects the low-income members of our community, at shareholder expense;
- 15 • Gathers information useful to future policy and ratemaking discussions;
- 16 • Starts the process of simplifying the APS bill;
- 17 • Supports APS financially, enabling it to continue to provide reliable electric  
18 service and achieve Arizona’s energy goals; and
- 19 • Preserves the Commission’s flexibility to direct energy policy.

20 Several of these benefits could not have or are unlikely to have resulted from  
21 litigation. Indeed, several provisions required significant concessions that the Company  
22 would have been unwilling to make outside of the settlement context and that could not be  
23 imposed upon APS absent its agreement. Failing to approve an Agreement with such  
24 unique and customer-friendly benefits, on the other hand, would send a message to the  
25 public and financial community that the constructive momentum demonstrated by the  
26 collaborative resolution of APS’s last rate filing has been lost, and that APS’s history of  
27 repeated, litigious, and drawn-out rate cases is likely to begin again. To put it mildly, any  
28

1 such outcome would be poorly received by the financial community. See Hearing  
2 Testimony of AIC Witness Steven Fetter (“Fetter Testimony”), Tr. at 921.

3 The primary questions for the Commission are whether the rates set in the settlement  
4 are fair, just, and reasonable for the service being provided and whether the Agreement  
5 serves the public interest. The evidence presented at hearing makes clear that the answer to  
6 those questions is “yes.” The Agreement has broad-ranging benefits to APS and its  
7 customers, enables APS to continue to provide reliable electric service and pursue  
8 Arizona’s energy goals, leaves resolution of policy issues to policy-making dockets, and  
9 should be approved.

10 **II. THE SETTLEMENT AGREEMENT PROMOTES THE PUBLIC INTEREST**  
11 **AND SHOULD BE APPROVED**

12 **A. The Positive Benefits to Customers that Will Result from the Agreement**  
13 **Balance the Proposed Rate Increase.**

14 *“Taken as a whole, the Settlement Agreement provides meaningful protections*  
15 *and benefits to customers while providing the Company with an opportunity to*  
16 *earn a fair return.”*

17 - Hearing Testimony of AECC Witness Kevin Higgins (“Higgins  
18 Testimony”), Tr. at 942.

19 The Agreement does not just propose an acceptable revenue requirement. Rather, it  
20 is strategically designed to provide tangible benefits to APS customers while supporting  
21 APS financially from now until 2016, without constraining the Commission’s ability to set  
22 energy policy.

23 **1. The Settlement Moderates Rates for at Least Four Years,**  
24 **Beginning with a Bill Decrease.**

25 *“I have to tell you, in all the years I have been doing this I cannot remember a*  
26 *time – the last time the Company has ever agreed with what RUCO’s direct case*  
27 *revenue recommendation was. So only good things can happen when they start*  
28 *off from that point.”*

- Opening Statement of RUCO Counsel Dan Pozefsky, Tr. at 72.

Arguably, the leading customer benefit of this Settlement is the triumvirate of:

- (1) A zero dollar base rate increase;

- 1           (2) A bill decrease on average for all APS customers through 2012; and  
2           (3) The rate stability that the Agreement will provide customers during a  
3           four-year base rate moratorium. *See* Agreement at §§ 2.1, 3.1.

4 Signatories uniformly view this unusual settlement result as a tremendous gain. For  
5 example, RUCO Witness Frank Radigan testified on behalf of residential customers that the  
6 stay out “is a key element of the settlement as it represents a four-year moratorium on rate  
7 cases where ratepayers will see no increase in base rates, and it puts the onus on  
8 management to control operating expenses, minimize capital expenditures, and improve the  
9 productivity of its workforce.” Testimony of Frank Radigan in Support of Settlement,  
10 RUCO Exhibit 4, at 4-5. Kroger Witness Stephen J. Baron testified that “the rate case  
11 stability provision, freezing base rates until July 1, 2016, is likely to be of significant benefit  
12 to all of the company’s ratepayers.” Testimony of Support of Stephen J. Baron, Kroger  
13 Exhibit 3, at 3.

14           On behalf of APS’s federal executive customers, FEA attorney Captain Sam Miller  
15 stated that “[t]he four year stay out provision gives commanders a certain degree of rate  
16 stability that allows them to more accurately allocate annual budget dollars towards the  
17 mission.” Opening Statement of FEA Counsel Sam Miller, Tr. at 64-65. Wal-Mart and  
18 Sam’s Club Witness Steve W. Chriss similarly testified that the zero dollar increase is a  
19 “substantial benefit” to all APS customers in “current economic conditions . . . versus the  
20 increase initially proposed by the Company,” and that the four-year rate case stability term  
21 “provides for certainty in base rate levels and aids in the development of cost forecasting  
22 and budgeting,” among other things. Settlement Testimony of Steve W. Chriss, W-M  
23 Exhibit 3, at 3-4. *See also* Testimony of Nancy Brockway (“Brockway Testimony”) *supporting*  
24 Settlement Agreement, AARP Exhibit 3, at 4-5; Fetter Testimony, Tr. at 918.

25           The fact that APS has various Commission-approved adjustment mechanisms in  
26 place does not undermine the customer value of the rate case moratorium. As AECC  
27 Witness Kevin Higgins explained,  
28

1 [e]ven though APS has a number of adjustor mechanisms, the preponderance  
2 of costs related to base rates are recovered through the general rate case  
3 process. And this Commission, quite frankly, has done an admirable job of  
4 limiting the number of adjuster mechanisms and keeping control of  
5 ratemaking. And as a result of that, a four-year rate case stay out has very  
6 real meaning. It really means that customers, in my view, will avoid the  
7 likelihood of rate increases over that time horizon. And I will say it is  
8 extraordinary in today's regulatory environment.

9 Hearing Testimony of AECC Witness Higgins, Tr. at 945-46.

10 While existing Commission-approved adjustors may increase customer bills after  
11 2012, these adjustments would occur irrespective of this Agreement. See Hearing  
12 Testimony of Commission Utilities Director Steven Olea ("Olea Testimony"), Tr. at 1024-  
13 25, APS Exhibit 17. Moreover, the bill impacts during the Settlement term that directly  
14 result from the Agreement's provisions will be more gradual than they would otherwise  
15 have been. See, e.g., APS Exhibit 17. As Mr. Olea testified,

16 [F]rom Staff's position, we felt it was a benefit to ratepayers to have small  
17 increases over a long term rather than have APS file rate cases every year or  
18 two and come in for big increases. And with the fact that we could get a zero  
19 base rate increase at this time, allow 15 months worth of post-test year plant,  
20 allow these adjustors, and still have a zero base rate increase, Staff felt that  
21 was a huge benefit to customers to get all this rolled into one package.

22 Olea Testimony, Tr. at 1059-60.

23 In addition, the Agreement provides for a future rate *decrease* to take effect prior to  
24 APS's next rate case. Notably, Section 6.3 requires APS to file a request to reduce the  
25 Systems Benefits Charge ("SBC") that customers pay to reflect a corresponding reduction  
26 of the nuclear decommissioning trust fund obligations associated with Palo Verde Unit 2,  
27 which is expected to be fully funded by the end of 2015. Simply put, that provision  
28 (one of several in the Agreement that cannot be achieved outside of a rate case) requires  
29 APS "to flow through a rate reduction sooner than the middle of 2016, because we will  
30 have fully funded Unit 2's decommissioning cost." Hearing Testimony of Jeff Guldner  
31 ("Guldner Testimony"), Tr. at 129. See also Higgins Testimony, Tr. at 941.

1                   2.     **The Settlement Provides Customers with Additional Rate**  
2                             **Options.**

3                   Several of the Agreement's provisions allow customers to choose among new rate  
4 options.

5                             (a)    **A Lost Fixed Cost Recovery Mechanism with Residential**  
6                                    **Opt-Out Rates as a Compromise on Full Decoupling.**

7                   *"[The] LFCR plus opt-out rate is a great achievement in this settlement."*

8                             - Jerich Testimony, Tr. at 1129.

9                   A key example of how the Agreement represents a balanced compromise is the  
10 mechanism it endorses to recover the fixed costs lost due to the Commission's EE and DG  
11 rules: the LFCR with residential opt-out rates. And for RUCO and AARP, coupling the  
12 opt-out rate with a narrowly-tailored LFCR mechanism was an essential and material  
13 component of the Settlement. Section 9.1 of the Agreement explains the issue that the  
14 mechanism seeks to address:

15                   [U]nder APS's current volumetric rate design, the Company recovers a  
16 significant portion of its fixed costs of service through kilowatt-hour  
17 ("kWh") sales. Commission rules related to EE and DG require APS to sell  
18 fewer kWh, which, in turn, prevents the Company from being able to recover  
19 a portion of the fixed costs of service embedded in its energy rates.

20                   The question of how the issue described in Section 9.1 should be addressed has been  
21 the subject of considerable and contentious debate. Energy efficiency advocates and  
22 utilities have tended to favor a full revenue per customer decoupling model, as reflected in  
23 the direct filings made this case. Many APS customers and parties to this proceeding, on  
24 the other hand, have vocally opposed decoupling. As RUCO Witness Jodi Jerich testified,  
25 the Commission has witnessed:

26                   [V]ocal consumer opposition to full revenue decoupling. Literally, and I  
27 know the bench has mentioned it and two other witnesses, but RUCO has  
28 attended public comment sessions where hundreds and hundreds of  
ratepayers will come out and oppose decoupling. And we have also . . . seen  
all the influx of letters into the docket in the Southwest Gas and APS case  
opposing decoupling.

1 Jerich Testimony, Tr. at 1121. Indeed, several representatives of APS's customers in this  
2 case, including RUCO, AARP, and FEA, stated on the record that they would not have  
3 signed the Settlement Agreement had it contained a full revenue per customer decoupling  
4 model. See Jerich Testimony, Tr. at 1120; Brockway Testimony, Tr. at 491; Blank  
5 Testimony, Tr. at 399. AIC Witness Gary Yaquinto agreed that the LFCR is "an essential  
6 component" to support "by all Signatories." See Testimony of Gary M. Yaquinto in Support  
7 of Settlement Agreement, AIC Exhibit 4, at 3.

8 To bridge the parties' differences, the Settlement endorses a narrowly-tailored Lost  
9 Fixed Cost Recovery mechanism ("LFCR") with residential opt-out rates, from which large  
10 commercial customers are excluded. See Agreement, § 9.2-9.13. The LFCR limits lost  
11 fixed cost recovery to only a portion<sup>2</sup> of the Company's revenues that are measurably lost  
12 because of Commission-authorized EE or DG; it does not include the impact of other  
13 potential factors that may reduce energy sales, such as weather or general economic  
14 conditions. See Agreement at § 9.3; Guldner Testimony, Tr. at 218-219, 481-482;  
15 Brockway Testimony, Tr. at 495; Snook Testimony, Tr. at 841, 848, 855-856; Fetter  
16 Testimony, Tr. at 930; Higgins Testimony, Tr. at 964, Jerich Testimony, Tr. at 1120, 1129;  
17 Solganick Testimony, Tr. at 1212, 1217, 1234-35. To further mitigate the customer bill  
18 impact, the LFCR is subject to an annual year-over-year one percent rate cap. See  
19 Agreement at § 9.4; Guldner Settlement Testimony, APS Exhibit 2 at 17. This means that  
20 the LFCR charge will never increase customer bills by more than one percent from one year  
21 to the next. *Id.*

22 The Settlement also provides residential customers a rate schedule choice to "opt  
23 out" of the LFCR and pay instead a small static increase to their basic service charge. See

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24  
25 <sup>2</sup>The LFCR does not include all of the lost fixed costs that result from Commission-authorized EE and DG programs.  
26 It excludes, for example, all generation costs, 50% of demand costs, all regulatory asset recovery and system benefits  
27 cost. See Guldner Testimony, Tr. at 420-21, Snook Testimony, Tr. at 835-36. Moreover, the one percent cap may  
28 prove too low to serve the purpose of the LFCR after 2016. See, e.g., Guldner Testimony, Tr. at 88. For these reasons,  
the LFCR mechanism will need to be reassessed in the Company's next rate case and tailored as necessary to  
accommodate the increased level of savings (and attendant lost fixed costs) required of APS after that time. See  
Guldner Testimony, Tr. at 88.

1 Agreement at § 9.8 and Attachment E. The opt-out rate was designed to recover, on  
2 average, the same amount of revenues as would the LFCR. *See* APS Exhibit 5; Guldner  
3 Testimony, Tr. at 250, 480-81; Jerich Testimony, Tr. at 1120. The existence of an “opt out”  
4 rate allows customers who either oppose decoupling conceptually or would prefer the  
5 stability of a fixed rate to avoid LFCR adjustor payments. *See* Guldner Settlement  
6 Testimony, APS Exhibit 2, at 17; Jerich Testimony, Tr. at 119. Like the LFCR, the purpose  
7 of the opt-out rate is to allow the Company to recover a portion of its lost fixed costs.  
8 Unlike the LFCR, however, the opt-out rate would not directly apportion a percentage of  
9 consumer savings to the Company – it would simply require an increase to the basic service  
10 charge, thus avoiding yearly adjustor rate variances.

11 During the first year of new rates, customers are permitted to switch between the  
12 LFCR and the opt-out rate one time to make sure that the rate to which they subscribe is  
13 right for them. *See* Miessner Testimony, Tr. at 618. After that, consistent with other of  
14 APS’s rate schedules, customers may switch to the alternative rate (either the LFCR or the  
15 opt-out) only if they have been on their current rate for 12 months or more. *See id.*; Jerich  
16 Testimony, Tr. at 1138-39. This 12 month requirement is intended to prevent customers  
17 from “gaming” the two rates (paying one rate during the summer and another during the  
18 winter so as to avoid paying their share of the Company’s lost fixed costs). *See* Miessner  
19 Testimony, Tr. at 618.

20 The Settlement commits APS to work with stakeholders, such as RUCO and  
21 Commission Staff, to develop an outreach program to inform and educate customers about  
22 both the LFCR and voluntary opt-out rates and thereafter implement the program. *See*  
23 Agreement at § 9.9; AARP Witness Nancy Brockway Settlement Testimony, AARP  
24 Exhibit 3, at 4. And, as RUCO Witness Ms. Jerich testified, “I have every reason to think  
25 the utility will do a good job in the customer outreach.” Jerich Testimony, Tr. at 1137.

26 Residential customer representatives testified that they support the LFCR with  
27 residential opt-out rates in large part because the concept addresses the cost recovery issue  
28 associated with EE and DG in a manner that gives customers choices about how to manage

1 their energy bills. *See, e.g.*, Jerich Testimony, Tr. at 1121, 1130. Fundamentally, the LFCR  
2 enables APS to continue offering customers a variety of EE and DG programs – programs  
3 that by their nature give participating customers greater control over their energy costs. *See*  
4 Guldner Testimony, Tr. at 87-88; Guldner Testimony, Tr. at 331-332; Olea Testimony, Tr.  
5 at 973-974. APS testified that, absent a workable ratemaking mechanism like the LFCR,  
6 the Company could no longer offer EE and DG programming at the Commission’s required  
7 levels and customers would lose much of that benefit for at least the next four years. *See,*  
8 *e.g.*, Guldner Settlement Testimony, APS Exhibit 2, at 4 and 16.

9       As important (if not more important) to residential customers is the opt-out rate,  
10 which RUCO described as a “very creative idea” that “provides customers with increased  
11 choice and flexibility” but that does not “compromise the Commission’s direction on EE  
12 policy or the Company’s finances.” Jerich Testimony, Tr. at 1121, 1130. RUCO also  
13 views the stability of the opt-out rate design itself as a tremendous benefit, believing that  
14 this stability sends more appropriate price signals and thereby encourages customer  
15 conservation. *Id.* at 1122. RUCO also suggested that the mere existence of an opt-out rate  
16 may inspire a customer to try the LFCR at the start (knowing that he or she has an out if  
17 needed), and then discover through that subscription that the concept of a lost fixed cost  
18 recovery device is not as objectionable as he or she once believed. *See* Jerich Testimony,  
19 Tr. at 1121-22. In this way, the adoption of the LFCR with opt-out rates in this case may  
20 ultimately “help customers gain acceptance of decoupling.” *Id.* at 1121.

21       Importantly, the opt-out rate does not require a customer to opt-out of supporting or  
22 participating in EE programs or DG. As Ms. Jerich explained,

23       A customer who participates in the opt-out rate and a customer who  
24 participates in the LFCR participates to the same extent in DG and EE  
25 programs, and here is why. Both customers will pay for DG programs  
26 through the RES adjuster. Both customers will pay for EE programs through  
27 the DSM adjuster. Both customers will pay the company for lost fixed costs.  
28       One will do it through the LFCR, the other will do it through the opt-out rate.

27 Jerich Testimony, Tr. at 1123. *See also* Olea Testimony, Tr. at 1012-13, 1046-47.

1 APS's commercial customers also support the LFCR. The mechanism excludes  
2 General Service customers taking service under rate schedules E-32L, E-32L TOU, E-34  
3 and E-35. These customers, in contrast to residential or smaller commercial customers,  
4 already pay a relatively large portion of the fixed costs that APS incurs to serve them  
5 through a demand charge. *See* Agreement, § 9.3; Guldner Testimony, Tr. at 121. Rather  
6 than requiring these customers to be included in the LFCR, the parties agreed to change  
7 their rate design so that the distribution demand component would recover even more fixed  
8 costs. *See* Agreement at § 9.3; Hearing Testimony of Wal-Mart and Sam's Club Witness  
9 Steve Chriss ("Chriss Testimony"), Tr. at 517-18; Guldner Settlement Testimony, APS  
10 Exhibit 2, at 17; Olea Testimony, Tr. at 1012-1013, 1046-1047; Miessner Testimony, Tr. at  
11 553-555; Snook Testimony, Tr. at 822-823.

12 Although not exempted from the LFCR, representatives of the Company's smaller  
13 commercial customers testified that the Settlement is fair to each of the Company's  
14 commercial classes. *See* Chriss Testimony at, Tr. 523-24 (noting that APS's, Wal-Mart and  
15 Sam's Club customers include small and extra small commercial facilities); Opening  
16 Statement of Captain Sam Miller on behalf of FEA, Tr. at 65 (noting that the LFCR benefits  
17 smaller FEA customers, such as post offices); Blank Testimony, Tr. at 399 (noting that, in  
18 supporting the settlement, he is representing a broader group than just the large customers,  
19 and that several federal agency customers of APS fall into smaller general service classes).

20 **(b) Rate Schedule AG-1**

21 *"Rate rider AG-1 is a very customer-friendly innovation. It has the potential to*  
22 *enable Arizona businesses to improve their economic health through energy cost*  
23 *savings at no risk to other customers."*

- 24 - Direct Settlement Testimony of AECC Witness Kevin Higgins, AECC  
25 Exhibit 3, at 10.

26 The proposed Alternative Generation Rate Schedule ("AG-1") provides certain of  
27 APS's business customers increased flexibility to manage energy costs. Capped at 200  
28 MW participation and limited to an initial four year period, the AG-1 rate schedule  
establishes an experimental buy-through rate that permits eligible customers to select a

1 power provider other than APS. *See* Agreement at § 17.1. APS proposed this rate offering  
2 as part of its direct case in response to customer feedback received during a 2009  
3 Commission workshop, in which certain of APS's large customers expressed an interest in  
4 having greater control over their energy bills. *See* Lynch Testimony, Tr. at 508; Guldner  
5 Testimony, Tr. at 265.

6 The AG-1 rate schedule is designed to allow eligible customers more control over  
7 their power costs, without adversely impacting other customers. Specifically, customers  
8 with an aggregated load of 10 MW or more will have the opportunity to select a Generation  
9 Service Provider ("GSP") other than APS and negotiate a price with that GSP for the  
10 customer's power. *See* Agreement at Attachment J. APS will then buy that power from  
11 the selected GSP in a wholesale transaction on that customer's behalf. *Id.* The buy-  
12 through transaction will permit customers to select a GSP based upon price and level of  
13 service. *See* Lynch Testimony, Tr. at 508. With this increased level of control, customers  
14 might be better able to manage their energy costs by establishing a hedge based upon the  
15 alternative supply resource they selected. *See* Guldner Testimony, Tr. at 369-70. The  
16 offering also gives customers additional opportunities to select a certain type of generation,  
17 such as solar or wind power, to meet a specific corporate sustainability goal. *See* Hendrix  
18 Testimony, Tr. at 513-14. Customers see AG-1 as providing "an opportunity for  
19 participating customers to improve their economic health and take advantage of energy  
20 cost savings." Higgins Testimony, Tr. at 948.

21 The AG-1 rate schedule will provide eligible customers these benefits while  
22 insulating all other customers from any attendant cost shifting. AG-1 may cause APS to be  
23 unable to recover a portion of the fixed costs included in its generation rates. *See*  
24 Agreement at § 17.1; Brockway Testimony, Tr. at 496. For that reason, the Agreement  
25 contains certain provisions to allow APS to mitigate the financial impact of displaced  
26 generation (such as by maximizing off-system sales ), *see* Guldner Testimony, Tr. at 432,  
27 and it specifically requires APS to take commercially reasonable efforts to eliminate or  
28 mitigate all unrecovered costs that might result from the program. *See* Agreement at §

1 17.2. If those efforts fail, not only must APS explain the failure in its next rate case, but  
2 APS is specifically prevented from later seeking to recover any lost fixed costs relating to  
3 the AG-1 rate from residential customers. See Agreement at § 17.2. In other words,  
4 residential customers are “held harmless” from any resulting cost shifting. See Guldner  
5 Testimony, Tr. at 142. See also Brockway Testimony, Tr. at 496 (“What we didn’t want  
6 was a situation in which there would be stranded costs and they could be transferred to  
7 customers who neither wanted nor benefited from the AG-1.”). Further, that does not  
8 mean that the costs will be imposed on smaller commercial customers who are ineligible  
9 for the program (such as some of those represented by the FEA and Wal-Mart). Rather, the  
10 Commission retains the flexibility to decide whether and how any unrecovered cost impact  
11 resulting from AG-1 should be recognized in APS’s next rate case. See Olea Testimony,  
12 Tr. at 1034-35.

13 In the end, the proposed AG-1 program considers all APS customers, not just those  
14 who are eligible for it. As AECC Witness Kevin Higgins summarized,

15 [AG-1] is customer friendly in that it provides an opportunity for customers  
16 to do something a little bit different. It provides an opportunity for customers,  
17 through APS, to acquire power that is priced at market prices. And that, in  
18 my view, is very customer friendly, because APS is providing that kind of  
19 flexibility and choice to customers. And I believe that by making that  
20 available, it is going to provide an opportunity for participating customers to  
21 improve their economic health and take advantage of energy cost savings.  
22 And it is also customer friendly in the sense that the ability for customers to  
23 save money by taking advantage of AG-1 is not going to cause a cost that is  
24 imposed on other customers. So the entire manner in which the AG-1 option  
25 has been presented, refined, and ultimately negotiated, in my view, is a – I  
26 know of no better description than to say it is very customer friendly.

27 Higgins Testimony, Tr. at 948.

28 (c) **Other residential and commercial rate options.**

29 “[The Settlement] offer[s] several optional rate programs that provide opportunities for  
30 customers to save on their bill.”

31 - Direct Settlement Testimony of Charles A. Miessner, APS Exhibit 7, at 9.

32 The Settlement also establishes two new experimental demand response program

1 options – one for residential customers and one for extra large business customers. Each of  
2 these programs gives participating customers an additional opportunity to manage their  
3 energy payments.

4         The first, a residential peak time rebate program, partners with – but performs  
5 differently than – the Company’s existing residential critical peak pricing program. *See*  
6 *Miessner Testimony, Tr. at 576.* The existing critical peak pricing program is an  
7 experimental demand response rate for residential customers. Customers subscribed to that  
8 rate agree to pay a higher rate for energy used during “critical peak periods,” of which they  
9 are notified in advance. *See Miessner Testimony, Tr. at 577.* If a customer does not want  
10 to pay the higher rate, he or she must reduce usage during the designated critical time. *Id.*  
11 By contrast, the proposed experimental peak time rebate program will allow customers  
12 who choose to enroll to be paid a rebate for energy saved during the notified critical peak  
13 period. *Id. at 577-78.* The more energy a customer saves during the designated time, the  
14 greater the rebate. *Id.* APS intends to compare the load reduction data gathered from these  
15 two programs to determine whether positive reinforcement (the rebate provided in the  
16 proposed peak time rebate program) or negative reinforcement (the higher rate required for  
17 usage in the existing critical peak pricing program) is more effective in promoting  
18 conservation, and will propose to implement the most effective of the two on a full time  
19 basis. *Id. at 576.*

20         The Agreement also allows extra large business customers who consume at least  
21 3,000 kW per month the opportunity to subscribe to an experimental interruptible rate rider  
22 schedule. *See Agreement at Attachment K; Miessner Testimony, Tr. at 578-89.* Similar in  
23 concept to the residential peak time rebate program, the interruptible rate rider pays the  
24 participating customer an incentive rebate for reducing consumption during a designated  
25 period. *See Miessner Testimony, Tr. at 607.* The amount of that incentive payment varies  
26 depending upon how much advance notice of an upcoming critical period the customer  
27 requires and how long the customer is willing to reduce consumption. *Id.* So, for example,  
28 a customer that requires little notice and is able to manage a longer service interruption

1 may receive a fairly large rebate. *Id.* at 607-608. Like its residential counterpart, the  
2 proposed experimental interruptible rate rider is another example of how the Agreement  
3 expands the opportunities for APS customers to manage their energy bills.

4           3.       **The Settlement Protects APS's Most Vulnerable Customers**

5       *"The provisions contained in this agreement that address the low income*  
6 *community will help families like this APS customer: She manages a grocery*  
7 *store for a national chain . . . he has been laid off from his construction job. And*  
8 *their 12 year old daughter has diabetes. They aren't currently able to make ends*  
9 *meet and they have asked for assistance for the first time ever with their electric*  
10 *and their water bills . . . Being able to rely on the fact that their utility costs will*  
11 *not increase at this time and that bill assistance is available is a huge relief to*  
12 *them and the many other Arizonans that are struggling."*

13           - Opening Statement of Cynthia Zwick, Tr. at 45-46.

14       As of the date of the hearing, the poverty rate in Arizona was the second highest in  
15 the country. *See Zwick Testimony, Tr. at 533.* Recognizing that the Company's low-  
16 income customers are vulnerable generally, and particularly in the current economic  
17 climate, the Agreement contains two measures designed to help the most impoverished in  
18 our community.

19       The first, contained in section 14.1, extends from a commitment that APS made in  
20 Decision No. 71448. In that case, APS agreed to augment the bill assistance program  
21 approved in Decision No. 69663 by contributing five million dollars of shareholder funds –  
22 a contribution that was set aside specifically to assist customers whose incomes are between  
23 150% and 200% of the Federal Poverty Income Guidelines. *See Guldner Settlement*  
24 *Testimony, APS Exhibit 2 at 28.* Surprisingly, a striking \$4.7 million of that contribution  
25 remains today, notwithstanding the unfortunate state of the economy. *See Zwick*  
26 *Testimony, Tr. at 529.* The reason, as Ms. Zwick testified, is that the families for whom the  
27 five million dollar contribution was set aside were just falling into poverty after the decline  
28 in the economy. *Id.* at 528. These families often exhausted their assets before turning to  
low income assistance agencies for help, so by the time they sought bill assistance their  
incomes had dropped below the targeted criteria of the 150% - 200% of the federal poverty  
level group. *Id.*

1           This Agreement fixes that problem. So that additional low income customers may  
2 benefit from the Company's bill assistance contribution, APS agreed in the Settlement to  
3 allow its five million dollar contribution to be used to assist customers whose incomes fall  
4 between zero and 200% of the federal poverty level. As Ms. Zwick testified, with this  
5 provision, "that money will be much easier to distribute to vulnerable families." Zwick  
6 Testimony, Tr. at 529. AARP Witness Ms. Brockway echoed that point, noting that "this  
7 provision will expand the usefulness of the funding." Brockway Testimony Supporting  
8 Settlement Agreement, AARP Exhibit 3, at 6. Given that the average bill assistance  
9 payment today is approximately \$293.00 per eligible customer, expanding the reach of the  
10 remaining \$4.7 million means that more than 16,000 low or limited income customers will  
11 have the opportunity to benefit from shareholder-funded bill assistance if the Settlement is  
12 approved. *Id.* at 531.

13           The second provision relating to low income customers eliminates the existing and  
14 confusing nature of the low income rate structure. In its place, low income customers will  
15 be placed on a regular residential rate schedule and be subject to all of the adjustment  
16 mechanisms now paid by APS's other residential customers (including the PSA, from  
17 which low income customers have been exempt but from which they would have  
18 measurably benefitted in recent years). *See* Miessner Testimony, Tr. at 548-49. However,  
19 to insulate low income customers from the rate increase that would otherwise result from  
20 these changes, the Settlement requires APS to materially raise the discount that applies to  
21 the low income customer's bill, tiered in four blocks to reflect energy consumption. For  
22 example, the discount grows from 40% to 65% for the lowest usage group, from 26% to  
23 45% for the next lowest usage group, from 14% to 26% for the second highest usage block,  
24 and from a dollar credit of \$13 per month to \$31.75 per month for those who consume the  
25 most. *Id.* at 615.

26           Ms. Zwick agrees that this modified rate design was a consistent and reasonable  
27 expectation for low income customers and believes that the best interests of low income  
28 customers will be addressed by the Settlement Agreement. *See* Zwick Testimony, Tr. at

1 531. RUCO also agrees that the simplified rate design is fair, primarily because the  
2 application of the PSA to low income customers will give those customers the opportunity  
3 to benefit from the bill credit associated with lower fuel costs and because the proposed  
4 discount structure will initially hold low income customers harmless from the change. *See*  
5 Jerich Testimony at 1139. AARP also supports the change, noting that “the inverted block  
6 of the low-income rate design . . . will have a positive effect on customer incentives to  
7 conserve energy.” Brockway Testimony Supporting Settlement Agreement, AARP Exhibit  
8 3, at 4.

9 **4. The Settlement Preserves the Commission’s Policy Flexibility**

10 *“I believe the Settlement Agreement provides some flexibility for things that are in*  
11 *process or are being considered and are coming before the Commission, and it*  
12 *does so by either leaving the settlement agreement open in the case of the*  
13 *performance incentives, or by using adjustors that could flexibly respond to*  
14 *changes in the Commission’s policies over time.”*

15 - Schlegel Testimony, Tr. at 675.

16 From a policy perspective, the Settlement responds to the Commission’s expressed  
17 interest in retaining the flexibility to set energy policy as it deems appropriate in the future.  
18 *See, e.g.,* Agreement § 9.2. For this reason, the Settlement was specifically designed to  
19 allow for changes in Commission policy that may occur, without either constraining the  
20 Commission or resulting in economically unsustainable results for the Company. As APS  
21 Witness Jeff Guldner testified, the Company has learned since its 2009 Settlement “an  
22 evolutionary lesson in how we pursue or discuss settlement agreements.” Guldner  
23 Testimony, Tr. at 285. In this case, the parties intentionally focused on negotiating rate  
24 mechanisms that will allow APS to adapt to any Commission policy that may be  
25 determined in the dockets devoted to more general policy-making (such as the dockets  
26 dedicated to resource planning and the RES and DSM Implementation Plans). *See id.;*  
27 Guldner Testimony, Tr. at 285-86, 307-09, 342-43, 443, 448, 465-66; Snook Testimony,  
28 Tr. at 844-845, 892, 894; Fetter Testimony, Tr. at 917; Olea Testimony, Tr. at 974-975;  
Jerich Testimony, Tr. at 1121.

This flexibility is perhaps best demonstrated by how the Settlement resolves APS’s

1 original proposal for a decoupling mechanism. As previously described, the Settlement  
2 supports EE as a low cost resource but does not adopt a broad, full revenue per customer  
3 decoupling model. Rather, sensitive to the Commission's interest in directing EE and DG  
4 policy, the Settlement proposes that the Commission adopt the LFCR mechanism with  
5 residential opt-out rates – a ratemaking device that is narrowly-tailored to recover only a  
6 portion of the fixed cost revenues measurably lost because of the EE or DG programs  
7 actually authorized by the Commission. See APS Exhibits 2 at 9-10; APS Exhibit 9 at 3,  
8 RUCO Exhibit 6 at 11; Staff Exhibit 10 at 18; AECC Exhibit 3 at 3; Jerich Testimony, Tr.  
9 at 1120-1121; Brockway Testimony, Tr. at 495. So calculated, the mechanism financially  
10 equips APS to support these programs at whatever level or pace the Commission sets until  
11 the Company's next rate case. See, e.g., Guldner Testimony, Tr. at 326; Olea Testimony,  
12 Tr. at 1047-1048. In this way, the LFCR mechanism "moves up or down depending on  
13 what level of distributed generation and energy efficiency is authorized by the  
14 Commission. It doesn't purport to tell the Commission what that level should be."  
15 Guldner Testimony, Tr. at 443. As Mr. Olea testified,

16 The way that we set up the Agreement, it allows the Commission to – and  
17 especially with respect to energy efficiency and renewables – to put whatever  
18 requirements they want on the Company. They can increase the standards  
19 that are in the rules, they can decrease them, they can double them, they can  
20 eliminate them, whatever they want to do. And the LFCR will go up and  
21 down with that. And unlike the previous settlement agreement that actually  
22 put some conditions on the company that they had to meet certain  
23 requirements for EE and DG or any type of renewable, this agreement  
24 doesn't contain that.

25 Olea Testimony, Tr. at 974-75.

26 The Agreement also enhances the Commission's flexibility with respect to EE/DSM  
27 issues by its treatment of the DSM Performance Incentive. In light of the Commission's  
28 discussions about potentially modifying the existing DSM Performance Incentive, the  
29 Agreement requires APS to work with stakeholders and Staff to develop and file for  
30 Commission consideration a new performance incentive structure by December 2012 – the  
31 end of this year. See Agreement at § 9.14(d). To remove any possible legal challenge to

1 the Commission's ability to implement a new performance incentive outside of a rate case,  
2 the Agreement leaves this rate case docket open so that the Commission can immediately  
3 implement whatever performance incentive it deems appropriate in response to the  
4 Company's filing, without having to wait until the Company's 2016 rate case to do so. *See*  
5 *id.*; Guldner Testimony, Tr. at 448-49.

6 The Agreement gives the Commission autonomy over how the future performance  
7 incentive should be structured – it does not purport to bind the Commission to adopt the  
8 proposal that APS or any other stakeholder files. *Id.* As Mr. Olea testified, the Agreement  
9 “gives the Commission great flexibility with the performance incentive, in that you could  
10 end up with completely eliminating the performance incentive, to leaving it the same, to  
11 enhancing it somehow. But the outcome of [Section 9.14(d)] is completely up to the  
12 Commission.” Olea Testimony, Tr. at 977.

13 As an interim measure, the Agreement defines a modified performance incentive for  
14 use until the Commission fully vets and finally rules on the issue in response to APS's later  
15 performance incentive filing. *See* Agreement § 9.14(b). The evidence at hearing  
16 demonstrated that this modified performance incentive is appropriate, notwithstanding the  
17 establishment of the LFCR. As SWEEP Witness Mr. Schlegel testified, there is “broad  
18 agreement amongst stakeholders in Arizona that performance incentives, performance  
19 based incentives . . . are a good thing.” Schlegel Testimony, Tr. at 655. Performance  
20 incentives serve a different purpose than a lost fixed cost recovery mechanism or full  
21 revenue decoupling. *See* Cavanagh Testimony, Tr. at 763. Performance incentives are  
22 designed to incent a utility to perform well and create effective DSM programs, not simply  
23 spend more on programs. *See* Guldner Testimony, Tr. at 313. As Mr. Schlegel explained,  
24 “[t]he performance incentives, in our view, are very important, and are essentially an  
25 essential policy instrument that the Commission should use and exercise to both influence  
26 and direct energy efficiency outcomes.” Schlegel Testimony, Tr. at 655. This Agreement  
27 puts the procedural mechanism in place that will allow the Commission to design and  
28 implement whatever performance incentive it believes will serve that purpose.

1 Yet another example of how the Settlement enhances the Commission's flexibility is  
2 its treatment of renewable energy cost recovery issues. It does so in two ways: first, by  
3 taking steps to reduce the current level of the Renewable Energy Surcharge ("RES"), *see*  
4 Sections 8.1-8.3; and second, by undoing a prior constraint on how the Commission may  
5 allocate RES charges and caps, *see* Section 8.4. As to the first, the Agreement builds upon  
6 the Commission's recent decision regarding APS's 2012 RES Implementation Plan<sup>3</sup> by  
7 shifting cost recovery of certain APS-owned renewable resources from the RES surcharge  
8 to base rates. *See* Agreement at § 8.1. At the same time, it moves certain renewable  
9 energy-related purchase power agreement costs out of the PSA and into the RES adjustor.  
10 *Id.* at § 8.3. Shifting cost recovery of the identified APS-owned projects from the RES  
11 adjustor to base rates will reduce the RES adjustor from \$3.84 to \$2.78 for residential  
12 customers. *See* Guldner Testimony, Tr. at 353. And it will reduce the typical customer bill  
13 by approximately 1.22%. *See* Guldner Testimony, Tr. at 178-79.

14 Second, the Agreement removes the requirement established in Decision No. 67744  
15 that APS allocate RES charges amongst customer classes in certain proportions. *Id.* at §  
16 8.4. As Mr. Olea testified, "this provision was designed to provide the Commission with  
17 greater flexibility in setting RES adjuster (sic) rates and related caps...." Olea Testimony,  
18 Tr. at 983-84. Currently, if the Commission changes the RES adjustor for one class of  
19 customers, it must also change the adjustor for other classes by certain proportions. *See*  
20 Olea Testimony, Tr. at 1033. But by eliminating the proportionality requirement, the  
21 Agreement "allows the Commission the flexibility to keep the same proportionality,  
22 change it proportionally, do whatever they want with the caps.... It just gives [the  
23 Commission] more flexibility in setting the caps." Olea Testimony, Tr. at 1033. With this  
24 flexibility, the Commission can make targeted decisions about renewable energy policy by  
25 changing the cost-allocation of the related costs.

26 Finally, the Settlement's proposal with respect to the Company's line extension  
27 policy ("Service Schedule 3") is another example of how the Agreement enhances the

28 \_\_\_\_\_  
<sup>3</sup> *See* Decision No. 72737 (January 18, 2012).

1 Commission's policy-making flexibility. *See* Agreement at § 15.1. The 2009 Settlement  
2 tied a revenue stream that was of material importance to APS to the Company's current  
3 line extension policy. That policy, which removed a "free footage" component that was  
4 important to many customers, became highly controversial. When the Commission  
5 expressed an interest in revisiting the policy, the link between the Company's revenue and  
6 that specific policy made it difficult for APS to adapt to any potential line extension policy  
7 changes. *See* Guldner Testimony, Tr. at 449. This Settlement breaks that link, taking two  
8 specific actions relating to Schedule 3. First, it implements a new version of Schedule 3  
9 that was negotiated between the Company and interested stakeholders and recently  
10 approved by the Commission in Decision No. 72684. *See* Agreement at § 15.1. Second, it  
11 eliminates the accounting treatment authorized in the 2009 Settlement, requiring APS to  
12 record customer funds received toward the line extension as contributions in aid of  
13 construction rather than as revenue. *See* Guldner Testimony, Tr. at 424-25. This  
14 accounting change will enable the Company to adapt to the new version of Schedule 3 that  
15 will be implemented on the rate effective date in this case and, for that matter, any other  
16 line extension policy ordered by the Commission in the future.

17 **5. The Settlement Gathers Useful Information.**

18 The Agreement also provides various means by which the Commission will gather  
19 information from the Company that will likely be useful in future Commission dockets.  
20 For example, the experimental AG-1 rate will permit the Commission, APS and APS's  
21 customers to learn more about the costs and benefits of buy-through rates in Arizona. *See*  
22 Guldner Tr. at 268-69. As APS Witness Guldner stated, "part of what we want to do with  
23 the reporting, is then say how does the mitigation [of potential revenue loss] tie to the  
24 performance of the rate. So in other words, if a customer leaves and you've got generation  
25 and you remarket it, can that offset the lost fixed costs for that narrow rate, experimental  
26 rate." Guldner Tr. at 221-22. The narrowly-designed buy-through rate provides the  
27 opportunity to gain calculable data about the effects of the program, and will allow the  
28 Commission and interested parties to: (1) ascertain whether it results in unrecovered fixed

1 costs; and (2) if so, how to proceed going forward in light of that information.

2 The Agreement also requires APS annually to report information regarding the  
3 performance of the LFCR relative to the Company's originally proposed revenue per  
4 customer decoupling mechanism. See Agreement at § 9.2. This information is beneficial,  
5 as RUCO Witness Ms. Jerich testified, because it "provides data to both the utility and the  
6 Commission on customer behavior on this issue of decoupling. And both the Commission  
7 and the utility going forward can use that data that's collected for the next couple of years  
8 when decoupling is revisited, either in this docket or for other utilities." Jerich Testimony,  
9 Tr. at 1122.

10 The Agreement also requires APS to provide certain demographic information  
11 relating to its workforce, including the mean and median age of Electrician-Journeyman,  
12 Lineman-Journeyman, Technician-E&I, and Operator-Power Plant (a/k/a Auxiliary  
13 Operators and Control Operators), the amount of retirement-eligible employees in the same  
14 job classifications and hiring and attrition levels. See Agreement at § 18.2. This  
15 requirement provides the Commission information regarding the challenges of human  
16 resource planning amidst an aging workforce and the actions that APS is taking to address  
17 such challenges. *Id.* This provision was of particular importance to representatives of  
18 local unions. See Settlement Testimony of G. David Vandever, IBEW Exhibit 2, at 4-5.

19 The Agreement also contains two audit requirements: one for fuel and power  
20 procurement (*see* Agreement at § 7.4) and one for DSM programs and associated energy  
21 savings (*see* Agreement at § 9.14(e)). It further requires APS to submit a technical  
22 reference manual that documents the program and measure savings assumptions to be  
23 updated annually in the DSM implementation plan process. See Agreement at § 9.15.

24 Finally, Section 17.3 of the Agreement adopts Staff's recommendation that APS  
25 submit a plan detailing information on tiered conservation rates, time-of-use and other  
26 demand response rates, plans for cancelling rates, ideas for new rate offerings and other  
27 relevant rate design issues. See Staff Exhibit 5 at 21-22 and APS Exhibit 7 at 6. This plan  
28 will help the Company and the Commission assess how effectively the rates perform and

1 whether the more complex rate designs are customer-friendly. This information may be  
2 used to help shape future proposed rate designs, providing a benefit to customers. *See*  
3 Solganick Tr. at 1244-1246; Miessner Testimony, Tr. at 584-585.

4 **6. The Settlement Starts the Process of Simplifying the APS Bill.**

5 *“What 16.1 reflects is . . . a growing concern that over the last 10 or more years . . .*  
6 *the complexity of our bill has significantly increased.”*

7 - Guldner Testimony, Tr. at 136:8-12.

8 The Signatories recognized a need to revise APS’s bill format to make it more  
9 understandable for customers. The current “unbundled” bill format causes customer  
10 confusion regarding, among other things, whether certain enumerated charges are  
11 mandatory verses optional. *See* Guldner Testimony, Tr. at 136-38. Customers are also  
12 confused by what the various adjustors reflected on the bill represent. *See* Olea Testimony,  
13 Tr. 1031-32; Hearing Testimony of RUCO Witness Jerich, Tr. 1133-34. For example, the  
14 bill format presently combines both RES charges and DSM charges on one line item. At  
15 least one Signatory and one Commissioner indicated that customers may prefer to see these  
16 charges split apart, so customers can understand what they are being charged for renewable  
17 initiatives as opposed to energy efficiency initiatives. *See* Jerich Testimony, Tr. at 1133-  
18 34. Other stakeholders oppose such a change. *See* Olea Testimony, Tr. at 1014-15, 1031-  
19 32.

20 To address customers’ concerns about APS’s bill presentation, Section 16.1 of the  
21 Agreement requires that APS, within 90 days following approval of the Agreement, initiate  
22 stakeholder meetings to obtain input about bill presentation issues with the goal of  
23 developing a bill format that is easier for customers to understand. *See* Agreement at §  
24 16.1. Thereafter, APS will file an application with the Commission explaining the input  
25 received during the meetings and seeking any necessary authorization to revise its bill  
26 format. *Id.* This process – while comprehensive and potentially lengthy (especially when  
27 one considers the time necessary to implement a revised bill) – will benefit APS customers  
28 by providing APS with the necessary inputs to revise its bill format in a manner that makes

1 it more understandable and useful for customers.

2           **7. The Settlement Supports APS Financially During a Four Year**  
3           **Stay Out.**

4           *“I need to keep APS healthy in order for the customers to benefit. Because the*  
5           *way I always look at any ratemaking is, my job is to look out for customers, and I*  
6           *do that by making sure that APS is healthy, so that when a customer flips that*  
7           *light switch, that light comes on.”*

8                           - Olea Testimony, Tr. at 1062.

9           Finally, the Agreement provides APS the opportunity to maintain adequate financial  
10 health from the Settlement’s rate effective date through 2016, allowing it to continue to  
11 provide high quality service to customers and achieve Arizona’s energy goals. As Mr.  
12 Olea explained, “[i]f you’re APS, you have to keep the lights on. Because without  
13 electricity, there’s no computers; there’s no business. Those lights have to be reliable.  
14 That power has to be reliable. And in order to do that, there has to be – the company has to  
15 be financially healthy.” Olea Testimony, Tr. at 1064. Keeping APS in financial health  
16 redounds to customers’ benefit in other ways, too. As AIC Witness Mr. Yaquinto stated,  
17 “[a]pproval of the Settlement Agreement will support APS’s continued financial health -  
18 that has a positive, reverberating impact throughout Arizona in the form of jobs, taxes and  
19 income.” Testimony of Gary M. Yaquinto in Support of Settlement Agreement, AIC  
20 Exhibit 4, at 4.

21           Certain of the Agreement’s terms provide an economic package that was  
22 specifically engineered to keep the base rate increase at zero while sustaining APS’s  
23 financial health during the four year rate moratorium. Each of these provisions is material  
24 to APS’s financial condition. All combine to close the gap between the Company’s  
25 minimal financial needs and the maximum zero dollar base rate increase that the  
26 Signatories were willing to require of customers. In addition to the LFCR, these include:  
27 (1) an authorized 10% cost of equity (Agreement at § 5.2); (2) a process to mitigate the  
28 financial impact on APS should the Commission allow APS to pursue the Company’s  
proposed acquisition of Southern California Edison’s share of Four Corners Units 4 and 5

1 and should the transaction thereafter close; (3) a deferral mechanism that protects APS and  
2 customers from changes to APS's Arizona property tax expense caused by changes to the  
3 tax rate; (4) the elimination of the 90/10 sharing component of the Company's Power  
4 Supply Adjustor; and (5) modifications to the existing Environmental Improvement  
5 Surcharge to cover the capital carrying costs on new government-mandated environmental  
6 controls (subject to a cap). Also important to APS are procedural changes related to the  
7 Company's Transmission Cost Adjustor that streamline the pass-through of future federal  
8 rate changes. This brief addresses each of these issues in turn.

9 **(1) Authorized 10% Cost of Equity**

10 *"The authorized return on common equity ("ROE") of 10% falls somewhat below recent*  
11 *ROE awards in other jurisdictions for vertically integrated electric utilities, while the*  
12 *53.94% equity component within APS's capital structure is consistent with a level that*  
13 *should continue to allow the Company to improve its financial condition and credit*  
*ratings over time. Accordingly, I find those two provisions of the Settlement Agreement*  
*to be a fair accommodation between the positions put forward by the parties."*

14 - Testimony of Steven M. Fetter in Support of Settlement Agreement, AIC  
15 Exhibit 5, at 8.

16 In addition to the zero dollar base rate increase described above, an important  
17 component of the revenue requirement is an authorized 10% cost of equity. See Agreement  
18 at § 5.2. That 10% ROE is the exact number proposed by RUCO in its direct filing, slightly  
19 above Staff's 9.9% original ROE recommendation, and a full 100 basis points below APS's  
20 currently authorized 11% ROE. As Mr. Olea testified, "Staff's analysis in its Direct  
21 Testimony recommended an ROE of 9.9%. So to go to 10 percent wasn't a big jump for  
22 Staff." Olea Testimony, Tr. at 1061-62.

23 Of course, the 10% authorized cost of equity is no assurance that APS will actually  
24 earn this return:

25 [APS has] an opportunity now to earn that 10.0. There's no guarantee. If  
26 they don't keep expenses down, if for some reason their revenue isn't what  
27 they think it's going to be, if they have cold summers and warm winters, the  
28 amount of revenue they think they're going to get isn't going to come in.  
Well, there's no guarantee for them to earn 10.0, but now they have the  
opportunity.

1 Olea Testimony, Tr. at 1061. Notably, an authorized 10% ROE is below the 11% industry  
2 average. See Fetter Testimony, Tr. at 918, 928. Nonetheless, APS agreed that the 10% ROE  
3 will be adequate until the Company's next rate case, and the evidence suggested that an  
4 ROE at this level – taken in context with the Agreement as a whole – should be viewed  
5 positively by the financial community. As former Fitch ratings analyst and Michigan Public  
6 Service Commissioner Steve Fetter opined, "I am confident that the financial community  
7 will view Commission approval of the agreement as a constructive step." Fetter Testimony,  
8 Tr. at 918.

9 **(2) Four Corners Rate Rider**

10 *"[The Agreement] provides [APS] a rate rider for the Four Corners acquisition if*  
11 *that all should happen. And RUCO finds that extremely important for the*  
12 *Company's continued financial viability, because it will get plant in service into*  
13 *rate base in a more timely fashion."*

14 -Jerich Testimony, Tr. at 1144.

15 APS has a request pending before the Commission to authorize a specific  
16 transactional exemption from the self-build moratorium established in Decision No. 67744  
17 in order to allow APS to purchase Southern California Edison's ("SCE") share of Four  
18 Corners Units 4 and 5 with the subsequent retirement of Units 1-3. See Docket No. E-  
19 01345A-10-0474 (the "Four Corners Docket"). The Four Corners Docket is separate from  
20 the rate case and, as Mr. Olea testified, "this Agreement completely leaves the Four Corners  
21 matter in the hands of Commissioners" to decide in that separate Docket. See Olea  
22 Testimony, Tr. at 1073. Put another way, the Settlement does not presuppose whether the  
23 requests made in the Four Corners Docket will or will not be granted or whether the  
24 proposed Four Corners transaction will or will not close. Rather, it puts a procedural  
25 framework in place that allows APS to address the ratemaking impacts of the transaction  
26 prior to the Company's next rate case if and only if the transaction closes prior to December  
27 31, 2013. See Guldner Testimony, Tr. at 92. Whether the transaction will be authorized or  
28 close is by no means certain. That is contingent upon several variables, including the  
Commission's approval of APS's request for a specific transactional exemption from the

1 self-build moratorium and for a deferral authorization, a closing of the transaction, a  
2 subsequent Commission determination that the transaction is prudent, approval by  
3 California and federal regulators, and timely execution of a new fuel agreement. *See*  
4 Guldner Testimony, Tr. at 92-3, 110, 245-46; Higgins Testimony, Tr. at 941; Olea  
5 Testimony, Tr. at 1058, 1073-74.

6 Leaving this rate case open as provided in the Settlement to accommodate the  
7 potential Four Corners transaction is essential to sustain the four-year rate moratorium  
8 contained in the Settlement. Absent such a provision, APS likely could not agree to a four-  
9 year rate stay-out. *See* Guldner Testimony, Tr. at 111-13. As APS Witness Jeff Guldner  
10 explained,

11 [I]f we spend \$295 million . . . to acquire the asset and we can't reflect the  
12 cost of that investment for a number of years, we either, one, can't do the  
13 acquisition, even if it's in the best interests of customers, because we just  
14 can't financially do it. . . . [and] two, the rating agencies and the folks that  
15 look at how the regulatory environment is operating would view that as a step  
16 backwards, because again, in most, many jurisdictions there are mechanisms  
in place that would allow companies to do this and recover the investment  
costs in adjusters or other step increases or things like that. So this we view  
as being constructive in allowing us to move forward on the transaction.

17 Guldner Testimony, Tr. at 249.

18 Customers also benefit from this approach because, if the transaction moves forward  
19 and closes, the associated customer rate impact will be more gradual than it would be if the  
20 almost \$300 million transaction was added to base rates on top of the Company's other  
21 plant investments in the rate filing made four years from now. Speaking on behalf of APS's  
22 commercial and industrial customers, AECC describes this provision as "a defined and  
23 equitable path forward for the recovery of costs associated with any acquisition by APS of  
24 Southern California Edison's share of Four Corners Units 4 and 5, if the Commission finds  
25 the Four Corners transaction to be prudent." Higgins Testimony, Tr. at 941. RUCO  
26 supports it as well. *See, e.g.*, Jerich Testimony, Tr. at 1144.

27 Put plainly, if the Commission does not authorize APS to pursue the Four Corners  
28 transaction and/or it does not close, there will be no bill impact associated with the

1 transaction during the term of the Agreement. If the APS's requests in the Four Corners  
2 Docket are granted and the transaction closes and this Agreement is approved, the PSA  
3 adjustment in February of 2012 will be lower than it otherwise would be due to the resulting  
4 lower fuel costs and potential profits from additional off-system sales that would credit the  
5 PSA balance charged to customers. See Guldner Testimony, Tr. 99-100; 105. The rate rider  
6 would take effect no earlier than July 1, 2013. See Agreement at § 10.3.

7 **(3) Arizona Property Tax Expense Deferral**

8 *"[B]ecause this particular provision of the settlement has generated so many*  
9 *questions from the bench, I just wanted to point out that RUCO sees this as a*  
10 *ratepayer benefit."*

11 - Jerich Testimony, Tr. at 1118.

12 Section 12 of the Settlement authorizes a partial accounting and ratemaking deferral  
13 of increased APS property taxes that are attributable solely to increases in property tax  
14 rates.<sup>4</sup> Increases in property taxes resulting from changes in the assessed value of APS  
15 property cannot be deferred. See Agreement at § 12.1. The deferral is "partial" in the  
16 sense that only a portion, not all, of the increases in property tax expense attributable to tax  
17 rate increases are deferred – 25% of any increase for the second half of 2012, 50% for  
18 2013, and 75% for 2014 and beyond. See Agreement at § 12.1(a). In contrast, any  
19 reductions in property tax expense due to tax rate decreases would be 100% deferred for  
20 the future benefit of APS customers. See Agreement at § 12.1(b). In APS's next general  
21 rate case, any deferred balance of higher property taxes found to be prudently-incurred  
22 would be recovered from APS customers over an extended 10-year period. However, any  
23 deferred credit for lower taxes would be refunded to APS customers over an accelerated  
24 three-year period. See Agreement at § 12.2. The referenced prudence review of any  
25 deferred tax balance, although normally undertaken in a rate case, could occur at any time  
26 during the four-year term of the Settlement. See Agreement at § 12.3.

27 APS Witness Jeff Guldner explained how and why Section XII was critical to the

28 <sup>4</sup> APS will, of course, still be required to timely pay whatever level of property tax is lawfully assessed by Arizona  
taxing authorities. The deferral is solely an accounting and ratemaking device.

1 Company's willingness and ability to agree to the four-year stay out. *See* Direct Settlement  
2 Testimony of Jeff Guldner, APS Exhibit 2, at 6; Guldner Testimony, Tr. at 130. Property  
3 taxes represent a risk of unanticipated costs over which APS has no control. Further,  
4 electric utilities such as APS are at special risk because their assessed value for property  
5 tax purposes is fixed by law at book value (depreciated original cost). That assessed tax  
6 value has not declined in the recession as have the assessed tax values for residential and  
7 non-utility commercial property. As those non-utility tax values decline, state and local  
8 taxing authorities have to raise the tax rate to attempt to maintain tax revenues. The impact  
9 of such property tax rate increases falls disproportionately on APS for these reasons. *See,*  
10 *e.g.*, Direct Settlement Testimony of Jeff Guldner, APS Exhibit 2, at 26-27. However, and  
11 for these same reasons, if the real estate market in APS's service territory recovers during  
12 the four-year stay out, any property tax rate increases would be ameliorated or perhaps  
13 might even turn into tax rate *decreases*, in which event APS customers would receive  
14 100% of the benefit. *See id.*

15 **(4) Elimination of the PSA's 90/10 Sharing Component**

16 ***"Staff believes that if the company is prudently acquiring power, then that is a***  
17 ***prudent expense, and they should be able to recover all of that prudent expense."***

18 - Olea Testimony, Tr. at 974.

19 APS is the only electric utility in Arizona that is at risk of recovering less than 100%  
20 of its prudently-incurred fuel and purchase power expense. *See* APS Exhibit 2 at 13; Blank  
21 Testimony, Tr. at 403. APS itself has only been subject to the 90/10 sharing mechanism  
22 since 2005 – a small fraction of the decades during which the Company has had some  
23 manner of adjustment clause for fuel and purchased power. *See* Blank Testimony at 402-  
24 03. In Decision No. 70667 (December 24, 2008), the Commission suggested that the  
25 parties to APS's then-pending general rate case seek to eliminate the 90/10 sharing  
26 mechanism. *Id.* at 37. Although the 2009 Settlement ultimately retained the 90/10 sharing  
27 provision, the Signatories to this Agreement forged a compromise acceptable to the  
28 overwhelming majority of the parties based on a proposal set forth in Staff's Direct Pre-

1 Settlement Testimony. *See* Staff Exhibit 6 at 24.

2       The 90/10 sharing provision is replaced by both an asymmetrical interest provision  
3 in the PSA (wherein APS customers earn a high return on any over-collections while APS  
4 continues to earn only a token return on under-collections of fuel and purchased power  
5 costs), and an ongoing commitment to undergo periodic prudence reviews (funded by  
6 APS) of its procurement and plant operations. *See* Agreement at §§ 7.3 and 7.4. The  
7 asymmetrical interest provision is a powerful incentive to properly manage fuel cost  
8 deviations from the Base Fuel Rate already reviewed for prudence by Staff and other  
9 parties and established in Section 7.1 of the Settlement. *See* Olea Testimony, Tr. at 978-  
10 79. It is precisely such actual cost deviations that result in over- or under-collections of  
11 costs deferred through the PSA mechanism. The periodic audits will assure the  
12 Commission that the Company's fuel and purchased power operations remain prudent, as  
13 has already been found by the Commission's consultant, Liberty Consulting Group, in  
14 Decision No. 69663. *Id.* at 101-105.

15       APS listed the elimination of the 90/10 PSA sharing mechanism as a key component  
16 of the Settlement allowing the four-year base rate stay out. *See* APS Exhibit 2 at 6. The  
17 90/10 sharing provision has historically resulted in APS forfeiting literally tens of millions  
18 of dollar in fuel costs in just a single year. *See* Direct Testimony of APS Witness Peter  
19 Ewen, APS Exhibit 4, at 15; Snook Testimony, Tr. at 825. Extending the risk of fuel price  
20 volatility for a four-year base rate stay out period was simply unacceptable to APS. Other  
21 parties agreed to eliminate the 90/10 sharing provision in the spirit of compromise. *See,*  
22 *e.g.,* Blank Testimony, Tr. at 402; Radigan Testimony, Tr. at 808-09. *Cf.* Testimony of  
23 Steven M. Fetter in Support of Settlement Agreement, AIC Exhibit 5, at 3 (noting that,  
24 unlike a litigated case, a settlement allows a commission to "determine the values that each  
25 contesting party placed upon each component of the positions argued" and "see the manner  
26 in which those parties had struck a fair balancing of their competing positions").

1           **(5) Modifications to the EIS**

2           ***“The changes to the EIS take a small step towards helping APS defray the impact of [its***  
3           ***increasing] environment-related cost pressures.”***

4                     - Direct Settlement Testimony of Jeff Guldner, APS Exhibit 2, at 26.

5           Pursuant to Decision No. 69663, APS currently collects an Environmental  
6           Improvement Surcharge (“EIS”) from its customers to offset the increasing costs  
7           associated with government-mandated environmental controls. *See, e.g.*, Direct Settlement  
8           Testimony of APS Witness Jeff Guldner, APS Exhibit 2, at 26; Olea Testimony, Tr. at  
9           1007-08. Because customers now pay the EIS before APS installs the plant, APS records  
10          the proceeds as Contributions in Aid of Construction. *See* Olea Testimony, Tr. at 1007.

11          Section 11 of the Agreement modifies the existing EIS in two ways. First,  
12          beginning on the rate effective date, APS will no longer receive customer contributions  
13          through the EIS and the current EIS charge will be reset to zero. *See* Agreement at § 11.5;  
14          Olea Testimony, Tr. at 1007. This reset will cause an immediate “positive impact on the  
15          customer’s rate....” Jerich Testimony, Tr. at 1117-18. Second, when future government-  
16          mandated environmental projects arise, “APS with its own money, shareholder money will  
17          put those pieces of plant in, just like [APS does] any other piece of plant....” Olea  
18          Testimony, Tr. at 1007-08. *See also* Agreement at § 11.2; Direct Settlement Testimony of  
19          APS Witness Jeff Guldner, APS Exhibit 2, at 26. When APS makes such an investment,  
20          the EIS will recover the associated capital carrying costs, as that term is defined in the  
21          footnote to Settlement § 8.1.<sup>5</sup> *See* Agreement at § 11.2; Direct Settlement Testimony of  
22          APS Witness Jeff Guldner at 26; Olea Testimony, Tr. at 1008 (“Instead of ratepayers  
23          paying for the plant up front, APS shareholders will pay for the plant up front, and  
24          ratepayers will just pay the rate of return on it just like they do in any rate case.”).

25          Importantly, the Agreement caps the EIS at its current level so that customers will  
26          pay no more under the amended EIS than they do today. *See* Agreement at § 11.2; Olea

27 \_\_\_\_\_  
28 <sup>5</sup> Notably, this was how the EIS would have operated, absent the cap agreed to in the Settlement, had the  
Recommended Opinion and Order issued in the proceedings underlying Decision No. 69663 been adopted without an  
amendment to that term.

1 Testimony, Tr. at 1008. As modified, however, the EIS dollars that customers do pay will  
2 support a far greater amount of APS's government-mandated environmental controls. *See*  
3 Olea Testimony, Tr. at 1006-1007. Adjustments to the EIS for applicable capital projects  
4 will become effective on April 1st of each year unless Staff requests Commission review or  
5 the Commission otherwise orders. *See* Agreement at § 11.2. The projects for which the  
6 EIS will apply will be subject to the Commission's prudence reviews. *See* Guldner  
7 Testimony, Tr. at 327.

8 The EIS changes will help customers and protect APS. By resetting the current EIS  
9 to zero, this component of the customer bill will immediately go down. *See* Jerich  
10 Testimony, Tr. at 1118; Olea Testimony, Tr. at 1007. And, as APS begins capital  
11 investments to comply with government-mandated environmental regulations, APS will be  
12 able to recover on a more timely basis some of the related capital carrying costs up to the  
13 current EIS cap. *See* Olea Testimony, Tr. at 1008; Jerich Testimony, Tr. at 1118. This  
14 switch from contributions in aid of construction to revenues will help "the company  
15 continue on [the] path of financial health." Jerich Testimony, Tr. at 1144.

16 **(6) Procedural Modifications to the TCA**

17 *"Given the constraints on Commission resources, we do not believe that it is an efficient*  
18 *use of those resources to require a Commission order to establish a new TCA rate, after*  
19 *the transmission rates have been established by FERC."*

20 - Decision No. 72430, Finding of Fact No. 22 (June 27, 2011).

21 Sections 13.2 and 13.3 of the Agreement modify the TCA implementation process,  
22 consistent with the Commission's discussion in and disposition of Decision No. 72430. *See*  
23 Decision No. 72430 at 6-7; Olea Testimony, Tr. at 1011, 1095-96. By federal law, the  
24 Federal Energy Regulatory Commission ("FERC") has exclusive jurisdiction over APS's  
25 transmission rates to both retail and wholesale customers. *See* APS Exhibit 2 at 27;  
26 Miessner Testimony, Tr. at 602. Since FERC's adoption of a formula rate for APS, retail  
27 customers have benefitted by this Commission's active and diligent participation in FERC  
28 formula rate proceedings. *See* APS Exhibit 2 at 27; Olea Testimony, Tr. at 1019. So that  
the Commission is not required separately to affirm a FERC-jurisdictional decision as its

1 own, the Settlement changes the existing process. *See* Agreement at § 13.2. Specifically,  
2 the Agreement requires APS to file a notice with Docket Control that includes its revised  
3 TCA tariff and other relevant information by May 15 of each year, and then permits the  
4 annual TCA adjustment to become effective June 1 of each year without the need for  
5 affirmative Commission approval, unless Staff requests review or it is otherwise ordered by  
6 the Commission. *See* Agreement at §§ 13.2 and 13.3.

7 **III. THE ARGUMENTS RAISED BY SWEEP AND NRDC IN PARTIAL**  
8 **OPPOSITION TO THE SETTLEMENT SHOULD BE REJECTED**

9 **A. Scope of Partial Opposition by SWEEP and NRDC**

10 *“There is a lot to like in this Settlement Agreement.”*

11 - SWEEP Counsel Tim Hogan’s Opening Statement, Tr. at 33.

12 Both SWEEP and NRDC went to great pains to emphasize that they did not want  
13 the Commission to reject the Settlement or make any changes to it aside from certain parts  
14 of Section IX. SWEEP Witness Jeff Schlegel summarizes this partial opposition into six  
15 categories: (1) the Settlement limits the Commission’s policy options in that it did not  
16 specifically propose full per customer revenue decoupling as an alternative to the LFCR  
17 mechanism; (2) the Settlement did not adopt full per customer revenue decoupling; (3) the  
18 Settlement did not address incentives for EE as SWEEP would have liked; (4) the four-year  
19 rate stay out exacerbates SWEEP’s concerns about 1 and 2, above; (5) the Settlement did  
20 not propose to include \$70 million of DSM costs in base rates; and (6) the Settlement did  
21 not propose to adjust test year billing determinants to reflect anticipated compliance with  
22 the Commission’s EE and DG rules for the first rate effective year. *See* Schlegel  
23 Testimony, Tr. at 646-647. NRDC Witness Cavanagh, on the other hand, largely focused  
24 NRDC’s partial opposition to the Settlement on only the second of SWEEP’s objections –  
25 the failure of the Settlement to adopt full revenue per customer decoupling. *See* NRDC  
26 Exhibit 2 at 5; Cavanagh Testimony, Tr. at 757-58.

27 The Signatories regard the first two of SWEEP’s objections to be essentially the  
28 same as that raised by NRDC, and addressed the first (regarding the Commission’s  
flexibility with respect to energy policy) in detail above. *See supra* at 17-21. The

1 remaining objections will be addressed below. None of them justifies rejection of the  
2 Settlement or the risk of disrupting the broad support it enjoys by amending key terms  
3 known to be material to parties such as AECC, RUCO, AARP, FEA, Kroger, Wal-Mart and  
4 Sam's Club.

5 **B. The LFCR Supports the Commission's EE and DG Requirements**

6 *"Through its support of the settlement agreement, APS has concluded that the*  
7 *combination of the LFCR mechanism and rate design improvements in the*  
8 *agreement sufficiently removes the company's financial disincentives to meet the*  
9 *Commission's standards. By itself, I believe this is sufficient grounds to refrain*  
10 *from imposing decoupling. If the entity, namely APS, whose financial interest is*  
11 *intended to be protected by decoupling, concludes that decoupling is not*  
12 *necessary, then I really see no good reason to impose decoupling against the will*  
13 *of customers."*

14 - Higgins Testimony at Tr. 942-43.

15 The LFCR is directly linked to achieved kWh sales reductions attributable to  
16 Commission-authorized DSM and DG programs. Although APS will be receiving less  
17 than 100% of what APS believes to be its unrecovered fixed costs through the LFCR (*see,*  
18 *e.g., Solganick Testimony, Tr. at 1218*), the Company has been unequivocal in its  
19 commitment to achieve the Commission's authorized DSM and DG programs through  
20 2016 with the LFCR in place. *See Direct Settlement Testimony of Jeff Guldner, APS*  
21 *Exhibit 2, at 16; Responsive Settlement Testimony of Jeff Guldner, APS Exhibit 3, at 2.*  
22 All Signatories have underscored that commitment. As Utilities Division Director Steve  
23 Olea testified, for example:

24 [B]ecause of the LFCR, [APS] ha[s] committed to meet whatever EE  
25 requirement the Commission imposes in the future. If they double that  
26 requirement, they'll meet that. If they cut that requirement in half, they'll  
27 meet that. Whatever the Commission adopts, not only with EE but with DG,  
28 APS has committed that if they get the LFCR, they will meet whatever  
requirement is put on them by the Commission.

Olea Testimony, Tr. at 1048

SWEEP and NRDC allege that the LFCR mechanism will encourage APS to bring  
forth DSM programs that will "test well" but not produce real energy savings (*see*  
Cavanagh Testimony, Tr. at 792). These allegations are wholly speculative and contrary to

1 the means provided for in the Settlement to demonstrate actual lost kWh sales attributable  
2 to DSM and DG. *See, e.g.*, APS Exhibits 3 at 4; Olea Testimony, Tr. at 999-1000; Jerich  
3 Testimony, Tr. at 1120; Brockway Testimony, Tr. at 495. The measurement, evaluation  
4 and research (“MER”) results presently provided by an independent third party in  
5 conjunction with the annual DSM Implementation Plan filings and metered date for DG  
6 eliminate the possibility for the sort of “gaming” that NRDC and SWEEP professedly fear.  
7 *See* Solganick Testimony, Tr. at 1213-1216.

8 SWEEP Witness Jeff Schlegel conceded that mechanisms such as the LFCR were  
9 common regulatory responses to the problem of unrecovered fixed costs associated with  
10 DSM and DG. *See* Schlegel Testimony, Tr. at 671. He also agreed that the LFCR  
11 mechanism was preferable to the status quo, was “in the public interest” and a “positive  
12 step in the right direction.” Schlegel Testimony, Tr. at 670, 672. Even NRDC Witness  
13 Cavanagh, a clearly passionate advocate of full per customer revenue decoupling, agreed  
14 that it was not in the public interest for the Commission to do nothing about the problem of  
15 financial disincentives to promoting DSM and DG. *See* Cavanagh Testimony, Tr. at 764.

### 16 **C. The Settlement Allows for Changes to the APS DSM Incentive**

17 Although SWEEP may not like the interim performance incentive contained in  
18 Section 9.14(b), it – like every other EE stakeholder and this Commission – has an  
19 immediate opportunity to argue for a change to that incentive in the proceedings outlined in  
20 Section 9.14(d). As discussed earlier, the Settlement is quite specific concerning the APS  
21 DSM incentive mechanism. First, it modifies the existing incentive structure for use in the  
22 Company’s 2013 DSM Implementation Plan (“2013 DSM Plan”) (a plan presently due to  
23 be filed with the Commission by June 1, 2012 – one month before the proposed effective  
24 date of new rates in this case). *See* Agreement at § 9.14(b).<sup>6</sup> Second, the Settlement  
25 establishes a process for amending that incentive structure for any subsequent DSM Plan if  
26 the Commission finds such a change appropriate. *See* Agreement at § 9.14(d). The

27  
28 <sup>6</sup> If the Settlement is approved after June 1, 2012, APS would amend the 2013 DSM Implementation Plan filing to conform with Section 9.14 (b).

1 Signatories agree that the existing incentive structure – especially its link to DSM program  
2 spending – should be reviewed, and held the present rate case docket open specifically so  
3 that the Commission can undertake that review outside of a rate case. *See id. See also*  
4 *supra* at 18-19.

5 The only real dispute is thus one of timing. And Staff Director Steve Olea was  
6 adamant about the impracticality of developing a new performance incentive structure  
7 before APS's 2013 DSM Plan is filed, or even prior to the end of 2012. *See* Staff Exhibit 1  
8 at 4; Olea Testimony, Tr. at 1027-28. Given Staff's heavy workload and the time needed  
9 for the substantive review of the 2013 DSM Plan, the end of 2012 deadline established by  
10 the Settlement is as expeditious a timeframe as possible. As it stands, Section 9.14(d) is  
11 ambitious and will require significant effort by Staff, APS and other affected parties. How  
12 fast any revised incentive structure is considered by the Commission and for which DSM  
13 Plan year it will first apply are matters left by the Settlement completely to the  
14 Commission's discretion.

15 **D. The Four Year Stay Out Benefits Customers Without Constraining the**  
16 **Commission.**

17 *"A four-year stay-out is extraordinary in today's regulatory environment, and*  
18 *conveys a very significant benefit to customers in terms of rate stability and rate*  
19 *certainty."*

20 - Higgins Testimony, Tr. at 945.

21 As previously noted, the four-year base rate stay-out provision set forth in Section  
22 2.1 was uniformly cited by APS customer representatives who signed the Agreement as an  
23 important benefit of the Settlement. This is true even though APS has several  
24 Commission-approved rate adjustment mechanisms that will affect customer bills during  
25 the four-year base rate stay out period. *See* Higgins Testimony, Tr. at 945. *See also supra*  
26 at 5-6. Moreover, the Signatories carefully designed the Agreement so that APS could  
27 implement policy decisions that the Commission might make during the next four years  
28 outside of a rate case. The Settlement's flexibility in this regard substantially minimizes  
any perceived risk that an issue will arise in the EE-policy arena over the next four years

1 that would require a rate case to resolve. Finally, the Settlement in no way purports to  
2 constrain the Commission's ratemaking authority. Section 19.1 concludes: "Nothing in  
3 this provision is intended to limit the Commission's ability to change rates at any time  
4 pursuant to its lawful authority."

5 **E. Retaining \$10 Million of DSM Costs in Base Rates for Now Is a**  
6 **Reasonable Compromise.**

7 Section 9.16 of the Settlement retains in base rates \$10 million worth of DSM costs  
8 originally agreed to in Decision No. 67744 (April 7, 2005). Although the overall level of  
9 DSM spending was discussed in APS's next general rate case, no change to the \$10 million  
10 in base rates was made or proposed. See Decision No. 69663 (June 28, 2007) at 90. In  
11 Decision No. 71448 (December 30, 2009), the \$10 million in base rates was again retained,  
12 with the proviso that the issue would be further examined in this proceeding.

13 In the current Settlement, as in the 2009 Settlement, the \$10 million was a  
14 compromise between those parties that wished to include additional sums of DSM costs in  
15 base rates and those who wished all such costs removed from base rates and collected  
16 through the DSMAC. As APS Witness Jeff Guldner explained, policy arguments support  
17 either position and the Signatories did not attempt to resolve this policy issue in the  
18 Settlement. See Guldner Testimony, Tr. at 317. See also Jerich Testimony, Tr. at 1127-  
19 1128.

20 This issue is revenue neutral to APS, but would affect APS customers in different  
21 ways. The DSMAC dollars are essentially allocated on a kWh basis, while base rates in  
22 the Settlement have been established on more or less an equal percentage basis, taking into  
23 account the reset of the PSA in 2013. Removing DSM dollars from base rates and adding  
24 them to the DSMAC would increase, albeit slightly, the percentage of overall DSM costs  
25 borne by non-residential customers. Adding more DSM costs to base rates would have the  
26 opposite effect, raising the proportion of such costs borne by residential customers. Even if  
27 the dollars added to base rates were all collected on a per kWh basis through the BSC  
28 component of base rates, such a move would alter the allocation of DSM costs within the

1 non-residential class in a manner unanticipated by the Signatories.

2 **F. SWEEP'S Proposed Pro Form Adjustments to Billing Determinants**  
3 **Would Result in a Change to Base Rates and Customer Bills Not Agreed**  
4 **to By the Signatories.**

5 SWEEP has recommended that the test year billing determinants (*i.e.*, kWh sales) in  
6 this case should be adjusted to reflect the period after the effective date of rates in this  
7 proceeding. *See* SWEEP Exhibit 3 at 11; Schlegel Testimony, Tr. at 647. APS proposed a  
8 similar adjustment in each of its last two rate cases. In Decision No. 69663, the  
9 Commission rejected the adjustment outright, and in Decision No. 71448, the Commission  
10 approved a Settlement that declined to adopt it.

11 In this case, the narrowly-tailored LFCR mechanism will accomplish the same  
12 objective sought by SWEEP with two important differences. Whereas the SWEEP pro  
13 forma would be based on *forecast* kWh sales reductions due to DSM and DG, the LFCR  
14 mechanism is an *after-the-fact* adjustment for such sales reductions based on MER and  
15 metered results. Second, the anticipated 0.2% increase in customer bills would not occur  
16 in March of 2013, as proposed in the Settlement, but concurrent with the new base rates in  
17 this case – July 1, 2012. Both of these aspects of the LFCR mechanism were attractive to  
18 many of the Signatories and represent bargained-for benefits of the Agreement that are  
19 important to them.

20 **IV. CONCLUSION**

21 *“The settlement agreement represents a thoughtful and creative package of*  
22 *provisions which are well balanced across disparate interests. The agreement is*  
23 *likely to be well-received by the investment community and rating agencies, and it*  
24 *affords the Commission considerable energy policy flexibility.”*

25 - Fetter Testimony, Tr. at 918.

26 The Signatories are presenting the Commission an extraordinary Settlement.

- 27 1. It moderates rates during a four-year stay out.
- 28 2. It allows customers to choose among new rate options.
3. It protects Arizonans on low incomes from increasing electric bills during continually difficult economic times.

- 1           4.    It preserves the Commission's flexibility with respect to energy
- 2           policy.
- 3           5.    It promotes environmental stewardship by supporting government-
- 4           mandated energy efficiency measures and renewable energy.
- 5           6.    It maintains the financial condition of Arizona's largest utility, thus
- 6           enabling the Company to continue to provide reliable electric service
- 7           and promote Arizona's energy goals.

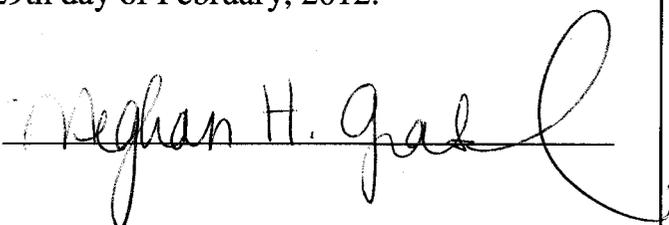
8   **And the Settlement does all this, while providing a one percent *decrease* to average**  
9 **residential customer bills through 2012 and *zero dollar* base rate increase – rare and**  
10 **significant customer benefits.**

11           It is no wonder that this Agreement is supported by so many. Twenty-two parties  
12 representing a broad array of APS rate case stakeholders have found that this Agreement,  
13 when taken as a cohesive package, supports the public interest. The Signatories urge the  
14 Commission to do the same and approve the Agreement.

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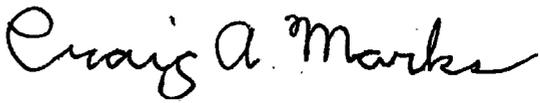
RESPECTFULLY SUBMITTED this 29th day of February, 2012.

By: 

For: Arizona Public Service Company

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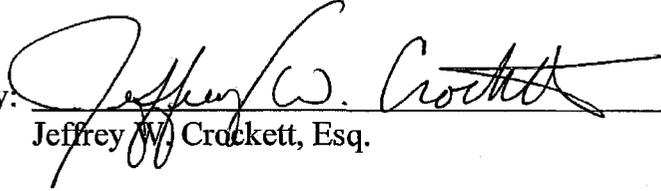
RESPECTFULLY SUBMITTED this 29th day of February, 2012.

By:   
Craig A. Marks

For: AARP

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RESPECTFULLY SUBMITTED this 29th day of February, 2012.

By:   
Jeffrey W. Crockett, Esq.

For: Arizona Association of Realtors

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RESPECTFULLY SUBMITTED this 29th day of February, 2012.

By:   
\_\_\_\_\_  
Greg PATTERSON

For: AZCPA  
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RESPECTFULLY SUBMITTED this 29th day of February, 2012.

By:   
C. Webb Crockett  
Patrick J. Black  
Fennemore Craig, P.C.

For: Attorneys for Arizonans for Electric Choice and Competition

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RESPECTFULLY SUBMITTED this 29th day of February, 2012.

By: Michael M. [Signature]  
Gallagher & Kennedy, P.A.

For: Arizona Investment Council

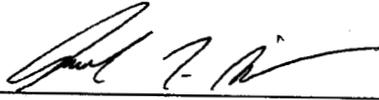
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RESPECTFULLY SUBMITTED this 29th day of February, 2012.

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By:   
\_\_\_\_\_

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Capt Samuel T. Miller

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For: Federal Executive Agencies

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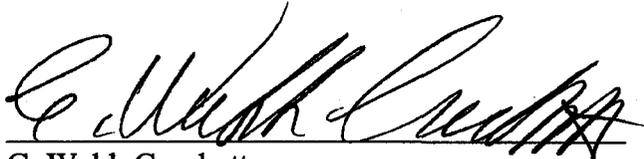
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RESPECTFULLY SUBMITTED this 29th day of February, 2012.

By:   
C. Webb Crockett  
Patrick J. Black  
Fennemore Craig, P.C.

For: Attorneys for Freeport-McMoRan Copper & Gold Inc.

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RESPECTFULLY SUBMITTED this 29th day of February, 2012.

By: *Jarrett J. Haskovec*  
Jarrett J. Haskovec, Lubin & Enoch, P.C.

For: IBEW Locals 387, 640, + 769

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RESPECTFULLY SUBMITTED this 29th day of February, 2012.

By: Kurt Bohm  
Kurt Bohm

For: Kroger Co.

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RESPECTFULLY SUBMITTED this 29<sup>th</sup> day of February, 2012.

By: Lawrence V. Robertson, Jr.  
Lawrence V. Robertson, Jr.

For: Noble Americas Energy Solutions LLC,  
Constellation NewEnergy, Inc., Direct Energy,  
LLC and Shell Energy North America (US), L.P.

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RESPECTFULLY SUBMITTED this 29th day of February, 2012.

By:   
Chief Counsel

For: 

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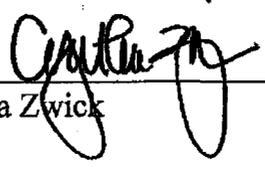
RESPECTFULLY SUBMITTED this 29<sup>th</sup> day of February, 2012.

By: Lawrence V. Robertson, Jr.  
Lawrence V. Robertson, Jr.

For: Southwestern Power Group II, L.L.C. and Bowie  
Power Station, L.L.C.

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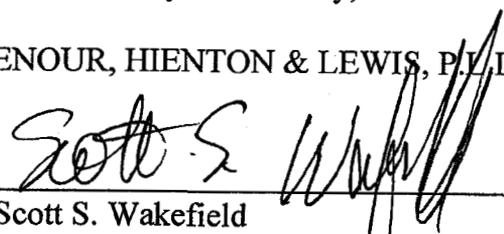
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By:   
Cynthia Zwick

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RESPECTFULLY SUBMITTED this 29th day of February, 2012.

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1 ORIGINAL and thirteen (13) copies  
2 of the foregoing filed this 29th day of  
3 February, 2012, with:

4 Docket Control  
5 ARIZONA CORPORATION COMMISSION  
6 1200 West Washington Street  
7 Phoenix, Arizona 85007

8 AND copies of the foregoing mailed, hand-delivered,  
9 faxed or transmitted electronically this 29th day of  
10 February, 2012 to:

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15 Phoenix, AZ 85007

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