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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

BOB STUMP, Chairman
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH

IN THE MATTER OF THE APPLICATION OF THE ARIZONA ELECTRIC POWER COOPERATIVE, INC. FOR A HEARING TO DETERMINE THE FAIR VALUE OF ITS PROPERTY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RETURN THEREON AND TO APPROVE RATES DESIGNED TO DEVELOP SUCH RETURN	Docket No. E-01773A-12-0305 **AEPCO'S NOTICE OF FILING TESTIMONY SUMMARIES**

Notice is given that, pursuant to the Procedural Order dated September 11, 2012 in this docket, Arizona Electric Power Cooperative, Inc. ("AEPCO") files the testimony summaries of Peter Scott, Gary E. Pierson and Richard Kurtz.

RESPECTFULLY SUBMITTED this 25th day of July, 2013.

GALLAGHER & KENNEDY, P.A.

By

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Testimony Summary of Peter Scott
Arizona Electric Power Cooperative, Inc. ("AEPCO" or the "Cooperative")
Rate Case
Docket No. E-01773A-12-0305

Mr. Scott is the Chief Financial Officer of AEPCO. He serves on the Cooperative's Division Managers Group and reports directly to the Chief Executive Officer. His direct testimony provides information, among other things, about AEPCO, its membership structure, its Board review and approval process for this rate filing and AEPCO's rate history.

AEPCO's current rates were approved by the Commission in Decision No. 72055 and became effective on January 1, 2011. That decision also approved continuation of AEPCO's Purchased Power and Fuel Adjustment Clause ("PPFAC"). At AEPCO's request, in Decision No. 72735, the Commission approved certain modifications to the Cooperative's base and PPFAC rates, which took effect on January 1, 2012.

Mr. Scott explains that AEPCO is requesting an overall 2.92% <u>decrease</u> in its revenue requirements, which is a blend of a 1.30% decrease in revenues from all-requirements members and a 3.12% decrease in revenues from AEPCO's partial-requirements members.

Attached to Mr. Scott's direct testimony as Exhibit PS-1 is a copy of a study conducted by Black & Veatch Corporation that assesses the gas- and coal-fired units at Apache Station. Based on the results of this study and in accordance with Rural Utilities Service regulatory requirements, Mr. Scott requests Commission approval of the depreciation rates shown on Exhibit PS-2.

Mr. Scott requests that the Commission enter its Order authorizing implementation of new rates as of November 1, 2013, which is the same implementation date requested in the companion rate case filed by Southwest Transmission Cooperative, Inc.

Testimony Summaries of Gary E. Pierson
Arizona Electric Power Cooperative, Inc. ("AEPCO" or the "Cooperative")
Rate Case
Docket No. E-01773A-12-0305

Direct Testimony

Gary E. Pierson is the Manager of Financial Services for Sierra Southwest Cooperative Services, Inc., which provides various support services to AEPCO. His direct testimony explains that the primary purpose of the rate case filing is to update AEPCO's depreciation rates as required by the Rural Utilities Service guidelines. Because Commission rules provide that revised depreciation rates may be authorized only in the context of a rate case, AEPCO performed a broader revenue requirements study to take into account changes in other expenses and revenues. Mr. Pierson's testimony supports the Cooperative's application for an overall rate decrease of approximately 2.92% and explains the financial Schedules A-H.

In particular, Mr. Pierson discusses the summary A Schedules and the C Schedules, which contain the adjusted test year data, as well as the supporting schedules for the income statements. Mr. Pierson also sponsors the Cooperative's cost of service study and the G Schedules and explains the process of functionalization and classification of adjustments, expenses and revenue credits. His testimony also addresses AEPCO's rate design H Schedules.

Finally, Mr. Pierson's direct testimony requests that the Commission approve continuation of the Purchased Power and Fuel Adjustment Clause ("PPFAC"), including continuation of the efficacy provision approved by the Commission in AEPCO's prior rate cases. Mr. Pierson also requests certain modifications to the PPFAC to (1) recover fixed fuel costs from a separate PPFAC pool with its own fuel adjustor rate and (2) separate the bank balances from the fuel adjustor rate and, instead, recover/refund them through a six-month amortization tariff rider.

Rebuttal Testimony

On rebuttal, Mr. Pierson provides AEPCO's response to the direct testimonies of Staff witnesses Messrs. Vickroy, Kalbarczyk and Antonuk.

On the issue of cost of capital and rate sufficiency, Mr. Pierson explains why AEPCO's proposed 1.32 DSC is appropriate and why the Cooperative opposes Mr. Vickroy's recommendation of a 1.56 DSC. Mr. Pierson analyzes AEPCO's risk profile, including risks related to the EPA's Regional Haze requirements. His testimony states that the EPA recently granted AEPCO's petition for reconsideration, which is a strong indicator that the EPA will approve the Cooperative's alternative Best Available Retrofit Technology ("BART") proposal at a capital cost of approximately $30 million instead of the original estimated compliance cost of $200 million. Given this recent development with the EPA, as well as AEPCO's historically strong financial profile, Mr. Pierson concludes that rates based on a 1.32 DSC would provide rate sufficiency. He suggests that any additional capital that needs to be raised in connection with environmental regulatory compliance should be collected via an Environmental Compliance Adjustment Rider ("ECAR") and provides a description of how the ECAR would operate if approved.

In response to Mr. Kalbarczyk's testimony, Mr. Pierson states that AEPCO accepts Staff's rate base adjustments in order to narrow disputed issues. Mr. Pierson also describes rebuttal adjustments to operating income that result in proposed test year revenues of about \$159.3 million, operating expenses of \$148.6 million, electric operating income (margins) of approximately \$10.7 million and a net margin of slightly less than \$2 million. With regard to rate design, Mr. Pierson confirms that the parties are in agreement regarding design, though AEPCO's specific proposed rates differ from Staff's due to the parties' differing recommendations on the appropriate DSC level.

Finally, Mr. Pierson provides AEPCO's response to Mr. Antonuk's testimony regarding fuel, purchased power and the PPFAC. Attached as Exhibit GEP-5 to Mr. Pierson's rebuttal testimony is the report of Emily Regis, AEPCO's Fuels Resource Administrator. Ms. Regis' report provides a detailed response and explanation regarding the concerns raised by Liberty Consulting Group regarding AEPCO's coal forecasting, procurement and inventory management in 2012. Mr. Pierson and Ms. Regis both confirm that AEPCO is committed to accurate coal forecasting and is implementing a plan to decrease its coal inventory to achieve compliance with target levels. With regard to the PPFAC, Mr. Pierson clarifies that the tariff rider proposed in his direct testimony will be a continuing rider and that AEPCO withdraws its request to include carbon taxes and Cap and Trade Allowances in the PPFAC. With these clarifications, Mr. Pierson confirms that AEPCO and Staff both recommend continuation of the PPFAC, including AEPCO's proposed modifications and the efficacy provision.

<u>Rejoinder Testimony</u>

Mr. Pierson's rejoinder testimony responds to the surrebuttal testimonies of Messrs. Vickroy, Kalbarczyk and Spangenberg.

Mr. Pierson reiterates AEPCO's recommendation that its revenue requirements be based on a DSC of 1.32 in light of a variety of factors, including the strength of the Cooperative's historical financial position and the reduction in construction build risk associated with its proposed BART alternative. Mr. Pierson stresses the Cooperative's past efforts to be rate competitive and points out that the requested overall revenue requirement decrease will further this goal. Also, he explains that AEPCO has worked closely with its Members to operate more efficiently and at lower costs and that those savings should be passed along to the Members and their retail customers.

In response to Mr. Spangenberg's testimony regarding coal forecasting, procurement and inventory management, Mr. Pierson confirms that AEPCO has taken and continues to take steps (1) to improve the accuracy of coal forecasting and (2) to bring coal inventory within the Cooperative's target range. Mr. Pierson points out that, thanks to AEPCO's 2012 coal management strategy, the Cooperative's average delivered cost of coal has gone down by more than 20% since the 2011 test year. Additionally, he reports that, as of June 26, 2013, AEPCO has successfully brought its coal inventory back within the target range.

With regard to AEPCO's proposed ECAR, Mr. Pierson clarifies that the tariff is proposed in conjunction with rates set on a 1.32 DSC and he stresses that the Cooperative does not support an ECAR if its request for an overall revenue requirement decrease is denied. Assuming a 1.32 DSC is approved, Mr. Pierson confirms AEPCO's agreement with Staff's suggestion that the docket be held open while the parties work together to develop a process for and details of the ECAR mechanism. Mr. Pierson also explains AEPCO's intent that the ECAR would be set at zero until the Cooperative has completed its study of Apache Station (described below) and developed its Environmental Compliance Strategy.

As to the economic study of Apache Station, Mr. Pierson explains that AEPCO met with Staff to obtain further details regarding Staff's position. While the parties were not able to reach complete agreement, Mr. Pierson states that the Cooperative has refined its study proposal, which is consistent with the analysis that AEPCO's Strategic Resource Planning Group ("SRPG") has already commenced. Mr. Pierson provides an overview of the SRPG study and states that AEPCO will submit the results to the Commission by June 30, 2014.

Finally, Mr. Pierson summarizes AEPCO's various requests to the Commission, including approval of its $4.3 million decrease in revenue requirements and corresponding revised rates.

Supplemental Rejoinder Exhibit

Following the filing of rejoinder testimony, AEPCO continued discussions with Staff regarding the SRPG study. The parties reached agreement regarding the description of the study, which AEPCO filed on July 24, 2013 as a supplemental exhibit to Mr. Pierson's rejoinder testimony, Exhibit GEP-11.

Testimony Summaries of Richard P. Kurtz
Arizona Electric Power Cooperative, Inc. ("AEPCO" or the "Cooperative")
Rate Case
Docket No. E-01773A-12-0305

<u>Rebuttal Testimony</u>

Richard P. Kurtz is the Vice President of Power Services and Planning for Sierra Southwest Cooperative Services, Inc. His responsibilities include directing and administering the resource planning functions for AEPCO.

Mr. Kurtz' rebuttal testimony provides AEPCO's response to the direct testimony of Staff witness Richard Mazzini. Attached to his testimony is a report that addresses three specific topics: (1) Apache Station ST2 and ST3 Output – 2000 to Date and its Future; (2) Assessment of ST1 2010 Repairs, its Operational Usefulness and Life; and (3) Past and Ongoing Apache Station Strategic Planning.

With regard to Apache Station coal unit output since 2000, Mr. Kurtz explains that the decline referenced by Mr. Mazzini was limited to two distinct periods and was attributable to discrete, non-recurring factors—nothing indigenous to the units themselves. Mr. Kurtz further states that Units ST2 and ST3 are operating now and are expected to continue to operate over the next several years at levels exceeding those experienced in the past four years. For these reasons, among others, he concludes that the useful lives of ST2 and ST3 to the year 2035 are adequately supported and, therefore, their associated depreciation rates should be approved.

In response to Mr. Mazzini's testimony regarding Unit ST1, Mr. Kurtz confirms that the repairs made to the unit in 2010 were well supported and justified, which is consistent with Liberty Consulting Group's analysis of the repairs in AEPCO's last rate case. Mr. Kurtz also discusses the unit's continued value as capacity, as well as its availability for intermediate summer generation and backup to Apache Station coal unit operation. He explains that all of these factors support the conclusion that ST1 remains used and useful and its depreciation rates through 2020 should be approved.

Finally, Mr. Kurtz provides a detailed explanation of AEPCO's strategic planning for Apache Station. He explains that, thanks to its prior planning efforts, the Cooperative was able to respond promptly to the EPA's Regional Haze requirement with the current proposed alternative that will save AEPCO and its Members many millions of dollars in capital costs. Mr. Kurtz also describes the Cooperative's Strategic Resource Planning Group ("SRPG") and the work it will do going forward to evaluate Apache Station. Mr. Kurtz suggests that, in light of these past and ongoing planning efforts, another formal study of Apache Station is unnecessary.

Rejoinder Testimony

Mr. Kurtz' rejoinder testimony addresses the surrebuttal testimony of Mr. Mazzini.

With regard to Apache Station performance, Mr. Kurtz reiterates AEPCO's well-documented explanation of the previous decline in ST2 and ST3 usage. He confirms that the coal unit output has already increased significantly and is expected to remain high for the next several years. Mr. Kurtz also provides additional support for the conclusion that Unit ST1 (CC1) has value as capacity. Further, he describes the recent cost savings that AEPCO achieved by running the unit earlier this summer.

Mr. Kurtz' rejoinder testimony provides additional detail regarding the study underway by the SRPG. Specifically, he describes the Strategist modeling, the analysis of unit retirement and the public request for information process involved in the study. Mr. Kurtz explains that the data and information gathered during the study will provide variable cost projections for financial forecasting and rate projections that AEPCO can use to make future decisions regarding Apache Station. In light of the comprehensive nature of the SRPG study, Mr. Kurtz recommends that the Commission approve the process that AEPCO has already developed and commenced.