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BEFORE THE ARIZONA CORPORATIO

COMMISSIONERS
BOB STUMP - Chairman
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH

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AZ CORP COMMISSION
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IN THE MATTER OF THE APPLICATION OF ARIZONA ELECTRIC POWER COOPERATIVE, INC. 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 **STAFF'S NOTICE OF FILING WITNESS TESTIMONY SUMMARIES AND NOTICE OF ADDITIONAL HEARING WITNESS**

The Utilities Division ("Staff") of the Arizona Corporation Commission ("Commission") hereby provides notice of filing the testimony summaries of Staff witnesses John Antonuk and Randall E. Vickroy in the above-referenced matter. At the procedural conference held on July 22, 2013, Staff indicated that only Mr. Antonuk would be available to testify in person on August 1, 2013. However, Staff has since learned that Mr. Vickroy is also available to testify in person on that date. Accordingly, Staff additionally provides notice that Mr. Vickroy will be available to testify as a witness in this matter.

RESPECTFULLY SUBMITTED this 26th day of July, 2013.

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Arizona Corporation Commission
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EXECUTIVE SUMMARY
STAFF WITNESS
JOHN ANTONUK
ARIZONA ELECTRIC POWER COOPERATIVE, INC.
DOCKET NO. E-01773A-12-0305

On behalf of the Utilities Division ("Staff"), the Liberty Consulting Group ("Liberty") filed testimony from John Antonuk, Dennis Kalbarczyk, Richard Mazzini, and Donald Spangenberg. Their testimony addresses the results of Liberty's: (a) examinations of fuel, purchased power, and plant operations policies, activities, and costs, (b) revenue requirements, (c) cost of service, and (d) an engineering review of AEPCO's facilities. Major areas of focus in the prudence and engineering reviews included: (a) fuel oils and natural gas, (b) coal, (c) power transactions, and (d) power plant planning, operations, and maintenance.

This review led Liberty to identify several moderate adjustments to AEPCO's proposed revenue requirements. However, Liberty found that consideration of issues involving the future of the Apache Generating Station ("Apache") merited a different approach to assessing AEPCO's rate filing. Liberty's PPFAC review recommended more aggressive steps to reduce coal inventory levels.

As in its prior evaluation, Liberty found Apache's technical performance, people, and facilities to be generally sound. Plant operations typified what one would expect to find in the industry. From a strategic perspective, however, the warning signals Liberty identified in the previous rate case in 2010 have grown into firm indicators of problems that leave the future of Apache uncertain. While recent EPA challenges add to this burden, it remains clear that the strategic issues forcing the station's decline existed before the EPA's actions and will remain afterwards as well. AEPCO needs to consider all these factors in its assessment of Apache's future. Liberty recommends a candid and complete assessment of Apache's future compared with other alternative supply options. Liberty's recommended study would include:

- Comprehensive supply scenarios based on robust power supply alternatives as well as additional Apache configurations
- Assessment of Apache remaining life based on economics, physical condition and planned operating mode
- Consideration of third party oversight to assure that assumptions, methods, and conclusions are reliable
- Rate analyses to determine what, if any, stranded costs will be borne by the members and their customers, and total rate impacts of the power supply alternatives.

Liberty also reviewed AEPCO's rate base and revenue requirements proposals. This review examined all proposed adjustments. That review found small (in number and size) adjustments to be appropriate when considered in isolation. However, balancing them against the risks that AEPCO faces, Liberty determined that the adjustments it found technically appropriate should not be made, in order to keep rates at current levels.

Liberty also reviewed AEPCO's rate design methods, finding them appropriate. With minor changes, AEPCO offered the same cost allocation and rate design methods here as it used in prior proceedings. Liberty also reviewed AEPCO's proposed changes to the PPFAC, finding them appropriate, with the exception that Liberty disagreed with the too open-ended request to allow PPFAC recovery of future carbon taxes, CO_2 Cap and Trade Allowances or similar levies.

AEPCO also proposed the adoption of a surcharge (the Environmental Compliance Adjustor Rider, or "ECAR") to address environmental compliance costs. Liberty did not have time to examine the proposal fully, but did find the concept acceptable, although subject to clarification in a number of important respects. Liberty recommended that, if adopted, the ECAR rate be set at "zero" until completion and Commission consideration of supply alternatives study of the type Liberty recommended. Liberty also recommended discussion of a number of administrative details that require amplification before such a clause can be considered effective.

EXECUTIVE SUMMARY
STAFF WITNESS
RANDALL E. VICKROY
ARIZONA ELECTRIC POWER COOPERATIVE, INC.
DOCKET NO. E-01773A-12-0305

On behalf of the Utilities Division ("Staff"), the Liberty Consulting Group ("Liberty") filed testimony from Randall E. Vickroy. Liberty reviewed, evaluated, and made recommendations addressing cost of capital issues. Liberty evaluated AEPCO's cost of capital and coverage requirements based on well-documented risk evaluation techniques used by credit rating agencies. AEPCO has not established a credit rating, but the criteria used by Moody's and the other rating agencies are appropriate for determining a reasonable expectation for financial metrics and results, provided one adequately considers the specific business and financial risks of AEPCO.

Moody's analysis of "qualitative factors" has major importance in AEPCO's specific situation. Applying these factors shows that AEPCO faces comparatively greater risk, emerging over the past few years from declining competitiveness of its generating assets and unresolved EPA environmental requirements that could make the Apache assets even less competitive. On the whole, AEPCO's circumstances give it very high levels of risk under these factors, which make up the majority (60 percent) of the weight in the relevant analysis as Moody's conducts it.

Moody's also includes an appendix to its G&T rating guidelines. It emphasizes three key, potentially overriding issues for entities with substantial coal-fired generation: global climate change and environmental awareness, rising costs for generation and transmission, and rate increases that may test members' willingness to raise rates. The uncertainties facing Apache make these factors also important in assessing AEPCO's financial strength.

AEPCO requested the same target DSC ratio of 1.32 as approved in the previous rate case. This DSC would require a rate decrease. AEPCO's business situation and challenges have changed substantially; Liberty's testimony opposed a rate decrease because AEPCO's key generation resources have become less competitive with market generation sources. The AEPCO faces much greater business risk due to EPA environmental mitigation requirements; its already high costs and rate levels could increase significantly.

A normal DSC range of 1.20 to 1.50 is sufficient for a G&T that faces normal business risks. AEPCO is a special case. It faces markedly increased risks. Circumstances justify consideration of DSC ratios above 1.50, pending successful resolution of power supply and environmental issues. It takes a DSC of only 1.56 (just outside the normal range), to eliminate AEPCO's proposed rate decrease of $4.5 million entirely. The prudent course is to leave rates at present levels pending further assessment and action by AEPCO to address its power supply resources.