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BEFORE THE ARIZONA CORPORAT

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AZ CORP COMMISSION  
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IN THE MATTER OF THE APPLICATION  
OF 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

MOHAVE ELECTRIC COOPERATIVE,  
INCORPORATED'S NOTICE OF  
FILING REJOINDER TESTIMONY

Mohave Electric Cooperative, Incorporated ("MEC") by and through  
undersigned counsel, gives notice of filing the Rejoinder Testimony of Carl N. Stover.

DATED this 17<sup>th</sup> day of July, 2013.

CURTIS, GOODWIN, SULLIVAN,  
UDALL & SCHWAB, P.L.C.

By:

Michael A. Curtis  
William P. Sullivan  
501 East Thomas Road  
Phoenix, Arizona 85012-3205  
Attorneys for Mohave Electric  
Cooperative, Incorporated

Arizona Corporation Commission  
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2 I hereby certify that on this 17<sup>th</sup> day of July, 2013, I caused the foregoing  
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8 this 17<sup>th</sup> day of July, 2013 to:

9 Teena Jibilian  
10 Administrative Law Judge  
11 Hearing Division  
12 Arizona Corporation Commission  
1200 West Washington  
Phoenix, Arizona 85007

13 Janice Alward, Chief Counsel  
14 Legal Division  
15 Arizona Corporation Commission  
1200 West Washington  
Phoenix, Arizona 85007

16 Steven M. Olea, Director  
17 Utilities Division  
18 Arizona Corporation Commission  
1200 West Washington  
19 Phoenix, Arizona 85007

20 Michael M. Grant  
21 Jennifer Cranston  
22 Gallagher & Kennedy, P.A.  
2575 East Camelback Road  
Phoenix, Arizona 85016

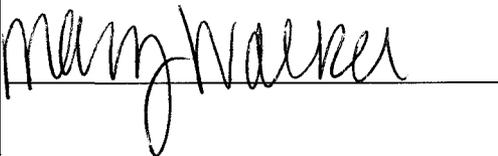
Michael W. Patten  
Roshka, Dewulf & Patten PLC  
400 East Van Buren, Suite 800  
Phoenix, Arizona 85004

Russell E. Jones  
Waterfall Economidis Caldwell  
Hanshaw & Villamana, PC  
5210 East Williams Circle, Suite 800  
Tucson, Arizona 85711

Vincent Nitido  
Karen Cathers  
Trico Electric Cooperative, Inc.  
8600 West Tangerine Road  
Post Office Box 930  
Marana, Arizona 85653

Jeffrey W. Crockett  
Brownstein Hyatt Farber Schreck LLP  
One E. Washington St., Suite 2400  
Phoenix, Arizona 85004

Kirby Chapman  
SSVEC  
311 1 E. Wilcox Dr.  
Sierra Vista, Arizona 85635

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1 **REJOINDER TESTIMONY**

2 **OF**

3 **CARL N. STOVER, JR.**

4 **ON BEHALF**

5 **OF**

6 **MOHAVE ELECTRIC COOPERATIVE, INCORPORATED**

7 **INTRODUCTION**

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

9 A. My name is Carl N. Stover, Jr.; my business address is 5555 North Grand Boulevard,  
10 Oklahoma City, Oklahoma 73112-5507.

11 **Q. Are you the same Carl N. Stover, Jr. who submitted Rebuttal Testimony in this**  
12 **proceeding?**

13 A. Yes.

14 **Q. What is the purpose of the testimony that you are presenting at this time?**

15 A. I am responding to surrebuttal testimony presented by Randall Vickroy that he filed  
16 in response to my rebuttal testimony. As I discuss below, the fundamental issue to  
17 be decided by the Arizona Corporation Commission is whether a properly  
18 performed analysis of the five factors identified by Moody's, and relied on by Mr.  
19 Vickroy, justifies rejecting AEPCO's proposal to reduce its rates and forcing AEPCO  
20 Members to pay an additional \$4.287 million annually, indefinitely. I conclude they  
21 do not and urge the Commission to authorize the reduced rates requested by AEPCO  
22 and supported unanimously by its Members, including Mohave.

23 **Q. What are the points with which Mr. Vickroy disagrees with you?**

24 A. Mr. Vickroy identifies five points in which he takes exception to filed rebuttal  
25 testimony. My testimony is referenced in four of the five points (Points One, Two,

1 Three and Five). I will address each of the four points where my rebuttal testimony  
2 is discussed.

3 **POINT ONE: REPRESENTATION OF DSC RANGE**

4 **Q. Does Mr. Vickroy contend your rebuttal testimony incorrectly represented his**  
5 **position with regard to the sufficiency of a DSC range of between 1.2 to 1.5?**

6 A. Yes (Vickroy, Surrebuttal, p. 1, lines 23-27), even though he had characterized a DSC  
7 range of between 1.2 to 1.5 as "normal" (Vickroy, Direct at p. 18, line 32) and further  
8 concluded that "the financial targets included in its [AEPCO] rate request [a 1.32  
9 DSC], if they were to be realized over a period of years, would probably qualify  
10 AEPCO for an investment grade credit rating and the ability to access capital  
11 markets (Vickroy, Direct, p. 13, line 3).

12 **Q. Did you mischaracterize his testimony as indicating that he supported use of a**  
13 **DSC of between 1.2 to 1.5 to set AEPCO's rates?**

14 A. No. He clearly recommends using the fallout DSC of 1.56 (i.e., the DSC achieved at  
15 current revenue levels on an adjusted test year basis). What my testimony reflects  
16 is that Mr. Vickroy's conclusion is not supported by the five factors he claimed  
17 justified his conclusion.

18 **Q. Please summarize why the five factors examined by Mr. Vickroy do not**  
19 **support setting rates based upon a DSC of 1.56.**

20 A. Importantly, I present the discussion of this issue using the same framework Mr.  
21 Vickroy used in his direct testimony to evaluate the appropriate rate level for  
22 AEPCO. Mr. Vickroy presented an analysis in which he identified five factors that  
23 needed to be considered to determine the appropriate rate level for AEPCO (Vickroy

1 Direct at p. 9, lines 25-31). The five factors were based on Moody's Global Corporate  
2 Finance Rating Methodology for U.S. Electric Generation & Transmission  
3 Cooperatives dated December 2009. (Note: the number sequence used by Mr.  
4 Vickroy differs from that in the Moody report; however, the same concepts are  
5 captured in the analysis.)

6 Mr. Vickroy's first factor involved Financial Performance Metrics, which are  
7 weighted as 40% of the overall rating. As noted above, Mr. Vickroy concluded that  
8 the financial metrics AEPCO used to propose a 2.77% rate reduction (a \$4.287  
9 million annual savings to its Members) likely will allow AEPCO to maintain an  
10 investment grade rating. So with regard to Financial Performance metrics the  
11 proposed rate decrease was appropriate. Therefore, my rebuttal testimony focused  
12 on the other four factors in Mr. Vickroy's analysis in order to determine whether  
13 they support Mr. Vickroy's risk assessment, his 1.56 DSC recommendation and  
14 rejecting AEPCO's proposed 2.77% rate reduction.

15 The four factors included:

- 16 2. Long-term Wholesale Power Supply Contacts/Regulatory Status
- 17 3. Rate Flexibility/Rate Shock
- 18 4. Member/Owner Profile
- 19 5. Size

20 **Q. Has Mr. Vickroy's analysis justified rejecting AEPCO's proposed rate reduction**  
21 **and imposing an additional \$4.287 million annual cost on its Members and the**  
22 **customers they serve?**

1 A. As I indicated in my rebuttal testimony, I do not believe the level of risk associated  
2 with the other four factors off-sets the findings associated with Factor 1 (Financial  
3 Performance Metrics). As discussed below, Mr. Vickroy's surrebuttal testimony still  
4 fails to support the high level of risk he assigns to the other four factors.

5 **POINT TWO: IMPLICATIONS OF EPA CAPITAL REQUIREMENTS**

6 **Q. What is Mr. Vickroy's criticism of your analysis of the risks associated with the**  
7 **EPA's requirements?**

8 Mr. Vickroy testified in his direct testimony that facing "the prospect of *at least* \$190  
9 million of capital expenditures to meet EPA requirements over the next 3 to 5 years"  
10 and the associated rate increase of 18% *or more* justified placing AEPCO in the high  
11 risk category related to Rate Flexibility/Rate Shock (Vickroy, Direct at p. 14, lines  
12 19-25, emphasis added). AEPCO testified in rebuttal it will be in the range of \$30  
13 million. As one would expect, my rebuttal testimony indicated this significant  
14 reduction in the anticipated cost (84%) also significantly lessens the associated risk  
15 assessment.

16 Mr. Vickroy admits he has no basis for gauging the probabilities surrounding the  
17 associated risks. Yet, Mr. Vickroy maintains, unchanged, his "high risk" assessment  
18 with regard to construction build and rate shock associated with the EPA  
19 requirements. (Vickroy, Surrebuttal at p. 2, lines 18-26). The Commission must  
20 not use outdated cost estimates as a basis of setting rates, especially where the  
21 utility (AEPCO) has testified that a significantly (84%) lower cost is likely.

1 **Q. Would approval of an Environmental Compliance Adjustment Rider (“ECAR”),**  
2 **as requested by AEPCO, increase or reduce risk associated with EPA’s**  
3 **mandated environmental compliance costs?**

4 A. As I discussed in my rebuttal testimony (Stover, Rebuttal at p. 21, line 16 – p. 22, line  
5 8), an appropriately designed ECAR lessens even further the risk associated with  
6 these reduced EPA mandated environmental compliance costs.

7 **POINT THREE: COMPETITIVE CONSIDERATIONS**

8 **Q. What is Mr. Vickroy’s criticism of your rebuttal testimony regarding AEPCO’s**  
9 **cost competitiveness?**

10 A. I am not exactly sure. We both agree that it is important for AEPCO to provide  
11 competitive wholesale rates. My rebuttal testimony points out the Members and  
12 AEPCO are dealing with the issue by reducing costs and requesting the Commission  
13 to pass through the savings by reducing AEPCO’s wholesale rates. In contrast, Mr.  
14 Vickroy contends the existing rates, which he contends are uncompetitive, should be  
15 maintained. I don’t understand how Mr. Vickroy’s recommendation, if adopted by  
16 the Commission, addresses the rate competition issue.

17 **POINT FIVE: IMPLICATIONS OF PRM CONTRACT**

18 **Q. Does Mr. Vickroy contend that you are incorrect in suggesting that AEPCO’s**  
19 **relationship with its partial requirements members (PRMs) lessens, rather**  
20 **than increases AEPCO’s risk as he suggests?**

21 A. Yes. I provided examples in my rebuttal testimony which need not be repeated. His  
22 surrebuttal merely confirms that he does not appreciate the nature of the

1 relationship between AEPCO and its PRMs. Mr. Vickroy's surrebuttal testimony  
2 states:

3 The AEPCO Partial Requirements Members are purchasing increasing  
4 amount of energy and capacity from the marketplace in place of  
5 AEPCO assets and operations, reducing the relevance and economics  
6 of these assets as lower level of megawatts are produced. (Vickroy,  
7 Surrebuttal at p. 3, line 27.)

8 This is simply not true for AEPCO. The PRM is required to pay its full allocated  
9 share of the fixed cost associated with AEPCO's Allocated Capacity (AC) each month.  
10 The AC consists of both Base Resources (coal and hydro) and Other Resources (gas-  
11 fired turbines). The allocated share is based on the Allocated Capacity Percentage  
12 (ACP) which is a fixed value. For Mohave, the ACP is 35.8%. Mohave's allocated  
13 Base Resources total approximately 133 MW (the value will change slightly based  
14 on available hydro) and Other Resources total 58 MW (reference Stover Rebuttal  
15 Testimony, Exhibit CNS-2, Schedule C1.0). Mohave pays the fixed costs associated  
16 with these assets each month, independent of the capacity that Mohave may  
17 purchase from third parties. In fact, Mohave pays the fixed cost reflected in the  
18 rates independent of the Mohave load. In short, the PRMs are committed to pay the  
19 vast majority of AEPCO's fixed costs, whether or not they purchase one kWh of  
20 output.

21 It is true that the amount of energy purchased from the allocated AC can vary;  
22 however, the AEPCO energy rate reflects the variable cost associated with providing  
23 the energy. If Mohave (or any other PRM) purchases energy from a third party, then

1 AEPCO avoids incurring the variable costs associated with providing that energy to  
2 the PRM. The same relationship is true for services to all of the PRMs.

3 Mr. Vickroy's statement simply does not reflect the economic realities of the PRM  
4 agreements. If Mr. Vickroy would review the contracts, and in particular review the  
5 rate design proposed to recover cost, he would understand that changes in capacity  
6 and energy purchased from the marketplace, in place of the AEPCO assets, does not  
7 reduce the relevance and economics of the assets. AEPCO has a guaranteed revenue  
8 stream for recovery of fixed costs as reflected in the rates.

9 Mr. Vickroy at p. 3, lines 18-24 of his surrebuttal testimony references the Moody's  
10 rating criteria in an attempt to support his position. However, he fails to provide a  
11 full explanation of how Moody's applies its criteria. The Moody valuation process in  
12 fact recognizes that partial requirements contracts are not necessarily a basis for  
13 increased risk. The report specifically mentions Oglethorpe (page 19) and the fact  
14 that Oglethorpe does not provide the total requirements of its Members, and that  
15 under a strict interpretation this rating matrix factor, Oglethorpe would receive a Ba  
16 rating. The report goes on to state that:

17 In Oglethorpe's case, we are not unduly concerned because its  
18 members remain joint and severally liable to pay all of the  
19 cooperative's cost and we believe Oglethorpe's stable supply of  
20 relatively affordable baseload power will become increasingly  
21 valuable to its Members as their needs grow and they are continually  
22 forced to look for additional sources of supply. We believe an  
23 indicated rating of A more appropriately captures the degree of credit

1 impact from the current relationship between OPC and its Members  
2 when considered together with its rate autonomy. (Page 20)

3 Moody's primary concern is the extent to which the PRM contracts tend to increase  
4 or mitigate risk. Moody states:

5 Against a backdrop of significant spending for capital projects, volatile  
6 fuel costs and looming carbon legislation and related costs, the  
7 strength of the wholesale power contracts and predictable revenue  
8 stream they provide for G&T co-ops remains a primary source of  
9 credit support. (Page 7)

10 The AEPCO/PRM relationship that exists today:

- 11 1. Eliminates AEPCO's obligation to raise capital to meet future PRM load  
12 growth requirements, unless the PRM and AEPCO agree otherwise.
- 13 2. Provides for recovery of fuel cost through rates.
- 14 3. Guarantees fixed cost recovery, as defined in the rate tariff for AEPCO  
15 independent of either capacity or energy purchases from the allocated AC  
16 and even independent of Member load.
- 17 4. Provides a predictable revenue stream tied to AEPCO's fixed costs for the  
18 extended term of the existing agreements.
- 19 5. Compliments AEPCO's long-term agreements with its ARMs.

20 When the true character of AEPCO's relationship with its PRMs and ARMs is fully  
21 understood, they present less risk to AEPCO under Moody's rating criterion.

22 **SUMMARY**

23 Q. Do you believe that the rate decrease proposed by AEPCO is appropriate?

1 A. Yes.

2 **Q. Please summarize the basis of your position given the analysis presented in**  
3 **Mr. Vickroy's direct and surrebuttal testimony.**

4 A. Examining the five criteria identified by Moody's and used by Mr. Vickroy:

5 1. **Financial Performance and Metrics (40%)**: There is no disagreement with  
6 Mr. Vickroy that the proposed coverage, if realized in future periods, should  
7 allow AEPCO to maintain investment grade status and have access to capital  
8 markets.

9 2. **Long-term Wholesale Power Supply Contracts/Regulator Status (20%)**:  
10 Mr. Vickroy, in both his direct and surrebuttal testimony, is attributing a high  
11 level of risk associated with the PRM contracts. Mr. Vickroy continues to  
12 believe that by purchasing power from third parties there is an adverse  
13 impact on AEPCO. A review of the contracts and the rates charged  
14 demonstrate the risks attributed thereto by Mr. Vickroy simply do not exist.  
15 In fact, the guaranteed recovery of the fixed costs reflected in the proposed  
16 rates serves to reduce, not increase, risk. The AEPCO energy rates reflect  
17 only variable cost so the purchase of energy from a third party does not  
18 increase risk for AEPCO.

19 3. **Rate Flexibility/Rate Shock (20%)**: The underlying facts relied on by Mr.  
20 Vickroy in his direct testimony have changed significantly. The estimated, *at*  
21 *least*, \$190 million EPA compliance cost is now estimated by AEPCO to be \$30  
22 million or approximately 84% less. Yet, Mr. Vickroy made no adjustment to

1 his risk analysis or recommendation for this change despite his concern  
2 regarding AEPCO's past, current, as well as future, rate competitiveness.

3 4. **Member/Owner Profile (10%)**: Mr. Vickroy did not provide any rebuttal  
4 testimony on this issue. After an analysis (reference Stover Rebuttal  
5 testimony beginning page 13) using AEPCO member specific data, it is clear  
6 there should be no risk adjustment for this factor.

7 5. **Size (10%)**: No question, AEPCO is small compared to other G&Ts. As they  
8 say - it is what it is! Fortunately, Moody's assigns a low ratio to this factor.

9 I did not find any information or data in Mr. Vickroy's Surrebuttal Testimony  
10 that supports his conclusion that the risk associated with Factor 2, 3, 4 and 5  
11 is sufficient to off-set his conclusion that a rate decrease is justified based on  
12 Factor 1 (Financial Performance and Metrics).

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

14 **A.** Yes.

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