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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** **CORRECTED MOHAVE ELECTRIC COOPERATIVE, INCORPORATED'S OPENING POST HEARING BRIEF**

Intervenor Mohave Electric Cooperative, Incorporated ("Mohave") submits its opening post hearing brief and respectfully requests that the Commission approve Arizona Electric Power Cooperative's ("AEPCO") request to set rates and charges to reduce operating revenues by $4.287 million annually; a 2.6%.decrease in total revenues (from $163,624,000 to $159,337,135).[1] Mohave is a nonprofit member owned cooperative and a partial requirements class A member ("PRM") of AEPCO.[2] AEPCO's members unanimously support AEPCO's request.[3]

The public officials and members of the public that spoke during the public comment session and sent in comments on this matter vigorously support the decrease. They

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[1] AEPCO-5, Exhibit GEP-4, line 5, Col. D & E.

[2] MEC-1, p.2, ll. 8-9.

[3] MEC-1, p. 5, ll. 17-18.

emphasize that a rate decrease will assist them and their beleaguered economies, even if the rates have to increase in the future. For example, Jack Hakim, Mayor of Bullhead City commented:

> "Commissioners, we must point out to you a few things that make this decrease very important to the community we serve. Economic times are still tough. And Mohave County still has a disproportionately higher number of citizens that are at or under the poverty level. And they all could use a power cost relief, even if only for a few years."[4]

Similarly, Steven Moss, Mohave County Supervisor, District 5, in addition to explaining that $30 in electric savings annually would pay the membership fee for the local soccer league, commented:

> "They [his constituents] are a very conservative group socially speaking even though they are very poor, and they have a hard time comprehending that when a utility's costs rise the utility gets a rate increase, but when, and they think it is only fair and natural, and I agree with them, that when the utility's costs decrease, the rates should decrease. It is a pendulum that goes up and down. . . . That is business sense from their standpoint. So the vast bulk of my constituency thinks of this in terms of natural justice."[5]

A. THERE IS ONLY ONE CONTESTED ISSUE

Only one issue remains unresolved: What is the proper level of debt service coverage ("DSC") or margin? AEPCO requests a DSC of 1.32 (the same level currently authorized by Decision No. 72055), which will provide AEPCO a margin of $1.96 million. Staff proposes a

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[4] Public Comment Transcript, p. 6, ll.16-22.

[5] *Id.* at pp. 9, l. 23 – 11, l. 10.

DSC of 1.55 and a margin of $6.24 million - $4.287 million (324.4%) more than AEPCO is requesting.[6]

The 1.32 DSC more than satisfies the Rural Utilities Service's ("RUS") requirements. "The Cooperative's RUS mortgage agreement debt covenants and other loan and credit agreements require both a DSC and a TIER of at least 1.0 times in two of three consecutive years."[7]

The 1.32 DSC will enable AEPCO to secure a financial rating of A. G & Ts receiving an A financial rating have DSCs between 1.2 and 1.4.[8]

Staff's proposal, while maintaining AEPCO's test year revenues overall, <u>imposes a rate increase on four (4) of AEPCO's six (6) Class A members</u>. Under Staff's proposal Trico Electric Cooperative ("Trico"), a PRM, will incur a 4.51% rate increase and all three (3) of AEPCO's all-requirements class A members ("ARMs") incur a 1.20% rate increase.[9]

B. STAFF MISAPPLIED MOODY'S FIVE RISK CRITERIA

On behalf of Staff, Mr. Vickroy evaluated "whether AEPCO's cost of capital request provides adequate margins and debt coverage in light of business risks facing the Cooperative"[10] by examining the five primary criteria specified by Moody's Investors Services ("Moody's"). The Moody's factors and the weight to be provided to each are:

1. Financial Performance and Metrics (40 percent)
2. Long-term Wholesale Power Supply Contracts/Regulatory Status (20 percent)
3. Rate Flexibility/Rate Shock Exposure (20 percent)

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[6] Transcript (Tr.), p. 14, ll. 19-25; AEPCO-5, Exhibit GEP-9, line 13, Columns D and E.

[7] S-4, p. 5, ll. 3-6.

[8] S-4, Exhibit REV-3.

[9] AEPCO-6, Exhibit GEP-10, p. 1, line 13, Col. 5 vs. Col. 6. Mohave and Sulphur Springs Valley Electric Cooperative ("SSVEC") will experience lesser rate decreases under Staff's proposal.

[10] S-4, p. 2, ll. 13-14.

4. Member/Owner Profile (10 percent)
5. Size (10 percent).[11]

Mr. Vickroy explained:

> "The rating agency techniques include both quantitative criteria based on financial metrics and qualitative criteria associated with the business risks of G&T cooperatives. *The financial credit metrics provide a quantitative foundation for the financial results required to achieve a solid investment grade rating*. I then factored in qualitative criteria also used by the rating agencies to evaluate the business risks specific to AEPCO.
> Using both the quantitative and qualitative risk factors, I then evaluated the request for rate levels based on a target DSC coverage ratio. The DSC ratio is preferred for use in evaluating G&Ts' financial strength, because it takes into consideration cash requirements and principal payments, which are substantial for most cooperatives. I considered AEPCO's prospects as evaluated by the business risk criteria to determine whether the target return and coverage levels requested are reasonable and adequate."[12]

(emphasis added).

Mr. Vickroy concludes the 1.32 DSC requested by AEPCO likely satisfies the financial performance and metrics established by Moody's:

> The financial metrics provide a quantitative basis for determining AEPCO's risk profile. *We have determined that the financial targets included in its rate request, if they were to be realized over a period of years, would probably qualify AEPCO for an investment grade credit rating and the ability to access capital markets*. Moody's gives a 40 percent weight to the financial metrics . . . [13]

(emphasis added).

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[11] *Id.*, p. 9, ll. 24-31.

[12] S-4, p. 8, ll. 8-18.

[13] S-4, p. 13, ll. 2-6.

Staff further acknowledges that AEPCO has historically met the financial criteria established by Moody's:

> "[V]alues for the mid-points of the "A" rating category for the financial metrics generally lie close to the pro forma results of AEPCO's rate request target. AEPCO's 3-year averages for the financial ratios from 2010-2012 also compare favorably. The rating mid-point for DSC coverage, for instance, falls at 1.30 times. AEPCO has requested a coverage of 1.32 times. Based solely upon historical, quantitative metrics, *AEPCO has produced financial results that could qualify it for an investment-grade credit rating*. The financial metric qualifications in total comprise 40 percent of the evaluation."[14]

(emphasis added).

Despite the foregoing, Staff contends a 1.32 DSC is inadequate due to AEPCO's non-financial metrics, or qualitative ratings factors (constituting 60% of the overall rating) which Staff claims "have an overriding influence on whether an enterprise can actually realize the targeted returns and ratios included in rate filings, and on overall business risk."[15]

Mr. Stover, the Chairman of the Board of C.H. Guernsey & Company, Engineers●Architects●Consultants, reviewed these same non-financial criteria, and concluded Mr. Vickroy's analysis of 3 of the 4 criteria was fatally flawed: [16]

> "2. Long-term Wholesale Power Supply Contracts / Regulatory Status (20%)
>
> Mr. Vickroy is in error in his assessment of the implications of the existing wholesale power contracts with the PRMs. The obligations established in these contracts decrease risk to AEPCO

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[14] S-4, p. 12, ll. 18-25.

[15] S-4, p.13, ll. 6-10.

[16] MEC-2, pp. 6, l. 8 – 7, l. 2; MEC-3, pp. 9-10, l.12.

and do not increase risk as suggested by Mr. Vickroy. Factor #2, when properly evaluated, does not support his conclusion.

3. <u>Rate Flexibility / Rate Shock (20%)</u>
   Mr. Vickroy has not accurately characterized the impact of the EPA compliance issue and the associated cost impact. The Members recognize that EPA compliance will impact rates to some degree; however, AEPCO's proposed rate decrease helps to mitigate the issues, whereas Staff recommendations exacerbate the issue. When properly evaluated Factor #3 does not support Mr. Vickroy's conclusion.

4. <u>Member / Owner Profile (10%)</u>
   Mr. Vickroy has not properly computed the consolidated residential sales metric in application of the risk criteria. When computed properly this metric shows AEPCO to be in the "A" level. Calculation of the composite equity shows ranking slightly below the "A" level. When properly evaluated, Factor #4 does not support Mr. Vickroy's conclusion."[17]

At hearing, Mr. Vickroy testified Staff was really only concerned with two risks – the environmental compliance issue and the competitiveness of the Apache assets in the current energy markets. Both of these risks fall within the "Rate Flexibility/Rate Shock Exposure" criterion.[18] This criterion constitutes only 20% of the overall risk criteria outlined by Moody's. Mr. Vickroy acknowledges that it is unnecessary to achieve an A rating in all five criteria for a G&T to achieve an overall A rating.[19] He also acknowledges that providing AEPCO an additional $4.287 million in revenues annually would not necessarily help AEPCO meet its environmental mitigation responsibilities or do anything to make AEPCO

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[17] MEC-2, pp. 6, l. 8 – 7, l. 2; Mr. Stover acknowledged that AEPCO is small compared to most G&Ts rated by Moody's, but noted its members' loads are diverse and service territories geographically significant as they relate to Arizona. Tr., p. 186, ll. 3-12.

[18] Tr., pp. 203, l. 21 – 205, l. 6. The new construction build exposure and rate competitiveness risks both fall under this single primary rating criterion. S-4, p. 14, ll. 9-10.

[19] Tr., p. 211, ll. 21-24.

more competitive in the energy market.[20] In fact, Staff's opposition to AEPCO's request to decrease rates is counter-intuitive to Staff's concern regarding AEPCO's ability to compete in the current energy market.[21]

Mr. Vickroy acknowledges Staff's DSC recommendation is nothing but "a fallout number."[22] While on the one hand he insists AEPCO's risk requires a DSC in excess of 1.5,[23] he testified he would not recommend a rate increase even if existing rates were producing the 1.32 DSC adopted by the Commission in Decision No. 72055 and requested by AEPCO:

> Q. [Mr. Sullivan] Okay. So if existing rates didn't achieve a 1.5 you would be recommending a rate increase?
> A. [Mr. Vickroy] No.
> Q. So if existing rates produced a 1.40 would you be recommending a rate increase?
> A. No.
> Q. If existing rates actually produced a 1.32 DSC would you be recommending a rate increase to get to 1.50?
> A. No.
>
> . . .
>
> Q. . . . I thought you just testified that you thought a 1.5 or above would be necessary to, DSC, would be necessary to deal with the risk that you see in this company. Correct?
> A. Something above 1.5. But I think that those particular numbers or the calculation of risk is not in a quantitative mode and, as presented in the testimony, that the consideration of risks becomes key and that it is not, as you can tell in my testimony, you don't put a number on that. . . .[24]

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[20] Tr., p. 212, ll. 4-16.

[21] Tr., p. 212, ll. 11-16.

[22] Tr., p. 210, l. 10.

[23] Tr., p. 207, l. 17.

[24] Tr., pp. 206, l. 23 - 207, l. 22.

In short, Staff identifies an appropriate DSC necessary to maintain an investment grade rating but then ignores their own finding and states that the appropriate DSC is whatever DSC is produced from the current rates. While unwilling to support a rate increase if necessary to achieve a DSC above 1.50, Staff still contends AEPCO's members should be compelled to pay AEPCO $4.287 million annually in margins above the amount needed to satisfy Moody's financial metrics because the present rates provide that as a fallout DSC/margin. The Commission must reject such an approach to rate setting.

C. STAFF'S RECOMMENDATION IS PREMISED ON UNKNOWNS

Mr. Antonuk testified that "it is fair to say that how risky AEPCO is is the paramount issue and the one that really does dwarf all others."[25] Mr. Antonuk's assertion that these are "current" risks[26] does not make them known, definite or measurable. In fact, it is their very uncertainty that leads Staff to propose imposing rates on AEPCO's members that produce $4.287 million in excess margins for AEPCO annually.[27] Certainly this is not a position Staff traditionally takes on the treatment of unknown, indefinite and unquantified costs/risks for ratemaking purposes.

For example, in opposing Arizona Water Company's ("AWC") request for a Distribution System Improvement Charge ("DSIC") to recover costs for system improvements *actually installed and placed in service* between rate cases, "Staff expressed concern that a DISC alters the balance of ratemaking lag by reducing lag time for recovery of depreciation and return on plant investments, to the benefit of AWC and the detriment of its

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[25] Tr., p. 247, ll. 18-20.

[26] Tr., p. 247, l. 25.

[27] Tr., pp. 248, l. 21 – 250, l. 17 (arguing the ultimate cost of addressing the environmental mandates is "speculative" and suggesting this risk justifies providing the additional revenues). Staff made no adjustment to its recommendation when the estimated cost to address the environmental mandates of EPA was reduced 85% from approximately $200 million to approximately $30 million. AEPCO-5, p. 2, ll.13-21; MEC- 2, p. 4, ll. 8-21.

ratepayers; that allowing recovery of capital improvement costs between regular rate cases results in less scrutiny of plant investments both as to prudency and the used and usefulness of the plant . . . ."[28]

In contrast, in the present case, Staff recommends AEPCO be provided $4.287 million of additional revenues (margins) each year, indefinitely, due to (1) unknown construction and operating costs related to environmental facilities, where the nature of the required facilities has not been agreed upon by EPA or ADEQ and (2) unquantified risks associated with the long-term viability of the Apache station. Staff's position is far from meeting the known and measurable standard. Nor does it meet the "in-service" standard for ratemaking treatment for new plant.

As to Staff's concerns relating to the future economic viability of the Apache assets, Staff has recommended,[29] and AEPCO has agreed to conduct a comprehensive study of the Apache units;[30] a process AEPCO's strategic resource planning group had already commenced.[31] AEPCO-7 (Exhibit GEP-11) reflects the scope of the study mutually agreed upon by Staff and AEPCO. Again, pending the outcome of the study and implementation of its recommendations, this concern is not a basis for imposing higher rates on AEPCO's members.

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[28] Decision No. 73938, p. 13, ll. 21-26. Staff ultimately supported and the Commission approved a System Improvement Benefits ("SIB") mechanism which required Commission pre-approval of SIB-eligible projects; SIB project eligibility criteria; a limit on SIB surcharge recovery to the pre-tax rate of return and depreciation expense associated with SIB-eligible projects; an "efficiency credit" of five percent; a cap on the SIB surcharge of five percent of the Phase 1 revenue requirement; separate line items on customer bills reflecting the SIB surcharge and the efficiency credit; Commission approval of the SIB surcharge prior to implementation and adjustments; a limit of five SIB surcharge filings between general rate cases; an annual true-up of the SIB surcharge; and notice to customers at least 30 days prior to SIB surcharge adjustments.

[29] S-6, p. 3.

[30] Tr., pp. 54, l. 21 – 55, l. 2.

[31] MEC-1, p. 8, ll. 1-13.

Finally, Staff, through Mr. Vickroy and Mr. Antonuk, expressed a concern that decreasing rates today will cause rate shock or at least preclude rate stability in the near term.[32] While rate shock and rate instability should be avoided, there is no evidence on this record, let alone substantial evidence, suggesting either will occur.

D. AEPCO IS ADDRESSING ITS RISKS

Rather than deprive its members and their customers of the annual $4.287 million reduction in rates today, AEPCO has chosen to address the future uncertainties facing the electric industry, and AEPCO specifically, in a number of other ways. First, as demonstrated by the significant pro forma reductions to test year operating costs, all of which Staff has accepted,[33] AEPCO has actively pursued cost saving steps and the rate reduction proposed by AEPCO passes a portion of those savings back to its members.[34]

Second, AEPCO successfully requested EPA to reconsider its original environmental haze requirements, estimated to cost more than $200 million and expects EPA or ADEQ to approve an alternative that will cost 85% less to implement, or approximately $30 million.[35]

Third, AEPCO is proposing an environmental compliance adjustment rider ("ECAR") that will allow AEPCO to adjust rates to collect known and definite costs associated with implementing the mandates ultimately imposed by EPA. AEPCO has submitted a tariff and plan of administration related to the ECAR. Mohave understands AEPCO seeks the record to remain open so Staff, AEPCO and the Intervenors can address the proposal without delaying the effective date of the new rates. Mr. Vickroy acknowledges that the ECAR "should take

[32] Tr., p. 204, ll. 2-8, p. 231, ll. 1-5, p. 252, ll. 1-10.

[33] S-1, p. 9, Table 4.

[34] Tr., p. 94, ll. 17-24.

[35] AEPCO-5, p. 2, ll. 13-21.

care of most of their [AEPCO's] increased costs" from complying with the environmental mandates.[36]

Fourth, AEPCO has implemented a rate design that collects its fixed and variable costs in a manner that closely tracks the incurrence of costs.[37] Each Class A member is responsible for paying a set monthly Fixed Charge and O&M Charges regardless of whether a single kW or kWh is taken from AEPCO.[38] Even though AEPCO proposes to decrease the overall revenue requirement, the fixed component of the rates will go up.[39] This type of rate design lessens AEPCO's financial risk.[40] Mr. Vickroy, on behalf of Staff, agrees that the "fact that rates are designed to recover fixed costs helps to ensure that the targeted returns and ratios included in the rate filings are met" [41].

E. UNCONTESTED ITEMS

To summarize various items where there is no dispute:

TY Total Revenues:	$163,624,600[42]
TY Total Op Expenses:	$148,660,479[43]
FVRB:	$261,075,032[44]
Interest & Other Deductions:	$ 9,745,481[45]

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[36] Tr., p. 241, l. 6.

[37] Tr., pp. 63, l. 13 – 66, l. 9; AEPCO-6, Exhibit GEP-10.

[38] Tr., p. 63, ll. 23-5; p. 64, ll. 5- 16.

[39] Tr., p. 66, ll. 10-12; AEPCO-6, Exhibit GEP-10, Compare Col. 1 with Col. 6.

[40] Tr., p. 66, ll. 13-16; pp. 168, l. 5 – 169, l. 3.

[41] Tr., p. 238, ll. 17-21.

[42] AEPCO-5, Exhibit GEP-4, p. 3, line 5, Col. D; Tr., p. 138, ll. 22-24.

[43] AEPCO-5, Exhibit GEP-4, p. 3, line 22, Col. D; Tr., p. 57, ll. 5-7.

[44] AEPCO-6, Exhibit GEP-9, line 34, Col. D & E; Tr., p. 57, ll. 2-4.

[45] AEPCO-6, Exhibit GEP-9, line 10, Col. D & E; Tr., p. 57, ll. 11-14.

Non-Operating Margins:	$	1,026,046[46]
Interest on Long Term Debt:	$	9,281,871[47]
Depreciation & Amortization	$	13,349,504[48]
Principal Payments:	$	9,345,853[49]
Debt Service	$	18,627,724[50]

Apache Station Study to be conducted as set forth in GEP-11.

Rate Design and PPFC Modifications as proposed by AEPCO.[51]

F. CONCLUSION

This is one of those unusual cases where the utility is voluntarily seeking to decrease its revenue requirement 2.6% overall or $4.287 million annually. Staff opposes the decrease and recommends increasing the margin component of the revenue requirement by $4.29 million citing risks which it is unable to quantify and concern over future rate shock, which, again, is based on pure speculation. Staff is asking the Commission to accept a 219% increase in a cost component (margin) to reflect out-of-period, non-quantifiable, and purely speculative events in lieu of an alternative (ECAR) proposed by AEPCO and supported by the members that avoid issues of uncertainty and speculation and that will ensure an alignment of cost and rates. It is also important for the Commission to evaluate the Staff recommendation for higher rates in the context of comments made by public witnesses who are rate payers and members of the cooperative. Mohave, and all the other members of AEPCO, join AEPCO in

[46] AEPCO-6, Exhibit GEP-9, line 12, Col. D & E; Tr., p. 57, ll. 15-19.

[47] AEPCO-6, Exhibit GEP-9, line 17, Col. D & E; Tr., p. 57, ll. 20-23.

[48] AEPCO-6, Exhibit GEP-9, line 23, Col. D & E; Tr., pp. 57, l. 24 - 58, l. 2.

[49] AEPCO-6, Exhibit GEP-9, line 28, Col. D & E; Tr., p. 58, ll. 3-5.

[50] AEPCO-6, Exhibit GEP-9, line 29, Col. D & E; Tr., p. 58, ll. 6-9.

[51] AEPCO-6, Exhibit GEP-10.

requesting the Commission approve the rate decrease, together with an ECAR that will allow AEPCO to promptly and fairly, subject to Commission oversight and approval, address environmental compliance costs, once they are known and the solution is being implemented.

DATED this 4th day of September, 2013.

CURTIS, GOODWIN, SULLIVAN,
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PROOF OF AND CERTIFICATE OF MAILING

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