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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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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

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Reply Brief of

Arizona Electric Power Cooperative, Inc.

General Rates Application

Arizona Corporation Commission
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INTRODUCTION

Utilities Division Staff claims that "now is not the time" for a revenue requirements decrease.[1] But, if a utility's attempt to pass along known and measurable operational savings to its customers can be defeated by speculation about future events and the threat that those events may cause rates to increase later, then rate decreases would never be appropriate.

Arizona Electric Power Cooperative, Inc. ("AEPCO" or the "Cooperative") urges the Commission to reject Staff's proposal because it admittedly violates one of the most basic principles of ratemaking – utilizing known and measurable information.[2] Staff's "no decrease" position is also inconsistent with the demonstrated best interests of the Cooperative's Members' retail customers. Specifically, instead of providing rate relief at a time when it is fully warranted and known and measurable, Staff's proposal would actually <u>increase</u> the rates of four of AEPCO's six Class A Members and their customers.[3]

Rather than collecting an extra $4.3 million from its Members for the next several years, AEPCO's proposal is clearly the better option: (1) set rates based on current, known facts; and (2) authorize an Environmental Compliance Adjustment Rider ("ECAR") to be used if and when it becomes necessary in order to respond to future environmental compliance requirements based on detailed cost information. Therefore, AEPCO requests that the Commission set its rates based on a debt service coverage ratio ("DSC") of 1.32, which will reduce the Cooperative's revenue requirements by 2.77%.[4]

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[1] Staff's Brief, p. 3, l. 4.
[2] *See, e.g.*, Hr. Tr., Vol. II, p. 229, ll. 10-13 (Vickroy admission that Liberty's rate recommendation is not based on known and measurable information, but on "magnitude" or "ballpark" of risk).
[3] Mohave's Opening Brief, p. 3, ll. 9-12.
[4] Mohave references the requested rate decrease as a 2.6% decrease. Mohave Opening Brief, p. 1, l. 17. This calculation differs from AEPCO's because Mohave uses total revenues, not just Class A Member revenues.

RATE IMPACT REMAINS UNKNOWN

In support of its timing argument, Staff claims that a rate decrease now is inappropriate because the EPA regional haze regulations "will require" an even larger rate increase in the near future.[5] Despite the definitive language used by Staff, the impact of the EPA's regulations on AEPCO's rates is neither as certain nor as drastic as Staff contends.

To begin with, the cost estimates associated with the EPA's regulations have changed substantially throughout the course of this rate case. When the EPA issued its ruling in December 2012, the initial estimate of the associated capital costs was $190 million.[6] In response to this initial estimate, Liberty requested additional information, including "all interim conclusions, analysis and comparison of alternatives."[7] In February 2013, AEPCO provided Liberty with that interim data, including comparisons between the $190 million FIP and the $30 million BART alternative.[8]

Significantly, Liberty did not conduct its own analysis of the potential rate impact of the EPA regulations:

> Q. [By Mr. Sullivan] Has Liberty done any independent analysis of what the rate impact will be by the environmental mitigation options that AEPCO is looking at?
>
> A. [By Mr. Vickroy] No.[9]

So, the <u>only</u> support for Staff's conclusory assumption – "clearly" AEPCO's rates will "very shortly be north of what they are today" – are the interim calculations that AEPCO provided

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[5] Staff's Brief, p. 3, l. 12 – p. 4, l. 3.
[6] Hr. Tr., Vol. II, p. 235, l. 19 – p. 236, l. 3.
[7] Hr. Tr., Vol. II, p. 216, ll. 5-18.
[8] Hr. Tr., Vol. II, p. 236, ll. 4-7.
[9] Hr. Tr., Vol. II, p. 215, ll. 14-17.

Liberty in February 2013.[10] Staff's conclusion ignores the "interim" nature of the analysis. For example, as AEPCO made clear at the rate case hearing, it is still in the process of analyzing the actual capital and O&M costs:

> Q. [By Administrative Law Judge Jibilian] You answered Mr. Hesla that you don't know what the rate impact would be if AEPCO is required to invest $30 million. Do you have a ballpark figure at all as to what that would require in additional revenues?
>
> A. [By Mr. Scott] As we are in the midst of our planning efforts, and we are still, we are still identifying our, the actual capital compliance costs and the O&M compliance costs, at this point I think it would be premature to make that, to put that in the record until we are, we are done with our analysis.[11]

Additionally, these calculations were put together prior to AEPCO's proposal of the ECAR, so they do not incorporate or reflect the potential impact of that mechanism on rates. Given that these costs and rate impact estimates were provided to Staff as "interim" calculations, before the ECAR was contemplated and remain a work in progress today, they obviously provide an inadequate basis on which to deny AEPCO's firm and well-supported revenue requirements decrease.

As to the claim that AEPCO would increase its rates fourfold in order to comply with the EPA FIP, Staff again ignores the evidence. First, in both its pre-filed and live testimony, AEPCO established a very high likelihood that the EPA will approve its BART alternative.[12] More importantly, AEPCO has never indicated that it would actually implement the $190 million option. Instead, as Trico's CEO explained, in the unlikely event the EPA would reject the BART

[10] Staff's Brief, p. 3, n. 23 and p. 4, n. 24 (citing S-10); Hr. Tr., Vol. II, p. 250, l. 18 – p. 251, l. 1 (Antonuk testimony relying on S-10).
[11] Hr. Tr., Vol. I, p. 35, l. 25 – p. 36, l. 10. *See also* Hr. Tr., Vol. I, p. 45, ll. 2-10 (O&M costs could decrease) and p. 73, l. 25 – p. 74, l. 15 (AEPCO's "back of the envelope" estimates did not consider changes in operations).
[12] AEPCO-6, p. 2, l. 12 – p. 3, l. 3; Hr. Tr., Vol. II, p. 219, l. 7 – p. 220, l. 14.

alternative, raising rates to cover $190 million in capital costs is simply not "a realistic possibility."[13] Staff's continued reliance on this outdated and irrelevant estimate seems a desperate grasp for any theory to support its otherwise unsupportable opposition to AEPCO's decrease request.

Lastly, assuming *arguendo* that a future rate increase is a foregone conclusion, it is still an increase that would occur in the future. Staff has not explained how or why charging AEPCO's Members an extra $4.3 million per year before it needs the funds is in anyone's best interest.[14] The concept of rate stability should not be used as an excuse to overcharge ratepayers now based on non-quantifiable future needs.

APACHE STATION IS NOT IN JEOPARDY

Staff's second proffered justification for opposing the decrease is a fear that Apache Station is in "jeopardy."[15] Specifically, Staff has expressed concern about the economic viability of AEPCO's coal units due to the combination of declining gas prices "over time" and reduced station output in 2011 and 2012.[16] This continued fixation on Apache Station and inexplicable doomsday assumption are curious, given the lack of any AEPCO-specific supporting evidence.

In Staff's direct testimony, Liberty initially expressed concern over what it perceived to be a downward trend in AEPCO's coal unit output.[17] In response, AEPCO conducted a thorough review of Apache Station's performance since 2000 and presented voluminous data supporting the conclusion that the coal units were not in a downward spiral and that the periods of reduced

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[13] Hr. Tr., Vol. I, p. 122, l. 7 – p. 123, l. 2.

[14] Though it's not entirely clear, Staff appears to believe that, if the BART alternative is approved, AEPCO's 1.32 DSC will be insufficient to meet AEPCO's financing obligations. Staff's Brief, p. 4, ll. 12-14 and p. 6, ll. 6-7. There is no support for this statement in the record. Rather, Mr. Pierson testified clearly and unequivocally that the 1.32 DSC would comply with AEPCO's mortgage covenants and provide the Cooperative with necessary operating reserves. Hr. Tr., Vol. I, p. 71, ll. 10-14.

[15] Staff's Brief, p. 4, ll. 17-18.

[16] Staff's Brief, p. 4, l. 19 – p. 5, l. 2.

[17] S-6.

output were linked to isolated, non-reoccurring outside influences.[18] Specifically, the reduced output in 2011 was directly connected to the scheduled expiration of AEPCO's 100 MW sales contract with Salt River Project in 2010.[19] With regard to 2012, AEPCO's delivered coal prices at that time did not yet reflect the full impact of the Cooperative's victory over the railroads before the Surface Transportation Board in late 2011. With AEPCO's energy prices still reflecting the prior years' higher coal costs, AEPCO and its Members elected to purchase from the market, which resulted in reduced output from the coal units in that year.[20]

Based on this information, AEPCO concluded that the output declines in 2011 and 2012 were not indicative of any problems intrinsic to the units. Further, in light of AEPCO's negotiation of significantly reduced coal contracts, the Cooperative projected that it would regain its competitive market position going forward. This prediction has proved quite accurate. AEPCO's current delivered coal costs are more than 20% lower than they were in 2011 – that's a clear market advantage in light of the fact that natural gas prices have been increasing since 2012.[21] As a result, AEPCO's coal-fired units are performing at a five-year high and are expected to continue to do so for at least the next several years.[22]

Having provided no substantive response to any of AEPCO's analyses, there is no basis for Staff or Liberty to continue to argue that Apache Station is in "jeopardy" or that the study will find its units not to be viable. These unsupported concerns clearly do not provide a rational basis for denial of AEPCO's decrease request.

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[18] AEPCO-2, p. 4, l. 12 – p. 5, l. 3 and attached June 13, 2013 Report, pp. 2-8.
[19] AEPCO-2, June 13, 2013 Report, p. 7.
[20] AEPCO-2, June 13, 2013 Report, p. 7.
[21] Hr. Tr., Vol. II, p. 216, l. 19 – p. 218, l. 1.
[22] AEPCO-3, p. 1, l. 22 – p. 2, l. 6. *See also* Hr. Tr., Vol. I, p. 48, l. 23 – p. 49, l. 14 (Apache Station's capacity factor increased by 20% since January 1, 2013).

ECAR STRIKES THE RIGHT BALANCE[23]

However, assuming for the sake of argument that Staff's concerns about environmental compliance costs and Apache Station's viability have any foundation, the ECAR still provides a much better mechanism to address them rather than Staff's 'blunt instrument' proposal to just hang on to an additional $4.3 million a year.

For example, Staff's Brief raises the possibility that the Apache Station study could alter AEPCO's alternative BART proposal.[24] If so, the ECAR would be the perfect mechanism to adjust rates based on the complete and accurate information developed in the study. As Mr. Stover explained, the AEPCO Board's approach with the ECAR is a much better, more appropriate solution – in terms of timing as well as known and measurable information – than Staff's proposal to leave rates higher than necessary:

> Everybody recognized that we needed to keep AEPCO solvent in terms of . . . recovery of cost. And we wanted to do it in such a fashion that also kept the rates as low as possible. So we do not do what is really being proposed here [by Staff], in that, well, we think we have got an event out in the future, we are not sure if it is a $200 million event or a $30 million event, but let's just charge our members $4.3 million more.
>
> * * *
>
> [The Board of Directors] will do what they actually have done in this proceeding and they say what is the best way to deal with that, let's have the ECAR, because <u>then we will know what our costs are and we will know all the offsetting factors.</u> **<u>That's the right time to put it in place</u>**.[25]

As to Staff's discussion of rate shock and rate gradualism, the possible impact on customers of potentially increased rates in the future has to be weighed against the undeniable

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[23] Staff's Brief unfairly characterizes AEPCO's ECAR proposal as lacking in detail and specificity. In its rebuttal testimony, AEPCO provided substantial detail about the ECAR by attaching a draft, three-page Tariff supported by a five-page Plan of Administration. AEPCO-5, Exhibits GEP-7 and GEP-8. It was Staff's, not AEPCO's, suggestion to hold off on finalizing the mechanism until next year.

[24] Staff's Brief, p. 5, ll. 6-21.

[25] Hr. Tr., Vol. II, p. 164, ll. 4-21 (emphasis supplied).

impact of deliberate overcharging. The revenue requirements decrease at issue is 2.77% and the anticipated impact on residential customer bills is a decrease of between $2 and $4 per month.[26] If the rates are reduced now and then increase later under the ECAR, customers will still have saved something. At this point, that's obviously more beneficial than no savings at all. If Staff's proposal is adopted and it turns out that AEPCO does not need some or all of that additional $4.3 million each year, then the Cooperative will have collected money from its customers that it cannot return. Weighing these interests, the ECAR is clearly the better option.

CONCLUSION

Based on the foregoing, AEPCO urges the Administrative Law Judge to recommend and the Commission to approve its requested 2.77% revenue requirements decrease based on a DSC of 1.32. This decrease, along with authorization to finalize and seek approval of the ECAR mechanism, strikes the appropriate balance between planning for AEPCO's financial future while passing along savings to its Members (and their retail customers) in a timely fashion.

RESPECTFULLY SUBMITTED this 12th day of September, 2013.

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[26] Hr. Tr., Vol. I, p. 113, l. 22 – p. 114, l. 2 (average Mohave residential customer will save $2 per month) and p. 118, ll. 3-8 (average Trico residential customer will save $4 per month).

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