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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

Docket No. E-01345A-11-0224

IN THE MATTER OF THE APPLICATION OF
 ARIZONA PUBLIC SERVICE COMPANY FOR A
 HEARING TO DETERMINE THE FAIR VALUE OF
 THE UTILITY PROPERTY OF THE COMPANY
 FOR RATEMAKING PURPOSES, TO FIX A JUST
 AND REASONABLE RATE OF RETURN
 THEREON, TO APPROVE RATE SCHEDULES
 DESIGNED TO DEVELOP SUCH RETURN.

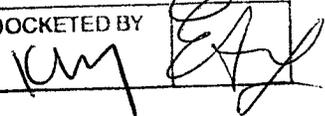
GALLAGHER & KENNEDY, P.A.
 2575 E. CAMELBACK ROAD
 PHOENIX, ARIZONA 85016-9225
 (602) 530-8000

**OPENING BRIEF OF
 ARIZONA INVESTMENT COUNCIL**

Arizona Corporation Commission

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GALLAGHER & KENNEDY, P.A.
2575 E. CAMELBACK ROAD
PHOENIX, ARIZONA 85016-9225
(602) 530-8000

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I. INTRODUCTION

The Arizona Investment Council (“AIC”) supports the December 30, 2013 Application by Arizona Public Service Company (“APS” or the “Company”) to approve a Four Corners Rate Rider in relation to its purchase of Southern California Edison’s 48% share of Units 4 and 5 of the Four Corners Power Plant (the “Acquisition”). Because APS previously held a 15% participating interest in these Four Corners units, the Acquisition increases its total share in Four Corners to 63%. The AIC recommends the Commission approve the relief requested in the Application and testimony in support—a total annual revenue requirement of \$65.44 million.¹

II. BACKGROUND

This proceeding has its roots in two prior Commission Decisions. In Decision No. 73130 (the “Acquisition Order”), the Commission authorized APS to move forward with the Acquisition, concluding it presented the Company “a genuine, unanticipated opportunity to acquire a power supply resource at a clear and significant discount...[which provides] a unique value to APS customers.” That order was quickly followed by Decision No. 73183—the Company’s 2012 Rate Case decision (the “Rate Order”). There, among other things, the parties recommended—and the Commission approved—a four-year rate case stay-out provision.

However, as important to rate stability over four years were the Settlement Agreement and Rate Order provisions assuring no rate jolt would wait customers at the end of the moratorium. To accomplish both objectives, the Commission held the rate case record open and approved the filing of this Application authorizing APS:

¹ AIC takes no position on the issue of how the rider should apply to customers receiving service on the AG-1 rate.

1 [T]o reflect in rates the rate base and expense effects associated with the
2 acquisition of SCE's share of Units 4 and 5, the rate base and expense effects
3 associated with the retirement of Units 1-3, and any cost deferral authorized in
4 Docket No. E-01345A-10-0474.²

5 Only Commission approval of the Company's request for a weighted average cost of
6 capital ("WACC") of 8.33% will satisfy the Rate Order's twin objectives of rate stability, but, as
7 importantly, no rate jolt waiting for APS' customers at the end of the moratorium.

8 Mr. Guldner discussed the issue at hearing:

9 Q. [By Mr. Grant] Could you summarize why use of the weighted average
10 cost of capital here as proposed by APS does allow the rate base and
11 expense effects of the transaction to be appropriately recognized?

12 A. [T]he cost of capital means there's a cost to making that investment. That
13 consists of a debt cost, if you're partially debt financed, which we are, and
14 an equity cost to the extent you're financed with a portion of equity. The
15 weighted average cost of capital that's reflected in the last rate case is the
16 most recent balance of debt and equity costs. If you under reflect that in
17 an asset that you rate-base, you're going to under recover the true cost of
18 capital that's being incurred to support that asset.³

19 Approval of either Staff's suggestion to use the same rate of return mentioned in
20 Section 5.3 of the Settlement Agreement or the RUCO position to use the cost of a recent APS
21 debt issuance will not allow the Company to recognize the "rate base and expense effects" of the
22 Acquisition. As former Commissioner Mike Gleason often noted, the Staff and RUCO positions
23 will "simply kick the can down the road."

24 Those positions will increase the Acquisition's impact on customers in the next case—
precisely the result the parties and Commission sought to avoid in holding open that rate case for
this adjustment. From an investors' standpoint, equally important is the signal approval of APS'

² Section 10.2, p. 15, Settlement Agreement approved in Decision No. 73183 (emphasis supplied).

³ HR TR, p. 145, l. 16-p. 146, l. 4.

1 Application and the requested WACC continues to send to the investment community about the
2 Commission's balanced and constructive regulatory approach.

3 III. ARGUMENT

4 A. APS' Application to acquire Four Corners Units 4 and 5 should be approved.

5 Although there is a disagreement among the Company, Staff, RUCO and AIC as to the
6 precise level of rate relief APS should be granted, there is no disagreement among these parties
7 that the Application to acquire Units 4 and 5 should be approved. The sole outlier on that subject
8 is the Sierra Club.

9 It recommends "the Commission deny APS's petition at this time and direct the
10 Company to re-file its request with a revised analysis."⁴ In response, AIC President Gary
11 Yaquinto stated:

12 Given the Sierra Club's opposition to coal-fired generating resources in general, I
13 was not surprised it would oppose APS' Acquisition of Southern California
14 Edison's interest in the coal-fired Four Corners Plant...I note, however, Company
15 witness James Wilde's discussion on this subject...[H]e states that Sierra Club
16 criticisms of the ratepayer benefits which will flow from the transaction are
17 unfounded and points out that ACC Staff's consultant agrees the Four Corners
18 acquisition does, in fact, provide significant benefits to customers.⁵

16 At hearing, the Staff consultant, James Letzelter, elaborated on his seven findings—ranging from
17 the facts that the additional capacity is "used and useful" through "ancillary benefits add to
18 customer positives"—as to why the APS Acquisition is, in fact, prudent:

19 [W]e looked at, some of the risks beyond pure economics of the acquisition that
20 could be calculated analytically...and we felt comfortable that, for example, in
21 that risk that the company had plans to mitigate any such risk.

21 So clearly with such a large valuation on the positive impacts of this transaction,
22 there were no major nonfinancial risks that could offset that great [\$315.5 million]
23 potential benefit.

23 ⁴ Hausman Testimony, SC-1, p. 42, ll. 19-20.

24 ⁵ AIC-2, p. 2, l. 14-p. 3, l. 5.

1 Q. [By Mr. Grant] And I think you just indicated this, but that also would
2 include environmental risk?

3 A. Yes.⁶

4 The Sierra Club just recycles here many of the same arguments it raised and lost in the
5 docket in which the Commission approved the Four Corners Acquisition in Decision No. 73130.
6 Nothing has changed to alter the Commission's finding there that:

7 [R]etiring the older, "dirtier" plants early and acquiring an interest in the more
8 efficient [Units 4 and 5]... provides unique value to [APS] customers, both from
an environmental and rate impact standpoint.⁷

9 B. The Commission should approve APS' request that the Acquisition assets receive
10 the same 8.33% WACC rate treatment which all other APS assets received in the
Rate Order.

11 The central issue in this case is the correct rate of return to be applied to Units 4 and 5.
12 Briefly to recount, APS and AIC's positions are that this docket was held open for the express
13 purpose of allowing the Company to reflect in rates the "rate base and expense effects of
14 acquiring Units 4 and 5." Only use of the rate case's 8.33% WACC complies with that directive.

15 AIC President Gary Yaquinto explained why:

16 APS witness Snook, in his rebuttal testimony, provides the mathematical basis for
17 calculating the proper return on the Units 4 and 5 assets in his critique of the
18 analyses performed by Staff and RUCO. Mr. Snook correctly calculates the
19 return as if the addition of Units 4 and 5 was part of the original rate case, which
20 was, in fact, held open in Decision No. 73183 for the express purpose of rate-
basing these assets once the transaction was completed. As Mr. Snook points out,
21 the weighted cost of capital of 8.33% found in Decision No. 73183 is the correct
22 value to apply to Units 4 and 5's original cost rate base, just as it was utilized in
the rate case for the Company's total original cost rate base. In contrast, the Staff
analysis simply applies the fair value rate of return of 6.09 percent determined in
Decision No. 73183 to the original cost rate base value of Units 4 and 5. This is
incorrect, because the fair value rate of return used by Staff reflects a blended
rate, which combines the weighted cost of capital of 8.33 percent on OCRB with

23 ⁶ HR TR, p. 597, ll. 22-23-p. 598, l. 9.

24 ⁷ Decision No. 73130, p. 32, ll. 4-6.

1 the much lower return rate of 1 percent on the “incremental fair value rate base,”
2 which is a proxy measure of the replacement value for the assets to arrive at
3 FVROR. [If APS had included the 1% FVRB increment] it would have added
4 approximately \$4 million more to the revenue requirement. (Emphasis supplied.)⁸

5 As for RUCO, its position to use the costs of a recent debt issuance to measure the
6 appropriate rate of return to be applied here is similarly flawed. It results in an “egregious
7 misuse of proper ratemaking methods...to preclude the Company from earning the return on its
8 investment to which it’s entitled in the rate case.”⁹ Among other flaws, it would not allow APS
9 to recover its cost of capital as recommended by RUCO.

10 At hearing, RUCO witness Mease agreed he could not recall RUCO ever taking a
11 position on a fair value rate of return that—as its position would here—did not allow a company
12 to recover the cost of capital also recommended by RUCO.¹⁰ He attempted to distinguish this
13 case by calling it “unique.” The only thing which would make it unique, however, would be for
14 APS to earn a different return on its pre-existing 15% Four Corners ownership than the return
15 allowed on the additional 48% of the Four Corners Units 4 and 5 involved here as both Staff and
16 RUCO suggest.

17 IV. CONCLUSION

18 The Settlement Agreement’s terms, Decision No. 73183, the filed testimony and this
19 record confirm the reasonableness and appropriateness of applying APS’ 8.33% WACC to the
20 Acquisition assets. That’s the same return accorded all other APS assets in the Rate Case. It was
21 held open for the purposes of sustaining the Company’s financial viability over an unprecedented
22 four-year rate stay-out and easing consumer impact when the next case is filed. Further, the total

23 ⁸ AIC-2, p. 4, l. 16–p. 5, l. 19.

⁹ Yaquinto Surrebuttal, *Id.* at p. 6, ll. 4-7 (emphasis in original).

¹⁰ HR TR, p. 574, ll. 9-12.

1 annual relief sought is consistent with—although less than—the \$70 million result estimated by
2 these parties and discussed by the Commission in the 2012 Rate Order.¹¹

3 The Utilities Division Director summarized it this way in his testimony supporting the
4 Settlement Agreement:

5 I need to keep APS healthy in order for the customers to benefit. Because the
6 way I always look at any ratemaking is, my job is to look out for customers, and I
7 do that by making sure that APS is healthy, so that when the customer flips that
8 light switch, that light comes on.¹²

8 APS' request for this Four Corners rate adjustment should be approved.

9 RESPECTFULLY SUBMITTED this 29th day of August, 2014.

10 GALLAGHER & KENNEDY, P.A.

11

12

By 

13

Michael M. Grant
Jennifer A. Cranston
2575 East Camelback Road
Phoenix, Arizona 85016-9225
Attorneys for Arizona Investment Council

14

15

16 **Original and 13 copies** filed this
17 29th day of August, 2014, with:

17

18 Docket Control
19 Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

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¹¹ Decision No. 73183, p. 25.

¹² Settlement Hearing Transcript at p. 1062.

24

1 **Copy** of the foregoing delivered this
29th day of August, 2014, to:

2
3 Lyn A. Farmer
4 Chief Administrative Law Judge
5 Arizona Corporation Commission
6 1200 West Washington Street
7 Phoenix, Arizona 85007

8 **Copies** of the foregoing mailed
9 this 29th day of August, 2014, to:

10 Meghan H. Grabel
11 Thomas L. Mumaw
12 Pinnacle West Capital Corporation
13 P.O. Box 53999, MS 8695
14 Phoenix, Arizona 85072-3999

15 C. Webb Crockett
16 Patrick J. Black
17 Fennemore Craig, P.C.
18 2394 East Camelback Road, Suite 600
19 Phoenix, Arizona 85016-9077
20 Attorneys for Freeport-McMoRan
21 Copper & Gold, Inc. and Arizonans
22 for Electric Choice and Competition

23 Daniel Pozefsky
24 Residential Utility Consumer Office
1110 West Washington Street, Suite 220
Phoenix, Arizona 85007

Michael A. Curtis
William P. Sullivan
Melissa A. Parham
Curtis, Goodwin, Sullivan,
Udall & Schwab, P.L.C.
501 East Thomas Road
Phoenix, Arizona 85012-3205
Attorneys for the Town of Wickenburg
and Town of Gilbert

Barbara Wyllie-Pecora
14410 West Gunsight Drive
Sun City West, Arizona 85375

Timothy M. Hogan
Arizona Center for Law
in the Public Interest
202 East McDowell Road, Suite 153
Phoenix, Arizona 85004
Attorneys for Western Resource Advocates,
Southwest Energy Efficiency Project
and ASBA/AASBO; Local Counsel for
Sierra Club Environmental Law Program

David Berry
Western Resource Advocates
P.O. Box 1064
Scottsdale, Arizona 85252-1064

Jeff Schlegel, Arizona Representative
Southwest Energy Efficiency Project
1167 West Samalayuca Drive
Tucson, Arizona 85704-3224

Kurt J. Boehm
Jody M. Kyler
Boehm, Kurtz & Lowry
36 East Seventh Street, Suite 1510
Cincinnati, Ohio 45202-4454
Attorneys for Kroger Co.

1 Jeffrey W. Crockett
Brownstein Hyatt Farber Schreck, LLP
2 One East Washington Street, Suite 2400
Phoenix, Arizona 85004
3 Attorneys for Arizona Association
of Realtors

4 John William Moore, Jr.
5 7321 North 16th Street
Phoenix, Arizona 85020
6 Attorneys for Kroger Co.

7 Cynthia Zwick
1940 East Luke Avenue
8 Phoenix, Arizona 85016

9 Michael W. Patten
Roshka DeWulf & Patten, PLC
10 One Arizona Center
400 East Van Buren, Suite 800
11 Phoenix, Arizona 85004-2262
Attorneys for Tucson Electric Power

12 Bradley S. Carroll
13 Tucson Electric Power Company
88 East Broadway Boulevard, HQE910
14 Tucson, Arizona 85701-1720

15 Greg Patterson
Munger Chadwick
16 2398 East Camelback Road, Suite 240
Phoenix, Arizona 85016
17 Attorneys for Arizona Competitive
Power Alliance

18 Karen S. White, Staff Attorney
19 Samuel T. Miller
USAF Utility Law Field Support Center
20 139 Barnes Avenue, Suite 1
Tyndall AFB, Florida 32403

Nicholas J. Enoch
Lubin & Enoch, P.C.
349 North Fourth Avenue
Phoenix, Arizona 85003
Attorneys for IBEW
Locals 387, 640 & 769

Jay I. Moyes
Steve Wene
Moyes Sellers & Hendricks
1850 North Central Avenue, Suite 1100
Phoenix, Arizona 85004
Attorneys for AzAg Group

Jeffrey J. Woner
K.R. Saline & Assoc., PLC
160 North Pasadena, Suite 101
Mesa, Arizona 85201

Craig A. Marks
Craig A. Marks, PLC
10645 North Tatum Boulevard, Suite 200-676
Phoenix, Arizona 85028
Attorneys for AARP

Scott S. Wakefield
Ridenour, Hinton & Lewis, P.L.L.C.
201 North Central Avenue, Suite 3300
Phoenix, Arizona 85004-1052
Attorneys for Wal-Mart Stores, Inc.
and Sam's West, Inc.

Steve W. Chriss
Senior Manager, Energy Regulatory Analysis
Wal-Mart Stores, Inc.
2011 Southeast 10th Street
Bentonville, Arkansas 72716-0550

Lawrence V. Robertson, Jr.
P.O. Box 1448
Tubac, Arizona 85646
Attorneys for SWPG/Bowie and
Noble/Constellation/Direct/Shell

1 Laura E. Sanchez
Natural Resources Defense Council
2 P.O. Box 65623
Albuquerque, New Mexico 87193

3 Jody Kyler
4 36 East Seventh Street, Suite 1510
Cincinnati, Ohio 45202

5 Douglas Fant
6 Suite A - 109, PMB 411
3655 West Anthem Way
7 Anthem, Arizona 85086

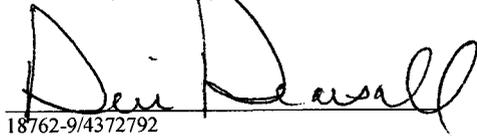
8 Nellis Kennedy-Howard
Travis Ritchie
9 Sierra Club Environmental Law Program
85 Second Street, 2nd Floor
10 San Francisco, California 94105
Attorneys for Sierra Club Environmental
11 Law Program

12 Janice Alward
Legal Division
13 Arizona Corporation Commission
1200 West Washington Street
14 Phoenix, Arizona 85007

15 Steve Olea, Director
Utilities Division
16 Arizona Corporation Commission
1200 West Washington Street
17 Phoenix, Arizona 85007

18

19


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22

23

24