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BEFORE THE ARIZONA CORPORATION COMMISSION

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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, AND TO APPROVE RATE  
SCHEDULES DESIGNED TO DEVELOP  
SUCH RETURN.

Arizona Corporation Commission  
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**RUCO'S CLOSING BRIEF**

The RESIDENTIAL UTILITY CONSUMER OFFICE ("RUCO") submits its Closing Brief in the above matter.

**INTRODUCTION**

This matter involves Arizona Public Service ("APS") request to recover \$65.43 million annual revenue requirement for its Four Corners Acquisition ("FCA").<sup>1</sup> Application at 2. Specifically, there are two disputed issues that concern RUCO. First, the issue of what is the appropriate return to apply to the ratebase increase resulting from the FCA. Second, what is

<sup>1</sup> For ease of reference, trial exhibits will be identified similar to their identification in the Transcript of Proceedings. The transcript volume number will identify references to the transcript.

1 the best way to address the Four Corners Rate Rider's applicability to the customers served  
2 under the AG-1 Rate Schedule?

3 **1. THE COMMISSION SHOULD APPLY THE COST OF DEBT TO THE FOUR**  
4 **CORNERS' RATEBASE INCREASE**

5 Like everything in regulation, each case is different and the Commission needs to  
6 consider the circumstances of each case. Here, the situation is unique in that the Commission  
7 held the underlying rate case open pending the Four Corner's acquisition to include the costs  
8 associated with that acquisition. In the interim, the parties to the rate case entered into a  
9 settlement ("Settlement") which the Company seems to suggest affects the Commission's  
10 decision going forward regarding the appropriate cost of capital to be applied to the Four  
11 Corner's assets.

12 APS takes the position that the weighted average cost of capital ("WACC" or "full" cost  
13 of capital) should be applied to the rate base increase<sup>2</sup>. S-20. Applying the 8.33 percent  
14 WACC results in an annual revenue increase of \$65.43 million. RUCO-4 Executive Summary.  
15 RUCO's recommendation to apply the Company's documented cost of debt of 4.75 percent  
16 results in a revenue increase of \$49.20 million. RUCO-4 at 6, RUCO-5 - Executive Summary.  
17 Whereas, Staff is recommending the Commission apply the Company's Fair Value Rate of  
18 Return ("FVROR") of 6.09 percent which will result in a revenue increase of \$57.05 million. S-3  
19 at 12-13. Guiding this issue, is the Commission's directive in Decision No. 73130 (the Four  
20 Corner's Order) that the "goal" of APS in the way it manages the acquisition of Four Corners  
21 is to minimize the rate impact to its customers. Decision No. 73130 at 37. Of the three

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23  
24 <sup>2</sup> Unless otherwise stated ratebase increase refers to the ratebase increase resulting from the FCA.

1 alternatives, merits aside, without question, RUCO's proposal is closest to the Commission's  
2 stated goal – APS' proposal is the farthest.

3 Moreover, RUCO's proposal is supported by the unique circumstances of this case  
4 which the Commission, in its Four Corners Order recognized as a paramount concern.

5 We find that APS' request for an accounting order should be  
6 granted. As discussed herein, *APS has identified with the proposed*  
7 *transaction and Staff and RUCO agree that circumstances warrant a*  
*variation from the usual ratemaking treatment of plant acquired*  
*between rate cases.* Decision No. 73130 at 36. (Emphasis Added)

8 The Commission, in recognition of the unique circumstances of the case allowed  
9 deferral of the "non-fuel" costs at the documented debt cost. Id. At 37. The Commission  
10 rejected APS' request for an accounting order that includes capital carrying charges. Id. APS  
11 argued that the Commission never has chosen to completely disallow cost of capital in a  
12 deferral authorization. Decision No. 73130 at 37. APS continues to argue that the  
13 Commission does not authorize anything but the full cost of capital to ratebase elements. See  
14 for example, Transcript at 93, 111.

15 RUCO does not take issue with APS' assertion that the Commission normally provides  
16 full cost of capital treatment for ratebase additions - but this case is not normal. The  
17 Commission itself recognized the need for unusual ratemaking treatment in this case when it  
18 considered the deferral order. What has changed? If anything, this case has become even  
19 more unique. Consider the test year – 2010. We are now more removed from the test year  
20 than we were when the Commission considered the Accounting Order. Staff makes a valid  
21 point in its cross examination of the Company's witness on this issue, Mr. Leland Snook. Staff  
22 ascertained that the Company's proposal updated the fair value rate base only but not the cost  
23 of capital since the rate case. Transcript at 397-412. APS' use of the WACC will result in a  
24

1 different FVROR than was authorized by the Commission in the rate case. Transcript at 412.

2 Mr. Snook testified, among other things

3           You know, the more you start to change -- the settlement  
4           was clear that this was not to be a brand new rate case, and  
5           where do you, where do you draw the line? It starts to feel like  
6           the more elements you start to change, it becomes a brand  
7           new rate case, and you're relitigating issues that we thought we  
8           had resolved in the settlement. Transcript at 410.

9           **"Where do you draw the line?"** Not surprisingly, **APS** draws it in a manner that  
10          provides it with the greatest amount of revenue -- clearly sidestepping the  
11          Commission's directive to "minimize the rate impact to its customers." Mr. Snook's  
12          testimony shows the arbitrary nature of APS' proposal. Staff's point calls into question the  
13          disparity of application in APS' proposal. While one could argue that RUCO's proposal has an  
14          element of arbitrariness, RUCO's proposal is consistent with the debt cost treatment in the  
15          accounting order as well as the goal of keeping the impact to a minimum. The Commission  
16          should adopt RUCO's proposed treatment.

17          The unique nature of this case is further highlighted by the fact that the total amount of  
18          the rate base increase is acquisition premium. APS witness, Elizabeth Blankenship testified  
19          that the total amount of the acquisition premium is \$252 million and the ratebase increase is  
20          \$225,934,000. Transcript at 450. Acquisition premium usually refers to the total amount of  
21          money the Company pays above the book value. The Commission has typically not allowed  
22          acquisition premiums except in extraordinary situations. Transcript at 563. Moreover, APS  
23          only paid the cost of its debt for this acquisition premium. Transcript at 568. Why should  
24          ratepayers have to pay more than what the Company paid for an acquisition premium?

          The Company suggests that they are entitled to recover the entire cost of capital  
          because of the provisions of the Settlement Agreement -- Section 10.2 specifically. APS-1 at

1 4-5. But nowhere in the Settlement, as the Company readily admits, was there language or a  
2 number that defined what cost of capital would be attributable to the ratebase increase.  
3 Transcript at 94-97. The Settlement is clear - it says in relevant part, that the Company may  
4 (not will, has to, etc.) within 10 business days after the closing date file an application seeking  
5 to reflect in rates the rate base and expense effects associated with the acquisition and  
6 decommissioning of units 1, 2, and 3. APS-1 at 4. The issue of what return to apply to the  
7 ratebase increase in this case is not an interpretation of the Settlement since the Settlement is  
8 undisputedly quiet on the issue.

9 While the Company admits that the Settlement does not specify what return will be  
10 applied to the ratebase increase, APS' witness, Jeff Guldner testified that it was his  
11 "presumption" that the Company would earn its full cost of capital on the increase. Mr.  
12 Guldner's presumption is based on how the Commission traditionally has handled ratebase  
13 and how other states do it. Transcript at 97. Upon reflection, however, the presumption as  
14 well as its basis, is simply misplaced. The hearing on the APS rate case took place after the  
15 Four Corners application. Transcript at 88-90. In the Four Corners matter, Staff agreed that  
16 the circumstances warranted an accounting order, but thought that it was premature to  
17 address the cost of capital issues. Decision No. 73130 at 35. APS argued that it should be  
18 awarded full cost of capital treatment on the deferral based on the same argument that it  
19 makes now - that this is how the Commission normally does it and that this is how other  
20 regulatory commissions always do it. Id. At 36. Staff argued that APS' arguments are  
21 situation specific and did not provide guidance in that case (the deferral case).

22 Likewise, RUCO initially opposed an accounting order but changed its position. RUCO  
23 also opposed APS' request to earn a return on the deferred accounts. Decision No. 73130 at  
24 36. In other words, APS was surely on notice from the Four Corners case that other parties,

1 including Staff and RUCO, recognized that the situation was unique and were not supportive of  
2 cost of capital treatment. Ultimately, the Commission did authorize only the documented debt  
3 cost on the acquisition costs and did not authorize any carrying charges on any deferred costs.  
4 Id. At 37. Either the Company is oblivious to the fact that this is not the "normal" set of  
5 circumstances, chooses to simply not accept the fact that the situation is unique, or thinks that it  
6 simply does not matter – it is entitled to it.

7 And as stated above, these unique circumstances, if anything, have changed in ways  
8 that make the Company's position even less tenable - we are now further away from the test  
9 year, and the Commission itself has recognized the uniqueness in the circumstances by only  
10 approving the debt cost to the non-fuel costs in the deferral order. There is no support at this  
11 point to award the Company the full cost of capital it seeks.

12 Finally, nobody is requesting that the return the Commission approves in this rate case  
13 moving forward will extend beyond the next rate case. It will remain in effect until the next rate  
14 case. At that point it will all be rolled into the ratebase in the next rate case and subject to the  
15 same ratebase treatment at the then approved rate. The Commission should continue to  
16 provide cost of debt treatment up through the next rate case and reject the Company's  
17 proposal.

## 18 **2. THE COMMISSION SHOULD APPLY RUCO'S PROPOSED AG-1 RATE RIDER** 19 **ALLOCATION**

20 RUCO and APS are for the most part aligned on this issue. The only difference in the  
21 two positions is that RUCO believes that the reserve capacity charges associated with the  
22 Four Corners Acquisition ("FCA") charge should be assessed on the reserve capacity charges  
23 included in the AG-1 Rate Rider. Both RUCO and APS propose that the FCA costs should be  
24 applied to the non-generation costs of the AG-1 bill which amounts to approximately 30

1 percent of the AG-1 bill. RUCO-3 at 4. The main dispute here concerns the position of  
2 Arizonans for Electric Choice and Competition ("AECC") and Walmart who have recommended  
3 the expansion of the definition of "generation" in such a way to effectively exclude all AG-1  
4 customers from the entirety of the FCA costs.

5 Part five of Section 10.3 of the Settlement states that "an adjustment rider that recovers  
6 the rate base and non-PSA related expenses associated with any Four Corners acquisition on  
7 an equal percentage basis across all rate schedules which shall not become effective before  
8 July 1, 2013." Id. At 3. Attachment J to that part of the Settlement excludes generation  
9 charges from charges associated with their underlying retail rate schedule. RUCO-3 at 6.  
10 Decision No. 73183, Settlement, Attachment J page 4 of 5. The same Attachment includes  
11 among Schedule AG-1 charges a monthly reserve capacity charge. Decision No. 73183,  
12 Settlement, Attachment J page 4 of 5.

13 AECC and Walmart improperly expand the definition of generation charges to include  
14 the non-generation related charges that the FCA applies to, effectively excluding AG-1  
15 customers from any FCA charges. RUCO disagrees with AECC and Walmart's approach and  
16 believes it conflicts directly with Section 10.3 Section 5. That section of the Settlement was  
17 clear – a rider that would spread the FCA costs on an equal basis across all rate schedules.  
18 Moreover, the monthly reserve capacity charge is an explicit generation charge with ties to the  
19 Four Corners plant. Why would the FCA not apply to that charge? Expanding the definition of  
20 generation charges to exclude AG-1 customers from any of the FCA charges directly conflicts  
21 with Section 10.3 of the Settlement.

22 It also violates the understanding of all of the parties to the Settlement that the  
23 experimental AG-1 rate design would "...insulate all other customers from any cost shift."  
24 Decision No. 73183. There is no question that if the AG-1 customers are excluded,

1 ratepayers' rates in the other classes will go up – AECC's witness Mr. Higgen's testified that  
2 ratepayers' rates will go up; Walmart's witness, Steve Chris evaded the question. Transcript at  
3 181, and 206-208.

4 Why should the residential ratepayer now pay more for an experimental rate which will  
5 allow certain large customers to purchase their generation elsewhere? This sounds more  
6 egregious when one considers that AG-1 customers will benefit from the FCA. The AG-1 rate  
7 is an experimental, temporary rate limited to four years. Decision No. 73183 at 30. No one  
8 knows if the rate will continue after the designated time period or what will happen. The rate is  
9 set to terminate at the end of the four year period and large customers will be back to their  
10 standard rate. These same customers will then enjoy the lower rates that will result from the  
11 FCA. In fact, even if the AG-1 rate continues, AG-1 customers may decide to jump off that rate  
12 if the economics of full service from APS are more favorable. Transcript at 223-224. Due to  
13 this ability for customers to switch, APS cannot plan for a leaner system to serve less load.  
14 APS must invest in a system that can accommodate all ratepayers. This is not free. Just like a  
15 solar customer that is still connected to the grid, AG-1 customers are still connected to the  
16 system. Therefore, the cost of system investments like Four Corners must be covered.

17 Partly as a consequence of ignoring long term system planning, AECC and Walmart  
18 make the argument that they are not paying for the retired units of Four Corners and therefore  
19 they should not pay for the newly acquired units. Transcript at 200. RUCO would argue that  
20 this was not a purposeful omission. Rather it is a function of not carrying over the proper cost  
21 categories from a regulated space to a somewhat imaginary competitive space. As Jeff  
22 Guldner touched upon, there is no long-term reliability infrastructure charge on an AG-1  
23 customer's bill. Transcript at 58. There is the shorter term reserve capacity charge but nothing  
24 that accounts for the long-term investment needed to accommodate customers that can switch

1 between APS and competitive suppliers. Transcript at 59. The traditional system has no such  
2 breakdown of this specific charge because it is bundled with generation related charges for  
3 simplicity because no customer could jump in and out of APS service while remaining in the  
4 service territory. Transcript at 60. Therefore, Four Corners represents to AG-1 customers a  
5 form of reliability infrastructure which clearly does not fit in the definition of "generation  
6 charges" in attachment J.

7 Finally, AECC and Walmart's broad definition of generation is misplaced. There is no  
8 definition of generation in the Settlement or any of the attachments. Attachment J which  
9 covers the exemptions does not say that AG-1 customers will be exempted from the  
10 acquisition costs of the generation related assets. RUCO-3 at 6. There obviously is a  
11 distinction – buying fuel pursuant to a purchase power agreement is a generation cost –  
12 decommissioning Units 1, 2 and 3 of Four Corners is not a generation cost – it's an acquisition  
13 cost. Under AECC and Walmart's perspective, one can argue that everything is tied into  
14 generation (which appears to be the argument here) and therefore is a generation cost. But in  
15 the absence of a specific definition the Commission needs to take a common sense approach.  
16 Moreover, the exception needs to be read in the context of the other provisions of the  
17 Settlement – specifically section 10.3(5). It is highly unlikely that any signatory meant to  
18 render section 10.3(5) meaningless by excluding AG-1 customers from FCA costs. The whole  
19 point of 10.3(5) and the Settlement for that matter on the issue of AG-1 was to hold other  
20 classes harmless – why should they pay more for an experiment which allows large users to  
21 obtain their generation elsewhere? Moreover, APS is only applying those costs to services  
22 relating to the customer's underlying rate schedule not the larger pass through portion of the  
23 bill. Id. The Commission should reject the recommendations of AECC and Walmart.



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