



BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

ORIGINAL

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.

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Arizona Corporation Commission

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**POST-HEARING REPLY BRIEF  
 OF  
 ARIZONA PUBLIC SERVICE COMPANY  
 ON  
 THE FOUR CORNERS RATE RIDER**

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1 **I. INTRODUCTION.**

2 The initial post-hearing briefs of Staff and Intervenors largely repeat the same  
3 arguments offered at hearing. Still lacking is any persuasive explanation as to why it is  
4 appropriate to apply Arizona Public Service Company's ("APS" or "Company") Weighted  
5 Average Cost of Capital ("WACC") to every APS rate base asset in Decision No. 73183  
6 (May 24, 2012), including the Company's pre-existing share of Four Corners Units 4 and 5,  
7 but not to the additional 48% of *the same two units* acquired by APS from Southern  
8 California Edison Company ("Four Corners Acquisition"). And there is still no explanation  
9 of why recovery in rates of the Company's WACC is not a "rate base" or "expense effect"  
10 of the Four Corners Acquisition as described in Decision No 73183 and Paragraph 10.3 of  
11 the 2012 Settlement.

12 Regarding the prudence of the Four Corners transaction, Intervenor Sierra Club  
13 continues to ignore the conclusions of Staff Witness Letzelter, who concluded through  
14 independent analysis that there is a 99.4% probability of the Four Corners Acquisition  
15 economically benefiting APS customers. (*See Letzelter, Tr. at 588:5-15; 596:19-597:12;*  
16 *and Staff Exh. 19.*)

17 And regarding AG-1, Arizonans for Electric Choice and Competition, et al. ("AECC,  
18 et al.") continue to find intent to exclude AG-1 customers entirely from the Four Corners  
19 Rate Rider because "generation" charges are excluded on page 4 of the AG-1 Rate Rider,  
20 ignoring the more pertinent settlement clause requiring that the Four Corners Rate Rider be  
21 applied to all customers on an equal percentage basis (not to "all customers but AG-1").  
22 (*See Paragraph 10.3 of the 2012 Settlement Agreement.*) As in its Initial Post-Hearing Brief,  
23 APS will endeavor to avoid repetition of arguments now familiar to the Commission.

24 The limited new arguments that the parties' initial post-hearing briefs present are as  
25 follows:

- 26 (1) Staff's argument that the Company's approach to determining fair value  
27 rate of return ("FVROR") in this proceeding is contrary to *Chaparral*  
28

1 *City Water Company v. Arizona Corporation Commission*, 1 CA-CC  
05-0002 (Ariz. App. 2007) (mem. decision)<sup>1</sup>;

2 (2) Staff's argument that Decision No. 71914 ("Black Mountain Decision")  
3 supports Staff's position on FVROR<sup>2</sup>; and,

4 (3) ASBA/AASBO's<sup>3</sup> argument that this entire proceeding is a violation of  
5 the Court of Appeals' holding in *Scates v. Arizona Corporation*  
6 *Commission*, 118 Ariz. 531, 578 P.2d 612 (App. 1978).<sup>4</sup>

7 **II. THE FAIR VALUE RATE OF RETURN ON THE FOUR CORNERS**  
8 **ACQUISITION SHOULD ALLOW RECOVERY OF APS'S WACC.**

9 Before addressing the new arguments raised by Staff and Intervenor ASBA/AASBO  
10 in their initial post-hearing briefs, APS would like to dispel the notion that somehow the  
11 Company's requested Four Corners Rate Rider was contrary to the expectations of the  
12 parties to the 2012 Settlement. (See Staff Initial Brief at 12-14.) In fact, Staff's settlement-  
13 related expectations relative to the Four Corners Rate Rider were stated at page 25 of  
14 Decision No. 73183. There, Staff indicated that "the non-fuel annual revenue requirement  
15 associated with the Four Corners transaction amounts to approximately \$70 million  
16 annually." There is simply no way the annual revenue requirement associated with the Four  
17 Corners Acquisition could be anywhere close to \$70 million unless the WACC was to be  
18 used in developing that revenue requirement.

19 Similarly, Staff's Initial Post-Hearing Brief contends that Section X of the 2012  
20 Settlement represents a "tremendous benefit to APS" and somehow suggests that this is a  
21 reason not to permit APS an opportunity to recover its WACC on the Four Corners  
22 Acquisition. (See Staff Initial Brief at 15.) Section X is beneficial to APS, just as the Four  
23 Corners Acquisition is *a tremendous benefit to APS customers*. The relative benefits are  
24 beside the point. Beneficial or not, Section X was part of the same Settlement that  
25 determined the Company's WACC was 8.33% and that APS should earn 1% on the Fair  
26 Value Increment. Any effect of Section X on either of these components of FVROR was

27 <sup>1</sup> Staff Initial Brief at 16.

<sup>2</sup> Staff Initial Brief at 18.

<sup>3</sup> Arizona School Boards Association and Arizona Association of School Business Officials

<sup>4</sup> ASBA/AASBO Initial Brief at 3-5.

1 already reflected in the 2012 Settlement and Decision No. 73183. There is no reason now  
2 for Staff to suggest a second bite at the apple on either the 8.33% WACC or the 1% return  
3 on the Fair Value Increment simply because the provision in question benefits APS.

4 **A. APS's Position on FVROR Does Not Violate *Chaparral City* and**  
5 **Is Fully Consistent with the Court's Holding in That Case.**

6 As the Commission is aware, the court in *Chaparral City* did not reject the  
7 underlying finding of FVROR because it was formulaic. Indeed, many aspects of  
8 ratemaking are formulaic, such as the WACC, the revenue conversion factor, rate  
9 adjustment mechanisms, etc. Instead, the Court rejected the Commission's FVROR finding  
10 in that case because it was a "*superfluous mathematical exercise*" (emphasis supplied) that  
11 gave no weight to FVRB. (*Chaparral City* at 7 – 8 and 28.) The court criticized the  
12 Commission for simply taking the Original Cost Rate Base ("OCRB") times the WACC  
13 and divided it by FVRB. In other words, the Commission had determined FVROR in  
14 accordance with the formula described by APS Witness Snook, *except that the Fair Value*  
15 *Increment was given no return.*

$$16 \quad \text{FVROR} = \frac{[(\text{WACC} \times \text{Original Cost Rate Base}) + (0\% \times \text{Fair Value Increment})]}{\text{Fair Value Rate Base}}$$

17 (See Rebuttal Testimony of Leland Snook, APS Exhibit No. 5, at 3.) And it was because  
18 the Commission gave the Fair Value Increment no return that the court deemed the rate  
19 treatment of the FVROR to be a "*superfluous mathematical exercise.*" (*Id.*)

20 The Commission's response to *Chaparral City* in both the Company's 2009 rate case  
21 and its 2012 rate decision was to determine a specified return on the Fair Value Increment.  
22 (See Decision Nos. 71448 (December 30, 2009) at Exhibit A, Paragraph 4.3, Attachment A;  
23 and 73138 at Exhibit A, Paragraph 5.3.) Doing so resolved the *Chaparral City* court's  
24 concern by making the Fair Value Increment meaningful. (Note, however, that giving a  
25 specified return on the Fair Value Increment is not the only way the Commission can satisfy  
26 *Chaparral City*, as APS discusses later with reference to the Black Mountain Decision.)  
27  
28

1 In this docket, Staff and RUCO effectively reduce the 1% return on the Fair Value  
2 increment agreed to in the 2012 Settlement by (i) giving no incremental weight to the  
3 FVRB associated with the Four Corners Acquisition; and, (ii) diluting the return on the Fair  
4 Value Increment agreed to in the 2012 Settlement and adopted in Decision No. 73183.  
5 *Chaparral City* stands for the proposition that the Commission must give some meaningful  
6 consideration of fair value in determining FVROR. Recommendations, such as those  
7 advanced by Staff and RUCO, that dilute the return already established in a proceeding for  
8 the Fair Value Increment run afoul of *Chaparral City*. It is only the Company's suggested  
9 FVROR that fully preserves the weight afforded FVRB in Decision No. 73183 and remains  
10 consistent with *Chaparral City*.

11 **B. The Facts in the Black Mountain Decision Are Distinguishable**  
12 **from the Current Proceeding in Several Critical Respects, and**  
13 **the Determination of FVROR Using the Same Method Used in**  
14 **the Black Mountain Decision Would Increase the Company's**  
15 **Revenue Requirement Attributable to the Four Corners**  
16 **Acquisition by Over \$12 Million.**

17 In the Black Mountain Decision, the Commission determined that a previously  
18 calculated FVROR of 6.18% should be applied to a new generating plant not previously  
19 owned by the utility or included in rate base. Although superficially similar to the situation  
20 in this proceeding, there are several critical factual and legal differences between the two  
21 proceedings.

22 First, the Black Mountain Generation Unit at issue in the Black Mountain Decision  
23 was an entirely new and discrete generating unit. Unlike in the present circumstance,  
24 nobody was suggesting that part of Black Mountain earn the utility's WACC and another  
25 part earn significantly less than the utility's WACC.

26 Second, Black Mountain was previously the seller in a power purchase agreement  
27 with the utility. The PPA provided for a return to the seller equal to the utility's WACC.  
28 When the PPA was folded into the utility's cost of service, so was the return. (*See* Decision  
71914 at 32.) Therefore, the real issue before the Commission in the Black Mountain

1 Decision was whether the utility would be allowed a premium over and above that already-  
2 determined cost of service. APS is not nearly so ambitious here. The Company's proposed  
3 FVROR would allow it an opportunity to recover APS's WACC—nothing more or less.

4 Third, the Commission did not determine FVROR in the Black Mountain Decision  
5 by assigning a return value to the Fair Value Increment and then factoring in the resultant  
6 product with the WACC to produce a FVROR, as was done in this proceeding and the  
7 Company's previous rate case. In Black Mountain, by contrast, the Commission took the  
8 WACC and removed an inflation factor of 2.1% from the utility's 8.28% WACC to produce  
9 a 6.19% FVROR. This methodology mathematically favors utilities having a large Fair  
10 Value Increment relative to OCRB, as was the case in the Black Mountain Decision. (*See*  
11 *Decision No. 71914 at 51.*) For example, if the same inflation adjustment method used in  
12 *Black Mountain* were employed in this proceeding, APS's FVROR would be 6.23% (8.33%  
13 - 2.1%), not 6.14% as requested by APS, and certainly not the 6.09% suggested by Staff.  
14 Using the 6.23% value, the resultant revenue requirement increase associated with the Four  
15 Corners Acquisition would be over \$78 million. In addition, the fair value of Black  
16 Mountain was found to be higher than its original cost. Thus, the FVROR of 6.19% was  
17 applied to a higher figure than original cost. This is also a distinction between the Black  
18 Mountain Decision and the present proceeding.

19 What is consistent between APS's position in this proceeding and the Commission's  
20 decision in Black Mountain is that in both circumstances, the Commission decided upon a  
21 FVROR that permitted the utility to recover at least the utility's WACC. This is consistent  
22 with the Commission's conclusions in *Arizona Water Company*, where the Commission  
23 held:

24 "[t]he beginning point of our inquiry [concerning FVROR] must be the cost  
25 of capital. It is difficult to imagine a situation in which a reasonable return  
26 on FVRB [Fair Value Rate Base] would yield *less* than the cost of capital  
27 which comprises that rate base." [Emphasis in original.]  
28

1 In the Company's Initial Brief at page 4, APS stated: "Neither Staff nor RUCO has cited  
2 any Commission decision since *Arizona Water Company* that established a FVROR that did  
3 not, at a minimum, recover the utility's WACC. (See Mease, Tr. at 573:23-74:12; Yaquinto,  
4 Tr. 540:4-20)." The Black Mountain Decision is no exception to the position espoused in  
5 *Arizona Water Company*, which should be applied to this case.

6  
7 **III. THE COMPANY'S ACQUISITION OF EDISON'S INTEREST IN FOUR  
8 CORNERS WAS PRUDENT.**

8 As discussed in the Company and Staff's opening briefs, there is overwhelming  
9 evidence that the Four Corners Transaction has substantial benefits for APS customers –  
10 both economic and non-economic benefits. This is true even considering the uncertainty  
11 surrounding key drivers such as natural gas prices and potential carbon costs and regulation.  
12 The benefits and risks of the transaction were discussed at length in the hearing and in  
13 APS's closing brief. In the interest of brevity they will not be repeated here. However, as  
14 Staff eloquently stated in their opening brief: "[W]hile the risks of the transaction defy  
15 perfect quantification and mitigation, Staff's review of the transaction concluded that the  
16 reasonably foreseeable risks are more than offset by the economic benefits of the  
17 transaction." (See Staff Opening Brief at 10:11-13) Indeed, Staff's Witness, Mr. Letzelter,  
18 concluded "that there is a 90 percent chance of the value [of the transaction to APS  
19 customers] being between \$97 million and \$512 million" and "that there is a greater than  
20 99 percent chance that the acquisition will have a positive net present value, 99.4 percent."  
21 (See Letzelter, Tr. at 588:6-7, 13-15)

22 In contrast, the Sierra Club's Initial Brief continues its mantra that APS has provided  
23 insufficient information to support its analytics or has somehow failed to properly consider  
24 the risks of this transaction. This criticism is wholly unfounded and appears to emanate-not  
25 from an actual lack of information-but rather from an ideological position that simply  
26 opposes coal fired generation at any cost. (See Sierra Club Witness Dr. Hausman's  
27  
28

1 testimony, Tr. at 272:15-275:15.) Dr. Hausman admitted: “I have not nor would anybody  
2 likely hire me to be a witness in favor of a coal plant.” (See Hausman, Tr. at 272:25-273:1)

3 Except for the Sierra Club, no other party to these proceedings has suggested that  
4 there is insufficient information in the record to properly evaluate this transaction or  
5 questioned the prudence of the transaction. Importantly, Staff Witness Mr. Letzelter, who  
6 testified he had sufficient information to not only evaluate APS’s analysis, but to conduct  
7 his own rigorous analysis on certain key economic drivers, found that APS used “sound  
8 economic and financial principles” in its analysis of the transaction. (See Letzelter, Tr. at  
9 587:2-11, 598:23-599:7).

10 Witnesses for APS and Staff have soundly refuted the Sierra Club’s contention that  
11 future natural gas and carbon emission prices will make this transaction uneconomical and  
12 the Commission may properly disregard the Sierra Club’s testimony on this issue for the  
13 reasons stated in APS’s opening brief, among others. (See APS Opening Brief at 6:26-7:18)  
14 In addition, there is no evidence supporting the Sierra Club’s suggestion that Units 4 and 5  
15 will not continue to operate as needed. Mr. Wilde testified that historically there have been  
16 swings up and down to the capacity factors for Units 4 and 5. But, accordingly to Wilde,  
17 there is no reason to believe that, properly maintained, these units will not continue to run at  
18 a high capacity factor in the future. (See generally Wilde Rebuttal Testimony, at 5:8-25)

19 Likewise, the Sierra Club’s criticisms regarding APS’s disclosure of information  
20 pertaining to capital expenditure data used in the Company’s NPV analysis are spurious.  
21 There is no basis to disregard Mr. Wilde’s testimony explaining the components, basis or  
22 changes in APS’s capital expenditure forecasts. As Mr. Wilde explained in response to the  
23 Sierra Club’s questioning, the total forecasted capital expenditures for Four Corners Units 4  
24 and 5 increases in real dollars over the amount forecasted in the 2010 filing. (See Wilde,  
25 Tr. at 500:22-24, 502:1-3) The net present value of those expenditures, however, is  
26 approximately the same as 2010 due to a variety of factors including the \$100 million  
27 reduction in the purchase price for SCE’s share of Units 4 and 5 and APS’s agreement with  
28

1 the EPA that installation of Selective Catalytic Reduction controls on Units 4 and 5 could  
2 be delayed for two years until 2018. (See Wilde, Tr. at 499:25-501:7) Mr. Wilde also  
3 thoroughly explained why the projected percent increase in capital expenditures for Four  
4 Corners between the Company's 2010 and 2014 analysis is lower than the projected  
5 increase from 2010 to 2014 for APS's other generating plants. (See Wilde, Tr. at 501:12-  
6 502:11) In short, in 2010, APS had more information available and more certainty  
7 regarding planned environmental upgrades and expenditures at Four Corners than it did for  
8 certain other plants in its fleet. Thus, there was more change from 2010 to 2014 in the  
9 projected future capital expenditures as to the non-Four Corners generating plants.

10 The parties had ample opportunity to conduct discovery on APS's capital  
11 expenditure forecasts and at the hearing the Sierra Club was allowed to fully and fairly  
12 cross-examine Mr. Wilde regarding these forecasts. Had Sierra Club wanted to probe this  
13 issue further it should and could have done so during discovery or at the hearing. It should  
14 not now be allowed another mulligan on this issue. The fact that the Sierra Club does not  
15 agree with Mr. Wilde's testimony or conclusions does not mean they are unsupported and  
16 certainly does not provide a basis for the Commission to deny APS's request.

17 APS has thoroughly explained its analyses, as well as the basis for the inputs and  
18 forecasts used in those analyses, all of which have conclusively demonstrated the economic  
19 value of this transaction to APS's customers. Accordingly, APS requests that the  
20 Commission find that the Four Corners transaction was reasonable, prudent and calculated  
21 to benefit APS customers.

22  
23 **IV. THE COMPANY'S PROPOSED APPLICATION OF THE FOUR CORNERS**  
24 **RATE RIDER TO AG-1 CUSTOMERS IS FAIR AND CONSISTENT WITH**  
25 **THE 2012 SETTLEMENT.**

26 The issue here is crystal clear: should AG-1 be excluded from the Rate Rider  
27 application even though the plain language of the Agreement states that it will be applied on  
28 "an equal percentage basis across all rate schedules." (See Paragraph 10.3 of the 2012  
Settlement Agreement.) APS would, however, acknowledge and endorse a salient point

1 made in Staff's Initial Post-Hearing Brief. AECC, et al., have argued that the term  
2 "generation" at page 4 of Rate Rider AG-1 is a broad generic term encompassing all costs  
3 reasonably attributable to APS generation. (See AECC, et al., Initial Brief at 2-3.) Staff  
4 correctly notes that if the lower case "generation" had the all-inclusive meaning suggested  
5 by AECC, et al., there would have been no need to list the PSA and EIS as separate  
6 exclusions. (See Staff Initial Brief at 21-22.) Thus the most reasonable conclusion is that  
7 the term "generation" refers solely to the unbundled generation charge in the AG-1  
8 customers' underlying rate schedules.

9  
10 **V. THE PROVISIONS OF DECISION NO. 73183 AUTHORIZING THIS  
PROCEEDING DO NOT VIOLATE SCATES.**

11 Intervenor ASBA/AASBO issued no data requests, filed no testimony, presented no  
12 witnesses, and cross-examined only a single witness – a Staff witness at that. In Decision  
13 No. 73183, it is stated for the record that ASBA/AASBO: "did not take a position [on the  
14 2012 Settlement] and did not intend to file testimony." (See Decision No. 73183 at 9, ft. nt.  
15 35.) ASBA/AASBO neither requested rehearing of nor appealed Decision No. 73183.

16 Decision No. 73183 is a final decision of the Commission. It cannot be collaterally  
17 attacked in this proceeding. (See A.R.S. Section 40-252.) Yet it is Decision No. 73183 that  
18 authorized a proceeding to adopt a Four Corners Rate Rider, established a deadline for  
19 applying for a Four Corners Rate Rider (December 31, 2013), and delineated the updated  
20 2010 Test Year information required for such a Four Corners Rate Rider. And those are  
21 precisely the things ASBA/AASBO now alleges are deficient. The time for attacking  
22 Section X of the 2012 Settlement and the Commission order adopting that Settlement,  
23 Decision No. 73183, has come and gone. No belated remorse by ASBA/AASBO for not  
24 having actively participated in and objecting to the 2012 Settlement can change that fact or  
25 authorize what the law prohibits.

26 In fact, there is no violation of *Scates*. The Court in *Scates* did not overturn the  
27 Commission's order on telephone connection charges because it was outside a general rate  
28

1 case (which is clearly not the situation here) but because the Commission made no  
2 examination and finding of FVRB and FVROR. The Commission even expressly refused to  
3 consider the evidence of these factors proffered by the utility. Indeed, the Court was clear  
4 that the Commission had broad discretion in the process used to consider increases in rates  
5 so long as that process resulted in consideration of FVRB and a finding of a FVROR,  
6 specifically suggesting the update of a prior rate proceeding as was done here.

7 APS filed all the information required by Decision No. 73183, which is in the form  
8 of the same Standard Rate Case Filing Requirements ("SFRs") delineated by A.A.C. R14-2-  
9 103 for rate cases, excepting for the SFRs related to rate design and other issues already  
10 decided by the 2012 Settlement and Decision No. 73183. (See Direct Testimony of  
11 Elizabeth A. Blankenship, APS Exh. 10, at 4-9) ASBA/AASBO contends Staff's review of  
12 the Company's filing was "cursory at best." (See ASBA/AASBO Initial Brief at 4.) APS,  
13 having responded to numerous Staff data requests, strongly disagrees with that assertion.  
14 But how thoroughly Staff or any Intervenor did or did not review that information is of no  
15 legal consequence. ASBA/AASBO obviously believed no review was necessary, having  
16 propounded not a single question to APS concerning its filing.

17 The Commission should reject this last minute attack by ASBA/AASBO on a  
18 proceeding now over two years in the making and one that at its inception ASBA/AASBO  
19 took no position on and to which ASBA/AASBO offered not so much as a word of  
20 opposition. There is no *Scates* issue here and belated attempts to conjure one up are simply  
21 smoke and mirrors. They should be dismissed as such.

## 22 VI. CONCLUSION.

23 The APS Application for the Four Corners Rate Rider should be granted using the  
24 Company's revenue requirement of \$65.44 million. The only condition to the adoption of  
25 the Four Corners Rate Rider, the prudence of the Four Corners Acquisition, has been more  
26 than satisfied.  
27  
28

1 RESPECTFULLY SUBMITTED this 12<sup>th</sup> day of September 2014.

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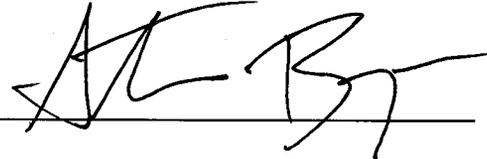
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