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September 11, 2014

Re: Reply Post-Hearing Brief of Sierra Club -
Arizona Corporation Commission Docket Number E-01345A-11-0224

To Whom It May Concern:

Please find enclosed four copies of the Reply Post-Hearing Brief of Sierra Club.

Please let me know if you have any questions.

Sincerely,

/s/ Derek Nelson

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Before the Arizona Corporation Commission

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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.	Docket No. E-01345A-11-0224 **SIERRA CLUB REPLY POST-HEARING BRIEF**

In accordance with the direction of the Administrative Law Judge at the July 30, 2014 pre-hearing conference, Sierra Club hereby submits the following reply post-hearing brief addressing the net present value of the Four Corners acquisition in the above-captioned proceeding. Sierra Club has filed direct testimony, surrebuttal testimony and an initial post-hearing brief in this matter.

In its filings and initial post-hearing brief, Arizona Public Service Company ("Company") fails to address the many significant concerns raised by Sierra Club. In doing so, the Company fails to provide the Arizona Corporation Commission ("Commission") with a full and complete analysis to deem the Company's purchase of Units 4 and 5 of Four Corners Power Plant ("transaction") as prudent. Without this full and complete analysis, Sierra Club recommends the Commission: 1) Reject the Company's request to rate base the costs associated with the acquisition of Units 4 and 5; 2) Condition future approval of rate base adjustments on revised and robust analysis that provides a full explanation for the numerous changes in the Company's assumptions made by the Company since the purchase was initially proposed; and 3) Put the Company on notice that a fully updated analysis will be required if the Company intends to rate base any future costs associated with the Company assuming the 7% shortfall obligation associated with El Paso Electric's decision to not sign the 2016 coal supply agreement.

I. It Is Not The Responsibility of Intervening Parties to Produce Alternative Fuel Prices or to Provide Alternative Net Present Value (NPV) Determinations for This Transaction.

The Company's attempt to show Sierra Club's "criticisms are unfounded"[1] because Sierra Club does not offer alternative calculation of NPV or alternative gas and carbon price forecasts is unreasonable and irrelevant. It is the Company's responsibility to produce fully substantiated and reasonable fuel price forecasts and associated NPV analysis and not the responsibility of other parties in this proceeding. To assume that other parties involved in this proceeding are responsible for providing alternative fuel price forecasts and NPV analysis is unreasonable. To produce such forecasts and analysis would be unduly and extraordinarily burdensome to any party.

[1] APS Initial Post-Hearing Brief at p. 6, lines 25 and following.

The Company is the utility service provider and therefore the Company bears the burden to not only produce fuel price forecasts, but also to defend why these forecasts are reasonable. It is not enough for the Company to merely specify where the prices were obtained—in this case, an internal and undocumented database vaguely described as "based on" NYMEX futures prices. Instead, it is the Company's responsibility to defend these forecasts as being reasonable by showing clear, convincing and rigorous analysis that conclusively shows why the forecasts are well founded. The Company's criticism with Sierra Club is merely a distraction from its own inability to support the proposed natural gas forecast, along with its carbon price forecasts and associated NPV analysis.

To date, the Company has not clearly shown the Commission why its assumptions are reasonable or reliable. In its filings, Sierra Club has repeatedly raised concerns regarding forecasted capital expenditures, operational viability and natural gas and carbon price assumptions. The Company has not directly addressed these concerns. In many instances, the Company has vaguely described where the prices originate, but provided no explanation for why these prices should be considered reasonable or reliable. In other instances, the Company does not even provide the origins for fuel price assumptions and instead explains the numbers are a result of the Company's proprietary database.

Overall, the Company fails to show clear and transparent analysis supporting this transaction and therefore the Commission cannot assume the Company's analysis is rigorous, robust or reasonable, and thus cannot deem the transaction prudent.

II. The Commission Staff's Witness Performed a Limited Analysis That Resulted in a Conditional Probability of Consumer Benefits and Is No Substitute for the Company Preparing and Defending a NPV Resulting From a Rigorous and Transparent Analysis.

In Section III of its initial post-hearing brief, the Company provides less than three pages explaining why the Company's acquisition was prudent.[2] Over two pages of Section III focus on the analysis provided by the Commission Staff's witness, Mr. Letzelter. It should be noted it is the Company's responsibility to provide and defend reasonable and reliable NPV analysis and not the responsibility of any other party to this proceeding (see above). The Company's reliance on another party's analysis is no substitute for the Company providing and defending a NPV that is the result of the Company's rigorous, robust and transparent analysis.

However, the Company's initial post-hearing brief relies heavily on Mr. Letzelter's analysis and conclusions. In response to this reliance, Sierra Club notes: 1) Mr. Letzelter has not performed an independent analysis of the transaction; 2) Mr. Letzelter's analysis is incomplete and limited, in that it investigated the impact of only two factors (gas and carbon prices) in a multifaceted analysis; and 3) Mr. Letzelter's conclusion regarding probability of consumer benefits is a conditional probability and not an absolute probability. These three factors alone show that neither the Company nor the Commission can adequately rely on Mr. Letzelter's conclusions when reviewing the prudence of the transaction.

a. Mr. Letzelter Has Not Performed an Independent Analysis of the Transaction.

Mr. Letzelter clearly stated in his testimony that he performed a review of the Company's analysis and then provided an original analysis that was "based on many of the basic parameters"[3] of the Company's own analysis. By using many of the Company's basic parameters, Mr. Letzelter's analysis is de facto not independent, nor is it free of any bias inherent

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[2] APS Initial Post-Hearing Brief at p. 5, Section III.
[3] Transcript, Volume III, Aug. 6, 2014, hereinafter ("Transcript") at p. 599, lines 2 and following.

in the Company's assumptions. An independent and objective analysis would not be based on the basic parameters provided by the Company and instead would be the result of independent data and independently-derived assumptions.

The Company's analysis was not robust and was based on a number of questionable and unsupported assumptions. By relying upon the Company's basic parameters, Mr. Letzelter's analysis is predicated on the Company's unsupported assumptions regarding capital costs, future plant operations and even natural gas prices. Mr. Letzelter incorporates all of the Company's assumptions into his analysis, except two variables.[4] Therefore, if the Company's other assumptions underlying its NPV analysis are inaccurate or biased, Mr. Letzelter's analysis is identically impacted.

The Company's attempt to support its own NPV calculation by referencing Mr. Letzelter's original analysis is no substitute for the Company performing its own transparent, robust and rigorous analysis in support of its NPV calculation.

b. Mr. Letzelter's Analysis Is Incomplete and Limited.

The Company's attempt to support the Company's NPV calculation by referencing Mr. Letzelter's analysis is unsound because Mr. Letzelter did not perform a complete analysis. Mr. Letzelter incorporated all of the Company's basic parameters into his analysis, except two variables: natural gas and carbon prices.[5] For these two variables, Mr. Letzelter performed a detailed assessment of their impact on the valuation. However, Mr. Letzelter did not perform a detailed assessment of any of the Company's other assumptions to determine accuracy or reliability. Similarly, Mr. Letzelter did not examine any variation of the Company's other assumptions.

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[4] Natural gas price forecasts and CO_2 price forecasts.

[5] Transcript at p. 599, lines 4 and following.

A full and comprehensive analysis would include a detailed assessment for uncertainty in all variables, not simply the natural gas and carbon prices. Therefore, Mr. Letzelter's analysis is limited and incomplete and cannot be relied upon to characterize the probability of consumer benefits. The Company's attempt to support its own NPV calculation by referencing Mr. Letzelter's limited and incomplete analysis is no substitute for the Company performing its own transparent, robust and rigorous analysis in support of its NPV calculation.

c. Mr. Letzelter's Conclusion Regarding Probability Is a Conditional Probability and Not an Absolute Probability.

Mr. Letzelter's limited analysis resulted in a conclusion finding a 90% probability the transaction benefits would be between $97 million and $512 million.[6] Mr. Letzelter's limited analysis also finds there is a 99.4% chance that benefit would exceed zero.[7] Implicit in Mr. Letzelter's analysis and conclusions is acceptance of the Company's untested and unjustified assumptions in areas not tested by Mr. Letzelter, including future capital costs and future operations for the Four Corners units. Mr. Letzelter's probabilistic conclusions are conditional upon these assumptions and are not absolute.

Mr. Letzelter's testimony accepts the Company's assumptions at face value and offers a variation for only two key drivers. To assume the Company's assumptions are correct at face value poses a significant risk to ratepayers when the Company has failed to transparently show its own robust and rigorous analysis.

[6] *Id.* at p. 587, lines 19 and following.
[7] *Id.* at p. 588, line 13 and following.

III. Dr. Hausman Has Performed a Thorough Review of the Company's Analysis and Raised a Number of Significant Concerns That Have Not Been Addressed by the Company Despite Having a Significant Impact on the NPV of the Transaction.

The Company asserts Dr. Hausman has "performed little or no analyses" of APS's analytics. It further attempts to show Sierra Club's "criticisms are unfounded"[8] because Sierra Club does not offer alternative calculation of NPV or alternative gas and carbon price forecasts. Finally, the Company attempts to dismiss the very significant and salient points raised by Dr. Hausman on the grounds that "The Sierra Club was the only party that even questioned the prudency of the acquisition."[9]

Dr. Hausman's extensive analysis of the Company's input assumptions is thoroughly documented in his 45 pages of direct testimony, 12 pages of surrebuttal testimony, and responses to cross examination. The fact that Dr. Hausman did not perform a full and independent NPV analysis nor provide independent input variables for the Company's use does not negate the validity of his criticisms regarding the shortcomings of the Company's analysis and input assumptions; nor does it relieve the Company of its obligation to provide its own transparent, robust and rigorous analysis in support of its NPV calculation. Nor does the fact that Dr. Hausman was retained in support of Sierra Club's intervention in this matter in any way negate the validity of his analysis. Dr. Hausman is a recognized expert in utility resource planning with extensive experience in planning cases throughout the United States. His independent and unbiased analysis and conclusions regarding the Company's analysis should be evaluated based on their merits, and not dismissed either because he did not provide a full and independent NPV analysis, or because he was retained for this matter by the Sierra Club.

No party in this proceeding other than APS performed a full and independent NPV analysis, nor was it their responsibility to do so. Both Dr. Hausman and Mr. Letzelter performed

[8] APS Initial Post-Hearing Brief at p. 6, line 25 and following.
[9] *Id.* at p. 6, line 23.

independent analysis of parts of the Company's NPV analysis. Mr. Letzelter showed that, assuming the Company's forecasts of capital costs, operations, and numerous other economic and operational factors were correct, the acquisition would provide ratepayer benefits under a wide range of gas and CO_2 emissions cost scenarios. Dr. Hausman demonstrated that in fact there are serious deficiencies and omissions in the Company's treatment of capital costs and future operational scenarios. These findings do not contradict each other; Mr. Letzelter's conclusions were conditioned upon certain of the Company's assumptions being reasonable, but as Dr. Hausman has exhaustively documented, the Company has not shown that this is so. The Company has not made a robust or transparent case that the acquisition was prudent.

IV. Neither the Company nor Mr. Letzelter Addresses Concerns Raised by Sierra Club Regarding Capital Expenditures and the Viability of Continued Operations in Post-Hearing Briefs.

The Company fails to address concerns raised by Sierra Club regarding anomalies in capital expenditures or the viability of continued operations at the plant. These two significant concerns go unaddressed by the Company in its initial post-hearing brief and are also not mentioned in the Commission Staff's initial post-hearing brief. Individually or collectively, these two concerns have a significant impact on the overall NPV of the transaction and could ultimately turn a net benefit into a net liability. By not addressing these two concerns, the Company asks the Commission to ignore these concerns and the risks they pose to ratepayers.

It is quite possible the Company's capital expenditures will be significantly higher than the Company has estimated, both in nominal terms and in impact to NPV. The Company has failed to transparently explain and support why it predicts capital expenditures for every other plant in its portfolio will increase by 21% except for Four Corners and instead provides a vague and unsupported explanation that if one were to add up all the SCR costs it would result in the projected capital expenditures. This is far from a clear, thorough, and transparent explanation supporting the Company's capital expenditure projections.

Furthermore, the Company does not incorporate any risks into its NPV analysis associated with the plant failing to operate or operating at a lower capacity than the Company projects. In essence, the Company fails to account for the real possibility that for operational, financial or other environmental regulatory reasons, the plant may fail to operate at as high a level as the Company has posited throughout the Company's NPV analysis. Such a scenario would significantly impact and potentially devastate any net benefit projected by the Company. By failing to acknowledge and account for such a significant risk, the Company asks the Commission to ignore these real concerns and the risk they pose to ratepayers.

Any of the factors highlighted by Sierra Club and by Dr. Hausman would have a significant, negative impact on the ratepayer benefits of the acquisition, even to the point of turning these benefits into liabilities. However, the Company has failed to incorporate these risks into its analysis and the Commission has been asked not to give them any consideration at all. Any deviation from the Company's operational projection has a substantial probability of negatively impacting ratepayers and yet these concerns are unaccounted for in the Company's NPV analysis or initial post-hearing brief. Similarly, Mr. Letzelter relies upon the same assumptions made by the Company in these areas, and considers no uncertainty in future operations in his limited and conditional analysis.

It is unreasonable for the Company to assume the Commission has enough information to support the Company's purchase as prudent when such significant concerns remain unaddressed.

V. Conclusion.

The Company's efforts to refute the many significant concerns raised by Sierra Club are unsupported. The Company attempts to counter concerns raised by Sierra Club by shifting the focus from the Company's decision to purchase an additional 179 MW of coal to its criticisms of the Sierra Club. The Company criticizes Sierra Club for not producing alternative fuel price forecasts or alternative NPV calculations. The Company further criticizes Sierra Club by claiming Sierra Club's witness did not perform a thorough analysis of the transaction despite having provided over 50 pages of testimony on the Company's acquisition. These criticisms are irrelevant. It is not the responsibility of any other party to produce or defend alternative fuel price forecasts or NPV analysis. It is the sole responsibility of the Company to support its decision to purchase additional coal.

Beyond criticizing Sierra Club, the Company attempts to support its decision to purchase an additional 179 MW of coal by relying heavily on Mr. Letzelter's analysis. In doing so, the Company fails to provide its own transparent explanation and analysis to support why the transaction is prudent. The analysis of another party that utilizes a majority of the Company's assumptions is not an independent analysis and it is certainly not a substitute for the Company explaining and supporting why the transaction is prudent.

The Company's criticisms of Sierra Club and reliance on another witness' analysis are only a distraction by the Company and not a response to the many concerns raised by Sierra Club. The Company's decision to purchase additional coal in light of pending carbon regulation exposes ratepayers to uncertainty and risk. The Company's analysis and assumptions must be reasonable, objective and transparent so that the Commission, intervenors and the public have an opportunity to review the analysis and comment on whether they are reasonable. The failure of the Company to address concerns regarding capital expenditures and future operations of the plant is unacceptable and alarming.

The Company has failed to provide this Commission with a transparent and robust analysis for review and instead has offered criticisms to distract from the Company's failed efforts to fully support the transaction as being prudent. It is for these reasons Sierra Club recommends the Commission: 1) Reject the Company's request to rate base the costs associated with the acquisition of Units 4 and 5; 2) Condition future approval of rate base adjustments on revised and robust analysis that provides a full explanation for the numerous changes in the Company's assumptions made by the Company since the purchase was initially proposed; and 3) Put the Company on notice that a fully updated analysis will be required if the Company intends to rate base any future costs which are associated with the Company's assumption of the 7% shortfall obligation due to El Paso Electric's decision to not sign the 2016 coal supply agreement.

Dated this 11th day of September, 2014.

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I hereby certify that I have this day served the foregoing REPLY POST-HEARING BRIEF OF SIERRA CLUB on all parties of record in this proceeding by mailing a copy thereof, properly addressed with first class postage prepaid to:

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Dated at San Francisco, California, this 11th day of September, 2014.

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