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**BEFORE THE ARIZONA CORPORATION C**

Arizona Corporation Commission

COMMISSIONERS

**DOCKETED**

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

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

DOCKET NO. E-01345A-11-0224

DECISION NO. 74876

**OPINION AND ORDER ON FOUR CORNERS RATE RIDER**

DATE OF HEARING: July 30, 2014 (Pre-Hearing Conference); August 4, 5, and 6, 2014

PLACE OF HEARING: Phoenix, Arizona

ADMINISTRATIVE LAW JUDGE: Teena Jibilian

APPEARANCES: Mr. Thomas L. Mumaw and Ms. Melissa Krueger, Law Department, PINNACLE WEST CAPITAL CORPORATION, on behalf of the Applicant;

Mr. Michael M. Grant, GALLAGHER & KENNEDY, PA, on behalf of Arizona Investment Council;

Mr. C. Webb Crockett, FENNEMORE CRAIG, PC, on behalf of Freeport-McMoRan Copper & Gold, Inc. and Arizonans for Electric Choice and Competition;

Mr. Lawrence V. Robertson, Jr., MUNGER CHADWICK, PLC, on behalf of Noble Americas Energy Solutions, LLC;

Mr. Scott S. Wakefield, RIDENOUR, HIENTON & LEWIS, PLLC, on behalf of Wal-Mart Stores, Inc. and Sam's Club West;

Ms. Nellis Kennedy-Howard, SIERRA CLUB ENVIRONMENTAL LAW PROGRAM, on behalf of Sierra Club;

Mr. Timothy M. Hogan, ARIZONA CENTER FOR LAW IN THE PUBLIC INTEREST; on behalf of Southwest Energy Efficiency Project, Western Resource

Advocates, Arizona School Boards Association, and Arizona Association of School Business Officials;

Mr. Daniel W. Pozefsky, Chief Counsel, on behalf of the Residential Utility Consumer Office; and

Ms. Janet Wagner, Assistant Chief Counsel, Ms. Maureen A. Scott, Senior Staff Counsel, and Mr. Charles O. Hains, Attorney, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

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1 **BY THE COMMISSION:**

2 **INTRODUCTION**

3 On June 1, 2011, Arizona Public Service Company (“APS” or “Company”) filed with the  
4 Arizona Corporation Commission (“Commission”) an application to determine the fair value of the  
5 utility property of the Company for ratemaking purposes, to fix a just and reasonable rate of return  
6 thereon, and to approve rate schedules designed to develop such return.

7 On April 24, 2012, prior to the issuance of a Commission determination on the rate case  
8 application in this docket, the Commission issued Decision No. 73130 in Docket No. E-01345A-10-  
9 0474. Decision No. 73130 authorized APS, if it so chose, to acquire Southern California Edison’s  
10 (“SCE’s”) ownership interest in the Four Corners Generating Station (“Four Corners”) Units 4 and 5,  
11 together with the retirement of Four Corners Units 1-3. Decision No. 73130 also authorized APS to  
12 defer for possible later recovery through rates all non-fuel costs of owning, operating, and  
13 maintaining the acquired SCE interest in Four Corners Units 4 and 5 and associated facilities; ordered  
14 APS to reduce the deferrals by non-fuel operations and maintenance and property tax savings  
15 associated with the closure of Four Corners Units 1-3; and authorized APS to defer for possible later  
16 recovery through rates all unrecovered costs associated with Four Corners Units 1-3 and additional  
17 costs incurred in connection with the closure of Four Corners Units 1-3. Decision No. 73130 ordered  
18 the accumulated deferred balance associated with all amounts deferred pursuant to Decision No.  
19 73130 to be included in the cost of service for ratemaking purposes in either the pending rate case or  
20 the next general rate case for APS; ordered APS to prepare and retain accounting records sufficient to  
21 permit detailed review, in a rate proceeding, of all deferred costs and cost benefits authorized in the  
22 Decision; ordered APS to prepare a separate detailed report of all costs deferred under the deferral  
23 authorization; and ordered APS to include that report as an integral component of each of its general  
24 rate applications in which it requests recovery of those deferred costs.<sup>1</sup>

25 On May 24, 2012, the Commission issued Decision No. 73183 in this docket. Decision No.

26 \_\_\_\_\_  
27 <sup>1</sup> Decision No. 73130 ordered that nothing in that Decision shall be construed in any way to limit the Commission’s  
28 authority to review the entirety of the acquisition of SCE’s ownership share of Four Corners Units 4 and 5, unrecovered costs or additional costs incurred in connection with the closure of Four Corners Units 1-3, the accumulated deferred balance associated with all amounts deferred pursuant to that Decision, and to make disallowances thereof due to imprudence, errors or inappropriate applications of the requirements of that Decision.

1 73183 approved a Settlement Agreement on the rate case filing.<sup>2</sup> Decision No. 73183 held the  
2 record open in this rate proceeding to allow APS to file by December 31, 2013, an application for  
3 approval to adjust its rates to reflect its acquisition of SCE's ownership interest in Four Corners Units  
4 4 and 5; the retirement of Four Corners Units 1-3; and any cost deferral authorized in Docket No. E-  
5 01345A-10-0474.

6 On December 30, 2013, APS filed an Application to Approve Four Corners Rate Rider  
7 ("FCRR Application") in this docket.

8 On August 4, 5, and 6, 2014, a hearing on the FCRR Application was held before a duly  
9 authorized Administrative Law Judge of the Commission. APS, Arizona Investment Council  
10 ("AIC"), Freeport-McMoran Copper & Gold, Inc. and Arizonans for Electric Choice and  
11 Competition (collectively, "AECC"), Noble Americas Energy Solutions, LLC ("Noble Solutions"),  
12 Wal-Mart Stores Inc. and Sam's West, Inc. (collectively, "Walmart"), Sierra Club, Southwest Energy  
13 Efficiency Project ("SWEEP"), Western Resource Advocates ("WRA"), Arizona School Boards  
14 Association ("ASBA"), Arizona Association of School Business Officials ("AASBO"), the  
15 Residential Utility Consumer Office ("RUCO"), and the Commission's Utilities Division ("Staff")  
16 appeared through counsel. APS, AIC, AECC, Noble Solutions, Walmart, Sierra Club, RUCO and  
17 Staff presented evidence for the record, and all parties were provided an opportunity to cross-examine  
18 witnesses.

19 On August 29, 2014, APS, AIC, the "AG-1 Intervenors" (collectively, Walmart, AECC,  
20 Noble Solutions, and Kroger), Sierra Club, the "School Associations" (collectively ASBA and  
21 AASBO), RUCO, and Staff filed Initial Closing Briefs. On September 12, 2014, APS, AIC, the AG-  
22 1 Intervenors, RUCO, and Staff filed Reply Closing Briefs, and the matter was taken under  
23 advisement.

## 24 DISCUSSION

### 25 I. **Overview of FCRR Application**

26 Four Corners is a coal-fired power plant located near Fruitland, New Mexico on property  
27

28 <sup>2</sup> For ease of reference, a copy of the Settlement Agreement is attached hereto as Exhibit A.

1 leased from the Navajo Nation. On December 30, 2013, APS finalized the acquisition of SCE's 48  
2 percent interest in Four Corners Units 4 and 5, and shortly thereafter, shut down Four Corners Units  
3 1-3. Four Corners Units 4 and 5 are now owned 63 percent by APS, 13 percent by Public Service  
4 Company of New Mexico, 10 percent by Salt River Project, 7 percent by Tucson Electric Power and  
5 7 percent by El Paso Electric. Four Corners is operated by APS and serves customers in Arizona,  
6 Texas, and New Mexico. Following the retirement of the 560 MW of Four Corners Units 1-3, Four  
7 Corners now has a capacity of 1,540 MW.<sup>3</sup>

8 With its FCRR Application, APS prepared all supporting schedules and calculated all rate  
9 base and expense adjustments resulting from the closure of Four Corners Units 1-3 and the purchase  
10 of Four Corners Units 4 and 5.<sup>4</sup> APS offset the rate base and expense amounts of the closed Four  
11 Corners Units 1-3 against the newly-acquired interest in Four Corners Units 4 and 5 going forward,  
12 and used the net adjustments to calculate an increase to the rate base approved in Decision No.  
13 73183.<sup>5</sup> APS then calculated a required revenue increase to reflect the increased rate base using an  
14 8.33 percent weighted average cost of capital ("WACC"). APS is requesting recovery of \$65.44  
15 million through the FCRR, assuming an effective date of December 1, 2014.<sup>6</sup>

16 APS proposes to recover the revenue increase as a 2.33 percent increase to the base rate  
17 portion of customers' bills. For customers taking service under the experimental Schedule AG-1  
18 approved in Decision No. 73183, APS proposes to apply the 2.33 percent increase to the "APS"  
19 portion of bills for AG-1 customers, but not to the portion of their bills that represents the pass  
20 through of charges from AG-1 customers' Alternative Generation Service Providers ("GSPs").<sup>7</sup> APS  
21 proposes similar treatment for its E-36XL customers due to their unique customer profile.<sup>8</sup>

22 Parties to this proceeding dispute four issues related to the FCRR Application, as follows: (1)  
23 the School Associations dispute whether APS's requested FCRR can lawfully be approved in this  
24 proceeding; (2) Sierra Club disputes whether APS's acquisition of SCE's ownership interest in Four

25 <sup>3</sup> Staff Initial Brief ("Br.") at 1-2.

26 <sup>4</sup> Direct Testimony of RUCO witness Robert B. Mease, Hearing Exhibit ("Exh.") RUCO-5 at 5.

27 <sup>5</sup> *Id.*

28 <sup>6</sup> Rebuttal Testimony of APS witness Elizabeth A. Blankenship, Hearing Exh. APS-11 at 2 and Rebuttal Attachment EAB-4.

<sup>7</sup> Direct Testimony of APS witness Jeffrey B. Guldner, Hearing Exh. APS-1 at 10.

<sup>8</sup> *Id.*

1 Corners Units 4 and 5 was prudent; (3) RUCO and Staff dispute whether the Fair Value Rate of  
2 Return (“FVROR”) proposed by APS is the appropriate rate of return to be applied to the new rate  
3 base addition; and (4) the AG-1 Intervenors dispute whether the FCRR should apply to those  
4 customers taking service under the experimental Schedule AG-1 approved in Decision No. 73183.

## 5 **II. Lawfulness of the Requested FCRR**

6 The School Associations argue that the Commission is constitutionally prohibited from  
7 approving the FCRR without a determination of the current fair value of APS’s property, and that it is  
8 unlawful for the Commission to approve a rate increase based only on changes due to the Four  
9 Corners acquisition. APS, the School Associations, AIC, and Staff briefed the issue.

### 10 **A. APS**

11 APS states that Decision No. 73183 authorized a proceeding to adopt the FCRR, established a  
12 deadline for applying for the FCRR, and delineated the updated 2010 test year information required  
13 for the FCRR. APS notes that the School Associations were parties to this docket for the hearing on  
14 the Settlement Agreement, but as indicated in Decision No. 73183, the School Associations took no  
15 position on the Settlement Agreement, did not file testimony, and did not request rehearing of  
16 Decision No. 73183 or appeal Decision No. 73183.<sup>9</sup> APS argues that Decision No. 73183 is a final  
17 Commission Decision, and as such, the time has passed for attacking the terms of the Settlement  
18 Agreement and Decision No. 73183 which approved it.

19 APS asserts that approval of the FCRR would not violate *Scates v. Arizona Corp. Comm’n*,  
20 118 Ariz. 531, 578 P.2d 612 (App. 1978). APS states that the Court in *Scates* overturned the  
21 Commission’s order on appeal not because it was outside a general rate case, but because the  
22 Commission in that case had made no examination and finding of fair value rate base (“FVRB”) and  
23 FVROR. APS argues that the *Scates* Court clearly acknowledges the Commission’s broad discretion  
24 in ratesetting so long as the process considers FVRB and a finding of a FVROR, and specifically  
25 suggested the update of a prior rate proceeding. APS states that it filed all the information required  
26 by Decision No. 73183. APS disagrees with the School Associations’ claim that Staff’s review of the  
27

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28 <sup>9</sup> APS Reply Br. at 9, citing to Decision No. 73183 at 9, fn 35.

1 FCRR Application was cursory, given the numerous data requests it received from Staff, and points  
2 out that the School Associations propounded no data requests.

3 **B. School Associations**

4 The School Associations contend that keeping this ratemaking docket open for purposes of  
5 determining APS's in this proceeding does not satisfy the requirements of Article 15, § 14 of the  
6 Arizona Constitution because, with the exception of adjustments for the post test year acquisition of  
7 SCE's interests in Four Corners Units 4 and 5, there have been no updates to APS's FVRB, revenues  
8 or expenses since the December 31, 2010 test year. The School Associations also contend that  
9 because the only costs, revenues and expenses examined in this proceeding were those associated  
10 with Four Corners Units 4 and 5, approval of the FCRR would constitute single issue ratemaking, and  
11 is prohibited by *Scates*. The School Associations further claim that there was no critical evaluation  
12 in this proceeding of APS's financial statements and their underlying assumptions, as there would be  
13 in a full rate case, and that no evidence supports a determination that the rate of return approved in  
14 Decision No. 73183 continues to be appropriate.

15 **C. AIC**

16 AIC contends that the School Associations have unreasonably delayed their objections to the  
17 provision in the Settlement Agreement holding the docket open, and the Commission's approval  
18 thereof in Decision No. 73183. AIC states that the School Associations have been parties to this  
19 docket since October 2011; were among the 27 parties who participated in the rate case settlement  
20 meetings that led to the Settlement Agreement; knew the Settlement Agreement included the  
21 provision to hold this docket open for the purpose of allowing the FCRR Application, as well as the  
22 expectation that APS's Four Corners transaction could result in a rate increase; and knew that the  
23 "hold open" provision was a key factor in APS's consent to the Settlement Agreement; yet the School  
24 Associations took no position on the Settlement Agreement, and did not alert the Commission to the  
25 constitutional issues the School Associations now raise. AIC points out that the members of ASBA  
26 and AASBO have enjoyed the benefit of the zero increase to base rates authorized by Decision No.  
27 73183, and contend that the doctrine of laches may be applicable to the School Associations'  
28 arguments, due to their two year delay in raising their arguments and the resultant prejudice to APS.

1 AIC disagrees with the School Associations' argument that approval of the FCRR would be  
 2 unconstitutional due to the time that has passed since the 2010 test year. AIC contends that Arizona  
 3 case law recognizes that the Commission has discretion to consider matters subsequent to the historic  
 4 test year.<sup>10</sup> AIC states that the requested FCRR promotes rate stability and minimizes the need for a  
 5 constant series of rate hearings, two public interest criteria identified by the Arizona Supreme  
 6 Court.<sup>11</sup>

7 AIC disagrees with the assertion that the FCRR Application raises the same "single issue  
 8 ratemaking" concerns raised by the Decision appealed in *Scates*. AIC asserts that the assertion  
 9 ignores the fact that the requested FCRR is an adjustment to rates, which, by definition, is intended to  
 10 change rates based on additional, post-test year events and information, and which is allowed by  
 11 *Scates* under appropriate circumstances.<sup>12</sup> AIC states that contrary to the School Associations'  
 12 position that the FCRR Application includes all new information, the record before the Commission  
 13 in Decision No. 73183 included extensive information regarding the costs and impacts of the Four  
 14 Corners transaction,<sup>13</sup> and that the primary difference between the information previously provided  
 15 and the information provided in this proceeding is that APS proposes a FCRR that is 67 basis points  
 16 lower than was anticipated in Decision No. 73183.<sup>14</sup> AIC asserts that the data provided by APS in  
 17 this proceeding is precisely the type of information the *Scates* court indicated the Commission should  
 18 consider in connection with a rate adjustment request. Further, AIC asserts that APS's filing balances  
 19 the interests of ratepayers with the interests of the utility, as the Arizona Supreme Court has  
 20 endorsed.<sup>15</sup>

#### 21 D. Staff

22 Staff disagrees with the School Associations' arguments, which it characterizes as suggesting

23 <sup>10</sup> AIC Reply Brief ("Reply Br.") at 9, citing to *Arizona Corp. Comm'n v. Arizona Pub. Serv. Co.*, 113 Ariz. 368, 371, 555  
 24 P.2d 326, 329 (1976).

25 <sup>11</sup> AIC Reply Br. at 9, 10, citing to *Arizona Pub. Serv. Co.* at 371, 555 P.2d at 329 (finding that "it appears to be in the  
 public interest to have stability in the rate structure within the bounds of fairness and equity rather than a constant series  
 of rate hearings").

26 <sup>12</sup> AIC Reply Br. at 10, citing to *Scates* at 537, 578 P.2d at 618 (acknowledging that a rate increase outside a full rate case  
 may be permissible based on limited or updated rate case data).

27 <sup>13</sup> AIC Reply Br. at 9, citing to Decision No. 73183 at 25-26 and Docket No. E-01345A-10-0474.

28 <sup>14</sup> AIC Reply Br. at 9.

<sup>15</sup> AIC Reply Br. at 10, 11, citing to *Arizona Cmty. Action Ass'n v. Arizona Corp. Comm'n*, 123 Ariz. 228, 231, 599 P.2d  
 184, 187 (1979).

1 that the Commission's ratesetting procedures should be limited to the traditional rate case procedure  
 2 embodied by A.A.C. R14-2-103. Staff contends that the Arizona Constitution does not confine the  
 3 Commission's ratemaking jurisdiction to general rate cases, and that a full rate case is not the only  
 4 means by which the Commission can exercise its ratesetting expertise. Staff states that Arizona  
 5 courts have recognized that the Commission's ratemaking authority is not as narrow as the School  
 6 Associations suggest, and provides a broad range of regulatory tools to use in its legislative  
 7 discretion.<sup>16</sup> Staff states that the Arizona Supreme Court has upheld the Commission's authority to  
 8 permit rate adjustments through step increases in order to address special circumstances, while noting  
 9 that the Commission instituted "innovative procedures in an attempt to deal promptly and equitably  
 10 with increasingly complex regulatory matters."<sup>17</sup> Staff states that further, the court in *Arizona Cmty.*  
 11 *Action Ass'n* found no fault with the Commission's efforts to avoid "a constant series of extended  
 12 rate hearings" and indicated that adjustments between rate cases "were adequate to maintain a  
 13 reasonable compliance with the constitutional requirements if used only for a limited period of  
 14 time."<sup>18</sup>

15 In regard to the School Associations' contention that approval of the FCRR would constitute  
 16 single issue ratemaking in contravention of the *Scates* opinion, like AIC, Staff contends that the  
 17 holding of *Scates* is much more narrow, finding that the Commission was without authority in the  
 18 appealed Decision to increase the rate without any consideration of the overall impact of that rate  
 19 increase upon the utility's return and without a determination of FVRB.<sup>19</sup>

#### 20 **E. Conclusion**

21 In Decision No. 73183, we held this docket open for the express purpose of allowing APS to  
 22 seek to include in rates the rate base and expense effects associated both with the acquisition of Four  
 23 Corners Units 4 and 5 and the retirement of Four Corners Units 1, 2 and 3 as discussed in that  
 24 Decision and in Decision No. 73130.<sup>20</sup> We approved the Settlement Agreement among the parties

26 <sup>16</sup> Staff Reply Br. at 5-6, citing to *Arizona Corp. Comm'n v. State ex rel Woods*, 171 Ariz. 286, 294, 830 P.2d 807, 815  
 (1992) and *Simms v. Round Valley Light & Power Co.*, 80 Ariz. 145, 154, 294 P.2d 378, 384 (1956).

27 <sup>17</sup> Staff Reply Br. at 5, citing to *Community Action Ass'n* at 230, 599 P.2d at 186.

28 <sup>18</sup> Staff Reply Br. at 5, citing to *Community Action Ass'n* at 231, 599 P.2d at 187.

<sup>19</sup> Staff Reply Br. at 6, citing to *Scates* at 537, 578 P.2d at 618.

<sup>20</sup> Decision No. 73183 at 47 and Section 10.2 of the approved Settlement Agreement.

1 which required APS to submit for review, in any filing seeking such a rate adjustment, updated  
 2 financial information as well as analyses of the proposed increase on both APS and APS's customers.  
 3 We required the information so that we would have sufficient information to analyze whether, in the  
 4 discretion of the Commission, a requested adjustment to the rates approved in Decision No. 73183,  
 5 based on a post test year known and measurable change in APS's rate base, would result in just and  
 6 reasonable rates. APS complied with the procedural and substantive requirements of Decision No.  
 7 73183. We have before us the necessary factual record to adjust the rates set by Decision No. 73183,  
 8 and the discretion to do so pursuant to the Arizona Constitution.

### 9 **III. Prudence of the Acquisition**

10 Decision No. 73130 found that APS had adequately addressed Decision No. 67744's  
 11 requirements for a waiver of the self-build moratorium. Decision No. 73130 granted APS's request  
 12 for an accounting order and authorized various accounting deferrals for potential consideration in a  
 13 future rate case.<sup>21</sup> Decision No. 73130 expressly did not address the prudence of APS's acquisition  
 14 of SCE's ownership interest in Four Corners Units 4 and 5, leaving that determination to a future rate  
 15 proceeding. Sierra Club alleges that APS's acquisition of SCE's ownership interest in Four Corners  
 16 Units 4 and 5 was not prudent. APS, Sierra Club, AIC and Staff briefed the issue.

#### 17 **A. APS**

##### 18 1. Overview

19 According to APS's witness Jeffrey Guldner, APS's acquisition of Four Corners Units 4 and  
 20 5 "not only maintains a diverse generation portfolio . . . it also provides over \$400 million in  
 21 customer benefits, \$225 million in economic benefit to local communities, employs over 800 people,  
 22 greatly supports the Navajo Nation, and reduces plant emissions . . . thereby promoting a cleaner  
 23 environment."<sup>22</sup> APS believes that the evidence in this proceeding, in particular the testimonies of  
 24 APS's witness James Wilde and Staff's witness James Letzelter, establishes that the acquisition was  
 25 reasonable, prudent, and benefits APS customers, and requests that the Commission make such a

26 <sup>21</sup> Decision No. 73130 states that "[t]he 'non-fuel costs' that are authorized for deferral include: depreciation,  
 27 amortization of the acquisition adjustment, decommissioning costs, operations and maintenance costs, property taxes,  
 final coal reclamation costs, the documented debt costs of acquiring SCE's interest in Units 4 and 5, and miscellaneous  
 28 other costs." Decision No. 73130 at 37, footnote 122.

<sup>22</sup> APS Br. at 5, citing to Tr. at 49-50.

1 finding.<sup>23</sup> APS cites to the conclusion of Staff's witness that there is a 90 percent chance that the  
 2 transaction has a monetary value to APS's customers of between \$97 million and \$512 million, and  
 3 that there is a 99.4 percent chance that the acquisition will have a positive net present value.<sup>24</sup> APS  
 4 points out that no party but Sierra Club has questioned the prudence of the acquisition. APS contends  
 5 that Sierra Club's criticism that APS has provided insufficient information to support a finding that  
 6 the transaction was prudent is unfounded, and emanates from an ideological position that opposes  
 7 coal-fired generation at any cost.<sup>25</sup>

## 8 2. Net Present Value Analysis

9 APS's witness Mr. James Wilde testified that APS has provided all data and analysis  
 10 necessary to evaluate the net present value of the transaction, that Staff has concurred with the  
 11 analysis, and that no party other than Sierra Club has questioned that the transaction has a substantial  
 12 positive economic benefit for APS's customers.<sup>26</sup> Mr. Wilde testified that the inputs used and the  
 13 analysis performed by APS were sound and reasonable and support a conclusion that the transaction  
 14 provides significant benefits to APS's ratepayers, just as Staff's witness concluded.<sup>27</sup>

## 15 3. Natural Gas Price Assumptions and Carbon Price Projections

16 APS rejects Sierra Club's witness Dr. Hausman's criticisms of the natural gas price  
 17 assumptions and carbon price projections used in APS's net present value analysis. APS argues that  
 18 while Dr. Hausman was critical of the robustness of APS's economic analysis, he offered no  
 19 alternative net present value calculation and proposed no alternative natural gas price assumptions or  
 20 carbon price projections.<sup>28</sup> APS states that Staff's witness Mr. Letzelter concluded that APS's  
 21 analysis was "based on sound economic and financial principles,"<sup>29</sup> and that even after Mr. Letzelter  
 22 adjusted APS's natural gas price assumptions and carbon price projections, Staff's witness concluded  
 23 that APS's acquisition was prudent, and had a projected net present value of \$315 million.<sup>30</sup> APS  
 24

25 <sup>23</sup> APS Br. at 5-6, APS Reply Br. at 8.

26 <sup>24</sup> APS Reply Br. at 6, citing to Tr. at 588.

27 <sup>25</sup> APS Reply Br. at 6.

28 <sup>26</sup> Rejoinder Testimony of APS witness James Wilde, Hearing Exh. APS-13 at 1.

29 <sup>27</sup> Rebuttal Testimony of APS witness James Wilde, Hearing Exh. APS-12 at 6.

30 <sup>28</sup> APS Br. at 6-7.

<sup>29</sup> APS Br. at 7 and APS Reply Br. at 7, citing to Tr. at 587.

<sup>30</sup> APS Br. at 7, citing to Direct Testimony of Staff witness James Letzelter, Hearing Exh. S-1 at 9-13.

1 argues that APS's and Staff's witnesses have soundly refuted the Sierra Club's contention that future  
2 natural gas and carbon emission prices will render the acquisition uneconomical.<sup>31</sup>

3 **4. Projected Capital Expenditures and Continued Operations**

4 APS responded to Sierra Club's allegations that APS has not provided sufficient information  
5 regarding projected capital expenditures at Units 4 and 5 and the viability of continued operations of  
6 Units 4 and 5. APS contends that no evidence supports Sierra Club's suggestion that Four Corners  
7 Units 4 and 5 will not continue to operate as needed. APS's witness Mr. Wilde testified that there is  
8 no reason to believe that Four Corners Units 4 and 5, properly maintained, will not continue to run at  
9 a high capacity factor in the future.<sup>32</sup> APS disputes Sierra Club's assertion that it provided  
10 insufficient information regarding projected capital expenditures at Units 4 and 5. APS states that its  
11 witness Mr. Wilde explained why the projected increase in capital expenditures for Four Corners  
12 Units 4 and 5 between the 2010 and 2014 analysis is lower than the projected increases for APS's  
13 other generating plants. In 2010, APS had more information available and more certainty regarding  
14 planned environmental upgrades and expenditures for Four Corners than it had for its other  
15 generating plants, and therefore, there was more change from 2010 to 2014 for its other generating  
16 plants.<sup>33</sup> APS states that the net present value of the total forecasted capital expenditures for Four  
17 Corners Units 4 and 5 is approximately the same as the 2010 forecast, due to the fact that the  
18 purchase price was reduced by \$100 million, and due to the consequences of APS's agreement with  
19 the U.S. Environmental Protection Agency ("EPA") that installation of Selective Catalytic Reduction  
20 Controls ("SCRs") could be delayed for two years, until 2018.<sup>34</sup>

21 **B. Sierra Club**

22 **1. Overview**

23 Sierra Club opposes Commission approval of the FCRR Application, alleging that APS's  
24 acquisition of SCE's ownership interest in Four Corners Units 4 and 5 was not prudent. Sierra Club  
25 argues that APS claims a net present value benefit from the acquisition, but has not provided the

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27 <sup>31</sup> APS Reply Br. at 7.

<sup>32</sup> APS Reply Br. at 7, citing to Rebuttal Testimony of APS witness James Wilde, Hearing Exh. APS-12 at 5.

<sup>33</sup> APS Reply Br. at 8, citing to confidential hearing testimony of its witness James Wilde, Tr. at 501-502.

28 <sup>34</sup> APS Reply Br. at 8, citing to confidential hearing testimony of its witness James Wilde, Tr. at 499-501.

1 Commission with a full, complete, and transparent analysis to support its decision to acquire Units 4  
2 and 5, and that the Commission cannot therefore assume APS's analysis is rigorous, robust or  
3 reasonable, and deem the transaction prudent.<sup>35</sup> Sierra Club recommends that the Commission reject  
4 APS's request to rate base the costs associated with the acquisition of Units 4 and 5; condition future  
5 approval of rate base adjustments on a revised analysis that provides a full explanation for changes in  
6 assumptions since the initial proposal of the acquisition; and put APS on notice that a fully updated  
7 analysis will be required if it intends to request rate base treatment of future costs associated with  
8 APS assuming the 7 percent shortfall obligation associated with El Paso Electric's decision not to  
9 sign the 2016 coal supply agreement.<sup>36</sup>

10 Sierra Club asserts that its expert witness Dr. Hausman demonstrated serious deficiencies and  
11 omissions in APS's treatment of capital costs and future operational scenarios,<sup>37</sup> and that Dr.  
12 Hausman's analysis and conclusions regarding APS's analysis should not be dismissed because he  
13 did not offer a full and independent net present value analysis, or because he was retained for this  
14 matter by the Sierra Club.<sup>38</sup> Sierra Club contends that it is APS's responsibility alone to produce  
15 substantiated and reasonable fuel price forecasts and associated net present value analysis, and that  
16 the fact Dr. Hausman did not offer an alternative calculation of net present value or alternative gas  
17 and carbon price forecasts is irrelevant.<sup>39</sup> Sierra Club believes it would be unduly and extraordinarily  
18 burdensome for other parties to produce such forecasts and analysis, and that APS has not clearly  
19 shown why its assumptions are reasonable or reliable.<sup>40</sup>

## 20 2. Net Present Value Analysis

21 Sierra Club is critical of Staff witness Mr. Letzelter's finding of a 90 percent probability that  
22 the benefits of the acquisition would be between \$90 million and \$512 million, and the finding that  
23 there is a 99.4 percent chance that the benefit would exceed zero.<sup>41</sup> Sierra Club argues that Mr.  
24 Letzelter's probabilistic conclusions are conditional on the assumptions in APS's net present value

25 <sup>35</sup> Sierra Club Br. at 1-2, 9-10, Sierra Club Reply Br. at 3.

26 <sup>36</sup> Sierra Club Br. at 2, Sierra Club Reply Br. at 2, 10-11.

27 <sup>37</sup> Sierra Club Reply Br. at 8.

28 <sup>38</sup> *Id.* at 7.

<sup>39</sup> *Id.* at 2, 7.

<sup>40</sup> *Id.* at 2-3.

<sup>41</sup> Sierra Club Br. at 7-9, Sierra Club Reply Br. at 6.

1 analysis which Mr. Letzelter did not test, and with which Sierra Club disagrees.<sup>42</sup> Sierra Club asserts  
 2 that Mr. Letzelter's analysis and conclusions are not independent, and are not free of any bias  
 3 inherent in APS's assumptions regarding capital costs, future plant operations, and base case gas  
 4 prices.<sup>43</sup> Sierra Club does not accept Staff witness Mr. Letzelter's opinion that while CO2 regulation  
 5 will drive some coal plants into early retirement, Four Corners is not one of those plants, and is  
 6 critical of the fact that Mr. Letzelter assigned no probability to this opinion.<sup>44</sup> Sierra Club contends  
 7 that APS's ratepayers are put at risk by Mr. Letzelter's analysis, because it assumes that the basic  
 8 parameters and assumptions in APS's net present value analysis are correct at face value, and Mr.  
 9 Letzelter offers a variation for only two inputs, while accepting APS's inputs for future capital costs,  
 10 future plant operations, and base case gas prices.<sup>45</sup>

### 11 3. Natural Gas Price Assumptions

12 Sierra Club argues that APS has not provided a full and complete analysis of the natural gas  
 13 price assumptions used in its net present value analysis, and that APS relied on New York Mercantile  
 14 Exchange ("NYMEX") open trade prices, which Sierra Club claims results in abnormally high gas  
 15 price trajectories favoring a decision to acquire Units 4 and 5.<sup>46</sup> Sierra Club claims that APS fails to  
 16 provide adequate support for its assumptions related to natural gas prices, that APS relies on  
 17 unsupported projections provided by APS's proprietary database DataMart, and that APS does not  
 18 explain how DataMart's projections are calculated or why the calculation approach is reasonable.<sup>47</sup>  
 19 Sierra Club disagrees with APS's claim that DataMart is based on NYMEX data, asserting that such a  
 20 claim is inconsistent with the nature, quality, and availability of NYMEX data to support DataMart's  
 21 forecasts.<sup>48</sup> Sierra Club asserts that NYMEX data serve as a reasonable basis for forecasts only to the  
 22 extent that they reflect a high volume of settled trades, and that using open trades has little to no  
 23

24 <sup>42</sup> Sierra Club Reply Br. at 6.

25 <sup>43</sup> Sierra Club Br. at 7-9, Sierra Club Reply Br. at 4-5. However, despite Sierra Club's strong emphasis on a lack of  
 26 independence in Mr. Letzelter's analysis, Sierra Club, in its Reply Br. at 7-8, also states that both Mr. Letzelter and its  
 27 expert witness Dr. Hausman performed independent analysis of parts of APS's net present value analysis, and that their  
 28 findings do not contradict each other.

<sup>44</sup> Sierra Club Br. at 8.

<sup>45</sup> Sierra Club Br. at 8-9, Sierra Club Reply Br. at 6.

<sup>46</sup> Sierra Club Br. at 2-3, Sierra Club Reply Br. at 3.

<sup>47</sup> Sierra Club Br. at 2.

<sup>48</sup> *Id.*

1 value for forecasting purposes.<sup>49</sup> Sierra Club argues that to the extent APS inappropriately or  
 2 erroneously used NYMEX data as forecasts without regard to the volume of settled trades the data  
 3 represent, APS's analysis is flawed.<sup>50</sup> Sierra Club is also critical of APS's reliance on the analysis of  
 4 Staff's witness Mr. Letzelter, asserting that such reliance does not constitute an independent  
 5 analysis.<sup>51</sup>

#### 6 4. Carbon Price Projections

7 Sierra Club contends that the carbon price projections APS used in its net present value  
 8 analysis are not high enough, and have a direct impact on the calculation of the net present value of  
 9 the transaction.<sup>52</sup> Sierra Club criticizes APS for failing to incorporate known considerations when it  
 10 purchased Units 4 and 5, and for disregarding the recommendations of its consultant, Charles River  
 11 Associates ("CRA"), which recommended a carbon price over twice that APS used.<sup>53</sup> Sierra Club  
 12 asserts that APS's decision to disregard its consultant's recommendations fail to take into  
 13 consideration risks posed by federal carbon regulation.<sup>54</sup> Sierra Club contends that several factors  
 14 have resulted in APS's projections being unrealistic, including use of a set carbon price based on a  
 15 single California market carbon trading price, and use of a carbon price escalation rate that accounts  
 16 for 2.5 percent inflation alone, instead of 5 percent above inflation per year after 2019.<sup>55</sup>

#### 17 5. Projected Capital Expenditures and Continued Operations

18 Sierra Club contends that APS's net present value analysis is unreasonable because it does not  
 19 reflect the risk of possible early retirement or decreased output from Units 4 and 5.<sup>56</sup> Sierra Club also  
 20 faults the analysis of Staff's analyst Mr. Letzelter in this regard because it relies upon the same  
 21 assumptions as APS.<sup>57</sup> Sierra Club asserts that APS has not provided sufficient information  
 22 regarding either the viability of continued operations, or the projected capital expenditures at Units 4  
 23

24 <sup>49</sup> Sierra Club Br. at 3.

25 <sup>50</sup> *Id.*

26 <sup>51</sup> Sierra Club Reply Br. at 10.

27 <sup>52</sup> Sierra Club Br. at 5-6.

28 <sup>53</sup> *Id.*

<sup>54</sup> *Id.* at 6.

<sup>55</sup> *Id.* at 5-6.

<sup>56</sup> Sierra Club Br. at 7, Sierra Club Reply Br. at 9.

<sup>57</sup> Sierra Club Reply Br. at 9.

1 and 5.<sup>58</sup> Sierra Club posits that it is “quite possible” that capital expenditures will be significantly  
 2 higher than APS’s estimates.<sup>59</sup> Sierra Club disagrees with the explanation of APS’s witness Mr.  
 3 Wilde that APS’s projected capital expenditures equal projected SCR costs, and questions why APS’s  
 4 predicted capital expenditures for Units 4 and 5 differ from APS’s predicted capital expenditures for  
 5 other plants in its portfolio.<sup>60</sup> Sierra Club is critical of the fact that APS’s witness Mr. Wilde testified  
 6 at the hearing concerning the basis of its projected capital costs without prefilng such testimony prior  
 7 to the hearing. On brief, Sierra Club states that the parties should be offered an opportunity to  
 8 propound additional discovery on capital expenditures, recommends that the testimony elicited at the  
 9 hearing be disregarded, and recommends that APS’s projected capital expenditures be treated as  
 10 unsupported and unexplained “due to the inability of all parties to review and provide comment.”<sup>61</sup>

### 11 C. AIC

12 AIC asserts that the weight of the evidence supports approval of APS’s acquisition of Units 4  
 13 and 5.<sup>62</sup> In particular, AIC points to the testimony of Staff’s witness Mr. Letzelter in support of its  
 14 position.<sup>63</sup> AIC argues that the Sierra Club’s criticisms of the prudence of APS’s Four Corners  
 15 acquisition stem from its general views against all coal-fired generation resources, and that Sierra  
 16 Club’s criticisms of APS’s economic analysis of the transaction are without merit.<sup>64</sup> AIC contends  
 17 that Sierra Club has raised many of the same arguments it raised when the Commission last  
 18 considered the Four Corners acquisition, and that nothing has changed since the Commission issued  
 19 Decision No. 73130, which stated that APS had demonstrated that retiring the older Four Corners  
 20 units early and acquiring an interest in the more efficient Units 4 and 5 would provide value to APS

21 \_\_\_\_\_  
 22 <sup>58</sup> Sierra Club Br. at 3-4, Sierra Club Reply Br. at 8-9.

23 <sup>59</sup> *Id.*

24 <sup>60</sup> Sierra Club Reply Br. at 8-9.

25 <sup>61</sup> Sierra Club Br. at 4-5. Mr. Wilde’s prefiled Rebuttal Testimony provided a response to Sierra Club’s concerns  
 26 regarding capital expenditures. Sierra Club had the opportunity to conduct further discovery on the issue prior to the  
 27 hearing. Based on the record in this proceeding, the parties had ample time to propound discovery. Mr. Wilde’s hearing  
 28 testimony did not exceed the scope of his prefiled testimony, and there was no request at the hearing for supplementation  
 of the record. While Sierra Club made no motion, but made the statements on brief, it should nevertheless be noted that  
 there is no procedural basis for disregarding Mr. Wilde’s hearing testimony, or for allowing additional discovery time at  
 this point in the proceeding. Sierra Club did not request an opportunity to propound additional discovery prior to the  
 close of the hearing. *See* Tr. at 654.

<sup>62</sup> AIC Reply Br. at 3.

<sup>63</sup> AIC Reply Br. at 3, citing to Direct Testimony of Staff witness Letzelter, Hearing Exh. S-1 at 3.

<sup>64</sup> AIC Br. at 3-4, AIC Reply Br. at 2-3.

1 customers, both from an environmental and rate impact standpoint.<sup>65</sup>

2 **D. Staff**

3 Staff states that the capacity provided by the Four Corners acquisition is necessary, and the  
4 purchase of SCE's 48 percent interest allowed APS to acquire SCE's 740 MW of generation capacity  
5 from Units 4 and 5, for a net increase of 179 MW to APS's generation portfolio after the retirement  
6 of older Units 1-3, which would have otherwise required significant environmental upgrades.<sup>66</sup> Staff  
7 believes that the timing of the transaction was appropriate and appropriately balanced shareholder  
8 and customer interests.<sup>67</sup> Owing to the need for environmental upgrades to Four Corners Units 1-3  
9 and the fact that SCE could not recover the costs of any environmental upgrades to Units 4 and 5 due  
10 to California's regulatory requirements, APS had a narrow window of time in which it had to act.<sup>68</sup>  
11 Based on its review of APS's Integrated Resource Plan ("IRP") filings for 2014, Staff determined  
12 that for the 2017 to 2023 timeframe, with the Four Corners acquisition, APS's supply plan produces  
13 near optimum annual reserve margins.<sup>69</sup>

14 Staff found the transaction to be economically sound, after comparing the net present value  
15 impact of various alternative scenarios to the net present value impact of APS's acquisition. Staff  
16 states that the risks of the transaction cannot be perfectly quantified or mitigated, but that Staff  
17 concluded that the reasonably foreseeable risks of the transaction are more than offset by the  
18 economic benefits of the transaction. Staff found that there is a 99.4 percent chance that the  
19 transaction will have a positive net present value, with 90 percent confidence that the net present  
20 value will be between \$97 million and \$512 million.<sup>70</sup> Staff's analysis produced a net present value  
21 of \$315.5 million for the acquisition, compared to APS's \$425.6 million, with the difference largely  
22 due to differing estimates on future gas prices and carbon emissions cost projections, two inputs for  
23 which there is great uncertainty.<sup>71</sup> In contrast to the Sierra Club's assertion that APS's natural gas

24 \_\_\_\_\_  
25 <sup>65</sup> AIC Br. at 4, citing to Decision No. 73130 at 32.

26 <sup>66</sup> Staff Br. at 6.

27 <sup>67</sup> Staff Br. at 9-10.

28 <sup>68</sup> *Id.*

<sup>69</sup> *Id.* at 7, citing to Direct Testimony of Staff witness James Letzelter, Hearing Exh. S-1, attached Liberty Report at 5.

<sup>70</sup> *Id.* at 9, citing to Direct Testimony of Staff witness James Letzelter, Hearing Exh. S-1, attached Liberty Report at 13 and Tr. at 587-88.

<sup>71</sup> *Id.* at 7-8, citing to Direct Testimony of Staff witness James Letzelter, Hearing Exh. S-1, attached Liberty Report at 12.

1 price estimates were inappropriately high, Staff's witness found them to be conservatively low, and  
 2 based on gas price forecasts, found the transaction to be more economic than APS projected.<sup>72</sup>  
 3 Staff's analysis of carbon price forecasts, however, led to higher carbon prices than APS's and based  
 4 on carbon price projections, Staff found the transaction to be less economic than APS projected.<sup>73</sup>  
 5 Staff's witness testified that while new proposed EPA rules requiring future reductions in carbon  
 6 emissions will drive some coal-fired power plants into early retirement, he does not believe Four  
 7 Corners will be one of them.<sup>74</sup> Staff's witness did not believe that Four Corners' exposure due to the  
 8 new proposed EPA rules required the use of different assumptions in his analysis.<sup>75</sup>

9 According to Staff, the difference between the \$181,127,000 cash price APS paid for Four  
 10 Corners Units 4 and 5, and the negative book value of \$73,613,500 of the acquired assets and  
 11 liabilities, represents an acquisition adjustment of approximately \$254,787,393 (the acquisition  
 12 adjustment was updated in Staff's Surrebuttal Testimony to \$252,509,950).<sup>76</sup> Staff states that this  
 13 acquisition adjustment differs from those normally addressed by the Commission, in that this  
 14 acquisition involved an additional interest in an asset in which APS had an existing interest, and not  
 15 the acquisition of an entirely new system.<sup>77</sup> Staff states that while neither Decision No. 73130 nor  
 16 Decision No. 73183 addressed whether it would be appropriate to allow APS to recover the  
 17 acquisition adjustment resulting from the purchase of SCE's interest in Four Corners Units 4 and 5,  
 18 Staff supports such recovery.<sup>78</sup>

### 19 E. Conclusion

20 Based on its criticisms of APS's and Staff's analysis, Sierra Club recommends that the  
 21

22 <sup>72</sup> *Id.* at 8, citing to Direct Testimony of Staff witness James Letzelter, Hearing Exh. S-1, attached Liberty Report at 10-13.

23 <sup>73</sup> *Id.* at 8, citing to Direct Testimony of Staff witness James Letzelter, Hearing Exh. S-1, attached Liberty Report at 10-13.

24 <sup>74</sup> *Id.* at 8-9, citing to Direct Testimony of Staff witness James Letzelter, Hearing Exh. S-1, attached Liberty Report at 10-13 and Tr. at 590.

25 <sup>75</sup> *Id.*

26 <sup>76</sup> Staff Br. at 19. The book value (cost less accumulated depreciation) of Units 4 and 5 (including the auxiliary boiler) is approximately \$60,778,500. Adding the \$12,963,000 for the cost of other assets related to the acquisition and deducting the \$147,355,000 for the estimated cost of assumed liabilities produces a negative book value of approximately \$73,613,500. Direct Testimony of Staff witness Dennis Kalbarczyk, Hearing Exh. S-2 at 13. Surrebuttal Testimony of Staff witness Dennis Kalbarczyk, Hearing Exh. S-3 at 8.

27 <sup>77</sup> Staff Br. at 19.

28 <sup>78</sup> *Id.*

1 Commission reject APS's request to rate base the costs associated with the acquisition of Units 4 and  
2 5; condition future approval of rate base adjustments on a revised analysis that provides a full  
3 explanation for changes in assumptions since the initial proposal of the acquisition; and put APS on  
4 notice that a fully updated analysis will be required if it intends to request rate base treatment of  
5 future costs associated with APS assuming the 7 percent shortfall obligation associated with El Paso  
6 Electric's decision not to sign the 2016 coal supply agreement.

7 We have considered the arguments propounded by Sierra Club critiquing the inputs in APS's  
8 and Staff's analyses, and do not find them convincing. The review of the transaction undertaken by  
9 Staff's witness Mr. Letzelter vigorously tested the validity of APS's analytical approach and the data  
10 and models APS used to support the prudence of the acquisition. According to the analysis of Staff's  
11 witness, the transaction was prudent and the requested rate recovery pursuant to the terms of the  
12 Settlement Agreement adopted by Decision No. 73183 is appropriate. Based on the entirety of the  
13 record in this proceeding, we agree, and will not adopt Sierra Club's recommendations. Any  
14 additional costs for which APS requests recovery associated with coal supply will of course require  
15 justification, but at this time, we do not find it necessary to require a new net present value analysis of  
16 the acquisition in order to consider such a future request.

17 As Staff described, the acquisition will allow APS to acquire additional generation consistent  
18 with the load growth in APS's service territory, while allowing APS to maintain a diverse resource  
19 portfolio that does not overly expose APS's customers to the fuel price volatility that could result  
20 from over-reliance on natural gas as a fuel source.<sup>79</sup> The acquisition is economically sound and  
21 provides direct and indirect benefits. The transaction's direct benefits include preservation of more  
22 stable rates and protection of the existing investment in Units 4 and 5, as opposed to new investment  
23 in gas-fired generation.<sup>80</sup> Indirect economic benefits include retained jobs for the power plant, the  
24 Navajo Nation, and the coal mine that provides fuel for the plant.<sup>81</sup> We approve the acquisition  
25 because it will help ensure the continued provision of reliable and reasonably priced electricity for

26 <sup>79</sup> See Staff Br. at 10, citing to Direct Testimony of Staff witness James Letzelter, Hearing Ex. S-1, attached Liberty  
27 Report at 15.

28 <sup>80</sup> See Staff Br. at 10, citing to Direct Testimony of Staff witness James Letzelter, Hearing Ex. S-1, attached Liberty  
Report at 16.

<sup>81</sup> See *id.*.

1 customers in APS's service territory.

2 **IV. Fair Value Rate of Return**

3 APS, RUCO, and Staff proposed the following as the FVROR to be applied to the newly-  
4 acquired Four Corners assets:

	<u>Proposed FVROR</u>	<u>Derivation</u>	<u>Resulting Revenue Increase</u>	<u>Monthly Surcharge Rate</u>
7 APS	8.33%	WACC derived from the Settlement Agreement	\$65.44M	2.33%
8 RUCO	4.725%	Incremental cost of debt authorized in Decision No. 73130	\$49.20M	1.55%
9 Staff	6.09%	FVROR authorized in Decision No. 73183	\$57.05M	2.03%

10 APS, AIC, RUCO, and Staff briefed the issue.

11 **A. APS**

12 1. Settlement Agreement Terms

13 APS requests that the Commission use the WACC derived from the formula the settling  
14 parties used to calculate the FVROR in the Settlement Agreement as the FVROR to apply to the Four  
15 Corners rate base addition, instead of applying the FVROR established in Decision No. 73183.

16 According to APS, due to the 1 percent Fair Value Increment included in the FVROR  
17 methodology used to reach the 6.09 percent FVROR in the Settlement Agreement and adopted in  
18 Decision No. 73183, the increase in rate base associated with the acquisition of Four Corners Units 4  
19 and 5 requires the application of an 8.33 percent WACC to the newly acquired assets,<sup>82</sup> with the  
20 result that the FVROR "necessarily changes," from the FVROR of 6.09 percent the Commission  
21 authorized in Decision No. 73183, to 6.14 percent.<sup>83</sup>

22 APS asserts that in addition to the FVROR, other figures delineated in the Settlement  
23 Agreement and Decision No. 73183 also necessarily change due to the acquisition, including  
24 Paragraph 3.1 of the Settlement Agreement and Findings of Fact No. 40, which specify a non-fuel  
25

26 <sup>82</sup> APS asserts that the Settlement Agreement and Decision No. 73183 determined the WACC of 8.33 percent by the  
27 specific findings of a debt/equity ratio of 46.06 percent/53.94 percent, a Cost of Equity of 10 percent, and a Cost of Debt  
28 of 6.38 percent. APS Br. at 3, citing to Decision No. 73183 at Findings of Fact Nos. 37 and 38 and Settlement Agreement  
Paragraphs 5.1 and 5.2, and citing to Hearing Exh. APS-4 which shows the mathematical calculation of the inputs to  
arrive at a WACC of 8.33 percent.

<sup>83</sup> APS Br. at 2-4.

1 revenue increase; and Paragraph 3.2 of the Settlement Agreement and Findings of Fact No. 35, which  
 2 specify FVRB and OCRB.<sup>84</sup> APS adds that although it is not expressly delineated in the Settlement  
 3 Agreement, the agreed upon revenue requirement adopted by Decision No. 73183 also implicitly  
 4 included allowances for property taxes, depreciation expense, and other expenses which also must  
 5 necessarily increase in this proceeding to reflect the costs of the Four Corners acquisition.<sup>85</sup>

6           2.     Capital Cost Recovery

7           APS claims that the FVROR recommendations of both RUCO and Staff would fail to recover  
 8 the cost of capital associated with the Four Corners acquisition, and asserts that no party has  
 9 explained why recovery in rates of the WACC approved in Decision No. 73183 is not a rate base or  
 10 expense effect as described in Paragraph 10.3 of the Settlement Agreement.<sup>86</sup> APS disagrees with  
 11 Staff that the benefit conferred upon APS by the parties' agreement to hold the rate case open, for  
 12 consideration of rate recovery of the Four Corners acquisition, provides a justification for allowing  
 13 what APS believes is less than full recovery of APS's WACC on the newly-acquired assets.<sup>87</sup> APS  
 14 contends that any effect of Section 10 of the Settlement Agreement on either the 8.33 percent WACC  
 15 or the 1 percent Fair Value Increment was already reflected in the Settlement Agreement and  
 16 Decision No. 73183.<sup>88</sup>

17           APS asserts that its request to apply an 8.33 percent WACC to the newly-acquired assets is  
 18 not contrary to the rate-related expectations of the parties at the time of the Settlement Agreement,  
 19 and points out that Staff's expectation as set forth in Decision No. 73183 was that "the non-fuel  
 20 annual revenue requirement associated with the Four Corners transaction amounts to approximately  
 21 \$70 million annually."<sup>89</sup> APS argues that the only way the annual revenue requirement associated  
 22 with the Four Corners acquisition could be close to \$70 million was if APS's WACC was to be used  
 23 to develop that revenue requirement.<sup>90</sup>

24           APS posits that it would be "difficult to imagine" the Commission granting a FVROR that

25 <sup>84</sup> *Id.* at 2.

26 <sup>85</sup> *Id.*, citing to Tr. at 438 (redirect examination of APS witness Leland R. Snook).

27 <sup>86</sup> APS Reply Br. at 1.

28 <sup>87</sup> *Id.* at 2.

<sup>88</sup> *Id.* at 2-3.

<sup>89</sup> *Id.* at 2, citing to Decision No. 73183 at 25.

<sup>90</sup> APS Reply Br. at 2.

1 does not provide a utility with the opportunity to recover, at a minimum, the utility's WACC, citing  
 2 to Decision No. 53537 (April 27, 1983) (Arizona Water Company rates).<sup>91</sup> APS argues that no party  
 3 has cited to a Commission Decision issued since Decision No. 53537 that established a FVROR that  
 4 did not, at a minimum, recover the utility's WACC.<sup>92</sup>

5 Citing to the settlement agreements in APS's 2009 and 2012 rate cases, APS asserts that the  
 6 Commission determined a specified return on the Fair Value Increment in response to the court's  
 7 holding in *Chaparral City Water Co. v. Ariz. Corp. Comm'n*, 1 CA-CC 05-002 (Ariz. App. Feb. 13,  
 8 2007) (mem. decision).<sup>93</sup> APS contends that of the FVROR alternatives presented in this proceeding,  
 9 only APS's fully preserves the weight afforded FVRB in Decision No. 73183.<sup>94</sup> APS argues that  
 10 both RUCO's and Staff's recommendations effectively reduce the 1 percent return on the Fair Value  
 11 Increment specified in the 2012 Settlement Agreement in two ways - first by giving no incremental  
 12 weight to the FVRB associated with the Four Corners acquisition, and second, by diluting the return  
 13 on the Fair Value Increment the parties agreed to in the Settlement Agreement and adopted in  
 14 Decision No. 73183.<sup>95</sup>

15 3. Different FVROR for Existing Share and Newly-Acquired Share of Four  
 16 Corners Units 4 and 5

17 APS argues that there is no reason to treat the newly-acquired share differently from Decision  
 18 No. 73187's treatment of the existing share, and that under RUCO's and Staff's recommendations,  
 19 APS would not recover the rate base effects of the Four Corners acquisition, and that the result would  
 20 be contrary to Paragraph 10.3 of the Settlement Agreement and Decision No. 73183.<sup>96</sup> APS asserts  
 21 that Staff and RUCO have not persuasively explained why it would be appropriate to apply the  
 22 WACC approved in Decision No. 73183 to every rate base asset, including APS's pre-existing share  
 23

24 <sup>91</sup> APS Br. at 4.

25 <sup>92</sup> APS Br. at 4, APS Reply Br. at 6, citing to the following from Decision No. 53537:

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

29 <sup>93</sup> APS Reply Br. at 3, citing to Decision No. 71448 at Exhibit A, Paragraph 4.3, Attachment A, and Decision No. 73183  
 at Exhibit A, Paragraph 5.3.

30 <sup>94</sup> APS Reply Br. at 4.

31 <sup>95</sup> *Id.*

32 <sup>96</sup> APS Br. at 4.

1 of Four Corners Units 4 and 5, but not to the additional 48 percent of the same two units APS  
2 acquired from SCE.<sup>97</sup>

3 APS disputes Staff's position that Decision No. 71914 (September 30, 2010) ( UNS Electric  
4 ("UNSE") rates) supports use of Decision No. 73183's FVROR because the Commission rejected  
5 UNSE's request to apply its WACC as a return for its newly-acquired Black Mountain Generating  
6 Station ("BMGS"). APS asserts that Decision No. 71914 permitted UNSE to recover at least its  
7 WACC on FVRB, including BMGS, and contends that APS's position on FVROR in this proceeding  
8 is consistent with the FVROR awarded in Decision No. 71914 to UNSE.<sup>98</sup> APS argues that critical  
9 factual and legal differences distinguish the UNSE BMGS issue in Decision No. 71914 from the Four  
10 Corners acquisition issue here. APS believes that UNSE BMGS is distinguishable because the  
11 FVROR determination in the UNSE BMGS case was reached differently than the determination in  
12 Decision No. 73183, and in APS's prior rate case, Decision No. 71448 (December 30, 2009)(APS  
13 rates), which assigned a return value to the Fair Value Increment. Decision No. 71914 reached the  
14 FVROR determination by removing an inflation factor of 2.1 percent from UNSE's 8.28 percent  
15 WACC to produce a FVROR of 6.18 percent.<sup>99</sup> APS also believes Decision No. 71914 is  
16 distinguishable because BMGS was an entirely new and discrete generating unit, in contrast to the  
17 acquisition here, and because prior to acquiring BMGS, UNSE was the buyer in a power purchase  
18 agreement ("PPA") with the seller of BMGS, and the PPA provided for a return to the seller equal to  
19 UNSE's WACC. When the PPA was folded into UNSE's cost of service in the rate case, so was the  
20 return.<sup>100</sup> APS frames the issue before the Commission in the UNSE BMGS case as whether UNSE  
21 would be allowed a premium over and above the already-determined FVROR. APS argues that here,  
22 it is asking for an opportunity to recover only its WACC on the acquisition.<sup>101</sup>

23 ...

24 ...

25 <sup>97</sup> APS Br. at 4, APS Reply Br. at 1.

26 <sup>98</sup> APS Reply Br. at 5.

27 <sup>99</sup> APS asserts that the methodology used in the UNSE BMGS case mathematically favors utilities that have a large Fair Value Increment [difference between OCRB and Reconstruction Cost Depreciated ("RCND") ] relative to OCRB, as in the UNSE BMG case. APS Reply Br. at 5, citing to Decision No. 71914 at 51.

28 <sup>100</sup> APS Reply Br. at 4, citing to Decision No. 71914 at 32.

<sup>101</sup> APS Reply Br. at 4-5.

1           **B. AIC**

2           AIC argues that APS's proposal treats the Four Corners rate base addition as if it were part of  
 3 the original rate case, which is the reason this docket was held open until the acquisition was  
 4 completed.<sup>102</sup> Like APS, AIC contends that APS's application of the 8.33 percent WACC to the  
 5 newly-acquired assets will allow APS to rate base the effects of the acquisition as agreed by the  
 6 parties to the Settlement Agreement.<sup>103</sup> AIC opposes both RUCO and Staff's FVROR proposals,  
 7 arguing that neither would allow APS to recognize the rate base and expense effects of the  
 8 acquisition as set forth in Section 10.3 of the Settlement Agreement.<sup>104</sup> AIC asserts that it is  
 9 important, from an investor's standpoint, for the Commission to send a signal to the investment  
 10 community about the Commission's balanced and constructive regulatory approach by adopting  
 11 APS's position on FVROR, and states that the effect of adoption of RUCO or Staff's positions on  
 12 FVROR in this case will increase the impact of the acquisition on customers in the next rate case, a  
 13 result that AIC argues the parties to the Settlement Agreement sought to avoid by holding this rate  
 14 case docket open for the acquisition adjustment.<sup>105</sup>

15           AIC argues that of the three positions in this case on FVROR, RUCO's proposal varies most  
 16 from the provision of Section 10.3 of the Settlement Agreement that allows APS to reflect in rates the  
 17 rate base and expense effects of the acquisition transaction.<sup>106</sup> AIC argues that RUCO's  
 18 recommended FVROR, which is based on the 4.725 percent cost of debt the Commission authorized  
 19 for the deferral of acquisition costs in Decision No. 73130, relies on the wrong Commission  
 20 Decision, because the requirements of Decision No. 73183, the rate order, are controlling in this  
 21 matter.<sup>107</sup> AIC states that RUCO's proposed FVROR would result in a revenue requirement increase  
 22 approximately \$20 million less than the approximately \$70 million contemplated by the parties to the  
 23 Settlement Agreement.<sup>108</sup> AIC finds fault with RUCO's argument that minimization of rate impacts  
 24 should guide the Commission's FVROR determination in this proceeding. AIC claims that rate

25 <sup>102</sup> AIC Br. at 4, citing to Surrebuttal Testimony of AIC witness Gary Yaquinto, Hearing Exh. AIC-2 at 4.

26 <sup>103</sup> AIC Br. at 4, AIC Reply Br. at 7.

27 <sup>104</sup> AIC Br. at 2.

<sup>105</sup> *Id.* at 2-3.

<sup>106</sup> AIC Reply Br. at 5.

<sup>107</sup> *Id.* at 4.

28 <sup>108</sup> *Id.*

1 impact minimization was directed in Decision No. 71310, not Decision No. 73183; that APS's  
 2 position does minimize rate impact, by cutting the anticipated revenue requirement by \$4.5 million  
 3 from what was anticipated, which reduces the anticipated average residential impact from 3 percent  
 4 to 2.33 percent; and that RUCO's position ignores the positive impact that the transaction will have  
 5 for customers.<sup>109</sup>

6 AIC contends that the parameters for this proceeding are set forth in Section 10 of the  
 7 Settlement Agreement, which makes no mention of the 6.09 percent FVROR which is set forth in  
 8 Section 5 of the Settlement Agreement.<sup>110</sup> AIC argues that if the parties, in crafting the Settlement  
 9 Agreement, or the Commission, in approving it, wished to have the 6.09 percent FVROR included in  
 10 Section 10 of the Settlement Agreement, it could have been specified, but that it was not.<sup>111</sup> AIC  
 11 further argues that the parties are "expressly prohibited" from relying on Section 5.3 of the  
 12 Settlement Agreement in this proceeding by Section 10.4, which states: "The signatories shall not  
 13 raise any issues in the rate adjustment proceeding other than those specifically described in Section  
 14 10.2."<sup>112</sup> AIC contends that Staff's proposed 6.09 percent FVROR would not allow APS to realize  
 15 the results intended in the terms of the Settlement Agreement, which AIC describes as minimizing  
 16 the earnings erosion that would otherwise result from the agreed-upon four year rate case stay-out  
 17 provision, supporting APS's earnings profile in the interim, and avoiding negative earnings and  
 18 ratings impacts.<sup>113</sup>

### 19 C. RUCO

#### 20 1. Settlement Agreement Terms

21 RUCO states that the cost of capital that would be attributable to rate base increases is  
 22 mentioned nowhere in the Settlement Agreement,<sup>114</sup> and that the Commission has the discretion to  
 23 choose the FVROR it wishes to apply moving forward.<sup>115</sup>

24 . . .

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25 <sup>109</sup> AIC Reply Br. at 4-5.

26 <sup>110</sup> *Id.* at 6, 7.

27 <sup>111</sup> *Id.* at 6.

28 <sup>112</sup> *Id.* at 6-7.

<sup>113</sup> *Id.* at 6.

<sup>114</sup> RUCO Br. at 4-5, citing to Tr. at 94-97 (cross-examination of APS witness Jeffrey Guldner).

<sup>115</sup> RUCO Reply Br. at 1, 3.

1                   2.     Impact to Ratepayers

2                   RUCO contends that the Commission directive in Decision No. 73130 that APS manage the  
3 Four Corners acquisition to minimize the rate impact to customers should guide the issue of the  
4 appropriate FVROR to apply to the new assets in this proceeding. RUCO argues that the 4.725  
5 percent cost of debt approved in Decision No. 73130 most closely aligns with the Commission's  
6 objective of protecting ratepayers.<sup>116</sup> In contrast, RUCO argues, approving APS's request to use the  
7 8.33 percent WACC as the FVROR would have the opposite effect, maximizing the rate impact to  
8 APS customers.<sup>117</sup>

9                   3.     Capital Cost Recovery

10                  RUCO argues that the circumstances of the acquisition warrant unique ratemaking treatment  
11 that would result in recovery of less than APS's full cost of capital, and RUCO disagrees with APS's  
12 position that it should earn its full cost of capital on the rate base increase associated with the  
13 acquisition.<sup>118</sup> RUCO contends that the unusual circumstance of holding the rate case open pending  
14 the acquisition to allow inclusion of the costs associated with the acquisition warrants a variation  
15 from usual ratemaking treatment.<sup>119</sup> RUCO acknowledges that normally, the Commission provides  
16 full cost of capital treatment for rate base additions, but asserts that because the acquisition occurred  
17 far from the 2010 test year, different treatment of the acquisition is warranted.<sup>120</sup> Additionally,  
18 RUCO asserts that awarding a lower FVROR to the newly acquired share of Four Corners Units 4  
19 and 5 from that earned by APS's existing share of Units 4 and 5 is appropriate, because the requested  
20 rate base addition was acquired at more than book value.<sup>121</sup>

21                  In response to APS's argument that consistent with Decision No. 53537, the Commission  
22 should award a FVROR that recovers no less than the WACC, RUCO states that Decision No. 53537  
23

24 \_\_\_\_\_  
25 <sup>116</sup> RUCO Br. at 2 and Reply Br. at 1, citing to Decision No. 73130 at 37, which states as follows: "We expect APS to  
26 manage the acquisition of the interest in Units 4 and 5 and the proposed transaction with a goal of minimizing the rate  
27 impact to customers, while at the same time, maximizing the environmental benefits of accelerating the retirement of  
28 Units 1-3."

<sup>117</sup> RUCO Reply Br. at 1-2.

<sup>118</sup> RUCO Br. at 5-6.

<sup>119</sup> *Id.* at 2-3.

<sup>120</sup> *Id.* at 3.

<sup>121</sup> RUCO Br. at 4, 6, RUCO Reply Br. at 3

1 did not address an acquisition such as this one.<sup>122</sup> RUCO argues that in this case, the Commission  
 2 has already made a determination that awarded less than full cost of capital treatment, in Decision  
 3 No. 73130, by granting cost deferral of only the documented debt cost for nonfuel costs associated  
 4 with the expected acquisition, and not capital or carrying costs.<sup>123</sup> RUCO contends that its proposal  
 5 in this case to use the debt cost as the FVROR is consistent with both the debt cost treatment in the  
 6 accounting order authorized by Decision No. 73130, and with the goal of keeping the rate impact of  
 7 the acquisition to a minimum.<sup>124</sup>

#### 8 **D. Staff**

##### 9 1. Settlement Agreement Terms

10 Staff recommends that the FVROR adopted by the Commission in this matter in Decision No.  
 11 73183 be applied to the new rate base associated with the Four Corners Units 4 and 5 acquisition.  
 12 Staff believes that the terms of the Settlement Agreement approved in Decision No. 73183 relevant to  
 13 the correct FVROR are not ambiguous, and that APS's proposal to recalculate the FVROR would  
 14 confer upon it a benefit not contemplated by the plain language of the Settlement Agreement,  
 15 canceling the settlement result achieved by the other parties.<sup>125</sup> Staff contends that its 6.09 percent  
 16 FVROR proposal is the only proposal supported by the Settlement Agreement, and APS's proposed  
 17 revenue increase should be rejected because it is not based on the FVROR agreed to in Section 5 of  
 18 the Settlement Agreement and adopted by Decision No. 73183.<sup>126</sup>

19 Staff argues that APS's position ignores that that 6.09 percent FVROR was the product of a  
 20 give and take settlement between the parties, and claims that adoption of APS's position would result  
 21 in APS continuing to receive a significant value from Section 10.2 of the Settlement Agreement, but  
 22 cancellation of the value achieved by Section 10.2 for other parties.<sup>127</sup> Staff states that together,  
 23 Decision Nos. 73130 and 73183 provide significant benefit to APS, and argues that if the Four  
 24 Corners FCRR had not been authorized through Section 10.2 of the Settlement Agreement, APS

25 \_\_\_\_\_  
 26 <sup>122</sup> RUCO Br. at 6, RUCO Reply Br. at 2.

<sup>123</sup> RUCO Br. at 3, RUCO Reply Br. at 2.

<sup>124</sup> RUCO Br. at 4.

<sup>125</sup> Staff Br. at 12.

<sup>126</sup> Staff Br. at 11-18, Staff Reply Br. at 1-4.

<sup>127</sup> Staff Br. at 15, Staff Reply Br. at 3, 16.

1 would have only been able to recoup its cost of debt as provided in Decision No. 73130, for the  
2 deferral period until APS's next rate case.<sup>128</sup> Staff points out that Section 10.2 of the Settlement  
3 Agreement states only that the rate base and expense effects associated with the acquisition shall be  
4 recognized, and makes no similar reference to the FVROR.<sup>129</sup> Staff contends that had the parties  
5 intended to update the FVROR, language could have been inserted into Section 10.2 of the  
6 Settlement Agreement, and because it was not, recalculation of the FVROR would be  
7 inappropriate.<sup>130</sup>

8 Staff disagrees with APS's argument that using Staff's recommended 6.09 percent FVROR  
9 would ignore the rate base and expense effects of the acquisition. Staff contends that its  
10 recommendation appropriately recognizes the rate base and expense effects of the acquisition, noting  
11 that APS accurately calculated and supported its proposed revenue requirement elements, with the  
12 exception of the FVROR.<sup>131</sup> Staff disputes APS's contention that paragraphs 3.1 and 3.2 of the  
13 Settlement Agreement and Findings of Fact Nos. 40 (authorized revenues) and 35 (OCRB and  
14 FVRB) in Decision No. 73183 must be modified in this Decision to reflect updated information.<sup>132</sup>  
15 Staff asserts that these provisions merely set forth the various elements of the rate increase granted in  
16 Decision No. 73183, and that the Settlement Agreement expressly required updated rate base and  
17 expense information associated with the Four Corners transaction.<sup>133</sup>

## 18 2. FVROR Formula

19 Staff states that the Commission is not bound to use a rigid formula to determine FVROR and  
20 argues that APS's reliance on the output of a formula is misplaced. Staff asserts that APS's  
21 implication that the Commission is compelled as a matter of law to use the proposed formula and

22 <sup>128</sup> Staff Reply Br. at 3.

23 <sup>129</sup> Staff Br. at 12.

24 <sup>130</sup> *Id.*

25 <sup>131</sup> Staff notes on brief, citing to the Surrebuttal Testimony of Staff witness Dennis Kalbarczyk, Hearing Exh. S-3 at 8-9,  
26 that using APS's updated projections to November 30, 2014, which Staff accepted, the acquired plant in service (inclusive  
27 of the acquisition adjustment, the auxiliary boiler, and the deferred expenses) is \$939,446,031, and less accumulated  
28 depreciation of \$555,871,704, net plant in service is \$383,614,337. With the addition of deferred debits of \$4,633,133  
less deferred credits of \$154,321,424, the rate base adjustment for the transaction totals \$225,933,911, after APS's 96.06  
allocation factor is applied. Staff further notes, citing to the Surrebuttal Testimony of Staff witness Dennis Kalbarczyk,  
Hearing Exh. S-3 at 10, that Staff accepted the pro forma adjustments resulting from the transaction to APS's operating  
income of \$20,680,000, which reflects a deferral period through November 30, 2014. Staff Br. At 13.

<sup>132</sup> Staff Reply Br. at 2-3.

<sup>133</sup> *Id.* at 2.

1 WACC as the FVROR for Four Corners Units 4 and 5 is inconsistent with the Commission's  
 2 ratemaking discretion under the Arizona Constitution.<sup>134</sup> Staff contends that accepting APS's  
 3 position that the FVROR is a "mathematical exercise" would mean that the FVROR is "in all cases  
 4 simply the byproduct of a mathematical formula where the Commission does not have the ability or  
 5 discretion to structure a return that is fair in any given case, and the significant discretion afforded the  
 6 Commission would be severely limited."<sup>135</sup> In addition, Staff takes issue with the WACC and OCRB  
 7 inputs APS used in the proposed formula. Staff states that the \$226 million price APS paid to acquire  
 8 the Four Corners Units 4 and 5 assets does not accurately represent the OCRB of the new assets,  
 9 because it includes an acquisition adjustment of approximately \$254,787,393 (the acquisition  
 10 adjustment was updated in Staff's Surrebuttal Testimony to \$242,509,950).<sup>136</sup> Staff's witness Mr.  
 11 Kalbarczyk testified that while the \$226 million purchase price, which was the product of an arm's  
 12 length transaction, reflects the best indicator of fair value of the facilities for determining the revenue  
 13 requirement in this case, it is not an accurate representation of OCRB.<sup>137</sup>

14 Staff contends that APS's reliance on Decision No. 53537 for the proposition that APS is  
 15 entitled to recover its WACC at a minimum is misplaced, because it was issued well before the  
 16 Arizona Court of Appeals decision in *Chaparral City Water Company*,<sup>138</sup> and because Decision No.  
 17 53537 did not involve a settlement agreement.<sup>139</sup>

18 Staff believes that the Commission's determination in Decision No. 71914 on the FVROR to  
 19 be applied to newly-acquired plant supports Staff's position in this case. In Decision No. 71914, the  
 20 Commission decided an issue raised by UNSE, where UNSE had requested a higher FVROR for the  
 21 BMGS. UNSE argued that its WACC should be used as the FVROR for the BMGS asset, because  
 22 the OCRB and RCND for BMGS were nearly identical. Staff points out that in the UNSE BMGS

23 <sup>134</sup> Staff Br. at 17.

24 <sup>135</sup> *Id.* at 16, citing to Surrebuttal Testimony of Staff witness Dennis Kalbarczyk, Hearing Exh. S-3 at 5.

25 <sup>136</sup> Staff Br. at 17 and 19, citing to Direct Testimony of Staff witness Dennis Kalbarczyk, Hearing Exh. S-2 at 13 (The  
 26 book value (cost less accumulated depreciation) of Units 4 and 5 (including the auxiliary boiler) is approximately  
 \$60,778,500. Adding the \$12,963,000 for the cost of other assets related to the acquisition and deducting the  
 \$147,355,000 for the estimated cost of assumed liabilities produces a negative book value of approximately \$73,613,500.)  
 and Surrebuttal Testimony of Staff witness Dennis Kalbarczyk, Hearing Exh. S-3 at 6. Surrebuttal Testimony of Staff  
 27 witness Dennis Kalbarczyk, Hearing Exh. S-3 at 8.

<sup>137</sup> Staff Br. at 17, citing to Surrebuttal Testimony of Staff witness Dennis Kalbarczyk, Hearing Exh. S-3 at 6.

<sup>138</sup> *Chaparral City Water Co. v. Ariz. Corp. Comm'n*, 1 CA-CC 05-002 (Ariz. App. Feb. 13, 2007)(mem. decision).

28 <sup>139</sup> Staff Br. at 16, Staff Reply Br. at 3.

1 case, the Commission rejected UNSE's argument, as follows:

2 We do not find it appropriate to use a separate FVROR with BMGS. A Company's  
3 rate base is comprised of both new and old plant, and it would be onesided to apply a  
4 different (higher) rate of return to only newly acquired individual items of plant.<sup>140</sup>

5 Staff contends that it would also be one-sided in this case to apply a different (higher) rate of  
6 return to APS's newly acquired interest in Four Corners Units 4 and 5.<sup>141</sup>

### 7 3. Re-Evaluation of WACC

8 Staff argues that if, as alleged by APS, the FVROR is asset-specific and should change as a  
9 result of the acquisition, then all aspects of the FVROR should be re-examined before the surcharge  
10 takes effect.<sup>142</sup> Staff states that it may be appropriate to use RUCO's proposed FVROR of 4.725  
11 percent to reflect that APS incurred long-term debt in the amount of \$250 million specifically for the  
12 acquisition.<sup>143</sup> Staff contends that using the 8.33 percent WACC embedded in the Settlement  
13 Agreement for a specific asset would be inappropriate, because the debt and equity components of  
14 the FVROR for the specific asset should also be reevaluated.<sup>144</sup> Staff asserts that such re-evaluation  
15 should include updating of both the WACC and FVROR to reflect the individual financing  
16 arrangements and risk reduction associated with the Four Corners deferral and the FCRR, including  
17 the benefit to APS of holding open the rate case to allow for rate treatment of the Four Corners  
18 acquisition through a surcharge.<sup>145</sup> Staff states that the debt/equity ratio associated with the  
19 acquisition is quite different from that suggested by APS. Staff points out that the information  
20 provided in the prospectus for APS's recent debt offering suggests conservatively that the \$225  
21 million rate base addition was funded by an 80/20 debt/equity ratio of 4.725 percent debt and 10  
22 percent equity, which would produce a 5.75 percent WACC.<sup>146</sup>

23 . . .

24 . . .

25 <sup>140</sup> Staff Br. at 18 and Staff Reply Br. at 4, citing to Decision No. 71914 at 52.

26 <sup>141</sup> Staff Br. at 18.

<sup>142</sup> *Id.* at 15.

<sup>143</sup> *Id.*

27 <sup>144</sup> Staff Br. at 15, Staff Reply Br. at 4.

<sup>145</sup> *Id.*

28 <sup>146</sup> Staff Reply Br. at 4, citing to Prospectus for APS's \$250 Million Debt Offering, Hearing Exh. S-5.

1           **E. Conclusion**

2           The FCRR Application requests an addition to FVRB of \$225,933,911 associated with the  
3 acquisition of SCE's share of Four Corners Units 4 and 5, and pro forma adjustments resulting from  
4 the acquisition to APS's operating income totaling \$20,680,000. Staff agreed with APS's FVRB and  
5 Operating Income adjustments, and no party objected to their accuracy. These requests for  
6 recognition of the rate base and expense effects of the acquisition were made in compliance with the  
7 requirements of Decision No. 73183, are supported by the evidence in this proceeding, and will be  
8 adopted to determine the additional revenue requirement to be recovered via the FCRR.

9           APS's request for an increase to the FVROR authorized in Decision No. 73183 was not made  
10 in compliance with the requirements of Decision No. 73183, is not supported by the evidence in this  
11 proceeding, and would result in rates that would recover in excess of the rate base and expense  
12 effects of the completed acquisition. The facts and legal arguments presented in this docket do not  
13 support APS's requested change to the FVROR established in Decision No. 73183.

14           As we stated in Decision No. 71308, the FVROR is intended to allow a utility to attract  
15 capital on reasonable terms; maintain the utility's financial integrity; and permit the utility an  
16 opportunity to realize a return that is commensurate with the returns earned by enterprises with  
17 commensurate risks.<sup>147</sup> The FVROR must also produce a result that does not overcompensate the  
18 utility for the fair value of its property through rates and charges that are not just and reasonable.<sup>148</sup>  
19 The FVROR authorized in Decision No. 73183 is just and reasonable. Use of the FVROR of 6.09  
20 percent was authorized by the Commission, and agreed upon by all the parties. Nothing in the  
21 Settlement Agreement or in Decision No. 73183 authorizes the FVROR to change. The only  
22 authorized changes are the rate base and operating expenses associated with the Four Corners  
23 acquisition. The authorized FVROR will apply to APS's entire rate base, and not single out only new  
24 plant, and will allow APS to recover its WACC because it was derived using the 8.33 percent  
25 WACC. It would be inappropriate to change the FVROR without updating the cost of capital.

26  
27  
28 <sup>147</sup> Decision No. 71308 at 47.

<sup>148</sup> See, e.g., Decision No. 70441 at 33.

1 The FCRR Application requests an increase to the FVROR to be applied to the rate base  
2 addition of the Four Corners acquisition from 6.09 percent to 8.33 percent. The result of this request  
3 would be a change to the FVROR agreed to by the parties, and adopted by the Commission from 6.09  
4 percent to 6.14 percent. In its determinations of FVROR, the Commission has used two different  
5 methods to make sure that inflation is not double counted when applying a rate of return to  
6 FVRB; the method adopted in the Settlement Agreement, which eliminates inflation by applying  
7 the WACC to OCRB, and then potentially adding an extra Fair Value Increment, or by the  
8 method where inflation is removed from the WACC and applied to FVRB.

9 Contrary to the assertions of APS and AIC, neither Decision No. 73183 nor the Settlement  
10 Agreement provided that the FVROR determined therein would change as a result of this proceeding.  
11 APS implies that because the settling parties reached the 6.09 percent FVROR using a Fair Value  
12 Increment methodology, the FVROR must necessarily change with the rate base addition. AIC  
13 argues that if the parties had wished to include the 6.09 percent FVROR in Section 10 of the  
14 Settlement Agreement, it could have been specified, but that it was not. AIC does not, however,  
15 explain how the filing requirements in Section 10.2 could be read to indicate that the settling parties  
16 contemplated a change to the agreed-upon FVROR. Section 10 contains no requirement for the filing  
17 of any cost of capital schedules or analysis that would be necessary to update the cost of capital or  
18 support a different FVROR than that agreed to by the parties, and which the Commission found  
19 reasonable and adopted in Decision No. 73183. No mention of a WACC of 8.33 percent is made in  
20 either the Settlement Agreement or Decision No. 73183. Further, the Settlement Agreement did limit  
21 the operating income resulting from the Four Corners rate adjustment. Section 10.3 states:

22 Any filing seeking a rate adjustment pursuant to Section 10.2 shall include at a  
23 minimum the following schedules: . . . (3) an earnings schedule that demonstrates that  
24 the operating income resulting from the rate adjustment does not result in a return on  
25 rate base in excess of that authorized by this Agreement in the period after the  
adjustment becomes effective . . .

26 Figure A appearing in the Rebuttal Testimony of APS witness Leland Snook demonstrates that APS's  
27 proposal would result in a FVROR in excess of what was authorized in the Settlement Agreement  
28 and in Decision No. 73183.

1 APS's attempt to justify its request by claiming that it is entitled to recover a WACC of 8.33  
2 percent on the newly-acquired assets fails on several levels. First, rates are not set based on  
3 application of the WACC to FVRB, but by application of the FVROR to FVRB. Second, even  
4 assuming *arguendo* that it would be proper to apply the WACC to FVRB, it is unknown at this time,  
5 nearly four years from the test year in this proceeding, what APS's actual WACC is. The WACC  
6 that was used in the Settlement Agreement to reach the agreed-upon FVROR may not be the WACC  
7 that would be determined today for APS. As Staff has pointed out, APS's recent debt offering to  
8 fund the acquisition would likely result in the finding of a different (and lower) WACC for APS than  
9 that which existed in 2012.<sup>149</sup> Third, as we stated in the UNSE BMGS case, "[a] Company's rate  
10 base is comprised of both new and old plant, and it would be on-sided to apply a different (higher)  
11 rate of return to only newly acquired individual items of plant."<sup>150</sup> As we found in that case, it is not  
12 appropriate to use a separate FVROR for the newly-acquired plant.

13 APS contends that application of the FVROR authorized in Decision No. 73183 to the FVRB  
14 increase would effectively reduce the 1 percent return on the Fair Value Increment in the Settlement  
15 Agreement. This argument is not convincing. APS proposed a FVRB that is equal to its proposed  
16 OCRB. The Fair Value Increment is equal to FVRB minus OCRB, which in this case is zero.  
17 According to Section 5.3 of the Settlement Agreement, the 6.09 percent FVROR includes a return on  
18 the Fair Value Increment of 1 percent. Although there is no Fair Value Increment on the Four  
19 Corners acquisition, the FVROR of 6.09 percent is not being reduced by that 1 percent.

20 APS argues that applying the 6.09 percent FVROR to the FVRB increase will result in the  
21 application of a different WACC to APS's newly-acquired share of Four Corners Units 4 and 5  
22 compared to its pre-existing share of those units. APS's argument is misleading in two respects.  
23 First, as we stated before, rates are set by applying a FVROR to FVRB, not by applying WACC to  
24 FVRB. The same FVROR will be applied to all assets in APS's FVRB. Second, APS's argument  
25 implies that Decision No. 73183 did not contemplate, in its determination of a just and reasonable

26 \_\_\_\_\_  
27 <sup>149</sup> As Staff pointed out, the information provided in the prospectus in APS's recent debt offering suggests conservatively  
28 that the \$225 million rate base addition was funded by an 80/20 debt/equity ratio of 4.725 percent debt and 10 percent  
equity, which would produce a 5.75 percent WACC.

<sup>150</sup> Decision No. 71914 at 52.

1 FVROR, the rate base addition for which this record was held open. The implication that the likely  
2 addition to FVRB was not considered in Decision No. 73183's determination of an appropriate  
3 FVROR is disingenuous. The fact that APS might acquire SCE's share of Four Corners Units 4 and  
4 5 was fully contemplated at the time the parties reached consensus on an appropriate FVROR, when  
5 the FVROR recommendation was presented to the Commission, and when the Commission  
6 determined that a FVROR of 6.09 percent was just and reasonable, and adopted it.

7 In Decision No. 73130, we referred to Staff's estimation at the time of the non-fuel related  
8 annual revenue requirement that might be associated with the Four Corners transaction, at  
9 approximately \$70 million. APS and AIC both refer to this figure in an attempt to justify APS's  
10 proposal. APS fails to note, as does AIC in referring to the \$70 million figure, that the \$70 million  
11 revenue requirement estimate was made prior to the \$100 million reduction in the purchase price that  
12 APS achieved due to the delay in closing of the transaction. It would be wholly inappropriate to  
13 inflate the return on the actual investment beyond the agreed upon and adopted 6.09 percent FVROR  
14 in order to satisfy a projected revenue stream that was based on different investment levels, when the  
15 capital investment was actually lower than expected, especially when we are granting an acquisition  
16 adjustment.

17 The facts before us and the legal arguments presented in this proceeding do not support APS's  
18 requested change to the 6.09 percent FVROR established in Decision No. 73183. We find that the  
19 FVROR established in Decision No. 73183 continues to be appropriate and will result in just and  
20 reasonable rates. Accordingly, we will allow recovery of \$57.05 million via the FCRR.

21 **V. Applicability of FCRR to AG-1 Schedule**

22 Section 17.1 of the Settlement Agreement, as approved by Decision No. 73183, authorized  
23 Schedule AG-1, the Experimental Rate Rider Schedule AG-1 Alternative Generation General  
24 Service, which was attached to the Settlement Agreement as Attachment J. For ease of reference, a  
25 copy of Schedule AG-1 is attached hereto as Exhibit B. Schedule AG-1 is a rate rider tariff available  
26 for Standard Offer customers who have an Aggregated Peak Load of 10 MW or more and are served  
27 under Rate Schedules E-34, E-35, E32-L, or E-32 TOU L. An aggregated group may also include  
28 metered accounts that are served under Rate Schedules E-32 M or E-32 TOU M, if the accounts are

1 located on the same premises and served under the same name as an otherwise eligible customer.<sup>151</sup>  
 2 Total program participation is limited to 200 MW.<sup>152</sup> APS received customer requests to participate  
 3 in the program well in excess of the 200 MW limit, and conducted a lottery as a means of equitably  
 4 selecting participants, pursuant to the requirements of Schedule AG-1.<sup>153</sup> Schedule AG-1 allows  
 5 participating APS customers to select specific third-party GSPs who sell wholesale power to APS  
 6 on behalf of the specific customers who have selected them.<sup>154</sup> The alternative buy-through  
 7 generation is utilized for the participating AG-1 customers in lieu of APS's generation.<sup>155</sup> APS  
 8 purchases and manages the requested generation on behalf of the AG-1 customers.<sup>156</sup>

9 The AG-1 Intervenors contend that the terms of the Settlement Agreement exempt them from  
 10 application of the Four Corners FCRR. APS, the AG-1 Intervenors, RUCO, and Staff briefed the  
 11 issue.

#### 12 A. APS

13 APS contends that it is fair and consistent with the plain language of the Settlement  
 14 Agreement to apply the FCRR increase to the services relating to AG-1 customers' underlying retail  
 15 schedules (E-34, E-35 and E-32L), with the exception of the exclusions appearing on Page 4 of  
 16 Schedule AG-1. APS contends that its proposal for applying the FCRR to Schedule AG-1 properly  
 17 gives the intended meaning to both Section 17.1 of the Settlement Agreement, which refers to  
 18 Schedule AG-1, and also to Section 10.3, which provides that the Four Corners FCRR should be  
 19 assessed on "an equal percentage basis across all rate schedules."<sup>157</sup> APS states that it did not apply  
 20 the FCRR increase to any of the charges only applicable to Schedule AG-1, but applied the increase  
 21 to the same rate elements of AG-1 customers' underlying retail schedules as for other E-34, E-35 and  
 22 E-32L customers not selected for Schedule AG-1, except for the list of exclusions appearing on Page  
 23

24 <sup>151</sup> Schedule AG-1.

25 <sup>152</sup> *Id.*

26 <sup>153</sup> Staff Br. at 20.

27 <sup>154</sup> AG-1 Intervenors' Br. at 2, citing to Direct Testimony of AECC, Noble Solutions and The Kroger Co. witness Kevin C. Higgins, Hearing Exh. ANK-1 at 6; Staff Br. at 20.

28 <sup>155</sup> AG-1 Intervenors' Br. at 2, citing to Direct Testimony of AECC, Noble Solutions and The Kroger Co. witness Kevin C. Higgins, Hearing Exh. ANK-1 at 6.

<sup>156</sup> Staff Br. at 20.

<sup>157</sup> APS Br. at 7-8.

1 4 of Schedule AG-1.<sup>158</sup>

2 APS disagrees with the AG-1 Intervenors' contention that the term "generation" at page 4 of  
 3 Schedule AG-1 is a broad generic term encompassing all costs reasonably attributable to APS  
 4 generation. APS, like Staff, asserts that if the lower case term "generation" had the all-inclusive  
 5 meaning argued by the AG-1 Intervenors, there would have been no need to list the Power Supply  
 6 Adjustor ("PSA") and the Environmental Impact Surcharge ("EIS") in Schedule AG-1 as separate  
 7 exclusions.<sup>159</sup> APS contends that because those items are listed as separate exclusions, the most  
 8 reasonable conclusion is that the term "generation" refers solely to the unbundled generation charge  
 9 in the AG-1 customers' underlying rate schedules.<sup>160</sup>

10 APS believes that its proposal to apply the FCRR to those services directly supplied by APS  
 11 to AG-1 customers and other customers similarly situated, rather than assessing it on the AG-1  
 12 customer's entire bill, harmonizes two different provisions of the Settlement Agreement and treats all  
 13 customers eligible for Schedule AG-1 fairly.<sup>161</sup>

#### 14 **B. AG-1 Intervenors**

15 The AG-1 Intervenors oppose APS's proposal to apply the FCRR to only those services  
 16 directly supplied by APS to AG-1 customers. They also oppose RUCO's proposal to apply the  
 17 FCRR to the reserve capacity charges delineated in Schedule AG-1, suggesting that to the extent APS  
 18 may incur additional costs associated with its reserve capacity as a result of the acquisition, APS is  
 19 free to seek an increase in the reserve capacity charge at the Federal Energy Regulatory Commission  
 20 ("FERC"), and any such increase authorized by FERC will flow through to AG-1 customers as  
 21 provided by Schedule AG-1.<sup>162</sup>

22 The AG-1 Intervenors assert that APS's proposal for application of the FCRR to AG-1  
 23 customers is "rooted in its mistaken belief that there is a conflict between Section 10.3 [of the  
 24 Settlement Agreement] and Attachment J [Schedule AG-1]."<sup>163</sup> The AG-1 Intervenors argue that

25 <sup>158</sup> *Id.*

26 <sup>159</sup> APS Reply Br. at 9, citing to Staff Br. at 21-22.

27 <sup>160</sup> APS Reply Br. at 9.

28 <sup>161</sup> APS Br. at 8.

<sup>162</sup> AG-1 Intervenors Br. at 11.

<sup>163</sup> AG-1 Intervenors Br. at 5, citing to Tr. at 72 (cross examination testimony of APS witness Jeffrey Guldner) and Tr. at 326 (cross examination testimony of APS witness Leland Snook).

1 contrary to the claims of some parties, the language used in the Settlement Agreement is neither  
 2 ambiguous nor inconsistent regarding whether AG-1 customers should pay the FCRR charges.<sup>164</sup>  
 3 The AG-1 Intervenor contend that even if there were ambiguity in the Settlement Agreement, that  
 4 the specific terms of Schedule AG-1 supersede the terms of Section 10.3 of the Settlement  
 5 Agreement.<sup>165</sup>

6 The AG-1 Intervenor also contend that because Schedule AG-1 is a rate rider, and not a rate  
 7 schedule, like the rate schedules E-34, E-35 and E-32L under which AG-1 customers take service, to  
 8 the extent the terms of the rider schedule are inconsistent with those of the underlying rate schedule,  
 9 the terms of the rate rider supersede, or “trump” those of the underlying rate schedule.<sup>166</sup> The AG-1  
 10 Intervenor contend that Page 1 of Schedule AG-1 specifically so states this “trumping effect,” in the  
 11 following sentence: “[a]ll provisions of the customer’s applicable rate schedule will apply in addition  
 12 to this Schedule AG-1, except as modified herein.”<sup>167</sup> According to the AG-1 Intervenor, the  
 13 exemption “[t]he generation charges will not apply” at Page 4 of Schedule AG-1<sup>168</sup> has the effect of  
 14 modifying the otherwise applicable provisions of the customers’ underlying retail rate schedules, and  
 15 therefore the charges recovered through the FCRR surcharge, which the AG-1 intervenors argue are  
 16 generation charges, cannot be applied to AG-1 customers.<sup>169</sup>

17 The AG-1 Intervenor state that Schedule AG-1 does require them to pay some generation-  
 18 related charges, including a reserve capacity charge, a buy-out charge related to fuel hedging costs,  
 19 and a GSP default charge, but that AG-1 customers are only responsible for those costs because they

20 \_\_\_\_\_  
 21 <sup>164</sup> AG-1 Intervenor Br. at 6.

<sup>165</sup> *Id.* at 8-11.

<sup>166</sup> AG-1 Intervenor Br. at 7, AG-1 Intervenor Reply Br. at 5.

<sup>167</sup> AG-1 Intervenor Br. at 7, citing to Schedule AG-1.

<sup>168</sup> The section of Schedule AG-1 in dispute reads as follows:

23 RATES

24 All provisions, charges and adjustments in the customer’s applicable retail rate schedule will continue  
 to apply except as follows:

- 25 1. The generation charges will not apply;
- 26 2. Adjustment Schedule PSA-1 will not apply, except that the Historical Component will apply  
 for the first twelve months of service under this rate rider schedule;
- 27 3. Adjustment Schedule EIS will not apply; and
- 28 4. The applicable proportionate part of any taxes or governmental impositions which are or may  
 in the future be assessed on the basis of gross revenues of the Company and/or the price or  
 revenue from the electric energy or service sold and/or the volume of energy generated or  
 purchased for sale and/or sold hereunder shall be applied to the customer’s bill.

<sup>169</sup> AG-1 Intervenor Br. at 7.

1 are specifically identified in Schedule AG-1, and that the FCRR costs are not set forth as an  
2 exception to the exemption from generation costs.<sup>170</sup> The AG-1 Intervenors contend that the FCRR  
3 charges “are without question generation charges.”<sup>171</sup> The AG-1 Intervenors also argue that whether  
4 Four Corners Units 4 and 5 provide any capacity related benefits to APS’s system at this time is  
5 irrelevant, because, the AG-1 Intervenors argue, capacity costs and energy costs are both generation  
6 costs that are to be excluded under Schedule AG-1.<sup>172</sup>

7 The AG-1 Intervenors contend that the meaning of the exemption “[t]he generation charges  
8 will not apply” at Page 4 of Schedule AG-1 should be read broadly.<sup>173</sup> They argue that if the settling  
9 parties had intended to exclude AG-1 customers only from APS’s charges for unbundled generation  
10 service, they could have done so, either by retaining phrasing that APS had originally proposed for  
11 Schedule AG-1, or by using the defined term “Standard Generation Service” to describe the charges  
12 that would not apply to AG-1 customers, but they did not.<sup>174</sup> In response to Staff’s argument that  
13 “generation charges” should be read narrowly to apply to generation charges in the underlying retail  
14 tariffs under which AG-1 customers take service, the AG-1 Intervenors argue that the term  
15 “generation charges” in Schedule AG-1 must be read to have a different meaning from the term  
16 “Generation Charge” in the underlying retail rate schedules, noting that one is capitalized while the  
17 other is not, and one is stated in the plural, while the other is not, and that the differences are real and  
18 meaningful.<sup>175</sup> The AG-1 Intervenors assert that “generation charges” is broader than “Generation  
19 Charge” in the underlying retail rate schedules, and it was for that reason that it was necessary to  
20 specifically exempt the PSA and EIS in Schedule AG-1.<sup>176</sup>

21 The AG-1 Intervenors contend that exempting AG-1 customers from the FCRR does not  
22 ignore long-term system planning, as RUCO asserts, and that the Four Corners acquisition does not  
23 provide any more reliability infrastructure to benefit AG-1 customers any more than other generation  
24

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25 <sup>170</sup> *Id.* at 7-8.

26 <sup>171</sup> *Id.* at 6.

27 <sup>172</sup> *Id.* at 6, citing to Tr. at 169 (hearing testimony summary of AECC, Noble Solutions and The Kroger Co. witness Kevin C. Higgins).

28 <sup>173</sup> AG-1 Intervenors Br. at 3, AG-1 Intervenors Reply Br. at 2.

<sup>174</sup> AG-1 Intervenors Br. at 3.

<sup>175</sup> AG-1 Intervenors Reply Br. at 3.

<sup>176</sup> *Id.* at 3-4.

1 resources APS has at its disposal.<sup>177</sup> The AG-1 Intervenors contend that contrary to RUCO's  
 2 assertions, Schedule AG-1 contains provisions that cover system planning costs when an AG-1  
 3 customer returns to APS for generation service.<sup>178</sup> Finally, the AG-1 Intervenors argue that  
 4 exempting AG-1 customers from the FCRR will not shift costs for services provided to AG-1  
 5 customers to other APS customers, but instead would shift costs from other APS customers to AG-1  
 6 customers for costs of acquiring generation resources which the AG-1 Intervenors argue do not  
 7 provide service to AG-1 customers.<sup>179</sup>

### 8 C. RUCO

9 RUCO states that it is aligned with APS's position on the issue of the applicability of the  
 10 FCRR to AG-1 customers, with the exception that RUCO believes the reserve capacity charges  
 11 associated with the FCRR should also increase Schedule AG-1 customers' reserve capacity charges  
 12 (excess reserve margin) included at Page 4 of Schedule AG-1.<sup>180</sup> RUCO agrees with APS that the  
 13 FCRR increase should apply to the non-generation portions of the AG-1 bill, which RUCO states  
 14 amounts to approximately 30 percent of the AG-1 bill.<sup>181</sup> RUCO disagrees with the AG-1  
 15 Intervenors' interpretation of the definition of "generation" to effectively exclude all AG-1 customers  
 16 from paying any costs of the FCRR, arguing that such an interpretation directly conflicts with Section  
 17 10.3(5) of the Settlement Agreement.<sup>182</sup> In addition, RUCO argues, acceptance of the AG-1  
 18 Intervenors' interpretation of "generation" as exempting them completely from the FCRR would  
 19 mean that other customers would experience a greater rate increase from the FCRR. RUCO believes  
 20 such a result would violate the understanding of the parties to the Settlement Agreement that the  
 21 experimental AG-1 Rider would insulate all other customers from any cost shift.<sup>183</sup> In the absence of  
 22 a specific definition of "generation," RUCO contends that the Commission needs to take a common-  
 23 sense approach, and argues that it is highly unlikely that any signatory to the Settlement Agreement  
 24 intended to render Section 10.3(5) meaningless by excluding AG-1 customers from the Four Corners

25 <sup>177</sup> *Id.* at 5-6.

26 <sup>178</sup> *Id.*

27 <sup>179</sup> AG-1 Intervenors Br. at 11, AG-1 Intervenors Reply Br. at 6.

28 <sup>180</sup> RUCO Br. at 6, 7, RUCO Reply Br. at 4.

<sup>181</sup> RUCO Br. at 6-7, citing to Surrebuttal Testimony of RUCO witness Lon Huber, Hearing Exh. R-3 at 4.

<sup>182</sup> RUCO Br. at 7.

<sup>183</sup> *Id.* at 7, 9.

1 acquisition costs.<sup>184</sup> RUCO argues that the point of Section 10.3(5) was to hold other rate classes  
2 harmless for an experiment that allows large users to obtain their generation from outside APS.<sup>185</sup>

3 RUCO points out that the exemptions in Schedule AG-1 do not state that AG-1 customers  
4 will be exempted from the acquisition costs of generation-related assets.<sup>186</sup> RUCO contends that  
5 because AG-1 customers are connected to the grid, and have the ability to switch back to full service  
6 from APS, APS must invest in a system that can accommodate them, and they therefore should pay  
7 their share of the cost of system improvements like the Four Corners acquisition.<sup>187</sup> RUCO asserts  
8 that the true long-term capacity costs of providing backup reliability for all customers, including AG-  
9 1 customers who obtain energy from providers other than APS, are not recovered from AG-1  
10 customers.<sup>188</sup> RUCO states that there is no separate long-term reliability infrastructure charge on an  
11 AG-1 customer's bill to account for the long-term investment needed to accommodate AG-1  
12 customers, who can switch between APS and competitive suppliers, but that instead, long-term  
13 reliability infrastructure costs are bundled in with all portions of the bill equally.

14 RUCO disagrees with the AG-1 Intervenors' argument that APS should go to FERC to have  
15 its tariffed reserve capacity charges amended, arguing that it would be nonsensical for APS to have to  
16 request an increase in transmission and distribution charges for each of its rate schedules, when the  
17 proper application of the Four Corners FCRR would collect APS's costs, per the intent of the  
18 Settlement Agreement.<sup>189</sup>

19 RUCO contends that AG-1 customers should not be fully exempted from the FCRR, but if  
20 there is an exemption greater than that proposed by APS, RUCO requests that residential customers  
21 be shielded from bearing the increased costs that would result, per the intent of the Settlement  
22 Agreement.<sup>190</sup>

#### 23 **D. Staff**

24 Staff contends that a complete exemption of the AG-1 customers from the FCRR would be

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25 <sup>184</sup> *Id.* at 9.

26 <sup>185</sup> *Id.*

26 <sup>186</sup> *Id.*

27 <sup>187</sup> RUCO Br. at 8, citing to Tr. at 223-224 (cross-examination testimony of Wal-Mart witness Steve W. Chriss).

27 <sup>188</sup> RUCO Br. at 8-9, RUCO Reply Br. at 3.

28 <sup>189</sup> RUCO Reply Br. at 4.

28 <sup>190</sup> *Id.*

1 inconsistent with Schedule AG-1 and the applicable retail schedules.<sup>191</sup> Staff points out that both  
 2 Decision No. 73183 and the Settlement Agreement specifically identify AG-1 as a rate schedule, and  
 3 Section 10.3 of the Settlement Agreement provides that the FCRR shall be applied “on an equal  
 4 percentage basis across all rate schedules.”<sup>192</sup> Staff argues that the interplay between the specific  
 5 provisions of Schedule AG-1 and the corresponding terms used in the applicable retail schedules  
 6 clearly shows that AG-1 customers were not intended to be completely exempt from the FCRR.<sup>193</sup>

7 Staff contends that the FCRR is a specific surcharge, which is not encompassed by the  
 8 “generation charges” referred to in the applicable schedules, as the AG-1 Intervenors argue.<sup>194</sup> Staff  
 9 asserts that the term “generation charges” in Schedule AG-1 is a specific reference to “generation  
 10 charges” set forth in the applicable retail schedules, and is not a term that refers comprehensively to  
 11 all generation functions or facilities.<sup>195</sup> Staff argues that if that meaning had been intended, it would  
 12 not have been necessary for Schedule AG-1 to specifically exempt the PSA and the EIS.<sup>196</sup> Staff  
 13 contends that because some generation-related mechanisms, the PSA and the EIS, are specifically  
 14 excluded from Schedule AG-1, it is reasonable to conclude that the statement “The generation  
 15 charges will not apply” in the listed exclusions on Page 4 of Schedule AG-1 refers back to the  
 16 applicable retail tariffs, and that on those retail tariffs, the term “generation charges” clearly does not  
 17 include the FCRR.<sup>197</sup>

18 Staff contends that the provisions of the Settlement Agreement and the applicable tariffs are  
 19 clear, and there is no need for additional evidence.<sup>198</sup> Staff asserts that it could easily be argued,  
 20 based upon the Settlement Agreement and Schedule AG-1, that the applicable provisions contemplate  
 21 an equal spread of the FCRR across all rate schedules, including Schedule AG-1, but that it is  
 22 difficult to conclude that Schedule AG-1 was intended to be completely excluded from the FCRR.<sup>199</sup>  
 23 Staff believes that in light of the express provisions of the Settlement Agreement and the applicable

24 <sup>191</sup> Staff Reply Br. at 8.

25 <sup>192</sup> Staff Br. at 20-21, citing to Settlement Agreement.

26 <sup>193</sup> Staff Reply Br. at 8.

27 <sup>194</sup> Staff Br. at 21, Staff Reply Br. at 8.

28 <sup>195</sup> *Id.*

<sup>196</sup> *Id.*

<sup>197</sup> Staff Br. at 21-22.

<sup>198</sup> *Id.* at 22.

<sup>199</sup> *Id.* at 23.

1 tariffs, APS's proposal is a fair result, not unreasonable, and consistent with the spirit and purpose of  
2 Schedule AG-1.<sup>200</sup>

### 3 **E. Conclusion**

4 The FCRR applies to the applicable rate schedules, and is not exempted from application to  
5 any retail rate schedule by Schedule AG-1. Four exclusions are listed on Page 4 of Schedule AG-1.  
6 We agree with Staff that because the second and third specific exclusions, the PSA and the EIS, are  
7 generation-related mechanisms, as a matter of construction it would be unreasonable to conclude that  
8 the term "generation charges" in the first exclusion is comprehensive. We do not find convincing the  
9 AG-1 Intervenor's argument that the capitalization of "Generation Charge" in the underlying rate  
10 schedules requires a different reading. The FCRR was contemplated by the Settlement Agreement,  
11 but was not set forth as an exclusion in Schedule AG-1, as were the PSA and the EIS. Further, the  
12 fact that the purpose of the FCRR is to recover costs related to the acquisition of generating assets  
13 does not render the FCRR solely a generation charge. As argued by RUCO, all APS customers, AG-  
14 1 customers included, benefit from the reliability gained from APS's investment in the acquisition of  
15 SCE's share of Four Corners Units 4 and 5.

16 The AG-1 Intervenor's argue that the terms of Schedule AG-1 supersede the terms of Section  
17 10.3 of the Settlement Agreement because they are more specific.<sup>201</sup> We disagree. While we  
18 understand that the language of Schedule AG-1 may be read to conflict with the language of Section  
19 10.3 of the Settlement Agreement, the governing document, the Settlement Agreement, clearly  
20 directed APS to include with its FCRR Application "an adjustment rider that recovers the rate base  
21 and non-PSA related expenses associated with any Four Corners acquisition on an equal percentage  
22 basis across all rate schedules." The AG-1 Intervenor's requested exemption from application of the  
23 FCRR is not supported by the language of the Settlement Agreement, which was submitted by the  
24 parties and approved by Decision No. 73183. Indeed, as Staff opined, it would not be unreasonable  
25 to apply the FCRR surcharges across all components of the AG-1 customers' bills. However, given  
26 the fact that the language of Schedule AG-1 may be read to conflict with the governing language in

27 \_\_\_\_\_  
28 <sup>200</sup> *Id.*, citing to Surrebuttal Testimony of Staff witness Dennis Kalbarczyk, Hearing Exh. S-3 at 11.

<sup>201</sup> AG-1 Intervenor's Br. at 8-11.

1 Section 10.3 of the Settlement Agreement, we find that APS's proposal to harmonize the provisions  
 2 of Section 10.3(5) of the Settlement Agreement with its Attachment J is not unreasonable. We do not  
 3 find it necessary to adopt RUCO's recommendation to apply the FCRR to the reserve capacity charge  
 4 appearing on Page 4 of Schedule AG-1. The amount of the reserve capacity charge was negotiated  
 5 between the parties and intended to be a proxy for reserve capacity costs.<sup>202</sup>

6 The proposal set forth by APS in its FCRR Application regarding its partial application of the  
 7 FCRR charges to AG-1 customers provides a reasonable harmonizing solution to the conflicting  
 8 language of Schedule AG-1 with the governing Section 10.3 of the Settlement Agreement, and it will  
 9 be adopted.

### 10 CONCLUSION

11 The transaction by which APS acquired SCE's share of Units 4 and 5 was prudent, and the  
 12 rate recovery pursuant to the terms of the Settlement Agreement adopted by Decision No. 73183 is  
 13 appropriate. The acquisition will help ensure the continued provision of reliable and reasonably  
 14 priced electricity for APS's customers. Under the unique circumstances of this case, it is appropriate  
 15 to allow APS to recover the Staff updated acquisition adjustment of \$252,509,950 resulting from the  
 16 purchase of SCE's interest in Four Corners Units 4 and 5. The record in this proceeding supports  
 17 granting the Four Corners FCRR Application to recover a revenue requirement of \$57.05 million, and  
 18 supports distributing the resulting rate adjustment across all rate schedules as proposed by APS.

19 \* \* \* \* \*

20 Having considered the entire record herein and being fully advised in the premises, the  
 21 Commission finds, concludes, and orders that:

### 22 FINDINGS OF FACT

23 1. On June 1, 2011, APS filed with the Commission an application to determine the fair  
 24 value of the utility property of the Company for ratemaking purposes, to fix a just and reasonable rate  
 25 of return thereon, and to approve rate schedules designed to develop such return.

26  
 27  
 28 <sup>202</sup> See Tr. at 330 (cross-examination testimony of APS witness Leland Snook).

1           2.     On May 24, 2012, the Commission issued Decision No. 73183 in this docket.  
2 Decision No. 73183 approved a Settlement Agreement allowing APS to file by December 31, 2013,  
3 an application for approval to adjust its rates to reflect the acquisition of SCE's ownership interest in  
4 Four Corners Units 4 and 5; the retirement of Four Corners Units 1, 2, and 3; and any cost deferral  
5 authorized in Docket No. E-01345A-10-0474.

6           3.     On December 30, 2013, APS filed the FCRR Application in this docket. The direct  
7 testimonies of APS witnesses Jeffrey B. Guldner and Elizabeth Blankenship were attached to the  
8 Application.

9           4.     On January 30, 2014, Sierra Club filed a Motion to Intervene in this docket in order to  
10 participate in proceedings on the Four Corners Application.

11          5.     On March 4, 2014, Sierra Club counsel Nellis Kennedy-Howard and Travis M.  
12 Ritchie filed a request for temporary admission *pro hac vice* to appear before the Commission.

13          6.     On March 6, 2014, Staff filed its Request for a Procedural Schedule, requesting  
14 approval of its proposed procedural schedule and indicating that several parties did not oppose the  
15 request. Staff's filing stated that APS had held two technical conferences on the Four Corners  
16 Application.

17          7.     On March 7, 2014, a Procedural Order was issued granting Sierra Club's Motion to  
18 Intervene, granting temporary admission *pro hac vice* for Sierra Club counsel Ms. Kennedy-  
19 Howard and Mr. Ritchie, and ordering them to complete the application procedures within 45  
20 days.

21          8.     On March 10, 2014, Arizona-licensed attorney Timothy M. Hogan filed a Motion  
22 to Associate Counsel *Pro Hac Vice* with Sierra Club counsel Nellis Kennedy-Howard and Travis  
23 M. Ritchie.

24          9.     On March 14, 2014, a Procedural Order was issued granting the March 10, 2014  
25 Motion to Associate Counsel *Pro Hac Vice* and designating Mr. Hogan as local counsel for Sierra  
26 Club counsel Ms. Kennedy-Howard and Mr. Ritchie.

27          10.    On March 25, 2014, a Procedural Order was issued setting a hearing to commence on  
28 August 4, 2014, and establishing associated procedural deadlines.

1           11.     On May 15, 2014, APS filed an Affidavit of Publication, indicating that notice of the  
2 Application and hearing was published in newspapers of general circulation within its service  
3 territory by May 1, 2014.

4           12.     On June 19, 2014, the following testimonies of witnesses for the following parties  
5 were filed: direct testimony of Gary Yaquinto on behalf of AIC; direct testimony of Kevin C.  
6 Higgins on behalf of AECC, Noble Solutions, and Kroger; direct testimony of Steve W. Chriss on  
7 behalf of Walmart; direct testimony of Ezra D. Hausman on behalf of Sierra Club; direct testimony of  
8 Robert B. Mease on behalf of RUCO; and direct testimonies of Dennis M. Kalbarczyk and James  
9 Letzelter on behalf of Staff.

10          13.     On June 24, 2014, Walmart filed a Notice of Errata.

11          14.     On July 3, 2014, APS filed the rebuttal testimonies of its witnesses Jeffrey B. Guldner,  
12 Leland R. Snook, Elizabeth A. Blankenship, and James C. Wilde.

13          15.     On July 18, 2014, AECC, Noble Solutions, and Kroger filed the surrebuttal testimony  
14 of Kevin C. Higgins.

15          16.     On July 21, 2014, Walmart filed notice that it would not be filing surrebuttal  
16 testimony in this matter.

17          17.     On July 21, 2014, the following testimonies of witnesses for the following parties  
18 were filed: surrebuttal testimony of Gary Yaquinto on behalf of AIC; surrebuttal testimony of Ezra  
19 D. Hausman on behalf of Sierra Club; surrebuttal testimonies of Robert B. Mease and Lon Huber on  
20 behalf of RUCO; and surrebuttal testimony of Dennis M. Kalbarczyk on behalf of Staff.

21          18.     On July 25, 2014, APS filed a letter indicating that it had no substantive changes to its  
22 prefiled testimony.

23          19.     On July 28, 2014, counsel for Noble Solutions filed a Motion for Leave to Participate  
24 Telephonically in Procedural Conference, which was granted by Procedural Order.

25          20.     On July 29, 2014, the Town of Wickenburg and the Town of Gilbert filed a Motion To  
26 Be Excused from participating in the hearing on the Four Corners application.

27          21.     On July 30, 2014, the pre-hearing conference for the hearing on the Four Corners  
28 application convened as scheduled. APS, AIC, AECC, Noble Solutions, Walmart, Sierra Club,

1 SWEEP, WRA, ASBA, AASBO, RUCO and Staff appeared through counsel. The filing by counsel  
2 for the Town of Wickenburg and the Town of Gilbert requesting to be excused from this proceeding  
3 was granted.

4 22. On August 4, 2014, the hearing on the FCRR Application convened as scheduled.  
5 APS, AIC, AECC, Noble Solutions, Walmart, Sierra Club, SWEEP, WRA, ASBA, AASBO, RUCO  
6 and Staff appeared through counsel.

7 23. On August 29, 2014, APS, AIC, the AG-1 Intervenors, Sierra Club, ASBA and  
8 AASBO, RUCO, and Staff filed Initial Closing Briefs. On September 12, 2014, APS, AIC, the AG-1  
9 Intervenors, RUCO, and Staff filed Reply Closing Briefs, and the matter was taken under advisement.

10 24. APS complied with the procedural requirements of Decision No. 73183. The record in  
11 this proceeding provides the necessary factual record to adjust the rates set by Decision No. 73183  
12 pursuant to the Commission's ratemaking discretion under the Arizona Constitution.

13 25. Based on the entirety of the record in this proceeding, we find that the Four Corners  
14 acquisition transaction was prudent and the rate recovery pursuant to the terms of the Settlement  
15 Agreement adopted by Decision No. 73183 is appropriate. The acquisition will ensure the continued  
16 provision of reliable and reasonably priced electricity for customers in APS's service territory. The  
17 recommendations of the Sierra Club are unnecessary and will not be adopted.

18 26. Under the unique circumstances of this case, it is appropriate to allow APS to recover  
19 the \$254,787,393 acquisition adjustment resulting from the purchase of SCE's interest in Four  
20 Corners Units 4 and 5.

21 27. We find that the Four Corners acquisition results in a \$225,933,911 addition to FVRB  
22 and an Operating Income adjustment of \$20,680,000.

23 28. It is just and reasonable and in the public interest to approve a revenue increase of  
24 \$57.05 million to be recovered through the FCRR to be applied across all rate schedules as proposed  
25 by APS, including partial application of the FCRR charges to customers taking service under  
26 experimental Schedule AG-1.

### 27 CONCLUSIONS OF LAW

28 1. APS is a public service corporation within the meaning of Article XV of the Arizona

1 Constitution, A.R.S. §§ 40-203, -204, -221, -250, -251, and -361, and A.A.C. R14-2-801 et seq.

2 2. The Commission has jurisdiction over APS and the subject matter of the application.

3 3. Notice of the application and hearing was provided in accordance with the law.

4 4. It is just and reasonable and in the public interest to approve an adjustment to the rates  
5 set by Decision No. 73183 that will recover the rate base and expense effects of APS's acquisition of  
6 SCE's share of Four Corners Units 4 and 5, as set forth herein.

7 5. Under the unique circumstances of this case, it is appropriate to allow Arizona Public  
8 Service Company to recover the Staff updated acquisition adjustment of \$252,509,950 resulting from  
9 the purchase of Southern California Edison's ownership interest in the Four Corners Generating  
10 Station Units 4 and 5.

11 6. The proposal set forth by APS in its FCRR Application regarding its partial  
12 application of the FCRR charges to customers taking service under the experimental Schedule AG-1  
13 is reasonable and appropriate and will be adopted.

14 **ORDER**

15 IT IS THEREFORE ORDERED that Arizona Public Service Company is hereby authorized  
16 to adjust the rates set by Decision No. 73183 by implementing a Four Corners Rate Rider that will  
17 recover on an equal percentage basis 2.03 percent to be applied to the base rates of applicable  
18 customer bills. This will result in an annual revenue requirement of \$57.05 million.

19 IT IS FURTHER ORDERED that under the unique circumstances of this case, it is  
20 appropriate to allow Arizona Public Service Company to recover the Staff updated acquisition  
21 adjustment of \$252,509,950 resulting from the purchase of Southern California Edison's ownership  
22 interest in the Four Corners Generating Station Units 4 and 5.

23 IT IS FURTHER ORDERED that the proposal set forth by Arizona Public Service Company  
24 in its Four Corners Rate Rider Application regarding the partial application of the Four Corners Rate  
25 Rider Application charges to customers taking service under the experimental Schedule AG-1 is  
26 reasonable and appropriate and is hereby approved.

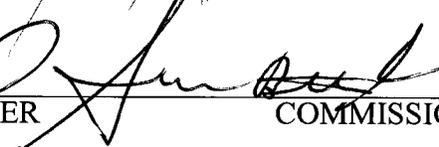
27 IT IS FURTHER ORDERED that Arizona Public Service Company shall file, by December  
28 31, 2014, effective with the first billing cycle in January 2015, a Four Corners Rate Rider tariff in

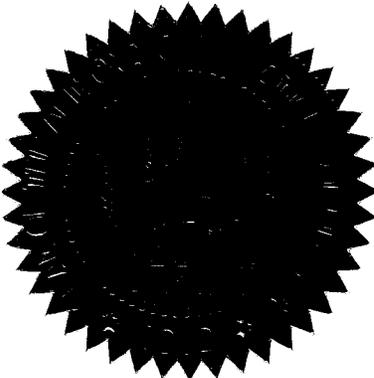
1 conformance with the determinations in this Decision.

2 IT IS FURTHER ORDERED that Arizona Public Service Company shall, concurrent with the  
3 implementation of the Four Corners Rate Rider surcharge, provide notice of the surcharge to its  
4 customers, in a form acceptable to the Commission's Utilities Division.

5 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

6 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

7  
8  
9  CHAIRMAN  COMMISSIONER  
10  COMMISSIONER  COMMISSIONER  COMMISSIONER  
11



13 IN WITNESS WHEREOF, I, JODI JERICH, Executive  
14 Director of the Arizona Corporation Commission, have  
15 hereunto set my hand and caused the official seal of the  
16 Commission to be affixed at the Capitol, in the City of Phoenix,  
17 this 23<sup>rd</sup> day of December 2014.

18   
19 JODI JERICH  
20 EXECUTIVE DIRECTOR

21 DISSENT \_\_\_\_\_

22 DISSENT \_\_\_\_\_  
23 TJ:tv

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28

**EXHIBIT A**

**ARIZONA PUBLIC SERVICE COMPANY**

**PROPOSED SETTLEMENT AGREEMENT**

**DOCKET NO. E-01345A-11-0224**

**January 6, 2012**

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**PROPOSED SETTLEMENT AGREEMENT OF DOCKET NO.  
E-01345-A-11-0224 ARIZONA PUBLIC SERVICE COMPANY REQUEST  
FOR RATE ADJUSTMENT**

The purpose of this Settlement Agreement (“Agreement”) is to settle disputed issues related to Docket No. E-01345A-11-0224, Arizona Public Service Company’s (“APS” or “Company”) application to increase rates. This Agreement is entered into by the following entities:

Arizona Corporation Commission Utilities Division (“Staff”)  
Arizona Public Service Company (“APS”)  
Residential Utility Consumer Office (“RUCO”)  
Cynthia Zwick  
Federal Executive Agencies (“FEA”)  
Kroger Co. (“Kroger”)  
Freeport-McMoRan Copper & Gold Inc. (“Freeport-McMoRan”)  
Arizonans for Electric Choice and Competition (“AECC”)  
Wal-Mart Stores, Inc. and Sam’s West, Inc. (“Wal-Mart”)  
IBEW Locals 387, 640, 769 (“IBEW”)  
AzAg Group (“AzAG”)  
Arizona Competitive Power Alliance (“AzCPA”)  
AARP (“AARP”)  
Arizona Association of Realtors (“AAR”)  
Barbara Wyllie-Pecora (“Wyllie-Pecora”)  
Arizona Investment Council (“AIC”)  
Southwestern Power Group II, LLC (“SWPG”)  
Bowie Power Station, LLC (“Bowie”)  
Noble Americas Energy Solutions LLC (“Noble”)  
Constellation NewEnergy, Inc. (“Constellation”)  
Direct Energy, LLC (“Direct”)  
Shell Energy North America (US), L.P. (“Shell”)

These entities shall be referred to collectively as “Signatories,” a single entity shall be referred to individually as a “Signatory.”

**I. RECITALS**

- 1.1 APS filed the rate application underlying Docket No. E-01345A-11-0224 on June 1, 2011. Staff found the application sufficient on July 1, 2011.
- 1.2 Subsequently, the Arizona Corporation Commission ("Commission") approved applications to intervene filed by AARP, Arizona Association of Realtors, AzCPA, AIC, ASBA, Association of School Business Officials, AZAg Group, Barbara Wyllie-Pecora, Cynthia Zwick, FEA, Freeport-McMoRan and AECC (collectively "AECC"), IBEW Locals 387, 640 and 769, Interwest, Kroger, Mel Beard, Noble et al, NRDC, RUCO, SWEEP, SWPG, Bowie, TEP, the Town of Gilbert, the Town of Wickenburg, Wal-Mart and Sam's Club, and WRA. Mel Beard subsequently withdrew as an intervenor in the case.
- 1.3 APS filed a notice of settlement discussions on November 18, 2011. Settlement discussions began on November 30, 2011. The settlement discussions were open, transparent, and inclusive of all parties to this Docket who desired to participate. All parties to this Docket were notified of the settlement discussion process, were encouraged to participate in the negotiations, and were provided with an equal opportunity to participate. Commission Staff filed a Preliminary Term Sheet regarding this matter on December 9, 2011, which was discussed in a Special Open Meeting held on December 16, 2011.
- 1.4 The terms of this Agreement are just, reasonable, fair, and in the public interest in that they, among other things, establish just and reasonable rates for APS customers; promote the convenience, comfort and safety, and the preservation of health, of the employees and patrons of APS; resolve the issues arising from this Docket; and avoid unnecessary litigation expense and delay.
- 1.5 The Signatories believe that this Agreement balances the interests of both APS and its customers. These benefits include:
  - an overall zero dollar base rate increase;
  - a zero percent bill impact for the remainder of 2012 (Commission-approved adjustors (including the possibility of a Four Corners rider pursuant to paragraph 10.3) may increase customer bills after December 31, 2012);

- a four year rate case stay out, in which APS agrees not to raise base rates as a result of any new general rate case filing prior to July 1, 2016;
  - a buy-through rate for industrial and large commercial customers;
  - a narrowly-tailored Lost Fixed Cost Recovery (“LFCR”) mechanism that supports energy efficiency (“EE”) and distributed generation (“DG”) at any level or pace set by this Commission;
  - an opt-out rate design for residential customers who choose not to participate in the LFCR;
  - a process for simplifying customers’ bill format; and
  - bill assistance for additional low income customers, at shareholder expense.
- 1.6 The Signatories agree to ask the Commission (1) to find that the terms and conditions of this Agreement are just and reasonable and in the public interest, along with any and all other necessary findings, and (2) to approve the Agreement and order that it and the rates contained herein become effective on July 1, 2012.

## TERMS AND CONDITIONS

### II. RATE CASE STABILITY PROVISION

- 2.1 APS agrees not to file its next general rate case prior to May 31, 2015. The test year end date for the base rate increase filing contemplated in this section shall be no earlier than December 31, 2014 but need not coincide with the end of a calendar year. No new base rates resulting from APS’s next general rate case will be effective before July 1, 2016.

### III. RATE INCREASE

- 3.1 APS shall receive a base rate increase of zero dollars (“revenue requirement”). This amount is comprised of: (1) a non-fuel base rate increase of \$116.3 million, which includes providing for a return on and of plant that is in service as of March 31, 2012 (“Post-Test Year Plant”); (2) a fuel base rate decrease of

\$153.1 million; and (3) a transfer of cost recovery from the Renewable Energy Surcharge ("RES") to base rates described in Paragraph VIII herein.

- 3.2 The Company's jurisdictional fair value rate base used to establish the rates agreed to herein is \$8,167,126,000. The Company's total adjusted Test Year revenue is \$2,868,858,000.

#### **IV. BILL IMPACT**

- 4.1 When new rates become effective, customers will have on average a 0.0% bill impact or less. This zero percent or slightly negative bill impact will be achieved by allowing the negative credit that exists in the Company's Power Supply Adjustor ("PSA") to continue until February 1, 2013, at which time it will reset. The annual 4 mill cap will be applied after the impact of the expiration of the then-current PSA credit.
- 4.2 Subsequent to the PSA reset for General Service customers in February 2013, the percentage bill impact spread resulting from this Settlement among the various segments of that customer class shall be equal. This shall be accomplished as set forth in Attachment A.
- 4.3 A zero percent bill impact will continue for the remainder of 2012 (Commission-approved adjustors (including the possibility of a Four Corners rider pursuant to paragraph 10.3) may increase customer bills after December 31, 2012).

#### **V. COST OF CAPITAL**

- 5.1 A capital structure comprised of 46.06% debt and 53.94% common equity shall be adopted.
- 5.2 A return on common equity of 10.0% and an embedded cost of debt of 6.38% shall be adopted.
- 5.3 A fair value rate of return of 6.09%, which includes a return on the fair value rate base increment of 1.0%, shall be adopted.
- 5.4 The provisions set forth herein regarding the quantification of cost of capital, fair value rate base, fair value rate of return, and the revenue requirement are made for purposes of settlement only and should not be construed as admissions against interest or waivers of litigation positions related to other or future cases.

**VI. DEPRECIATION/AMORTIZATION AND DECOMMISSIONING**

- 6.1 With the exception of Uniform System of Accounts 370.01 (electronic meters), 370.02 (electro-mechanical meters), and 370.03 (AMI meters), the depreciation and amortization rates proposed by APS and contained in Attachment REW-2 to Dr. Ron White's Pre-filed Direct Testimony shall be adopted until further order of the Commission. For Accounts 370.01, 370.02 and 370.03, the current depreciation rates will be retained, as proposed by Commission Staff Witness Ralph Smith.
- 6.2 The annual nuclear decommissioning amounts reflected in the rates agreed to herein are those shown in APS Witness Jason LaBenz workpaper JCL\_WP22, page 4, attached hereto as Attachment B.
- 6.3 APS shall file a request that the Commission adjust the Company's System Benefit Charge ("SBC") and reduce such charge to reflect a corresponding reduction of the decommissioning trust funding obligations collected through the SBC related to the full funding of Palo Verde Unit 2. Such filing shall be made in sufficient time for the reduction to occur by January 2016.

**VII. FUEL AND POWER SUPPLY ADJUSTMENT PROVISIONS**

- 7.1 The base fuel rate shall be lowered from \$0.037571 per kWh as set in Commission Decision No. 71448 to \$0.032071 per kWh. This change shall take effect on the effective date of the new rates contained in this Agreement, in accordance with the current approved Plan of Administration for the Power Supply Adjustor ("PSA").
- 7.2 For purposes of this case, APS will withdraw its request to recover through the PSA the cost of chemicals required for environmental compliance at APS's power plants, and APS shall not raise this request before its next general rate case.
- 7.3 The 90/10 sharing provision in APS's PSA will be eliminated. The PSA shall be modified to require APS to apply interest on the PSA balance annually, rather than monthly, at the following rates: any over-collection existing at the end of the PSA year will accrue interest at a rate equal to the Company's authorized ROE or APS's then-existing short term borrowing rate, whichever is greater, and will be refunded to customers over the following 12 months; any under-collection existing at the end of the PSA year will accrue interest at a rate

equal to the Company's authorized ROE or APS's then-existing short term borrowing rate, whichever is less, and will be recovered from customers over the following 12 months. APS may, at any time during the PSA year, request to reduce the PSA rate through the Transition Component. Any such request shall become effective beginning with the first billing cycle of the month following the filing date of the request.

- 7.4 To incent prudent fuel and power procurement and use, APS shall be subject to periodic audits. The first audit shall be for calendar year 2014. Commission Staff shall select a consultant to perform this audit and subsequent audits. Each audit shall be funded by APS in an amount not to exceed \$100,000 per audit.
- 7.5 The PSA Plan of Administration shall be amended as set forth in Attachment C.

## **VIII. RENEWABLE ENERGY**

- 8.1 APS currently collects the costs associated with certain APS-owned renewable energy projects through the RES. Consistent with the treatment of other Post-Test Year Plant adopted in this Agreement, the portion of those renewable projects that have been closed to plant in service as of March 31, 2012, shall be rate based and recovery of those costs shall be accomplished through base rates. The specific projects to be rate based pursuant to this Section are identified in Attachment D.
- 8.2 Effective with the date of the Commission's order in this matter, the capital carrying costs<sup>1</sup> for any APS renewable energy-related capital investments shall not be recovered through the RES adjustor, except that capital carrying costs for renewable energy-related capital investments that APS makes in compliance with Commission Decision No. 71448 shall be recovered in the RES adjustor unless and until specifically authorized for recovery in another adjustor or in base rates.
- 8.3 On the effective date of the new rates contained in this Agreement, the RES adjustor rate established for 2012 in Docket No. E-01345A-11-0264 shall be reduced to reflect the removal of the projects identified in Attachment D. At the same time, the renewable energy-related purchased power agreement costs that were moved from the RES to the PSA pursuant to the Commission's

<sup>1</sup> Capital carrying costs include (1) a return at the Company's Weighted Average Cost of Capital approved by the Commission in this rate case; (2) depreciation expense; (3) income taxes; (4) property taxes; (5) deferred taxes and tax credits where appropriate; and (6) associated O&M.

Decision in Docket No. E-01345A-11-0264, shall be transferred back to the RES.

- 8.4 To provide the Commission with greater flexibility in setting RES adjustor rates and related caps, the requirement established in Decision No. 67744 that any changes to RES charges and caps must be allocated between customer classes according to certain set proportions shall be eliminated.

**IX. ENERGY EFFICIENCY/LOST FIXED COST RECOVERY/OPT-OUT RESIDENTIAL RATE/LARGE GENERAL SERVICE CUSTOMER EXCLUSION**

- 9.1 The Signatories support energy efficiency as a low cost energy resource. The Signatories also recognize that, under APS's current volumetric rate design, the Company recovers a significant portion of its fixed costs of service through kilowatt-hour ("kWh") sales. Commission rules related to EE and Distributed Generation ("DG") require APS to sell fewer kWh, which, in turn, prevents the Company from being able to recover a portion of the fixed costs of service embedded in its energy rates.
- 9.2 The Signatories also recognize the Commission's interest in directing EE and DG policy. In signing this Agreement, the Signatories intend that a Lost Fixed Cost Recovery ("LFCR") mechanism with residential opt-out rates shall be adopted that allows APS relief from the financial impact of verified lost kWh sales attributable to Commission requirements regarding EE and DG while preserving maximum flexibility for the Commission to adjust EE and DG requirements, either upward or downward, as the Commission may deem appropriate as a matter of policy. Nothing in this Agreement is intended to bind the Commission to any specific EE or DG policy or standard.
- 9.3 To address the goals of Sections 9.1 and 9.2, the Signatories propose that the Commission adopt for APS an LFCR, similar to that recommended by Staff in this proceeding. The LFCR shall recover a portion of distribution and transmission costs associated with residential, commercial and industrial customers when sales levels are reduced by EE and DG. It shall not recover lost fixed costs attributable to other potential factors, such as weather or general economic conditions. The LFCR mechanism shall exclude the portion of distribution and transmission costs that is recovered through the Basic Service Charge ("BSC") and fifty (50) percent of such costs recovered through non-generation/non-TCA demand charges.

- 9.4 The LFCR shall be adjusted annually to account for the unrecovered costs associated with a portion of distribution and transmission costs resulting from EE programs as demonstrated by the Measurement, Evaluation and Reporting ("MER") conducted for EE programs and from DG as demonstrated pursuant to the means described in Section 9.5 below. An annual 1% year over year cap based on Total Company revenues will be applied to the adjustment. Any amount in excess of the 1% cap will be deferred (with interest at the nominal one-year Treasury Constant Maturities rate contained in the Federal Reserve Statistical Release H-15 or its successor publication) for collection until the first future adjustment period in which including such costs, would not cause the annual increase to exceed the 1% cap. The amount of any cap level set herein shall be evaluated in APS's next rate case.
- 9.5 For the purpose of the LFCR mechanism, APS shall be allowed to use statistical verification, output profile, or meter data for DG systems until December 31, 2014. Beginning January of 2015, APS shall only use meter data to calculate DG system savings
- 9.6 APS will file with the Commission to adjust its LFCR by January 15 of each year, and Staff will use its best efforts to process the matter by March 1 of each year. Each annual LFCR adjustment will not go into effect unless approved by the Commission. The annual adjustment will use actual data for the period through September and forecast data for the remainder of the year. The following year's adjustment shall be trued-up for verified EE MER and metered or otherwise verified DG results. The first adjustment will not occur before March 1, 2013. The March 1, 2013 adjustment shall include reduced sales from EE and DG for 2012 and will be pro-rated from the date rates become effective pursuant to a Commission decision on this Agreement. Subsequent adjustments shall reflect the full impact of reduced sales in the prior year plus the cumulative impact from previous adjustments, subject to the cap described in Section 9.4 herein.
- 9.7 The LFCR mechanism shall not apply to large General Service customers taking service under rate schedules E-32 L, E-32 L TOU, E-34, E-35 and E-36 XL, or to unmetered General Service customers under E-30 and lighting schedules. These rate schedules shall be modified in accordance with Attachment K to address unrecovered fixed costs through changes in rate design with enhanced distribution demand and BSC charges and a corresponding adjustment to energy charges.

- 9.8 Residential customers shall have a rate schedule choice to opt out of the LFCR by electing an optional BSC, graduated by kWh monthly usage. That option is attached hereto as Attachment E. The optional BSC will be incorporated into each residential rate schedule to provide customers with the maximum flexibility to opt out without requiring a shift to a different rate schedule. The purpose of this opt out rate is to replicate, on average, the effects of the LFCR.
- 9.9 APS shall seek stakeholder input regarding the development of a customer outreach program to inform and educate customers about both the LFCR and voluntary opt-out rates and shall implement this outreach program.
- 9.10 On January 15 of each year, APS shall file compliance reports with the Commission consistent with the schedules attached to the LFCR Plan of Administration. These reports shall include a comparison of the revenues recovered through the LFCR to those that would have been recovered had the Company's revenue per customer decoupling (full decoupling) proposal been adopted.
- 9.11 The LFCR shall be subject to Commission review at any time, the first to occur no later than APS's next general rate case. If the Commission decides to suspend, terminate, or materially modify the LFCR mechanism prior to the Company's next general rate case, and does not provide alternative relief that adequately addresses fixed cost revenue erosion, the moratorium for filing general rate case applications shall terminate.
- 9.12 The LFCR Plan of Administration is attached hereto as Attachment F.
- 9.13 The LFCR was designed to be a flexible means to maximize the policy options available to the Commissioners and to customers, allowing the pursuit of EE and DG programs at any level or pace directed by the Commission. The Signatories agree that if the Commission declines to adopt the LFCR or an alternative mechanism that adequately addresses fixed cost revenue erosion in this case, APS shall be granted relief from either the relevant EE and DG requirements or the financial impacts of EE and DG during that time.
- 9.14 For future Demand-Side Management ("DSM") Implementation Plan filings:
- (a) Beginning with APS's 2013 DSM Implementation Plan (filed in 2012), and excluding DSM-related capital investments already authorized by the

Commission, carrying costs for DSM-related capital investments shall not be recovered through the DSM Adjustment Clause.

- (b) APS's performance incentive shall be modified (1) to eliminate the top two tiers of percentages to be applied to Net Benefits or Percent of Program Costs based on APS's achievement relative to the EE Standard, and (2) to change the fourth tier to include any achievement greater than 105%. The first three tiers remain unchanged.

<u>Achievement Relative to the Energy Efficiency Standard</u>	<u>Performance Incentive as % of Energy Efficiency Net Benefits</u>	<u>Performance Incentive Capped at % of Energy Efficiency Program Costs</u>	<u>Proposed Change from Current</u>
<u>&lt;85%</u>	<u>0%</u>	<u>0%</u>	<u>No Change</u>
<u>85% to 95%</u>	<u>6%</u>	<u>12%</u>	<u>No Change</u>
<u>96% to 105%</u>	<u>7%</u>	<u>14%</u>	<u>No Change</u>
<u>&gt;105%</u>	<u>8%</u>	<u>16%</u>	<u>New</u>
<u><del>106% to 115%</del></u>	<u><del>8%</del></u>	<u><del>16%</del></u>	<u>Eliminated</u>
<u><del>116% to 125%</del></u>	<u><del>9%</del></u>	<u><del>18%</del></u>	<u>Eliminated</u>
<u><del>&gt;125%</del></u>	<u><del>10%</del></u>	<u><del>20%</del></u>	<u>Eliminated</u>

- (c) APS shall use the inputs and methodology that Commission Staff uses when calculating the present value of benefits and costs for DSM measures in its Societal Cost test. Commission Staff will regularly re-evaluate such inputs

and methodologies, considering comments from APS and other stakeholders.

(d) APS will work with stakeholders and Staff to develop and file for Commission consideration a new performance incentive structure by December 31, 2012 that optimizes the connection between energy efficiency, rates and utility business incentives and that creates a clear connection between the level of performance incentive and achievement of cost-effective energy savings. This rate case shall be held open to allow for Commission approval of including the new performance incentive structure in the DSM Adjustment Clause. At that time, the Commission should determine the plan year to which the new performance incentive structure shall apply. The Signatories shall recommend that any new performance incentive structure adopted should apply to the first plan year filed after its adoption.

(e) APS's DSM programs and associated energy savings shall be independently reviewed every five years by an evaluator selected by Staff and paid for by APS in an amount not to exceed \$100,000. The first review shall occur in APS's next general rate case or within five (5) years of a Commission order in this case, whichever is sooner.

9.15 APS shall compile and make available to all parties of the docket a technical reference manual documenting program and measure saving assumptions and incremental costs no later than December 31, 2013. This manual would be updated on an annual basis as part of the DSM implementation plan process and would serve as a reference tool for the LFCR analysis.

9.16 APS currently collects \$10 million of DSM costs in base rates, which level will be retained.

9.17 The DSM Adjustment Clause Plan of Administration shall be modified to reflect the terms of this Agreement as set forth in Attachment G.

**X. RATE TREATMENT RELATED TO ANY ACQUISITION BY APS OF SOUTHERN CALIFORNIA EDISON'S SHARE OF FOUR CORNERS UNITS 4-5.**

- 10.1 In Docket No. E-01345A-10-0474, APS has sought Commission permission to pursue acquisition of Southern California Edison's ("SCE") current ownership interest in Four Corners Units 4 and 5 and to retire Four Corners Units 1-3 (the "proposed Four Corners transaction").
- 10.2 Except as provided in Section 9.14(d), this rate case shall remain open for the sole purpose of allowing APS to file a request, no later than December 31, 2013, that its rates be adjusted to reflect the proposed Four Corners transaction, should the Commission allow APS to pursue the acquisition and should the transaction thereafter close. Specifically, APS may within ten (10) business days after any Closing Date but no later than December 31, 2013, file an application with the Commission seeking to reflect in rates the rate base and expense effects associated with the acquisition of SCE's share of Units 4 and 5, the rate base and expense effects associated with the retirement of Units 1-3, and any cost deferral authorized in Docket No. E-01345A-10-0474. APS shall also be permitted to seek authorization to amend the PSA Plan of Administration to include in the PSA the post-acquisition Operations and Maintenance expense associated with Four Corners Units 1-3 as a cost of producing off-system sales until closure of Units 1-3, provided that such costs do not exceed off-system sales revenue in any given year. APS's rates shall be adjusted only if the Commission finds the Four Corners transaction to be prudent.
- 10.3 Any filing seeking a rate adjustment pursuant to Section 10.2 shall include at a minimum the following schedules: (1) the most current APS balance sheet at the time of filing; (2) the most current APS income statement at the time of filing; (3) an earnings schedule that demonstrates that the operating income resulting from the rate adjustment does not result in a return on rate base in excess of that authorized by this Agreement in the period after the rate adjustment becomes effective; (4) a revenue requirement calculation, including the amortization of any deferred costs; (5) an adjustment rider that recovers the rate base and non-PSA related expenses associated with any Four Corners acquisition on an equal percentage basis across all rate schedules which shall not become effective before July 1, 2013; (6) an adjusted rate base schedule; and (7) a typical bill analysis under present and filed rates.

- 10.4 The Signatories shall not raise any issues in the rate adjustment proceeding other than those specifically described in Section 10.2. The Signatories shall use good faith efforts to process this rate adjustment request within a reasonable time.
- 10.5 If, at any time, APS determines that the Four Corners Transaction will not close, it shall so inform the Commission and the Signatories by filing a Notice to that effect in this Docket.

## **XI. MODIFICATION TO ENVIRONMENTAL IMPROVEMENT SURCHARGE**

- 11.1 For purposes of this proceeding, APS shall withdraw its request for approval of the proposed Environmental and Reliability Account ("ERA") mechanism, and APS shall not raise this request before its next general rate case.
- 11.2 APS shall implement a revised version of the existing Environmental Improvement Surcharge ("EIS"). As amended, APS shall no longer receive customer dollars through the EIS to pay for government-mandated environmental controls. However, when APS invests capital to fund any government-mandated environmental controls, the EIS will recover the associated capital carrying costs, subject to a cap equal to the charge currently in place for the EIS. Adjustments to the EIS shall become effective each April 1<sup>st</sup> unless Staff requests Commission review or unless otherwise ordered by the Commission. APS will not request a change in the rate cap prior to its next general rate case.
- 11.3 APS will be held responsible for demonstrating that the environmental controls were government-mandated and represented a reasonable and prudent option available to the Company at that time sufficient to meet the environmental requirements.
- 11.4 The EIS Plan of Administration shall be revised as set forth in Attachment H.
- 11.5 The existing EIS will be reset to zero on the effective date of the new rates contained in this Agreement.

## **XII. COST DEFERRAL RELATED TO CHANGES IN ARIZONA PROPERTY TAX RATE**

- 12.1 APS shall be allowed to defer for future recovery, in accordance with the provisions of Accounting Standards Codification ("ASC") 980 (formerly SFAS

No. 71), the following portions of Arizona property tax expense above or below the test year level of \$141.5 million caused by changes to the applicable Arizona composite property tax rate (not changes in the assessed value of property).

(a) When the property tax rate increases:

- For 2012: 25% (prorated with an assumed July 1 rate effective date);
- For 2013: 50%; and
- For 2014 and all subsequent years: 75%.

(b) When the property tax rate decreases: 100% in all years.

No interest shall be applied to the deferred balance.

- 12.2 Beginning with the effective date of the Commission decision resulting from APS's next general rate case, any final property tax rate deferral that has a positive balance will be recovered from customers over 10 years and any deferral that has a negative balance will be refunded to customers over 3 years.
- 12.3 The Signatories reserve the right to review APS's property tax deferrals for reasonableness and prudence such that the deferrals can be recognized in accordance with the provisions of ASC-980 (formerly SFAS No. 71).

### **XIII. TRANSMISSION COST ADJUSTMENT MECHANISM**

- 13.1 The level of transmission costs presently in APS's base rates will remain in base rates until further order of the Commission.
- 13.2 The annual TCA adjustment will become effective June 1 of each year without the need for affirmative Commission approval, unless Staff requests Commission review or unless otherwise ordered by the Commission.
- 13.3 APS shall file a notice with Docket Control that includes its revised TCA tariff, along with a copy of its FERC information filing of its annual update of transmission service rates pursuant to its Open Access Transmission tariff ("OATT"). This notice shall be filed with the Commission by May 15 of each year.
- 13.4 The TCA Plan of Administration shall be modified as set forth in Attachment I.

**XIV. LOW INCOME PROGRAMS**

- 14.1 In Section 16.3 of the 2009 Settlement, APS committed to augment the bill assistance program approved in Decision No. 69663 by funding \$5 million to assist customers whose incomes exceed 150% of the Federal Poverty Income Guidelines but are less than or equal to 200% of the Federal Poverty Income Guidelines. This Agreement provides that any funds remaining of that \$5 million funding requirement may be used to so assist customers whose incomes are less than or equal to 200% of the Federal Poverty Income Guidelines.
- 14.2 PSA and DSMAC adjustor rates shall apply to low-income customers. The billing method for low income customers shall be simplified by transferring customers to their corresponding non-low income rate schedule and applying the PSA and DSMAC rate schedules to those bills, but then applying a discount to the total bill such that low income customers, like other APS customers, will have no bill impact in this case as a result of the billing method change.

**XV. SERVICE SCHEDULE 3 (LINE EXTENSIONS)**

- 15.1 Version 12 of Service Schedule 3, as approved in Decision No. 72684 (November 18, 2011), shall become effective on the date that rates from this case become effective.

**XVI. BILL PRESENTATION**

- 16.1 Within 90 days following approval of this Agreement, APS will initiate stakeholder meetings to address issues related to the APS bill presentation with a goal of making the bill easier for customers to understand. APS shall thereafter file an application with the Commission for any *authorization needed* to modify its bill presentation. Such application shall explain how the APS bill presentation proposal reflects the input of stakeholders during the stakeholder meeting process.

**XVII. RATE DESIGN**

- 17.1 The Company's proposed Experimental Rate Schedule AG-1, a buy through rate for large commercial and industrial customers, should be capped at 200 MW and should be approved as modified herein, as should corresponding changes to the PSA. Proposed Experimental Rate Schedule AG-1 is set forth in Attachment J. Proposed Experimental Rate Schedule AG-1 does not address the subject of retail electric competition.

- 17.2 APS shall make commercially reasonable efforts to eliminate or mitigate all unrecovered costs resulting from the AG-1 experimental program established in this docket. If there are any lost fixed generation costs related to the AG-1 experimental rate, in its next general rate case, APS shall provide testimony that explains why it was unable to eliminate all lost fixed generation costs. Because AG-1 is an experimental program that may benefit certain General Service customers, and because residential customers cannot participate in the program, any APS proposal in APS's next general rate case that seeks to collect lost fixed generation costs related to the AG-1 experimental rate shall not propose to recover such costs from residential customers.
- 17.3 As recommended by Staff Witness McGarry, APS shall file a study in its next General Rate Case Application to support the cost basis of the various charges in Service Schedule 1, taking into account the impact Smart Grid technology may have on these costs.
- 17.4 APS shall withdraw its request to establish Service Schedule 9, an economic development service schedule. In its place, APS is authorized to pursue economic development opportunities through the use of Commission-approved special contracts.
- 17.5 The remaining rate design issues presented by this case shall be resolved as set forth in Attachment K.

## **XVIII. COMPLIANCE MATTERS**

- 18.1 Within ten days after the Commission issues a written order in this matter, APS shall file compliance schedules associated with this Docket for Staff review. Subject to Staff review, such compliance schedules will become effective on the effective date of the new rates contained in this Agreement.
- 18.2 APS shall report to the Commission identifying the extent of the challenges regarding workforce planning, the specific actions that APS is taking to address the issue, and the progress APS is making toward meeting those goals. The workforce planning report, which shall be filed on an annual basis in this docket on or before May 31, shall be limited to the following job classifications: Electrician-Journeyman, Lineman-Journeyman, Technician-E&I, and Operator-Power Plant (a/k/a Auxiliary Operators and Control Operators). At a minimum, the workforce planning report shall set forth: (1) the number of employees then currently holding these positions; (2) the present mean and median ages of APS's workforce with respect to those job

classifications; (3) the share of retirement-eligible employees, both as a percentage and in absolute terms, in each of these job classifications; and (4) anticipated hiring and attrition levels for each of these job classifications.

- 18.3 Decision No. 70667, as a compliance item, requires APS to periodically file with the Commission certain communications with rating agencies. It is appropriate to eliminate this filing requirement at this time.

## **XIX. FORCE MAJEURE PROVISION**

- 19.1 Nothing in this Agreement shall prevent APS from requesting a change to its base rates in the event of conditions or circumstances that constitute an emergency. For the purposes of this Agreement, the term "emergency" is limited to an extraordinary event that, in the Commission's judgment, requires base rate relief in order to protect the public interest. This provision is not intended to preclude APS from seeking rate relief or any Signatory from petitioning the Commission to examine the reasonableness of APS's rates pursuant to this Section in the event of significant developments that materially impact the financial results expected under the terms of this Agreement. This provision is not intended to preclude any party, including any Signatory to this Agreement, from opposing an application for rate relief filed by APS pursuant to this paragraph. Nothing in this provision is intended to limit the Commission's ability to change rates at any time pursuant to its lawful authority.

## **XX. COMMISSION EVALUATION OF PROPOSED SETTLEMENT**

- 20.1 All currently filed testimony and exhibits shall be offered into the Commission's record as evidence.
- 20.2 The Signatories recognize that Staff does not have the power to bind the Commission. For purposes of proposing a settlement agreement, Staff acts in the same manner as any party to a Commission proceeding.
- 20.3 This Agreement shall serve as a procedural device by which the Signatories will submit their proposed settlement of APS's pending rate case, Docket No. E-01345A-11-0224, to the Commission.
- 20.4 The Signatories recognize that the Commission will independently consider and evaluate the terms of this Agreement. If the Commission issues an order adopting all material terms of this Agreement, such action shall constitute

Commission approval of the Agreement. Thereafter, the Signatories shall abide by the terms as approved by the Commission.

- 20.5 If the Commission fails to issue an order adopting all material terms of this Agreement, any or all of the Signatories may withdraw from this Agreement, and such Signatory or Signatories may pursue without prejudice their respective remedies at law. For purposes of this Agreement, whether a term is material shall be left to the discretion of the Signatory choosing to withdraw from the Agreement. If a Signatory withdraws from the Agreement pursuant to this paragraph and files an application for rehearing, the other Signatories, except for Staff, shall support the application for rehearing by filing a document with the Commission that supports approval of the Agreement in its entirety. Staff shall not be obligated to file any document or take any position regarding the withdrawing Signatory's application for rehearing.

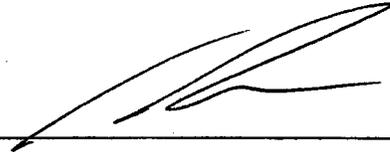
## **XXI. MISCELLANEOUS PROVISIONS**

- 21.1 This case has attracted a large number of participants with widely diverse interests. To achieve consensus for settlement, many participants are accepting positions that, in any other circumstances, they would be unwilling to accept. They are doing so because this Agreement, as a whole, is consistent with their long-term interests and with the broad public interest. The acceptance by any Signatory of a specific element of this Agreement shall not be considered as precedent for acceptance of that element in any other context.
- 21.2 No Signatory is bound by any position asserted in negotiations, except as expressly stated in this Agreement. No Signatory shall offer evidence of conduct or statements made in the course of negotiating this Agreement before this Commission, any other regulatory agency, or any court.
- 21.3 Neither this Agreement nor any of the positions taken in this Agreement by any of the Signatories may be referred to, cited, or relied upon as precedent in any proceeding before the Commission, any other regulatory agency, or any court for any purpose except to secure approval of this Agreement and enforce its terms.
- 21.4 To the extent any provision of this Agreement is inconsistent with any existing Commission order, rule, or regulation, this Agreement shall control.
- 21.5 Each of the terms of this Agreement is in consideration of all other terms of this Agreement. Accordingly, the terms are not severable.

- 21.6 The Signatories shall make reasonable and good faith efforts necessary to obtain a Commission order approving this Agreement. The Signatories shall support and defend this Agreement before the Commission. Subject to paragraph 20.5, if the Commission adopts an order approving all material terms of the Agreement, the Signatories will support and defend the Commission's order before any court or regulatory agency in which it may be at issue.
- 21.7 This Agreement may be executed in any number of counterparts and by each Signatory on separate counterparts, each of which when so executed and delivered shall be deemed an original and all of which taken together shall constitute one and the same instrument. This Agreement may also be executed electronically or by facsimile.

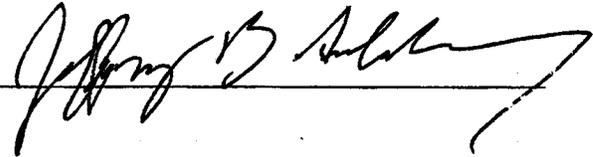
ARIZONA CORPORATION COMMISSION

By

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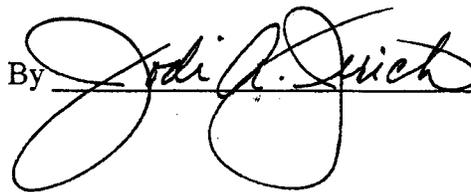
ARIZONA PUBLIC SERVICE COMPANY

By

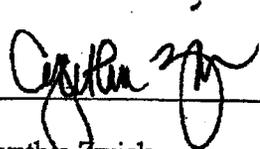
A handwritten signature in black ink, appearing to be "Jeffrey B. Anderson", written over a horizontal line.

RESIDENTIAL UTILITY CONSUMER OFFICE

By

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Docket No. E-01345A-11-0224

By   
Cynthia Zwick

DATED: January 5, 2012

DECISION NO. 74876

Docket No. E-01345A-11-0224

By Karen S. White  
Karen S. White  
Federal Executive Agencies

DATED: January 6, 2012

Docket No. E-01345A-11-0224

By K Boehm

Kurt J. Boehm, Esq.  
Attorney for Kroger Co.

DATED: 1-6-12, 2012

Docket No. E-01345A-11-0224

By   
C. Webb Crockett  
Patrick J. Black  
Fennemore Craig, P.C.  
Attorneys for Freeport-McMoRan Copper & Gold Inc.

DATED: January 6, 2012

DECISION NO. 74876

By 

C. Webb Crockett

Patrick J. Black

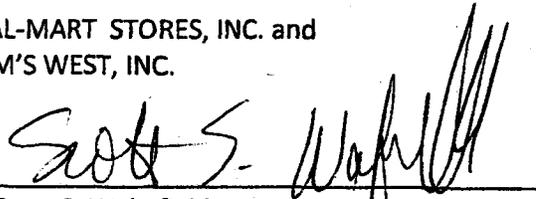
Fennemore Craig, P.C.

Attorneys for Arizonans for Electric Choice and Competition

DATED: January 6, 2012

WAL-MART STORES, INC. and  
SAM'S WEST, INC.

By:



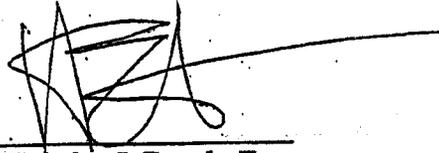
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Attorneys for Wal-Mart Stores, Inc. and  
Sam's West, Inc.

Dated: January 6, 2012

Docket No. E-01345A-11-0224

By:

A handwritten signature in black ink, appearing to be 'N. Enoch', written over a horizontal line.

Nicholas J. Enoch, Esq.

Attorney for Intervenors IBEW Locals 387, 640 & 769

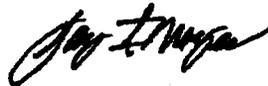
DATED: January 6, 2012

DECISION NO. 74876

Docket No. E-01345A-11-0224

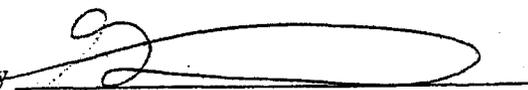
**AZAG GROUP**

By: \_\_\_\_\_



Jay I. Moyes  
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DATED: January 6, 2012

By 

Greg Patterson  
Arizona Competitive Power Alliance  
Director:

DATED: January 6, 2012

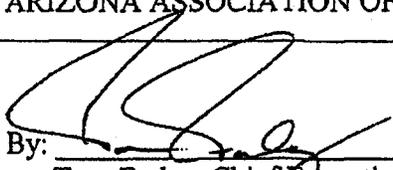
Docket No. E-01345A-11-0224

By Craig A. Marter  
Craig A. Marter  
AARP

DATED: 1/6, 2012

ARIZONA ASSOCIATION OF REALTORS, INC.

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By: 

Tom Farley, Chief Executive Officer

DATED: January 6, 2012

Docket No. E-01345A-11-0224

By Barbara Wyllie Pecora

BARBARA WYLLIE - PECORA

DATED: 1-6-12, 2012

Docket No. E-01345A-11-0224

By  \_\_\_\_\_

Gary Yaquinto, Its President  
Arizona Investment Council

DATED:  \_\_\_\_\_, 2012

Docket No. E-01345A-11-0224

By Lawrence V. Robertson, Jr.

Lawrence V. Robertson, Jr.

On behalf of Southwestern Power Group II, L.L.C.

DATED: January 6, 2012

Docket No. E-01345A-11-0224

By Lawrence V. Robertson, Jr.

Lawrence V. Robertson, Jr.

On behalf of Bowie Power Station, L.L.C.

DATED: January 6, 2012

Docket No. E-01345A-11-0224

By Lawrence V. Robertson, Jr.

Lawrence V. Robertson, Jr.

On behalf of Noble Americas Energy Solutions  
LLC

DATED: January 6, 2012

Docket No. E-01345A-11-0224

By Lawrence V. Robertson, Jr.

Lawrence V. Robertson, Jr.

On behalf of Constellation NewEnergy, Inc.

DATED: January 6, 2012

Docket No. E-01345A-11-0224

By Lawrence V. Robertson, Jr.

Lawrence V. Robertson, Jr.

On behalf of Direct Energy, LLC

DATED: January 6, 2012

Docket No. E-01345A-11-0224

By Lawrence V. Robertson, Jr.

Lawrence V. Robertson, Jr.

On behalf of Shell Energy North America (US),  
L.P.

DATED: January 6, 2012



**EXPERIMENTAL RATE RIDER SCHEDULE AG-1  
ALTERNATIVE GENERATION  
GENERAL SERVICE**

AVAILABILITY

This experimental rate rider schedule is available in all territories served by the Company at all points where facilities of adequate capacity and the required phase and suitable voltage are adjacent to the sites served.

APPLICATION

This rate rider schedule is available for Standard Offer customers who have an Aggregated Peak Load of 10 MW or more and are served under Rate Schedules E-34, E-35, E32-L, or E-32 TOU L. An aggregated group may also include metered accounts that are served under Rate Schedules E-32 M or E-32 TOU M, if the accounts are located on the same premises and served under the same name as an otherwise eligible Customer.

Customers must have interval metering, Advanced Metering Infrastructure, or an alternative in place at all times of service under this schedule. If the Customer does not have such metering, the Company will install the metering equipment at no additional charge. However, the customer will be responsible for providing and paying for any communication requirements associated with the meter, such as a phone line.

All provisions of the customer's applicable rate schedule will apply in addition to this Schedule AG-1, except as modified herein. This rate rider schedule shall be available for four years from the effective date of Schedule AG-1, unless extended by the Commission. Total program participation shall be limited to 200 MW of customer load, 100 MW of which shall be initially reserved for Customers served under Rate Schedule E-32 L.

DEFINITIONS

**Aggregated Peak Load:** The sum of the maximum metered kW for each of the Customer's aggregated metered accounts over the previous 12 months, as determined by the Company and measured at the Customer's meter(s) at the time of application for service under this rate rider schedule.

**Standard Generation Service:** Power provided by the Company to a retail customer in conjunction with transmission and delivery services, at terms and prices according to a retail rate schedule other than Schedule AG-1.

**Customer:** A metered account or set of aggregated metered accounts that meet the eligibility requirements for service and enrollment as an aggregated load for service, under this rate rider schedule.

**Generation Service Provider:** A third party entity that provides wholesale power to the Company on behalf of a Customer. This entity must be legally capable of selling and delivering wholesale power to the Company.

**Generation Service:** Wholesale power delivered to APS by a Generation Service Provider.

**Imbalance Energy:** For each Generation Service Provider, Imbalance Energy will be calculated by the Company as the difference between the hourly delivered energy from the Generation Service Provider and the actual hourly metered load for each Customer for all Customers that have selected the Generation Service Provider under this rate rider schedule.

**Imbalance Service:** Calculating and managing the hourly deviations in energy supply for imbalance energy.

**Total Load Requirements:** The Customer's hourly load including losses from the point of delivery to the Company's transmission system to the Customer's sites for the duration of the contract.



**EXPERIMENTAL RATE RIDER SCHEDULE AG-1  
ALTERNATIVE GENERATION  
GENERAL SERVICE**

CUSTOMER ENROLLMENT

The Company shall establish an initial enrollment period during which Customers can apply for service under this rate rider schedule. If the applications for service are greater than the program maximum amount, then Customers shall be selected for enrollment through a lottery process as detailed in the program guidelines, which may be revised from time-to-time during the term of this rate rider schedule.

AGGREGATION

Eligible customers may be aggregated if they have the same corporate name, ownership, and identity. In addition, (1) an eligible franchisor customer may be aggregated with eligible franchisees or associated corporate accounts, and (2) eligible affiliate customers may be aggregated if they are under the same corporate ownership, even if they are operating under multiple trade names.

DESCRIPTION OF SERVICES AND OBLIGATIONS

The Customer shall apply for service under this rate rider schedule.

The Company shall conduct the enrollment process in accordance with the provisions of this rate rider schedule.

The Customer shall select a Generation Service Provider to provide Generation Service in accordance with the timeline specified in the program guidelines

The Company shall enter into a contract with the Generation Service Provider to receive delivery and title to the power on the Customer's behalf.

The Generation Service Provider shall provide to the Company on behalf of the Customer firm power sufficient to meet the Customer's Total Load Requirements for each of the specified metered accounts, and will attest in its contract with the Company that this condition is met. For the purposes of this rate schedule, "firm power" refers to generation resources identified in Western System Power Pool Schedule C or a reasonable equivalent as determined by the Company.

The Company shall provide transmission, delivery and network services to the Customer according to normal retail electric service.

The Company will settle with the Generation Service Provider for Imbalance Service and other relevant costs on a monthly basis according to the program guidelines.

The Generation Service Provider shall bill the Company the monthly billed amounts for each customer for Generation Service and Imbalance Service according to the program guidelines.

The Company shall bill the customer for the Generation Service Provider's charged amounts and remit the amounts to the Generation Service provider.

The customer will be responsible for paying for the cost of the power provided by the Generation Service Provider, as specified in the contract and this rate rider schedule.



**EXPERIMENTAL RATE RIDER SCHEDULE AG-1  
ALTERNATIVE GENERATION  
GENERAL SERVICE**

DELIVERY OF POWER TO THE COMPANY'S SYSTEM

Power provided by the Generation Service Provider must be firm power as defined above and delivered to the Company at the Palo Verde network delivery point, or other point of delivery as agreed to by the Company. The Generation Service Provider is responsible for the cost of transmission service to deliver the power to the Company's delivery point.

SCHEDULING

The Company shall serve as the scheduling coordinator. The Generation Service Provider shall provide monthly schedules of hourly loads along with day-ahead hourly load deviations from the monthly schedule to the Company according to the program guidelines. Line losses, in the amount of 7%, from the point of delivery to the Customer's sites shall be either scheduled or financially settled.

IMBALANCE SERVICE

The Company will provide Imbalance Service according to the terms and provisions in the Company's Open Access Transmission Tariff, Schedule 4. Imbalance Energy will be based on the Generation Service Provider's portfolio of Customer loads.

POWER SUPPLY ADJUSTER AND HEDGE COST TRUE-UP

The customer will be subject to the power supply adjustment – historical component for the first twelve months of service under this rate rider schedule. The customer will also pay for the hedge cost associated with the customer's Standard Generation Service at the time the customer takes service under this rate rider schedule. For the purpose of this rate rider schedule, the Company will determine the applicable pro rata hedge cost based on the market price for hedge costs at the time the customer takes service under this rate rider schedule.

DEFAULT OF THE THIRD PARTY GENERATION PROVIDER

In the event that the Generation Service Provider is unable to meet its contractual obligations, the customer must notify the Company and select another Generation Service Provider within 60 days. Prior to execution of any new power contract, the Company shall provide the required power to the customer, which will be charged at the Dow Jones Electricity Palo Verde Hourly Index price for the power delivery date plus \$10 per MWh. In addition, all other provisions of this rate rider schedule will continue to apply.

If the Customer is unable to select another Generation Service Provider within sixty days, the customer will automatically return to Standard Generation Service, and be subject to the conditions below.

RETURN TO COMPANY'S STANDARD GENERATION SERVICE

Customer may return to the Company's Standard Generation Service under their applicable retail rate schedule without charge if: (1) they provide one year notice (or longer) to the Company; or (2) if this rate rider schedule is discontinued at the end of the 4 year experimental period; or (3) if the Commission terminates the program prior to the initial four year experimental period. Absent one of these three conditions, the Company will provide the customer with generation service at the market index rate provided in the Company's Open Access Transmission Tariff until the Company is reasonably able to integrate the customer back into their generation planning and provide power at the applicable retail rate schedule. This transition will be at the Company's determination but no longer than 1 year. The returning customer must remain with the Company's Standard Generation Service for at least 1 year.



**EXPERIMENTAL RATE RIDER SCHEDULE AG-1  
ALTERNATIVE GENERATION  
GENERAL SERVICE**

RATES

All provisions, charges and adjustments in the customer's applicable retail rate schedule will continue to apply except as follows:

1. The generation charges will not apply;
2. Adjustment Schedule PSA-1 will not apply, except that the Historical Component will apply for the first twelve months of service under this rate rider schedule;
3. Adjustment Schedule EIS will not apply; and
4. The applicable proportionate part of any taxes or governmental impositions which are or may in the future be assessed on the basis of gross revenues of the Company and/or the price or revenue from the electric energy or service sold and/or the volume of energy generated or purchased for sale and/or sold hereunder shall be applied to the customer's bill.

Schedule AG-1 charges determined and billed by the Company include:

1. A monthly management fee of \$0.00060 per kWh applied to the customer's metered kWh;
2. A monthly reserve capacity charge applied to 15% of the customer's billed kW (on-peak for Rate Schedules E-35 and E-32 TOU L) at the Company's applicable cost-based rate filed at the Federal Energy Regulatory Commission and revised from time to time, which is currently \$6.985 per kW month;
3. An initial charge or credit for fuel hedging costs, as described herein;
4. Returning Customer charge, where applicable, as described herein;
5. Generation Service Provider Default charge, where applicable, as described herein.

Schedule AG-1 Generation Service and Imbalance Service charges billed by the Company include:

1. Generation Service charges shall be charged at a rate within the minimum and maximum limits as follows:
  - a. When the contract provides for pricing that reflects a specific index price, the minimum price will be the specified index minus 35% and the maximum price will be the specified index plus 35%. The determination that a contract is consistent with this provision will be based on the specified index price applicable on the date the contract is executed.
  - b. When the contract provides for a fixed price supply for the term of the contract, the minimum price will be the generation rate of the Customer's applicable retail rate schedule minus 35%, and the maximum price shall be the generation rate of the Customers applicable retail schedule plus 35%. If the Customer has more than one otherwise applicable retail rate schedule, the highest applicable retail rate schedule will be used for purposes of the consistency determination. The determination that a contract is consistent with this provision will be based on the Customer's otherwise applicable retail rate schedule in effect on the date the contract is executed.
  - c. Losses from the delivery point to the Customer's meters and any charges assessed by the Company on the Customer, including charges for transmission and distribution, Capacity Reservation Charge, the Management Fee, Imbalance Service charges, PSA balance and hedging costs, and Returning Customer Charges, shall not be included in the Generation Service charge for purposes of determining whether the contract is consistent with the minimum and maximum price provisions of this rate rider schedule.
2. Imbalance Service charges shall be charged at a rate greater than \$0.00 per kWh and less than or equal to the rate that the Company charges the Generation Service Provider for Imbalance Service as specified herein.

**EXPERIMENTAL RATE RIDER SCHEDULE AG-1  
ALTERNATIVE GENERATION  
GENERAL SERVICE**

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**CONTRACT TERM AND REQUIREMENTS**

The term of the contract with the Generation Service Provider shall be for not less than one year and shall not exceed four years.

The Generation Service Provider and Customer will enter into a contract or contracts with the Company, stating the pertinent details of the transaction with the Generation Service Provider, including but not limited to the scheduling of power, location of delivery and other terms related to the Company's management of the generation resource.

**CREDIT REQUIREMENTS**

A Generation Service Provider or its parent company must have at least an investment grade credit rating or demonstrate creditworthiness in the form of either a 3rd-party guarantee from an investment grade rated company, surety bond, letter of credit, or cash in accordance with the Company's standard credit support rules