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Transcript Exhibit(s)

Docket #(s): E-01773A-12-0305

Arizona Corporation Commission
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EXHIBIT

S-11

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MEMORANDUM

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AZ CORP COMMISSION
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TO: Docket Control

FROM: Steven M. Olea
Director
Utilities Division

ORIGINAL

DATE: October 21, 2014

RE: IN THE MATTER OF THE APPLICATION OF ARIZONA ELECTRIC POWER COOPERATIVE, INC. TO DETERMINE THE FAIR VALUE OF ITS PROPERTY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RETURN THEREON AND TO APPROVE RATES DESIGNED TO DEVELOP SUCH RETURN-APPLICATION FOR APPROVAL OF THE ECAR PLAN OF ADMINISTRATION AND TARIFF (DOCKET NO. E-01773A-12-0305)

Attached is the Staff Report for the Application of Arizona Electric Power Cooperative, Inc. for approval of its proposed Environmental Compliance Adjustment Rider Tariff and Plan of Administration. Staff recommends approval of the application as discussed below.

SMO:CLA:vsc\BH

ORIGINATOR: Candrea Allen

Attachment: Original and Thirteen Copies

Arizona Corporation Commission
DOCKETED

OCT 17 2014

DOCKETED BY

SERVICE LIST FOR: ARIZONA ELECTRIC POWER COOPERATIVE, INC.
DOCKET NO. E-01773A-12-0305

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STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

ARIZONA ELECTRIC POWER COOPERATIVE, INC.
DOCKET NO. E-01773A-12-0305

IN THE MATTER OF THE APPLICATION OF ARIZONA ELECTRIC POWER COOPERATIVE, INC. TO DETERMINE THE FAIR VALUE OF ITS PROPERTY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RETURN THEREON AND TO APPROVE RATES DESIGNED TO DEVELOP SUCH RETURN-APPLICATION FOR APPROVAL OF THE ECAR PLAN OF ADMINISTRATION AND TARIFF

OCTOBER 21, 2014

STAFF ACKNOWLEDGEMENT

The Staff Report for the application of Arizona Electric Power Cooperative, Inc., Docket No. E-01773A-12-0305, for approval for approval of the ECAR plan of administration and tariff was the responsibility of the staff member listed below.

Candrea Allen
Public Utilities Analyst

INTRODUCTION

The Arizona Corporation Commission ("Commission") Decision No. 74173, dated October 25, 2013, was held open until April 30, 2014, to allow Arizona Electric Power Cooperative, Inc. ("AEPCO"), to file, after collaboration with Staff, a proposed Environmental Compliance Adjustment Rider ("ECAR") tariff and Plan of Administration ("POA"), for Commission approval. After collaboration with Staff, on April 30, 2014, AEPCO filed, for Commission approval, its proposed ECAR tariff and POA.

Decision No. 74173 also required AEPCO to provide notice of the proposed ECAR to the customers of its Class A member distribution cooperatives, within 30 days of filing its ECAR documents for Commission approval. On May 23, 2014, AEPCO filed a motion to extend the deadline to file proof of the notice of the ECAR application. In Decision No. 74600, the Commission granted AEPCO an extension of time to file the required notice until July 28, 2014, amending the deadline required by Decision No. 74173. On July 28, 2014, AEPCO filed its proof of the notice initially required in Decision No. 74173 and amended by Decision No. 74600.

BACKGROUND

AEPCO is a not-for-profit, generation and transmission cooperative that was initially granted a Certificate of Convenience & Necessity ("CC&N") by the Commission in Decision No. 33677, dated February 13, 1962. As part of the restructuring of AEPCO in the late 1990s and early 2000s, the Commission approved Decision No. 63868, dated July 25, 2001, which transferred AEPCO's transmission assets and transmission portion of its CC&N to Southwest Transmission Cooperative, Inc. ("SWTC"). In Decision No. 74591, dated July 30, 2014, the transmission portion of AEPCO's CC&N granted in Decision No. 33677 and transferred to SWTC in Decision No. 63868 was transferred back to AEPCO, among other approvals.

AEPCO provides generation and transmission services to three all-requirements distribution cooperative members ("ARM" or collectively "ARMs") (Duncan Valley Electric Cooperative, Inc.; Graham County Electric Cooperative, Inc.; and Anza Electric Cooperative, Inc.)[1] and three partial-requirements distribution cooperative members ("PRM" or collectively "PRMs") (Mohave Electric Cooperative, Inc.; Sulphur Springs Valley Electric Cooperative, Inc.; and Trico Electric Cooperative, Inc.). The ARMs receive all of their power and energy needs from AEPCO while each PRM only commits to purchase a fixed amount of capacity from AEPCO and may secure additional power and energy from other sources.

THE ECAR MECHANISM

The ECAR is a monthly surcharge intended to provide cost recovery of potential costs associated with future Environmental Protection Agency ("EPA") Regional Haze environmental compliance requirements for AEPCO's two coal-fired units at the Apache Generating Station ("Apache Station") and also any other potential obligations mandated by federal, state and/or local

[1] Anza Electric Cooperative is located in southern California.

environmental regulations. The ECAR would be applicable to all of AEPCO's Class A member distribution cooperatives. In addition to the ECAR, AEPCO would develop an Environmental Compliance Strategy ("ECS") plan to accompany the ECAR. The ECS plan would include the scope of work, anticipated timelines, and cost estimates specific to the ECAR that would apply. The ECS plan would specify the Qualified Environmental Compliance Projects ("QECP") that would be implemented in order to comply with any mandated environmental regulations. The costs associated with any QECP, as identified in an ECS plan, would be recovered through the ECAR, as approved by the Commission.

According to the proposed ECAR POA, the monthly ECAR amount would be calculated based on costs detailed in the accompanying ECS plan. Each member distribution cooperative would be apportioned a share of the costs specified in the ECS plan based on the Allocated Capacity Percentage ("ACP") of each cooperative. The monthly dollar amount to be collected from the ARMs would be based on the monthly demand ratio share. The term for collection of the costs would be determined by AEPCO in the ECS and/or the ECAR tariff. The proposed ECAR POA also specifies the qualifying Rural Utility Service ("RUS") accounts that would be recoverable through the ECAR and how the funds will be recorded for accounting purposes. The funds collected from the ECAR would be deposited into an interest bearing investment account that would be used only for QECP identified in an ECS plan.

Upon completion/termination of an ECS plan, any funds remaining would be refunded to the distribution cooperative members, which would return the ECAR to zero, using the same method used to calculate the collection of the ECAR. The rates would remain at zero until AEPCO filed a new ECS plan and corresponding ECAR tariff in response to new environmental regulations. Further, the proposed ECAR POA specifies the reporting requirements and process for filing semi-annual reports with the Commission which would be filed on September 1 for the previous January through June and March 1 for the prior year July to December period of each year. AEPCO would be required to obtain board approval prior to submitting an application for an ECS plan and ECAR tariff for Commission approval.

RECOMMENDATIONS

Staff and AEPCO came to agreement on the proposed ECAR POA and tariff filed in the instant application and Staff recommends approval of the ECAR surcharge mechanism. However, AEPCO is proposing to recover the costs for chemical expenses associated with the installation of the Selected Non-Catalytic Reduction ("SNCR") retrofit and the employment of an activated carbon injection system that would reduce NO_x and mercury emissions, respectively. Staff does not believe that these costs should be recovered through the ECAR.[2] In addition, Staff notes that no other utility has been granted Commission approval to recover such costs through the respective environmental surcharges. Therefore, Staff does not recommend that chemical expenses be recovered through the ECAR surcharge. Further, Staff recommends that upon completion/termination of an ECS Plan, after any remaining funds have been refunded to the distribution cooperative members, and rates are returned to zero (as described above), AEPCO

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[2] These chemical costs would be recorded in RUS account 502-Steam Expenses.

should be required to file the revised ECAR tariff reflecting the zero rates, as a compliance item to the Decision approving the corresponding ECAR tariff, within 30 days of the surcharge rates going to zero. Finally, Staff recommends that AEPCO file a revised ECAR POA removing the reference to RUS account 502-Steam Expenses, as a compliance item, within 15 days of a Decision in this matter.

EXHIBIT
S-12
ADMITTED

BEFORE THE ARIZONA CORPORATION COMMISSION

SUSAN BITTER SMITH
Chairman
BOB STUMP
Commissioner
BOB BURNS
Commissioner
DOUG LITTLE
Commissioner
TOM FORESE
Commissioner

IN THE MATTER OF THE APPLICATION OF ARIZONA ELECTRIC POWER COOPERATIVE, INC. TO DETERMINE THE FAIR VALUE OF ITS PROPERTY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RETURN THEREON AND TO APPROVE RATES DESIGNED TO DEVELOP SUCH RETURN.	DOCKET NO. E-01773A-12-0305 ECAR APPLICATION

DIRECT

TESTIMONY

OF

CANDREA ALLEN

PUBLIC UTILITIES ANALYST

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

AUGUST 26, 2015

EXECUTIVE SUMMARY
ARIZONA ELECTRIC POWER COOPERATIVE, INC.
DOCKET NO. E-01773A-12-0305

Staff's testimony details Staff's position and recommendations relating to Arizona Electric Power Cooperative, Inc.'s ("AEPCO") request to recover the costs for chemical expenses associated with the Environmental Protection Agency Regional Haze and Mercury and Air Toxics Standards environmental compliance requirements through its proposed Environmental Compliance Adjustment Rider. In addition, Staff addresses the changes AEPCO is proposing to its Tariff and Plan of Administration.

Q. Please state your name and business address.

A. My name is Candrea Allen. My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

Q. By whom are you employed and in what capacity?

A. I am employed by the Arizona Corporation Commission ("Commission") in the Utilities Division ("Staff") as a Public Utilities Analyst. I provide recommendations on various utility applications to the Commission. I have been employed by the Commission since 2006.

Q. What is the scope of your testimony in this case?

A. My testimony will be limited to Staff's position and recommendations relating to the Arizona Electric Power Cooperative, Inc.'s ("AEPCO") request to recover the costs for chemical expenses associated with the Environmental Protection Agency ("EPA") Regional Haze and Mercury and Air Toxics Standards ("MATS") environmental compliance requirements for AEPCO's two coal-fired units at the Apache Generating Station ("Apache Station") through its proposed Environmental Compliance Adjustment Rider ("ECAR"). In addition, I will be addressing the changes AEPCO is proposing to its ECAR Tariff and Plan of Administration ("POA") as described in the direct testimony of Joe King filed on June 19, 2015.

Q. Have you provided previous testimony in this docket?

A. No. However, on October 17, 2014, I did prepare a memorandum regarding the AEPCO application for approval of its proposed ECAR Tariff and POA. Staff recommended approval of AEPCO's proposed ECAR Tariff and POA with the exception of the chemical expenses requested to be recovered through the ECAR. Dennis Kalbarczyk provided surrebuttal testimony, on behalf of Staff, regarding the ECAR (filed July 3, 2013) as part of the initial AEPCO rate case.

Q. Please provide a brief history of the rate case proceeding regarding the proposed ECAR.

A. On July 5, 2012, AEPCO filed a rate case application with the Commission. The rate case application requested a decrease in AEPCO's revenue requirement, continuation of its Purchased Power and Fuel Adjustor Clause ("PPFAC"), with modifications, and approval of revised depreciation rates which were based on the results of a study of AEPCO's Apache Station, required from the previous rate case decision (Decision No. 72055). During this rate case proceeding, AEPCO proposed the ECAR as a surcharge mechanism that is intended to provide recovery of potential costs associated with environmental compliance requirements.

On October 25, 2013, the Commission issued Decision No. 74173 which approved AEPCO's requested rate decrease, among other things, and also ordered that this case remain open until April 30, 2014, for the limited purpose of allowing AEPCO to file for Commission approval, if it so chose, after collaboration with Staff, a proposed ECAR Tariff and POA. On April 30, 2014, AEPCO filed in this docket, an application for approval of its proposed ECAR Tariff and POA. On October 17, 2014, Staff filed its Staff Report regarding the ECAR application. On November 13, 2014, AEPCO filed its response to the Staff Report regarding the ECAR application. On January 14, 2015, a Proposed Order was issued by the Administrative Law Judge ("ALJ"). On January 21, 2015, Mohave Electric Cooperative, Inc. ("MEC") filed a letter indicating MEC's support for the requests in AEPCO's January 22, 2015, filing and on January 22, 2015, AEPCO filed a Request for Procedural Conference and Postponement of Commission Consideration Re ECAR. AEPCO requested that the Commission postpone consideration of the ECAR Application until after a hearing is held, and that a procedural conference be held for the purpose of scheduling a hearing on contested issues in its ECAR Application.

Following an extensive procedural history detailed in this docket, on May 7, 2015, the ALJ issued a procedural order setting the matter for a hearing and setting associated procedural deadlines, including notice requirements, for this matter. On August 10, 2015, the ALJ issued another procedural order revising the hearing date, among other procedural matters.

Q. Please briefly describe the ECAR mechanism.

A. The ECAR is a monthly surcharge intended to provide cost recovery of potential costs associated with future EPA Regional Haze environmental and MATS compliance requirements for AEPCO's two coal-fired units at the Apache Station and also any other potential obligations mandated by federal, state and/or local environmental regulations. The ECAR would be applicable to all of AEPCO's Class A member distribution cooperatives. In addition to the ECAR, AEPCO would develop an Environmental Compliance Strategy ("ECS") plan to accompany the ECAR. The ECS plan would include the scope of work, anticipated timelines, and cost estimates specific to the ECAR that would apply. The ECS plan would specify the Qualified Environmental Compliance Projects ("QECP") that would be implemented in order to comply with any required environmental regulations. The costs associated with any QECP, as identified in an ECS plan, would be recovered through the ECAR, as approved by the Commission.

Q. Please describe Staff's position regarding the recovery of chemical expenses through the ECAR.

A. Staff's initial position, based upon the information available at that time, was that the costs for chemical expenses (as recorded in Rural Utility Service ("RUS") account 502) should not be eligible for recovery through the ECAR. Subsequently, additional information was provided by the Company, culminating in the Stipulated Statement of Facts which was attached to AEPCO's Request for Briefing Order In Lieu Of Hearing Re ECAR filed on

April 22, 2015. AEPCO further submitted Direct Testimonies of Peter Scott and Joe King, which contained additional details about the chemical expenses portion of the ECAR, particularly regarding the estimates of the potential capital costs and chemical expenses.

According to information provided by AEPCO, the estimates of the costs for chemical expenses represent a significant portion of the total cost estimates for AEPCO to comply with the impending EPA regulations. The estimated annual costs for chemical expenses are: $2.2 million to $4.5 million in 2016; $3.1 million to $6.2 million in 2017; and $2.2 million to $5 million in 2018. Because the costs for chemical expenses represent such a significant portion of the costs AEPCO would incur to comply with the EPA regulations, Staff has determined that the exclusion of the recovery of chemical expenses would negatively impact AEPCO financially.

In addition, Staff notes that the cost for the chemical expenses alone are estimated to be more than the approximately $1.96 million net operating income (margin) approved in Decision No. 74173. Further, as stated in the Stipulated Statement of Facts (filed April 22, 2015), Staff has no evidence to the contrary regarding the cost estimates for both the urea and activated carbon that would be used to comply with EPA regulations nor the bill impact estimates made by AEPCO. Therefore, Staff does not dispute AEPCO's estimates.

Q. Please explain the rationale behind Staff's initial position and recommendation.

A. During its review of the AEPCO ECAR, Staff looked at the environmental surcharges that have been approved by the Commission for other utilities as a guideline. For example, Staff looked at the Environmental Improvement Surcharge ("EIS") that was approved for Arizona Public Service Company ("APS") in Decision No. 69663 (dated June 28, 2007) as modified by

Decision No. 73183 (dated May 24, 2012).[1] The only costs that were contemplated as being recoverable through the APS EIS were the capital costs associated with mandated environmental compliance (as specified by Federal Energy Regulatory Commission ("FERC") account). The costs for chemical expenses are not included in the list of qualified accounts as recoverable through the EIS.

In general, Staff believed and continues to believe that the intention behind how the surcharge should be implemented and the types of costs allowed to be recovered through such a surcharge should remain consistent across utilities. However, given the amount of the cost estimates for chemical expenses and the impact these costs could have on AEPCO financially, if not recovered, Staff believes recovery of the chemical expenses through the ECAR is appropriate.

Q. Has Staff reviewed the proposed changes to the ECAR Tariff and POA?

A. Yes. Staff has reviewed the proposed changes to the ECAR Tariff and POA. As described in the direct testimony of Joe King, AEPCO is proposing to include an energy charge ($/kWh) to recover the costs for chemical expenses in conjunction with a fixed monthly charge to recover the capital costs. The chemical expenses are on-going costs that may fluctuate based on the amount of energy produced and consumed. Therefore, an energy charge would provide transparency and more accurate tracking of these costs.

[1] The Commission also approved the Tucson Electric Power Company ("TEP") Environmental Compliance Adjustor ("ECA") in Decision No. 73912 (dated June 27, 2013). The ECA was modeled after the APS EIS. The APS EIS and the TEP ECA have been the only environmental surcharges approved by the Commission to date.

Q. Does Staff have any revisions to the proposed changes to the ECAR Tariff and POA?

A. No. Staff has reviewed the proposed changes to the ECAR Tariff and POA and believes the proposed changes to the ECAR Tariff and POA described in Joe King's June 19, 2015 testimony are appropriate. Staff recommends approval of the proposed changes.

Q. Does this conclude your direct testimony?

A. Yes, it does.

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

SUSAN BITTER SMITH, Chairman
BOB STUMP
BOB BURNS
DOUG LITTLE
TOM FORESE

IN THE MATTER OF THE APPLICATION OF THE ARIZONA ELECTRIC POWER COOPERATIVE, INC. FOR A HEARING TO DETERMINE THE FAIR VALUE OF ITS PROPERTY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RETURN THEREON AND TO APPROVE RATES DESIGNED TO DEVELOP SUCH RETURN	Docket No. E-01773A-12-0305

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

Direct Testimony of Joe King

on Behalf of

Arizona Electric Power Cooperative, Inc.

ECAR Application

June 19, 2015

4842045v3/10421-0067

EXHIBIT
A-8
ADMITTED

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INTRODUCTION

Q. Please state your name and business address?

A. My name is Joe King. My business address is 1000 South Highway 80, Benson, Arizona, 85602.

Q. By whom are you employed and in what capacity?

A. I am employed by Sierra Southwest Cooperative Services, Inc. ("Sierra Southwest") as a Senior Financial Analyst. As such, I am responsible for a number of internal and external rate-related matters for Arizona Electric Power Cooperative, Inc. ("AEPCO" or the "Cooperative") and Southwest Transmission Cooperative, Inc. ("SWTC"). Among other tasks, I oversee AEPCO's Purchased Power and Fuel Adjustment Clause ("PPFAC") as we well as the preparation of rate cases for both AEPCO and SWTC.

Q. Please briefly describe your educational background and work-related experience.

A. I hold an Associate of Arts Degree from Arizona Western College with emphasis in General Studies/Science, a BSBA degree from the University of Arizona with emphasis in Accounting, and a MA degree from the University of Arizona with emphasis in Economics. I have been employed by Sierra Southwest for approximately seven years. Before that, I held positions with the University of Arizona Division of Economic Business Research, the Public Utility Commission of Texas and Tucson Electric Power Company ("TEP"). During my tenure with TEP, I served as Manager of Pricing and Competitive Analysis as well as Manager of Energy Settlements and Customer

Accounting. I have previously testified before both the Public Utility Commission of Texas and the Arizona Corporation Commission.

Q. Mr. King, what is the purpose of your testimony?

A. I am testifying in support of AEPCO's proposed Environmental Compliance Adjustment Rider ("ECAR"). I will provide the Commission with an overview of the ECAR, including the various procedural steps that AEPCO will undertake before it can recover any costs through the mechanism. I will also explain the slight revisions that we are proposing to the ECAR Tariff and Plan of Administration in order to make the mechanism more consistent with the principles of cost causation and improve the manner in which chemical costs can be tracked and assessed. Finally, my testimony describes the environmental regulations that AEPCO is currently facing as well as the costs, both capital and chemical, that we anticipate incurring in connection with our compliance obligations and demonstrates why the Commission should approve chemical costs as eligible for potential recovery through the ECAR.

ECAR OVERVIEW

Q. Mr. King, what is the ECAR?

A. The ECAR is a funding mechanism tailored to assist AEPCO in meeting future environmental compliance obligations mandated by federal, state and/or local laws or regulations. As Peter Scott explains in his testimony, we originally proposed the ECAR in this rate case to address concerns raised by the Commission's Utilities Division Staff ("Staff") regarding the potential impact of a ruling from the Environmental Protection

Agency ("EPA") concerning regional haze. However, the ECAR is not limited to that one regulation. Instead, in keeping with the current regulatory atmosphere, we proposed the ECAR to be available, if necessary, to respond to a variety of environmental compliance obligations.

Q. Can you explain how the ECAR works?

A. Yes. Once approved by the Commission, the initial rate of the ECAR will be set at zero. Thereafter, in response to a particular environmental regulation, AEPCO will analyze its financial status, including its current rate levels and any expenses that qualify for recovery/refund through its PPFAC, to determine whether the Cooperative requires additional revenue to comply with the given regulation. If AEPCO determines that its margins are sufficient to cover the compliance costs, then it would <u>not</u> seek to raise the ECAR rate above zero.

However, if the results of AEPCO's financial analysis indicate that additional revenues are needed for environmental compliance, the Cooperative will prepare its initial Environmental Compliance Strategy ("ECS"). The ECS will, at a minimum, describe the scope of work, anticipated timeline and cost estimates. In preparing the ECS, AEPCO intends to limit the costs to be recovered through the ECAR to only those necessary to meet the shortfall in the Cooperative's margins. If the ECS is approved by AEPCO's Board of Directors and receives unanimous approval from its Class A Distribution Cooperative Members ("Members"), the Cooperative will then file the ECS with the Commission along with a revised tariff showing the additional charges to be assessed to each of the Members on their monthly invoices. If approved by the Commission, the ECAR tariff would remain in effect until the project, as specified in the ECS, has been completed or terminated. AEPCO's Members may pass along the ECAR charges to their retail members via their respective purchased power clauses.

Q. What kinds of costs does AEPCO envision funding through the ECAR?

A. The ECAR identifies specific costs, by Rural Utilities Service ("RUS") account number, that may be included in the ECS. The costs fall into two general categories: capital costs (carrying costs and/or contributions in aid of construction) and operations' expenses. However, the costs may not be duplicative of any expense already recovered in base rates or through any other adjustor mechanism. Also, AEPCO is not permitted to use the ECAR to recover environmental fines or penalties.

Q. How will the funds collected through the ECAR be accounted for and administered?

A. AEPCO will deposit the funds collected through the ECAR in a separate interest-bearing investment account; interest earned will be retained in the account. AEPCO may only draw monies from the account to pay for costs identified in the Commission-approved ECS. The funds collected will be separately identified and recorded as a regulatory liability and use of the funds will reduce the regulatory liability on a dollar-for-dollar basis. To the extent that AEPCO collects funds to pay for the Cooperative's capital additions (as opposed to capital carrying costs), those funds will be recorded as contributions in aid of construction. We will track the funds collected from each of AEPCO's Members such that, upon completion or termination of the ECS plan, all remaining funds in the account (including interest) can be refunded within ninety days.

Q. If the Commission approves AEPCO's initial ECS for a particular environmental compliance obligation, can the ECS and amount charged through the tariff be modified to address changes in circumstances, including price fluctuations?

A. Yes. The ECAR Plan of Administration describes a modification process. If authorized by its Members and Board, the Cooperative may file a revised ECS and ECAR tariff with the Commission, which can adjust the ECAR charges up or down depending on the nature of the change in compliance strategy and/or actual costs. The revised ECS and tariff will be subject to a sixty-day Staff review period and become effective at the end of that period unless the Commission suspends the revised tariff, in which case the revised tariff would become effective upon Commission approval.

Q. What happens after AEPCO finishes an environmental compliance project?

A. As indicated above, we will return all amounts owed to the Members during the ninety-day refund period. Also, we will file a revised ECAR tariff, resetting the rate to zero. The ECAR rate will remain at zero until the Cooperative deems it necessary to utilize the ECAR tariff again in response to a federal, state or local environmental requirement, in which case we will prepare and file another initial ECS and tariff for Commission approval.

Q. Will the ECAR tariff reset to zero if AEPCO files a rate case before an ECS plan is completed or terminated?

A. Yes. Although we anticipate that the ECAR will help AEPCO reduce the frequency of its rate filings, the ECAR tariff will be reset in a rate case (just like other adjustor mechanisms). After new base rates go into effect, AEPCO may use the ECAR to track and return or recover any over- or under-collected environmental compliance costs, similar to the Cooperative's PPFAC.

Q. Does the ECAR include any compliance reporting requirements?

A. It does. The Plan of Administration calls for semi-annual compliance reports while an ECS is in place. The reports will include ECAR account balances, the amount collected from AEPCO's Members (individually and collectively) and the amount of interest earned for the period. The reports will also provide total withdrawal information as well as the dates and amounts of each withdrawal and a description of each cost paid during the report period.

Q. How will AEPCO determine the amount to be charged to each Member through the ECAR?

A. Our initial draft of the ECAR proposed a monthly fixed charge, which would be calculated based on the costs identified in the Commission-approved ECS and allocated to each Member based on the Member's Allocated Capacity Percentage. The monthly charge to the individual All-Requirements Members would be based on the Member's monthly Demand Ratio Share, which is calculated on a 12-month rolling average basis.

This methodology makes sense for the capital compliance costs because these costs are one-time expenditures that are easier to estimate in advance and are less likely to change during the project. However, the operations' costs associated with compliance are on-going expenses that may fluctuate. For example, we anticipate that the price of the chemicals at issues will likely change over time. Further, the quantity of chemicals needed for compliance has a direct correlation to the amount of energy produced and consumed. Therefore, we believe the operations' costs should be collected through a variable rate instead of a fixed charge. To this end, we revised the ECAR to include two types of charges: (1) a fixed monthly charge to recover capital costs and (2) an energy charge ($/kWh) to recover environmental compliance operations' costs (including chemical expenses). The revised ECAR Tariff and Plan of Administration are attached as Exhibits JK-1 and JK-2, respectively.

AEPCO'S UPCOMING COMPLIANCE OBLIGATIONS & STRATEGY

Q. Mr. King, please describe the environmental compliance obligations currently faced by AEPCO.

A. There are two federal requirements with upcoming deadlines that may require funding through the ECAR. One is the EPA's regional haze requirement that was discussed earlier in this rate case. As described by Mr. Scott, under AEPCO's Better than BART plan, we will convert Steam Turbine Unit 2 ("ST2") to natural gas-fired operation and install Selective Non-Catalytic Reduction ("SNCR") technology on Steam Turbine Unit 3 ("ST3"). The deadline for this portion of the project is December 2017. Once the SNCR is installed, ST3 will continue to operate on coal, but AEPCO will need to use a chemical (urea) to further reduce the unit's emissions in order to comply with the regional haze requirements.

Q. **And the second federal requirement?**

A. The second compliance obligation we face is the EPA's Mercury & Air Toxics Standards ("MATS"). Beginning in April 2016, AEPCO must use another chemical – activated carbon – in the operation of both ST2 and ST3. We will use activated carbon in both units until ST2 is converted to natural gas in 2017; thereafter, activated carbon (in addition to the urea discussed above) will only be used in the operation of ST3.

Q. **Has AEPCO developed an ECS for either of these regulations?**

A. We have not prepared the actual ECS yet, but we do have some of the information that will be in the ECS. The scopes of work and project timelines are described above. The capital costs associated with these two projects are estimated to total $32 million. Based on this figure, we have estimated the annual revenue requirement (*i.e.*, the capital carrying costs without a margin component) associated with AEPCO's capital investment as follows: $0.41 million in 2016; $1.90 million in 2017; and $3.40 million in 2018. We also developed estimates for the chemical costs, but as discussed below, these expenses are variable and subject to market fluctuation. Based on currently available information, we estimate the annual chemical costs associated with regional haze and MATS compliance as follows: $2.2 million to $4.5 million in 2016; $3.1 million to $6.2 million in 2017; and $2.2 million to $5 million in 2018. Both sets of estimates (for the annual capital carrying costs and chemical costs) are non-cumulative.

Q. Has AEPCO prepared any estimates of the potential rate impacts on the Members' customers based on the cost estimates outlined above?

A. Yes. We estimated the potential rate impacts that the ECAR may have on our Members' residential customers based on average usage and current rate levels. These estimates were provided to Staff and the Members earlier this year. They will also be provided to the Members' customers as required by the May 7, 2015 Procedural Order.

CHEMICAL COST ELIGIBILITY

Q. Mr. King, please explain why AEPCO believes chemical costs should be eligible for inclusion in an ECS and ultimately recoverable through the ECAR.

A. There are several reasons. First and foremost, AEPCO cannot comply with the EPA's regional haze ruling or the MATS requirement without using these chemicals – they are an integral part of AEPCO's compliance responsibility. While we appreciate Staff's support for the ECAR to recover capital expenditures, excluding chemical costs will significantly limit the usefulness of the mechanism and our ability to respond to future regulations effectively and efficiently.

Q. Couldn't AEPCO just file a rate case and include the chemical costs in its base rates rather than collect them through the ECAR?

A. We could, but there are a couple problems with that option. First, we currently have limited information concerning the anticipated cost of both urea and activated carbon, which makes it difficult to develop pro forma adjustments. More importantly, including chemical costs in base rates would not address the issue of price fluctuation. Because the chemicals at issue are not recoverable through our current PPFAC, any change in price will result in over- or under-recovery from our Members.

Q. Please explain why AEPCO believes that the costs for these chemicals will fluctuate.

A. Historically, the price of urea (the chemical needed for the operation of ST3 after the SNCR retrofit) has been highly volatile. Attached as Exhibit JK-3 is a chart comparing historic urea prices with natural gas prices. The reason I offer this comparison is because the dramatic price fluctuations of natural gas have supported the use of fuel adjustor clauses for years; we believe the same rationale should apply to the chemicals at issue. Furthermore, while we don't have access to historical price information for activated carbon, industry experts are predicting that environmental regulation will significantly increase demand for this chemical, which will likely put upward pressure on prices in the future. Attached as Exhibit JK-4 is a summary of the predictions regarding activated carbon.

Q. Why can't AEPCO use its PPFAC to address the variations in these chemical costs?

A. In its current form (and as the name implies), the PPFAC addresses fluctuations in purchased power and fuel costs. There are some chemicals used in environmental compliance (like calcium bromide) that are recovered through the PPFAC, but that is because they are recorded as a fuel expense in RUS Account 501. The chemicals that AEPCO will use to comply with the EPA's regional haze and MATS requirements are recorded in RUS Account 502 as a steam expense and, as a result, do not qualify for inclusion in the PPFAC.

Q. What is the difference between Account 501 and 502 chemicals?

A. According to the RUS Uniform System of Accounts – Electric, chemicals applied before the fuel enters the hopper are included in the Account 501 definition of fuel. Chemicals used after that point are recorded in Account 502.

Q. Do you think this distinction should result in Account 502 chemicals being excluded from the ECAR?

A. No. The fact that the cost of calcium bromide is recoverable through the PPFAC demonstrates that some chemical costs are appropriate for inclusion in an adjustor mechanism. The question then becomes, which adjustor is most appropriate for the cost at issue. While we know of one utility, TEP, that has been authorized to recover an Account 502 chemical expense through its fuel adjustor, we believe the ECAR would be a better recovery mechanism because it is narrowly designed to address environmental compliance costs. In other words, including chemical costs associated with environmental compliance in the ECAR is consistent with the same cost causation principles that form the basis of AEPCO's current rate design. Furthermore and as a practical matter, to include Account 502 environmental compliance chemical expenses in the PPFAC or another adjustor mechanism other than the ECAR, AEPCO would have to file another rate case. We do not think filing a new rate case is necessary or appropriate under the circumstances.

Q. **Mr. King, has AEPCO analyzed the financial impact that exclusion of chemical costs from the ECAR could have on the Cooperative?**

A. We have done some preliminary analysis, but the impact is hard to predict given the uncertainty over the price of the chemicals. Also, the quantity of urea and activated carbon needed for compliance will vary based on the amount and type of coal used. Based on certain baseline assumptions regarding market prices, coal blend and unit operation, it is quite possible that AEPCO would need to file an expedited rate case in early 2016 if chemical costs are excluded from the ECAR. However, we do not believe filing a rate case under those circumstances would be in the best interest of the Cooperative or its Members and therefore request that the Commission approve the ECAR as proposed by AEPCO.

Q. **Does this conclude your direct testimony?**

A. Yes, it does.

EXHIBIT JK-1

Exhibit JK-1

ARIZONA ELECTRIC POWER COOPERATIVE, INC.

ENVIRONMENTAL COMPLIANCE ADJUSTMENT RIDER (ECAR)

TARIFF

Effective Date: ___________ 1, 2015

PURPOSE

The purpose of the Environmental Compliance Adjustment Rider ("ECAR") is to provide a revenue recovery mechanism that will create a fund to be used for the purpose of meeting environmental compliance obligations mandated by federal, state, or local laws or regulations. The ECAR is the tariff collection mechanism for the overall Environmental Compliance Strategy ("ECS") developed by Arizona Electric Power Cooperative, Inc. ("AEPCO" or "Company") and its Members.

APPLICABILITY

Applicable to all Class A Member Distribution Cooperatives of AEPCO.

TERMS AND CONDITIONS

1. The initial rates of the tariff shall be set at zero. AEPCO will calculate the capital costs (including carrying costs and/or contributions in aid of construction) and operations' costs (including chemical costs) to be collected from each Class A Member Distribution Cooperative through the ECAR as follows:

    a. Capital Costs – AEPCO will allocate the capital costs to each Class A Member Distribution Cooperative as a monthly fixed charge based on the Allocated Capacity Percentage ("ACP") of each Member. The monthly dollar amount to be collected from each individual Collective All-Requirements Member ("CARM") will be based upon each CARM's monthly Demand Ratio Share. The Demand Ratio Share is calculated each month as the percentage of each CARMs' 12-month rolling average demand to the total of the CARMs' 12-month rolling average demand. For contributions in aid of construction, AEPCO will also determine the term of collection for the costs.

    b. Operations' Costs – The operating costs associated with environmental compliance will be assessed to each Member on a per kWh basis.

2. Once the monthly fixed and variable charges and the term of collection, if any, have been established, AEPCO will file the ECS plan and a revised tariff with the Arizona Corporation Commission ("ACC" or "Commission"), for Commission approval.* Once the revised tariff is effective, each Member will be assessed a monthly charge on its bill

for environmental compliance capital costs and a variable charge for environmental compliance operating costs in addition to other rates and charges approved by the Commission. Exhibit A sets forth the monthly Member charges and anticipated term of collection, if any.

3. The level of funding and ECAR rates may be adjusted (up or down) depending on the actual environmental compliance funding needs of the Company as outlined in the ECS plan. Any changes to the ECS and ECAR tariff after the initial ECS plan is approved will be subject to a sixty (60) day ACC Staff review period.* The revised tariff shall become effective at the end of the sixty (60) day period unless the Commission elects to suspend the revised tariff, in which case it shall become effective upon Commission approval.

Details of the operation of the ECAR and ACC compliance requirements are as set forth in the Company's Plan of Administration.

*In order for the ECAR to be revised, AEPCO must obtain Board approval and the unanimous consent of its Class A Member Distribution Cooperatives, prior to being submitted to the Commission.

EXHIBIT A

The Monthly Charges shall be as follows for each of the Company's Class A Member Distribution Cooperatives:

	___________ 1, 2015*
Environmental Compliance Capital Costs	
Collective All-Requirements Members:	
Anza Electric Cooperative, Inc.	$0.00/mo.
Duncan Valley Electric Cooperative, Inc.	$0.00/mo.
Graham County Electric Cooperative, Inc.	$0.00/mo.
Partial Requirements Members:	
Mohave Electric Power Cooperative, Inc.	$0.00/mo.
Sulphur Springs Valley Electric Power Cooperative, Inc.	$0.00/mo.
Trico Electric Cooperative, Inc.	$0.00/mo.
Environmental Compliance Operations' Costs	
All Members:	$0.00000/kWh

*The stated Monthly Rates apply to service provided on and after this date.

EXHIBIT JK-2

Exhibit JK-2

Arizona Electric Power Cooperative, Inc.

Environmental Compliance Adjustment Rider

Plan of Administration

ECAR – Plan of Administration

General Description:

The purpose of the Environmental Compliance Adjustment Rider ("ECAR") Surcharge is to establish a fund to be used for the purpose of meeting, in whole or in part, the cost of environmental compliance obligations imposed on or applicable to the Arizona Electric Power Cooperative, Inc. ("AEPCO") that are mandated by federal, state or local laws or regulations or judicial or regulatory agency interpretations of such laws or regulations ("Environmental Regulations"). The ECAR provides for the recovery of capital addition costs, operations' costs and any other costs specified in the Environmental Compliance Strategy, as approved by the Commission. The ECAR is not intended to recover any costs already recovered in base rates approved in Decision No. 74173 or any subsequent rate case decision or recovered through any other Commission-approved adjustor mechanism.

Key Definitions:

1. ECAR Surcharge – A rate rider approved by the Arizona Corporation Commission ("ACC" or "Commission") in Decision No. XXXXX which authorizes AEPCO to: recover or mitigate Environmental Regulations operations' costs; or fund, in whole or in part, capital additions required by Environmental Regulations.

2. Environmental Compliance Strategy ("ECS") – A formal plan developed by AEPCO to meet Environmental Regulations. The ECS shall include, at a minimum, a scope of work, anticipated timelines and cost estimates.

3. Qualified Environmental Compliance Projects – Projects, as specified in the ECS plan, implemented in order to comply with standards mandated by Environmental Regulations. These standards include, but are not limited to, restrictions of carbon dioxide (CO_2), nitrogen oxide (NO_x), sulfur oxide (SO_x), ozone, particulate matter (PM), volatile organic compounds (VOC), mercury (Hg), and other toxins, coal ash and other requirements.

4. Qualified ECS Costs – The costs associated with Qualified Environmental Compliance Projects as identified in the ECS plan and approved by the Commission as appropriate for recovery through the ECAR Surcharge pursuant to ACC review of the ECS plan. The Qualified ECS Costs must be classified in one or more of the Rural Utilities Service ("RUS") accounts, or any other successor RUS account, listed below under Qualified RUS Accounts. Any costs already recovered in base rates approved in Decision No. 74173 or any subsequent rate case decision or recovered through any

other Commission-approved adjustor mechanism are not Qualified ECS Costs and are not recoverable through the ECAR. Environmental fines or penalties do not qualify for cost recovery through the ECAR Surcharge nor do costs that have been included as part of AEPCO's authorized cost of service for recovery through established rate tariffs.

Calculation of ECAR:

Based on costs detailed in the ECS, AEPCO will calculate the capital costs (including carrying costs and/or contributions in aid of construction) and operations' costs (including chemical costs) to be collected from each Class A Member Distribution Cooperative through the ECAR. AEPCO will allocate the capital costs to each Class A Member Distribution Cooperative as a monthly fixed charge based on the Allocated Capacity Percentage ("ACP") of each Member. The fixed charge to be collected from each individual Collective All-Requirements Member ("CARM") will be based upon each CARM's monthly Demand Ratio Share. The Demand Ratio Share is calculated each month as the percentage of each CARMs' 12-month rolling average demand to the total of the CARMs' 12-month rolling average demand. The operating costs associated with environmental compliance will be assessed to each Member on a per kWh basis. AEPCO will also determine the term of collection for any contributions in aid of construction.

Qualified RUS Accounts:

The costs classified in the following RUS accounts are eligible to be recovered through the ECAR. This list may be expanded to include other accounts approved by the Commission in the future.

Steam Production Plant

- 310 Land and Land Rights
- 311 Structures and Improvements
- 312 Boiler Plant Equipment
- 313 Engines and Engine Driven Generators
- 314 Turbogenerator Units
- 315 Accessory Electric Equipment
- 316 Miscellaneous Power Plant Equipment

Other Production Plant

- 340 Land and Land Rights
- 341 Structures and Improvements
- 342 Fuel Holders, Producers, and Accessories

- 343 Prime Movers
- 344 Generators
- 345 Accessory Electric Equipment
- 346 Miscellaneous Power Plant Equipment

Steam Power Generation Operations

- 502 Steam Expenses (limited to chemical expenses incurred solely due to Environmental Regulation(s) but not including any indirect expenses such as overhead)

Accounting:

Funds collected from the ECAR Surcharge will be separately identified by AEPCO and recorded as a regulatory liability. Accounting for these funds shall be done on a contributing Member Distribution Cooperative basis. Use of these funds to meet Qualified ECS Costs will reduce that regulatory liability on a dollar-for-dollar basis. Funds used for qualified environmental capital additions (as opposed to capital carrying costs) will be recorded as contributions in aid of construction.

Investment Administration:

AEPCO will deposit all funds collected through the ECAR Surcharge in a separate interest bearing investment account ("ECAR Surcharge Account") and may only draw monies from the account to fund Qualified ECS Costs. Interest earned on the investment of these funds shall be retained in the account. Upon completion or termination of the ECS plan, all remaining funds in the ECAR Surcharge Account, including interest earned, will be refunded to Members within ninety (90) days, returning the rates to zero, using the same method established for the collection of the ECAR (see Calculation of ECAR above).

Compliance Reports:

On September 1 for the previous January through June period and March 1 for the prior year July to December period of each year, AEPCO will file semi-annual reports concerning the ECAR Surcharge with the Commission, with a copy to its Members, containing the following information for the reporting period:

1. The beginning balance of the ECAR Surcharge Account.
2. The amount collected from each Class A Member through the ECAR Surcharge, including the total amount collected.
3. The total amount of interest earned by the ECAR Surcharge Account.
4. The total withdrawals for Qualified ECS Costs.
5. The ending balance of the ECAR Surcharge Account.

AEPCO will also file the following supporting information with the semi-annual report:

1. A listing of the dates and amounts of withdrawals.
2. A description of each Qualified ECS Cost paid during the period and the accounting for each cost.

Each report will be certified by AEPCO's Chief Executive Officer or Chief Financial Officer that all information provided in the filing is true and accurate to the best of his or her information and belief. However, no report shall be required for reporting periods during which there is no account activity and both the beginning and ending balances of the ECAR Surcharge Account are zero ($0.00).

<u>ECS and ECAR Surcharge Modifications:</u>

Pursuant to Decision No. XXXXX, the initial ECAR rates shall be set at $0.00. Thereafter, in response to an Environmental Regulation, AEPCO shall file its initial ECS plan and a revised ECAR tariff with Docket Control for Commission approval.

The level of funding and ECAR rates may be adjusted (up or down) depending on the actual environmental compliance funding needs of the Company as outlined in the ECS plan. Any changes to the ECS and ECAR tariff after the initial ECS plan is approved will be subject to a sixty (60) day ACC Staff review period. The revised tariff shall become effective at the end of the sixty (60) day period unless the Commission elects to suspend the revised tariff, in which case it shall become effective upon Commission approval.

Upon completion or termination of the ECS plan, all remaining funds in the ECAR Surcharge Account not needed to meet the Company's objective(s) for the ECS plan, including interest earned, will be refunded to Members within ninety (90) days, returning the rates to zero, using the same method established for the collection of the ECAR. AEPCO will file a revised tariff returning the rates to zero. The rates shall remain at zero until AEPCO deems it necessary to utilize the ECAR tariff again in response to an Environmental Regulation, in which case it will prepare and file an initial ECS plan and initial revised tariff for Commission approval.

<u>AEPCO Board Approval and Member Consent:</u>

Prior to filing an initial ECS plan and revised ECAR tariff or seeking a subsequent modification to either the ECS or ECAR, AEPCO will obtain authorization from its Board. AEPCO shall also notify its Member Distribution Cooperatives sixty (60) days in advance of a proposed filing with the Commission in order to confirm the unanimous consent of its Members. Absent receipt of timely written objections, Member consent shall be deemed obtained and AEPCO may proceed with the filing.

EXHIBIT JK-3

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EXHIBIT JK-4

Exhibit JK-4

ACTIVATED CARBON SUMMARY

1. US demand for activated carbon, including virgin and reactivated products sold by activated carbon suppliers, is expected to grow 11.2 percent per year to almost 1.3 billion pounds in 2017, with market value reaching almost $1.8 billion. Implementation of the US Environmental Protection Agency's Mercury and Air Toxics Standards (MATS) will drive most of the growth, as utilities and industrial manufacturers upgrade their coal-fired power plants to comply with the regulations.[1]
2. Global market for activated carbon was valued at USD 1,913.2 million in 2012 and is expected to reach USD 4,180.5 million by 2019, growing at a CAGR of 11.9% from 2013 to 2019. Air purification is expected to be the fasted growing market and is expected to grow at a CAGR of 13.9% from 2013 to 2019.[2]
3. North American demand for powdered activated carbon in mercury control applications, which grew at a dramatic 101% per year between 2007 and 2012, compared with an average overall growth rate for all applications of 13% per year. In October 2013, a new UN Treaty on mercury control will be signed that holds even greater potential for activated carbon consumption.[3]
4. Global market for Activated Carbon is projected to reach 1.87 million metric tons by 2018, driven by stringent environmental regulations, especially in the United States." The United States is forecast to emerge as the fastest growing market with a projected CAGR of 13.2% over the analysis period.[4]
5. The global market for activated carbon was estimated to be 1,254 kilo tons in 2012 and is expected to grow at a CAGR of 11.7% from 2014 to 2020.[5]

[1] Source: "Activated Carbon to 2017", Freedonia Group, May 2013.
[2] Source: "Activated Carbon Market – Global Industry Analysis, Size, Share, Growth, Trends and Forecast, 2013 – 2019", Transparency Market Research, August 2013.
[3] Source: "Activated Carbon: Global Industry Markets & Outlook", Roskill Information Services Limited, March 2013.
[4] Source: "Activated Carbon: A Global Strategic Business Report", Global Industry Analysts, Inc.
[5] Source: "Activated Carbon Market Analysis and Segment Forecasts to 2020", Grand View Research, February 2014.

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

SUSAN BITTER SMITH, Chairman
BOB STUMP
BOB BURNS
DOUG LITTLE
TOM FORESE

IN THE MATTER OF THE APPLICATION OF THE ARIZONA ELECTRIC POWER COOPERATIVE, INC. FOR A HEARING TO DETERMINE THE FAIR VALUE OF ITS PROPERTY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RETURN THEREON AND TO APPROVE RATES DESIGNED TO DEVELOP SUCH RETURN	Docket No. E-01773A-12-0305

Direct Testimony of Peter Scott

on Behalf of

Arizona Electric Power Cooperative, Inc.

ECAR Application

June 19, 2015

4842115v3/10421-0067

EXHIBIT
A-9
ADMITTED

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INTRODUCTION

Q. Mr. Scott, are you the same Peter Scott who sponsored direct testimony for Arizona Electric Power Cooperative, Inc. ("AEPCO" or the "Cooperative") in the general rate case portion of this matter in July 2012?

A. Yes, I am.

Q. What is your present employment and connection to AEPCO?

A. I am the Chief Financial Officer for Sierra Southwest Cooperative Services, Inc. ("Sierra Southwest") and, as such, I supervise that cooperative's financial activities. In addition, pursuant to their contractual agreements with Sierra Southwest, I am responsible for the financial activities of AEPCO and Southwest Transmission Cooperative, Inc. As Chief Financial Officer, I serve in the Division Managers Group and report directly to the Chief Executive Officer. My specific responsibilities for AEPCO include establishing fiscal policy, developing procedures and implementing appropriate financial controls. I am also responsible for financial planning, rate design development and implementation, corporate treasury functions, cash and working capital management and inventory control.

Q. What is the purpose of your present testimony?

A. I will provide the Commission with background information concerning AEPCO's request for an Environmental Compliance Adjustment Rider ("ECAR") as well as explain some of the unique characteristics of the Cooperative supporting our request that chemical costs be eligible for potential recovery through the ECAR. The testimony of

Joe King, Senior Financial Analyst, provides more specific details regarding the ECAR and the chemical costs at issue.

EVENTS LEADING TO AEPCO'S ECAR APPLICATION

Q. Please provide an overview of AEPCO's initial rate case filing.

A. On July 5, 2012, we initiated this rate case seeking an overall 2.92% decrease in AEPCO's revenue requirements, based on a debt service coverage ratio ("DSC") of 1.32 (the same DSC that was approved by the Commission in the Cooperative's last rate case). Our request for a rate decrease was based on a number of factors, but the primary driver was that we had successfully implemented a number of cost-cutting and efficiency measures and wanted to pass along those savings to our members. We analyzed the Cooperative's financial status, including its working capital needs to support future operations, and determined that a rate decrease based on the 1.32 DSC was appropriate. We reviewed this information with our members and filed the rate application after receiving unanimous approval from the AEPCO Board of Directors.

Q. Did any complications arise during the rate case that impacted AEPCO's request for a decrease?

A. Yes, the Environmental Protection Agency ("EPA") issued a ruling requiring the use of Best Available Retrofit Technology ("BART") at AEPCO's Apache Station in order to control emissions that cause or contribute to regional haze. In November 2012, the EPA's federal implementation plan was finalized and required AEPCO to install expensive Selective Catalytic Reduction ("SCR") technology on both Apache Station coal units. We initially estimated that the capital requirement for compliance with this requirement would be in the range of $200 million. In response to this development, the Commission's Utilities Division Staff ("Staff") questioned whether the rate decrease should be approved.

Q. How did AEPCO respond to the EPA's rule?

A. In February 2013, AEPCO submitted an alternative – "Better than BART" – plan that would achieve the goal of reducing regional haze through a less dramatic and costly process. Rather than install SCR on both coal units, AEPCO proposed to convert Steam Turbine Unit 2 to natural gas-fired operation and install Selective Non-Catalytic Reduction technology on Steam Turbine Unit 3. The estimated capital cost associated with AEPCO's alternative proposal was approximately $30 million. I am happy to report that AEPCO's plan received final EPA approval in February 2015.

Q. What about Staff's concerns?

A. In our Rebuttal Testimony, we proposed the ECAR as a means of addressing Staff's concerns about costs associated with future environmental compliance while achieving our initial goal of providing rate relief to our members. At the rate case hearing, several witnesses from AEPCO's distribution cooperative members testified that the combination of the proposed rate decrease and ECAR was in the best interest of their members – the retail ratepayers. These witnesses acknowledged that, due to pending and future environmental requirements imposed on AEPCO, the rate relief would likely be temporary. However, they explained that the temporary relief would come at a time when any decrease in rates would make a substantial difference to individuals and businesses still struggling to recover from the Great Recession. Another factor discussed by witnesses in support of the ECAR was the then-current uncertainty regarding the financial impact that the environmental compliance requirements would have on the Cooperative. They concluded that the ECAR was a better mechanism for recovering compliance costs because any adjustment to the rates would be based on more detailed cost information as it became available in the future.

Q. Did the Commission agree with the position of AEPCO and its distribution cooperative members?

A. Yes. In October 2013, the Commission issued Decision No. 74173 in which it approved revised rates for AEPCO based on a 1.32 DSC, resulting in an approximate $4.3 million decrease to the Cooperative's annual revenue requirement. AEPCO's revised rates have been in effect since November 2013, providing the much-needed rate relief to its members and their retail customers. In its Decision, the Commission also agreed with the ECAR in concept and, therefore, left the record open so that AEPCO and Staff could collaborate over the details of the mechanism. The Decision authorized AEPCO to file an application for approval of the ECAR by April 30, 2014.

DISPUTED AND UNDISPUTED ISSUES

Q. After the Commission's October 2013 Decision, did AEPCO collaborate with Staff regarding the ECAR?

A. Yes. Over the next six months, AEPCO and Staff discussed the ECAR and reached agreement on almost all of the terms of the Tariff and Plan of Administration. The parties agreed on several procedural aspects of the mechanism. Specifically, in response to Staff's comments, we included a provision requiring affirmative Commission approval of the Cooperative's initial Environmental Compliance Strategy ("ECS"), which is the document that will identify the specific costs to be recovered through the ECAR in connection with a particular environmental requirement. The parties also agreed on a number of specific categories of costs, identified by Rural Utilities Service ("RUS") account number, which would be eligible for inclusion in the ECS.

Q. You said "almost" all terms. Was there an issue upon which AEPCO and Staff did not agree?

A. There was. In addition to capital expenses, AEPCO's ECAR proposal identifies a limited category of chemical expenses (RUS Account 502-Steam Expenses incurred solely due to environmental regulations, but excluding any indirect expenses such as overhead) as eligible for inclusion in the ECS and potential recovery through the ECAR. Staff agrees that capital expenses should be included, but opposes the eligibility of chemical expenses. Accordingly, when we filed our application for approval of the ECAR in April 2014, we brought this disagreement to the Commission's attention and requested that the limited category of chemical costs be included as eligible expenses despite Staff's opposition.

Q. Do you know why Staff opposes the inclusion of chemical costs?

A. It is my understanding, based on the report that Staff filed in October 2014, that Staff's position is policy-based. I believe that Staff is concerned about maintaining consistency with the categories of costs included in other utilities' environmental surcharge mechanisms, which apparently do not include RUS Account 502-Steam Expenses.

Q. Are there any other disputed issues regarding the ECAR between AEPCO and Staff?

A. Not to my knowledge. In fact, earlier this year, the Administrative Law Judge questioned whether the chemical costs at issue are truly necessary for compliance with certain environmental regulations currently faced by AEPCO and whether the prices of those chemicals are variable and potentially volatile. In response to her questions, we worked with Staff to prepare a Stipulated Statement of Facts, which confirms that there are no factual disputes regarding either of these issues. A copy of the Stipulated Statement of Facts is attached as Exhibit PS-3.

<u>CHEMICAL COST ELIGIBILITY</u>

Q. Mr. Scott, please explain why AEPCO believes chemical costs should be eligible for inclusion in an ECS and ultimately recoverable through the ECAR.

A. There are several reasons, some of which are also addressed in Mr. King's testimony. First, there's no question that AEPCO will need to purchase certain chemicals in order to comply with the environmental regulations we currently face. However, the costs of these chemicals may change over time, such that, if we are limited to recovering them through future base rates without any adjustor, then AEPCO will either over- or under-recover from its members. Another reason to include chemical costs in the ECAR is transparency to our members. Specifically, using the ECAR to track compliance costs provides greater transparency by isolating expenses (including chemical costs) that AEPCO incurs solely as a result of environmental regulation. With this information, our members are better equipped to explain any compliance-related rate changes to their members (the retail ratepayers).

Q. Are there any other reasons why you disagree with Staff's policy position on this issue?

A. Yes, two actually. First, it is my understanding that the other environmental surcharge mechanisms that Staff is relying upon differ from the ECAR in at least one significant respect. If a cost listed in one of those mechanisms is incurred by the utility, it is automatically recovered from the ratepayer without any further Commission review. By contrast, ECAR eligibility does not mean that the cost will automatically be recovered through the ECAR. Instead, any particular chemical cost must first receive approval from a majority of AEPCO's Board and unanimous approval from our members before it can be included in the ECS. If included in the ECS, any cost must then receive affirmative approval from the Commission before it can actually be recovered through the ECAR.

Q. And the second reason?

A. The second reason is that I think excluding these costs from the ECAR overlooks the fact that AEPCO is a not-for-profit cooperative.

Q. Please explain why AEPCO's status as a cooperative is relevant to the issue of chemical cost eligibility.

A. It's my understanding that the other utilities with environmental surcharge mechanisms are investor-owned utilities ("IOU"). Under the IOU model, conflicts of interest sometimes arise between the utility owners (shareholders) and ratepayers because the shareholders are interested in the company's profits while the ratepayers want to keep rates as low as possible. In balancing these competing interests, the Commission sometimes adopts policies that encourage utilities to seek operational efficiencies in order to keep rates low but still produce a profit for the shareholders. Other times, the Commission determines that certain costs should be taken out of the shareholders' profits rather than borne by the ratepayers.

This conflict of interest does not exist between a cooperative and its members because, under the cooperative model, the ratepayers and the utility owners are the same. That means that any "profit" made by the utility benefits the members by virtue of the patronage capital system. Patronage capital is the company's revenues in excess of its expenses. Similar to shareholder distributions under the IOU model, patronage capital is returned to the cooperative members periodically. However, unlike IOUs, any expenses incurred by a cooperative that are not included in rates (base or as adjusted) are still passed on to the member/ratepayers through the reduction of patronage capital. Therefore, excluding costs in the cooperative context does not have the same effect as it does in IOU cases.

Finally, because cooperatives – including AEPCO – are governed by member-elected boards, the member/ratepayers are in a unique position to ensure that the company operates efficiently and incurs only those costs that benefit the company and its members. We believe this extra layer of ratepayer protection is another important distinction between AEPCO and IOUs and supports AEPCO's ECAR as proposed.

CONCLUSION

Q. **Do you have any concluding remarks?**

A. I do. First, we appreciate both Staff's support of the ECAR as a mechanism to recover capital costs and Staff's willingness to work with us on narrowing the disputed issues. For the reasons addressed herein and as described by Mr. King, AEPCO maintains that the narrow category of chemical costs identified in its Plan of Administration should be deemed eligible for potential recovery through the ECAR. Accordingly, we ask that the Commission enter its Order approving the ECAR Tariff and Plan of Administration, which are attached as Exhibits JK-1 and JK-2 to Mr. King's testimony.

Q. **Does this conclude your direct testimony concerning the ECAR?**

A. Yes, it does.

EXHIBIT PS-3

Docket No. E-01773A-12-0305
Arizona Electric Power Cooperative, Inc.
Environmental Compliance Adjustment Rider
Stipulated Statement of Facts

1. On April 30, 2014, Arizona Electric Power Cooperative, Inc. ("AEPCO" or the "Cooperative") filed its application for approval of an Environmental Compliance Adjustment Rider ("ECAR").
2. The purpose of the ECAR is to establish a monthly surcharge to provide AEPCO with a revenue mechanism to meet future environmental compliance obligations mandated by federal, state and/or local laws or regulations. Examples of such obligations currently faced by AEPCO include:
    a. modifications to AEPCO's generating facilities at its Apache Station and the need to use urea in the Selective Non-Catalytic Reduction ("SNCR") process, which have been approved by the Environmental Protection Agency ("EPA") as a means for AEPCO to meet the EPA's regional haze requirements as of December 2017; and
    b. the Cooperative's need to purchase and use activated carbon in order to comply with the EPA's Mercury and Air Toxics Standards ("MATS") as of April 2016.
3. As proposed, the ECAR rate will initially be set at zero. Thereafter, in response to a particular environmental regulation, AEPCO will analyze its financial status, including its current rate levels and any expenses that qualify for recovery/refund through its Purchased Power and Fuel Adjustment Clause ("PPFAC"), to determine whether the Cooperative requires additional revenue to comply with the given regulation or whether its margins are sufficient. If AEPCO determines that its margins are sufficient, the ECAR rate would remain at zero.
4. If the results of AEPCO's financial analysis indicate that additional revenues are needed for environmental compliance, the Cooperative will prepare and file with Docket Control its initial Environmental Compliance Strategy ("ECS"), which, at a minimum, will include a scope of work, anticipated timelines and cost estimates. Prior to filing an initial ECS, AEPCO must obtain authorization from its Board of Directors as well as unanimous consent from its Class A Distribution Cooperative Members ("AEPCO's Members"). The compliance costs identified for recovery in the initial ECS cannot be recovered through the ECAR without affirmative approval by the Arizona Corporation Commission. If approved, the ECAR rate will be charged to AEPCO's Members, who, in turn, may pass those charges through to their retail members via their respective purchased power clauses.
5. AEPCO's ECAR Plan of Administration ("POA") identifies (by RUS account number) the categories of costs that would be eligible for recovery through the ECAR. AEPCO's proposal includes capital costs necessary to achieve compliance with environmental regulation. AEPCO is also requesting inclusion of certain chemical costs as eligible for recovery through the ECAR. Specifically, the POA identifies as eligible for recovery

RUS Account 502 Steam Expenses "limited to chemical expenses incurred solely due to Environmental Regulation(s) but not including any indirect expenses such as overhead."

6. The Commission's Utilities Division Staff ("Staff") supports approval of the ECAR and use of the mechanism for recovery of necessary capital expenses, as specified by the RUS accounts included in the proposed POA. However, Staff opposes AEPCO's proposal to the extent that it includes chemical costs as eligible for recovery through the ECAR (RUS Account 502-Steam Expenses).
7. The RUS Account 502 chemical costs identified in AEPCO's POA will be necessary for compliance with both the EPA's regional haze and MATS regulations. Specifically, AEPCO's compliance plan for the EPA's regional haze regulation requires the use of urea. Likewise, AEPCO will need to purchase and utilize activated carbon in order to comply with MATS.
8. The price of both urea and activated carbon are subject to market forces, making them variable and potentially volatile. Historically, the price of urea has been highly volatile, as shown on Exhibit 1 to AEPCO's Response to Staff Report re ECAR Plan of Administration and Tariff, dated November 13, 2014 ("AEPCO's Response"). Also, Exhibit 2 to AEPCO's Response indicates that the demand for activated carbon is anticipated to increase significantly in the future, which will result in upward pressure on prices.
9. Another chemical that AEPCO has and will continue to purchase and use in connection with its mercury-related environmental compliance obligations (imposed by the State of Arizona) is calcium bromide. The cost of calcium bromide is included in RUS Account 501 because the chemical is applied before the fuel enters the hopper. Because this chemical is recorded as an RUS Account 501 expense (as opposed to a 502 expense), it qualifies for inclusion in AEPCO's PPFAC.
10. AEPCO's current estimates for the combined RUS Account 502 chemical costs required to comply with the EPA's regional haze and MATS regulations over the next three years range from a low of $2.2 million to a high of $6.2 million annually: $2.2 million to $4.5 million in 2016; $3.1 million to $6.2 million in 2017; and $2.2 million to $5 million in 2018. AEPCO's current estimated revenue requirements associated with the Cooperative's capital investment for compliance with the EPA's regional haze and MATS regulations over the next three years are as follows: $0.41 million in 2016; $1.90 million in 2017; and $3.40 million in 2018.
11. AEPCO asserts that the impact of these costs on the retail customer is difficult to determine because AEPCO's Members have different retail rate levels and structures. Based on its preliminary analysis and communications with and input from the Members, AEPCO estimates the average monthly residential bill impact (based on Member 2013 Form 7 data) related to the chemical compliance costs could range as follows: $0.61 to $2.10 in 2016; $0.84 to $2.91 in 2017; and $0.59 to $2.34 in 2018. Using the same methodology, AEPCO estimates the average monthly residential bill impact related to capital costs could range as follows: $0.11 to $0.19 in 2016; $0.53 to $0.90 in 2017; and $0.94 to $1.61 in 2018. According to AEPCO, these increases are not cumulative and would only be implemented through the ECAR if AEPCO includes the chemical and

capital cost components in its ECS and if that ECS receives approval from AEPCO's Board, its Members and the Commission. AEPCO further asserts that, otherwise, the ECAR associated with any particular ECS may continue at the initially set level of zero. Staff neither agrees nor disagrees with the foregoing assertions or bill impact estimates provided by AEPCO; Staff has no evidence to the contrary and, therefore, is not disputing the Cooperative's assertions or estimates.

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

SUSAN BITTER SMITH, Chairman
BOB STUMP
BOB BURNS
DOUG LITTLE
TOM FORESE

IN THE MATTER OF THE APPLICATION OF THE ARIZONA ELECTRIC POWER COOPERATIVE, INC. FOR A HEARING TO DETERMINE THE FAIR VALUE OF ITS PROPERTY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RETURN THEREON AND TO APPROVE RATES DESIGNED TO DEVELOP SUCH RETURN	Docket No. E-01773A-12-0305

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Rebuttal Testimony of Peter Scott

on Behalf of

Arizona Electric Power Cooperative, Inc.

ECAR Application

September 16, 2015

5048568v1/10421-0067

EXHIBIT
A-10
ADMITTED

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ELIMINATION OF DISPUTED ISSUES 1

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INTRODUCTION

Q. Mr. Scott, are you the same Peter Scott who sponsored direct testimony in this docket for Arizona Electric Power Cooperative, Inc. ("AEPCO" or the "Cooperative") in July 2012 and June 2015?

A. Yes, I am. Specifically, my June 19, 2015 direct testimony concerned AEPCO's request for an Environmental Compliance Adjustment Rider ("ECAR"). My testimony – along with the direct testimony sponsored by Joe King – provided additional information in support of the Cooperative's request that a limited category of chemical expenses (RUS Account 502 – Steam Expenses incurred solely due to environmental regulations, but excluding any indirect expenses such as overhead) be approved as eligible for recovery through the ECAR.

ELIMINATION OF DISPUTED ISSUES

Q. Have you reviewed the direct testimony of Candrea Allen, which was filed on behalf of the Commission's Utilities Division Staff ("Staff") in this matter on August 26, 2015?

A. Yes, I have. Ms. Allen's testimony states that Staff initially took the position that chemical costs should not be eligible for recovery through the ECAR. However, based on the additional information provided by AEPCO, Staff now agrees that recovery of RUS Account 502 chemical expenses through the ECAR is appropriate.

Q. In light of Ms. Allen's testimony, are there any other ECAR-related disputes for the Commission's consideration at this time?

A. No. In addition to agreeing that chemical costs should be eligible for recovery, Ms. Allen's testimony also confirms Staff's agreement with a change proposed by AEPCO regarding the ECAR cost recovery methodology. As described in Mr. King's direct testimony, AEPCO originally drafted the ECAR to recover costs through a fixed monthly charge. However, upon further reflection, AEPCO now proposes that environmental compliance capital costs be collected through a fixed monthly charge while operations' costs (including chemical costs) be recovered through a variable energy rate ($/kWh). The Cooperative's proposed ECAR Tariff and Plan of Administration, attached as exhibits to Mr. King's direct testimony, reflect these two types of charges and Staff has recommended approval of the same.

Q. Do you have any concluding remarks?

A. I do. We appreciate both Staff's willingness to re-evaluate its position in light of the additional information provided by AEPCO and Staff's support of the ECAR as revised. Therefore, we ask that the Commission enter its Order approving the ECAR Tariff and Plan of Administration in the form attached as Exhibits JK-1 and JK-2 to Mr. King's June 19, 2015 direct testimony.

Q. Does this conclude your rebuttal testimony concerning the ECAR?

A. Yes, it does.

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