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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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IN THE MATTER OF THE APPLICATION OF UNS ELECTRIC, INC. FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF THE PROPERTIES OF UNS ELECTRIC, INC. DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA AND FOR RELATED APPROVALS.	DOCKET NO. E-04204A-15-0142 **NOTICE OF FILING JOINT REPLY BRIEF ON BEHALF OF FREEPORT MINERALS CORPORATION, ARIZONANS FOR ELECTRIC CHOICE AND COMPETITION AND NOBLE AMERICAS ENERGY SOLUTIONS LLC**

JOINT REPLY BRIEF

May 11, 2016

Arizona Corporation Commission
DOCKETED

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Freeport Minerals Corporation, Arizonans for Electric Choice and Competition (collectively "AECC") and Noble Americas Energy Solutions LLC ("Noble Solutions"), hereby submit this Joint Reply Brief ("Reply Brief") in the above-captioned Docket. In our Joint Opening Brief, AECC and Noble Solutions addressed the evidence on the record in support of both our revenue allocation and buy-through proposals. In this Reply Brief, AECC and Noble Solutions address the larger issue of fundamental fairness, and the need for the Arizona Corporation Commission ("Commission") to provide large commercial and industrial customers with options to control power costs at a time when economic development and financial stability are important policy goals throughout the state.

INTRODUCTION

Large commercial and industrial ("C&I") customers make up an important part of UNS Electric, Inc.'s ("UNSE" or "Company") customer base. In addition to historically subsidizing electric rates for residential and small general service (SGS) ratepayers, C&I customers have provided jobs, economic development and civic support in UNSE's service territory. In that regard, it is uncontroverted in the hearing record that the Company and the Commission must address and meaningfully begin to correct in this proceeding both the intra and inter-class cross subsidization that has existed for years.

The Company made a good faith effort to more closely match cost-causation with cost-recovery in its November 4, 2015 filing . Although the subsidy-paying classes still would have been providing approximately $9 million in subsidies to the subsidy-receiving classes, the Company's initial proposal represented meaningful gradualism towards cost parity. However, once other parties filed Direct Testimony, UNSE made several concessions intended to benefit residential and small commercial customers to the detriment of the large C&I customers.

By way of illustration, UNSE reduced its requested revenue increase by $7.5 million dollars in two steps, first in its rebuttal and then in its rejoinder. *More than 100%*

of the rebuttal reduction of $4.1 million went to residential and small commercial customers; that is, UNSE's proposed rate increase for C&I customers was *higher* in its rebuttal case than in its direct case despite the reduction in revenue requirement. The Company's rejoinder filing did spread the second step decrease of $3.4 million to each class relative to the Company's rebuttal filing, but in the final spread C&I customers were still worse off than where they started from in the Company's direct filing – when the proposed revenue increase was $7.5 million higher.

In its latest (Opening Brief) proposal, the Company revised its rate design to eliminate mandatory demand charges for non-DG residential and SGS customers, and is offering both two-part and three-part rate structure options. This retreat from the Company's Rejoinder Testimony position and the elimination of mandatory demand charges will undoubtedly result in shifting more cost-recovery through the Lost Fixed Cost Recovery ("LFCR") mechanism, and the Purchased Power Fuel Adjustor Clause ("PPFAC") – surcharges that are paid by all customer classes. Finally, UNSE is now proposing to establish a new program for members of the Fresh Produce Association of the Americas ("FPAA") that will be funded by ***all*** customers through the PPFAC[1] – despite the Company's earlier (but unfounded) criticism of AECC and Noble Solutions' buy-through proposal because of alleged potential rate impacts it might have on ***all*** other customers.

What is missing from this ever-changing rate proposal scenario is any material endeavor by the Company, Staff or any other non C&I party, to provide some benefit to large C&I customers – the same customers that have been shouldering the burden as subsidy-paying ratepayers for several years, if not decades.[2] AECC and Noble Solutions strongly believe that the revenue allocation in this proceeding should move customer class

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[1] UNSE Initial Post-Hearing Brief ("UNSE Brief") at 43.

[2] In that regard, UNSE's largest industrial customer, Nucor Steel Corporation ("Nucor"), seeks revisions concerning the Company's LPS-TOU tariff structure to address intra-class subsidies, which are summarily dismissed by the Company as unnecessary and inappropriate. UNSE Brief at 36.

rates closer to cost of service. However, if the Commission is inclined to adopt either the Company or Staff's revenue allocation proposal, then a buy-through program becomes an essential tool in any endeavor to retain existing large C&I customers who might otherwise reduce operations, or relocate, due to perpetuation of the existing institutionalized inter-class subsidies by UNSE. Accordingly, AECC and Noble Solutions respectfully urge the Commission to adopt a buy-through program for UNSE as in the public interest, so that larger customers are given an option to manage power costs and avail themselves of technological advances in light of the subsidies they will continue to pay after the conclusion of this rate proceeding.

DISCUSSION

I. Revenue Allocation

There is virtually no disagreement among the parties that UNSE and the Commission must address the current disparity in cost recovery from within and among customer classes in this proceeding. In that regard, AECC and Noble Solutions demonstrated in the Opening Brief that the revenue allocations proposed by the Company and Staff do not go far enough to make any meaningful move towards matching cost-causation with cost recovery. The disparity is also highlighted in Staff's Exhibit S-18, which provides several revenue allocation scenarios and the resulting impacts on each customer class.

Under Staff's preferred approach to gradualism, UNSE's recovered rate of return on rate base from the Residential class would be merely 0.42% (less than one percent), while the return from the Medium General Service (MGS) and Large General Service (LGS) classes would be 19.33% -- nearly 46 times more. In addition, the rate of return on rate base from the Large Power Service (LPS) class would be 33.27%, or a whopping 80 times more than from the Residential class.

Although UNSE's move from its original proposal towards Staff's proposed revenue allocation is less onerous than Staff's proposal on members of the MGS LGS and LPS classes, it nonetheless results in rates of return of 13.32% and 23.20% respectively. Perhaps a better indicator of the disparity is to look at the unitized rate of return ("UROR") attributed to each customer class under both proposals. The UROR measures the degree of inter-class subsidy paid or received by a customer class. A UROR of less than 1.00 indicates that the class is receiving a subsidy, while a UROR above 1.00 indicates that the class is paying a subsidy. The relative UROR's for the various customer classes under the two proposals are as follows:

Unitized Rate of Return

Customer Class	Residential	SGS	MGS/LGS	LPS
Staff UROR	0.07	0.31	3.10	5.43
UNSE UROR	0.50	0.51	2.14	3.73

Clearly, the very large UROR disparity between the residential/SGS and large C&I customer classes that results from the Company's and Staff's revenue allocation proposals demonstrate that *neither* creates "fair and equitable rates for all customer classes under sound Cost-of-Service and Rate Design principles."[3] By contrast, AECC and Noble Solutions' revenue allocation proposal represents a rate structure that gradually brings each customer class more meaningfully closer to cost-of-service rates, and should be adopted as a means to bring all customers closer to rate parity.

II. AECC and Noble Solutions' Buy-Through Proposal

As with revenue allocation, AECC and Noble Solutions' Opening Brief goes into great detail discussing questions relating to the buy-through proposal, which arose during the hearing. In that regard, AECC/Noble Solutions anticipated and effectively addressed all of the arguments made by opponents. However, in its Initial Post Hearing Brief, UNSE

[3] Craig Jones Direct Testimony at p. 8, ln. 20-21.

raises a new "issue" by suggesting that the proposed buy-through raises "serious questions about discrimination" under Article XV, Section 12 of the Arizona Constitution.[4] Ironically, that same concern can be raised about the Company's proposed EDR, which seeks to treat customers within the same class differently based on several determinants, including load factor, peak demand and pre-qualification under Arizona state economic development tax credits. However, AECC and Noble Solutions believe that neither the buy-through or EDR proposals constitute "unreasonable discrimination"; and, it is only that form of rate discrimination which is unlawful.

In what has become an all-too familiar theme during the course of these proceedings, the Company and the Arizona Investment Council ("AIC") seek to apply a double standard when addressing proposals made by AECC and Noble Solutions. For instance:

1. As a way to promote economic development in the Company's service territories, UNSE would not seek recovery of any lost non-fuel revenues associated with the EDR because the long-term benefits outweigh the short-term costs. In contrast, the Company is unwilling to absorb any costs associated with a buy-through program, despite its large customer retention potential;

2. The Company seeks to *eliminate* the alleged intra-class subsidies received by solar DG residential customers, yet does not make any meaningful move to address inter-class subsidies in the short term;

3. The Company wants to implement untested new and innovative residential rate tariff offerings that provide customers choice and the ability to utilize technological advancements to manage and control power costs. However, the concept of a buy-through tariff for large industrial customers, which would also offer "customer choice" for similar purposes, is argued by UNSE and AIC to be pre-mature and it is asserted that the Commission should wait until it can assess the results of Arizona Public Service Company's AG-1 program;

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[4] Id. at p. 47.

4. UNSE contends that the most serious flaw in AECC and Noble Solutions' buy-through proposal is the impact upon other customers.[5] However, the Company also proposes to provide members of the FPAA with an annual $300,000 subsidy, to be paid by all other customers by recovery of such subsidy through the PPFAC; and

5. Under the funding mechanism contained in AECC and Noble Solutions' buy-through proposal, lottery winners would be receiving a subsidy at the expense of others in the rate class, and it is contended by UNSE and AIC that is problematic. Whereas under the EDR, participants must first qualify for Arizona economic development tax credits (a subsidy) at the expense of Arizona taxpayers, and yet it is implicitly contended by UNSE and AIC that is not problematic.

To be clear, AECC and Noble Solutions do not oppose approval of the EDR, as the more economic development tools which are available to the Company, the better. Likewise, AECC and Noble Solutions do not oppose providing economic benefits to members of the FPAA with the creation of a second MGS rate tariff, and in that regard would suggest that the $300,000 annual cost could be integrated into the buy-through funding mechanism proposed by AECC and Noble Solutions to shield residential and SGS customers from any impacts of the program. In fact, AECC and Noble Solutions do not oppose ***any*** of the Company's initiatives highlighted above, but wish to note that *all of them violate the very principles UNSE uses to criticize the buy-through proposal*. AECC and Noble Solutions believe that providing large C&I customers a means to control power costs and avail themselves of technological advances through market purchases for generation service, without harm to the Company or other ratepayer classes, is clearly consistent with the public interest and the concept of fundamental fairness in ratemaking.

CONCLUSION

The Commission is charged with balancing the interests of public service corporations and their ratepayers when setting rates and rate classifications. The Commission must also balance the interests of each customer class, and sound principles of

[5] Id. at p. 45.

rate making dictate that rates should reflect cost based recovery. The further away the Commission strays from these fundamental precepts, the closer it gets to approving unduly burdensome and discriminatory rate structures. For AECC and Noble Solutions, the buy-through proposal represents (i) an opportunity for the Commission to begin eliminating the inequity to large C&I customers inherent in continued cross-subsidization of other customer classes, and (ii) a means to avoid the establishment of unjust and unreasonable rates in violation of the Arizona Constitution.

RESPECTFULLY SUBMITTED this 11th day of May, 2016.

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