I. INTRODUCTION.

The Utilities Division Staff ("Staff") of the Arizona Corporation Commission ("Commission") hereby files its Initial Brief on whether the issues raised in Arizona Public Service Company’s ("APS" or "Company") April 2, 2015 Motion\(^1\) to Reset its Lost Fixed Cost Recovery ("LFCR") mechanism need to be decided in a rate case.

APS, in its Application, seeks to reset its LFCR mechanism to further address the issue of cross-subsidization of customers with net-metered Distributed Generation ("DG") systems by customers without such systems. It is Staff’s position that the Commission may lawfully process APS’s Application outside a rate case. While APS’s Application does not require a rate case, processing the Application for LFCR reset outside a rate case will do little to further the ultimate solution to these difficult issues. Decision No. 74202 suggests that this issue is better addressed in a rate case because continued resets to the LFCR will not fix the underlying rate design issues. The Company intends to file its next rate case in the second quarter of 2016. Staff believes that this matter should be addressed then where these issues can be addressed in a more holistic and comprehensive fashion. Staff has consistently taken the position since this matter was first raised, that these issues can be most effectively resolved in a rate case. In the end, the Commission has the discretion to decide how best to process the issues raised in APS’s filing.

\(^1\) Although styled as a motion, Staff believes that APS’s filing should be treated as an application. Staff’s position is supported by the April 28, 2015, procedural order which finds that summary disposition of this matter is not appropriate.
II. BACKGROUND.

On April 2, 2015, APS filed a motion requesting that its LFCR be adjusted from $.70 per kW to $3 per kW, effective August 1, 2015. For the average DG system of 7 kW, this would equate to $21 per month. Currently, DG customers pay approximately $5.00 per month for a 7 kW system.

On July 15, 2013, the Company filed an Application for approval of a Net Metering Cost Shift Solution ("Initial Application"). APS’s Initial Application stated that the Company sought a solution to the cross-subsidization of customers with net metered DG systems by customers without such systems. The problem was discussed in Finding of Fact 21 of Decision No. 74202:

With increasing levels of DG penetration, the potential of shifting costs from customers with DG systems to those customers without such systems becomes apparent. As more customers offset a portion of their monthly bills by using energy produced by their DG systems, they purchase less energy from the utility. Because residential rates are typically designed to recover much of the utility’s fixed costs through volumetric energy rates, DG customers effectively pay less of these fixed costs. The additional fixed costs then must be picked up by non-DG customers either through higher energy rates or through other mechanisms such as APS’s Lost Fixed Cost Recovery mechanism ("LFCR"). The magnitude and significance of this cost shift increases as more and more DG systems are added to the utility’s system. However, base rates are not changed until the utility’s next rate case. Therefore, for systems installed after APS’s last test year (2010), the cost shift has not yet occurred (except for that in the LFCR).

APS proposed two possible solutions in its Initial Application: 1) take service under APS’s existing ECT-2 rate and use Net Metering ("NM") ("the NM Option"), or 2) take full requirements service under the customer’s existing rate and receive a bill credit for 100 percent of the DG system’s production at a market-based price for power (the "Bill Credit Option"). The Commission found that most of the rate design proposals put forward by the Company would need to be addressed in a rate case. However, the Commission found that an interim LFCR DG adjustment accounted for through APS’s LFCR mechanism was appropriate to address the cost shift from APS’s residential DG customers to APS’s residential non-DG customers. The adjustment was to be done in a revenue neutral manner by reducing the amount of lost fixed costs APS must collect from residential non-DG customers.
APS states that it filed its current Motion to Reset the LFCR under the framework of Decision No. 74202. In response to APS’s April 2, 2015, Application, on April 17, 2015, Staff recommended that APS withdraw its April 2, 2015, filing so that the Commission could consider the matters more holistically in a rate case. If APS was not inclined to withdraw its Application, Staff requested that a briefing schedule be established on the issue of whether dismissal was appropriate. On April 23, 2015, APS filed a response to Staff’s Request stating that it declined to withdraw its Motion to Reset.

Several other parties including the Residential Utility Consumer Office ("RUCO"), The Alliance for Solar Choice ("TASC"), and Western Resource Advocates ("WRA") also filed comments on APS’s Motion. RUCO stated that it believed a rate case is where the net metering issues will need to be addressed for the long term, and although RUCO recommends the Commission act on APS’s motion, it would support a determination to defer the matter to APS’s next rate case. WRA opposes APS's request to increase the LFCR adjustment again and argues that any reallocation of fixed costs should occur in a rate case. TASC requested that APS’s filing be dismissed, stating that the issues raised are properly considered in a rate case.

On April 28, 2015, the ALJ issued a procedural order establishing a briefing schedule on the issue of whether any portion of APS’s Application had to be addressed in a rate case. The Procedural Order required the parties to file initial briefs by May 22, 2015, and reply briefs by June 5, 2015.

III. DISCUSSION.

A. The Commission May Lawfully Process APS’s Application Outside A Rate Case.

Some parties argue that APS’s Application amounts to single issue ratemaking which is not allowed under Arizona law. These parties typically rely upon the Scates case. They may go so
far as to suggest that a rate case is required every time the Commission changes rates. *Scates* does not stand for this proposition. That case focuses upon the requirements of Article XV, Section 14 of the Arizona Constitution, which pertains to determining fair value rate base:

We...hold that the Commission was without authority to increase the rate without any consideration of the overall impact of that rate increase upon the return of ...[the utility], and without, as specifically required by our law, a determination of ...[the utility’s] rate base.16

The *Scates* court was careful to make clear that a full rate case is not required for every increase in rates.17 The court noted that “[t]here may well be exceptional situations in which the Commission may authorize partial rate increases without requiring” a full rate case.18

The LFCR adjustment mechanism was established as part of the Company’s last rate case.19 Where a mechanism is adopted in the context of a rate case as part of a utility’s rate structure, rate adjustments achieved through that mechanism have been found to satisfy constitutional requirements.20 Additionally, APS maintains that the changes are revenue neutral and the process was designed to ensure revenue neutrality.21 Under the circumstances presented by APS’s Application, the Commission is not required to address this matter in a full rate case.

B. Although APS’s Application Does Not Require A Rate Case, Processing It Outside A Rate Case Will Limit The Commission’s Options For Addressing The Issues Raised.

APS’s Application identifies the need for fundamental changes to its rate design. APS’s rates are designed to recover a significant portion of the Company’s fixed costs through volumetric (kWh) rates. In an environment where kWh sales decline, the Company will very likely experience an under-recovery of fixed costs. This phenomenon was anticipated in APS’s last rate case, wherein the LFCR was established. This mechanism allows APS to track and recover certain identifiable lost fixed costs, which would otherwise be unrecovered.

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16 id. at 537, 578 P.2d at 618.
17 id.
18 id.
19 Decision No. 73183.
20 id. at 535, 578 P.2d at 616.
21 Allowing multiple reset proceedings in one year could result in a small revenue increase until an adjustment is made in the next reset proceeding. However, the amount of revenue increase is minimal and, in Staff’s opinion, could be trued-up in a subsequent reset.
In Decision No. 74202, the Commission determined that a disproportionate share of the LFCR was being borne by non-DG customers.\(^{22}\) The Commission adopted the $.70 per kWh charge to address these issues, but acknowledged that a rate case would be necessary to finally resolve the matter.\(^{23}\)

Staff believes that the issues raised in APS’s Application are best addressed in a rate case. While APS’s requested relief does not require a rate case, Staff believes that processing the Application outside a rate case will do little to resolve the larger issue which APS itself acknowledges is one which is in need of a much broader inquiry and remedy in the Company’s next rate case.

APS acknowledges that “resolving the cost shift for the long term and creating a sustainable future for all types of customer-sited technologies requires updating rate design in APS’s rate case in a manner that is fair for all customers.”\(^{24}\) As Staff has stated in response to similar applications of other utilities, the recovery of fixed costs is fundamentally a rate design issue. Some possible solutions may include instituting a higher monthly minimum charge, applying a demand charge, introducing new rate schedules, and many other possibilities. The solution adopted in a rate case could address these issues for all customers where under-recovery of fixed costs is an issue, such as energy efficiency, as opposed to just rooftop solar customers. The issues are clearly best handled in a rate case where the Commission has a much larger tool chest to address the type of complex rate design issues raised in APS’s Application.

Handling this issue in a rate case will also promote efficiency and conserve Staff and Commission resources. APS intends to file its next rate case in the second quarter of 2016. The Commission should address this issue in that rate case.

C. The Commission Has The Discretion To Decide How Best To Process The Issues Raised In APS’s Filing.

In its response to Staff’s Request for Procedural Order, APS states that “the decision to afford non-DG customers additional interim relief is one of policy” which is “best left to the

\(^{22}\) Decision No. 74202 at 25, FOF 99 and 96.

\(^{23}\) Decision No. 74202 at 29.

\(^{24}\) APS’s Mot. at 7.
Commission.”25 Staff agrees with APS that the Commission has the discretion to determine how best to proceed with APS’s Application. This discretion encompasses whether to proceed at all at this time or whether to address it in the Company’s upcoming rate case.26

APS offers several reasons why the Commission should address the issue now. First, the Company states that “the real issue underlying APS’s Motion – and the one that APS believes should inform the procedural framework of this proceeding – is one of timing and fairness”27 However, the Company does not give any indication why this particular rate design issue is more urgent than other typical rate case issues. Rate designs for large companies such as APS typically contain many rates and customer classes which are subsidized to some extent by other customer classes and rates.

As noted by Staff in the proceeding leading up to Decision No. 74202:

[D]uring general rate cases and as part of the rate design process, it is common practice to analyze matters of cost-shifts and cross-subsidizations within individual rate classes. Some rate designs commonly utilize subsidies to promote various public policy goals. The discount provided to low-income customers is a classic example of this intentional cross-subsidy. Another common example is the subsidy given to rural customers at the expense of urban customers to cover the higher cost of service to the more dispersed rural customers. Staff believes that the cross-subsidy discussed in the instant Application has explicit public policy considerations, and therefore would be most appropriately addressed in the setting of a general rate case.28

The Company has already received its LFCR reset for 2015,29 and it offers no compelling reason for the Commission to grant an additional reset for the same year. The Company cites to the proliferation of DG systems and the allegedly alarming rate at which non-DG customers are subsidizing DG customers. However, if another 7,800 systems were installed in 2015, the yearly cost shift associated with these systems according to APS would be $6.3 million. Further, as Staff noted in the proceeding leading up to Decision No. 74202, for systems installed after APS’s last test year (2010), the cost shift has not yet occurred (except for that in the LFCR). See Decision No. 74202 at 6. It is unlikely that this alleged cost shift is of such a magnitude that it must be addressed at this time.

25 APS Resp. at 3 (April 23, 2015).
26 Accordingly, APS’s April 23, 2015 Responses at 3. (“A decision to forgo action on the cost shift now would be one of policy, not law.”)
27 Id. at 2.
28 Decision No. 74202 at 9, FOF 33.
29 Decision No. 74994.
time and outside of the Company’s next rate case, which APS intends to file in the second quarter of
2016, using a 2015 test year.\footnote{See APS Data Resp. 3.4 attached at Ex. A.}

APS cites the concept of “gradualism” as supporting further relief at this juncture.\footnote{Id.} The
Company also states that fairly allocating fixed costs now will provide more flexibility in APS’ s next
rate case.\footnote{APS Mot. to Reset at 8.} Both of these arguments assume that adopting APS’s proposed grid access charge
(thereby decreasing the economic benefits for customers to install solar facilities) is the right first
step. It may not be. In a rate case, there may well be a way to achieve the twin goals of fair
apportionment of fixed costs and retention of incentives for solar. A rate case would give the
Commission many more options as it seeks to resolve these difficult issues.

The Company’s reasons in support of another LFCR reset at this time are not compelling.
The Commission should address the issue holistically in the Company’s next rate case.

IV. CONCLUSION.

Based upon the foregoing, Staff requests that the Commission dismiss APS’s Application
without prejudice, and address the issues raised by APS in the Company’s 2016 rate case where the
issues can be addressed in a more holistic and balanced fashion.

RESPECTFULLY SUBMITTED this 22\textsuperscript{nd} day of May, 2015.

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