ORIGINAL

The Overland Audit Report Coverup

Dear Commissioners:

It has been reported in the media that many of you are still reviewing the Overland Report ("Audit Report") that was utilized, in part, by Staff in its Rate Review Report ("Staff Summary") docketed on June 4, 2019. With than in mind, I am submitting my evaluation and assessment that may be helpful in your own review.

It is the part of the Audit Report that was not utilized in and covertly omitted from Staff Summary that raises serious questions about Staff's objectivity and transparency — especially on the eve of a new rate case. Even the Notice of Filing submitted by Maureen Scott in disclosing the Audit Report omits, and therefore attempts to sweep under the rug, the most important rationale behind ordering the rate review that was unambiguously articulated in Decision No. 77292, namely, "... **a rate review of APS ... is the best way to determine definitively whether APS's rates and charges remain just and reasonable.**" (Decision No 77292 at 75:17-19)

The Champion Complaint (E-01345A-18-0002) claimed that APS rates authorized by Decision No. 76295 were not just and reasonable. There is ample evidence that Staff repeatedly sided with APS in the Champion Complaint and asserted that APS rates were just and reasonable and were fair to the consumers. An inescapable conclusion from the Audit Report, however, is that APS has and continues to overearn. It follows then — and should have been the headline — that the current rates are not just and reasonable. I urge the Commission to issue such an equivocal statement.

The Audit Report contradicts virtually every position Staff has staunchly asserted about the justness and reasonableness of APS rates in the Champion Complaint. Staff Summary, in my assessment, sanitized the Audit Report's language, cherrypicked the audit's findings, and buried clear and convincing evidence, including that of significant and ongoing APS overearning.

Staff Summary suppressed crucial information, thereby depriving the intervenors and stakeholders the benefit of the Audit Report. Equally importantly, Staff's delayed and untimely disclosure prevented the Commission itself from considering, publicly debating, arguing questioning, and weighing the evidence from the independent and outside-expert perspective of Overland Consulting, a firm that was specifically retained at a cost of $250,000 to provide it. Instead, the Commission while voting on key decisions, including Decision No. 77270 and 77292, relied on Staff Summary that presented an incomplete and inaccurate picture.

The remainder of the document expounds on the following points that support the overall conclusions:

1. The authorized rate of return determines whether rates are just and reasonable
2. Return on equity is a "key element" and has "tremendous" impact on rates
3. Staff deprived the public, the media, and the Commission the benefit of the Audit Report
4. Staff has had a conflict of interest and had had taken a pro-APS and anti-ratepayer position throughout the Champion Complaint
5. Staff Summary buried clear and convincing Audit Report evidence of APS overearning, and therefore of the unjustness and unreasonableness of the rates

Please let me know if you have any questions or wish to discuss further.

Abhay Padgaonkar
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The Overland Audit Report Coverup

1. The rate of return determines whether rates are just and reasonable.

- Decision No. 77292 stated that the litmus test for the justness and reasonableness of APS's rates was to determine definitively through a Rate Review whether APS is earning more than its authorized rate of return.
- If the current rates are not just and reasonable, the Commission *has* the authority to rescind Decision No. 76295 as per A.R.S. § 40-252.

Rates are not just and reasonable if they do not produce a reasonable rate of return.

> 9 rates meet the overall operating costs of a utility and produce a reasonable rate of return. Rates are not
> 10 just and reasonable if they do not produce a reasonable rate of return or if they produce revenue that
> 11 exceeds a reasonable rate of return.[347] Just and reasonable rates are fair to both consumers and public

Decision No 77292 at 68:9-11

If APS is earning more than its authorized rate of return then the rates are not just and reasonable.

> 19 To prevail in this complaint, premised on the justness and reasonableness of APS's rates
> 20 authorized in Decision No. 76295, complainants must show that it is more likely than not that APS's
> 21 current rates and charges result in APS earning more than its authorized rate of return or that APS's
> current rates and charges are otherwise unfair.

Decision No 77292 at 68:19-21

If the current rates are not just and reasonable, the Commission has the authority to rescind Decision No. 76295 as per A.R.S. § 40-252

> 18 as reparations. The Commission can rescind a prior Decision subject to the requirements of A.R.S. §
> 19 40-252 (*i.e.*, after providing notice to the affected corporation and an opportunity to be heard), when
> 20 such action is in the public interest.[339] Thus, if there were a showing that APS's current rates and
> 21 charges are not just and reasonable, the Commission would have the authority to rescind Decision No.
> 22 76295 subject to the due process protections of A.R.S. § 40-252. Reparations, however, are appropriate

Decision No 77292 at 65:18-22

The type of information in a Rate Review is necessary to determine overearning.

> 24 return. At a minimum, the type of information considered in a rate review (*i.e.*, the rate base, operating
> 25 revenue and expenses, and cost of capital schedules required under A.A.C. R14-2-103) is necessary to
> 26 determine over- or under- earning.

Decision No 77292 at 72:24-26

A rate review of APS is the best way to determine definitively whether APS's rates and charges remain just and reasonable.

17	assessment. Thus, based on the record in this proceeding, we believe that a rate review of APS and
18	audit of its customer outreach and education program is in the public interest and is the best way to
19	determine definitively whether APS's rates and charges remain just and reasonable.

Decision No 77292 at 75:17-19

The Rate Review docket determined the reasonableness of APS's rates and charges.

5	**ORDER**
6	IT IS THEREFORE ORDERED that the relief sought in the Champion Complaint concerning
7	the reasonableness of Arizona Public Service Company's rates and charges established in Decision No.
8	76295, and the adequacy of its customer education and outreach program, has been adequately
9	addressed in Docket No. E-01345A-19-0003.
10	IT IS FURTHER ORDERED that this Decision shall become effective immediately.
11	BY ORDER OF THE ARIZONA CORPORATION COMMISSION.
12	
13	**DISSENT**
14	CHAIRMAN BURNS COMMISSIONER DUNN COMMISSIONER KENNEDY
15	
16	COMMISSIONER OLSON COMMISSIONER MARQUEZ PETERSON

Decision No 77292 at 92:5-16

A.R.S. § 40-252

40-252. Rescission or amendment of orders by commission; collateral attack on final orders or decisions prohibited

The commission may at any time, upon notice to the corporation affected, and after opportunity to be heard as upon a complaint, rescind, alter or amend any order or decision made by it. When the order making such rescission, alteration or amendment is served upon the corporation affected, it is effective as an original order or decision. In all collateral actions or proceedings, the orders and decisions of the commission which have become final shall be conclusive.

Source: https://www.azleg.gov/ars/40/00252.htm

2. Return on equity is a "key element" and has "tremendous" impact on rates.

- Chairman Burns has been quoted as saying that the return on equity is a "key element that has tremendous impact on the rates" and even "a half of a percent is millions and millions of dollars."
- It is hard to imagine any commissioner fundamentally disagreeing with that statement.

Here's why your APS bill is so high (and the only thing you can do about it)

Laurie Roberts, Arizona Republic
Published 12:09 p.m. MT June 27, 2019 | Updated 3:56 p.m. MT June 27, 2019

> Commission Chairman Bob Burns, the lone commissioner who voted against that 2017 APS rate increase, told me he'll be taking a hard look at whether a 10 percent return on investment is warranted during the next rate case, which APS has been ordered to file this fall.
>
> "The return on equity is a key element that has tremendous impact on the rates and it needs to be examined closely," he said. "A half of a percent is millions and millions of dollars. Every single percentage point on that return is a very high number."

Source:
https://www.azcentral.com/story/opinion/op-ed/laurieroberts/2019/06/27/here-why-your-arizona-public-service-bill-so-high/1586492001/

The Dunn and Burns Letter requested a rate review because of the possibility of APS earning more than authorized by Decision No 76295.

> and perhaps even reduce their bills. Based on all this, we believe there may be a possibility that APS is overearning, i.e., earning more than was authorized by Decision No. 76295.
>
> Therefore, because APS may be overearning, we would request that ACC Staff ("Staff") perform a rate review of APS, using calendar year 2018 as a test year. We believe 2018 is a

> We expect this rate review to be extensive and thorough;

> If this rate review reveals that APS is indeed overearning and/or that APS's customer education and outreach program was lacking in any way, the ACC should immediately take whatever action is available to it to remedy the situation(s).

Correspondence from Commissioners Dunn and Burns at: https://docket.images.azcc.gov/0000194691.pdf

The possibility that APS could be exceeding its authorized rate of return has been a concern.

> 5 Nevertheless, we are concerned that given the significant rate design changes approved in
> 6 Decision No. 76295, there is the possibility that APS could be exceeding its authorized rate of return.

Decision No 77292 at 75:5-6

3. Staff deprived the public, the media, and the Commission of the benefit of the Audit Report.

- Decision No. 77270 ordered that the findings contained in the Utilities Division Staff's Rate Review Report are reasonable and in the public interest and are hereby adopted.
- A majority (three out of five) of the Commissioners confirmed to 12News that they had not seen the Overland's Audit Report and had relied on the Staff Rate Review Report.
- In fact, it is entirely possible that none of the Commissioners had seen the previously-suppressed Audit Report when they ordered unanimously for APS to file a new rate case at the Open Meeting on June 11-12, 2019 — at which time the Champion Complaint resolution had been deferred and was only voted on the following month in July 2019 via Decision No. 77292.

ORDER

IT IS THEREFORE ORDERED that the findings contained in the Utilities Division Staff's Rate Review Report are reasonable and in the public interest and are hereby adopted.

IT IS FURTHER ORDERED that Findings of Facts 39 through 51 herein containing Staff's recommendations, and as modified by the Commission, are reasonable and in the public interest and are hereby adopted.

IT IS FURTHER ORDERED that Arizona Public Service Company shall file a rate case no later than October 31, 2019, utilizing a 12-month test-year period ending June 30, 2019. Arizona Public Service shall also file its 2017 expenditures as a supplemental report.

Decision No. 77270 at 11:4-12

Joe Dana at 12News reported on August 21 in his story about the Commission's refusal to release the 3rd-party audit that three Corporation Commissioners told him that they have not seen the Overland Consulting report either and they were relying on the summary provided to them by Staff.

Arizona regulators won't release 3rd-party audit of APS

The Arizona Corporation Commission is refusing to release a third-party consultant's report about Arizona Public Service's finances and business decisions.

https://www.12news.com/article/news/investigations/eyeteam-investigations/arizona-regulators-wont-release-3rd-party-audit-of-aps/75-442d459f-4a7f-4b17-b3a2-8a55b826ac59

(**Note:** Staff provided a 100% redacted Audit Report to 12News by hiding behind questionable privileges — finally succumbing only to the threat of legal action. This delay wasted several precious months and prevented everyone including the Commissioners from viewing the full, unvarnished Audit Report by not docketing it until October 24.)

4. Staff has had a conflict of interest and had taken a pro-APS and anti-ratepayer position throughout the Champion Complaint

Staff has had an inherent conflict of interest as a signing party to the Settlement Agreement, which was adopted in Decision No. 76295 authorizing the rate increase, and thereby consented to "support and defend" it before the Commission or before any court.

> 40.6 The Signing Parties shall make reasonable and good faith efforts necessary to obtain a Commission order approving this Agreement. The Signing Parties shall support and defend this Agreement before the Commission. Subject to subsection 40.5, if the Commission adopts an order approving all material terms of the Agreement, the Signing Parties will support and defend the Commission's order before any court or regulatory agency in which it may be at issue.

DOCKET NO. E-01345A-16-0036 ET AL.

Arizona Public Service Company
Proposed Settlement Agreement
Docket Nos. E-01345A-16-0036 & E-01345A-16-0123

SIGNATURE PAGE

ARIZONA CORPORATION COMMISSION

By: _____

Name: Elijah Abinah

Title: Acting Director, Utilities Division

Date: March 24, 2017

Decision No. 76295

Staff had argued during the Champion Complaint that it should be denied the requested relief and should be dismissed without any changes or without even ordering a new rate case.

> 17 in this case. Because Complainant has failed to meet her burden of proof, the Commission should
> 18 deny the requested relief and dismiss the Complaint. APS should be directed to conduct additional

Staff Reply Brief in Champion Complaint (https://docket.images.azcc.gov/0000194520.pdf)

Staff had asserted throughout Decision No. 77292 that APS rates were presumed to be just and reasonable…

15	Staff notes that there is a strong presumption that the established rates are just and reasonable.[270]

… that there was no proof that APS was overearning …

12	Staff argues that Ms. Champion has not submitted proof by a preponderance of the evidence
13	that APS is likely overearning. Staff states that Mr. Padgaonkar's analysis of APS's earnings ignores

… and that the Commission had properly considered the interests of APS and its customers …

14	to encourage conservation. Staff argues that the evidence shows that the Commission properly
15	considered the interests of APS and its customers
16	Staff asserts that Ms. Champion improperly relies on "the limited actual data available to call
17	into question the accuracy of the projected 4.54-percent average bill increase analysis." Staff states:

… and that Champion's overearning bill impact analysis was inaccurate …

16	Staff asserts that Ms. Champion improperly relies on "the limited actual data available to call
17	into question the accuracy of the projected 4.54-percent average bill increase analysis." Staff states:

… and that more revenues, even if true, didn't mean that APS was exceeding its authorized rate of return…

23	Staff asserts that even if APS is realizing more revenue than projected, Ms. Champion has failed
24	to demonstrate that it means APS is earning more than its authorized rate of return.[306] Staff explains:
25	

… and that it should deny the Champion Complaint, should not rescind/alter the rates although the Commission had the ability to do so, and should not even order a new rate case…

13	may include, but are not limited to, a full-scale rate case.[268] Thus, Staff asserts, the Commission has the
14	ability to reopen and modify the prior Commission decision pursuant to A.R.S. § 40-252.[269]

11	Thus, Staff argues, the Commission should deny Ms. Champion's and Intervenors' requests to order
12	reparations and/or monetary penalties; to rescind, alter, or amend the rates and charges adopted in
13	Decision No. 76295; and/or to order a new rate case.[321]

… and that there was no evidence that APS was exceeding its authorized rate of return.

8	
9	Staff asserts that the record in this proceeding contains no evidence that APS is exceeding its
10	authorized rate of return.[308] Furthermore, Staff states, any evidence presented in support of a claim of

5. Staff Summary buried clear and convincing Audit Report evidence of APS overearning, and therefore of the unjustness and unreasonableness of the rates.

- The Audit Report, however, confirmed almost all the claims in the Champion Complaint while contradicting virtually every major position Staff (and APS) had taken.
- Staff Summary sanitized the Audit Report's language, cherrypicked the audit's findings, and buried clear and convincing evidence, including that of significant and ongoing APS overearning.

Specifically, the following clear and convincing evidence in the Audit Report was omitted from Staff Summary. Please be aware that this is not an exhaustive list.

The 2018 actual Return on Equity (ROE) was 10.45% and was in excess of the ACC authorized ROE of 10.0%. The excess profit over the authorized ROE was approximately $25.7 million.

> The 2018 actual return on average equity was 10.45%, which is somewhat in excess of the ACC authorized return on equity of 10.0%. The APS year-end equity was $5.7 billion.[10] The excess revenue over the authorized ROE was approximately $34.1 million.[11] The ACC jurisdictional amount of this excess is approximately $28.4 million.[12] $6.7 million of this excess earnings is associated with higher than expected revenues due to rate design changes made in the 2016 rate case.
>
> [8] Moody's Investor Service, May 16, 2018, p. 1.
> [9] Response to Discovery, Staff 2.8.
> [10] 2018 10-k. (Calculated)
> [11] $5.7 billion x 0.45% x 1.3288.
> [12] APS Filing Exhibits, Workpaper B-1. Rate Base percentage = 83.31%.

More than 1 out of 3 customers had described APS's reputation as "poor" — a number that had doubled — despite Don Brandt's description of APS's reputation in the community as being excellent ("embarrassed at the kudos being thrown at me") at the Commission hearing on September 4, 2019.

> as "good" or "very good" declined from 82% to 65%. During this time the percentage of respondents choosing "poor" to describe the company's reputation approximately doubled, from 18% to 35%.[14]

(**Note:** APS had also completely mischaracterized the CEOP in response to Commissioner Dunn's request and touted it as exceptional: "APS's Outreach and Education Plan has been the most robust customer communications campaign in the Company's history, and very successful by general industry standards. Customer response to the Company's service plan transition communications was exceptional.")

APS's own internal surveys had shown that customer satisfaction had rapidly deteriorated

> 4. APS's semi-annual Brand Alignment Tracking studies (BATs) show that customer satisfaction began to deteriorate from at least autumn 2015, before APS filed its rate case. The percentage

Nearly 3 out of 5 customers (56%) believed that APS was not offering useful suggestions to help keep their bill as low as possible.

Table 2-3– APS Brand Alignment Study Results- Service Plan, Utility

APS Brand Alignment Study Results - Service Plan, Utility Bill and Customer Communication Metrics Respondents Rating "Good" or "Very Good"								
METRIC	SPRING 2015	FALL 2015	SPRING 2016	FALL 2016	SPRING 2017	FALL 2017	SPRING 2018	FALL 2018
Offering useful suggestions to help keep your bill as low as possible	68%	63%	66%	57%	60%	47%	55%	44%

Only 1 out of 10 Customers believed that APS Rates were very reasonable

APS Brand Alignment Study Results - Rate Perceptions Metric								
MEASURE	SPRING 2015	FALL 2015	SPRING 2016	FALL 2016	SPRING 2017	FALL 2017	SPRING 2018	FALL 2018
Rates very reasonable	23%	20%	21%	15%	19%	14%	14%	**10%**

The Settlement Agreement that Staff had fully supported was "not typical for a utility" and its "unavoidable features" were bound to create customer dissatisfaction.

> The approved settlement agreement included higher customer rates and new customer rate plans based on restructured tariffs. It is not typical for a utility to implement a rate increase and a complete structural overhaul of tariffs, particularly residential tariffs, in the same proceeding. If the objective of the CEOP was to completely prevent dissatisfaction due to the changes, then the fact that there was customer dissatisfaction supports a conclusion that the CEOP was ineffective. However, the CEOP can only be evaluated in the context of the approved settlement agreement and the changes it imposed. Many of the problems that customers experienced were largely unavoidable features of the approved settlement agreement, rather than a direct result of the CEOP. These included:

(**Note:** Champion Complaint had also insisted that the rates and the adjustor transfer confusion etc., not the communication per se, were to blame primarily.)

Residential customers had incurred the doubling of adjustors since the 2015.

> 3. While adjustor revenues accounted for under 6% of APS' total retail revenues in 2018, the increases since 2015 have been noteworthy. In particular, residential customers have incurred the vast majority of adjustor increases since the 2015 test year, nearly doubling in the years since.

(**Note:** Champion Complaint had also shown that adjustors were a major culprit behind the much higher bill impact compared to the APS advertised 4.54% increase.)

Total bill impact and revenue analysis must include base as well as adjustor revenues.

In addition to base revenues collected in the form of service charges, energy charges and demand charges, APS collects revenues from adjustor mechanisms that represent additional cost recoveries under separate ACC proceedings. Current adjustors include the Lost Fixed Recovery Surcharge, Environmental Improvement Surcharge, and Power Supply Adjustor. The tables below show the impact of these adjustor mechanisms on APS' 2018 revenues.[12]

(**Note:** Champion Complaint had also taken an identical position in analyzing the total bill impact whereas Staff and APS had misleadingly advertised and fixated on the base bill impact only, thereby providing an incomplete picture of the true bill impact.)

Certain adjustors were rolled into base rates in 2017, only to return to pre-rate increase levels as separate line items on customer bills in the following year.

- Certain rate "adjustors" (discussed in a separate section of this report) were rolled into base rates in 2017, only to return to pre-rate increase levels as separate line items on customer bills in the following year.

(**Note:** This is also a point intervenor Mr. Gayer repeatedly made in the Champion Complaint without either Staff or APS acknowledging it.)

The revenue recognized from the six continuing adjustors increased by $150.7 million.

Table 4-1 – APS Continuing Adjustor Mechanisms

APS Continuing Adjustor Mechanisms (in 000s)	
Description	**2018 Revenues (in 000's)**
Power Supply Adjustor	$ 113,259
Transmission Cost Adjustor	173,260
Lost Fixed Cost Recovery Mechanism	81,271
Environmental Improvement Surcharge	4,785
Demand-Side Management Adjustment Charge	36,382
Renewable Energy Adjustment Charge	129,242
% of Total	**$ 538,199**
Source: Table 4-11.	

This represented a $150.7 million increase over revenues recognized in 2016 for these same six adjustor mechanisms.

Adjustor revenues would have been nearly $151 million higher in 2018 than 2016, if not for TEAM.

Because of the significant decrease in corporate tax rates, the TEAM adjustor mechanism reduced customer billings in 2018 by $119,499,000. If not for this offset, total adjustor mechanism revenues would have been nearly $151 million higher in 2018 than 2016 if the effect of the rate case transfer was taken into account.[31]

With adjustor revenues factored in, APS has earned $77 million more than expected in revenues.

When adjustor revenues are factored into APS' 2015 revenue assumptions, the company has earned $77 million, or 2.3% more than expected, with over 80% of that increase from its residential customers.

APS would have an Operating Income surplus of $79 million and an ACC jurisdictional revenue surplus of $105 million based on 2018 operations.

While our analysis is not intended to replicate that which would be performed in a typical rate case, in order to determine an estimate of ACC jurisdictional revenue requirements during the period under review (2018), it is necessary to gain an understanding of the utility's financial results for the purpose of identifying underlying reasons for performance as well as to make reasonable comparisons when reaching conclusions regarding the extent of deviations from authorized returns. After performing this analysis, we conclude that APS had an ACC jurisdictional revenue surplus of approximately $105 million based on 2018 operations. The rest of this chapter provides the basis for this conclusion.

ARIZONA PUBLIC SERVICE COMPANY
COMPUTATION OF INCREASE IN GROSS REVENUE REQUIREMENTS
ACC JURISDICTION
YEAR ENDED DECEMBER 31, 2018
(Thousands of Dollars)

Line No.	Description	Electric Original Cost	
1.	Rate Base (avg)	$ 7,566,766	(a)
2.	Operating Income	592,780	(b)
3.	Current Rate of Return	7.83%	
4.	Required Operating Income	513,783	
5.	Required Rate of Return	6.79%	
6.	Operating Income (Surplus) / Deficiency	(78,997)	
7.	Gross Revenue Conversion Factor	1.3288	(c)
8.	Increase (Decrease) in Base Revenue Requirements Estimate	$ (104,971)	

(**Note:** This is true even though Overland has apparently not judged the prudency of a significant 16% increase in APS's Rate Base since the last rate case due to the increase in net utility plant in service — despite flat sales).