CHAIRWOMAN LEA MÁRQUEZ PETERSON'S PROPOSED AMENDMENT NO. 2

TIME/DATE PREPARED: October 21, 2021

COMPANY: Arizona Public Service Company (APS) AGENDA ITEM NO.: 18

DOCKET NO.: E-01345A-19-0236 OPEN MEETING DATE: October 26, 2021

Purpose: This amendment adopts a multi-year; multi-rate-case plan and performance incentive mechanism to achieve a target reduction in its average retail rates to **$0.09/kWh by 2030**. This amendment is consistent with the multi-year rate plan and incentive mechanism the Commission adopted in the company's 1991,[1] 1994,[2] and 1996[3] rate cases, which achieved two company-supported rate decreases within the existing regulatory compact. Furthermore, the amendment supports Chairwoman Márquez Peterson's November 2020 request for parties to "work together" to come up with a plan to "achieve a rate decrease."[4]

The amendment proposes APS achieve a target average retail rate of $0.09/kWh by 2030, based on the possible paths to achieve that goal illustrated in the table below. The average retail rate for APS in 2020 was $0.1172/kWh.[5]

Starting Avg. (Cents/kWh)	Cost Reduction	Target Avg. (Cents/kWh)	Target Year
11.72/kWh	2-5% every 1-3 years	9.00/kWh	2030

To encourage APS to pursue prudent cost-reduction strategies and management decisions in furtherance of the rate reduction target in this proposal, this amendment establishes a performance incentive mechanism that allows APS to retain, as an addition to the company's otherwise appropriate revenue requirement, 45 percent of any achieved cost and capital savings that, after applying the 45-percent performance incentive, result in no increase in rates. Additionally, to demonstrate progress toward achieving the rate reduction target set forth in this proposal, and because there may be many avenues to reach the target of $0.09/kWh by 2030, this amendment requires APS to work collaboratively with staff and stakeholders to develop a comprehensive plan and annual report detailing the cost-reduction strategies that APS intends to pursue as well as the outcomes of the cost reduction strategies it pursued in the previous year.

This amendment incentivizes APS to embark on tangible "management action"[5] by "tightening the belt,"[6] which benefits both ratepayers and shareholders. The Recommended Opinion & Order (ROO) carefully examines the current financial situation of APS, such that the provisions of this amendment should not adversely affect the company's financial health. Rather, this amendment should sharpen management's focus on the challenges of the future and align shareholder interests in a manner that benefits ratepayers.

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[1] Decision No. 57649 (Dec. 6, 1991).
[2] Decision No. 58644 (Jun. 1, 1994) (authorizing a rate reduction of $38.3 million, or 2.7%).
[3] Decision No. 59601(Apr. 24, 1996) (authorizing a rate decrease of $48.5 million, or 3.26%).
[4] Correspondence from Commissioner Lea Márquez Peterson (Nov. 17, 2020), https://docket.images.azcc.gov/E000010132.pdf?i=1634688128177.
[5] Energy Information Administration, *2020 Utility Bundled Sales to Ultimate Customers*, https://www.eia.gov/electricity/sales_revenue_price/pdf/table10.pdf (last visited Oct. 20, 2021). For reference, the average retail rate for Salt River Project in 2020 was $0.0973/kWh. The average rate for Tucson Electric Power in 2020 was $0.1101/kWh. Id.
[5] Fitch Ratings, *Fitch Downgrades Pinnacle West Capital & Arizona Public Service to 'BBB+', Outlooks Remain Negative*, https://docket.images.azcc.gov/E000016137.pdf?i=1634690274112. (Oct. 12, 2021)
[6] Abhay Padgaonkar, *The Fitch Ditch: What's the Ratepayer Impact (Negligible) and Who is to Blame (APS)?*, https://docket.images.azcc.gov/e000016203.pdf?i=1634690274112 (Oct. 18, 2021).

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With this amendment, the Commission aims to ensure that the investor-owned utility offers superior customer service and grid reliability to customers at an affordable rate, while ensuring that investors earn a just and reasonable rate of return for devoting their used and useful and prudently invested capital to public use. The amendment recognizes and strengthens the regulatory compact in Arizona by utilizing a performance incentive mechanism and collaborative approach between the Commission and utility to achieve effective rate regulation in Arizona's vertically integrated framework, rather than retail electric competition, where market principles and operational excellence determine returns on equity and prudent investments, not general rate cases and a guaranteed rate of return. This reduces the risk for creditors and investors looking at Arizona as a viable place to fund future economic growth and a clean energy transition.

Lastly, this amendment gives APS an opportunity to improve its relationship with the Commission and restore the public's trust and confidence in the Company. As billionaire investor, Carl Icahn, recently stated in an open letter to the Board of Directors of Southwest Gas, "Loss of trust with regulators is extremely damaging to both shareholders and ratepayers."[7]

Page 330, line 16, INSERT:

"A. Establishment of Future Rate Principles

According to Mark Crawford of Area Development, "energy availability and cost" is a "top 10" factor for corporate site selectors looking to locate or expand their company's facilities or operations in other states, especially for "industries that consume large amounts of energy, such as manufacturing, distribution, and data centers."[8] According to Tim Comerford of Site Selection Magazine, "Finding affordable energy is one of the most important factors in identifying and choosing the right site when a company is expanding or relocating—especially in the case of large industrial facilities."[9] According to 2019 data published by EIA.gov in November 2020, Arizona has the second-highest average retail electric rate in the Western Interconnection at $0.1052/kWh, which was second only to California at $0.1689/kWh, while the majority of other western states' average retail electric rates were well-below $0.09/kWh, including Idaho ($0.0789/kWh), Wyoming ($0.0810/kWh), Utah ($0.0824/kWh), Washington ($0.0840/kWh), Nevada ($0.0878/kWh), Oregon ($0.0881/kWh), and New Mexico ($0.0899).[10] We note that in 2020 Montana was just above $0.09/kWh, at $00902/kWh.[11] While we understand that APS's average retail electric rates constitute only one input in EIA's overall calculation of Arizona's statewide average, we also note that APS's 2020 average retail rates of $0.1172/kWh[12] constitute the highest retail electric rate in Arizona and, as a result, upwardly skew our state's average in comparison to other utilities operating in Arizona. For reference, the average retail electric rate for Salt River Project in 2020 was $0.0973/kWh, and the average retail electric rate for Tucson Electric Power in 2020 was $0.1101/kWh.[13] Although we note that in a vertically-integrated state, such as Arizona, electric service providers do not "compete" for customers located in their respective service areas, however, utilities clearly compete for customers in the site selection process, *before* they become captive. Consequently, based on our review APS's TY operating expenses, as well as our general review of average rates in competing jurisdictions, we believe more could be done to improve APS's price competitiveness in the West, as well as APS's price competitiveness

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[7] Carl C. Icahn, *Carl C. Icahn Issues Open Letter to Board of Directors of Southwest Gas* (Oct. 4, 2021), https://carlicahn.com/open-letter-to-southwest-gas-board-of-directors/.

[8] https://www.areadevelopment.com/logisticsInfrastructure/q4-2016/energy-availability-and-costs-critical-site-selection-factor.shtml.

[9] https://siteselection.com/issues/2016/may/affordable-energy.cfm.

[10] Energy Information Administration, *2020 Utility Bundled Sales to Ultimate Customers*, https://www.eia.gov/electricity/sales_revenue_price/pdf/table10.pdf (last visited Oct. 20, 2021).

[11] Id.

[12] Id.

[13] Id.

among other utilities in Arizona. We believe APS's current retail electric rates are too high for customers facing mounting economic challenges and communities trying to attract economic development. And we believe APS's rates need to be more competitive with other utilities in the industry, especially of those in states with which Arizona competes for attracting new economic opportunities and jobs. **Therefore, like the Commission ordered in Decision No. 58644 (June 1, 1994), we believe APS must work collaboratively with Staff and stakeholders to find ways to reduce the Company's average retail electric rates and develop a comprehensive plan and roadmap to achieve a target rate of $0.09/kWh by 2030.**

To meet this goal, APS will need to prudently pursue cost reduction strategies in all controllable operating and capital expenses, including but not limited to purchased power and fuel expense, executive compensation and bonuses, , and construction costs and rate base. Reductions in APS's operating and capital expenses will need to offset increases in externally imposed costs that APS cannot control to meet this goal. In addition, APS will have to respond appropriately to changes in fuel volatility and availability, financial risks inherent to Arizona's growing economy, and the capital costs associated with transitioning to clean energy safely and reliability, including the need for distribution system upgrades, deployment of make-ready EV charging station infrastructure, and increased integration of intermittent and variable renewable energy resources. APS will also have to make a good faith attempt to develop new internal practices and procedures that are responsive to achieving the target rate of $0.09/kWh, and, most of all, realign the company's culture to meet the customer service, affordability, and reliability expectations of customers.

To demonstrate the Company's efforts in furtherance of these initiatives, and because there may be many paths APS could take to reach $0.09/kWh by 2030, APS shall work collaboratively with Staff and stakeholders to develop and file, by April 15 of each year, an annual report detailing the following: (1) the cost reduction strategies it proposes to take; (2) the cost reduction strategies it has successfully achieved during the time since filing its last report; and (3) the bottom-line impact to shareholders and ratepayers of those successful cost reduction strategies.

B. Adjustment for Effective Cost Containment

In furtherance of the Commission's goal to strengthen the regulatory compact and encourage superior utility performance through the use of market incentives and further cost reductions, the Company should have, like it had in 1994, the opportunity to earn a reward in its next general rate case if that rate proceeding results in no increase in rates.[14] In that proceeding, the Commission shall compare the costs of service for purchased power and fuel expense, operation and maintenance expenses, and other jurisdictional above-the-line expenditures for the test period under review, as well as the costs of capital for the test period under review, with the same costs of service and capital in the TY utilized in the Company's previous rate case to determine if the Company achieved additional cost savings. Any achieved cost savings that, after applying the performance incentive below, result in no increase in rates shall be allocated in such rate proceeding between the Company's customers and its shareholders by first adding to the Company's otherwise calculated jurisdictional revenue requirement 45 percent of such savings.

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[14] We note Decision No. 58644 stated "residential rates." We are concerned that focusing on only residential customers, who generally would not benefit from the elimination of subsidization, would create a perverse incentive for APS to impose all cost increases on non-residential customers regardless of what future COSSs show. Thus, in this Order, we remove the word "residential" and ensure the outcome is beneficial to all customers.

"IT IS FURTHER ORDERED that APS shall prudently pursue cost reduction strategies in all controllable operating and capital expenses, including reductions in APS's operating and capital expenses to offset increases in externally imposed costs that APS cannot control, to reduce the Company's average retail electric rates and achieve a target rate of $0.09/kWh by 2030.

IT IS FURTHER ORDERED that, in APS's next general rate case, the Commission shall compare the costs of service and capital for the test period under review with the same costs of service and capital in the TY utilized in the Company's previous rate case and determine if the Company achieved additional cost savings. If, after applying the performance incentive below, the rate proceeding results in no increase in rates, then any achieved cost savings shall be allocated in such rate proceeding between the Company's customers and its shareholders by first adding to the Company's otherwise calculated jurisdictional revenue requirement 45 percent of such savings.

IT IS FURTHER ORDERED that APS shall work collaboratively with Staff and stakeholders to prepare and file in the docket by April 15 of each year a comprehensive annual plan and roadmap identifying the following: (1) the operating and capital cost reduction strategies it proposes to take to achieve a target average retail electric rate of $0.09/kWh by 2030; (2) the operating and capital cost reduction strategies it has successfully achieved since filing its last report; and (3) the bottom-line impact to shareholders and ratepayers of those successful operating and capital cost reduction strategies."

**** Make all conforming changes**

THIS AMENDMENT:

_____ Passed _____ Passed as amended by _____

_____ Failed _____ Not Offered _____ Withdrawn