Lost Fixed Cost Recovery
Plan of Administration

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1. General Description

This document describes the plan of administration for the Lost Fixed Cost Recovery (LFCR) mechanism approved for Arizona Public Service Company (APS or Company) by the Arizona Corporation Commission (ACC or Commission) in Decision No. 78317 (November 9, 2021), Decision No. 78585 (May 27, 2022), Decision No. 79293 (March 5, 2024) and Decision No. 79581 (October 21, 2024). The LFCR mechanism provides for the recovery of lost fixed costs authorized by the Commission, as measured by revenue, associated with the amount of energy efficiency (EE) savings and distributed generation (DG) determined to have occurred as described herein. Costs to be recovered through the LFCR include the portion of distribution costs included in base rates, less what is already recovered by 50% of demand revenues associated with distribution.

2. Definitions

<u>Applicable Company Revenues</u> – The amount of revenue generated by sales to retail customers, for all applicable rate schedules.

<u>Balancing Account</u> - The Balancing Account shall accumulate and defer the difference between Lost Fixed Cost Revenue, including revenue from Rate Rider LFCR DG, and recovery through the LFCR Adjustment. If the Balancing Account has accrued an over or under collected balance in a given period, any such over or under collection shall be included in Lost Fixed Cost Revenue in a future year. In years where the LFCR adjustor is set to zero as a result of the earnings test results, the total Lost Fixed Cost Revenue for the period calculated on Schedule 2 will not be included in the balancing account for future recovery.

<u>Current Period</u> – The same calendar year as the Earnings Test Period.

<u>DG Savings</u> – The amount of MWh sales reduced by DG. Where available, APS will use meter data to calculate DG system savings. Each year, APS will use actual data to calculate the savings. The calculation of DG Savings will consist of the following by class:

a. Current Period: The annual energy production (MWh) produced by the cumulative total of DG installations since the effective date of APS's most recent general rate case in which cost recovery was transferred from the LFCR surcharge revenues to base revenues.

b. Excluded MWh Production: The reduction of recoverable DG Savings calculated for commercial and industrial customers, by subtracting the amount of DG produced by customers on Excluded Rate Schedules.

c. True-Up Prior Period: The reconciliation of APS's DG sales reductions, if necessary, to verified DG sales reductions in the Prior Period.

Earnings Test – Comparison of the Earnings Test Period's rate of return with the Earnings Test Threshold. The Earnings Test Period's rate of return will be based on APS's most recently filed FERC Form 1, using the Earnings Test Period's costs, revenues, and other financial information, with certain pro forma adjustments related to surcharges and explicit items removed in the Company's most recently approved rate case applicable to the evaluation year. If the Earnings Test Period's rate of return is higher than the Earnings Test Threshold, the LFCR Adjustment for the coming year will be set to zero. In years where the LFCR adjustor is set to zero, the total Lost Fixed Cost Revenue for the period calculated on Schedule 2 will not be included in the balancing account for future recovery. Schedule 3 will continue to accumulate lost sales for the period in which the adjustor was set to zero, and in the year following, the Annual Incremental Cap will apply to the incremental growth from the last filing in which the LFCR was not set to zero.

Earnings Test Period – Historical calendar year represented in the most recently filed FERC Form 1.

Earnings Test Threshold – The Return On Equity (ROE) authorized in the most recent rate case with an updated capital structure and cost of debt adjusted to reflect authorized recovery of the Fair Value Increment approved in the most recent rate case.

EE Programs – Any program approved in APS's annual implementation plan.

EE Savings – The amount of MWh sales reduced by EE as demonstrated by the Measurement, Evaluation, and Research (MER) conducted for EE Programs. The calculation of EE Savings will consist of the following by class:

a. Cumulative Verified: The cumulative total MWh reduction as determined by the MER using the effective date of APS's most recent general rate case in which cost recovery was transferred from the LFCR surcharge revenues to base revenues as a starting point.

b. Current Period: The annual EE related sales reductions (MWh). Each year, APS will use actual MER verified data to calculate annual savings.

c. Excluded MWh reduction: The reduction of recoverable EE Savings calculated for commercial and industrial customers, by subtracting the amount of actual EE Savings achieved by customers on Excluded Rate Schedules.

d. True-Up Prior Period: The reconciliation of APS's annual EE sales, if necessary, to the MER verified EE sales reductions in the Prior Period.

Excluded Delivery Revenue – 50% of any delivery demand (kW) revenue calculated on Schedules 6 and 7 as determined in Decision No. 79293.

Excluded Rate Schedules – The LFCR mechanism will not apply to large general service customers taking service under rate schedules E-32 L, E-32 L TOU, E-32 L SP, E-34, E-35, XHLF and E-36 XL, or to unmetered General Service customers under E-30 and lighting schedules, Contract 12.

LFCR Adjustment – Total Lost Fixed Cost Revenue as calculated on Schedule 2, divided by forecast retail kWh sales for the proposed adjustor period. For customers on a demand rate the adjustment will be applied as a kW charge. For customers on an energy only rate the adjustment will be applied as a kWh charge. This adjustment will be applied to all customer bills, with the exception of those customers on Excluded Rate Schedules, or if the customer's current rate has alternate provisions.

Lost Fixed Cost Rate – A rate determined at the conclusion of APS's most recent general rate case by taking the sum of allowed Distribution Revenue for each General Service & Residential rate class and dividing each by their respective class adjusted test year kWh billing determinants.

Lost Fixed Cost Revenue – The amount of fixed costs not recovered by the utility because of EE and DG during the calendar year. This amount is calculated by multiplying the Lost Fixed Cost Rate by Recoverable MWh Savings, by rate class.

Prior Period – The 12 months preceding the Current Period.

Rate Case Transfers – During a general rate case proceeding, APS will effectuate a transfer of the Lost Fixed Cost Revenue recognized during the test year to base rates by (1) removing Lost Fixed Cost Revenues through an income statement pro forma adjustment, and (2) removing EE and DG MWh in Schedules 3 and 4 that correspond to the amount of the pro forma adjustment which reduces the accumulated LFCR balance in Schedule 2 by the amount of the pro forma adjustment.

If only a portion of Lost Fixed Cost Revenue recognized during the test year is transferred to base rates, the EE and DG MWh in Schedules 3 and 4 will be reduced by an amount equivalent to the dollars being transferred and the remaining EE and DG MWh will continue to be recovered through the LFCR as calculated in Schedules 3 and 4.

If none of the Lost Fixed Cost Revenue recognized during the test year is transferred to base rates, the LFCR rate will continue to recover the total amount of Lost Fixed Cost

Revenue and the EE and DG MWh in Schedules 3 and 4 will not reduce until a future rate case transfer.

Recoverable MWh Savings – The sum of EE Savings and DG Savings by rate class.

Transition Balance – The Lost Fixed Cost Revenue balance as calculated in compliance with the LFCR Plan of Administration applicable during that time period per Decision No. 73183 and modified in Decision No. 74202.

3. LFCR Annual Incremental Cap

The LFCR Adjustment will be subject to an annual 1% year-over-year cap based on Applicable Company Revenues. If the annual LFCR Adjustment results in a surcharge and the annual incremental increase exceeds 1% of Applicable Company Revenues, any amount above the 1% cap will be deferred for collection until the first future adjustment period in which including such costs would not cause the annual increase to exceed the 1% cap. The one-year Treasury Constant Maturities, effective on the first business day each year, as published on the Federal Reserve website or its successor publication will be applied annually to any deferred balance.

4. Historical Transition

Upon implementation of the revised LFCR Plan of Administration in Decision No. 76295, the Transition balance will be calculated on Schedule 4 (LFCR Historical Transition) and reported on Schedule 2 (LFCR Annual Incremental Cap Calculation).

5. Filing and Procedural Deadlines

APS will file the calculated LFCR Adjustment, including all Compliance Reports, with the Commission for the previous year by July 31st of each year. The new LFCR Adjustment will not go into effect until approved by the Commission. If approved, the new rate will take effect with the first billing cycle in November of each year, unless otherwise specified by the Commission.

6. Compliance Reports

APS will provide comprehensive Compliance Reports to Staff and the Residential Utility Consumer Office. The information contained in the Compliance Reports will consist of the following schedules:

- Schedule 1: LFCR Annual Adjustment
- Schedule 2: LFCR Annual Incremental Cap Calculation
- Schedule 3: LFCR Calculation
- Schedule 4: LFCR Historical Transition
- Schedule 5: LFCR Test Year Rate Calculation
- Schedule 6: Distribution Revenue Calculation – General Service

- Schedule 7: Distribution Revenue Calculation – Residential
- Schedule 8: Annual DG Installation Report
- Schedule 9: Annual Earnings Test
- Schedule 10: Capital Structure

Schedules 1 through 10, attached hereto, will be submitted with APS's annual compliance filing.