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ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

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All Parties in Docket No. E-01345A-03-0437

(In the Matter of the Application of Arizona Public Service Company for a Hearing to Determine the Fair Value of the Utility Property of the Company for Ratemaking Purposes)

1200 West Washington Street  
Phoenix, Arizona 85007

In Re: Direct Testimony of Douglas C. Smith, on behalf of Staff of the Arizona Corporation Commission

Dear Colleagues and Parties:

I am writing to express grave concern over Douglas Smith's testimony on behalf of Commission Staff. The testimony varies from the Commission's Constitutional mandate, past Commission Decisions and fails to account for the likely (some would argue inevitable) increase in wholesale electric generation prices in the Western interconnection.

Let me first express my unhappiness with the tenor of APS' Motion to Amend Procedural Order dated February 6, 2004. The assertion that Commission Staff's motive is to "punish" APS or to "cripple its ability to provide reliable service ..." is gratuitously emotional and inflammatory. However, I have long articulated the view that stability and predictability are paramount concerns of this Commission. Regulatory uncertainty breeds disrespect for government and law and repels investment in infrastructure. Jurisdictions with stable and predictable utilities regulation over the long term have well-capitalized public utilities with low debt structures, and their consumers enjoy low rates. On the contrary, jurisdictions with fickle and volatile regulatory regimes generally expose their domestic utilities to weak market capitalizations and high debt burdens. In the long run, those customers pay higher rates.

Finally, volatility in commodity costs imposes a great burden upon ratepayers. We have learned that fluctuating wholesale gas and electric prices inadequately managed by regulation can be devastating to consumers hit with high summer electric or winter gas bills. Management of price volatility is one of the most important things we can do.

Article XV of the Arizona Constitution requires this Commission to balance ratepayer interests with those of the company. The Commission is not RUCO – we are required to balance interests, not simply to argue one side of a question. To my mind that requirement extends to Staff, and thus to the witnesses Staff offers in any case.

The Direct Testimony of Douglas Smith purports to list “advantages and disadvantages” of adjustor mechanisms. Nowhere in that list is found a discussion of the impact of adjustor mechanisms (pro or con) on the regulated utility – other than a brief mention of earnings stability. This one sided argument is strikingly out of context with our Constitutional imperative and fails to provide the Commission with the balanced perspective we are required to demonstrate.

Secondly, in numerous decisions adopting adjustor mechanisms the Commission has found that increased fuel prices can affect earnings variability, and as a result the Commission should emplace PPFACs if and when fuel prices are volatile. [See for example In the Matter for review of the Purchased Power and Fuel Adjustment Clause for Tucson Electric Power Company, Decision No. 56659, Page 27, Lines 5-9: “We share TEP’s concerns that future increased fuel prices can affect its earnings variability, and as a result we will reserve the right to reinstate a PPFAC if fuel prices do again become volatile.”] Yet, in direct testimony, Mr. Smith recommends against a PPFAC not based on whether fuel prices are volatile – the Commission’s historic standard – but on the aforementioned list of “advantages and disadvantages”.

Lastly, Mr. Smith assumes in his testimony that electric generation costs will decrease from the current historically low prices, and natural gas costs will increase only slightly. This despite mountains of evidence, and his own attestation that “[I]t is reasonable to expect that both gas and electricity market prices will continue to vary significantly in the foreseeable future...Even if APS does conduct an aggressive hedging program, it will probably not be practical to eliminate all fuel cost uncertainty.”

The Commission’s adoption of Douglas Smith’s unbalanced testimony would sidetrack the Commission from the Constitutionally required balancing test, ignore past decisions, overturn Decision No. 66567 adopted only months ago and ignore the probability of increasing wholesale electricity costs. I write to express my deep displeasure with this testimony and to ask all the other parties in this case to devote some portion of their rebuttal testimony to the concerns I express herein.

Very Truly Yours



Marc Spitzer  
Chairman