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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

- MARC SPITZER - CHAIRMAN
- WILLIAM A. MUNDELL
- JEFF HATCH-MILLER
- MIKE GLEASON
- KRISTIN K. MAYES

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, INC., AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS SUN CITY WEST WATER AND WASTEWATER DISTRICTS.

Docket No. WS-01303A-02-0867

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, INC., AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS SUN CITY WATER AND WASTEWATER DISTRICTS.

Docket No. WS-01303A-02-0868

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, INC., AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES BASED THEREON FOR UTILITY SERVICE BY ITS MOHAVE WATER DISTRICT AND ITS HAVASU WATER DISTRICT.

Docket No. W-01303A-02-0869

Arizona Corporation Commission

**DOCKETED**

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1 IN THE MATTER OF THE APPLICATION OF  
2 ARIZONA-AMERICAN WATER COMPANY,  
3 INC., AN ARIZONA CORPORATION, FOR A  
4 DETERMINATION OF THE CURRENT FAIR  
5 VALUE OF ITS UTILITY PLANT AND  
6 PROPERTY AND FOR INCREASES IN ITS  
7 RATES AND CHARGES BASED THEREON  
8 FOR UTILITY SERVICE BY ITS AGUA FRIA  
9 WATER DISTRICT AND ITS ANTHEM / AGUA  
10 FRIA WASTEWATER DISTRICT.

Docket No. WS-01303A-02-0870

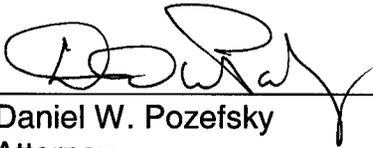
6 IN THE MATTER OF THE APPLICATION OF  
7 ARIZONA-AMERICAN WATER COMPANY,  
8 INC., AN ARIZONA CORPORATION, FOR A  
9 DETERMINATION OF THE CURRENT FAIR  
10 VALUE OF ITS UTILITY PLANT AND  
11 PROPERTY AND FOR INCREASES IN ITS  
12 RATES AND CHARGES BASED THEREON  
13 FOR UTILITY SERVICE BY ITS TUBAC  
14 WATER DISTRICT.

Docket No. W-01303A-02-0908

11 **NOTICE OF ERRATA**

12 The Residential Utility Consumer Office ("RUCO") hereby provides an errata to the  
13 Surrebuttal Testimony of Marylee Diaz Cortez filed October 31, 2003. Exhibit MDC-A was  
14 inadvertently omitted. Attached hereto is the exhibit.

15 RESPECTFULLY SUBMITTED this 5<sup>th</sup> day of November, 2003.

16  
17   
18 Daniel W. Pozefsky  
19 Attorney

1 AN ORIGINAL AND TWENTY-ONE COPIES  
2 of the foregoing filed this 5<sup>th</sup> day  
3 of November, 2003 with:

3 Docket Control  
4 Arizona Corporation Commission  
5 1200 West Washington  
6 Phoenix, Arizona 85007

5 COPIES of the foregoing hand-delivered/  
6 mailed this 5<sup>th</sup> day of November, 2003 to:

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By   
Jennifer Rumph

**EXHIBIT  
MDC-A**

BEFORE THE ARIZONA CORPORATION COMMISSION

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RICHARD KIMBALL  
CHAIRMAN  
JUNIOUS HOFFMAN  
COMMISSIONER  
MARIANNE M. JENNINGS  
COMMISSIONER

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 RATE MAKING PURPOSES, TO FIX A )  
JUST AND REASONABLE RATE OF RETURN )  
THEREON, AND THEREAFTER, TO APPROVE )  
RATE SCHEDULES DESIGNED TO DEVELOP )  
SUCH RETURN. )

DOCKET NO. U-1345-83-155

DECISION NO. 54204

OPINION AND ORDER  
(Electric-Phase I)

DATES OF HEARING: January 30, 1984 (Pre-hearing Conference)  
February 6, 7, 8, 9, 10, 14, 15, 16, 17, 21, 22, 23,  
24, 27 and 28; March 1, 5, 9, 20 and 21; April 3, 17  
(Pre-Hearing Conference), 18 and 30; May 1, 2, 3, 4,  
17, 18, 21, 22, 23, 24, 29 and 30; June 5, 6, 7, 8, 19  
and 20, 1984

PLACE OF HEARING: Phoenix, Arizona

PRESIDING OFFICERS: Wm. R. Giese  
Thomas L. Mumaw

IN ATTENDANCE: Commissioner Richard Kimball, Chairman  
Commissioner Junius Hoffman  
Commissioner Marianne M. Jennings

APPEARANCES: Jaron B. Norberg, Vice President, and Raymond F.  
Heyman, Legal Department, and Snell & Wilmer, by Steven  
M. Wheeler, on behalf of Arizona Public Service Company

James M. Flenner, Chief Counsel, and Ann Garriott,  
Legal Division, on behalf of the Arizona Corporation  
Commission Staff

Ben P. Marshall, Assistant City Attorney, on behalf of  
the City of Phoenix, City of Scottsdale, City of  
Glendale, and City of Tempe

Roger A. Schwartz, on behalf of the Residential Utility  
Consumer Office

Norman J. Furuta, Assistant Counsel, Naval Facilities  
Engineering Command, on behalf of the Department of  
Defense and Federal Executive Agencies

Wentworth & Lundin, by John E. Lundin, on behalf of  
Arizona Public Service Company Shareholders Association

1 Fennemore, Craig, von Ammon, Udall & Powers, by Scot  
2 Butler III, on behalf of Arizona Multihousing  
3 Association, Arizona School Boards Association, and  
4 Arizona Association of Community College District  
5 Governing Boards

6 Martinez & Curtis, by William P. Sullivan, on behalf of  
7 the Arizona Cotton Growers Association

8 Twitty, Sievwright & Mills, by John F. Mills, on behalf  
9 of Magma Copper Company

10 Charles D. Wahl, on behalf of Sun City Taxpayers  
11 Association, Inc.

12 Nadine Wettstein, Lynn Bernabei and Victor Aronow, on  
13 behalf of Coalition for Responsible Energy Education

14 John Michael Morris, in propria persona

15 Campana and Horne, by Thomas C. Horne, on behalf of  
16 Arizona Association of Industries, Arizona Energy Users  
17 Association, Arizona Hotel and Motel Association, and  
18 Arizona Hospital Association

19 Neal J. Beets, Arizona Center for Law in the Public  
20 Interest, on behalf of Eleanor and Norman Herring

21 BY THE COMMISSION:

22 On July 5, 1983, Arizona Public Service Company ("APS") filed an  
23 Application with the Arizona Corporation Commission ("Commission") wherein APS  
24 requested that the Commission set a time and place for a hearing to determine  
25 the "fair value" of its property for rate making purposes, to fix a just and  
26 reasonable rate of return thereon, and thereafter, to approve rate schedules  
27 designed to produce said return. In accordance with A.C.R.R. R14-3-101, a Rate  
28 Case Procedural Order was issued on July 19, 1983. Said Rate Case Procedural  
Order was thereafter amended on November 7, 1983, and January 20, 1984. Unlike  
previous rate proceedings involving APS, the Rate Case Procedural Order of July  
19, 1983, as amended, provided for a unitary hearing addressing both revenue  
requirements and rate design.

Pursuant to the Rate Case Procedural Order, APS published Notice of its

1 Application in newspapers of general circulation throughout its service  
2 territory. APS also mailed said Notice to each of its customers.

3 Subsequent to the filing of the Application, numerous Petitions seeking  
4 leave to intervene were filed on behalf of various interested parties. These  
5 Petitions were granted by Procedural Order prior to the hearing.

6 In accordance with the above Notice, the Application came on for hearing  
7 before a duly authorized Hearing Officer of the Commission at its offices in  
8 Phoenix, Arizona, on February 6, 1984. Thereat, statements from the public  
9 were received and made a part of the record as were numerous petitions and  
10 letters in opposition to the Application. APS, the Commission's Utilities  
11 Division Staff ("Staff")<sup>1</sup>, as well as the Intervenors set forth above, entered  
12 appearances. The proceeding was continued from time to time, and in total,  
13 there were forty (40) days of evidentiary hearings.<sup>2</sup>

14 During the course of these hearings, the Application underwent several  
15 changes. The most significant was the separation of the requested increase in  
16 gas rates from the electric portion of the Application. After presentation of  
17 a stipulated agreement negotiated by APS and the Residential Utility Consumer  
18 Office ("RUCO"), the Commission approved an increase in gas rates in Decision  
19 Nos. 54056 (May 30, 1984) and 54183 (September 26, 1984). Even with regard to  
20 the electric increase, APS's original proposal for a five (5) step increase was  
21 pared to two (2) steps at APS's request. Moreover, the Commission initially  
22 dismissed even the second step of the Application in Decision No. 54018 (April  
23 26, 1984) but later reversed itself in Decision No. 54025 (May 17, 1984). The  
24

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25 1. Staff was represented by the private consulting firms of Lubow, McKay,  
26 Stevens & Lewis and QED Research, Inc., for purposes of the instant proceeding.

27 2. There were also two (2) prehearing conferences. The initial conference  
28 was held on January 30, 1984. The second, scheduled after the first of several  
major revisions to APS's Application, was held on April 17, 1984.

1 proposed second step increase was scheduled for a separate hearing which began  
2 on October 9, 1984.

3 NATURE OF APS'S OPERATIONS

4 APS is an Arizona corporation engaged in providing electric service to  
5 approximately 475,000 customers. APS also provides gas utility service to  
6 nearly 350,000 customers but has recently agreed to sell its gas operations to  
7 Southwest Gas Corporation prior to the end of 1984.<sup>3</sup> APS's utility business  
8 encompasses twelve (12) Arizona counties and, in terms of net assets devoted to  
9 public service, APS is Arizona's largest public service corporation. APS and  
10 its various predecessors in interest have received Certificates of Public  
11 Convenience and Necessity from this Commission authorizing it to provide  
12 electric and gas service to the public.

13 APS's electric system is fully integrated. APS also makes sales to other  
14 electric distribution systems. Sales for resale are regulated by the Federal  
15 Energy Regulatory Commission ("FERC"). However, the great majority of APS's  
16 business consists of retail sales within this state. These latter sales are  
17 under the Commission's jurisdiction and are the subject of the current  
18 Application.

19 APS's service territory has been among the fastest growing areas in the  
20 United States. APS is currently involved in one of the largest building  
21 programs, the bulk of which relates to the Palo Verde Nuclear Generating  
22 Station ("Palo Verde"). Palo Verde consists of three (3) separate units with  
23 design capacities of 1250 MW each. Begun in 1976,<sup>4</sup> the first unit ("PV-I") is  
24 now (by APS's estimation) 99.5% complete and is scheduled to begin  
25

26 3. This sale was approved by the Commission in Decision Nos. 54057 and 54058  
27 (May 30, 1984) and was part of the overall settlement between RUCO and APS  
which also resulted in Decision Nos. 54056 and 54183.

28 4. 1976 marks the beginning of actual construction. Palo Verde was first  
conceived several years earlier.

1 commercial operation late in 1985. PV-II is similarly estimated at 98.9%  
2 complete, while PV-III is presently believed to be 87% complete. Commercial  
3 operation of PV-II and PV-III are presently planned for the summers of 1986 and  
4 1987, respectively. As of June 30, 1983, APS had invested approximately  
5 \$850,000,000 in PV-I alone. APS's total cost for all three (3) units is  
6 presently estimated at over \$2,700,000,000, inclusive of capitalized financing  
7 and overhead. APS owns 29.1% of Palo Verde and is the manager of the project  
8 for a consortium of California, Arizona, New Mexico and Texas utilities. Each  
9 member of the Palo Verde group pays a proportionate share of all construction  
10 costs and will, upon commercialization of the units, pay a commensurate amount  
11 of the operating expenses. Although no portion of this massive investment has  
12 previously been included in the calculation of APS's "fair value" rate base,  
13 Decision No. 53909 (January 30, 1984), wherein the Commission granted APS an  
14 emergency rate hike, implicitly recognized the tremendous strain Palo Verde has  
15 exerted upon APS's cash resources.

#### 16 PROPOSED INCREASE

17 APS has requested that its operating revenues for electric service be  
18 increased by \$122,115,000 (16.12%) based upon sales levels for the year ending  
19 June 30, 1983. Somewhat more than \$55,000,000 of this amount represents  
20 confirmation of the interim emergency increase granted in Decision No. 53909.  
21 As was noted earlier, APS's original Application contained four (4) additional  
22 rate steps based upon certain milestones of construction at Palo Verde. All  
23 but the second step, consisting of some \$79,000,000, has been dismissed, and  
24 only the first step will be addressed herein. APS's last permanent rate  
25 increase was authorized by Decision No. 53761 (September 30, 1983).

#### 26 TEST YEAR

27 APS originally proposed a Test Year ("TY") consisting of calendar year  
28 1982. The Commission's Rate Case Procedural Order of July 19, 1983, rejected

1 this TY and required resubmission of APS's Application with a TY ending June  
2 30, 1983. To this TY, APS and Staff have made numerous pro forma adjustments  
3 "to obtain a normal or more realistic relationship between revenues, expense,  
4 and rate base," and which were known and measurable at the time of the  
5 hearing. See A.C.R.R. R14-2-103(i). Indeed, so many adjustments were proposed  
6 herein that, in some respects, the TY has been effectively changed to the year  
7 ending November 30, 1983, the latest date for which complete data was available  
8 at the time of Staff's audit.

9 No party has suggested that the Commission's original designation of a TY  
10 was inappropriate. Although the information contained in the TY is now quite  
11 stale, this was the result of the extraordinary length of these proceedings  
12 rather than any inherent defect in the TY. With the appropriate pro forma  
13 adjustments, we continue to believe that the year ending June 30, 1983, is a  
14 reasonable basis for setting rates.

#### 15 ALLOCATION FACTORS

16 APS must allocate its plant and expenses between the Commission's Arizona  
17 retail jurisdiction and the FERC's wholesale jurisdiction. Common overhead  
18 expenses and items of common plant (e.g., corporate headquarters) must be  
19 further allocated between gas and electric operations. APS has done such an  
20 allocation in Schedules B-1, B-2, B-3, B-4, B-4a, B-5, C-1, C-1a, C-2a, and GJ  
21 of Exhibit No. 1. See also the testimony of Alan Propper in Exhibit No. 3.  
22 APS has utilized the four month (June, July, August and September) coincident  
23 peak ("4-CP") methodology to allocate demand costs (the bulk of APS's electric  
24 plant). This is the same basic methodology adopted by APS in previous  
25 Commission proceedings as well as before the FERC. There has been no question  
26 raised concerning the jurisdictional allocations performed by APS (a fact of  
27 some considerable significance to our discussion of rate design), and they will  
28 be accepted herein.

OPERATING INCOME

1  
2 APS's statement of TY electric operating income is found in the "C"  
3 Schedules of Exhibit No. 1. The actual TY results were modified by the  
4 following pro forma adjustments:

- 5 (1) TY operating revenues were increased by \$54,042,000 to reflect the  
6 net effect of the higher base, and fuel and purchased power  
7 adjustment clause ("PPFAC"), rates authorized by Decision No. 53761;  
8 the higher rates sought in FERC Docket No. 82-481; the loss of both  
9 jurisdictional and FERC sales; the addition of "wheeling" revenue;  
10 the substitution of Southern California Edison for Utah Power &  
11 Light with regard to the Cholla Unit #4 layoff sale; and, the actual  
12 1983 Commission and RUCO regulatory assessment;
- 13 (2) TY operating expenses were increased by \$28,170,000 to reflect the  
14 corresponding expense adjustments related to the increased revenue  
15 included above;
- 16 (3) TY operating expenses were increased by \$691,000 to reflect the net  
17 (after income taxes) effect of a five (5) year amortization of APS's  
18 investment in the Palo Verde Uranium Venture;
- 19 (4) TY operating expenses were increased by \$543,000 to reflect the net  
20 effect of the three (3) year amortization of the accounting changes  
21 mandated by FASB #43 and approved in Decision No. 53761;
- 22 (5) TY operating expenses were increased by \$805,000 to reflect the  
23 estimated net effect of increased ad valorem taxes during the second  
24 half of 1982;
- 25 (6) TY operating expenses were decreased by \$284,000 to reflect the net  
26 change in expenses at the West Phoenix Steam plant which was  
27 "mothballed" during the TY;
- 28 (7) TY operating expenses were increased by \$3,268,000 to reflect the  
net effect of the SO<sub>2</sub> removal project at the Four Corners Generating  
Station, which project is presently scheduled for completion in  
December of 1984;
- (8) TY operating expenses were increased by \$565,000 to reflect the net  
effect of annualized changes in the Four Corners Operating  
Agreement;
- (9) TY operating expenses were increased by \$160,000 to reflect the net  
effect of annualizing the expenses incurred by the particulate  
removal project equipment installed at Four Corners late in 1982;
- (10) TY operating expenses were increased by \$2,086,000 to reflect the  
net effect of annualized depreciation and amortization for plant in  
service as of June 30, 1983;

1 (11) TY operating expenses were increased by \$2,508,000 to reflect the  
2 net effect of annualized depreciation and ad valorem taxes  
3 associated with additions to APS's 500 KV transmission system made  
4 after the close of the TY; and,

5 (12) TY operating expenses were increased by \$35,279,000 to reflect the  
6 annualized effect of numerous income tax items more fully described  
7 at Schedule C-2 of Exhibit No. 3 and by the testimony of Paul E.  
8 Williams II, in Exhibit No. 5.

9 APS originally proposed several other adjustments to TY operating results  
10 to reflect the first year of operations at Palo Verde for PV-I. These items  
11 are not longer at issue in view of the Commission's determination that only the  
12 first step of APS's original five (5) step Application will be addressed  
13 herein. However, the inclusion or exclusion of investment in PV-I from the  
14 determination of "fair value" rate base does have operating income significance  
15 because of the effects of interest synchronization and FERC Order No. 144 tax  
16 normalization.

17 Of all the other parties, only Staff presented a comprehensive alternative  
18 analysis of TY electric operations. In Exhibit No. 31-BS, Staff increased  
19 APS's TY operating income by \$11,974,000. Specifically:

20 (1) operating income was reduced by \$6,478,000 to reflect the deletion  
21 of out-of-period and/or nonrecurring fuel costs and revenues, the  
22 use by Staff of actual costs and revenues for the last quarter of  
23 the TY, whereas APS had submitted only estimates, and the  
24 annualization of changes to APS's PPFAC approved in Decision  
25 No. 53761;<sup>5</sup>

(2) operating income was reduced by \$1,817,000 because of abnormally hot  
weather during the TY;

(3) operating income was increased by \$8,619,000 by the inclusion of  
annualized customer sales as of November 30, 1983;

(4) operating income was increased by \$109,000 to reflect the annualized  
wheeling revenues from the Plains Electric Cooperative less revenues  
lost from direct sales to that customer;

26 5. Each of these adjustments was to APS's unadjusted TY. Consequently, any  
27 difference between the amount of an APS adjustment and the corresponding Staff  
28 adjustment to disallow that item has been accounted for in the total of TY  
operating expenses.

- 1 (5) operating income was increased by \$198,000 as a result of using  
2 APS's presently effective rates for wheeling service;
- 3 (6) operating income was reduced by \$11,854,000 to reflect layoff sales  
4 from Cholla Unit #4 during the time rates approved herein will be in  
5 effect rather than those during the first year of operation of PV-I;
- 6 (7) operating income was reduced by \$2,129,000 as a result of  
7 annualizing wage and salary increases granted by APS during the TY;
- 8 (8) operating income was further reduced by \$263,000 to reflect APS's  
9 share of FICA taxes resulting from the above wage and salary  
10 adjustments;
- 11 (9) operating income was increased by \$464,000 to reflect savings  
12 accrued through APS's early retirement program;
- 13 (10) operating income was increased by \$1,130,000 as a result of changes  
14 in the effective ad valorem tax rate less the additional tax due on  
15 property additions between June 30, 1983 and November 30, 1983;
- 16 (11) operating income was reduced by \$1,292,000 due to the increased  
17 annualized depreciation on the above property additions;
- 18 (12) operating income was reduced by \$122,000 to reflect the net effect  
19 of interest on customer deposits;
- 20 (13) operating income was increased by \$638,000 by the disallowance of  
21 APS's proposed adjustment for losses incurred in the Palo Verde  
22 Uranium Venture;
- 23 (14) operating income was increased by \$2,298,000 by the disallowance of  
24 APS's proposed adjustment for the operating costs of the SO<sub>2</sub> removal  
25 equipment at Four Corners;
- 26 (15) operating income was increased by \$101,000 to reflect revisions to  
27 APS's earlier estimates as to the effects of changes to the Four  
28 Corners Operating Agreement and the Four Corners particulate removal  
project;
- (16) operating income was increased by \$151,000 to reflect the allocation  
to FERC jurisdiction of a reasonable portion of R & D expenses;
- (17) operating income was increased by \$197,000 to reflect removal from  
TY results of all nuclear advertising and the Palo Verde Information  
Center;
- (18) operating income was increased by \$1,276,000 by the elimination of  
the Energy Control Credit Program ("ECCP");
- (19) operating income was increased by \$20,748,000 through a reduction in  
income tax expense resulting from such nonoperating items as the  
annualized effects of FERC Order No. 144 normalization, changes in  
depreciation practices not normalized, and interest synchronization.

1 Exhibit No. 31-BS indicates that adjusted TY operating income would be  
2 increased by an additional \$8,147,000 should the Commission adopt Staff's  
3 recommendations with regard to CWIP. This result is primarily due to the fact  
4 that interest expense now capitalized net of income tax as part of the  
5 Allowance for Funds Used During Construction ("AFUDC") will thereafter be used  
6 to directly reduce income tax expense for purposes of determining operating  
7 income.

8 Most of Staff's proposed adjustments are clearly appropriate, reflect  
9 policies previously adopted by the Commission in Decision No. 53761, or were  
10 uncontested by any party to these proceedings. APS did take strong exception  
11 to several of these adjustments and presented rebuttal testimony concerning  
12 Staff's customer annualization, payroll annualization and the revenue  
13 conversion factor ("RCF") initially used by APS and adopted by Staff.<sup>6</sup>

14 With regard to customer annualization, APS noted that Staff annualized the  
15 increased number of residential customer sales but not the decreased industrial  
16 and commercial sales. APS also contended that Staff's adjustment assumed that  
17 all residential customers added between July 1 and November 30, 1983, were  
18 full-time residents rather than seasonal visitors. These two (2) items would  
19 reduce Staff's operating income adjustment by \$1,445,000.

20 The payroll adjustment found APS in agreement with the concept but in  
21 disagreement with Staff's computation. APS included pension and other  
22 benefits, as well as the FICA and wage (salary) increases utilized by Staff.  
23 APS further adjusted Staff's figures by the small increase in employees  
24 associated with customer services as of November 30, 1983. The net effect was  
25 to decrease Staff's adjusted TY operating income by \$2,537,000.

26  
27 6. The RCF will be discussed in the AUTHORIZED INCREASE section of this  
28 Decision.

1 We believe that APS's rebuttal evidence has been persuasive. It is  
2 clearly unfair to reflect pro forma adjustments which increase TY operating  
3 income without making corresponding adjustments to reduce operating income.  
4 APS's incremental adjustment to annual labor expense is consistent with Staff's  
5 inclusion of pro forma customer levels, Staff's pro forma adjustments to rate  
6 base, and with its previous labor adjustment. With the above adjustments to  
7 Staff's computations, we find adjusted TY operating revenues to be  
8 \$827,660,000; adjusted TY operating expenses to be \$607,739,000; and, adjusted  
9 TY operating income to be \$219,921,000.<sup>7</sup>

10 RATE BASE

11 In comparison with pro forma TY operating income, there were relatively  
12 few adjustments to TY original and reproduction cost new rates bases ("OCRB and  
13 RCRB") made by either APS or Staff other than those adjustments related to Palo  
14 Verde. Moreover, no other participant in these proceedings presented testimony  
15 on any rate base item other than Palo Verde. Consequently, the Palo Verde  
16 issue will be addressed separately within this portion of the Decision.

17 APS made only three (3) basic adjustments to its June 30, 1983, plant  
18 balances. It increased depreciation reserve to reflect the annualized  
19 depreciation taken for income statement purposes. It added pro forma  
20 adjustments for improvements to APS's 500 KV transmission line system and the  
21 addition of SO<sub>2</sub> removal equipment at Four Corners. Finally, APS included Plant  
22 Held for Future Use.

23 Staff disallowed each of APS's adjustments except the increased  
24 depreciation reserve. Even that figure had to be modified since Staff utilized  
25 November 30, 1983, plant balances except where such balances were not found to  
26 be representative or consistent with Staff's earlier operating income  
27

28 7. Includes effects of \$260,000,000 in Palo Verde CWIP.

1 adjustments. The two (2) instances in which this happened were in the areas of  
2 fuel inventory and prepayments. Utilizing the same inventory method adopted as  
3 reasonable by the Commission in Decision No. 53762, Staff reduced inventory by  
4 \$9,708,000.<sup>8</sup> Prepayments were reduced by \$432,000 using the thirteen month  
5 average rather than end of TY balances. The transmission line projects were  
6 treated as part of Palo Verde in Staff's analysis, while some \$18,991,000 in  
7 Plant Held for Future Use was eliminated consistent with our previous  
8 determination in Decision No. 53761. The SO<sub>2</sub> project was excluded because it  
9 would not be complete as of the time rates were projected to go into effect.  
10 Finally, Staff deducted some \$3,981,000 in customer deposits from rate base as  
11 was also done in Decision No. 53761.

12 APS presented rebuttal testimony which indicated that it had, in fact,  
13 subsequently reduced its oil inventory from TY levels, and that should the  
14 Commission approve of such a lowered inventory, Staff's adjustment would be  
15 reduced by \$3,181,000. APS also indicated that only one (1) of the (2) 500 KV  
16 transmission lines was associated with Palo Verde. The other line, comprising  
17 some \$15,312,000 and placed into service during June of 1984, connected APS's  
18 Yuma properties with the rest of the APS system. APS testified that this line  
19 will both increase the reliability of its service to Yuma and decrease fuel  
20 costs for all its customers.<sup>9</sup> At present, APS must run relatively inefficient  
21 oil units in the Yuma area to assure adequate service since there was  
22 insufficient transmission capacity between the main APS service territory and  
23 Yuma. Moreover, APS was able to build the line in conjunction with several  
24 other utilities, thus achieving further economies. APS has again objected to  
25 the removal of Plant Held for Future Use, arguing that such a policy may

26  
27 8. As with operating income, all figures are stated on an ACC jurisdictional  
basis.

28 9. Fuel savings will be flowed back to APS's customers through the PPFAC.

1 discourage prudent investments by APS in property later needed by its  
2 ratepayers.

3 We find that APS should be permitted to include both the 500 KV Yuma  
4 transmission line and the Four Corners SO<sub>2</sub> project in its rate base. The  
5 former was clearly in service by the close of the hearings in this proceeding,  
6 was not revenue producing, would provide cost savings which would go directly  
7 to the ratepayer rather than partially or wholly offsetting the project's  
8 capital costs, and will improve the quality of electric service enjoyed by  
9 APS's Yuma customers. The SO<sub>2</sub> project may be considered a form of nonrevenue  
10 producing CWIP. We believe that strong public policy considerations support  
11 prompt rate base treatment for pollution control equipment. It should be noted  
12 that even those jurisdictions which generally do not permit CWIP in rate base  
13 (even in cases of financial need) make an exception for pollution control  
14 projects. This investment by APS in better air quality is hardly insignificant  
15 (\$39,334,000). For APS to bear this investment without remuneration until yet  
16 another rate application has been heard, having already done so prior to the  
17 effective date of this Decision, seems to us both unfair and possibly  
18 counterproductive should such a result discourage APS from making future  
19 investment decisions of this kind.

20 APS presents us with a close case with its revised oil inventory  
21 adjustment. However, we will continue to accept Staff's figure for several  
22 reasons. First, while APS has shown that Staff's methodology has produced  
23 allowances which are clearly excessive for one plant and clearly inadequate for  
24 another, it has yet to show that the overall Staff allowance for oil inventory  
25 is inadequate. Second, APS has a previous "track record" concerning excessive  
26 inventory levels which does not lead us to accord management its usual degree  
27 of deference in this area. We note that APS has continually reduced its level  
28 of oil inventory over the past few years. The incentive for efficiency which

1 is embodied by Staff's inventory allowances has apparently been effective. How  
2 far APS's oil inventory can be safely reduced is still in doubt. However, the  
3 relative abundance of both oil and gas, as well as APS's extensive  
4 interconnections with other utilities would all seem to point to the  
5 possibility of further economies in this area.

6 Plant Held for Future Use presents us with no such problems. APS has not  
7 shown that any of the property in question represents a prudent investment and  
8 even if that were the case, Arizona does not follow that standard as was  
9 evident by our discussion in Decision No. 53761. We are not totally  
10 unsympathetic to APS's position and believe that the inclusion of such land in  
11 plant accounts upon its eventual utilization at a market value higher than  
12 original cost may be a solution. However, that issue need not be addressed  
13 until and if these parcels become used and useful. Although APS's decision to  
14 reactivate the West Phoenix Steam Plant in the summer of 1985 would seem to  
15 cast some doubt on its continuing classification as Plant Held for Future Use,  
16 we are not inclined to begin carving out exceptions to an otherwise simple and  
17 straightforward policy. In addition, West Phoenix's activation would not have  
18 been necessary had PV-I not been delayed. By permitting its inclusion in rate  
19 base, we would, in effect, be charging ratepayers for some of the increased  
20 cost attributable to the delay prior to determining APS's culpability (if any)  
21 for such costs.

22 The above adjustments to Staff's position increase OCRB by some  
23 \$54,646,000. As can be seen by Exhibit No. 31-BS, OCRB as of June 30, 1983, on  
24 a pro forma basis would be \$1,701,666,000 prior to consideration of Palo Verde  
25 related CWIP. RCRB would be increased by a similar amount to \$3,096,050,000  
26 (pre-Palo Verde).

27 Palo Verde

28 An incredible amount of the testimony as well as numerous (to say the

1 least) exhibits were devoted to the issue of whether or not some portion of  
2 Palo Verde should be included in rate base as CWIP. Most of that testimony and  
3 the great majority of the exhibits were based upon the premise that if Palo  
4 Verde were demonstrated to be an imprudently conceived and managed project or  
5 that at the very least, mistakes had been made during its long construction, it  
6 would logically follow that no Palo Verde related CWIP should be placed into  
7 rate base. That premise is not shared by the majority of this Commission.

8 That the original idea to build Palo Verde was, in some sense, imprudent  
9 seems doubtful given the state of then existing knowledge. Whether Palo Verde  
10 will prove to be imprudent with the aid of "20/20" hindsight remains to be  
11 determined by the course of future events. There are still far too many  
12 variables concerning the final construction costs of Palo Verde, its operating  
13 behavior, the costs of coal (including possible "acid rain" and solid waste  
14 disposal costs), etc., to warrant the hasty conclusions reached by some parties  
15 herein. Certainly errors were made in Palo Verde's construction. Of this we  
16 were fully aware even before being inundated by "CAR's" and other such Nuclear  
17 Regulatory Commission ("NRC") documents. After all, Palo Verde is being built  
18 by human beings, not mistake-proof automata. Only a comprehensive and  
19 independent construction audit can assure us that Palo Verde's total cost is  
20 reasonable, i.e., that instances of good judgement and prudent management  
21 outweighed the inevitable examples to the contrary. Such an audit is being  
22 planned by this Commission at the present time. In the meantime, it is our  
23 responsibility to see that our own mistakes are not added to any made by APS.

24 No witness has seriously disputed the Commission's observation that the  
25 inclusion of CWIP in rate base saves ratepayers money over the life of the  
26 included asset. Indeed, with the \$1.20 AFUDC reduction for each \$1.00 in CWIP  
27 cash earnings, the financial deck is stacked in favor of the ratepayer. In  
28 Decision No. 53761, the primary reason cited by the Commission for rejecting a

1 similar APS CWIP proposal was the poor overall state of the APS service  
2 territory's economy and the need for a deferral of further electric rate  
3 increases, if at all possible, until better economic times. Such reasoning can  
4 hardly be considered applicable today. The other considerations discussed  
5 during the course of that prior proceeding, and subsequently by members of this  
6 Commission, concerned the possible diminution of APS's construction incentives  
7 should CWIP be included, as well as the possible bias CWIP inclusion might  
8 create in support of large-scale capital intensive construction projects. In  
9 response, the amount of CWIP being discussed herein is but a small part of the  
10 total project. The 20% premium demanded by this Commission with reference to  
11 Palo Verde CWIP comes directly from the shareholders' future stream of earnings  
12 and provides a powerful incentive for management to complete PV-I. Moreover,  
13 further incentives are planned in Phase II of this docket. APS has no future  
14 plans for nuclear generating plants, and even its coal construction projects  
15 have not been started and lie far into the future. It is extremely doubtful  
16 that anything we decide in this proceeding will have an appreciable effect on  
17 long-term resource allocation. On the other hand, it is an absolute certainty  
18 that a decision to exclude CWIP would needlessly increase the cost of an  
19 already expensive project.

20 Various Intervenors herein have raised two (2) additional arguments  
21 against CWIP not discussed in Decision No. 53761. The first is the  
22 "intergenerational equity" argument. In this regard, it must be said that if  
23 every generation demanded from society an exact match between burdens and  
24 benefits, it is doubtful that any project of significance would ever be  
25 undertaken, since the project would have to be both completed and all possible  
26 benefits realized within the remaining lifetime of those responsible for its  
27 conception. Second, the "intergenerational equity" argument would make more  
28 sense if we were talking about a plant coming on line in the year 2000 or even

1 five (5) years hence. PV-I is little over a year from completion. Again we  
2 are faced with a very small, if any, "inequity" versus a very large increase in  
3 total project cost for all ratepayers. The final argument is that some  
4 ratepayers simply can not afford any additional electric rate increases. The  
5 inability of some members of society to pay for even basic levels of electric  
6 service is not a trivial matter. However, it would seem that postponing a  
7 smaller increase today in favor of an even larger one tomorrow will do such  
8 individuals little good.

9 Both Staff and APS have supported inclusion of various levels of CWIP.  
10 APS originally sought \$425,000,000 while Staff argued that only \$325,000,000  
11 was necessary to achieve satisfactory cash flow criteria. This is our first  
12 decision allowing permanent Palo Verde CWIP in the rate base. We do it for two  
13 reasons. First, to preserve APS's financial viability; second, and equally  
14 important, it will encourage optimal pricing of baseload facilities. Since we  
15 look forward to the development of more sophisticated and effective pricing and  
16 incentive mechanisms in Phase II and other upcoming cases, the allowance of  
17 CWIP in this case should not be deemed to be a precedent for any principle of  
18 general CWIP allowance in rate base. Moreover, and contrary to both APS and  
19 the Staff, we believe that an amount of \$260,000,000 of CWIP will be sufficient  
20 to achieve present satisfactory cash flow criteria.

21 Rate Base Summary

22 The addition of \$260,000,000 in CWIP to the OCRB and RCRB figures  
23 previously cited produces a total OCRB of \$1,961,666,000 and a total RCRB of  
24 \$3,356,050,000 for the TY. The Commission has traditionally weighted OCRB and  
25 RCRB "50/50" in the determination of "fair value." No party has suggested a  
26 different procedure, and we can find no rationale in this record which would  
27 support any change from our previous position. Consequently, we will find the  
28 "fair value" of APS's rate base to be \$2,658,858,000.

RATE OF RETURN

1  
2 As has been stated on numerous occasions, the starting point of any  
3 rational rate of return analysis must be the cost of capital. This, in turn,  
4 is a function of the cost of the individual components utilized in APS's  
5 capital structure. In this proceeding, all the expert witnesses have adopted  
6 APS's actual corporate capital structure. December 31, 1983, was selected by  
7 Staff as representative of APS during the period under examination, and we find  
8 no evidence which would dispute Staff's determination.

Cost of Long-Term Debt and Preferred Stock

9  
10 As can be seen by both Exhibit No. 29-S and Exhibit No. 1, the embedded  
11 cost of preferred stock as of December 31, 1983, was 9.94%. There was some  
12 disagreement between Staff's estimation of long-term debt costs (10.80%) and  
13 that of APS (11.23%). This discrepancy existed because of APS's use of  
14 estimated debt costs and Staff's inclusion on a pro forma basis of some  
15 relatively low cost pollution control debt issued during 1984. APS has not  
16 taken exception of Staff's adjustment in its rebuttal testimony, and we will  
17 accept the lower figure for purposes of determining a fair rate of return. It  
18 should be similarly noted that Staff disregarded the insignificant amount of  
19 short-term debt (less than 2%) outstanding at the end of 1983. Both the cost  
20 and amount of short-term debt used by APS are quite volatile, and the  
21 exclusion of such debt is consistent with our previous discussion of this issue  
22 in Decision No. 53761.

Cost of Common Equity

23  
24 There were numerous witnesses on the subject of common equity cost.<sup>10</sup>  
25

26  
27 10. Although presented with the other rate of return witnesses, Dr. Hadaway of  
28 the Shareholders' Association, and Mr. Copeland for the Coalition for  
Responsible Energy Education were, in reality, rate base witnesses addressing  
the CWIP issue. Both had actually accepted APS's figure of 17.50% for purposes  
of their analyses.

1 At one (1) end of the range, Staff's and APS's experts recommended returns of  
2 17.50% and 17-18%. APS had originally requested a return of 17% in this  
3 proceeding, and its latest filing in Exhibit No. 1 reflects an equity cost of  
4 17.50%. On the other hand, RUCO and various other Intervenors have presented  
5 experts supporting cost estimates of between approximately 13% and 15.6%. Most  
6 also indicated that the Commission's inclusion of CWIP would serve to lower  
7 their estimates of capital costs. Dr. Trout of Staff attempted to quantify the  
8 effect as approximately 20 basis points, while Mr. Parcell for the Department  
9 of the Navy put the "CWIP effect" in the range of 50-60 basis points.

10 All of the witnesses utilized market measures for determining cost of  
11 common equity, although Mr. Parcell and Dr. Smith also studied so called  
12 comparable earnings, and various other experts performed types of "risk  
13 premium" analyses wherein cost of common equity was related to the current cost  
14 (interest rate) of certain types of debt instruments. The differences among  
15 these witnesses largely arise from the selection of data for their respective  
16 studies. Those witnesses who attempted to directly gauge future growth  
17 expectations, whether by direct inquiry or by resort to popular financial  
18 publications having supposed influence with the investor, tended to come up  
19 with high growth estimates, and consequently, high returns given the relative  
20 agreement as to APS's present dividend yield. On the other hand, witnesses who  
21 concentrated on recent historical results concluded that there was little  
22 growth potential for APS.

23 We believe that all the rate of return witnesses have managed to be at the  
24 same time both wrong and right about growth. It is true APS's recent  
25 performance with regard to earnings and book value growth has been poor. This  
26 reflects the strain of Palo Verde construction combined with a relatively high  
27 rate of dividend growth and numerous issuances of common stock below book  
28 value. For the short-term, little improvement is to be expected in earnings,

1 but the book value growth figure should accelerate due to reduced common stock  
 2 issuances and a slowing down in the rate of dividend growth now that APS has  
 3 achieved a payout ratio consistent with industry norms. After completion of  
 4 Palo Verde, APS should resume its pre-Palo Verde pattern of high growth in  
 5 earnings per share. Since each of the experts has focused on either negative  
 6 short-term phenomena or more positive long-term expectations to the exclusion  
 7 of the other, they have consistently overstated or understated the cost of  
 8 common equity appropriate for these proceedings.

9 The one (1) fact that all witnesses agreed upon was that capital costs for  
 10 common equity have increased since the issuance of Decision No. 53761. There  
 11 is also more or less universal acknowledgement that the inclusion of CWIP  
 12 provides a counterforce to the upward trend of the capital markets. It is our  
 13 judgement that these factors have roughly cancelled each other out, and so we  
 14 will simply affirm our finding of 16.15% as set forth in Decision No. 53761.<sup>11</sup>

APS Cost of Capital Summary

<u>Capital Item</u>	<u>% of Total LT Capital</u>	<u>Unit Cost</u>	<u>Weighted Cost</u>
Long-term debt	47.40%	10.80%	5.12%
Preferred Stock	11.80	9.94	1.17
Common Equity	<u>40.80</u>	<u>16.15</u>	<u>6.59</u>
TOTAL	100.00%	N/A	12.88%

20 The cost of capital alone requires a return on APS's "fair value" rate  
 21 base of no less than 9.50% if APS is to be permitted an opportunity to recover  
 22

23 11. In Decision No. 53761, we were determining a composite cost of common  
 24 equity for a combination electric and gas utility. It is generally conceded  
 25 that APS's gas operations were less responsible for APS's financial problems  
 26 than the electric operations. See Decision No. 53909. The divestiture of the  
 27 gas business, although clearly a short-term plus because of the cash due from  
 28 the sale, may have long-term effects not fully reflected in the market data  
 used by the expert witnesses herein.

1 its total cost of providing electric service, including capital costs.  
2 Although some witnesses have argued that APS should receive less than its  
3 actual costs because of allegations concerning Palo Verde, we continue to view  
4 this matter as a rate base issue and will treat it accordingly.

#### 5 AUTHORIZED INCREASE

6 Multiplying the 9.50% rate of return found to be reasonable by APS's "fair  
7 value" rate base produces required operating income of \$252,592,000 for  
8 electric operations. This is \$32,671,000 more than was produced by APS's  
9 adjusted TY. As was alluded to earlier, APS has modified its original RCF to  
10 reflect the extension of Arizona's "temporary" sales tax surcharge. So  
11 modified, the RCF of 2.0897 produces a required increase in TY operating  
12 revenues of \$68,273,000 or 8.25%. Of this total, it should be remembered that  
13 some \$55,363,000 (6.70%) was previously authorized by Decision No. 53909, and  
14 that the incremental increase is less than 1.5090%.

#### 15 RATE DESIGN

16 APS's rate design incorporates two (2) distinct concepts. Specific rate  
17 increases were proposed for connect and reconnect services, dusk to dawn  
18 lighting, and various miscellaneous items. These latter increases were based  
19 upon the higher cost of providing such specialized services and account for  
20 some \$2,199,000 of the authorized rate increase. The bulk of the remaining  
21 revenue requirement is realized by a modified "across the board" increase on  
22 the base (non-fuel) portion of electric rates. This general principle is  
23 modified because strict application of the methodology followed in Decision  
24 No. 53671 would not produce sufficient revenues from the irrigation class. APS  
25 therefore raised irrigation rates by the same percentage as its residential  
26 customers. Another variation was with reference to the street lighting rate  
27 schedule. APS's proposed increase for that class of service was in accordance  
28 with the Commission's previous direction in Decision No. 53615 (June 27,

1 1983). Finally, APS notified seven (7) contract rate customers of proposed  
2 increases in accordance with provisions in their respective contracts.

3 Except for changing the general level of each tariff component, APS did  
4 not significantly restructure any of its electric rates with the notable  
5 exception of Rate 32 (General Service). APS made several changes to Rate 32  
6 throughout the course of this proceeding, but its final proposal was embodied  
7 in Exhibit No. 12-K. APS also capped the residential and general service  
8 customer charge at \$12.50 with any remaining increase attributable to those  
9 schedules being reflected in the kwh rate.

10 APS has submitted a separate proposal to vintage rates according to a  
11 customer's contribution to CWIP related charges. This was an attempt to  
12 partially address the intergenerational equity argument raised by several  
13 intervenors with regard to CWIP. Although that argument has been previously  
14 rejected in the RATE BASE portion of this Decision, there are other reasons for  
15 not adopting this suggestion, as will be discussed hereinafter.

16 APS has presented both embedded and marginal cost studies which generally  
17 support its method of spreading any increase authorized by this proceeding. By  
18 support, we mean that this methodology moves each rate schedule closer to its  
19 calculated cost of service ("COS"). The embedded COS study utilizes the 4-CP  
20 method previously adopted for purposes of jurisdictional allocations. The  
21 marginal COS study employs a "peaker" methodology developed by National  
22 Economic Research Associates ("NERA"), and sometimes referred to as the NERA  
23 method.

24 All parties, with exception of the Center for Law in the Public Interest  
25 ("Center"), supported the basic thrust of APS's COS studies, although they did  
26 criticize what they regarded as specific shortcomings in APS's analysis.  
27 Specifically, they noted that the data set used for COS purposes did not match  
28 that used for revenue requirements. Line losses were not shown by rate

1 schedule, and no voltage distinctions were incorporated into the PPFAC portion  
2 of rate design. APS likewise failed to show its rate of return by rate  
3 schedule under its proposed rates and did not separately allocate wheeling  
4 costs as is presently required by FERC. The 4-CP method was also inconsistent  
5 with APS's use of five (5) months for purposes of billing demand charges and  
6 the 80% (single month) demand ratchet. Finally, it was suggested by several  
7 expert witnesses that the 4-CP method should be reconsidered after PV-I has  
8 been placed into service because of its dramatic effect upon the configuration  
9 of system costs. Each of these criticisms seems, in large part, to be valid,  
10 and APS should attempt to incorporate as many of these changes as is possible  
11 in future studies. Although Staff's analysis shows that at the present time,  
12 use of another embedded cost methodology such as "average and excess" does not  
13 significantly affect the final result, this may no longer be true after PV-I  
14 comes on line. Consequently, we will require APS to provide COS analyses based  
15 on both 4-CP and "average and excess" methodologies.<sup>12</sup> (In the alternative,  
16 APS may substitute a 12-CP study for one based on "average and excess.")  
17 Criticisms aside, however, it is not clear to the Commission that APS's studies  
18 are so flawed as to negate their conclusion that the modified "across the  
19 board" rate spread represents continued progress toward COS based rates. While  
20 some parties have argued that APS has not moved far and fast enough in this  
21 regard, we are persuaded by Staff's and the Center's witnesses that some  
22 caution should be exercised in attempting to precisely mirror COS studies which  
23

---

24 12. While there would be some comfort in adopting the same methodology for  
25 both jurisdictional separations and COS as is presently used at FERC, we do not  
26 view this as an absolute necessity. APS's contention that it would under or  
27 over recover its total costs if differing methods are adopted assumes a  
28 symmetry between state and federal proceedings which simply does not exist.  
Moreover, the overwhelming majority of APS's business is under the Commission's  
jurisdiction. To adopt an allocation methodology which we find inappropriate  
merely because FERC has used it is clearly a case of the tail wagging the dog.

1 do not fully and perhaps properly reflect Palo Verde. In sum, we will adopt  
2 APS's proposal for a modified "across the board" spread of revenues.<sup>13</sup>

3 As to specific rate schedules, we are in agreement with those witnesses  
4 who advocated that Rate 32 be disaggregated into small, medium, and large  
5 categories. For small and medium customers, a seasonal demand and energy  
6 charge should replace the existing demand ratchet mechanism. The compromise  
7 version of Rate 32 contained in Exhibit No. 12-K should be adopted on an  
8 interim basis, adjusted, of course, for the lesser revenue increase and higher  
9 customer charge authorized herein. Furthermore, unmetered usage should be  
10 separated from the general service tariff and placed on a separate rate based  
11 upon connected kw load and reflecting, where appropriate, time of use  
12 considerations. Finally, we are convinced by the evidence presented that the  
13 basic residential customer (service) charge is, if anything, too high.  
14 Likewise, existing service charges for rate schedules 32 and 38 appear too  
15 low. Consequently, we will freeze the residential service charge for rate  
16 schedules E-10, EC-1, and E-12.<sup>14</sup> Any revenue increase attributable to those  
17 schedules should reflect a proportionate increase in all kwh charges. APS's  
18 remaining customer charges will be approved as proposed by the company with the  
19 additional revenue requirement spread to all other portions of these tariffs on  
20 an equal percentage basis.

21 We will also reject APS's vintage rate proposal. Dr. Wilson, testifying  
22 on behalf of RUCO, described this concept as tantamount to granting "squatter's  
23 rights" to certain customers. Since rates would be vintaged by service  
24

25 13. This "across the board" rate spread is, of course, after implementation of  
26 APS's specific Step I rate proposals for street lighting, connect and reconnect  
27 charges, dusk to dawn lighting, other miscellaneous charges, and contract rate  
28 increases.

14. At the current interim levels.

1 location, there is no assurance that even this massive increase in tariff  
2 complexity will produce any more equity by the precise matching of burdens with  
3 benefits.

4 MISCELLANEOUS

5 In Decision No. 53909, the Commission required that APS forego \$1.20 in  
6 AFUDC earnings for each \$1.00 in cash earnings granted by reason of that  
7 Decision. At that time, it was not specifically contemplated that such a  
8 "premium" would necessarily be demanded in the context of a permanent rate  
9 Application. However, APS itself has conceded that this 20% "premium" for cash  
10 earnings over AFUDC earnings is not unreasonable and serves as a powerful  
11 incentive to complete PV-I as quickly as possible. Were APS's net AFUDC  
12 accrual rate equal to the after tax cost of capital as determined herein, we  
13 could simply order APS to cease accruals of AFUDC on \$312,000,000 of PV-I CWIP  
14 in exchange for including \$260,000,000 of such CWIP in its "fair value" rate  
15 base. Unfortunately, the AFUDC rate, although in part determined by the  
16 Commission's cost of capital allowance, is seldom if ever exactly equal to  
17 APS's effective original cost return. In addition, the AFUDC rate can be  
18 changed over time.<sup>15</sup> We will therefore simply instruct APS to continue to  
19 credit PV-I AFUDC by \$1.20 for each \$1.00 in earnings derived from our  
20 inclusion of CWIP in "fair value" rate base. To insure that APS has  
21 appropriately calculated this amount, APS shall be required to file monthly  
22 reports with the Commission's Staff detailing how the aforementioned credit has  
23 been determined and applied.

24 On March 19, 1984, RUCO filed a series of Motions with the Commission,  
25

26 15. AFUDC accrual rates are generally determined by FERC using a more or less  
27 standardized formula. Although the Commission could specifically require that  
28 a different rate be used for ACC jurisdictional purposes, this has not been the  
Commission's policy.

1 two (2) of which remain outstanding at this time. The first is a request that  
2 APS pay Intervenors' and Staff's expenses through March 9, 1984, the date when  
3 APS withdrew Steps III, IV and V of their original rate Application. The  
4 second Motion seeks that the Commission authorize a construction audit of Palo  
5 Verde. To that end, RUCO has attached to its Motion a proposal for such an  
6 audit.

7 The Commission has long supported the idea of a construction audit which  
8 would conclusively determine how much of the Palo Verde project, including  
9 PV-I, should ultimately be permitted in APS's rate base and thereafter charged  
10 to its customers. Such an audit, by its very nature, can not be meaningfully  
11 undertaken until the project is substantially complete. Subsequent to the  
12 issuance of Decision No. 53761, the Commission contacted the regulatory  
13 commissions of California, Texas, and New Mexico. Each of these states  
14 regulates a member or members of the Palo Verde consortium. The purpose (among  
15 others) for these contacts was to formulate plans for a joint construction  
16 audit of Palo Verde. Various staff members for these respective bodies have  
17 been working for months on this subject. A decision to proceed with this audit  
18 was issued in San Francisco on September 21, 1984, and approved by the full  
19 Commission on September 26, 1984. We view this approach to be superior to the  
20 RUCO plan, but should this Commission and its sister regulatory agencies not be  
21 able to agree on a common audit plan, we will then consider unilateral action  
22 of the type suggested in RUCO's Motion. However, at the present time, RUCO's  
23 Motion will be denied.

24 The Commission has held on several previous occasions that a general  
25 reference in its Rules of Practice to the Arizona Rules of Civil Procedure does  
26 not serve to expand the substantive powers of the Commission. The power to  
27 award costs and attorneys' fees is an inherent judicial power which can only be  
28 conferred upon another branch of government (such as the Commission) by

1 specific legislative or constitutional enactment. Therefore, RUCO's Motion for  
2 costs and attorneys' fees will be denied.

3 \* \* \* \* \*

4 Having considered the entire record herein and being fully advised in the  
5 premises, the Commission finds, concludes and orders that:

6 FINDINGS OF FACT

7 1. APS is an Arizona corporation engaged in providing electric service  
8 to the general public within portions of Arizona pursuant to authority granted  
9 by this Commission.

10 2. On July 5, 1983, APS filed an Application with the Commission  
11 wherein it requested an increase in its rates and charges for electric service.

12 3. In accordance with A.C.R.R. R14-3-101, Rate Case Procedural Orders  
13 were issued by the Commission on July 19 and November 7, 1983, and January 20,  
14 1984.

15 4. Pursuant to said Rate Case Procedural Orders, as amended, Notice of  
16 the Application and the scheduled hearing date thereon was published in  
17 newspapers of general circulation throughout APS's service territory and was  
18 mailed to each of APS's customers by First Class U.S. Mail.

19 5. Subsequent to said Notice, public hearings on the Application were  
20 held in Phoenix, Arizona, on the dates indicated hereinabove.

21 6. On March 9, 1984, APS withdrew Steps III, IV and V of its original  
22 Application.

23 7. On April 26, 1984, the Commission dismissed Step II of the  
24 Application, but later reversed that Decision in Decision No. 54025.

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1           8.    Decision No. 54025 indicated that Step II (therein denominated as  
2 "Phase II") would be addressed in a separate hearing and order, with said  
3 hearing to begin on October 9, 1984.

4           9.    In Decision No. 54056, the Commission separately approved an  
5 increase in gas rates for APS, thus removing another portion of the original  
6 Application from any further consideration herein.

7           10.   APS's adjusted electric operating revenues, expenses and TY  
8 operating income are \$827,660,000; \$607,739,000; and, \$219,921,000,  
9 respectively.

10           11.   APS's OCB is \$1,961,666,000 for electric operations.

11           12.   APS's RCB is \$3,356,050,000 for electric operations.

12           13.   APS's "fair value" rate base is \$2,658,858,000 for electric  
13 operations.

14           14.   A reasonable rate of return on APS's "fair value" rate base is not  
15 less than 9.50%.

16           15.   Electric operating income of \$252,592,000 is necessary to produce a  
17 9.50% rate of return on that portion of APS's "fair value" rate base devoted to  
18 electric service.

19           16.   Electric operating revenues for the TY (prior to the interim  
20 increase authorized by Decision No. 53909) must be increased by \$68,273,000 to  
21 produce the required operating income, said increase to be inclusive of excise  
22 (sales) and other "add on" taxes.

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1 17. APS's proposed increase of \$122,115,000 would produce an excessive  
2 rate of return on the portion of APS's "fair value" rate base devoted to  
3 electric service.

4 18. The increase required for electric service pertains solely to  
5 non-fuel costs.

6 19. The modified "across the board" methodology proposed by APS will  
7 serve to move rates closer to COS.

8 20 APS's proposed increases for street lighting, dusk to dawn lighting,  
9 connect and reconnect charges, miscellaneous charges, and contract  
10 rates have not been specifically opposed by any party herein and follow general  
11 COS principles.

12 22. The changes in APS's proposed rates and charges set forth at pages  
13 21-25 of this Decision are likewise consistent with COS principles.

14 23. Cash earnings on CWIP are more valuable to APS at this time than  
15 would be a corresponding amount of FUDC earnings.

16 CONCLUSIONS OF LAW

17 1. APS is a public service corporation within the meaning of Article XV  
18 of the Arizona Constitution and A.R.S. Sections 40-250 and 40-251.

19 2. The Commission has jurisdiction over APS and of the subject matter  
20 of the Application.

21 3. Notice of APS's Application and proposed tariffs was given in the  
22 manner prescribed by law.

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1 4. APS should be authorized to file revised tariffs for electric  
2 service consistent with Findings of Fact Nos. 19-22, hereinabove, and our  
3 discussion of RATE DESIGN at pages 21-25 of this Decision.

4 5. APS should continue to offset its AFUDC earnings by its cash  
5 earnings on CWIP using a ratio of 1.2 to 1.0.

6 6. The two (2) outstanding Motions of RUCO filed on March 19, 1984,  
7 should be denied.

8 7. The interim rate increase authorized by Decision No. 53909 should be  
9 confirmed and any refund obligation of APS thereunder discharged.

10 ORDER

11 IT IS THEREFORE ORDERED that Arizona Public Service Company be, and the  
12 same is hereby authorized and directed to file a revised schedule of rates and  
13 charges for electric service in accordance with the discussion, Findings, and  
14 Conclusions of the Commission, hereinabove.

15 IT IS FURTHER ORDERED that said amended schedule of rates and charges  
16 shall be effective for all service rendered on and after the date of filing.

17 IT IS FURTHER ORDERED that Arizona Public Service Company shall notify  
18 each of its electric customers of the increased rates authorized herein by  
19 means of an insert in said customer's next regularly scheduled billing.

20 IT IS FURTHER ORDERED that Arizona Public Service Company shall credit its  
21 AFUDC accruals on PV-I by an amount equal to \$1.20 for each \$1.00 in cash  
22 earnings permitted herein on PV-I related CWIP expenditures.

23 IT IS FURTHER ORDERED that Arizona Public Service Company shall submit

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1 monthly reports to the Commission's Utilities Division Staff wherein the amount  
2 of the above credit is calculated and applied to the appropriate construction  
3 account, the first of said reports to be due no later than November 1, 1984.

4 IT IS FURTHER ORDERED that the Motions of the Residential Utility Consumer  
5 Office requesting costs and attorneys' fees, and seeking a construction audit  
6 of Palo Verde in the form attached thereto, shall be denied.

7 IT IS FURTHER ORDERED that the interim rates and charges authorized by  
8 Decision No. 53909 are hereby confirmed and any potential refund obligation of  
9 Arizona Public Service Company established therein is hereby discharged.

10 IT IS FURTHER ORDERED that this Decision shall be effective upon entry.

11 BY ORDER OF THE ARIZONA CORPORATION COMMISSION

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14 CHAIRMAN

*James Hyman*  
COMMISSIONER

*Marianne Jennings*  
COMMISSIONER

15 IN WITNESS WHEREOF, I, LORRIE DROBNY,  
16 Executive Secretary of the Arizona Corporation  
17 Commission, have hereunto set my hand and caused the  
18 official seal of this Commission to be affixed at the  
19 Capitol, in the City of Phoenix, this 11<sup>th</sup> day  
20 of October, 1984.

*Lorrie Droby*  
LORRIE DROBNY

Executive Secretary

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23 DISSENT

*Richard Kilb*  
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