ORIGINAL

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

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, TO FIX A JUST AND REASONABLE RATE OF RETURN TEHREON, TO APROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN, AND FOR APPROVAL OF PURCHASED POWER CONTRACT.

Docket No. E-01345A-03-0437

NOTICE OF FILING TESTIMONY SUMMARIES

Commission Staff hereby gives Notice of Filing Testimony Summaries of Ernest Johnson, Matt Rowell and Linda Jaress.

RESPECTFULLY SUBMITTED this 5th day of November, 2004.

Janet E. Wagner

Christopher C. Kempley, Chief Counsel
Janet Wagner, Attorney
Jason Gellman, Attorney
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007
(602) 542-3402

Original and 13 copies of the foregoing filed this 5th day of November, 2004, with:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ 85007

Copy of the foregoing sent by electronic mail this 5th day of November, 2004, to:

Thomas L. Mumaw
Karilee S. Ramaley
Pinnacle West Capital Corporation
P. O. Box 53999, MS 8695
Phoenix, AZ 85072-3999

Jeffrey B. Guldner
Kimberly Grouse
Snell & Wilmer
One Arizona Center
400 East Van Buren
Phoenix, AZ 85004-0001

Jana VanNess
Manager, Regulatory Compliance
Arizona Public Service
Mail Station 9905
P. O. Box 53999
Phoenix, AZ 85072

Jay L. Shapiro
Patrick J. Black
Fennemore Craig, P.C.
3003 N. Central, Suite 2600
Phoenix, AZ 85012
Attorneys for Panda Gila River

Raymond S. Heyman
Michael W. Patten
Roshka Heyman & DeWulf
One Arizona Center
400 E. Van Buren, Suite 800
Phoenix, AZ 85004
Attorneys for UniSource Energy Services

Deborah R. Scott
Unisource Energy Services
One South Church Street, Suite 200
Tucson, Arizona 85702

Lawrence V. Robertson, Jr.
Munger Chadwick, P.L.C.
National Bank Plaza
333 North Wilmot, Suite 300
Tucson, AZ 85711
Attorneys for Southwestern Power Group II, Bowie Power Station and Mesquite Power

Walter W. Meek, President
Arizona Utility Investors Association
2100 N. Central, Suite 210
Phoenix, AZ 85004

Scott S. Wakefield
Chief Counsel
RUCO
1110 W. Washington, Suite 220
Phoenix, AZ 85007

C. Webb Crockett
Fennemore Craig, P.C.
3003 N. Central, Suite 2600
Phoenix, AZ 85012
Attorneys for AECC and Phelps Dodge

Theodore E. Roberts
Sempra Energy Resources
101 Ash Street, HQ 12-B
San Diego, CA 92101-3017

Greg Patterson
Arizona Competitive Power Alliance
5432 East Avalon
Phoenix, AZ 85018

Major Allen G. Erickson
AFCES A/ULT
139 Barnes Drive, Suite 1
Tyndall AFB, Florida 32403-5319
Attorney for FEA

Michael L. Kurtz
Boehm, Kurtz & Lowry
36 E. Seventh Street, Suite 2110
Cincinnati, OH 45202
Attorneys for Kroger Company

Bill Murphy
Murphy Consulting
2422 E. Palo Verde Drive
Phoenix, AZ 85016
Consultant for Arizona Cogeneration Assn.

Robert W. Geake
Arizona Water Company
P. O. Box 29006
Phoenix, AZ 85038-9006

Michael A. Curtis
William P. Sullivan
Larry Udall
Martinez & Curtis, P.C.
2712 North Seventh Street
Phoenix, AZ 85006
Attorneys for Town of Wickenburg

Timothy M. Hogan
Arizona Center for Law in the Public Interest
202 E. McDowell Road, Suite 153
Phoenix, AZ 85004
Attorneys for Western Resource Advocates
and Southwest Energy Efficiency Project

S. David Childers
Low & Childers, P.C.
2999 North 44th Street, Suite 250
Phoenix, AZ 85018

Cynthia Zwick
Executive Director
Arizona Community Action Association
2627 North Third Street, Suite 2
Phoenix, AZ 85004

Coralette Hannon
AARP Department of State Affairs
6705 Reedy Creek Road
Charlotte, NC 28215

Rebecca C. Salisbury
56th Fighter Wing JA
7383 N. Litchfield Road
Luke AFB, AZ 85309-1540
Attorney for Federal Executive Agencies

Eric C. Guidry
Western Resource Advocates
2260 Baseline Road, Suite 200
Boulder, CO 80302

Jeff Schlegel
SWEEP Arizona Representative
1167 West Samalayuca Drive
Tucson, AZ 85704-3224

Jay I. Moyes
Moyes Storey, Ltd.
3003 N. Central Avenue, #1250
Phoenix, AZ 85012
Attorneys for PPL Sundance and PPL
Southwest Generation Holdings

Andrew W. Bettwy
Bridget A. Branigan
Southwest Gs Corporation
5241 Spring Mountain Road
Las Vegas, NV 89150

J. William Moore
Attorney at Law
1144 East Jefferson
Phoenix, AZ 85034

David Berry
Western Resource Advocates
P. O. Box 1064
Scottsdale, AZ 85252-1064

Daniel W. Douglass
Law Offices of Daniel W. Douglass, APC
6303 Owensmouth Avenue, 10th Floor
Woodland Hills, CA 91367-2262

James M. Van Nostrand
Stoel Rives, LLP
900 SW Fifth Avenue, Suite 2600
Portland, OR 97204

Jon Poston
AARP Electric Rate Project
6733 East Dale Lane
Cave Creek, AZ 85331

Katherine McDowell
Stoel Rives, LLP
900 SW Fifth Avenue, Suite 2600
Portland, OR 97204

George M. Galloway
Arizona Competitive Power Alliance
900 SW Fifth Avenue, Suite 2600
Portland, OR 97204

Nicholas J. Enoch
Lubin & Enoch, P.C.
349 North Fourth Avenue
Phoenix, AZ 85003
Attorneys for IBEW Locals 387, 640 and 769

Jesse A. Dillon
PPL Services Corporation
Two North Ninth Street
Allentown, PA 18101

Paul R. Michaud
Michaud Law Firm, P.L.C.
23 Crimson Heights Road
Portland, CT 06480
Dome Valley Energy Partners

Robert Annan
Annan Group
6605 E. Evening Glow Drive
Phoenix, AZ 85062

Marvin S. Cohen
Sacks Tierney, P.A.
4250 N. Drinkwater Blvd., 4th Floor
Scottsdale, AZ 85251-3693
Attorneys for Contellation NewEnergy, Inc.
And Strategic Energy, LLC

Sean Seitz
President
Arizona Solar Energy Industries Association
5056 South 40th Street, Suite C
Phoenix, AZ 85040

Nancy Roe

BEFORE THE ARIZONA CORPORATION COMMISSION

MARC SPITZER
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
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, TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN, AND FOR APPROVAL OF PURCHASED POWER CONTRACT	DOCKET NO. E-01345A-03-0437

SUMMARY OF

WITNESS TESTIMONY

OF

ERNEST G. JOHNSON

IN SUPPORT OF THE PROPOSED SETTLEMENT AGREEMENT

NOVEMBER 5, 2004

TESTIMONY SUMMARY

ARIZONA PUBLIC SERVICE COMPANY

DOCKET NO. E-01345A-03-0437

Mr. Johnson provides policy level testimony which summarizes the Settlement process, provides reasons which support Staff's conclusions that the Settlement Agreement is in the public interest and addresses several general policy considerations.

Staff's remaining witnesses will provide a detailed summary for each applicable subject area; by contrast, Mr. Johnson's testimony addresses the Settlement from a policy perspective. Mr. Johnson concludes that the Settlement Agreement is fair, balanced and in the public interest. Mr. Johnson asserts the following as support for Staff's conclusion that the Settlement Agreement is in the public interest:

- Staff believes that the agreement is fair to ratepayers because it precludes inappropriate utility profits and results in just and reasonable rates for consumers.

- Staff believes that it is fair to the utility because it provides revenues necessary for the utility to provide reliable electric service along with an opportunity for a reasonable profit.

- Staff believes that this proposal balances many diverse interests including those of low-income customers, the renewable energy sector, DSM advocates, merchant generators and retail energy marketers.

- Staff believes that the Agreement is in the public interest because it allows APS to rate base the PWEC Assets, which are the generating plants originally built by APS' affiliate, Pinnacle West Energy Corporation, at a value significantly below their book value.

- Although the Agreement calls for rate basing the PWEC Assets, it also addresses potentially anti-competitive effects associated with such rate basing. The Agreement adopts a self-build moratorium, provides for a competitive solicitation in 2005, and requires Staff to conduct workshops to address future resource planning and acquisition issues. In addition, the rate design section encourages general service customers, which are the customers most attractive to new competitors, to shop for competitive services by adopting cost-based unbundling for generation and revenue cycle services. These provisions are intended to promote competition.

- Staff believes that the Settlement eliminates long, complex litigation by resolving issues associated with prior Commission decisions that are currently on appeal (Track A and certain rate case issues). If the Agreement is approved, these appeals will be dropped.

- Staff believes that the Agreement promotes the public interest by facilitating the provision of reliable electric service at the lowest reasonable rates.

- The Agreement provides additional discounts to low-income APS customers, increases funding for advertising these discounts, and increases funding for APS' low-income weatherization program.

- The Agreement sets forth a comprehensive DSM proposal, which is intended to foster the development of new DSM programs. Significantly, the DSM section of the Agreement also includes provisions to ensure that DSM expenditures will be reasonable and that the Commission will be able to maintain appropriate oversight.

In its application, APS requested a rate increase of almost 10 percent. This increase was largely associated with the Company's desire to rate base the PWEC assets. Staff opposed rate base treatment of the PWEC assets thereby eliminating approximately 6 percent of the overall percentage increase.

We did that because, in our opinion, APS had failed to demonstrate that its request to rate base the PWEC units at a value of $889 million was warranted. We also stated that, if the Commission were inclined to rate base the PWEC assets that the amount allowed in rate base should be no more than the current value of the units, which we suggested was below their book value adjusted to reflect the value lost in foregoing the PWEC Track B contract. Under the Settlement Agreement, the PWEC assets would be rate based at a value of $700 million which is substantially less than the $889 million valuation as of the end of the test year.

Staff's decision to support rate basing the PWEC units is largely the result of the reduced valuation of the generation units, the ability to retain the benefits associated with the Track B Contracts, and enhancement of competitive wholesale and retail opportunities. Additionally, Staff considered the rebuttal arguments advanced by APS, particularly the testimony and analysis of Mr. Ajit Bhatti concerning:

- Resource additions for APS
- Higher efficiency and off-system sales associated with the combined-cycle units
- Resource Planning
- Market value of PWEC units

While much more persuasive than APS' original arguments, absent the benefits identified previously, Staff would oppose rate base treatment of the PWEC assets.

In concluding that the Settlement Agreement is in the public interest, Mr. Johnson notes that the Agreement addresses and resolves all of the main rate case issues, provides sufficient revenues and return for APS to maintain reliable electric service and results in rates and charges which Staff believes are just and reasonable.

BEFORE THE ARIZONA CORPORATION COMMISSION

MARC SPITZER
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
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, TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN, AND FOR APPROVAL OF PURCHASED POWER CONTRACT	DOCKET NO. E-01345A-03-0437

SUMMARY OF

WITNESS TESTIMONY

OF

LINDA A. JARESS

IN SUPPORT OF THE PROPOSED SETTLEMENT AGREEMENT

NOVEMBER 5, 2004

TESTIMONY SUMMARY

ARIZONA PUBLIC SERVICE COMPANY

DOCKET NO. E-01345A-03-0437

The proposed Settlement Agreement is in the public interest not only because it represents a consensus of the vast majority of the parties, but also because it provides long-term benefits to the customers of APS and the citizens of Arizona. The reduction in the value of the Pinnacle West Energy Corporation assets included in rate base is a permanent reduction that will benefit customers for many years, until the assets are fully depreciated. The proposed increase in Demand Side Management spending, if approved, will have long-term effects by reducing APS' need for new generation. The provision requiring APS to issue a special RFP for renewables in 2005 is a positive step toward providing long-term improvements to the natural environment in Arizona.

Among other reasons that the Settlement Agreement is in the public interest is the elimination of certain court cases and the end of the preliminary inquiry, allowing affected parties to shift their resources to more productive ends. Furthermore, if adopted, the Settlement Agreement will further define APS' role in electric competition in Arizona and creates opportunities for merchant plants to sell power to APS. Finally, the Settlement Agreement is in the public interest because it settles, once and for all, the issue of the $234 million write-off (and possibly more) and APS' request that ratepayers pay for its reversal.

APS' application requested an increase in revenues from its customers of $175.1 million including a proposed additional Competition Rules Compliance Charge ("CRCC") of $8.3 million. Staff's direct testimony recommended a net reduction of $142.7 million which included a $7.4 million CRCC surcharge. The direct testimony of the Residential Utility Consumer Office supported a decrease of $53.61 million. Arizonans for Choice and Competition recommended adjustments to APS' request that resulted in a revenue requirement increase of approximately $25.0 million. Ultimately, the parties agreed to a base rate increase of $67.6 million with an additional CRCC surcharge of $7.9 million, for a total increase of $75.5 million.

By supporting the Settlement Agreement and its benefits, Staff's movement from its recommended revenue requirement decrease in its direct case to the $75.5 million increase resulting from the Settlement Agreement is significant. The revenue requirement impact from ratebasing the Pinnacle West Energy Corporation assets at $700.0 million, by itself, increases Staff's recommended revenue requirement by approximately $76 million. The adoption by the Settlement Agreement of more current fuel and purchased power expenses increases the revenue requirement proposed by Staff by approximately $34 million. The negotiated capital structure and cost of debt and equity levels also had a significant effect, increasing the revenue requirement by approximately $35 million. Similarly, the resolution of depreciation issues and nuclear decommissioning expense issues results in an increase to

Staff's revenue requirement position of approximately $33 million. The main body of Ms. Jaress' testimony sets forth the rationale for Staff's adoption of these adjustments.

The listed amounts do not total the entire difference between the revenue requirement derived from the Settlement Agreement and the revenue requirement in Staff's direct testimony. It is important to remember that the revenue requirement reflected in the Settlement Agreement and adopted by Staff was derived as a result of consideration of specific revenue impacting adjustments <u>and</u> non-revenue impacting adjustments.

BEFORE THE ARIZONA CORPORATION COMMISSION

MARC SPITZER
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
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, TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN, AND FOR APPROVAL OF PURCHASED POWER CONTRACT	)	DOCKET NO. E-01345A-03-0437

SUMMARY OF

SEPTEMBER 27, 2004 STAFF REPORT

OF

MATTHEW ROWELL

IN SUPPORT OF THE PROPOSED SETTLEMENT AGREEMENT

NOVEMBER 5, 2004

STAFF REPORT SUMMARY

ARIZONA PUBLIC SEVICE COMPANY

DOCKET NO. E-01345A-03-0437

On August 18, 2004, a proposed Settlement Agreement of Arizona Public Service Company's ("APS") pending rate case was docketed. That agreement contained proposed resolutions of issues regarding the treatment of Pinnacle West Energy Corporation's ("PWEC") Arizona generation assets. The agreement also contains several provisions that are pertinent to competition in the wholesale and retail electric markets in Arizona.

The PWEC Assets

The parties to the Settlement Agreement agreed that APS should be allowed to acquire and rate base the following PWEC generating units: West Phoenix CC-4, West Phoenix CC-5, Saguaro CT-3, Redhawk CC-1, and Redhawk CC-2 (collectively, the "PWEC Assets"). In order to recognize the ratepayer benefits associated with the Track B contract, $148 million of the PWEC Assets' value will be disallowed, which results in an original cost rate base value of $700 million as of December 31, 2004.

The Settlement's resolution of issues regarding the treatment of PWEC's Arizona generation assets represents a departure from the primary position taken in Staff's direct case laid out in Mr. Harvey Salgo's February 3, 2004 testimony. However, the Settlement's treatment of the PWEC assets is largely consistent with Staff's alternative recommendation (also laid out in Mr. Salgo's February 3, 2004 testimony.) Specifically, Staff's direct case suggested the alternative of rate basing the PWEC assets at a reduced value.

Staff's direct case was driven by our belief that APS did not put forward a case that would justify inclusion of the assets at full book value. APS' direct case justified inclusion of the PWEC assets based mainly on, what Staff would characterize as, an equity argument, i.e. that Pinnacle West Capital was damaged by the Track A Order and thus rate basing the PWEC assets was justified. Staff did not believe that such an equity argument was sufficient to support the inclusion of assets that would have a revenue requirement effect of approximately $100 million.

Mr. Salgo's testimony pointed to several deficiencies in APS' direct testimony, the most important of which was that APS' proposal did not account at all for the value of the Track B contract between PWEC and APS. Mr. Salgo also indicated that APS had not established that the PWEC assets were the most efficient option available for reliably serving APS' customers' needs. In APS' rebuttal case, witness Ajit Bhatti presented several economic studies that support APS' contention that the PWEC assets were in fact an economical choice. For example, Mr. Bhatti's rebuttal testimony demonstrated that the choice to build combined cycle plants rather than combustion turbine plants (in spite of the combustion turbines' lower capital costs) was justified by the greater efficiency of combined cycle plants. Additionally, the responses to APS' last formal request for proposal did not indicate to Staff that the market would provide a superior alternative to the rate basing of the PWEC plants.

What primarily drove Staff's decision to agree to the terms of the settlement regarding the PWEC assets was the agreed upon rate base value of $700 million. This represents a discount of $148 million from the assets' end of 2004 depreciated value. The $148 million is a reasonable estimate of the value of the Track B contract and represents a long term benefit to APS' customers. The $148 million adjustment will have a downward impact on APS' revenue requirement in every rate case the company will file with the Commission in the foreseeable future. Staff believes that rate basing the PWEC assets, within the context of the other provisions of the Settlement agreement, is a good deal for APS' customers in the long term.

Resolving the PWEC assets issues ends a long standing dispute between APS and the Commission which allows both APS and the Commission to spend time and resources on more positive endeavors such as DSM, the promotion of renewable resources, and the development of competition (all of which the Settlement agreement also supports.)

The $234 million write off

The Settlement Agreement provides that APS will not recover (now or in any subsequent proceeding) the $234 million write-off attributable to Decision No. 61973, the Commission order that approved the 1999 APS Settlement Agreement. This is not a deviation from the position taken in Staff's direct case.

Competitive Procurement of Power

The Settlement Agreement includes provisions intended to enhance the wholesale market in Arizona while still protecting retail customers. APS agrees that it will not pursue any self-build option having an in-service date prior to January 1, 2015, unless expressly authorized by the Commission. This provision does not prevent APS from purchasing a generation plant from a merchant or a utility.

APS will issue an RFP or other competitive solicitation(s) no later than the end of 2005 seeking long-term future resources of not less than 1000 MW for 2007 and beyond.

The Commission Staff has agreed to schedule workshops on resource planning issues that focus on developing needed infrastructure and developing a flexible, timely, and fair competitive procurement process.

None of these provisions are inconsistent with Staff's positions put forth in its direct case. However, APS' commitment to these pro-competitive provisions did serve to mitigate Staff's concerns regarding the rate basing of the PWEC assets.