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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

Arizona Corporation Commission
DOCKETED
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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 STAFF REPORT SUMMARIES

Commission Staff hereby gives Notice of Filing Staff Report Summaries of Barbara Keene, Erin Andreasen and Robert Gray.

RESPECTFULLY SUBMITTED this 26th day of November, 2004.

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BEFORE THE ARIZONA CORPORATION COMMISSION

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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 RATEMAKING 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 ON

ADJUSTMENT MECHANISMS
CONTAINED IN THE PROPOSED SETTLEMENT AGREEMENT

BY

ROBERT GRAY AND BARBARA KEENE

NOVEMBER 26, 2004

The proposed settlement agreement in the Arizona Public Service (APS) rate proceeding contains provisions for implementing various adjustment mechanisms. These include the Power Supply Adjustor (PSA), the Demand Side Management (DSM) Adjustor, the Environmental Portfolio Standard (EPS) Adjustor, the Competitive Rules Compliance Charge (CRCC), the Returning Customer Direct Access Charge (RCDAC), and the Transmission Cost Adjustor (TCA). The DSM Adjustor and EPS Adjustor are discussed in the Staff Report and panel on Demand-side Management, Renewables, and Distributed Generation.

The structure and features of the adjustors are the result of settlement negotiations on a wide variety of issues in this case. Staff believes that the PSA, through a variety of provisions, reasonably balances the interests of ratepayers and APS while providing a measure of both certainty and flexibility in the future treatment of the PSA. As part of the overall settlement agreement, the adjustor mechanisms are in the public interest.

Power Supply Adjustor

The implementation of an adjustor mechanism such as the PSA entails a wide range of considerations which must be weighed carefully to ensure that such a mechanism is in the public interest. Adjustor mechanisms by their nature attempt to balance a variety of possible goals, such as certainty, flexibility, price stability, sending a price signal as prices change, and providing a reasonable opportunity to recover prudently incurred costs. The PSA contained in the proposed settlement agreement contains a variety of provisions which addresses both the interests of ratepayers and APS in a reasonable fashion. While no adjustor mechanism can fully protect ratepayers from the underlying volatility of energy markets, the proposed PSA helps shield ratepayers from price volatility through the provision of regular adjustments of the adjustor rate, the inclusion of a bandwidth limiting the amount of automatic adjustment in the adjustor rate, and the provision of the opportunity for cost recovery of the costs of hedging fuel and purchased power costs. Further, APS is motivated to minimize the cost of fuel and purchased power through a 90/10 sharing mechanism.

In Staff's direct case, Staff was concerned about potential over recovery of fixed costs due to load growth. Staff was willing to support an adjustor that would include fuel costs and a credit for revenues associated with sales for resale (off-system sales) in addition to purchased power costs, but Staff also believed that the PSA should include features to address the potential over recovery of fixed costs due to load growth. In APS' rebuttal case, APS states that, over the last five years, the Company's fixed costs have increased at about the same rate as sales growth over the same period. The PSA in the proposed agreement recognizes fuel costs and off-system sales as recommended in Staff's direct case.

Also in Staff's direct case, Staff felt that there was a need for an incentive, such as a deadband, for APS to hedge and otherwise keep down fuel and purchased power costs. APS, in its rebuttal case, proposed the 90/10 sharing mechanism that gives APS such an incentive to keep down costs. The proposed settlement agreement includes the 90/10 sharing mechanism, a form of a deadband, among the features of the PSA.

The five-year life of the PSA and related provisions protect the public interest by providing the opportunity to review the PSA mechanism in the future for possible modification or termination while also providing APS with a level of certainty regarding the method of cost recovery for its substantial fuel and purchased power costs. Such flexibility is important given the new nature of the proposed PSA and the uncertainty regarding what future conditions will be in the electricity industry.

The settlement contains strong safeguards which enable the Commission to review costs which APS would be passing through to its customers via the PSA. The settlement provides a commitment by APS to provide a wide variety of information related to the operation of the PSA on a monthly basis, which will assist the Commission and other interested parties in monitoring and assessing the operation of the PSA. Additionally, the settlement agreement specifically recognizes that the Commission can review the prudence of fuel and purchased power costs at any time. In summary, Staff believes the adjustor provisions contained in the proposed settlement agreement are in the public interest, as they reasonably balance the interests of ratepayers and APS and provide a variety of incentives to the Company to manage the PSA in a manner which is beneficial to its ratepayers while also providing the opportunity to address any problems which may arise in the future operations of the PSA.

Competitive Rules Compliance Charge

The settlement agreement includes the CRCC, which would enable APS to recover costs related to the transition to retail competition. APS would recover a maximum of $47.7 million plus interest through a charge of $0.000338 per kWh over a five-year collection period.

In Staff's direct case, Staff recommended that APS' proposed $49.3 million for the CRCC be reduced by removing ISO/RTO expenses, payroll-related expenses, and Track B expenses. In APS' rebuttal case, APS explained why the payroll-related expenses were necessary. APS also stated that Track B expenses should not be excluded from the CRCC because the Track B process was a Commission-ordered program related to the electric competition rules. The proposed settlement agreement continues to exclude the ISO/RTO expenses from the CRCC because APS should seek recovery of those costs through FERC-jurisdictional rates.

Returning Customer Direct Access Charge

The settlement agreement provides for an RCDAC which would apply only to large customers who return to standard offer service from direct access service and otherwise would impose costs on other standard offer customers. Staff's support for the RCDAC is consistent with Staff's direct case.

Transmission Cost Adjustor

The proposed TCA would apply only to costs related to changes in APS' open access transmission tariff or the tariff of an RTO or similar organization. The TCA would not go into effect until APS' transmission component of retail rates exceeds the test year base of $0.000476 per kWh by five percent. Staff supported a TCA in its direct case.

BEFORE THE ARIZONA CORPORATION COMMISSION

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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 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 ON

DEMAND-SIDE MANAGEMENT, RENEWABLES, AND DISTRIBUTED GENERATION ISSUES CONTAINED IN THE PROPOSED SETTLEMENT AGREEMENT

BY

BARBARA KEENE

NOVEMBER 26, 2004

The proposed settlement agreement contains provisions regarding demand-side management (DSM), renewables, and distributed generation. These provisions are the result of settlement negotiations on a wide variety of issues in this case. As part of the overall settlement agreement, these provisions are in the public interest.

The settlement agreement is in the public interest because of the following:

- The agreement provides for APS to implement considerably more DSM than is being done today, resulting in customer savings, utility cost reductions, and reduced impact on the environment.

- The agreement provides safeguards to ensure that the level of DSM expenditures will be reasonable, including Commission approval of programs, unspent amounts in base rates being returned to customers, and APS filing semi-annual reports on its DSM programs.

- The agreement provides for expenditures for low income weatherization and bill assistance to more than double over test-year expenditures.

- The agreement provides for the establishment of a collaborative DSM working group to provide APS with input on program development, implementation, and performance.

- The agreement changes the Environmental Portfolio Standard (EPS) surcharge into an adjustment mechanism to allow for flexibility in funding the EPS if the Commission were to approve a funding change.

- The agreement provides for APS to issue an RFP in 2005 seeking renewable resources that should help provide further diversity to APS' generation portfolio.

Demand-side Management

The settlement agreement provides for APS to spend $10 million each year through base rates for DSM, plus another $6 million per year through an adjustment mechanism. In Staff's direct case, Staff had wanted APS to do more DSM but had recommended a lower level of funding: a cap of $4 million per year to be collected through an adjustment mechanism. Staff had been most concerned about APS being able to ramp up to a higher level of spending in a short time. However, the settlement agreement provides that if APS does not spend the total $30 million in base rates from 2005 through 2007, the unspent amount would be returned to ratepayers through the DSM adjustor in 2008.

Environmental Portfolio Standard

In regard to the Environmental Portfolio Standard, APS would continue to recover $6 million annually in base rates as recommended by Staff in its direct case. The existing EPS surcharge, which provided $6.5 million during the test year, would be converted into an adjustment mechanism to allow for Commission-approved changes to APS' EPS funding. Although Staff had not contemplated in its direct case that the surcharge become an adjustor, Staff agrees with others that there is value in the flexibility of an adjustor because it would allow for Commission-approved changes in the amount of EPS revenue collected.

Special RFP

APS would issue a special RFP in 2005 for at least 100 MW and 250,000 MWh per year of renewable energy resources for delivery beginning in 2006. Either in this solicitation or in subsequent procurements, APS would seek to acquire at least 10 percent of its annual incremental peak capacity needs from renewable resources. Although Staff had not contemplated such an RFP in its direct case, Staff sees the value of the RFP in helping to provide APS with more diversification in its supply portfolio.

Distributed Generation

The settlement agreement provides for Staff to schedule workshops to consider outstanding issues concerning distributed generation. The workshops may be followed by rulemaking. Although Staff had not addressed the subject of distributed generation in its direct case, Staff understands that distributed generation can provide value and that these issues should be addressed.

BEFORE THE ARIZONA CORPORATION COMMISSION

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SUMMARY OF

SEPTEMBER 27, 2004 STAFF REPORT ON

RATE DESIGN, LOW INCOME PROGRAMS, AND SERVICE SCHEDULES CONTAINED IN THE PROPOSED SETTLEMENT AGREEMENT

BY

ERINN ANDREASEN
AND
BARBARA KEENE

November 26, 2004

The proposed settlement agreement addresses certain rate design, service schedule and low income provisions. Staff believes that the provisions regarding rate design and service charges are in the public interest.

Revenue Allocations

Staff has supported a revenue allocation that reflects cost of service considerations. This cost of service consideration was reflected in both Staff's recommended revenue allocations in its direct case and in its settlement position. Under the proposed settlement, the system average increase to base rates would be 3.77 percent. Residential rates would be increased by 3.94 percent and general service rates would be increased by 3.56 percent.

Residential Rates

In its direct case, Staff supported APS' request to phase out frozen rates E-10 and EC-1 with certain conditions, including a one-year phase out period and providing notice to customers. Under the proposed settlement agreement, Schedule E-10 and EC-1 would remain frozen and be retained with the intent to eliminate these rates in APS' next rate case proceeding. APS would provide a Staff-approved notice to customers on E-10 and EC-1.

In its rate application, APS proposed to increase basic service charges on certain residential rate schedules. In its direct case, Staff recommended that basic service charges should reflect cost but that no residential basic service charges should be increased by more than 5 percent. In the proposed settlement, the basic service charges are maintained for residential service schedules with the exception of E-12 which has been increased by 2.61 percent.

In its rate application, APS proposed to eliminate its winter peak differentiated pricing for its residential time-of-use rates. In its direct case, Staff supported maintaining on- and off-peak price signals during the winter period. In addition, Staff supported adopting time-of-use periods that reflect the actual time of system peak. Under the proposed settlement, APS would maintain its current on- and off-peak rates for the winter billing period and submit a study to Staff regarding flexibility in implementing on-and off-peak periods.

Under the proposed settlement, APS' proposed residential experimental time-of-use periods are adopted. The experimental periods would provide a limited number of customers with the option of selecting alternative on-peak time periods. In its direct case, Staff supported the adoption of APS' proposed experimental time-of-use periods.

General Service and Classified Rates

Under the proposed settlement, rate E-32 has been redesigned in an effort to simplify the rate. When designing the rate, consideration was given to smoothing out the rate impacts across customers of varying sizes. Changes include the addition of an energy block for customers with loads under 20 kW and the addition of a demand billing block for customers with loads greater than 100 kW. In its direct case, Staff supported the simplification of rate E-32.

Under the proposed settlement agreement, a new rate schedule, E-32 TOU, would be adopted to provide general service customers with an additional time-of-use rate. This rate would include on- and off-peak pricing signals. In its direct case, Staff supported the adoption of E-32 TOU with the adoption of on- and off-peak winter rates.

Under the proposed settlement, frozen rates E-38 and E-38T would not be eliminated in this proceeding as APS proposed in its initial application. These rate schedules would be retained with the intent to eliminate these rates in APS' next rate case proceeding. A Staff-approved notice would be provided to customers.

Under the proposed settlement agreement, the changes to the rate structure for lighting tariffs E-47 and E-58 proposed in APS' application would be adopted.

Under the proposed settlement, the existing 11:00 a.m. to 9:00 p.m. on-peak time periods would remain in effect for general service time-of-use customers, and the summer rate period would begin in May and conclude in October.

In its rate application, APS proposed to eliminate experimental time-of-use rates E-21, E-22, E-23, and E-24. Under the proposed settlement, experimental time-of-use schedules E-22, E-23, and E-24, would be frozen. Experimental time-of-use schedule E-21, which had previously been frozen, and E-22, E-23, and E-24 would be retained with the intent to eliminate these rates in APS' next rate case proceeding. APS would provide a Staff-approved notice to customers on these schedules.

APS' current time-of-use rate schedule, E-20, would be frozen.

Under the proposed settlement, transmission and primary voltage discounts are provided for certain general service rates which include military base customers that are served directly from APS substations.

Low Income Programs

The discount levels were increased for both the E-3 and E-4 tariffs. In addition, APS would increase its annual funding for marketing its E-3 and E-4 tariffs to $150,000.

Service Schedules

Under the proposed settlement, Schedules 1, 3, 4, 7, 10, and 15 would be modified. These changes are consistent with Staff's position in its direct case.