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Arizona Corporation Commission  
**DOCKETED**

MAR 28 2005

March 28, 2005

DOCKETED BY	<i>JV</i>
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Docket Control  
Arizona Corporation Commission  
1200 West Washington  
Phoenix, AZ 85007

RE: ARIZONA PUBLIC SERVICE COMPANY  
DOCKET NO. E-01345A-03-0437

To Whom It May Concern:

Attached please find Arizona Public Service Company's Talking Points on possible Commissioner Amendments to the Recommended Order affecting PSA in the above matter.

If you or your staff have any questions, please feel free to call me.

Sincerely,

Jana Van Ness  
Manager  
Regulatory Affairs

JVN/vld

Cc: Parties of Record

AZ CORP COMMISSION  
DOCUMENT CONTROL

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*APS Talking Points on*

*Possible Commissioner Amendments to Recommended Order Affecting PSA*

1. **General**

- The PSA in this case was based on the model purchased gas adjustor developed by the gas utilities subject to ACC jurisdiction along with Staff
- More restrictive than any other rate adjustment mechanism in use in Arizona
- More consumer safeguards than any other rate adjustment mechanism in use in Arizona
- Under the settlement PSA, Commission has to approve any change to the adjustor
- Utilities without effective PSA mechanisms are clearly considered riskier by capital markets and some (e.g., CA and NV) have suffered severe financial harm in relatively short periods of time

2. **Cost Sharing Percentage**

- In near term, Commissioner amendments provide no additional incentive, but just disallow prudently-incurred costs to serve APS customers
- Recovery of actual out-of-pocket fuel and purchased power expenses paid to third parties provides no profit, nor does it compensate APS for any risk of disallowance.
- The permanent loss of 2005 fuel/purchased power costs could be between over \$30 million (at 75/25) to over \$60 million (50/50) – impact in 2006 could be even greater.
- Entire base revenue increase called for in the Settlement after allowing for the mandatory increase in DSM spending included within that base revenue increase is just \$58.5 (\$75.5 million less CRCC less \$9 million increase in DSM in base rates), of which less than \$50 million will actually be recovered in 2005.
- Projected 2005 financial results and impact under amendments threaten fundamental APS creditworthiness.
- Loss of investment grade will cost APS consumers an additional \$1 BILLION in higher interest costs over the next ten years – also additional operating costs.
- Amendments will also adversely affect the competitive wholesale market.
- Around the country, the great majority of rate adjustment mechanisms similar to that of the PSA, including others in use in Arizona, provide for 100% cost recovery, and none have percentages of total unrecoverable costs remotely close to 50%.

2. **The Cumulative Four Mil Cap on PSA Cost Recovery (No deferral or limited deferral)**

- Without the ability to record as deferrals (i.e., in the bank balance) under-recoveries of prudent fuel and purchased power costs above a cumulative four mil cap, APS write-offs of such costs would be very substantial.

- 1 • Even if APS filed a new general rate case as quickly as possible following entry of a  
2 decision on this Settlement and that new rate case was concluded within the time  
3 permitted by Commission rule, APS could not avoid significant 2005 and 2006 under-  
4 recoveries of prudent and reasonable costs.
- 5 • Little if any hope of avoiding a significant decline in the Company's credit standing.
- 6 • Artificially capping rates for fuel and purchased power is contrary to some of the  
7 fundamental goals of the PSA: (1) providing timely recovery of significant and often  
8 volatile and unpredictable cost increases largely beyond the Company's control; (2)  
9 providing some measure of earnings stability for APS; and (3) improved price signals  
10 to APS customers as to the real cost of consuming additional electricity.
- 11 • Permitting full cost deferral (subject to 90/10 sharing) of prudent and reasonable  
12 power supply costs above a cumulative 4 mil cap until termination of PSA or next  
13 APS rate case (which would be very analogous to what the ACC did in the UniSource  
14 and Southwest Gas proceedings) would avoid the problem of 2005-2006 write-offs,  
15 thus achieving at least the second of the above three goals for a PSA.
- 16 • Whether average fuel/purchased power costs increase in future due to price increases  
17 or due to load growth (because marginal energy usage is more expensive than  
18 historical average) is irrelevant to the purposes of a PSA since both phenomena cause  
19 higher average costs, earnings erosion, and should signal customers that incremental  
20 energy use is more expensive than historical usage.
- 21 • Significantly diluting the price signal impact of the PSA discourages the very sort of  
22 energy conservation that is elsewhere a key objective of the Settlement and which  
23 many believe would itself exert downward pressure on the gas and power costs that  
24 drive the need to increase the PSA beyond 4 mils in the first instance.
- 25 • These proposals have no record support or precedent in Arizona or elsewhere.
- 26 • Commission has already addressed and dismissed "incentive" concerns as to PSA in  
27 Decision No. 66567, and PSA in the Settlement contains more incentives for proper  
28 performance by APS and more consumer safeguards than any adjustment mechanism  
heretofore approved by this Commission.
- Settlement was a careful balance for both APS and its customers between current base  
rate increases and exposure to future PSA charges, with both agreeing to a smaller  
figure today in exchange for a potentially higher number in the future.