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December 29, 2005

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RE: Docket Nos. E-01345A-03-0437, E-01345A-05-0526 and E-01345A-05-0816

Dear Colleagues:

During the October hearing on APS' Power Supply Adjustor (PSA) Plan of Administration and surcharge application, I introduced a table (Gleason-2) showing the operation of the PSA, from April 2006 through April 2011, using the accounting method Bob Gray presented in his March 9, 2005 memorandum to Ernest Johnson. Recently, I have determined that there is a computational error in Gleason-2. To rectify this matter, I have prepared the attached revision (Table 1), which accurately shows how the PSA operates given key parameters established in Decision No. 67744. Among others, these factors include:

- 1) A base cost of fuel and purchased power (F&PP) set at \$.020743/kWh,
- 2) A bandwidth limiting change in the PSA rate to \pm \$.004/kWh over the life of the PSA, and
- 3) A cap on recoverable annual net F&PP costs set at \$776.2 million.

A quick glance at the revised table shows, from 2007 on, balancing account balances well in excess of the \$50 million surcharge threshold (Line Q) and net F&PP costs hitting the \$776.2 million cap (Line F). This suggests that the current PSA parameters may prove ineffective for allowing timely recovery of under-collected F&PP costs. Accordingly, it is instructive to consider hypothetical adjustments to the key factors identified above as they may affect the frequency and manner with which money is refunded to APS through the PSA.

Base Cost of F&PP – Theoretically, the base cost of F&PP could be changed, but this would not be advantageous because a low base cost would be unfair to ratepayers, while a high base cost would not reimburse APS for its F&PP costs. Thus, the base cost must coincide with the base rate determined in the pertinent rate case.

Bandwidth – Before the amendment that changed the bandwidth to apply over the term of PSA (rather than year-to-year as provided in the Settlement Agreement) was adopted

at the March Open Meeting, neither Staff nor APS discussed the effect of this change. To examine this question, I have attached yet another version of the table in which the bandwidth may vary annually by more than the current \$.004/kWh limit (Table 2). Like previous versions, this table is not an attempt to predict future costs or load, but instead, is a vehicle to explore "what if" examples using the Excel environment. The data shown are not the numbers supplied by APS; they are assumed or "guesstimated" from various sources.

Changing the bandwidth each year in April to collect/refund F&PP costs avoids the problem of surcharges. If an error is made in one year, it could be corrected the next April. This would give the Commission an opportunity to review the F&PP costs each April and make corrections to the bandwidth as warranted. Multiple surcharge decisions would be avoided as any adjustments would be more or less routine so the ratepayer would not be shocked by the rate change.

The main advantage of changing the bandwidth is that it would allow APS to collect funds advanced for F&PP costs on a monthly basis, just as the money for the base rate costs is collected, without successive surcharge requests. The change in the amount of cost from year-to-year would have an effect on the appropriate recovery of funds. If F&PP costs increase, the advantage would be to the ratepayer. If F&PP costs decrease, the advantage would be to APS. If there were no change in F&PP costs, no advantage would result.

F&PP Cap – Lastly, the current annual \$776 million cap on recoverable F&PP costs needs to be reconsidered. When the \$776 million cap was adopted, the F&PP projections supported this number as an incentive for APS to file a rate case. Now that newer, and we hope, more accurate data are available, this number should be re-evaluated.

Sincerely,



Mike Gleason
Commissioner

c: Parties to Docket Nos:
E-01345A-03-0437 and E-01345A-05-0526
E-01345A-05-0816

Table I. Gleason-2 Revised

0.020743 base cost

	with cap	April 2006 reset 2005 gas cost	April 2007 reset 2006 gas cost	April 2008 reset 2007 gas cost	April 2009 reset 2008 gas cost	April 2010 reset 2009 gas cost	April 2011 reset 2010 gas cost
E) Annual Native Load Sales (MWH)		21,096,756	27,902,637	28,990,840	30,121,483	31,296,220	32,516,773
F) Annual Net Fuel and PP Costs		\$617,850,000	\$776,200,000	\$776,200,000	\$776,200,000	\$776,200,000	\$776,200,000
G) Annual Costs Recovered Thru Base Cost		\$437,610,010	\$578,784,399	\$601,356,994	\$624,809,922	\$649,177,491	\$674,495,422
H) Over/Undercollection (neg. is overcollected)		\$180,239,990	\$197,415,601	\$174,843,006	\$151,390,078	\$127,022,509	\$101,704,578
I) Balance After 90/10 Application		\$162,215,991	\$177,674,041	\$157,358,705	\$136,251,070	\$114,320,258	\$91,534,120
J) Previous Year's Balance Carryover		\$0	\$111,610,548	\$115,963,360	\$120,485,932	\$125,184,880	\$118,778,749
K) Previous Year's Collection from PSA Rate		\$0	-\$111,610,548	-\$115,963,360	-\$120,485,932	-\$125,184,880	-\$118,778,749
L) Remaining Balance		\$162,215,991	\$177,674,041	\$157,358,705	\$136,251,070	\$114,320,258	\$91,534,120
M) Amnt Expcted to Collect Through PSA Rate		\$111,610,548	\$115,963,360	\$120,485,932	\$125,184,880	\$118,778,749	\$97,026,166
N) Bal. per kwh of Native Load Sales		\$0.00769	\$0.00637	\$0.00543	\$0.00452	\$0.00365	\$0.00281
O) Bal. per kwh Captured Within \$0.004 band		\$0.00400	\$0.00400	\$0.00400	\$0.00400	\$0.00365	\$0.00281
P) Bal. per kwh Rmng Outside \$0.004 band		\$0.00369	\$0.00237	\$0.00143	\$0.00052	\$0.00000	\$0.00000
Q) Balancing Account Balance		\$77,828,967	\$143,892,460	\$185,287,805	\$201,052,944	\$201,052,944	\$201,052,944
R) Amount Bal. Account Exceeds \$50 million		\$27,828,967	\$93,892,460	\$135,287,805	\$151,052,944	\$151,052,944	\$151,052,944

Table 2. Gleason Variable Bandwidth Example

0.020743 base cost

	April 2006 reset <u>2005 gas cost</u>	April 2007 reset <u>2006 gas cost</u>	April 2008 reset <u>2007 gas cost</u>	April 2009 reset <u>2008 gas cost</u>	April 2010 reset <u>2009 gas cost</u>	April 2011 reset <u>2010 gas cost</u>
E) Annual Native Load Sales (MWH)	21,096,796	27,902,637	28,990,840	30,121,483	31,296,220	32,516,773
F) Annual Net Fuel and PP Costs	\$617,850,000	\$848,960,000	\$899,897,600	\$953,891,456	\$1,011,124,943	\$1,071,792,440
G) Annual Costs Recovered Thru Base Cost	\$437,610,839	\$578,784,399	\$601,356,991	\$624,809,914	\$649,177,500	\$674,495,423
H) Over/Undercollection (neg. is overcollected)	\$180,239,161	\$270,175,601	\$298,540,609	\$329,081,542	\$361,947,443	\$397,297,017
I) Balance After 90/10 Application	\$162,215,245	\$243,158,041	\$268,686,548	\$296,173,388	\$325,752,699	\$357,567,316
J) Previous Year's Balance Carryover	\$0	\$162,215,245	\$243,244,408	\$259,130,833	\$286,018,167	\$325,616,781
K) Previous Year's Collection from PSA Rate	\$0	-\$162,128,877	-\$252,800,123	-\$269,286,054	-\$286,154,085	-\$327,769,072
L) Remaining Balance	\$162,215,245	\$243,244,408	\$259,130,833	\$286,018,167	\$325,616,781	\$355,415,024
M) Amnt Expcted to Collect Through PSA Rate	\$162,128,877	\$252,800,123	\$269,286,054	\$286,154,085	\$327,769,072	\$366,047,813
N) Bal. per kwh of Native Load Sales	\$0.00769	\$0.00872	\$0.00894	\$0.00950	\$0.01040	\$0.01093
O) Bal. per kwh Captured Within band	\$0.00769	\$0.00872	\$0.00894	\$0.00950	\$0.01008	\$0.01062
P) Bal. per kwh Rmng Outside band	\$0.00000	\$0.00000	\$0.00000	\$0.00000	\$0.00032	\$0.00031
Q) Balancing Account Balance	\$86,367	-\$9,469,348	-\$19,710,937	-\$10,291,140	-\$2,288,209	-\$12,785,080
R) Amount Bal. Account Exceeds \$50 million	\$0	\$0	\$0	\$0	\$0	\$0
S) Balancing Account Excess in current Year	\$86,367	-\$9,555,716	-\$10,155,222	-\$135,918	-\$2,152,291	-\$10,632,789