EXCEPTION

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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
IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR APPROVAL OF A POWER SUPPLY ADJUSTOR SURCHARGE.	Docket No. E-01345A-05-0526

RUCO'S EXCEPTIONS

The Recommended Opinion and Order ("ROO") concludes that the Arizona Corporation Commission ("Commission") intended to create two separate balancing accounts when it adopted the power supply adjustor ("PSA")—one to "comprehensively track the ongoing inputs and outputs used to calculate the PSA 'bank balance'," and another to separately "record the 'carryover' amounts resulting from the application of the [4 mil] bandwidths."[1] However, regardless of the Commission's intention when it adopted the PSA in April 2005, subsequent

[1] ROO at 9, quoting Staff's Closing brief pg. 7.

events and new information regarding the importance of the timing of recovery of the rapidly growing PSA balance warrant the approval of the $80 million surcharge at this time.

Subsequent events

Since the Commission's approval of the PSA last March, a number of events have occurred which exacerbate the consequences of delaying the beginning of the recovery of APS's PSA balance. These include continuing increases in fuel costs, a confusing signal over whether the Commission will expeditiously process APS's rate case, a downgrade of APS's debt rating to one notch above junk bond, and an indication that further downgrade to junk status is likely if the undercollected balance is not addressed at least in part soon. Taken together, these events warrant approval of the surcharge at this time rather than a few months from now, to avert the costly consequences of an imminent downgrade of APS's debt rating.

The only fuel and purchased power costs currently being collected from APS customers is the base cost, which was set based on 2003 actual costs. These costs have increased dramatically since 2003.[2] As a result, as of August 31, 2005, APS had deferred for future collection from customers $115.2 million (post-90/10 sharing).[3] That amount had increased to $150 million as of the end of October 2005.[4] Because of these increased fuel and purchased power costs, it is unlikely that the PSA's undercollected balance will fall below $100 million, even with approval of a surcharge to collect $80 million over 2 years.[5]

On November 4, APS filed a new rate case application seeking an increase of $405 million, based on a test year ending December 31, 2004. On the date that the Commission

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[2] Gehlen Direct at 10-11 (Exh. S-2) (58% increase in natural gas prices and 45% increase in purchased power prices during the period 2003 through third quarter 2005).
[3] Gehlen Direct at 8 (Exh. S-2).
[4] Tr. at 341 (Wheeler).
[5] Gehlen direct at 8 (Exh. S-2).

Staff was due to make a filing indicating whether APS's filing met the Commission's sufficiency requirement, Staff filed a letter that neither indicated the filing was sufficient nor insufficient, but stated that the Company had agreed to file updated financial information through September 30, 2004. To clear up confusion of whether the timeclock to process the application should begin or not, the Chief Administrative Law Judge convened a procedural conference on December 22, 2005.

On December 21, 2005, Standard & Poor's ("S&P") downgraded APS's debt rating to one level above junk, but indicated that its outlook was stable due to its expectation that the Commission would "resolve at least a portion of APS's increasing deferred power costs in January 2006" and that progress would be made in addressing the Company's recent rate case filing. S&P stated that "any adverse regulatory development" could result in a downward revision of the outlook or an adverse rating action.[6]

APS asserted in its recent application for emergency rate relief that a downgrade of its debt rating would cost an additional $10 to $15 million in interest expense each year initially, and those annual increased costs could grow wildly in future years.[7]

Acting Now Avoids Serious Dangers

Because the PSA specifically allows prudently incurred deferred fuel and purchased power costs to be passed on to customers, the resolution of this matter will only have an impact on the timing of recovery and not on whether costs are recoverable. Initially, the only apparent impact of those timing differences was additional interest that would accrue during the period of non-recovery. However, the above-cited events reveal additional impacts from

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[6] Application for Emergency Interim Rate Increase, Docket No. E-01345A-06-0009, at 4.

[7] Exhibit A to Application (Affidavit of Donald E. Brandt at para. 20) filed January 6, 2006 in Docket No. E-01345A-06-0009.

deferring recovery that could have significant negative consequences to both the Company and its customers. In its emergency rate application, APS suggests that a downgrade to junk status could cost customers hundreds of millions of dollars and could threaten APS's ability to provide service in its rapidly growing service territory. Rather than face these possibilities, the Commission should authorize the surcharge now. The few month delay in a surcharge until April 1, 2006 is not worth the risk of the consequences of an additional downgrade to junk status.

Granting the surcharge now presents other advantages to customers. First, it sends a more accurate price signal to customers that the cost of energy has increased and continues to increase. Currently, the price signal consumers are receiving is based on 2003 costs. Implementing the surcharge signals to customers to begin to modify their electric usage accordingly prior to the beginning of the high-usage summer months. Further, initiating the surcharge minimizes the accrued interest that customers will ultimately pay on the unrecovered PSA balance. As with any costs that flow through the PSA, prudence can be reviewed in subsequent proceedings, and any necessary true-ups can be handled through the PSA's normal operation. The remaining aspects of APS's larger requests for emergency ($299 million) and permanent (preliminarily, $405 million) rate increases can be evaluated in their respective proceedings.

The ROO exposes what may have been a miscommunication between the parties to APS's rate settlement agreement and the Commission. However, the Commission should not lose sight of what is in the best interest of the public at this time, based on what is known today. Rather than fixating on what expectations were nine months ago, the Commission can act now in consumers' long run interests, and minimize the risks of dire consequences due to putting off the unfortunate reality of increasing energy costs.

RUCO has attached as Exhibit A a proposed amendment to alter the outcome of the ROO to approve the surcharge at this time.

RESPECTFULLY SUBMITTED this 13th day of January, 2006.

Scott S. Wakefield
Chief Counsel

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EXHIBIT A

RUCO's PROPOSED AMENDMENT

Page 14, lines 15-28 DELETE PARAGRAPH

Page 15, lines 1-7 DELETE PARAGRAPH

Page 15, line 24 INSERT NEW PARAGRAPH as follows:

However, as discussed below in our evaluation of the surcharge application, we believe that new circumstances merit the granting of the surcharge regardless of our intention in April 2005.

Page 15, line 24 to Page 16, line 20 DELETE

Page 19, line 15 to Page 20, line 9 DELETE and REPLACE with:

As discussed above, our determination based solely on expectations at the time we adopted Decision No. 67744 may have concluded that the surcharge application is premature and should be denied because it precedes the implementation of the first annual adjustment of the PSA. However, we find that events subsequent to our adoption of Decision No. 67744 compel us to implement the surcharge at this time in order to avoid dire consequences of waiting until the annual adjustor in April 2006. The continued escalation of fuel and purchased power costs and the size of the resulting unrecovered PSA balance has resulted in a downgrade of APS's debt rating to one level above junk. Our creation of the PSA essentially concluded that it was appropriate to pass through to customers the costs of fuel and purchased power, subject to the 90/10 sharing mechanism. Continued delay in beginning recovery of the PSA balance is likely to result in unnecessarily higher costs to finance ongoing capital expenditures to meet the demands of APS's growing service territory.[1] Therefore we will adopt a surcharge of $0.001416 per kWh for 24 months, or until it collects $80 million, whichever occurs first.

Further amendments to conform

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[1] We take administrative notice of APS's Application for Emergency Interim Rate Increase, Docket No. E-01345A-06-0009, filed January 6, 2006, which indicates that further downgrading of APS's debt would increase interest expense $10 million to $15 million annually.