

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

OPEN MEETING ITEM  
**ORIGINAL**



0000047953

**ARIZONA CORPORATION COMMISSION**

DATE: April 19, 2006  
DOCKET NO: E-01345A-06-0009  
TO ALL PARTIES:

Enclosed please find the recommendation of Chief Administrative Law Judge Lyn Farmer. The recommendation has been filed in the form of an Opinion and Order on:

ARIZONA PUBLIC SERVICE CO.  
(EMERGENCY RATES)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by **4:00 p.m.** on or before:

APRIL 24, 2006

**10-day period for filing of exceptions has been waived.**

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Open Meeting to be held on:

MAY 2, 2006

For more information, you may contact Docket Control at (602)542-3477 or the Hearing Division at (602)542-4250. For more information about the Open Meeting, contact the Executive Director's Office at (602) 542-3931.

BRIAN C. McNEIL  
EXECUTIVE DIRECTOR

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**BEFORE THE ARIZONA CORPORATION COMMISSION**

COMMISSIONERS

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

IN THE MATTER OF THE APPLICATION OF  
ARIZONA PUBLIC SERVICE COMPANY FOR  
AN EMERGENCY INTERIM RATE INCREASE  
AND FOR AN INTERIM AMENDMENT TO  
DECISION NO. 67744.

DOCKET NO. E-01345A-06-0009

DECISION NO. \_\_\_\_\_

OPINION AND ORDER

DATES OF HEARING: March 20, 21, 22, 23, 24, 27, 28, 29, 2006

PLACE OF HEARING: Phoenix, Arizona

IN ATTENDANCE: Jeff Hatch-Miller, Chairman  
William A. Mundell, Commissioner  
Marc Sptizer, Commissioner  
Mike Gleason, Commissioner  
Kristin K. Mayes, Commissioner

ADMINISTRATIVE LAW JUDGE: Lyn Farmer

APPEARANCES: Mr. Thomas L. Mumaw, PINNACLE WEST CAPITAL CORPORATION; and Mr. William Maledon, OSBORN MALEDON, on behalf of Arizona Public Service Company;  
Mr. C. Webb Crockett, FENNEMORE CRAIG, P.C., on behalf of AECC and Phelps Dodge;  
Mr. Scott S. Wakefield, Chief Counsel, on behalf of the Residential Utility Consumer Office;  
Mr. Jarrett J. Haskovec, LUBIN & ENOCH, on behalf of the International Brotherhood of Electrical Workers Local Unions 387, 640 and 769;  
Mr. Timothy M. Hogan, ARIZONA CENTER FOR LAW IN THE PUBLIC INTEREST, on behalf of Western Resources Advocates;  
Mr. Michael Grant, GALLAGHER & KENNEDY, on behalf of Arizona Utility Investors Association;  
Ms. Laura Sixkiller, ROSHKA, DeWULF & PATTEN, on behalf of UniSource Energy Services;

1 Mr. Lawrence V. Robertson, Jr., MUNGER  
2 CHADWICK, on behalf of Southwestern Power Group  
3 II, LLC, Mesquite Power, LLC, and Bowie Power  
4 Station, LLC;

5 Mr. Jay I. Moyes, MOYES STOREY, on behalf of  
6 Arizona Agricultural Group;

7 Lieutenant Colonel Karen White, on behalf of the  
8 Federal Executive Agencies; and

9 Mr. Christopher Kempley, Chief Counsel, and Mr. Jason  
10 D. Gellman, Attorney, Legal Division, on behalf of the  
11 Utilities Division of the Arizona Corporation  
12 Commission.

13 **BY THE COMMISSION:**

14 On January 6, 2006, the Arizona Public Service Company ("APS") filed an application with  
15 the Arizona Corporation Commission ("Commission") for an emergency interim rate increase and for  
16 an interim amendment to Decision No. 67744 (April 7, 2005) ("Application").

17 By Procedural Order issued January 9, 2006, a procedural conference to discuss the process  
18 for handling this matter was set for January 12, 2006. The January 12, 2006 procedural conference  
19 was held as scheduled.

20 On January 19, 2006, Staff filed a Notice of Filing Proposed Schedule which indicated that  
21 Staff, APS and the parties that participated in the procedural conference had agreed upon a  
22 procedural schedule. In accordance with that proposal, APS filed supplemental testimony on January  
23 20, 2006.

24 By various Procedural Orders, intervention was granted to: Phelps Dodge Mining Company  
25 ("Phelps Dodge"), Arizonans for Electric Choice and Competition ("AECC"), the Residential Utility  
26 Consumer Office ("RUCO"), the Arizona Utility Investors Association, Inc. ("AUIA"), Arizona  
27 Agricultural Group ("AzAg"), Western Resource Advocates ("WRA"), Unisource Energy Services  
28 ("UES"), Southwestern Power Group II, L.L.C., Mesquite Power, L.L.C. and Bowie Power Station,  
L.L.C. (collectively "Power Group"), Arizona Water Company ("AWC"), the Town of Wickenburg  
("Wickenburg"), the Arizona Community Action Association ("ACAA"), the Federal Executive  
Agencies ("FEA"), the International Brotherhood of Electrical Workers, AFL-CIO, CLC, Local  
Unions 387, 640 and 769 (collectively, "IBEW"), and the Arizona Competitive Power Alliance

1 (“Alliance”).

2 On January 27, 2006, a procedural order was issued setting a hearing in this matter.

3 A procedural conference was held on March 14, 2006 to discuss the scheduling of witnesses  
4 and other procedural matters. The hearing on this application was noticed as an A.R.S. § 40-252  
5 proceeding in order to allow the Commission flexibility to modify its previous decisions.

6 The hearing was held as scheduled on March 20, 21, 22, 23, 24, 27, 28, and 29, 2006. APS  
7 presented testimony of Donald Brandt, Peter Ewen, Steven Wheeler, Steven Fetter, Elliott Pollack,  
8 David Rumolo, and Donald Robinson. Staff presented testimony of J. Randall Woolridge, Ralph  
9 Smith, William Gehlen, and Barbara Keene. RUCO presented testimony from Marylee Diaz Cortez;  
10 the Power Group presented testimony of David Getts; AECC presented testimony from Kevin  
11 Higgins; and IBEW sponsored testimony of Robert DeSpain.

12 On March 30, 2006, AECC/Phelps Dodge filed its Notice of Filing of AECC Late-Filed  
13 Exhibit No. 8 (Supplement to AECC Exhibit No. 7).

14 On April 7, 2006, 2006, Staff filed its Closing Brief and its late-filed exhibit S-11.

15 On April 10, 2006, RUCO filed its Post-Hearing Brief.

16 On April 11, 2006, APS, AECC/Phelps Dodge, AUJA, WRA, and the FEA filed their post-  
17 hearing briefs.

18 On April 12, 2006, the Power Group filed their Post-Hearing Brief.

### 19 DISCUSSION

20 In its Application, APS requests an interim rate increase of \$299 million in additional annual  
21 electric revenues, or approximately a 14 percent increase, to be effective April 1, 2006, and subject to  
22 refund pending the Commission’s final decision in APS’ pending permanent rate application.<sup>1</sup>  
23 According to the Application, this increase represents only the higher annual fuel and purchased  
24 power costs the Company expects to incur based on 2006 prices as reflected in its January, 2006,  
25 updated filing in the permanent rate case, and thus is not an additional increase. Granting the  
26 emergency interim rate increase requested in the Application would result in an interim base fuel cost  
27

28 <sup>1</sup> Docket No. E-01345A-05-0816.

1 of \$.031904 per kWh. According the Application, APS earns no markup or profit on fuel and  
2 purchased power costs, and these costs are unavoidable and largely uncontrollable. The Application  
3 states that the requested interim base fuel rate also reflects expected 2006 operations at Palo Verde  
4 and the other APS power plants and is not impacted by any of the 2005 unplanned Palo Verde  
5 outages. APS' Application also requests that the Commission amend Decision No. 67744 (April 8,  
6 2005) on an interim basis to remove the \$776.2 million "cap" on total retail fuel and purchased power  
7 costs recoverable in rates.<sup>2</sup>

### 8 APS Position

9 In its rebuttal testimony filed on March 13, 2006, APS modified its request to \$232 million  
10 due to declines in fuel prices between November 2005 and the end of February 2006.

11 According the Application, APS is experiencing a substantial operating cash flow deficiency  
12 that has already led to one downrating of its debt securities to the bottom rung of the investment  
13 grade ladder. According to the Company, this increases its financing costs by approximately ten to  
14 fifty basis points and decreases the marketability of its securities. APS believes it is likely that it will  
15 be further downgraded to non-investment "junk bond" status for the first time in its over 100-year  
16 history of service in Arizona if its interim rate relief to address the "massive under collection of fuel  
17 and purchased power costs" is not granted. The Application states that APS would be among the  
18 least credit-worthy non-bankrupt utilities in America and the Company's ability to successfully  
19 undertake the multi-billion dollar construction program the Company believes is necessary to render  
20 adequate utility service to its customers at a reasonable cost would be put in serious jeopardy.

21 Attached to the Company's application is an Affidavit by Donald Brandt, the Executive Vice-  
22 President and Chief Financial Officer for both Pinnacle West Capital Corporation ("Pinnacle West")  
23 and APS. Mr. Brandt is responsible for the finance, treasury, accounting, tax, investor relations,  
24 financial planning and power marketing and trading functions at Pinnacle West and APS. Mr. Brandt  
25 testified concerning APS' financial condition and credit ratings. APS must access the capital market  
26 to issue debt to fund a portion of the cost of the Company's infrastructure additions and improvement

27 \_\_\_\_\_  
28 <sup>2</sup> In Commission Decision No. 68437, the Commission amended Decision No. 67744 and allowed APS to defer costs  
above the \$776.2 million "cap" pending resolution in this docket.

1 required to meet customer needs, including new and upgraded transmission and distribution facilities,  
2 generation plant improvements, new environmental control systems, and other service facilities. The  
3 Company's capital expenditure budget for 2006 is approximately \$650 million, and during 2006-  
4 2009, capital expenditures are expected to be more than \$3 billion and the Company will need to  
5 access the capital markets to issue over \$1 billion of debt to fund the projects that make up the  
6 budget.

7       The cost that APS pays for the debt it must issue to fund the capital expenditures is based  
8 upon the credit ratings that it is assigned. According to Mr. Brandt, these costs increase dramatically  
9 when a Company's credit rating falls to non-investment ("junk") grade level and for that reason he  
10 believes that both APS and its customers have a strong interest in maintaining investment grade credit  
11 ratings. Mr. Brandt testified that the key financial metric examined by the credit rating agencies is  
12 the ratio of Funds from Operations to Debt ("FFO/Debt"). The FFO/Debt measures the sufficiency of  
13 a Company's cash flow to service both debt interest and debt principal over time. According to Mr.  
14 Brandt, because the Company is unable to collect in a timely manner a significant portion of its fuel  
15 and purchased power cost, an imbalance has developed between cash revenue and cash expense,  
16 thereby worsening the FFO/Debt ratio.

17       Mr. Brandt testified that in order for a company to maintain a BBB credit rating, Standard and  
18 Poor's ("S&P") expects a company to maintain a FFO/Debt of 15 percent to 22 percent for a  
19 Business Profile 5 and 18 percent to 28 percent for a Business Profile 6. On December 21, 2005, S&P  
20 changed APS from a Business Profile 5 to a 6, reflecting its assessment that APS faces increased  
21 regulatory and operating risk. The December 21, 2005 S&P Research Update indicated that "an  
22 additional factor contributing to PWCC's weakened business profile is the performance of Palo  
23 Verde nuclear units in 2005. S&P also downgraded APS' debt. According to Mr. Brandt, APS'  
24 borrowing costs have increased \$1 million per year as the result of this S&P downgrade to BBB -. In  
25 addition, APS will incur an incremental 10-50 basis points, or \$100,000 to \$500,000 in additional  
26 interest costs per year for each \$100 million of long-term borrowing. Further, Mr. Brandt testified  
27 that the downgrade imposed onerous restrictions on the Company's ability to access funds needed for  
28 its construction program. Mr. Brandt believes that absent emergency interim rate relief APS will

1 likely be further downgraded to non-investment grade or junk bond status. Mr. Brandt testified that  
2 any further downgrade in APS' credit rating from its current BBB- rating to below investment grade  
3 could cause an immediate additional annual increase in interest expense in the range of \$10 million to  
4 \$15 million. Further, by 2015, the additional amount of annual interest expense would grow to \$150  
5 million to \$230 million, for a cumulative amount of between \$625 million and \$1.2 billion in  
6 additional interest costs.

7 Mr. Brandt testified that the impact of downgrading from APS' current credit rating to non-  
8 investment grade would be costly in the following ways:

- 9
- 10 • During the next 10 years, APS will need to issue almost \$5 billion worth of additional  
11 long term debt to finance essential generation, environmental control, transmission  
12 and distribution construction programs, and to refinance existing long-term debt when  
13 it matures. As a result, the Company's annual financing costs would increase between  
14 \$110 million and \$225 million over what they would have been if APS had not been  
15 downgraded to junk status;
  - 16 • APS' approximate \$539 million of tax exempt debt and the cost associated with this  
17 debt would increase an additional \$4 million per year due to increased fees and  
18 additional interest.
  - 19 • Because of the seasonal nature of APS' cash flow, APS relies heavily on commercial  
20 paper for its working capital needs. If APS were further downgraded to non-  
21 investment grade, its access to the commercial paper market would be eliminated and  
22 APS would be turning to its more costly revolving credit agreement to satisfy its daily  
23 working capital needs. This would increase APS' overall cost of borrowing by about  
24 \$1 million per year.
  - 25 • Further negative impacts include difficulty renewing existing credit agreements;  
26 negative effects to its marketing and trading functions including collateral calls which  
27 could place a significant liquidity strain on APS when the Company is least able to  
28 access the markets; in addition to cash collateral calls, energy trading counterparties  
may place other onerous terms on their dealings with a non-investment grade company  
including prepayments for a large portion of APS' power plant fuel needs, thereby  
making APS' cost of doing business in the wholesale market increase significantly and  
making it more difficult to hedge the Company's commodity position.

25 In his direct testimony, Mr. Brandt testified that the emergency the Company faces includes:

- 27 • An unprecedented increase in APS' fuel and purchased power costs since base fuel  
28 rates were established in Decision No. 67744 and continuing significant increases in

1 those costs during 2006 due to ongoing exogenous factors and fundamental shifts in  
2 the global energy market.

- 3 • Continued cost deferrals in 2006 from the imbalance between fuel costs and cost  
4 recovery which has weakened the Company's key financial indicators and a further  
5 downgrade according to APS if the Commission does not address fuel cost recovery in  
6 a manner that promises to reverse the downward trend in the Company's financial  
7 indicators.
- 8 • A credit rating agency downgrade of APS to non-investment grade would increase  
9 interest expense in 2006 by at least \$10 to \$15 million, increasing to between \$115 an  
10 \$230 million by 2015.
- 11 • Credit limitations imposed on APS' as a result of a further downgrading would  
12 increase the cost of fuel acquisition and purchased power.
- 13 • Once a Company experiences an important credit downgrade, it takes years of  
14 sustained positive regulatory action to reverse the situation.
- 15 • Without an interim raising of the \$776.2 million cap, APS will be unable to defer  
16 approximately \$65 million in 2006.
- 17 • Pending APS general rate case will possibly not be decided within a "reasonable  
18 time".

19 Mr. Brandt testified in his direct testimony that since the Affidavit and Application were filed,  
20 S&P issued an additional Research Summary regarding APS and both Moody's and Fitch have taken  
21 negative rating actions regarding the Company. According to APS witness Brandt, all three of the  
22 rating agencies point directly to the Company's increasingly critical need to recover in a timely  
23 manner fuel and purchased power costs prudently incurred to serve its customers as the basis for its  
24 negative action. Mr. Brandt testified that the combination of weak cash flow and the resulting need  
25 for additional debt will result in a weaker FFO/Debt ratio which will likely cause the downgrade of  
26 the Company to junk grade.

27 In his rebuttal testimony, Mr. Brandt states that the Company faces "an emergency situation  
28 and critically needs timely action by the Commission permitting the Company to recover its fuel and  
purchased power costs on a current basis. Without such action, the Company faces a continuation of  
its cash flow crisis and the very real and substantial risk of a downgrade of its credit ratings to non-  
investment 'junk' grade levels." (Brandt rebuttal p. 2) He testified that the recent reports of the credit  
rating agencies are clear that the recent "partial relief" granted by the Commission will not cure the  
Company's cost-recovery issues. He disagrees with Staff and RUCO witnesses' interpretations of  
those reports and believes that they have understated the risk and likelihood of a further downgrade.  
Mr. Brandt testified that putting off recovery of these costs "distorts the true cost of electricity,

1 increases the total amount to be recovered, potentially shifts some of those true costs from current  
 2 ratepayers to future ratepayers, and raises the very real possibility that ratepayers will be saddled with  
 3 massive additional interest costs over the next decade if APS' credit ratings suffer a downgrade as a  
 4 result of a decision by the Commission to defer recovery of these costs." APS exhibit 3, p. 36. At the  
 5 hearing, Mr. Brandt presented his opinion of how the various proposals affected the risk probability  
 6 that APS' credit rating would be downgraded to junk.<sup>3</sup> He also presented an exhibit that set forth  
 7 APS' expectation as to what FFO/Debt would be obtained under the various proposals.<sup>4</sup> Mr. Brandt  
 8 testified that neither the Staff's nor the AECC/Phelps Dodge proposal is a sufficient alternative to the  
 9 requested emergency rate relief.

10 Mr. Peter Ewen, Manager of Revenue and Fuel Analysis and Forecast Department for APS,  
 11 testified concerning the increasing costs of the Company is experiencing. Those costs include:

- 12
- 13 • Incremental sales growth and fuel mix. APS has one of the fastest growing territories in the  
 14 country and growth is one of the dominant factors producing increase fuel and purchased  
 15 power costs. The Company's incremental sales attributable to growth is met primarily with  
 high cost natural gas and purchased power. This factor alone accounts for \$147 million of the  
 requested interim rate increase.
- 16 • Natural gas prices. Natural gas prices have increased dramatically since 2002 according to  
 17 Mr. Ewen and coupled with purchased power price increases are responsible for a \$330  
 18 million increase in the Company's base cost of fuel prior to the results of the hedging  
 program.
- 19 • Purchased Power Prices. Prices for purchased power, most of which comes from natural gas  
 20 generation also increased significantly.
- 21 • Coal prices. Coal prices increased 13 percent between 2003 and November 2005 and are  
 22 projected to increase an additional 6 percent in 2006. These higher coal prices have raised the  
 Company's base cost of fuel by \$34 million.
- 23 • Hedging. All of the above price increases would have amounted to an increased fuel expense  
 24 of approximately \$364 million; however, that amount was reduced by more than \$160 million  
 through APS' hedging program.

25 According to Mr. Ewen, the requested amount reflects expected 2006 fuel and purchased  
 26 power prices and corresponding hedging result; a credit for anticipated off-system sales margins; and,  
 27

28 <sup>3</sup> APS Exhibit 6.

<sup>4</sup> APS Exhibits 4 & 9.

1 the effects of adding the Sundance Unit to the APS system. Mr. Ewen used the Company's  
2 production cost simulation tool ("RTSim") to calculate the new base fuel rate. The RTSim is a  
3 computer model which replicates the dispatch of the APS system and is the primary fuel expense and  
4 off-system sales forecasting tool used by the Company in preparing its annual budgets, long range  
5 fuel forecasts, and near term operational plans. In his rebuttal testimony, Mr. Ewen testified that the  
6 Company had re-estimated its fuel expenses using February 28, 2006 forward prices and has  
7 modified its request downward by \$67 million, to \$232 million.

8 APS rebuttal witness Steven Wheeler testified about "modifications and enhancements" to the  
9 Staff and to the AECC/Phelps Dodge recommendations which he believes would decrease the  
10 likelihood of rating downgrades and would impact the continued buildup of uncollected fuel and  
11 purchased power costs. Mr. Wheeler further testified that he does not agree that resetting the base  
12 fuel rate prior to the conclusion of the pending permanent rate case is prohibited by the APS  
13 Settlement Agreement or Decision No. 67744.

14 APS witness Elliott Pollack testified that non-investment junk credit rating of a local electric  
15 utility will negatively impact businesses perceptions about Arizona.

16 APS witness Steven Fetter testified concerning comments from the three major credit rating  
17 agencies and stated that "[t]o me, S&P's recent press releases about APS indicate that the rating  
18 agency is looking for additional support from the Commission for significant near-term cash recovery  
19 by APS for its power supply expenditures that were prudently-incurred." APS Exhibit 7, p. 14. He  
20 also testified if APS were downgraded to junk status, that there would be a "marked change in the  
21 investor profile" for APS and noted that "major utility investors such as insurance companies and  
22 pension funds operate under legal restrictions that severely limit their ability to invest in below  
23 investment-grade debt instruments, or 'junk bonds'" and that some mutual funds may also be  
24 affected. *Id.* at 20. Mr. Fetter advised the Commission that if the Commission views the deferred fuel  
25 and purchased power costs as prudently incurred, that he would "strongly encourage action before  
26 further degradation of APS' credit ratings occurs. While raising rates to provide such recovery is  
27 never a welcome task, there would be a much greater negative impact on customers if their rates were  
28

1 to go up due to a further downgrade of APS into below investment-grade status, while the issue of  
2 power supply cost recovery remained looming as a potential further rate escalator.” *Id.* at 29.

3 APS witness Donald Robinson testified that the Staff recommendation is consistent with how  
4 the parties’ viewed the Power Supply Adjustor (“PSA”) working under the Settlement Agreement.  
5 Mr. Robinson testified that Staff’s recommendation allows the PSA to better track changes in fuel  
6 costs, which then improves the Company’s operational cash flow and resulting financial metrics. He  
7 believes that Staff’s recommendation to allow surcharges would better match the payment of costs  
8 with the customers incurring those costs and would provide a better signal to customers concerning  
9 the cost of their use of energy and the value of conserving energy. At the hearing, Mr. Robinson  
10 testified about the Company’s expenses related to advertising and bonuses for its officers in response  
11 to questions by Commissioners.<sup>5</sup>

12 APS witness Rumolo testified and presented exhibits on the bill impacts of the requested  
13 increase.

#### 14 RUCO’s Postion

15 RUCO presented one witness, Marylee Diaz Cortez, on its behalf. Ms. Diaz Cortez testified  
16 that APS’ Application does not reflect an emergency at this time. Ms. Diaz Cortez testified that prior  
17 to the issuance of Decision No. 68437 (February 2, 2006), there might have been a case to debate  
18 over whether APS’ condition was such that its ability to maintain service pending a formal rate  
19 determination was in serious doubt, but since the issuance of that decision, there are no grounds for  
20 finding an emergency. Ms. Diaz Cortez testified that there is no longer any basis for a perception by  
21 the rating agencies that the Commission will not deal with the growing deferrals in a timely manner  
22 and so the threat of an imminent downgrade to junk bond status is reduced. Ms. Diaz Cortez cites  
23 S&P’s statement in December 2005 and the fact that since the Commission voted on Decision No.  
24 68437, two of the rating agencies have indicated that their present investment grade ratings are stable.  
25 Ms. Diaz-Cortez testified that on “January 26, 2006, S&P affirmed its current BBB –, even though  
26 two days earlier it had reported that it appeared unlikely the Commission would grant the pending  
27

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28 <sup>5</sup> See letters from Commissioner Mayes on January 11, 2006, and February 1, 2006.

1 emergency rate application.” RUCO exhibit 5, p. 7. Also, while Fitch downgraded APS’ rating for  
2 senior unsecured debt from BBB + to BBB on January 30, 2006, it reported a stable ratings outlook.  
3 RUCO concluded that the rating agencies view Decision No. 68437 as adequate to maintain APS’  
4 current investment grade ratings.

5 Ms. Diaz Cortez testified that since there is no emergency, rates cannot to be changed without  
6 a finding of fair value. She further testified that APS did not present evidence that it would be unable  
7 to continue to provide electric service absent emergency interim rate relief, citing APS’ testimony  
8 that the deferrals have constrained only 20 percent of its equity returns. Ms. Diaz Cortez testified that  
9 RUCO’s position is that “granting an emergency interim rate increase at this juncture would  
10 substantially change the terms of the settlement agreement and Decision No. 67744” because fuel and  
11 purchased power under or over recoveries were to be shared 90/10 between stockholders and  
12 ratepayers. *Id.* at 9. An emergency interim rate request would circumvent the sharing mechanism and  
13 result in 100 percent of the under-recovered fuel and purchased power cost being borne by  
14 ratepayers, thereby changing the terms of the settlement agreement and Decision No. 67744, and  
15 would harm ratepayers.

16 At the hearing, Ms. Diaz Cortez testified that RUCO supported the Staff recommendation for  
17 surcharges. Tr. p. 1692. She explained that “we may not have given it (PSA) all the characteristics it  
18 needed to deal effectively with such large escalating fuel prices and that maybe in this proceeding  
19 that something we might want to contemplate doing is amending that adjustor mechanism that we put  
20 in place back in April ’05 so that it can deal effectively with the level of escalation that has actually  
21 come to be.” Tr. p. 1695.

22 In its Post-Hearing Brief, RUCO stated that the deferred fuel balance is growing and could  
23 become problematic and that the Commission should modify the PSA to provide more timely  
24 recovery of fuel costs. RUCO supported Staff’s quarterly surcharge proposal.

25 AECC/Phelps Dodge’s Position

26 Phelps Dodge Mining Company and Arizonans for Electric Choice in Competition  
27 (“AECC/Phelps Dodge”) sponsored testimony of their witness, Kevin Higgins, in this proceeding.  
28 Mr. Higgins testified that in light of rising fuel and purchased power costs and the recent downgrade

1 experienced by APS, some emergency relief is warranted. Mr. Higgins believes that an emergency  
2 interim increase sufficient to allow APS to attain a FFO/Debt ratio of 18 percent in 2006 is  
3 appropriate. He recommends that the ratio can be obtained through an emergency interim rate  
4 increase of \$126 million in calendar year 2006. If this rate increase were implemented on May 1,  
5 2006, revenue could be collected with an increase of approximately 7.8 percent. Mr. Higgins  
6 disagrees with APS' proposal to establish a new base energy rate in this proceeding as it would allow  
7 APS to avoid having to absorb its 10 percent share of the cost differential between the current base  
8 energy rate and its new proposed energy rate. Mr. Higgins proposes that the base energy rate should  
9 remain at the level established in APS' last general rate case and any revenues collected from the  
10 emergency surcharge should be applied as a credit against the PSA annual tracking account. This  
11 would recover the 90 percent cost share assignable to customers with the remaining 10 percent  
12 assigned to APS in accordance with the PSA mechanism. Under this recommendation, the new base  
13 energy rate would then be established in the pending general permanent rate case.

14 Mr. Higgins also opposed APS' proposed interim surcharge rate design. According to Mr.  
15 Higgins, although APS has stated that the proposed increase would be a 14 percent increase, Mr.  
16 Higgins believes that the Company's proposal would actually raise rates for many industrial  
17 customers by more than 20 percent. He believes that it is inappropriate in the context of an  
18 emergency rate filing with a limited record and restricted opportunity for analysis, to put in place  
19 disproportionate increases on different customer groups. He recommends that the only appropriate  
20 rate design would be an equal percentage increase for all customer groups and that this could be  
21 achieved through an equal percentage surcharge on total customer bills exclusive of PSA charges.

22 During the hearing, Mr. Higgins modified his \$126 million surcharge recommendation in  
23 response to APS' rebuttal testimony that included decreased net fuel costs. However, as testified to  
24 by APS witness Brandt, the expected extended summer 2006 Palo Verde outage would cancel out the  
25 fuel cost reduction. In its Post-Hearing Brief, AECC/Phelps Dodge readjusted its recommended  
26 increase back to its original \$126 million amount, indicating that using the Palo Verde outage costs to  
27 determine the amount needed to reach the targeted FFO/Debt ratio does not "constitute *de facto*  
28 prudence determination", nor will it allow the company to recover those costs, as the recommended

1 emergency surcharge will only flow to the PSA Tracking Account as a credit against costs found to  
2 be prudent by the Commission.

3 The Power Group's Position

4 The Power Group sponsored testimony of David Getts, the Chief Financial Officer of  
5 Southwestern Power Group II, L.L.C. The Power Group supports the level of emergency interim rate  
6 relief that APS is able to demonstrate is necessary to maintain securities and financial instruments of  
7 investment grade quality. The members of the Power Group are competitors in the wholesale electric  
8 market in Arizona and APS is the largest potential purchaser of capacity and energy in the market.  
9 Mr. Getts testified that APS' creditworthiness can have a direct effect on the terms and conditions  
10 offered to it, because when APS' credit is at risk, that risk affects the financial exposure and profile  
11 of the supplier. This means that the price offered to APS will be higher, and the terms and conditions  
12 more stringent. Those costs, if prudent, will ultimately be passed on to customers.

13 IBEW' Position

14 The IBEW sponsored the testimony of its witness, Robert DeSpain, who testified that the  
15 situation APS is in was not caused by the level of compensation that it pays its employees.

16 Staff's Position

17 Staff provided testimony of Ralph Smith, Jay Randall Woolridge, Barbara Keene, and  
18 William Gehlen. Mr. Smith testified that the Commission's cap of \$776.2 million does not currently  
19 constitute a financial emergency for APS because APS has not yet incurred fuel and purchased costs  
20 in excess of the cap and Decision No. 68437 has allowed APS to defer fuel and purchased power  
21 costs in excess of that cap. Mr. Smith recommends that APS should be allowed to defer fuel and  
22 purchased power costs in excess of the cap in 2006 with the actual costs incurred by APS being  
23 reviewed for whether they were prudently incurred.

24 Mr. Smith testified that APS has not proved that a \$299 million emergency rate increase is  
25 needed because it has not demonstrated that that rate relief would: prevent future downgrades of  
26 APS' debt ratings; result in an upgrade of APS' debt ratings; result in lower long-term costs for its  
27 customers; or be appropriate under the circumstances.

28

1 In his direct testimony, Mr. Smith cites two reasons why the requested emergency rate  
2 increase would not necessarily prevent future downgrades: "emergency" rate increases are subject to  
3 refund; and other factors such as a sustained, unplanned outage at an APS plant during a peak  
4 demand period could result in a downgrade. He also points out that hitting a particular FFO/Debt  
5 ratio does not dictate a certain bond rating. Mr. Smith testified that granting an emergency rate  
6 increase as a way to provide for APS to collect fuel and purchased power costs is not a preferred  
7 alternative because it would be based on forecast estimates of fuel costs under collections rather than  
8 collection of actual costs already incurred; it would likely require incurring additional costs for a  
9 surety bond; APS has not proven that it is currently experiencing a financial emergency or cash flow  
10 crisis; and there is no assurance that increasing APS' rates by \$299 million subject to refund would  
11 result in a bond rating upgrade or prevent a bond rating downgrade. Mr. Smith agreed that a  
12 downgrading of APS' debt to junk status would not be a desirable outcome because in addition to  
13 resulting in increased borrowing costs, it would impede the Company's access to credit.

14 Rather than grant APS emergency rate relief that is not needed, Staff recommended that the  
15 Commission should address any deferred fuel balances through means of quarterly surcharges. Staff  
16 testified that prompt action on the PSA surcharge request is a better and more appropriate way to  
17 address the Company's growing deferred fuel balance than the Company's request for emergency  
18 rate relief. Staff recommends that the functioning of the PSA be reviewed in the current APS rate  
19 case and be revised if necessary when additional operating expenses in 2006 can be taken into  
20 consideration. In the interim, in order to address any potential for growing fuel costs under collection  
21 that APS anticipates for 2006 and as the preferable alternative to an emergency rate increase, Staff  
22 recommended that the Commission allow APS to file for PSA surcharge request in 2006 on a  
23 quarterly basis if necessary. Commission Staff is willing to expedite the processing of the surcharge  
24 request by filing its recommendation no later than 30 days after APS' filing. Mr. Smith testified that  
25 allowing APS to make quarterly PSA surcharge filings if necessary in 2006 could function as a  
26 "safety valve" against financial pressure from carrying large deferred balances building to an  
27 emergency situation. He testified that it could help thwart an emergency situation from occurring  
28

1 later this year and could provide both the Commission and the Company with a ready means to  
2 address and prevent a potentially serious situation.

3 Staff recommends that regardless of whether an emergency rate increase is granted, the  
4 Commission should temporarily impose some additional reporting safeguards on APS in order to  
5 monitor any deterioration in APS' financial condition. Staff recommended that APS file monthly  
6 reports on APS' and Pinnacle West's cash position and financial ratios, their cash flow projections  
7 for the upcoming 12 months and notify the Commission immediately if any event occurs or is  
8 projected by APS to occur within the next 12 months which would constitute a default condition. Mr.  
9 Smith testified that this would enable the Commission to have an additional means of keeping  
10 apprised of any possible deterioration in APS' cash and financial situation.

11 Staff witness Dr. Woolridge testified concerning the impact of the recent bond rating  
12 downgrade on APS' financial condition, the cost of capital, ability to raise capital, and the  
13 Company's customers; an assessment of whether the downgrade constitutes a financial emergency;  
14 an evaluation of a likelihood of additional downgrades of APS' debt; and the impact of any such  
15 additional downgrade. Dr. Woolridge testified that although the downgrading of the Company's  
16 bonds certainly is not positive for the Company, recent reports from rating agencies and investment  
17 firms suggest that recent Commission actions appear to have stabilized the situation. Staff exhibit 1,  
18 pp. 2-3. Those agencies and firms reacted positively to the January 25, 2006 Commission decision to  
19 lift the cap on deferred costs and to advance the collection of deferred costs.

20 Dr. Woolridge discussed the role of financial ratios and the rating process and indicated that  
21 rating agencies consider many factors. These factors include many business risk indicators such as  
22 economic conditions of the service territory, competitive environment, regulatory climate, customers,  
23 and exposure to unregulated businesses. Ratio analysis is also part of the credit risk analysis  
24 performed by rating agencies.

25 Dr. Woolridge testified that it is important to note the fact that the ratios published by rating  
26 agencies for different bond ratings are not strict standards which must be met to achieve a particular  
27 bond rating. He also noted that of the three ratios reported by S&P, the only APS ratio that violates  
28 its guidelines for the BBB rating is FFO/Debt, with the other ratios falling within the range specified

1 for S&P for a BBB rating. Dr. Woolridge testified that he does not believe the bond downgrading  
2 has restricted the Company's access to capital and the Company has presented no evidence to support  
3 that assertion. He testified that if the Company were to be downgraded to junk status, such an event  
4 would restrict the Company's access to capital. He further testified the Company has not presented  
5 any evidence that its bonds are about to be downgraded to junk status and noted that the rating status  
6 of the bonds by S&P, the only agency that has the Company's bond rating one notch above junk  
7 status, is stable. Dr. Woolridge did note that the downgrading of the Company's bonds to BBB – by  
8 S&P has caused a slight increase in the Company's overall cost of capital and his analysis indicates  
9 that as of January 2006, it was at 15 point basis points.

10 Staff witness Barbara Keene set out the various rate impacts on customer bills for each of the  
11 requested rate increases, surcharges and emergency rate increase requests. At the hearing, she  
12 testified that pursuant to Decision No. 67744, low-income customers on the E-3 and E-4 low-income  
13 discount rates do not pay either the adjustor rate or any surcharges.

14 Staff also presented the testimony of William Gehlen. Mr. Gehlen testified that Staff  
15 evaluated the assumptions APS used in calculating the various projections for uncollected fuel and  
16 purchased power expenses for 2006. Mr. Gehlen testified that the Company has developed a hedge  
17 implementation strategy with the intent to manage price risks that has been caused by increased  
18 volatility in the natural gas and purchased power markets. The Company has hedged 85 percent of its  
19 2006 natural gas and purchased power requirements and so the projected uncollected fuel and  
20 purchased power cost changes are limited. Mr. Gehlen testified because of hedging, the greatest  
21 impact on fuel and purchased power expenses would be the loss of a nuclear or coal, base unit  
22 resource during the peak June through September period. APS would become even more reliant on  
23 its gas generating unit as well as the purchased power market which is indexed to the price of natural  
24 gas. Mr. Gehlen testified that this would result in a dramatic increase in gas and purchased power  
25 costs. Staff concluded that APS' projections for uncollected fuel and purchased power expenses are  
26 reasonable.

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28

**EMERGENCY RELIEF****Legal Standard**

The Commission's authority to grant a utility emergency rate relief is part of its constitutional ratemaking authority, which has been construed as plenary and exclusive. Ariz. Const. art. 15 § 3; *Arizona Corp. Comm'n v. State ex rel Woods*, 171 Ariz. 286, 830 P.2d 807 (1992); *State v. Tucson Elec. Light and Power Co.*, 15 Ariz. 294, 138 P. 781 (1914). In *Scates v. Arizona Corp. Commission*, 118 Ariz. 531, 578 P.2d 612 (1978), the court discussed the Arizona Attorney General's Opinion No. 71-17 ("Attorney General Opinion") and the limited circumstances where interim rates should be used: when an emergency exists; when a sufficient bond has been posted guaranteeing refunds to customers if the rates are later found to be excessive; and when the Commission will be making a final determination of just and reasonable rates after a valuation of the utility's property. The parties cite the Arizona Attorney General Opinion for criteria to determine whether an emergency exists.

The Opinion says:

The foregoing authorities make it clear that, in general, courts and regulatory bodies utilize interim rates as an emergency measure when sudden change brings hardship to a company, when a company is insolvent, or when the condition of the company is such that its ability to maintain service pending a formal rate determination is in serious doubt.

In addition, under the *Mountain States Telephone* case, *supra*, the inability of the Commission to grant permanent rate relief within a reasonable time would be grounds for granting interim relief.

Perhaps the only valid generalization on this subject is that interim rate relief is not proper merely because a company's rate of return has, over a period of time, deteriorated to the point that it is unreasonably low. In other words, interim rate relief should not be made available to enable a public service corporation to ignore its obligations to be aware of its earnings position at all times and to make timely application for rate relief, thus preserving its ability to render adequate service and to pay a reasonable return to its investors.

APS argues that the language of the AG's opinion merely gives examples of situations requiring emergency relief, and that they are not the only circumstances that may constitute an emergency. In its March 13, 2006 filing addressing the legal criteria for emergency or interim relief, APS argues that the "undisputed unexpected large increases in fuel and purchased power cost constitute 'sudden hardship' of an extreme nature to the company. The evidence is that as a consequence of those increased costs and the inability of the company to obtain timely permanent

1 relief, there is a real threat to the company's credit rating, which already has been recently  
2 downgraded. Finally, the undisputed evidence is that the company and its ratepayers will suffer  
3 substantial consequences if further downrating occurs." APS March 3, 2006 filing, p. 4. APS notes  
4 that the Attorney General's Opinion "did not conclude that emergency relief may be justified only by  
5 past economic events; no such limit is even suggested by the opinion." *Id.* p. 3. APS also discusses  
6 and summarizes Commission and other jurisdiction's decisions allowing emergency relief for  
7 prospective costs.

8 AECC/Phelps Dodge agrees with APS that the list in the Attorney General's Opinion was not  
9 intended to set forth the only conditions upon which the Commission could approve emergency  
10 interim rate relief. Citing several Commission decisions,<sup>6</sup> AECC/Phelps Dodge states that the  
11 Commission has granted emergency interim rate relief "not only in situations where only historical  
12 costs were evaluated, but also in situations where prospective costs threatened to severely impact the  
13 utility in a negative way." AECC/Phelps Dodge Post-Hearing Brief, p. 3. AECC/Phelps Dodge  
14 concludes that "Arizona law, and Commission precedent, support the conclusion that the  
15 Commission has sufficient authority to grant emergency interim rate relief when prospective costs are  
16 considered part of the circumstances that warrant an emergency." *Id.*

17 Staff argues that the Commission has broad discretion whether to grant emergency rate relief.  
18 In its brief, Staff states that while *Residential Utility Consumer Office v. Ariz. Corp. Comm'n*, 199  
19 Ariz. 588, 20 P.3d 1169 (App. 2001) requires that an emergency must exist to grant APS the relief it  
20 requests, the question of what qualifies as an emergency is largely a question of fact for the  
21 Commission to decide. Staff stated in its March 13, 2006 Prehearing Brief that the Commission's  
22 authority to grant emergency rate relief "should not be limited to specific, narrowly tailored sets of  
23 facts, but should instead be focused upon whether the application alleges circumstances sufficiently  
24 urgent to concern the interests of the public."

25 The FEA disagrees with APS' position that the Attorney General Opinion is "merely  
26 instructive". FEA Post-Hearing Brief p. 5. It cites subsequent Commission decisions and argues that

27 \_\_\_\_\_  
28 <sup>6</sup> Decision No. 67990 (July 18, 2005) Sabrosa Water Company; Decision No. 65914 (May 16, 2003) Pine Water  
Company; Decision No. 62651 (June 13, 2000) Thim Utility Co.

1 the Commission has interpreted the Attorney General's Opinion as setting forth criteria to evaluate  
2 when determining whether an emergency situation exists. The FEA believes that the Commission  
3 should determine whether interim emergency rates are appropriate under the framework set out in the  
4 Attorney General's Opinion and subsequent case law and Commission decisions.

5 RUCO asserts that Arizona courts would "likely narrowly interpret the Commission's  
6 authority to determine that an emergency exists and that an exception to the requirement to set rates  
7 only upon making a finding of fair value is justified." RUCO Post-Hearing Brief, p. 5.

8 Factual Evidence Necessary for Emergency Finding

9 In its brief, APS states that the emergency that justifies the "interim rate relief arises from the  
10 perilous financial situation created by the extremely large – and growing – imbalance between the  
11 Company's fuel and purchased power costs and its current rate revenues." APS Post-Hearing Brief p.  
12 1. APS also asserts that there is a "significant risk" that S&P and other credit rating agencies will  
13 further downgrade APS if the Commission does not permit "'timely and full' relief from its mounting  
14 unrecovered fuel and purchased power costs." APS witnesses testified that a further downgrade  
15 would be financially disastrous for APS, its customers and shareholders, and would have an adverse  
16 impact on the state's economy.

17 AECC/Phelps Dodge believes that rising fuel and purchased power costs, the recent  
18 downgrade, and the outlook for APS' FFO/Debt ratio in 2006 are sufficient reasons to provide  
19 emergency relief in order to avoid a further downgrade.

20 The Power Group points to evidence that if APS is downgraded to "junk", it would have an  
21 increase of between \$600 million and \$1.2 billion in its cost of capital, and its access to the capital  
22 markets would be severely restricted or foreclosed at a time when it needs to make substantial capital  
23 improvements. It adds that operating expenses, including higher prices for fuel and purchased power  
24 and the imposition of restrictive credit terms and conditions, would also be ultimately borne by APS  
25 ratepayers.

26 The AUIA cites to the "'sudden change' in its (APS') fuel and purchased power costs, the  
27 December/January rating agency business position and rating downgrades, current and expected  
28 deferral levels, resulting impacts on its FFO to Debt Ratio and likely drop to 'junk' status" as

1 “hardships” to the company. AUIA Post-Hearing Brief p. 5. AUIA also pointed to APS witness  
2 Wheeler’s testimony and concluded that “APS’ ability to provide ‘adequate service’ is likely to be  
3 adversely impacted and the Commission cannot act quickly enough on the general rate case to affect  
4 that result this year.” Id.

5 The FEA argues that APS provided “no evidence that a ‘sudden condition’ caused the  
6 growing deferrals of fuel and purchased power costs.” FEA Post-Hearing Brief, p. 8. Nor has APS  
7 claimed that it is insolvent, facing a liquidity crisis, or unable to provide service to its customers. The  
8 FEA concludes that APS has not met the criteria that would allow implementation of interim  
9 emergency rates.

10 Staff reviewed recent Commission emergency rate proceedings and concluded that in the  
11 majority of the cases where the Commission approved emergency interim rate relief, the utility’s  
12 crisis had already occurred or was occurring. Staff stated that the Commission is not bound to find an  
13 emergency when only certain parameters are met, but should look to the totality of the facts. Under  
14 Staff’s analysis, the facts and circumstances do not justify a finding of an emergency.

15 Staff cites the testimony that there is no threat of insolvency or a liquidity crisis if the request  
16 is denied, and Staff disagrees with APS’ assessment that the credit rating agencies’ written reports  
17 indicate that a downgrade is imminent. Staff believes that the written reports themselves should be  
18 given more weight than APS witness Brandt’s testimony about his conversations with rating agency  
19 personnel. Staff also notes that APS did not testify that it would be unable to continue to provide  
20 adequate and reliable service pending resolution of the permanent rate case. In its brief, Staff states  
21 that since “the concern of the rating agencies is over the PSA, then the direct solution is to address  
22 the PSA, either by allowing a quarterly surcharge or by increasing the 4 mil bandwidth rather than to  
23 implement emergency rates when no emergency exists.” Staff Post-Hearing Brief p. 7.

24 RUCO argues that rating agency comments do not create an emergency, and that the  
25 Commission should focus on setting just and reasonable rates. If the Commission were to consider  
26 the rating agencies opinions, RUCO believes that it is not clear that a downgrade to noninvestment  
27 status is as likely as APS initially suggested. RUCO notes that APS’ testimony focused on only one  
28 of the three credit metrics, and that S&P considers other factors, including the “effectiveness of

1 liquidity management, corporate governance practices, and the regulatory environment.” RUCO  
2 Post-Hearing Brief, pp. 7-8. RUCO also noted that the performance of Palo Verde is another factor  
3 that affects the credit rating and it is out of the Commission’s control. Further, RUCO argues that the  
4 Commission’s recent decisions to allow APS to begin recovering under its annual adjustor two  
5 months early and to approve a surcharge have adequately mitigated the rating agencies’ concerns.  
6 RUCO argues that if S&P “truly expected that denial of interim rates would result in a downgrade, it  
7 would not declare its current rating stable two days after stating that it does not appear likely that  
8 emergency rates would be approved.” RUCO Post-Hearing Brief, p. 11. RUCO’s review of the  
9 testimony about the credit rating reports leads it to conclude that no rating agency is threatening an  
10 imminent downgrade of APS’ credit rating to non-investment grade.

#### 11 OTHER RELIEF

12 Although Staff believes that no emergency exists to warrant an interim emergency rate  
13 increase, Staff does believe that the concern over the growing large deferred fuel and purchased  
14 power costs in 2006 is legitimate and warrants Commission action. Staff believes that the  
15 fundamental concerns over timing and certainty are best addressed by modifying the PSA  
16 mechanism. Staff’s recommendation is for a quarterly surcharge process whereby beginning in June  
17 2006, APS would file a surcharge application to recover actual deferred costs. Under Staff’s  
18 proposal, unplanned outage costs would not be included; all fuel and purchased power costs would be  
19 subject to a prudence review at a later time; the FFO/Debt ratio would improve to 16.6; and low  
20 income customers would be exempted from the surcharges. RUCO supports Staff’s proposal, but  
21 does not support the APS recommended modifications, including making the surcharge automatic,  
22 without prior review.

23 Staff also sees some merit in the AECC/Phelps Dodge proposal, finding it an improvement  
24 over the company’s request. The positive aspects are the timing, it preserves the 90/10 sharing  
25 agreement, and that there is only one rate impact. The negatives are that it is an emergency rate  
26 increase and is directly targeting and depends on meeting a specific FFO/Debt ratio of 18 percent.  
27 Staff recommends that the Commission should set just and reasonable rates using a traditional  
28 regulatory model.

1 Another method of modifying the PSA would be to expand the bandwidth of the annual  
 2 adjustor.<sup>7</sup> Staff believes that the increased bandwidth proposal is also a reasonable way to achieve  
 3 fuller and timelier recovery of deferred costs. Staff notes that: it is not an emergency rate per se; it  
 4 can be readjusted if appropriate in subsequent proceedings; it can likely go into effect on May 1,  
 5 2006; it requires only one adjustment; the 90/10 sharing is preserved; it adjusts the bandwidth directly  
 6 addresses the credit rating agencies' concerns; and because this proceeding was noticed as a A.R.S §  
 7 40-252 proceeding<sup>8</sup>, can be adopted at this time. RUCO believes that this proposal would not be  
 8 possible because of the timing of the annual adjustor.

### 9 ANALYSIS

10 Much testimony at the hearing concerned whether and under what certain circumstances a  
 11 credit rating downgrade would occur. Language from the credit rating agencies' reports, bulletins,  
 12 and updates was picked apart, "placed into context", explained and analyzed. The bottom line is that  
 13 no party or the Commission will know what action, if any, will be taken or when, because those  
 14 actions depend on future undetermined events and actions of entities not involved in this proceeding.

15 As a Commission, our role is to evaluate the Company's application from the broad  
 16 perspective of not only what is in the Company's best interests, but also what is in the public's best  
 17 interest. Although APS is appropriately concerned about its credit rating, deflecting responsibility for  
 18 the position that APS has gotten itself<sup>9</sup> into does nothing to show the credit rating agencies that it  
 19 should expect "sustained regulatory support" from the Commission. APS wants us to believe that our  
 20 actions alone will determine the Company's future, when in fact, APS' internal decisions and its  
 21 ability to manage its operations and respond to change is what fundamentally determines how it  
 22 performs. It is in the best interests of all stakeholders, including APS management, shareholders,  
 23 ratepayers, and the state, that APS continues to provide reliable service at reasonable rates.

24 Arizona law allows limited exception to the Constitution's requirement that rates should be  
 25 set in conjunction with making a finding of fair value of the utility's property.<sup>10</sup> One of those

26 <sup>7</sup> See, letters from Commissioner Gleason March 8, 2006, and from Chairman Hatch-Miller, March 23, 2006.

27 <sup>8</sup> See March 14, 2006 procedural conference transcript.

28 <sup>9</sup> APS agreed to base costs that it knew were probably insufficient and did not appeal the Commission's decision approving the settlement agreement with significant modifications to the PSA.

<sup>10</sup> Ariz. Const. art. 15, § 14; *Scates, Residential Utility Consumer Office v. ACC*.

1 exceptions is for emergency rates, and another exception that allows rates to increase without making  
2 a fair value finding is with automatic adjustment clauses. The parties have aptly set forth the  
3 applicable law concerning emergency rates and have differing views as to whether the facts presented  
4 rise to the level of an "emergency". Applying the conditions discussed in the Attorney General's  
5 Opinion, it is clear that APS is not insolvent. It is also clear that APS is able to maintain service  
6 pending a formal rate determination, albeit at a potentially higher cost. All of the parties seem to  
7 agree that APS is facing hardship because it has incurred and paid for substantial amounts of fuel and  
8 purchased power that it has not yet been able to recover through its current rate structure. The parties  
9 do not agree as to whether this "hardship" was the result of a "sudden change" as discussed in the  
10 Attorney General's Opinion. The parties also do not agree as to whether the possibility of a future  
11 downgrade is a sudden change causing hardship.

12 We agree with Staff that our authority to determine emergencies is not limited to specific,  
13 narrowly tailored facts, and that our ratemaking authority is sufficiently broad to enable us to grant  
14 relief tailored to many different situations. In some situations, that may be to grant emergency rate  
15 relief, and in other situations, the circumstances or public interest may require other forms of relief.  
16 Although not specified in the Attorney General's Opinion, we believe that another important factor in  
17 evaluating whether an emergency exists is whether there is some other form of relief that would  
18 address the asserted emergency besides the extraordinary remedy of interim emergency rates. APS'  
19 existing rate structure already has incorporated one exception to the constitutional fair value finding  
20 requirement in the form of the PSA mechanism. The PSA was established to address the very  
21 "emergency" asserted by APS, recovery of deferred fuel and purchased power costs. Given the  
22 existence of the PSA mechanism and our ability to modify it in this proceeding, we find that no  
23 "emergency" exists. We can address the hardship that APS is facing through modifications to the  
24 PSA mechanism and therefore, there is no reason to invoke another exception to the constitutional  
25 requirement by implementing emergency rates.

26 Although we find that an "emergency" does not exist, we do agree that some action should be  
27 taken to insure more timely recovery of APS' prudent fuel and purchased power costs. Taking action  
28 now will benefit APS ratepayers in the long run by: reducing the amount of interest accruing on

1 deferred costs and thereby the amount that ratepayers will pay; by sending more timely and accurate  
 2 messages to ratepayers as to the actual costs that are being incurred, thereby allowing them to adjust  
 3 their consumption; and by increasing the likelihood that APS will remain investment grade and  
 4 thereby maintain the lower capital costs that current rates are based upon.

5 Although we find merit in Staff's proposal to allow periodic surcharges to collect deferred  
 6 costs, we believe that the timing will not significantly reduce the interest that accrues, nor will it give  
 7 a very timely price signal that costs have increased and are being incurred. Multiple price changes in  
 8 a short period of time can be confusing to ratepayers and may not send the appropriate price signals.  
 9 The primary benefit of Staff's proposal is that the costs are not recovered until they are known and  
 10 incurred. However, under Staff's surcharge proposal, Staff's review is not intended as a prudence  
 11 review, but will just verify calculations and make sure unplanned outage costs are excluded. Tr. p.  
 12 2194 No party testified that APS' purchased power and fuel costs will be at or near the base costs  
 13 established in Decision No. 67744, and in fact, APS is 85 percent hedged for 2006.

14 Accordingly, in order to prevent the continued build up of a large balance in the 2006  
 15 Tracking Account and the amount of interest that will accrue that will need to be collected from  
 16 ratepayers beginning in February 2007, we will allow APS to implement an interim adjustor to  
 17 collect a portion of the 2006 purchased power and fuel costs that are above the base cost established  
 18 in Decision No. 67744. We believe that this adjustor should be set to collect an amount that will  
 19 leave no more than approximately \$110 million (or the amount that will be collected using a 4 mil  
 20 bandwidth starting in February 2007 once the 2005 adjustor ends) in the 2006 Tracking Account at  
 21 the end of December, 2006, plus the amount associated with any unplanned outages.<sup>11</sup>

22 Accordingly, we will authorize an interim adjustor for 2006 costs using a bandwidth of 5 mil  
 23 beginning May 1, 2006.<sup>12</sup> This will increase the monthly median residential summer customer bill by  
 24 \$4.09 and the monthly average residential summer customer bill by \$5.23. The monthly median

25 <sup>11</sup> Amounts associated with unplanned outages should be addressed through surcharge applications.

26 <sup>12</sup> Amount of expected unrecovered purchased power and fuel costs for 2006 of \$248 million, APS schedule 18(D), less 4  
 27 mil bandwidth recovery of at least \$110 million in adjustor implemented in February 2007, leaving approximately \$138  
 28 million for recovery through interim adjustor in 2006 (approximately \$97-99 million) and \$41 million for potential  
 surcharge for 2006 unplanned outage costs. The interim adjustor should continue until all 2006 Annual Tracking Account  
 costs are recovered except unplanned outage costs and the amount needed for the February 2007 4 mil bandwidth  
 adjustor.

1 residential winter customer bill would increase by \$2.66 and the monthly average residential winter  
2 customer bill by \$3.38.<sup>13</sup> Pursuant to Decision No. 67744, low-income customers on the E-3 and E-4  
3 low-income discount rates do not pay either the adjustor rate or any surcharges, and will not pay this  
4 interim adjustor rate.

5 APS should include a separate schedule for this interim adjustor in its monthly PSA filings  
6 and Staff should monitor on an ongoing basis whether APS is correctly accounting for the recovery,  
7 and that no unplanned outage costs are included in the interim adjustor. The amounts collected  
8 through the interim adjustor will remain subject to a prudence review at the appropriate time. In the  
9 event that Staff or any party believes that APS is not implementing the interim adjustor correctly,  
10 they should promptly notify the Commission.

11 By acting now, rather than waiting until February 2007 to begin collecting these costs, the  
12 ratepayers will be paying approximately four million dollars less in interest charges.<sup>14</sup> Further, it is  
13 important to highlight that this interim modification to PSA will not affect APS' earnings, it will only  
14 affect the timing of the already authorized recovery of prudent costs paid for fuel and purchased  
15 power.<sup>15</sup>

16 This modification of the PSA is an interim measure taken to address what we see as a  
17 significant and growing deferral of fuel and purchased power costs. We expect the parties in the  
18 pending permanent rate proceeding to propose modifications to the PSA that will address on a  
19 permanent basis, the issues with timing of recovery when deferrals are large and growing. We also  
20 expect the parties to explore other ways to implement a PSA and/or other tariffs that will give more  
21 accurate feedback in pricing terms, so that customers can modify their energy consumption in  
22 response to price.

23 We reject APS' request to eliminate the 90/10 sharing and will not modify the amount of  
24 2006 costs that APS can recover either now or in the general rate proceeding.

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26  
27 <sup>13</sup> Staff exhibit 9.

<sup>14</sup> APS exhibit 18 D shows annual interest of \$5,493,000 compared to APS exhibit 18 K which shows \$1,411,000 annual interest.

28 <sup>15</sup> Tr. pp. 1078, 1443.

1 Rate Design

2 APS, Staff and RUCO support any recovery of increased purchased power and fuel costs  
3 being applied to customers' bills on a per kWh charge basis. They believe that both the base rates  
4 and the PSA currently collect fuel and purchased power through a per kWh charge, so any additional  
5 costs that are collected should also be recovered on a per kWh basis. AECC argues that the costs  
6 should be collected as an equal percentage increase to customers' base bills because it believes that it  
7 is inappropriate in the context of an emergency rate filing to put in place disproportionate increases  
8 on different customer groups. AECC/Phelps Dodge argues that high-load factor E-34 customers  
9 could experience percentage increases that are 70 percent higher than the system average. The FEA  
10 agreed with AECC's recommendation, arguing that E-34 customers could experience rate increases  
11 of as much as 20 percent, depending on load factor.

12 In its post-hearing brief, AECC/Phelps Dodge proposes a compromise that incorporates  
13 elements of both rate design proposals. The compromise would first allocate the emergency amounts  
14 to be recovered to both Residential customers and Non-Residential customers as a whole on a cents-  
15 per-kWh basis as proposed by APS. Then the emergency surcharge on Residential customers would  
16 be determined on a flat cents-per-kWh basis, and the emergency increase allocated to Non-  
17 Residential customers would be recovered through an equal-percentage surcharge on all Non-  
18 Residential customer base bills as AECC/Phelps Dodge proposed. Under this compromise proposal,  
19 the Residential customers would pay the same way as they would under the APS rate design, and  
20 Non-Residential customers would each pay an equal-percentage surcharge.

21 There is merit in both approaches and in the compromise proposal, but because these are  
22 energy costs that are recovered through the PSA mechanism, we find that it is appropriate to collect  
23 these costs through the PSA's kWh charge. If this were an emergency rate increase unrelated to costs  
24 normally passed through an adjustor mechanism, then perhaps we would be more inclined to apply  
25 the increase as a percentage on bills. There is no reason to alter the formula for collecting the costs  
26 solely because they are being collected sooner. We encourage industrial and commercial customers to  
27 address the issue of rate design in the pending rate case.

28



1 production of electricity, and should look to significantly reducing demand for electricity through  
2 large scale, sustained energy efficiency programs, and use low cost renewable energy resources as a  
3 hedge against high fossil fuel costs. We agree that APS should be looking at ways to diversify its  
4 resources.

5 APS also argues in its Post-Hearing Brief that interim relief should not be conditioned or  
6 made subject to expense or dividend restrictions imposed on APS. APS believes that although the  
7 Commission can examine and exclude imprudent costs in the general rate case, it "would be  
8 inappropriate for the Commission to involve itself in internal corporate governance by dictating,  
9 directly or indirectly, whether and to what extent APS should advertise or sponsor local organizations  
10 with shareholder funds." APS Post-Hearing Brief, p. 36 APS believes that interim rate relief solely  
11 to recover deferred fuel and purchased power costs should not be conditioned on APS cutting  
12 unrelated expenses or be subject to further restrictions on dividends paid by APS. APS notes that it  
13 has already engaged in substantial cost cutting as a matter of corporate policy, and no party to the  
14 proceeding asserted that any of APS' costs or expenses are excessive or inappropriate. APS  
15 witnesses testified that the expenses are small and most of the advertising and sports sponsorship  
16 expenses are not included in the company's cost of services charged to APS customers.

17 In light of the growing costs of fuel and purchased power, we are concerned about the rate  
18 impacts on customers. APS should also share that concern and take all steps necessary to reduce its  
19 cost of service, which we will analyze in its rate case. However, APS should also look for ways to  
20 improve its cash flow, even looking at expenses that are borne by shareholders and not ratepayers,  
21 especially when the credit rating agencies are focusing on its FFO/Debt ratio.<sup>16</sup> Accordingly, while  
22 we are not imposing restrictions on APS dividend payouts or dictating that certain expenses be  
23 eliminated in this proceeding, we expect to APS to manage its operations in such a manner (including  
24 its generation assets) that with the relief granted herein, together with the measures that APS itself  
25 adopts, its business profile returns to 5, its FFO/Debt ratio continues to improve and its credit rating  
26 remains investment grade.

27 \_\_\_\_\_  
28 <sup>16</sup> Staff exhibit 11 indicates that the 5 mil interim adjustor will raise the FFO/Debt ratio to 17.8 percent and we believe that APS should be able to find ways to further improve that ratio.

1 \* \* \* \* \*

2 Having considered the entire record herein and being fully advised in the premises, the  
3 Commission finds, concludes, and orders that:

4 **FINDINGS OF FACT**

5 1. APS is a public service corporation principally engaged in furnishing electricity in the  
6 State of Arizona. APS provides either retail or wholesale electric service to substantially all of  
7 Arizona, with the major exceptions of the Tucson metropolitan area and about one-half of the  
8 Phoenix metropolitan area. APS also generates, sells and delivers electricity to wholesale customers  
9 in the western United States.

10 2. On January 6, 2006, APS filed with the Commission an application for a \$299 million,  
11 or 14 percent, emergency interim rate increase in annual electric revenues and for an amendment to  
12 Decision No. 67744, on an interim basis, to remove the \$776.2 million "cap" on total retail fuel and  
13 purchased power costs recoverable in rates. In its rebuttal testimony filed on March 13, 2006, the  
14 Company modified its request to \$232 million to reflect declines in fuel prices between November  
15 2005 and the end of February 2006.

16 3. Intervention was granted to AECC, FEA, RUCO, AUIA, Phelps Dodge, IBEW, AWC,  
17 WRA, UES, ACAA, Alliance, Wickenburg, AARP, and the Power Group.

18 4. Public comment was heard at the commencement of the hearing on March 20, 2006  
19 and approximately 40 public comment letters have been received by the Commission's Docket  
20 Control.

21 5. By Procedural Order issued January 26, 2006, the hearing was set to commence on  
22 March 20, 2006, and procedural dates were established for the filing of testimony and evidence.

23 6. On February 14, 2006, APS filed notice of publication indicating notice of the  
24 emergency application was published in the Arizona Republic on February 4, 2006 as required by the  
25 January 26, 2006 Procedural Order.

26 7. The hearing was held as scheduled on March 20, 21, 22, 23, 24, 27, 28, and 29, 2006.  
27 Public comment was taken and testimony was presented by APS, Staff, RUCO, the Power Group,  
28 AECC/Phelps Dodge, and IBEW.

1           8.       On March 30, 2006, AECC/Phelps Dodge filed its Notice of Filing of AECC Late-  
2 Filed Exhibit No. 8 (Supplement to AECC Exhibit No. 7).

3           9.       On April 7, 2006, 2006, Staff filed its Closing Brief and its late-filed exhibit S-11; on  
4 April 10, 2006, RUCO filed its Post-Hearing Brief; on April 11, 2006, APS, AECC/Phelps Dodge,  
5 AUIA, Western Resource Advocates, and the FEA filed their post-hearing briefs, and on April 12,  
6 2006, the Power Group filed their Post-Hearing Brief.

7           10.      In Decision No. 67744 (April 8, 2005) the Commission adopted the parties'  
8 Settlement Agreement and approved a PSA.

9           11.      In Decision No. 68437 (February 2, 2006), the Commission denied APS' application  
10 for a surcharge, accelerated the implementation of the adjustor, and ordered the parties to file a  
11 revised Plan of Administration.

12          12.      On December 21, 2005, S&P changed APS from a Business Profile 5 to a 6 and  
13 downgraded APS' debt to BBB-.

14          13.      APS' borrowing costs have increased approximately one million dollars as a result of  
15 this downgrade.

16          14.      Cost deferrals due to the imbalance between fuel costs and recovery have weakened  
17 the Company's FFO/Debt ratio.

18          15.      APS believes that absent emergency interim rate relief APS will likely be further  
19 downgraded to non-investment grade status.

20          16.      APS believes that during the next 10 years it will need to issue almost \$5 billion in  
21 long-term debt to finance essential generation, environmental control, transmission and distribution  
22 construction programs, and to refinance existing long-term debt and if it is downgraded to junk status,  
23 the Company's annual financing costs would increase between \$110 and \$225 million.

24          17.      Negative impacts of junk status include difficulty renewing existing credit agreement,  
25 collateral calls that could result in liquidity problems, the imposition of onerous terms and conditions  
26 in contracts in the wholesale market, and the elimination of access to commercial paper.

27          18.      The expected balance in the 2006 Annual Tracking Account at December 31, 2006 is  
28 approximately \$247,557,000.

1           19.     Based on the facts and evidence presented, Staff concluded that no emergency exists  
2 to justify the rate relief sought by APS, but does believe that concern over mounting fuel and  
3 purchased power deferrals is legitimate and sufficient to justify some action in this proceeding.

4           20.     Staff recommended that the Commission modify the PSA to allow for quarterly  
5 surcharge requests.

6           21.     Staff's recommendation balances ratepayer and Company interests by allowing the  
7 timely recovery of costs and by using actual costs; it addresses the concerns of the credit rating  
8 agencies; and it preserves the 90/10 sharing requirement.

9           22.     AECC/Phelps Dodge agreed with APS that an emergency existed and proposed  
10 recovery of \$126 million of 2006 deferrals through a surcharge to the Annual Tracking Account in  
11 order to reach a FFO/Debt ratio of 18 percent.

12           23.     RUCO does not believe that an emergency exists, and at the hearing, RUCO testified  
13 in support of Staff's proposal, and rejected APS' proposed modifications to make the surcharge  
14 automatic upon application.

15           24.     An important factor in evaluating whether an emergency exists is whether there is  
16 some other form of relief that would address the asserted emergency besides the extraordinary  
17 remedy of interim emergency rates.

18           25.     APS' existing rate structure already has incorporated one exception to the  
19 constitutional fair value finding requirement in the form of the PSA mechanism which was  
20 established to address the very "emergency" asserted by APS, recovery of deferred fuel and  
21 purchased power costs.

22           26.     Given the existence of the PSA mechanism and our ability to modify it in this  
23 proceeding, we find that no "emergency" exists.

24           27.     The hardship that APS is facing can be addressed through modifications to the PSA  
25 mechanism and therefore, there is no reason to invoke another exception to the constitutional  
26 requirement by implementing emergency rates.

27           28.     It is in the public interest to insure more timely recovery of APS' prudent fuel and  
28 purchased power costs.

1           29.     Although rates will increase in the short term, APS ratepayers will benefit from the  
2 modification to the PSA in the long run by: a reduction in the amount of interest accruing on deferred  
3 costs and thereby the amount that ratepayers will pay; by sending more timely and accurate messages  
4 to ratepayers as to the actual costs that are being incurred, thereby allowing them to adjust their  
5 consumption; and by increasing the likelihood that APS will remain investment grade and thereby  
6 maintain the lower capital costs that current rates are based upon.

7           30.     Staff's proposal to allow periodic surcharges to collect deferred costs has merit but the  
8 timing will not significantly reduce the interest that accrues, nor will it give a very timely price signal  
9 that costs have increased and are being incurred.

10          31.     Multiple price changes in a short period of time can be confusing to ratepayers and  
11 may not send the appropriate price signals.

12          32.     The primary benefit of Staff's proposal is that the costs are not recovered until they are  
13 known and incurred.

14          33.     Under Staff's surcharge proposal, Staff's review of the surcharge application will not  
15 be a prudency review, but will only verify calculations and insure that unplanned outage costs are  
16 excluded.

17          34.     No party testified that APS' purchased power and fuel costs will be at or near the base  
18 costs established in Decision No. 67744, and with hedges, APS anticipates a balance in the 2006  
19 Annual Tracking Account of approximately \$248 million.

20          35.     APS is 85 percent hedged for 2006.

21          36.     In order to prevent the build up of a large balance in the 2006 Tracking Account and  
22 the amount of interest that will accrue that will need to be collected from ratepayers beginning in  
23 February 2007, it is prudent to allow APS to implement an interim adjustor to collect a portion of the  
24 2006 purchased power and fuel costs that are above the base cost established in Decision No. 67744.

25          37.     This interim adjustor should be set to collect an amount that will leave no more than  
26 approximately \$110 million (or the amount that will be collected using a 4 mil bandwidth starting in  
27 February 2007 once the 2005 adjustor ends) in the 2006 Tracking Account at the end of December,  
28 2006, plus the amount associated with any unplanned outages.

1           38.     An interim adjustor for 2006 costs using a bandwidth of 5 mil should be implemented  
2 beginning May 1, 2006.

3           39.     The interim adjustor will increase the monthly median residential summer customer  
4 bill by \$4.09; the monthly average residential summer customer bill by \$5.23; the monthly median  
5 residential winter customer bill by \$2.66; and the monthly average residential winter customer bill by  
6 \$3.38.

7           40.     Pursuant to Decision No. 67744, the PSA requires that low-income customers on the  
8 E-3 and E-4 low-income discount rates do not pay either the adjustor rate or any surcharges, and  
9 those customers will not pay this interim adjustor rate.

10          41.     The implementation of the interim adjustor will reduce the amount of interest the  
11 ratepayers will pay by approximately four million dollars and will preserve the 90/10 sharing  
12 requirement.

13          42.     APS should include a separate schedule for this interim adjustor in its monthly PSA  
14 filings and Staff should monitor on an ongoing basis whether APS is correctly accounting for the  
15 recovery, and that no unplanned outage costs are included in the interim adjustor.

16          43.     The amounts collected through the interim adjustor will remain subject to a prudency  
17 review at the appropriate time.

18          44.     In the event that Staff or any party believes that APS is not implementing the interim  
19 adjustor correctly, they should promptly notify the Commission.

20          45.     The interim modification to PSA will not affect APS' earnings, it will only affect the  
21 timing of the already authorized recovery of prudent costs paid for fuel and purchased power.

22          46.     The modification of the PSA is an interim measure taken to address a significant and  
23 growing deferral of fuel and purchased power costs.

24          47.     The parties in the pending permanent rate proceeding should propose modifications to  
25 the PSA that will address on a permanent basis, the issues with timing of recovery when deferrals are  
26 large and growing.

27          48.     The parties should also explore other ways to implement a PSA and/or other tariffs  
28 that will give more accurate feedback in pricing terms, so that customers can modify their energy

1 consumption in response to price.

2 49. We reject APS' request to eliminate the 90/10 sharing and will not modify the amount  
3 of 2006 costs that APS can recover.

4 50. APS proposed, and Staff and RUCO agreed, that any additional costs that are collected  
5 should be recovered on a per kWh basis.

6 51. AECC/Phelps Dodge proposed an equal percentage increase for all customer groups,  
7 applying an equal percentage surcharge on total customer bills, exclusive of PSA charges.

8 52. In its Post-Hearing Brief, AECC/Phelps offered a compromise that incorporates  
9 elements of both rate design proposals.

10 53. Because these are energy costs that are recovered through the PSA mechanism, it is  
11 appropriate to collect these costs through the PSA's kWh charge.

12 54. There is no reason to alter the formula for collecting the costs solely because they are  
13 being collected sooner.

14 55. The industrial and commercial customers should address the issue of rate design in the  
15 pending rate case.

16 56. All parties support the continued waiver of the \$776 million cap until the permanent  
17 rate case is decided.

18 57. APS' long-term planning should include ways to diversify its resources in order to  
19 achieve and maintain reasonable, stable rates.

20 58. In light of the growing costs of fuel and purchased power, APS should take all  
21 appropriate steps necessary to reduce its cost of service while maintaining safe and reliable service.

22 59. APS should also look for ways to improve its cash flow, including looking at expenses  
23 that are borne by shareholders and not ratepayers, especially when the credit rating agencies are  
24 focusing on its FFO/Debt ratio.

25 60. Although we are not, at this time, imposing further restrictions on APS dividend  
26 payouts or dictating that certain expenses be eliminated, we do expect to APS to manage its  
27 operations in such a manner (including its generation assets) that with the relief granted herein,  
28 together with the measures that APS itself adopts, its business profile returns to 5, its FFO/Debt ratio

1 continues to improve and its credit rating remains investment grade.

2 61. Staff's recommendation that APS file monthly reports on APS' and Pinnacle West  
3 Capital Corporation's cash position and financial ratios, including their projected cash flows, until the  
4 pending general rate proceeding is resolved is reasonable and should be adopted.

5 **CONCLUSIONS OF LAW**

6 1. Arizona Public Service Company is a public service corporation within the meaning of  
7 Article XV of the Arizona Constitution and A.R.S. §§ 40-203, 204, 221, 250, 251, and 361.

8 2. The Commission has jurisdiction over Arizona Public Service Company and the  
9 subject matter of the application.

10 3. Notice of the application was provided in accordance with the law.

11 4. Notice was given that the Commission would consider this matter pursuant to A.R.S. §  
12 40-252.

13 5. No emergency exists to warrant the implementation of emergency interim rates.

14 6. The PSA mechanism should be modified on an interim basis to allow for an adjustor  
15 to collect a portion of the 2006 purchased power and fuel costs during 2006.

16 7. The pending general rate proceeding is the appropriate proceeding to address the  
17 "cap" of \$776.2 million adopted in Decision No. 67744, and until the issue is resolved in that  
18 proceeding, APS may continue to defer fuel and purchased power costs in excess of that cap.

19 8. The pending general rate proceeding is the appropriate proceeding to address  
20 permanent modifications to the PSA mechanism.

21 **ORDER**

22 IT IS THEREFORE ORDERED that Arizona Public Service Company is authorized to  
23 implement an interim adjustor for purchased power and fuel costs incurred in 2006, consistent with  
24 the discussion herein, to become effective May 1, 2006.

25 IT IS FURTHER ORDERED that Arizona Public Service Company shall provide its  
26 customers notice of the interim adjustor in its next monthly billing, in a form that is acceptable to  
27 Staff.

28 IT IS FURTHER ORDERED that Arizona Public Service Company's request for an

1 emergency interim rate increase is hereby denied.

2 IT IS FURTHER ORDERED that Arizona Public Service Company shall modify its monthly  
3 Power Supply Adjustor filings to include the separate interim adjustor schedule as set forth herein.

4 IT IS FURTHER ORDERED that Arizona Public Service Company shall file monthly reports  
5 on Arizona Public Service Company's and Pinnacle West Capital Corporation's cash position and  
6 financial ratios, including their projected cash flows, until the pending general rate proceeding is  
7 resolved.

8 IT IS FURTHER ORDERED that the issue of the timeliness of recovery of fuel and  
9 purchased power costs and any permanent modifications to Arizona Public Service Company's  
10 Power Supply Adjustor shall be further addressed in the pending general rate proceeding.

11 IT IS FURTHER ORDERED that Arizona Public Service Company and Pinnacle West  
12 Capital Corporation shall take appropriate steps to insure that Arizona Public Service Company's  
13 financial ratios remain investment grade.

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IT IS FURTHER ORDERED that Arizona Public Service Company may continue to defer fuel and purchased power costs in excess of the \$776.2 million "cap" referenced in Decision No. 67744 until the issue has been further examined in Docket No. E-01345A-05-0816.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN \_\_\_\_\_ COMMISSIONER

COMMISSIONER \_\_\_\_\_ COMMISSIONER \_\_\_\_\_ COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this \_\_\_\_ day of \_\_\_\_\_, 2006.

\_\_\_\_\_  
BRIAN C. McNEIL  
EXECUTIVE DIRECTOR

DISSENT \_\_\_\_\_

DISSENT \_\_\_\_\_

LF:mj

SERVICE LIST FOR:

ARIZONA PUBLIC SERVICE CO.

DOCKET NO.:

E-01345A-06-0009

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