

**ORIGINAL**



**BEFORE THE ARIZONA CORPORATION COMMISSION**

RECEIVED

2006 APR 11 A 8:10

AZ CORP COMMISSION  
DOCUMENT CONTROL

1  
2 JEFF HATCH-MILLER  
CHAIRMAN  
3 WILLIAM A. MUNDELL  
COMMISSIONER  
4 MARC SPITZER  
COMMISSIONER  
5 MIKE GLEASON  
COMMISSIONER  
6 KRISTIN K. MAYES  
COMMISSIONER

7  
8 IN THE MATTER OF THE APPLICATION OF  
ARIZONA PUBLIC SERVICE COMPANY  
9 FOR AN EMERGENCY INTERIM RATE  
AMENDMENT TO DECISION NO. 67744

Docket No. E-01345A-06-0009

10  
11 **RUCO'S POST-HEARING BRIEF**

12 The Residential Utility Consumer Office ("RUCO") recommends that the Arizona  
13 Corporation Commission ("Commission") make its own independent evaluation of whether  
14 Arizona Public Service Company's ("APS" or "the Company") power supply adjustor ("PSA") is  
15 providing adequate recovery of fuel costs that is fair to both consumers and the Company,  
16 rather than relying on speculation about future actions of the credit rating agencies. If the  
17 Commission concludes that PSA does not adequately permit recovery of prudently incurred  
18 fuel costs, the Commission should modify the PSA structure to improve its ability to achieve its  
19 original purpose. There is no need for the Commission to declare that APS faces an  
20 "emergency" to make necessary modifications to the PSA, and in fact there are a number of  
21 reasons that the Commission should avoid using emergency interim rates as the method to  
22 address any concerns it has about APS' ability to collect its fuel costs. The Staff proposal is an

1 appropriate modification to improve the PSA and address the fundamental rate making issues  
2 that the Company faces.

#### 4 **BACKGROUND**

5 In Decision No. 67744, the Commission adopted with modifications a settlement  
6 agreement in APS' rate case. As a part of the settlement, the Commission adopted a PSA  
7 through which costs of fuel and purchased power would be recovered. As modified, the PSA  
8 established a base cost of fuel,<sup>1</sup> permitted a nearly-automatic annual adjustment in rates in  
9 April of each year (based on the prior calendar year's cost), and provided for the possibility of  
10 surcharge applications if costs exceeded what was recoverable through the base rate and the  
11 annual adjustment. The annual adjustment was limited to 4 mils in any given year, and over  
12 the life of the adjustor. In addition, the Commission capped the amount of fuel costs that could  
13 be flowed through the PSA to \$776 million per year.

14 In July 2005, APS filed an application for a surcharge, seeking to recover \$80 million of  
15 the balance of the fuel adjustor account.<sup>2</sup> A hearing was held on the surcharge request in  
16 October 2005.

17 In December 2005, Standard & Poor's ("S&P") downgraded APS' credit rating from BBB  
18 to BBB- (one step away from non-investment grade), and modified APS' business profile from  
19 a 5 to a 6. S&P indicated it had a stable outlook on its BBB- rating.

---

22 <sup>1</sup> Precisely, the PSA tracks the costs of both fuel and purchased power. For ease of reference, this  
brief will refer to fuel and purchased power costs collectively as fuel costs.

23 <sup>2</sup> Docket No. E-01345A-05-0526. APS initially requested recovery of \$100 million, but later agreed to  
24 withdraw \$20 million of the balance related to increased costs associated with outages at the Palo Verde  
Nuclear Generating Station.

1 On January 6, 2006, APS filed an application seeking emergency interim rate relief in  
2 the form of an increase in the base cost of fuel from the current \$0.020743 per kWh to  
3 \$0.031904. APS indicated that it expected to recover \$299 million of additional revenue due to  
4 the change in base cost of fuel, but that the additional revenue would all be offset by a  
5 reduction in the future balance of the PSA. APS claimed that a downgrade of its debt ratings  
6 to non-investment grade was imminent without immediate relief, and that an emergency  
7 existed.

8 On January 25, 2006, the Commission adopted an order in the APS surcharge docket.  
9 The order was issued on February 2, 2006 as Decision No. 68437. In that Decision, the  
10 Commission declared the application premature, ruling that recovery of fuel balances through  
11 a surcharge application can only be sought once per year, after the annual adjustment takes  
12 place. The Commission also accelerated the annual adjustment from April 1 to February 1,  
13 and permitted APS to defer fuel costs above the \$776 million cap established in Decision No.  
14 67744.

15 In its rebuttal testimony in this proceeding, APS modified its request to seek a new base  
16 cost of fuel which would result in \$232 million of increased revenue.<sup>3</sup> The revised request was  
17 based on a decrease in fuel prices since the application was initially filed.<sup>4</sup>

18  
19 **COMMISSION SHOULD DECLINE TO FIND AN EMERGENCY EXISTS**

20 In this proceeding APS is asking the Commission to modify its base cost of fuel after  
21 finding that an emergency exists. The Commission should not make a finding of emergency,  
22

---

23 <sup>3</sup> Exh. APS-1 at 3 (Wheeler Rebuttal).  
24 <sup>4</sup> *Id.*

1 for several reasons. The scope of the emergency exception should be narrowly construed,  
2 and the Commission should not base a finding of an emergency on speculation about rating  
3 agencies' future actions, and should not find that increasing fuel cost deferrals create an  
4 emergency when a fuel recovery mechanism is in place to recover those costs. Further, the  
5 statements of the rating agencies taken as a whole demonstrate that the Commission's  
6 positive actions on January 25 significantly averted any risk of a downgrade of APS's credit  
7 rating to junk status.

8  
9 Emergency exception should be narrowly construed

10 The Arizona Constitution protects consumers by generally requiring that the  
11 Commission only change a utility's rates in conjunction with making a finding of the fair value  
12 of the utility's property.<sup>5</sup> However, Arizona's courts recognize that, "in limited circumstances,"  
13 the Commission may engage in rate making without ascertaining a utility's rate base.<sup>6</sup> The two  
14 limited circumstances identified by the courts are the changing of rates pursuant to a  
15 previously-established adjustor mechanism, and the establishment of interim rates when an  
16 emergency exists.<sup>7</sup>

17 The provisions of Arizona's Constitution should be liberally construed to carry out the  
18 purposes for which they were adopted.<sup>8</sup> Conversely, exceptions to a constitutional  
19  
20

---

21 <sup>5</sup> A.R.S. Const. Art. XV, § 14; *Simms v. Round Valley Light & Power Co.*, 80 Ariz. 145, 151, 294 P.2d  
22 378, 382 (1956); see also *State v. Tucson Gas*, 15 Ariz. 294, 308; 138 P. 781, 786 (1914); *Ariz. Corp.*

*Comm'n v. State ex rel. Woods*, 171 Ariz. 286, 295, 830 P.2d 807, 816 (1992).

23 <sup>6</sup> *Resid. Util. Cons. Office v. Ariz. Corp. Comm'n*, 199 Ariz. 588, 591 ¶¶11, 20 P.3d 1169, 1172 (App.  
2001).

<sup>7</sup> *Id.*; *Scates v. Ariz. Corp. Comm'n*, 118 Ariz. 531, 578 P.2d 612 (App. 1978) ("Scates").

24 <sup>8</sup> *Laos v. Arnold*, 141 Ariz. 46, 685 P.2d 111 (1984).

1 requirement should be narrowly construed.<sup>9</sup> Therefore, the protection to consumers afforded  
2 by the fair value requirement should be liberally construed, and exceptions for adjustor  
3 mechanisms and interim emergency rates should be narrowly construed.

4 The Commission's authority to establish interim rates is limited to circumstances in  
5 which 1) an emergency exists; 2) a bond is posted guaranteeing refund if interim rates are  
6 higher than final rates determined by the Commission; and 3) the Commission undertakes to  
7 determine final rates after making a finding of fair value.<sup>10</sup> The Attorney General has opined  
8 that an emergency exists when "sudden change brings hardship to a company, when a  
9 company is insolvent, or when the condition of the company is such that its ability to maintain  
10 service pending a formal rate determination is in serious doubt."<sup>11</sup> APS and Staff suggest that  
11 the Commission has historically exercised wide latitude in determining when an emergency  
12 exists. However, as discussed above, Arizona courts would likely narrowly interpret the  
13 Commission's authority to determine that an emergency exists and that an exception to the  
14 requirement to set rates only upon making a finding of fair value is justified. Essentially, the  
15 Commission cannot use the "emergency" exception to swallow the rule of finding fair value  
16 when setting rates.<sup>12</sup>

---

20 <sup>9</sup> See *Spokane & I.E.R. Co. v. U.S.*, 241 U.S. 344, 350, 36 S.Ct. 668, 671 (1916) (an "elementary rule"  
21 that exceptions from a general policy embodied in the law should be strictly construed).

<sup>10</sup> 199 Ariz. at 591, ¶12, citing *Scates*.

<sup>11</sup> 71-17 Op. Atty Gen. at 13 (1971)

<sup>12</sup> Attachment A is a description of a number of Commission decisions in emergency rate proceedings,  
22 as several Commissioners requested. Arizona case law and the Attorney General Opinion 71-17 set forth  
23 the legal parameters within which the Commission should act when considering emergency rate relief.  
24 RUCO's discussion of prior Commission decisions is not meant to imply that RUCO believes those decisions  
necessarily comply with the current or then-existing law on emergency rates.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24

Rating Agency comments do not create an emergency

The Commission’s constitutional duty is to set just and reasonable rates for public service corporations.<sup>13</sup> The general theory of utility regulation is that authorized revenue should be sufficient to meet a utility’s prudent operating costs and to give the utility an opportunity to earn a reasonable return on its investment.<sup>14</sup> The Commission determined in Decision No. 67744 that a PSA was an appropriate mechanism to allow APS to recover its prudent fuel costs.<sup>15</sup>

APS claims that it faces an “emergency” arising from credit rating agencies’ belief that the Company’s PSA is inadequate to recover fuel costs on a timely basis, and arising from APS’s belief that at least one rating agency is on the brink of downgrading the Company’s credit rating to junk status. APS requests that the Commission grant interim rate relief in response to this perceived “emergency.” Regardless of whether APS’ perceived threat of imminent downgrade is real or not, RUCO does not believe that the Commission should ignore its constitutional responsibilities by setting rates based on the expected reaction of credit rating agencies. Instead, the Commission should focus on the “fundamentals” of setting rates to allow recovery of prudent costs and an opportunity for a fair return.<sup>16</sup> The Commission should

---

<sup>13</sup> A.R.S. Const. Art. XV, § 3.  
<sup>14</sup> *Scates* at 533-34.  
<sup>15</sup> Decision No. 67744 at 36 (Finding of Fact No. 20).  
<sup>16</sup> Hearing Transcript (“Tr.”) at 1767 (Diaz Cortez).

1 maintain its usual goal of setting rates that are fair to ratepayers and that preserve the financial  
2 health of the utility, rather than “chasing smoke” by attempting to second guess how a credit  
3 rating agency will react.<sup>17</sup>

4 The Commission recognized the possibility of increased fuel cost when it approved the  
5 PSA in 2005. It would be incongruous for the Commission to now declare an emergency  
6 because of increasing fuel cost deferrals. The more appropriate way for the Commission to  
7 address any deferrals that have grown to concerning levels is to modify the mechanics of the  
8 PSA to permit swifter recovery of fuel costs, and allow the PSA to perform the task it was  
9 designed to do.<sup>18</sup>

10 Even if the Commission were to permit rating agencies to influence the rate setting  
11 process, it is not clear that a downgrade to non-investment status was as likely as APS initially  
12 suggested. Much of APS’s pre-filed testimony hinged on the funds from operations to debt  
13 (FFO/debt) ratio. However, that is only one of three financial ratios that rating agencies  
14 consider in their rate setting process.<sup>19</sup> APS’ score on the other two metrics, funds from  
15 operations to interest and debt to capital, are strongly in the BBB category.<sup>20</sup> Further, the  
16 exercise by which the rating agencies determine a credit rating involves more than just an  
17 application of the three metrics to a pre-determined range.<sup>21</sup> In addition to other financial  
18 ratios, S&P considers a number of other factors, which can include effectiveness of liquidity

19  
20  
21  

---

<sup>17</sup>

*Id.*

<sup>18</sup> Tr. at 1771 (Diaz Cortez). See discussion below of various alternatives involving modification of the PSA mechanics.

<sup>19</sup> See S&P June 2, 2004 Research Report, Exhibit 4 to Exh. RUCO-5 (Diaz Cortez Direct).

<sup>20</sup> S&P January 24, 2006 Research Credit FAQ, Attachment DEB-21 to Exh. APS-3 (Brandt Rebuttal).

<sup>21</sup> See S&P June 2, 2004 Research Report, Exhibit 4 to Exh. RUCO-5 (Diaz Cortez Direct).

1 management, corporate governance practices, and the regulatory environment.<sup>22</sup> Specific to  
2 APS, there can be issues that affect credit ratings that go beyond matters within the  
3 Commission's control, such as the performance of the Palo Verde nuclear generating units.<sup>23</sup>  
4 Regardless of the actual threat of a downgrade, the Commission should not adopt a policy of  
5 rescuing APS from a declining credit rating where that rating may reflect imprudent actions by  
6 the Company.

7  
8 ACC's recent action abrogated a potential downgrade to junk status

9 Even if the Commission were to consider whether credit rating agencies' threats of  
10 downgrade to non-investment grade status might create an emergency for which interim relief  
11 should be granted, the Commission's recent action allowing APS to begin recovery of the  
12 annual adjustor two months early,<sup>24</sup> and implementing a surcharge effective at the conclusion  
13 of this docket<sup>25</sup> have adequately mitigated the rating agencies' concerns.

14 The rating agencies' statements suggesting that the PSA was not recovering fuel costs  
15 on a sufficiently timely basis increased in intensity in October 2005, when S&P raised concerns  
16 about the pace at which APS' forthcoming rate case and pending surcharge applications would  
17 be addressed.<sup>26</sup> S&P maintained a stable outlook for its BBB rating, based on its expectation  
18 that the Commission would "resolve APS' large deferred power costs through a surcharge" no  
19 later than the end of 2005, and that APS' credit metrics would demonstrate "modest advances"

20  
21 <sup>22</sup> See S&P June 2, 2004 Research Report, Exhibit 4 to Exh. RUCO-5 (Diaz Cortez Direct), and Tr. at  
406 (Brandt).

22 <sup>23</sup> See Tr. at 770, 777-78 (Wooldridge).

23 <sup>24</sup> Decision No. 68437.

24 <sup>25</sup> Decision No. \_\_\_\_\_, Docket E-01345A-06-0063, approved at Open Meeting on April 5, 2006.

25 <sup>26</sup> See S&P October 4, 2005 Research Summary, Attachment DEB-16 to Exh. APS-3 (Brandt  
Rebuttal).

1 in the third quarter.<sup>27</sup> S&P's surprise downgrade to BBB- in December was based on  
2 "concern[ ] that the Arizona Corporation Commission (ACC) is not expeditiously addressing  
3 APS' growing fuel and purchased power cost deferrals,"<sup>28</sup> presumably because the  
4 Commission had not yet acted on APS' surcharge application. S&P recognized that the  
5 Commission's action on APS' pending surcharge application would "not completely resolve the  
6 issue" of increased fuel cost balances.<sup>29</sup> However, S&P did declare its new rating "stable"  
7 based on its expectation that the Commission would resolve at least a portion of the deferred  
8 fuel costs in January 2006, presuming that progress would be made in processing APS'  
9 general rate case, and dependent on improved 2006 performance at Palo Verde.<sup>30</sup>

10 On January 24, 2006, S&P described the January 12, 2006 Procedural Conference that  
11 took place in this docket. S&P indicated that "four of the five commissioners questioned the  
12 definition of an emergency and whether relief is justified. Based on the strong views  
13 expressed, it appears unlikely that the filing has support."<sup>31</sup> S&P further indicated that its  
14 forecast estimates do not assume that emergency relief is granted.<sup>32</sup>

15 The Commission met in Open Meeting on January 24 and 25, 2006 to consider the  
16 Recommended Opinion and Order ("ROO") that had been issued in the docket related to APS'  
17 July 2005 surcharge application.<sup>33</sup> At the January 25, 2006 Open Meeting, the Commission  
18 adopted what became Decision No. 68437, which denied the surcharge application as  
19 premature, but permitted APS to accelerate the implementation of annual adjustor to February  
20

---

21 <sup>27</sup> *Id.*  
22 <sup>28</sup> S&P December 21, 2005 Research Update, Attachment DEB-7 to Exh. APS-3 (Brandt Rebuttal).  
23 <sup>29</sup> *Id.*  
24 <sup>30</sup> *Id.*  
<sup>31</sup> S&P January 24, 2006 Research Credit FAQ, Attachment DEB-21 to Exh. APS-3 (Brandt Rebuttal).  
<sup>32</sup> *Id.*  
<sup>33</sup> Tr. at 431 (Brandt).

1 1, 2006. In essence, the Commission permitted recovery of more dollars, and over a shorter  
2 period of time, than the Company had asked for in its surcharge application.<sup>34</sup> In addition,  
3 Decision No. 68437 permitted APS to defer for possible future recovery any fuel costs above  
4 the \$776 million cap established in Decision No. 67744. The day after the Open Meeting, S&P  
5 issued a research report in which it described the Commission's action of the previous day as  
6 "an important indicator that the ACC acknowledges that timely action is necessary to limit cash  
7 flow pressure on the company."<sup>35</sup> S&P again declared its BBB- rating as stable, "premised on  
8 the ACC providing sustained regulatory support that adequately addresses building  
9 deferrals."<sup>36</sup> S&P made no statement retracting its prediction from two days earlier that the  
10 Commission was unlikely to grant emergency interim rates. S&P's only other recent statement  
11 on APS likewise made no indication that it believed emergency interim relief was likely to be  
12 granted.<sup>37</sup> If S&P had made a 180 degree change in its assumption about the likelihood of  
13 emergency interim rates being granted, it would have said so explicitly.<sup>38</sup>

14 Subsequent to the January 25 Open Meeting, Fitch has also issued a statement  
15 regarding APS' credit rating. On January 30, 2006, Fitch lowered APS' rating to BBB (still two  
16 steps away from non-investment grade status), and declared its outlook stable.<sup>39</sup> Thus, while  
17 Fitch does not expect any negative action on APS' credit ratings, it would have to downgrade  
18 APS two notches for APS' rating to be in the junk category.<sup>40</sup>

---

21 <sup>34</sup> The surcharge application as modified asked for \$80 million to be recovered over 24 months. The  
Commission authorized recovery of approximately \$112 million over 12 months. See Decision No. 68437.

22 <sup>35</sup> S&P January 26, 2006 Research Update, Attachment DEB-8 to Exh. APS-3 (Brandt Rebuttal).

23 <sup>36</sup> *Id.*

24 <sup>37</sup> S&P February 15, 2006 Research Report, Attachment DEB-17 to Exh. APS-3 (Brandt Rebuttal).

<sup>38</sup> Tr. at 774-75, 790 (Woolridge).

<sup>39</sup> Fitch January 30, 2006 Report, Attachment DEB-10 to Exh. APS-3 (Brandt Rebuttal).

<sup>40</sup> *Id.* and Tr. at 442-43 (Brandt).

1 Moody's rating of APS' credit is even further away from a non-investment grade. On  
2 January 10, 2006, after release of the ROO in the surcharge matter, Moody's placed its rating  
3 of Baaa1 under review for downgrade.<sup>41</sup> The Baaa1 rating is three steps away from a non-  
4 investment grade rating.<sup>42</sup> The following day, Moody's indicated that any downgrade would  
5 likely be limited to one notch.<sup>43</sup> Therefore, there is no imminent threat that Moody's will  
6 downgrade APS' rating to a junk category.

7 In summary, no rating agency is threatening an imminent downgrade of APS' credit  
8 rating to non-investment grade. One of the agencies' rating is three steps and another is two  
9 steps above a non-investment grade. Neither of those agencies foresees a downgrade to junk  
10 status. S&P, the only rating agency that currently has a rating only one notch from non-  
11 investment grade, considers that rating stable, and has expressly indicated that it does not  
12 expect emergency rates to result from this proceeding. If S&P truly expected that denial of  
13 interim rates would result in a downgrade, it would not declare its current rating stable two  
14 days after stating that it does not appear likely that emergency rates would be approved.  
15 Thus, the Commission's denial of emergency interim rates in this proceeding will not likely  
16 cause any rating agency to downgrade APS' credit rating to non-investment grade.

17  
18 **COMMISSION SHOULD MODIFY THE PSA TO PROVIDE MORE TIMELY RECOVERY OF**  
19 **FUEL COSTS**

20 While a downgrade to junk status is not just around the corner, APS' deferred fuel  
21 balance is growing and could become problematic. Rather than "kicking the can down the

22  
23 <sup>41</sup> Moody's January 10, 2006 Ratings Action, Attachment DEB-9 to Exh. APS-3 (Brandt Rebuttal).

<sup>42</sup> Tr. at 426 (Brandt).

<sup>43</sup> Moody's January 11, 2006 Credit Opinion, Attachment DEB-19 to Exh. APS-3 (Brandt Rebuttal).

1 road," the Commission should modify the PSA mechanism to provide APS an opportunity to  
2 seek recovery of previously-incurred fuel costs on a more timely basis. Several proposals to  
3 modify the PSA were discussed at the hearing. Some are more advantageous than others.

4 All of the proposals to modify the PSA present several practical advantages over  
5 declaring an emergency and granting an interim increase to the base cost of fuel. First, by  
6 addressing the growing fuel balance through a modification to the PSA, the Commission  
7 avoids establishing any degree of precedent that certain facts are sufficient to find an  
8 emergency exists. Emergency rate relief is an extraordinary remedy, and the Commission  
9 should avoid declaring an emergency if another vehicle exists to address the concerns about a  
10 utility's condition. Second, by modifying the PSA instead of declaring an emergency, APS  
11 would not be obligated to incur the cost of providing a bond guaranteeing repayment of rates if  
12 the Commission later determines permanent rates in a lesser amount. However, modification  
13 of the PSA does provide a similar opportunity to true-up rates that would be required if  
14 emergency interim rates were granted. If the Commission were to modify the PSA in such a  
15 way that results in APS recovering more than necessary to reduce unrecovered fuel balances,  
16 the continued operation of the PSA will true-up the difference by reducing future balances and  
17 corresponding charges to customers.

18 Third, by fashioning relief through a modification to the PSA mechanism rather than  
19 through a change to underlying base cost of fuel, the Commission can avoid shifting even  
20 greater burdens to customers for fuel costs. The 90-10 sharing mechanism of the PSA

1 provides that APS absorb 10 percent of the fuel costs that exceed the base cost of fuel.<sup>44</sup> If  
2 the Commission increased the base cost of fuel as APS requests, customers would receive a  
3 10 percent share of a smaller amount (whatever the difference is between actual costs and the  
4 increased base cost).<sup>45</sup> Based on APS' modified proposal of a \$232 million increase to the  
5 base cost of fuel and its February 28, 2006 fuel cost forecasts, \$18 million of costs would be  
6 shifted from shareholders to customers.<sup>46</sup> When the Commission adopted the PSA it found  
7 that the 90-10 sharing mechanism did not provide a sufficient incentive to APS to minimize its  
8 fuel costs.<sup>47</sup> To provide an additional incentive, the Commission adopted the \$776 million cap  
9 on fuel costs that could flow through the PSA.<sup>48</sup> Clearly, the Commission believes that the  
10 incentive provided by the 90-10 sharing mechanism is an important one, and decreasing the  
11 impact of that incentive would be contrary to the Commission's words and actions in Decision  
12 No. 67744. However, modifying the PSA permits the balance of the 90-10 sharing mechanism  
13 to continue.

14 Finally, by fashioning any relief as a modification to the PSA instead of as a change to  
15 the base cost of fuel, the Commission would insulate low income customers from the resulting  
16 rate impacts. Pursuant to the terms of the PSA as adopted by the Commission, customers on  
17 APS' low income tariffs are exempt from rate increases resulting from the PSA's operation.<sup>49</sup>  
18 Therefore, low income customers would be exempt from the impact of a decision to modify the  
19 PSA, but not from a decision to increase the base cost of fuel.<sup>50</sup>

20

---

21 <sup>44</sup> Tr. at 1981 (Robinson).  
22 <sup>45</sup> Tr. at 922, 971 (Higgins).  
23 <sup>46</sup> See Tr. at 1111-13 (Ewen).  
<sup>47</sup> Decision No. 67744 at 16 (lines 12-14).  
<sup>48</sup> Decision No. 67744 at 17 (lines 19-20).  
<sup>49</sup> Decision No. 67744 at 19 (lines 10-12); Tr. at 1748 (Diaz Cortez).  
24 <sup>50</sup> Tr. at 2158-59 (Keene).

1 Staff has proposed a modification to the PSA that APS be permitted to file an  
 2 application for a surcharge at the end of each calendar quarter until the general rate case is  
 3 concluded.<sup>51</sup> APS expects that it would make filings at the end of the second and third  
 4 quarters of 2006, but that it would not make a filing at the end of the fourth quarter of 2006.<sup>52</sup>  
 5 Instead, APS would include any balance in the filing for the annual adjustor, to begin February  
 6 1, 2007.<sup>53</sup> RUCO supports this method to address APS' deferred fuel balances.<sup>54</sup> APS  
 7 projected that its second and third quarter filings would request surcharges to recover \$33  
 8 million and \$144 million respectively.<sup>55</sup> RUCO has projected that, if the Commission approved  
 9 surcharges to recover those amounts over 12 months, the impact on an average residential  
 10 customer would be as follows:<sup>56</sup>

	Summer incremental increase \$	Summer Incremental increase %	Winter Incremental increase \$	Winter incremental increase %
13 Recover \$33 million	\$1.77 above February 2006 rates	1.08%	\$1.12 above February 2006 rates	1.43%
15 Recover \$144 million	\$7.74 above rates including the above surcharge	4.67%	\$4.88 above rates including the above surcharge	6.16%

17 Alternatively, if the Commission approved surcharges to recover those amounts over 24  
 18 months, the impact would be:<sup>57</sup>

---

21 <sup>51</sup> Exh. S-2 at 31 (Smith Direct)  
 22 <sup>52</sup> Exh. APS-1 at 14 (Wheeler Rebuttal).  
<sup>53</sup> *Id.*  
<sup>54</sup> Tr. at 1696 (Diaz Cortez).  
 23 <sup>55</sup> Exh. APS-1 at 14 (Wheeler Rebuttal).  
<sup>56</sup> Exhibit RUCO-7.  
 24 <sup>57</sup> *Id.*

	Summer Incremental increase \$	Summer Incremental increase %	Winter Incremental increase \$	Winter Incremental increase %	
1 2 3 4	Recover \$33 million	\$0.89 above February 2006 rates	0.54%	\$0.56 above February 2006 rates	0.72%
5 6	Recover \$144 million	\$3.87 above rates including the above surcharge	2.35%	\$2.44 above rates including the above surcharge	3.10%

7  
8 RUCO supports Staff's proposal because it permits timely recovery of APS' fuel costs,  
9 but provides adequate protection to consumers. The Commission would be required to act on  
10 any application prior to any surcharge becoming effective, insuring that increases do not go  
11 into effect automatically. The Commission can consider the appropriate amortization period for  
12 any surcharge on an individual case basis. However, the plan does permit the Commission to  
13 implement any surcharge within 60 days of the end of a calendar quarter.<sup>58</sup>

14 There was also discussion at the hearing of immediately widening the existing 4 mil  
15 bandwidth on the annual PSA adjustor as a means to achieve more timely collection of fuel  
16 costs. While this approach would allow APS to begin recovery of its previously-incurred fuel  
17 costs, it does not provide a mechanism for the recovery of the upcoming summer's fuel costs  
18 after they have been incurred but before the February 2007 annual adjustment.<sup>59</sup> Therefore,  
19 RUCO believes that Staff's proposal to permit quarterly surcharge applications is a better  
20 solution to address what could be an ongoing problem.

---

23 <sup>58</sup> Tr. at 1368-69 (Smith).  
24 <sup>59</sup> See Tr. at 1714 (Diaz Cortez).

1 APS has also proposed certain modifications to Staff's quarterly surcharge approach.  
2 APS' modifications include permitting the surcharge to become effective automatically thirty  
3 days after its filing unless a Staff review uncovers some "extraordinary circumstance."<sup>60</sup>  
4 RUCO opposes this modification to Staff's proposal. It is important that the Commission  
5 oversee the implementation of any surcharge that goes beyond the relatively-automatic annual  
6 adjustment that takes place on February 1 of each year.<sup>61</sup> RUCO can foresee circumstances  
7 similar to those occurring recently with Palo Verde Unit 1, where additional fuel costs may be  
8 incurred due to events that might be due to imprudent action by the Company. The  
9 Commission's oversight of surcharge applications is an appropriate safeguard to insure that  
10 customers are not saddled with costs that might be more appropriately borne by shareholders.

11  
12 **RATE DESIGN**

13 APS has proposed that the increased rates it seeks be recovered from customers by an  
14 equal per-kWh charge. Several intervenors support the use of an equal percentage of the bill  
15 methodology to impose any increased rates. The appropriate rate design for recovery of fuel  
16 costs, whether through base rates or through surcharges, is to impose an equal per-kWh  
17 charge on all customers.<sup>62</sup> Currently, the attribution of fuel costs recovery from the various  
18 customers classes is through an equal per-kWh rate. The base rate of fuel, on which the  
19 balance of the PSA account is based, is an equal per-kWh charge of \$0.020743.<sup>63</sup> Further,  
20 additional fuel costs recovered by the February 1 annual adjustor are collected through an

21  
22 

---

<sup>60</sup> Exh. APS-1 at 11 (Wheeler Rebuttal).

<sup>61</sup> See Tr. at 1698-99 (Diaz Cortez).

23 <sup>62</sup> See Tr. at 1538-39 (Rumolo), at 1581 (Ewen), at 1780-81 (Diaz Cortez).

24 <sup>63</sup> Decision No. 67744 at 14.

1 equal per-kWh charge.<sup>64</sup> In addition, the Commission's recent action to collect the first step  
2 surcharge related to APS' "paragraph 19(d) balancing account" balance imposes an equal per-  
3 kWh charge on all affected customer classes.<sup>65</sup> Though the Commission may have imposed  
4 equal percentage of the bill increases in some instances when approving emergency rates in  
5 the past, the recovery of fuel costs should be in an equal per-kWh charge, as is done when  
6 those same fuel costs are recovered through other aspects of the Company's rate structure.

7  
8 **CONCLUSION**

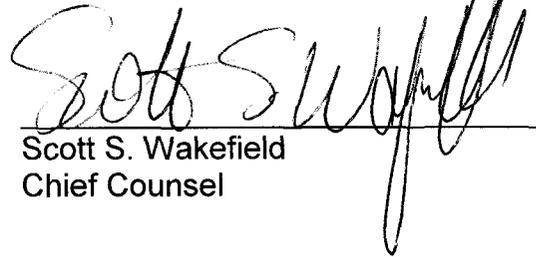
9 RUCO agrees that some level of relief should be awarded in this proceeding to more  
10 closely time the recovery of fuel costs to the time at which they are incurred. However, the  
11 Commission should not merely rely on speculation about rating agency downgrades as the  
12 basis for relief. Instead, the Commission should grant relief only after making its own  
13 conclusion about the degree to which the existing PSA is producing rates that are just and  
14 reasonable to customers and to the Company.

15 Crafting relief in the form of a modification to the PSA's mechanics presents a number  
16 of advantages over declaring an emergency and increasing the base cost of fuel on an interim  
17 basis. RUCO endorses Staff's quarterly surcharge proposal as an appropriate vehicle to use.  
18 Whatever relief the Commission approves, it should design recovery in the form in which fuel  
19 costs are generally recovered, an equal per-kWh charge.

20  
21  
22  
23 <sup>64</sup> Decision No. 68437 at 26.

24 <sup>65</sup> Decision No. \_\_\_\_\_, Docket E-01345A-06-0063, approved at Open Meeting on April 5, 2006.

1 RESPECTFULLY SUBMITTED this 11<sup>th</sup> day of April, 2006.

2  
3   
4 Scott S. Wakefield  
Chief Counsel

5 AN ORIGINAL AND THIRTEEN COPIES  
6 of the foregoing filed this 11<sup>th</sup> day  
7 of April, 2006 with:

8 Docket Control  
9 Arizona Corporation Commission  
1200 West Washington  
Phoenix, Arizona 85007

10 COPIES of the foregoing hand delivered/  
11 mailed this 11<sup>th</sup> day of April, 2006 to:

12 Lyn Farmer  
13 Chief Administrative Law Judge  
Hearing Division  
14 Arizona Corporation Commission  
1200 West Washington  
Phoenix, Arizona 85007  
15 Christopher Kempley, Chief Counsel  
16 Legal Division  
Arizona Corporation Commission  
17 1200 West Washington  
Phoenix, Arizona 85007

Deborah R. Scott  
Snell & Wilmer L.L.P.  
400 East Van Buren  
Phoenix, Arizona 85004-2202

C. Webb Crockett  
Patrick J. Black  
Fennemore Craig, P.C.  
3003 North Central Avenue  
Suite 2600  
Phoenix, Arizona 85012-2913

18 Ernest Johnson, Director  
19 Utilities Division  
Arizona Corporation Commission  
20 1200 West Washington  
Phoenix, Arizona 85007

Lawrence V. Robertson, Jr.  
Of counsel to:  
Munger Chadwick, PLC  
P. O. Box 1448  
Tubac, AZ 85646

21 Thomas L. Mumaw  
22 Karilee S. Ramaley  
Pinnacle West Capital Corporation  
Law Department  
23 P. O. Box 53999  
Phoenix, Arizona 85072-3999  
24

Timothy M. Hogan  
Arizona Center for Law in  
the Public Interest  
202 E. McDowell Road, Suite 153  
Phoenix, Arizona 85004

1 David Berry  
Western Resource Advocates  
2 P. O. Box 164  
Scottsdale, AZ 85252-1064  
3  
4 Eric C. Guidry  
Western Resource Advocates  
2260 Baseline Road, Suite 200  
5 Boulder, Colorado 80302  
6 Walter W. Meek, President  
Arizona Utility Investors Association  
7 2100 N. Central Avenue, Suite 210  
Phoenix, Arizona 85004  
8  
9 Jay I. Moyes, Esq.  
Moyes Storey Ltd.  
1850 N. Central Ave., Suite 1100  
10 Phoenix, Arizona 85004  
11 Kenneth R. Saline, P.E.  
K.R. Saline & Assoc., PLC  
12 160 N. Pasadena, Suite 101  
Mesa, Arizona 85201  
13  
14 Robert W. Geake  
Vice President & General Counsel  
Arizona Water Company  
15 P. O. Box 29006  
Phoenix, Arizona 85038-9006  
16  
17 Michael A. Curtis  
William P. Sullivan  
K. Russell Romney  
18 Curtis, Goodwin, Sullivan, Udall  
& Schwab, P.L.C.  
19 2712 North 7<sup>th</sup> Street  
Phoenix, Arizona 85006-1003  
20  
21 Nicholas J. Enoch  
Jarret J. Haskovec  
Lubin & Enoch, P.C.  
22 349 North Fourth Avenue  
Phoenix, Arizona 85003  
23  
24

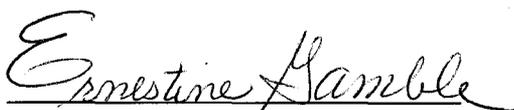
Lieutenant Colonel Karen S. White  
Chief, Air Force Utility Litigation Team  
AFLSA/JACL-ULT  
139 Barnes Drive  
Tyndall AFB, FL 32403

Greg Patterson, Director  
Arizona Competitive Power Alliance  
916 West Adams, Suite 3  
Phoenix, AZ 85007

Michelle Livengood  
Unisource Energy Services  
One South Church Street, Suite 200  
Tucson, AZ 85702

Michael Patten  
Roshka DeWulf & Patten  
400 E. Van Buren, Suite 800  
Phoenix, AZ 85004

Cynthia Zwick  
Arizona Communication Action  
Association  
2700 N. 3<sup>rd</sup> Street, Suite 3040  
Phoenix, AZ 85004

By   
Ernestine Gamble  
Secretary to Scott Wakefield

ATTACHMENT A

Attachment A  
RUCO's Summary of ACC Emergency Rate Case decisions

Decision No. 53909 **APS** (1984) – Finds that APS will be unable to raise sufficient capital to complete its nuclear construction program in a timely and cost-efficient manner, if at all, if it were rated BB and that a decline to BB rating would also cost customers millions in increased interest expense. The Commission granted emergency relief of \$60M (APS had requested \$163.5M, Staff proposed \$135M, RUCO opposed any emergency finding). It does not appear that the relief granted was related to a previously-expended amount of cash.

Decision No. 59250 **Mountain View Water** (August 1995) – Commission declined to find that Company's water hauling expenses qualified for emergency relief, as Company could have foreseen its need to provide an alternative source of water due to its failure to modify its system as Commission Staff had previously directed. The court order for the Company to provide an approved source of drinking and cooking water was foreseeable and should not be viewed as a hardship to the Company.

Decision No. 60394 **Diamond Valley Water Users** (September 5, 1997) – Commission declined to find an emergency where Company had positive cash flow from which it could make required system improvements. No relief granted.

Decision No. 61833 **Far West Water & Sewer** (July 20, 1999) – Far West commenced construction of new water treatment and delivery plant so it could acquire Colorado River water in order to address water quality concerns that the Commission had previously ordered it to address. By time of application, substantial portion of the construction was complete. The Commission had previously approved financing for the plant, but WIFA had conditioned financing (not yet provided to company) on rates that were sufficient to pay principal & interest. The Commission found an emergency, but only granted enough of an increase to service the new debt and pay increased operating costs associated with the new plant, not to provide a return on equity.

Decision No. 61930 **Vail Water Company** (Aug. 1999) – Commission denied Vail's request for emergency rates based on negative cash flow. The Company did not adequately demonstrate that it in fact had negative cash flow, thus the Commission declined to find an emergency.

Decision No. 65352 **Forty-Niner Water Company** (Nov. 2002) – Company had to purchase water from Tucson to augment its wells due to persistent drought and lack of conservation by customers. Commission found an emergency existed due to drought and large, unanticipated cost of the water from Tucson. Approved a commodity rate surcharge to recover previously-incurred cost of water.

Attachment A  
RUCO's Summary of ACC Emergency Rate Case decisions

Decision No. 66389 **Park Water Company** (Oct. 2003) – Approved interim rates (commodity charge) to recover actual water hauling costs due to drought conditions.

Decision No. 66732 **Mount Tipton Water** (Jan. 2004) – Non-profit cooperative water company requested emergency relief due to inability to meet debt service and ongoing operational expenses. Commission approved emergency relief in amount to permit company to continue making payments to WIFA pending resolution of a permanent rate case.

Decision No. 67984 **Naco Water Company** (July 2005) – Company was unable to pay its obligations as they came due. Earlier in the year the Company had large expenditures to address two sudden changes: relocating part of its system to accommodate a county road-widening project, and drilling a new well when an existing well went dry. In addition, another well appeared to be going dry, and the water table was dropping. The Company required large sums to make necessary improvements to its system while staying current on its obligations to WIFA in order to qualify for additional funding. The Commission approved emergency rates in an amount sufficient to meet ongoing obligations, but not to make any meaningful reduction in the accounts payable balance.

Decision No. 67990 **Sabrosa Water Company** (July 2005) – Staff found the water system to be in general disrepair, revenues were not sufficient to cover operating expenses and correct the Company's capacity and water quality problems. Company was not currently providing adequate service and Staff had no reasonable expectation that that it could begin to do so at existing rates. Commission found that an emergency existed and approved interim rates at a level necessary to cover ongoing expenses.