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BEFORE THE ARIZONA CORPORATION COMMISSION

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 **PHELPS DODGE MINING COMPANY AND ARIZONANS FOR ELECTRIC CHOICE AND COMPETITION'S EXCEPTIONS TO RECOMMENDED OPINION AND ORDER**

Pursuant to A.A.C. R14-3-110(B), Phelps Dodge Mining Company and Arizonans for Electric Choice and Competition (hereafter collectively "AECC") hereby submit their Exceptions to the Recommended Opinion and Order ("Recommended Order"), issued by Chief Administrative Law Judge Lyn Farmer on April 19, 2006, in the above-captioned matter.

INTRODUCTION

AECC recognizes the competing interests currently before the Arizona Corporation Commission ("Commission"), and the delicate balancing act required to preserve the public interest. While the amount of the proposed interim rate relief for Arizona Public Service Company ("APS") is similar to that proposed by AECC, the Recommended Order is legally deficient because it creates a new interim Power Supply Adjustor ("PSA") without: 1) a finding that APS is entitled to emergency rate relief; **or** 2) amending

Decision No. 67744 and the PSA established in *that* proceeding, pursuant to A.R.S. § 40-252.

Furthermore, applying this new PSA on a per kWh basis effectively places a disproportionate increase on APS's E-34 and E-32 customers to address the "hardships" – but not an emergency – currently facing APS. Because such a rate design is discriminatory and inappropriate given the circumstances under which it is created, the interim PSA is neither just nor reasonable.

EXCEPTIONS

AECC takes exception to that portion of the Recommended Order's analysis, beginning on page 24 at line 14 and continues through page 25 at line 22, which allows "APS to implement an interim adjustor to collect a portion of the 2006 purchased power and fuel costs that are above the base cost established in Decision No. 67744." Consequently, AECC also takes exception to Findings of Fact Nos. 36, 37 and 38, as well as the first Ordering Paragraph of the Recommended Order.

I. Legal Standard.

A. The New PSA Is an Interim Rate That Can Only Be Establish in the Context of An Emergency.

The Recommended Order creates an interim PSA designed to recover APS's unrecovered purchased power and fuel costs for 2006, using a 5 mil bandwidth above the base cost established in Decision No. 67744. Recommended Order at 24. It will 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. *Id.* The interim PSA is completely separate from the PSA established in Decision No. 67744 (which was capped at 4 mil), and APS is required to include it as a separate schedule in monthly PSA filings to the Commission. *Id.* at 25.

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In *Scates v. Arizona Corp. Commission*, 118 Ariz. 531, 578 P.2d 612 (1978), the Arizona Court of Appeals established three conditions that must be met for the Commission to grant interim rate relief: 1) the existence of an emergency, 2) the posting of a bond sufficient to guarantee refunds to ratepayers if such interim rates are later found to be excessive, and 3) a final determination by the Commission of the just and reasonableness of the interim rates after finding the fair value of the utility's property. *Id.* at 535, 616.[1] However, the Recommended Order specifically concludes that an emergency does not exist. Recommended Order at 23. The logical and legal conclusion, therefore, is that interim rates are unwarranted. Instead, the Recommended Order incorporates the other limited exception to the constitutional requirement that rates be established after a fair value finding of a utility's ratebase – the automatic adjustment clause.

B. The New PSA Is Not an Automatic Adjustment Clause Established in a Rate Proceeding.

The interplay between emergency rate relief and automatic adjustment clauses has been previously addressed by the Arizona Court of Appeals in *Residential Utility Consumers Office v. Arizona Corp. Comm'n*, 199 Ariz. 588, 20 P.3d 1169 (2001) [The Commission authorized a surcharge for a water utility facing increased cost in purchasing Central Arizona Project water to augment water quality and supply]. In *RUCO*, the court framed the issue as "address[ing] the parties' respective arguments relating to the classification of the surcharge at issue in this case as ***either*** an interim rate increase or an increased rate based on an automatic adjustment clause." [Emphasis added.] *Id.* at 592.

The Recommended Order characterizes the new interim PSA as an increased rate based on an automatic adjustment clause, since an emergency does not exist. Recommended Order at 22-23. However, *Scates* requires that any automatic adjustment

[1] The court adopts the position set forth in Arizona Attorney General Opinion No. 71-17 (1971).

must first be established in a rate proceeding. RUCO at 592, ("It is clear that Scates envisions the automatic adjustment clause as part of a utility's overall rate structure, which can only be set after a full rate hearing"). Under the requirements set forth in *Scates* and affirmed in *RUCO*, the Commission is free to modify the existing PSA by increasing the 4 mil bandwidth, as has already been suggested by Chairman Hatch-Miler and Commissioner Gleason. Alternatively, the Commission can grant interim rate relief by finding that an emergency exists. On the other hand, authorizing a wholly separate and interim PSA is not an act of modifying the existing PSA; the operative result being two separate automatic adjustment clauses that are tracked, charged and accounted for separately.

AECC re-asserts that the proper method to address APS's current hardship is to find that an emergency exists. Otherwise, interim rate relief is unnecessary. The Recommended Order states "The PSA was established to address the very 'emergency' asserted by APS, recovery of deferred fuel and purchased power costs." Recommended Order at 23. In actuality, the PSA authorized in Decision No. 67744 was established to allow APS to recover fuel and purchased power costs that rise and fall with the market. "We agree that the use of an adjustor when fuel costs are volatile prevents a utility's financial condition from deteriorating." Decision No. 67744 at 16-17. It was the potential surcharge, subject to Commission approval after timely application by APS, that was established as a means to address any "emergency" created by the continued build-up of large balances in APS's Tracking Account. *See* Decision No. 68437 (February 2, 2006) at 10-11.

The existing PSA and PSA-surcharge are two separate and distinct recovery mechanisms, designed to recover fuel and purchased power costs based on a different set of circumstances and conditions. One is an automatic adjustment, while the other is subject to Commission approval. The Recommended Order proposes to replace a process

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that requires Commission approval with a new interim PSA, an automatic adjustment specifically designed to recover 2006 deferred fuel and purchased power costs. *Scates* and *RUCO* preclude the Commission from establishing any new automatic adjustment without a fair value finding.

AECC takes exception to that portion of the Recommended Order that discusses "rate design" on page 26, Findings of Fact Nos. 53, 54 and 55, and the first Ordering Paragraph of the Recommended Order.

II. Rate Design.

AECC recommended that an emergency interim surcharge remain in effect until superseded by new rates established pursuant to the general rate proceeding. This action would have increased APS's revenues by $126 million in 2006. AECC's calculation assumed that the Step I PSA Surcharge requested by APS on February 2, 2006, is also implemented on May 1, 2006, an action that AECC believes is appropriate under the PSA mechanism. [Higgins Direct at 7-8.]

The flat, cents-per-kWh design in the Recommended Order is not reasonable in the context of an emergency filing. A flat kWh charge causes disparate impacts on different customer groups, with high-load-factor E-34 customers experiencing percentage increases that are 70 percent higher than the system average. It would also cause a disproportionate impact on higher load factor E-32 customers. In the context of an emergency rate filing, with its limited record and restricted opportunity for cost-of-service analysis, it is not appropriate to levy disproportionate increases on different customer groups. [Higgins Direct at 14.]

As APS Exhibit No. 22 indicates, the cumulative impact on an average industrial customer if all the rate increases either adopted or currently proposed is over 41 percent, as measured from April 2005. For high-load-factor industrial customers, the impact is significantly higher – in excess of 52 percent. For industrial customers, the looming

cumulative increase is of crisis proportions. [Higgins, Tr. at 930-31.] This specter contrasts with APS's projections for small E-32 customers, those with demands under 20 kW, who are facing a much more modest cumulative increase of about 15 percent. [APS Exhibit No. 22.] A flat kWh emergency surcharge contributes to these disproportionate burdens between customers.

AECC has identified six instances in which state regulatory commissions have increased base electric rates on an interim basis during 2004-05. In four of the cases, the state regulatory commissions adopted equal-percentage increases. Such equal-percentage increases are typical, and hardly surprising. Absent a record to properly determine that various customer groups should bear different burdens, it is the only reasonable approach to spreading an interim rate increase. [Higgins Direct at 17.]

Even though increased fuel and purchased power costs are important contributors to APS's financial duress, one cannot assume that the cost impacts that APS is experiencing translate into simplistic kWh impacts on all kWh. For example, it is clear that APS's increased fuel and purchased power expenses are not uniform across all seasons and times of use. Simply allocating these costs on a kWh basis, as the Recommended Order has done, assumes that a kWh consumed in the middle of the night in April has the same cost responsibility for mitigating APS's emergency as a kWh consumed in the heat of a July afternoon. This is clearly not the case. Consequently, it does not follow that the most appropriate interim rate design would be a flat kWh charge levied on all kWh – particularly given the magnitude of the increase and the fact that significant groups of customers would experience rate impacts that are 70-percent greater than the average under such an approach. [Higgins Direct at 19.]

Further, the proposed emergency increase is associated with a general rate case filing, and is heavily colored by the potential cost consequences to customers with respect to APS's future cost of capital if emergency relief is not provided. Thus, the emergency

filing incorporates issues that have across-the-board cost implications, which is suggestive on its face of a proportionate cost burden. [Higgins Direct at 18-19.] The proper allocation of any fuel and purchased power cost increases experienced by APS remains to be determined in the general rate case.

If the Commission elects not to adopt an equal-percentage increase on all customers, AECC requests that the Commission consider the following compromise that incorporates elements of both rate design proposals. The first step of the compromise would be to allocate the emergency amounts to be recovered to both Residential customers and Non-Residential customers as a whole on a cents-per-kWh basis as the Recommended Order has proposed. Next, the emergency surcharge on Residential customers would be determined on a flat cents-per-kWh basis, again as the Recommended Order has proposed. Finally, the emergency increase allocated to Non-Residential customers would be recovered through an equal-percentage surcharge on all Non-Residential customer base bills as AECC has proposed. Under such a compromise, Residential customers would pay the same charge as they would under the Recommended Order rate design, while Non-Residential customers would each pay an equal-percentage surcharge. While the compromise would forego the merits of a proportionate increase for all customers, it would eliminate, at least, the disparity in percentage impact across Non-Residential customers, by ensuring that each Non-Residential customer bears a proportionate burden in funding the emergency increase.

CONCLUSION

Arizona law precludes the Commission from establishing the new PSA proposed in the Recommended Order, as set forth herein. The new PSA is not an automatic adjustor created in APS's prior rate proceeding, but rather an interim rate replacement for a mechanism (PSA-surcharge) that requires Commission approval before implementation. AECC believes that an emergency does exist, and that a rate increase is in the public

interest if modified as follows:

- The interim increase should be levied on an equal-percentage basis, or on the basis of the compromise proposed by AECC; and
- Any revenues collected from the interim increase should be applied as a credit against the PSA Annual Tracking Account.

RESPECTFULLY SUBMITTED this 24th day of April 2006.

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this 24th day of April 2006 to *the remaining parties of record.*

By Mary Bollington