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Brian Brumfield
Supervisor
Regulatory Affairs

Tel. 602-250-2708
Fax 602-250-3003
e-mail Brian.Brumfield@aps.com

Mail Station 9708
PO Box 53999
Phoenix, Arizona 85072-3999

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

RE: Arizona Public Service Company –Rate Case Docket Nos. E-01345A-05-0816, E-01345A-05-0826, & E-01345A-05-0827

During the Rate Case Hearings held on December 5th, 2006, a portion was conducted in closed session. The Administrative Law Judge requested that APS go through the transcript of that section of the proceeding with the intent of making as much of it as possible open to public review. Attached is a redacted Public version of the transcript of that proceeding.

Sincerely,

Brian Brumfield /BH.

Brian Brumfield
Supervisor
Regulatory Affairs

BB/bec

Cc: Parties of Record

(Beginning of confidential information.)

CALJ FARMER: Let's go back on the record.

Commissioner Mayes?

COM. MAYES: No need for the microphones, I take it?

CALJ FARMER: We can't have them on. So everyone is going to have to speak up.

Q. (BY COM. MAYES) Mr. Brandt, I'm referring to page 47 in the Standard & Poor's presentation of September 12th. Can you just lay a little bit of groundwork for this? What was this presentation all about and why was it made by the Company? The whole presentation and then I'll get to page 47.

A. Well, semi-annually we go through a formal update, I'll call it formal, with the agencies. This was twice a year. We go through what I'll call a formal update process with the rating agencies. And this was part of that. And it was a presentation that was prepared.

Q. Okay. So this is something you do every -- fairly regularly?

A. Probably every six months or thereabouts. And this one, Standard & Poor's, typically, every year, every 18 months, two years at the most, likes to come out and visit on site with the Company. And they were on site in Phoenix visiting with us.

Q. Okay. And page 47 of the presentation obviously caught my eye. And it describes, as you said earlier, it's entitled, "Forecast Assumptions APS," and then it says, "Regulatory 21.2 percent base rate increase effective 5/1/2007."

So that bullet point essentially assumes that APS gets its entire asking?

A. Yes, sir.

Q. Okay. And then below that is a subtitle called, "Cash Flow." And it says, "Pinnacle West issues $400 million of equity in 2007 and infuses into APS." And then it describes the increase in the APS dividend that you talked about in 2008. [redacted]

Is it Pinnacle West's intention to issue $400 million of equity in 2007, only if it gets its entire asking? Is that what this slide implies?

A. No. It just says that in the forecast -- the detailed forecast that we provided them, that was an assumption that there is $400 million of equity issued in -- later in 2007. [redacted]

Q. But that's not dependent upon the 21.2 percent rate increase?

A. Well, ultimately it will be, but for purposes of what's in the financial model that they're looking at, the results includes a 21.2 percent base rate increase and a $400 million equity issuance and infusion into APS.

Q. Now I'm confused. Okay. Let me ask you this: If you get something less than 21.2 percent, whether it's Staff's proposal, RUCO's proposal, or Staff's proposal plus CWIP, or Staff's proposal plus depreciation, accelerated depreciation, are you going to do the $400 million of equity infusion into APS?

A. Well, Commissioner, when you said Staff or RUCO's proposal with the -- some or all of the other three attributes, if it gets us up to the full $434 million, it's probably likely, we will.

But if not for that, I mean, we talked about the dollars. They end up the same amount regardless of how you get there. If we're downgraded to junk, no, we won't. Highly unlikely.

Q. Okay.

A. I can't imagine that scenario.

Q. Now, I'm sorry if I'm being obtuse, but where is the $435 million figure coming from? Why -- if we get to $435 -- you mean representing the asking?

A. Yes.

Q. Okay. And if you -- let's say you get Staff's proposal, and only Staff's proposal plus CWIP and you're not downgraded to junk, do you do the $400 million of equity?

A. Okay. It was Staff along with which one?

Q. CWIP.

A. No. Full amount of that's $33 million in revenue. That's not near enough to make up.

Q. What are you making up? What's the threshold and what's the trigger for the $400 million in equity?

A. Well, there isn't a hard trigger, Commissioner, but Staff's plus $33 million in revenue, that's gross revenue, which would be tax effective roughly $20 million. That's not enough to save that situation.

Q. Save what situation?

A. To keep us investment grade.

Q. Well, let's say you're wrong. You also said there was a 40 percent chance that the emergency rate increase was going to result in a downgrade of your bond. It turned out it didn't.

So, you know, what if you're wrong and you're not downgraded to junk? Are you going to then do the $400 million in equity?

A. I don't know. I don't think I'm going to be wrong.

Q. So your answer to my question is I don't know? Is your answer I don't know?

A. If we're downgraded to junk, we won't be able to.

Q. No. If you're not downgraded to junk, you will be able to?

A. Commissioner, you're asking hypotheticals. I can't evaluate that just on the fact of two things until I know everything.

Q. Well, this is a hypothetical. You say 22.2 base rate increase. That's a hypothetical, isn't it?

You say 21.2 percent base rate increase, $400 million of equity in 2007, isn't that a hypothetical? Why is my hypothetical less relevant than yours?

A. Because this one I've evaluated. And this is our full ask, and I'm confident that this level will stay investment grade and it would be a positive outcome, constructive regulatory.

You'll see Moody's was a -- report or presentation to us was explicit. Staff's result in weak outcome.

Q. I didn't ask about Staff's. I said Staff's plus CWIP. So I'm asking you to do that hypothetical for me. And let's do a hypothetical that doesn't have a downgrade.

Let's just assume no downgrade, okay? Can we just set that aside for a second, and have you tell me whether you're going to do all $400 million equity infusion into APS next year if there's no downgrade?

A. I can't answer that, Commissioner.

Q. Why?

A. Because you're asking me what I'd do in a situation I don't believe there's any chance of happening.

Q. Well --

A. I mean, it's counter to everything I understand and believe, and based on my expertise in this area, it's not going to happen that way.

Q. Is the $400 million equity infusion dependent upon your not going to junk?

A. Yes.

Q. Okay. And if you don't go to junk with Staff plus CWIP, you will do the $400 million equity infusion with APS?

A. No, that's not what I said. It's not entirely dependent on staying investment grade. But if for some reason we don't -- believe me, if we call it nonconstructive result, I'm not going to go, and go, "Hey, guys, it's time to go to noninvestment grade, move us to junk." I'm not going to do that. We talked about that back in October. I will strongly advocate that.

Unfortunately, sometimes I don't even get a chance to do that, like it was in the case of December of last year, when I get a telephone call, "Don, I told you we were going to wait until the end of the year. Well, it's December 21st, the committee just met, you've been downgraded."

Q. [redacted]

A. [redacted]

Q. [redacted]

A[redacted]

Q[redacted]

A. [redacted]

Q. And does having a higher stock price help make an equity infusion like this more likely or more doable?

A. No.

Q. Why?

A. It's irrelevant.

Q. Why is it irrelevant?

A. Because it's our stock relative to the industry as a whole.

Q. Does having a stock that's outperforming the industry as a whole make it more likely or less likely than an equity that -- issuing equity would be successful?

A. Commissioner, we've got three or maybe four months of miniscule outperformance. That's like saying my last Black Jack hand I won, I'm a winner in Las Vegas. But I've been there for a week, but let's just talk about the last hand that I won.

Q. So it's irrelevant? Your stock price is irrelevant?

A. The stock price is going to be what it is. It's relevant. We've issued equity in 2003 in the low 30s. We've recently, a year and a half ago, 42-ish range. But it's relative to the market as a whole.

The stock price really has not a whole lot to do -- it's relative stock price that's the driving force.

Q. And right now relative to other utility stocks, APS is doing at least as well or better, correct?

A. As the average utility stock for the last few months, the index. It's an average, it's not all.

Q. Okay. You're doing as well or better than the average. You are above average. You are an above-average utility stock right now?

A. If you look at it from a three-month perspective. You look at it for 24 months, it's pretty lousy.

Q. Do you expect it to plunge at any time in the near future, the stock price?

A. No.

Q. You don't expect it to go down, do you?

A. Well, you said plunge. Plunge and go down are two different things.

Q. Do you think it's going to go down by $10 next week?

A. I have no idea.

Q. The $400 million dollars of equity, could you do that tomorrow?

A. No.

Q. Why not?

A. In the middle of this rate case, no.

Q. You can't do it in the middle of any rate case?

A. No.

Q. Why not?

A. Because there's too much uncertainty. Uncertainty is very expensive in the capital markets.

Q. Can you elaborate on that?

A. Commissioner, how do I -- I talked about doing the road show, meeting with the key investors. We have no idea what the Commission is going to do, but why don't you jump on the bandwagon now and go for a ride?

I mean, can it be done? Yes. But it would be horrendously expensive. No one would do that. I mean, for me to recommend that to our board, I'd be shot. I mean, I'm not sure many investment bankers --

Q. Why are you -- what is the purpose behind doing an equity infusion in 2007?

A. To help finance our capital expenditure program.

Q. And you can't do that unless you get all 21.5 percent?

A. You say "all."

Q. This is your hypothetical. You can't do this unless this hypothetical is --

A. No, that's not what this says, Commissioner. This says there's an assumption in the forecast. The math works that there's a 21.2 percent base rate increase effective May 1.

Also in the forecast, it's more than an Excel spreadsheet, but in the financial model is the $400 million equity [redacted] infusion of that amount into APS.

That's showing that we gave them the results of the model, and we're showing them the key assumptions that went into that.

Q. And the model doesn't work with anything but a 21.2 percent base rate increase?

A. Sure, it does.

Q. It does?

A. It will work with any -- it's like -- I don't want to demean it, but it's -- you take an Excel spreadsheet and do a quickie little model. You put in any number you want.

Q. The model in your head, Mr. Brandt, you don't think this pencils out properly unless it's 21.5 percent.

Let's say it's 15 percent. Going back to my original attempt to get you to respond to a hypothetical, which you refused to do, 15 percent, what happens when you plug that into the model?

A. In my head, it tells me that's not adequate to keep us investment grade.

Q. But if it does?

A. Commissioner, I don't think --

Q. What if you're wrong?

A. Well, what if I'm right and we are junk, and we pay for it for the next decade and our customers pay for it for the next decade?

Q. What if you're wrong and you don't go to junk? And what I'm trying to get you to respond to is the question.

A. It will still be a lousy return. It's a lousy story. Just because they didn't pull the trigger, people would be sitting back, they're asleep at the switch. Sooner or later they will.

Q. So a 15 percent rate increase is a lousy story, is that what you're telling us?

A. Yes.

Q. Really? Okay. 15 percent rate increase on top of the -- let's see, how many -- I'm trying to remember how much we've given you in rate increases in the past two years. Boy, 20 percent roughly? 20 percent. 15 plus 20 percent, 35 percent in rate increases, that's a lousy story to take to Wall Street?

A. The other side of it, Commissioner, we spend about eight to nine hundred million a year in capital expenditures.

Q. You spent? I thought you told Mr. Kempley you didn't know what you spent in the last five years.

A. I don't have the five years of numbers, but --

Q. But it's eight to nine hundred million each year?

A. Not for the last five years. It's hundreds of millions. Six to nine hundred million a year. It's a lot of money.

Q. So 15 percent is a lousy story, but 21 percent is a good story, and you'll do a $400 million equity infusion if that's what this Commission does. Is that what you're testifying to?

A. Yes, 15 percent is an inadequate result. And I'm confident that poses a very high risk of being downgraded to junk.

Q. Would a $400 million equity infusion forestall a downgrade? $400 million in addition to Staff's proposal?

A. No.

Q. Why not?

A. Because the CreditMetrics will still be subinvestment grade.

Q. It doesn't affect the CreditMetrics?

A. It affects the debt to equity more so than anything else, but all it does is it swaps out $400 million of debt on the FFO-to-debt ratio.

Q. What does it do -- what does the ratio come out to be after the $400 million infusion? I don't know if we have that chart.

A. We do. It's right here.

Q. So Staff projected PSA plus $400 million is what? What does that do to the ratio?

A. To Staff's?

Q. Mm-mm.

A. That would increase -- if one put in $400 million of equity, it would be about -- increase it about a percent. One percent, maybe 1.2.

Q. Okay. And you're still in junk territory under your proposal? Are you still saying that?

A. Yes.

Q. So you're going to go to junk even if we give you everything you want?

A. I don't think so. We've hovered around that level, and that's why I believe the probability is maybe 15 percent or so, even with our request.

Q. So with a $400 million equity infusion, that gets you to about 16-point what?

MR. MALEDON: I think, your Honor, the 2007, when the equity infusion would take place is about right here. This is the end of 2007. These are year-end.

COM. MAYES: Thank you, Mr. Maledon. That's true.

Q. (BY COM. MAYES) 16 percent? 16-point something percent? Junk is 18 percent?

A. That's correct.

Q. What does 5 percent increase in the rate increase do? Isn't that the difference between Staff's proposal and what I talked to you about -- is 15 percent? Do you know what I'm saying?

A. No.

Q. I asked you hypothetically about 15 percent, a 15 percent rate increase.

A. Oh, I thought you meant a 5 percent increase in Staff's as opposed to a 5 percent rate increase.

Q. Five percent plus Staff's. So 15 percent total rate increase.

A. In other words, starting at 15 percent?

Q. Uh-huh.

A. 15 plus 5?

Q. No, 15 percent.

A. Where does the plus 5 come from?

Q. Well, Staff's proposal is what?

A. I don't have that number here.

MR. MALEDON: Your Honor, it's reflected on -- or, Commissioner Mayes, it's reflected on APS Exhibit Number 10. And APS's proposal -- modified proposal is 21.2 percent. Staff's direct proposal was 9.6 percent rate increase, and RUCO's was 10.9 percent. That does not include Staff's forward looking PSA adjustment.

COM. MAYES: Okay.

Q. (BY COM. MAYES) So if that were a 15 percent rate increase that Staff were proposing, plus your $400 million equity infusion, where would that get us in the FFO-to-debt ratio?

You just said your $400 million would get us about a percent and some change.

A. Correct. I haven't done the math.

Q. Well, you did the math at 400 -- could you do the math?

A. Sure.

Q. Is it possible that would get us to above junk bond status or the 2 percent FFO to debt?

A. To rely on the 400 equity to get you there?

Q. No, increasing Staff's rate increase.

A. To 15 percent?

Q. Correct.

A. I don't believe that would get you above junk.

Q. Would it get us close?

A. No. I think the Company's doesn't get you to a hundred percent. The Company's gets you close on the north side of junk.

COM. MAYES: That's all I have.

CALJ FARMER: I do have just a couple of questions, and I think we're going to need to have this marked as an exhibit.

EXAMINATION

Q BY CALJ FARMER: Mr. Brandt, if you could take a look at page 8. It's actually slide 4.

A. I don't happen to have that one with me. I have all the confidential exhibits.

MR. MALEDON: I have it.

Q BY CALJ FARMER: It's page 8, ACC Staff recommendations, general rate case.

It's confusing because there's a page number, and then at the right there's a slide number. And the right-hand corner it says 4. On the bottom it says page 8 of 101.

A. Maybe if you could show me what --

Q. ACC Staff recommendations, general rate case. And this, to me, looks like just a general summary of the Commission Staff's recommendation in this case?

A. Yes.

Q. And the very last dash down there says, "Unclear on existing limitations (.004 lifetime cap, $776 million annual cap)."

It looks to me in this slide presentation the Company wasn't clear in telling S&P what the Staff recommendation was.

A. At the time this was prepared, we weren't -- we were not clear on it.

Q. Okay. And this is the time that you had prepared these projected FFO-to-debt ratios?

A. Yes.

Q. And have you updated S&P on your understanding?

A. Well, this went to them several weeks beforehand. So it was prepared August potentially -- well, it went to them a week to ten days ahead of the meeting and was prepared sometime before that.

[redacted]

Q. And have you updated them on Staff and the Company's rejoinder testimony?

A. Yes.

Q. Then also, you probably don't have this one either, mine says page 61 of 101, slide 50.

A. I've got the slide 50 number.

CALJ FARMER: This slide is not confidential, is it?

MR. MALEDON: No, it's not. That is not on the list.

CALJ FARMER: Because it's basically the same information that's on the board up there, is it not?

MR. MALEDON: Yes.

CALJ FARMER: But this slide was prepared before, I believe it was Staff witness Antonuk accepted the -- what I'll call the forward looking component of the PSA base fuel and purchased power cost. Not base, just the PPA costs?

THE WITNESS: This is based on the same financial model that was reflected in our rebuttal testimony.

CALJ FARMER: Okay. I think that answers my question.

COM. MAYES: Your Honor, on this slide --

Q. (BY COM. MAYES) Does this slide not assume a

$400 million equity infusion?

A. No, this assumes $400 million for APS, but not for Staff or RUCO.

Q. It does? Okay. That's what the 19.2 percent and the 17.5 percent are?

A. The APS numbers assume a $400 million equity infusion in 2007. The other alternatives do not. I think we're saying the same thing.

Q. But if that's the case, how are we ever supposed to know that, if we hadn't gotten our hands on this confidential document? Do we know -- is that in the record anywhere?

A. Oh, I think Mr. Wakefield --

Q. $400 million equity infusion is in the record?

A. Oh, yeah, we talked about that back in October. Both Staff counsel, Mr. Kempley and Mr. Wakefield, I think.

Q. In 2007?

A. Correct.

[redacted]

[redacted]

CALJ FARMER: Okay. Are there any further questions on this?

MR. WAKEFIELD: Not a question, but just for Commissioner Mayes' benefit, I believe RUCO Exhibit Number 2, which is Mr. Brandt's work papers to some the schedules in his rebuttal testimony, is the place where I had some discussion with him regarding the equity infusion. Those were the exhibits, and I referred to them in cross-examination.

MR. MALEDON: And I think just to supplement what Mr. Wakefield said, Commissioner Mayes, I think you will also find it in Mr. Brandt's rebuttal testimony. And these same FFO-to-debt ratio figures are part of his Attachments 1, 2, and 3, DEB 1RB, DEB 2RB, and DEB 3RB to his rebuttal testimony.

COM. MAYES: Okay. And can you explain, then, Mr. Maledon, the reasons for keeping the rest of the slides confidential, just so I know and we don't have this confusion again.

MR. MALEDON: Sure. The entire document was designated confidential at the beginning because we knew that there was forward looking information in there that the securities lawyers said could not be disclosed publicly.

When, I think it was you, Commissioner, raised an issue about which slides you wanted to look at, we went back to determine which ones were, in fact, confidential.

The other slides other than the ones that are on that list I gave you could be released, but slides 18, 43, 45, 47, 62, 67, and 72 have been identified by the securities lawyers as ones that could not be produced publicly without there being a disclosure problem under SEC rules and regulations.

COM. MAYES: So they all are SEC related?

MR. MALEDON: Yes. And with respect to

slide 47, I think the most sensitive information is the [redacted] Obviously that's not publicly available information.

COM. MAYES: [redacted]

MR. MALEDON: [redacted]

COM. MAYES: [redacted]

MR. MALEDON: [redacted]

COM. MAYES: [redacted]

MR. MALEDON: [redacted]

Q. (BY COM. MAYES) Mr. Brandt, do you recall that?

A. Frankly, I was looking at a different schedule and not paying attention.

Q[redacted]

MR. MALEDON: [redacted]

COM. MAYES: Oh, I thought you were talking about the third bullet.

MR. MALEDON: No. If you recall this morning, I elicited testimony from him on that, thinking that's what you were interested in.

COM. MAYES: No, it was not what I was interested in.

MR. MALEDON: Well, I was just trying to help, Commissioner.

THE WITNESS: Slide 18, Commissioner, on the summary of RFP proposals, that's not a SEC issue. The detail relative to -- while it's not extensive, Mr. Robinson still thought, and he's the guy running that, that providing that information publicly could let somebody do a little more analysis than we'd like them to be able to do as to what's in all the RFPs.

Q. (BY COM. MAYES) So that's unlike -- so Mr. Maledon is not correct, number 18 is not an SEC issue?

A. That's correct.

Q. It's a competitive issue?

A. Yes.

CALJ FARMER: One last question on the issue of the equity infusion.

Is there some magic to the $400 million, or would APS evaluate at any point in 2007, depending on what the Commission rules in this case, whether or not it would be helpful to issue some level of equity?

THE WITNESS: We obviously would -- I mean, the $400 million is not cast in stone under any scenario.

CALJ FARMER: Okay. Thank you.

Anything further for this?

We're going to end the confidential portion now.

(End of confidential information.)