ORIGINAL

000064030

BEFORE THE ARIZONA CORPORATION CC

RECEIVED

2006 NOV 22 P 3:20

AZ CORP COMMISSION
DOCUMENT CONTROL

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MIKE GLEASON
KRISTIN K. MAYES
BARRY WONG

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN, AND TO AMEND DECISION NO. 67744.	DOCKET NO. E-01345A-05-0816
IN THE MATTER OF THE INQUIRY INTO THE FREQUENCY OF UNPLANNED OUTAGES DURING 2005 AT PALO VERDE NUCLEAR GENERATING STATION, THE CAUSES OF THE OUTAGES, THE PROCUREMENT OF REPLACEMENT POWER AND THE IMPACT OF THE OUTAGES ON ARIZONA PUBLIC SERVICE COMPANY'S CUSTOMERS.	DOCKET NO. E-01345A-05-0826
IN THE MATTER OF THE AUDIT OF THE FUEL AND PURCHASED POWER PRACTICES AND COSTS OF THE ARIZONA PUBLIC SERVICE COMPANY.	DOCKET NO. E-01345A-05-0827

STAFF'S NOTICE OF FILING

Staff of the Arizona Corporation Commission hereby provides notice of filing the Supplemental Testimony and Exhibits of James R. Dittmer, in the above-referenced matter.

RESPECTFULLY SUBMITTED this 22nd day of November, 2006.

Arizona Corporation Commission
DOCKETED
NOV 22 2006
DOCKETED BY

Christopher C. Kempley

Christopher C. Kempley, Chief Counsel
Janet Wagner, Senior Staff Counsel
Charles Hains, Attorney
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Original and 17 copies of the foregoing filed this 22nd day of November, 2006 with:

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

Copy of the foregoing mailed this 22nd day of November, 2006 to:

Deborah R. Scott
Kimberly A. Grouse
SNELL & WILMER
One Arizona Center
400 East Van Buren Street
Phoenix, AZ 85004-2202

Thomas L. Mumaw
Karilee S. Ramaley
PINNACLE WEST CAPITAL CORPORATION
Post Office Box 53999, MS 8695
Phoenix, AZ 85072-3999

C. Webb Crockett
Patrick J. Black
FENNEMORE CRAIG, P.C.
3003 North Central Avenue, Suite 2600
Phoenix, AZ 85012-2913

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

Donna M. Bronski
Deputy City Attorney
City Attorney's Office
3939 North Drinkwater Boulevard
Scottsdale, AZ 85251

George Bien-Willner
3641 North 39th Avenue
Phoenix, AZ 85014

Michael W. Patten
J. Matthew Derstine
Laura E. Sixkiller
ROSHKA DEWULF & PATTEN, PLC
One Arizona Center
400 East Van Buren Street, Suite 800
Phoenix, AZ 85004

Michael L. Kurtz
BOEHM, KURTZ & LOWRY
36 East Seventh Street, Suite 1510
Cincinnati, OH 45202

Scott S. Wakefield
RUCO
1110 West Washington Street, Suite 220
Phoenix, AZ 85007

Lawrence V. Robertson, Jr.
Post Office Box 1448
Tubac, AZ 85646

Bill Murphy
Murphy Consulting
5401 North 25th Street
Phoenix, AZ 85016

Andrew W. Bettwy
Karen S. Haller
Assistants General Cunsel
Legal Affairs Department
5241 Spring Mountain Road
Las Vegas, NV 89150

Amanda Ormond
The Ormond Group LLC
Southwest Representative
Interwest Energy Alliance
7650 South McClintock, Suite 103-282
Tempe, AZ 85284

Joseph Knauer, President
Jewish Community of Sedona
and the Verde Valley
100 Meadowlark Drive
Post Office Box 10242
Sedona, AZ 86339-8242

David C. Kennedy, Esq.
818 East Osborn Road, Suite 103
Phoenix, AZ 85014

S. David Childers, Esq.
LOW & CHILDERS
2999 North 44th Street, Suite 250
Phoenix, AZ 85018

Tracy Spoon
Sun City Taxpayers Association
12630 North 103rd Avenue, Suite 144
Sun City, AZ 85351

Tammie Woody
10825 West Laurie Lane
Peoria, AZ 85345

Douglas V. Fant
Law Offices of Douglas V. Fant
3655 West Anthem Drive, Suite A-109
Anthem, AZ 85086

Walter W. Meek, President
Arizona Utility Investors Association
2100 North Central Avenue, Suite 210
Phoenix, AZ 85004

Sein Seitz, President
Arizona Solar Energy Industries Association
3008 North Civic Center Plaza
Scottsdale, AZ 85251

Dan Austin
Comverge, Inc.
6509 West Frye Road, Suite 4
Chandler, AZ 85226

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

Jay I. Moyes
Moyes Storey Ltd.
1850 North Central Avenue, Suite 110
Phoenix, AZ 85004

Kenneth R. Saline, P.E.
K.R. Saline & Assoc., PLC
160 North Pasadena, Suite 101
Mesa, AZ 85201

Robert W. Geake
Vice President and General Counsel
Arizona Water Company
Post Office Box 29006
Phoenix, AZ 85038-9006

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

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

Jim Nelson
12621 North 17th Place
Phoenix, AZ 85022

Barbara Klemstine
Brian Brumfield
Arizona Public Service
Post Office Box 53999, MS 9708
Phoenix, AZ 85072-3999

Jon Poston
AARP Electric Rate Project
6733 East Dale Lane
Cave Creek, AZ 85331

Coralette Hannon
AARP Government Relations & Advocacy
6705 Reedy Creek Road
Charlotte, NC 28215

Roseann Osorio

BEFORE THE
ARIZONA CORPORATION COMMISSION

IN THE MATER OF THE APPLICATION OF ARIZONA	)	
PUBLIC SERVICE COMPANY FOR A HEARING TO	)	
DETERMINE THE FAIR VALUE OF THE UTILITY	)	
PROPERTY OF THE COMPANY FOR RATEMAKING	)	DOCKET NO. E-01345A-05-0816
PURPOSES, TO FIX A JUST AND REASONABLE	)	
RATE OF RETURN THEREON, TO APPROVE RATE	)	
SCHEDULES DESIGNED TO DEVELOP SUCH	)	
RETURN, AND TO AMEND DECISION NO. 67744	)	

SUPPLEMENTAL TESTIMONY

OF JAMES R. DITTMER

ON BEHALF OF THE UTILITIES DIVISION STAFF

NOVEMBER 22, 2006

SUPPLEMENTAL TESTIMONY
OF
JAMES R. DITTMER

ARIZONA PUBLIC SERVICE COMPANY
DOCKET NO. E-01345A-05-0816

Q. Please state your name and address.

A. My name is James R. Dittmer. My business address is 740 Northwest Blue Parkway, Suite 204, Lee's Summit, Missouri 64086.

Q. By whom are you employed?

A. I am a Senior Regulatory Consultant with the firm of Utilitech, Inc.

Q. Have you previously presented testimony within this docket?

A. Yes. I previously filed direct and surrebuttal testimony on behalf of the Arizona Corporation Commission ("ACC" or "Commission") Utilities Division Staff ("Staff").

Q. On whose behalf are you providing this supplemental testimony?

A. This supplemental testimony is being presented on behalf of the ACC Staff.

Q. What is the purpose of your supplemental testimony?

A. First, I wish to clear up some confusion on the record regarding remaining differences between Staff and Company regarding pension and post retirement medical benefits expense.

Second, I will briefly respond to Commissioner Mayes' questions regarding development of cost-of-service income tax expense based upon a "consolidated" versus "stand alone" approach.

Third, I would simply note that I am available to attempt to answer any questions that may be deferred to me by other Staff witnesses addressing the policy issues surrounding the possible implementation of hook up fees. More specifically, I am available to attempt to answer questions surrounding the impact that hook up fees could be expected to have upon the Company's construction expenditures budget as well as the financial metrics that are most heavily relied upon by the credit rating agencies.

Fourth, I wish to briefly address the Company's acknowledgement that it intends to file a transmission case with the Federal Energy Regulatory Commission ("FERC"), and how such filing can be expected to affect the Company's claim for an "attrition" allowance in this case.

REMAINING PENSION AND POST-RETIREMENT MEDICAL EXPENSE DIFFERENCES BETWEEN COMPANY AND STAFF

Q. Please provide your understanding of the remaining differences between Company and Staff with regard to the issues of pensions and post-retirement medical benefits expense.

A. My understanding is that the only difference between Company and Staff with regard to pension expense or post-retirement medical benefits expense, after one final correction to Staff's case that I am making with this Supplemental Testimony, is that Staff continues to oppose the Company's request to recover over a five-year period the underfunded Projected Benefits Obligation.

By way of background, Staff had recommended in direct testimony that APS be required to effectively true-up pension expense and post-retirement medical benefits expense based upon the 2006 actuarial study that was not available at the time Staff was preparing its direct case. APS did, in fact, reflect the recently-issued 2006 actuarial study results in rebuttal testimony, which Staff in turn, reflected within the Joint Accounting Schedules that were revised and updated in surrebuttal testimony.

In direct testimony Staff had also opposed the Company's pension and post-retirement medical benefits expense adjustment that had been included as a subcomponent of the Company's payroll adjustment. In the exhibits filed with rebuttal testimony the Company did, in fact, withdraw that element of its payroll adjustment related to pensions and post-retirement medical benefits expense – though no specific mention of this withdrawal was made in the rebuttal testimony.

A review of the workpapers supporting the Company's pensions and post-retirement medical benefits adjustments revealed an allocation error contained within Staff's Joint Accounting Schedules C-6 and C-7. Accordingly, I am filing with this Supplemental Testimony corrected Schedules C-6 and C-7. With the corrections made in the attached revised Schedules C-6 and C-7, I believe the sole remaining difference between Company and Staff on the issue of pension and post-retirement medical benefits expense lies in the Company's continuing request to collect the underfunded Projected Pension Benefits Obligation over a five-year period.

"CONSOLIDATED" VERSUS "STAND ALONE" COST-OF-SERVICE INCOME TAX EXPENSE DEVELOPMENT

Q. Commissioner Mayes has posed questions regarding the reflection of "consolidated" versus "stand alone" cost-of-service income tax expense development. Please discuss your understanding of the two approaches to cost-of-service income tax development.

A. First, as the name implies, when utilizing the "stand alone" approach to developing cost-of-service income tax expense, the tax calculation entails simply utilizing the revenues and expense from regulated "stand alone" utility operations. It has been my experience that the vast majority of regulatory jurisdictions employ the "stand alone" approach to developing cost-of-service income tax expense.

I have not personally observed the calculation undertaken by any jurisdiction utilizing the "consolidated" tax approach. However, my understanding is that in those jurisdictions that employ the "consolidated" approach, tax losses stemming from unregulated business operations are considered in some fashion in reducing cost-of-service income tax expense. I believe the reasoning employed in adopting a *consolidated* approach is that it is unfair that ratepayers continually pay "phantom" federal and state income taxes that are never paid to taxing authorities, but rather, are transferred to unregulated affiliates that are temporarily or continually in a tax loss position.

Q. Do you advocate employment of the "stand alone" or "consolidated" approach to cost-of-service income tax development?

A. With perhaps one clarifying exception, I endorse employment of the "stand alone" approach to cost-of-service income tax development?

Q. Why do you generally endorse employment of the "stand alone" approach to cost-of-service income tax development?

A. This Commission as well as other regulatory commissions have taken steps to ensure that regulated utility operations do not subsidize any unregulated operations of the utility itself, or any affiliate of the utility. In my opinion, it would be unfair to utilize the "tax losses" of unregulated operations so long as all other "unregulated" operation's revenues, expenses and investment are excluded from the regulated utility's cost-of-service determination.

Q. In an earlier answer you stated that "with perhaps one clarifying exception," you endorsed the employment of the "stand alone" approach to cost-of-service income tax development. Please expand upon the "clarifying exception" that you noted.

A. In some instances, a utility subsidiary's "stand alone" common equity is, in fact, financed in part by debt at the parent company level. This scenario is commonly referred to as a "double leverage" situation. In situations where a utility company's rate base investment is supported by additional debt at the parent company level that is, in fact, being serviced by the return on common equity at the "stand alone" utility subsidiary level, I believe it is fair and reasonable to consider the interest at the parent company level in the cost-of-service income tax development. Since utility ratepayers are indirectly paying for at least a portion of interest being incurred at the parent level, it is reasonable, equitable and consistent to consider such "deduction" in the cost-of-service income tax calculation

Some may refer to the use of parent company interest in the cost-of-service income tax calculation as a form of a "consolidated" tax approach. Without getting into the semantics argument of whether use of parent company interest is or is not a form of a "consolidated" income tax expense calculation, I would simply summarize that to the extent that utility rate payers are indirectly paying the interest cost on parent company debt, they should in turn, receive the tax benefits stemming from such parent company interest cost.

IMPACT OF FERC TRANSMISSION CASE

Q. Is it your understanding that APS is intending to file a FERC transmission case?

A. In answer to a question by Administrative Law Judge Farmer, APS witness Mr. Steven Wheeler indicated that APS was planning on changing its rates at FERC, though to my knowledge no timetable was addressed in the record (Tr. Vol. II, page 351).

Q. Is the fact that APS is purportedly "under earning" on its transmission investment relevant to this proceeding?

A. Normally it would not be. However, in the rebuttal phase of this case the Company effectively abandoned its entire adjusted historic test year cost of service, and now essentially recommends that this Commission set the retail revenue requirement based upon the results of its 2007 and 2008 financial forecast. Because those forecasts which APS would now have the Commission set rates in this proceeding are based on APS' "total company" operating results – including its FERC-regulated transmission operations – the degree to which APS is "under earning" on its transmission rate base is very relevant to this proceeding.

Q. Do you know how much APS is earning on its transmission investment, or how much rate relief might be justified within a FERC transmission rate application?

A. I have not undertaken a detailed calculation, nor have I observed where APS or other parties have calculated a "transmission" cost of service and revenue deficiency. However, by subtracting out the *retail* cost of service results from the "total company" APS cost of service, one can get an idea of the total revenue shortfall from all of APS' unregulated operations.

Q. Have you undertaken such calculation?

A. Yes. On Attachment Supplemental JRD-1 I subtract out APS' originally-proposed *retail* rate base from the APS originally-calculated *total company* rate base. Additionally, I back out APS' originally-proposed *retail* net operating income under existing rates from APS' originally-calculated *total company* net operating income under existing rates. From those two noted calculations I am able to derive a calculated "Required Increase in Non-Jurisdictional Revenues" of slightly over $50 million.

Q. Are you suggesting that APS can justify a $50-plus million FERC-regulated transmission operations rate increase?

A. No. A more refined calculation is required. Further, I note that the APS amounts used in the simplified calculation undertaken on Attachment Supplemental JRD-1 include components with which the APS Staff can be expected to object – similar to objections being made within this retail docket. Rather, this calculation simply supports a conclusion that 1) some amount of transmission rate relief is required, and 2) part of the forecasted "total company" earnings short fall that APS would have this Commission consider in adopting its "attrition adjustment" is apparently being caused by earnings shortfall occurring with APS' operations which are not regulated by this Commission.

Q. If APS files at FERC, and receives a transmission rate increase, can such costs be passed onto retail customers outside the context of a retail rate application?

A. Pursuant to this Commission's order approving the settlement in Docket No. E-01345A-03-0437, APS was authorized to establish a transmission cost adjustor ("TCA") wherein APS may file for approval of a new TCA rate outside the context of a retail rate case so long as the change in the TCA rate exceeds the amount currently included in retail base rate development (i.e., $.000476) by five percent.

Q. If this Commission were to accept APS' proposed attrition adjustment based upon the unaudited 2007 and 2008 forecasts over the objections of Staff and other parties, would such finding have any impact on the APS FERC transmission proceeding?

A. No. Even if this Commission attempts in this case to help APS' "total company" operations out by adopting an attrition adjustment based upon "total company" forecasted results, I do not believe such facts would be relevant in a FERC proceeding. Or in other words, I do not believe the ACC or other parties to a FERC proceeding could successfully argue that any earnings shortfall for transmission operations had effectively been totally or partially remedied by this Commission's adoption of an attrition adjustment that had been based upon APS' "total company" operations.

Q. Does this conclude your Supplemental Testimony?

A. Yes, except to the extent that questions regarding possible implementation of a hook up fee may be deferred to me.

Witness: J. Dittmer

ARIZONA PUBLIC SERVICE
DOCKET NO. E-01345A-05-0816
PENSION EXPENSE ADJUSTMENT
FOR THE TEST YEAR ENDED SEPTEMBER 2005

Revised
Schedule C-6

LINE NO.	DESCRIPTION	REFERENCE	AMOUNT (000s)
	(A)	(B)	(C)
1	Reversal of APS' Proposed Total Company	APS Exhibits	
2	Adjustment to Amortize the Unfunded Projected	Sch. C-2, page 7	
3	Benefit Obligation Over a Five Year Period	Adj't No. 21	$ (43,695)
4	Company's Adjustment to Test Year Operations	Rockenberber	
5	to Reflect Actual 2006 Pension Expense	Rebuttal	
6		Attachment LLR-4	
7		-5RB	2,249
8	Pension Expense Adjustment Included Within APS'	LLR_WP21,	
9	Payroll Annualization Adjustment	page 34	(815)
10	Subtotal:	Sum Lines 7 - 9	1,434
11	Net Total Company Adjustment to APS' Proposed		
12	Level of Pension Expense	Line 3 + Line 10	(42,261)
13	Composite ACC Jurisdictional Wages		
14	and Salaries Allocator		94.212%
15	ACC Jurisdictional Adjustment to APS' Proposed		
16	ACC Jurisdictional Pension Expense	Line 12 * Line 14	$ (39,815)

Witness: J. Dittmer

ARIZONA PUBLIC SERVICE
DOCKET NO. E-01345A-05-0816
POST RETIREMENT MEDICAL BENEFITS ADJUSTMENT
FOR THE TEST YEAR ENDED SEPTEMBER 2005

LINE NO.	DESCRIPTION	REFERENCE	AMOUNT (000s)
	(A)	(B)	(C)
1	Company's Adjustment to Test Year Operations	Rockenberber	
2	to Reflect Actual 2006 PRMB Expense	Rebuttal	
3		Attachment LLR-4	
4		-6RB	$ (3,191)
5	Less: APS PRMB Expense Annualization		
6	Adjustment Included as Part of the	LLR_WP21,	
7	Payroll Expense Annualization	page 34	(469)
8	Net Total Company PRMB Adjustment to Annualize		
9	Expenses for 2006 Actuarial Estimates	Sum Lines 3 - 7	(3,660)
10	Composite ACC Jurisdictional Wages		
11	and Salaries Allocator		94.212%
12	ACC Jurisdictional Adjustment to APS' Proposed		
13	ACC Jurisdictional Pension Expense	Line 9 * Line 11	$ (3,448)