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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

JEFF HATCH-MILLER, Chairman
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2006 NOV 22 P 3:20

AZ CORP COMMISSION
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32

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 *sub*

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**BEFORE THE
ARIZONA CORPORATION COMMISSION**

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) 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

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**SUPPLEMENTAL TESTIMONY
OF
JAMES R. DITTMER**

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

8 Q. Please state your name and address.

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

11
12 Q. By whom are you employed?

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

14
15 Q. Have you previously presented testimony within this docket?

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

19
20 Q. On whose behalf are you providing this supplemental testimony?

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

22
23 Q. What is the purpose of your supplemental testimony?

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

1 Second, I will briefly respond to Commissioner Mayes' questions regarding
2 development of cost-of-service income tax expense based upon a "consolidated"
3 versus "stand alone" approach.
4

5 Third, I would simply note that I am available to attempt to answer any
6 questions that may be deferred to me by other Staff witnesses addressing the
7 policy issues surrounding the possible implementation of hook up fees. More
8 specifically, I am available to attempt to answer questions surrounding the
9 impact that hook up fees could be expected to have upon the Company's
10 construction expenditures budget as well as the financial metrics that are most
11 heavily relied upon by the credit rating agencies.
12

13 Fourth, I wish to briefly address the Company's acknowledgement that it
14 intends to file a transmission case with the Federal Energy Regulatory
15 Commission ("FERC"), and how such filing can be expected to affect the
16 Company's claim for an "attrition" allowance in this case.
17

18 **REMAINING PENSION AND POST-RETIREMENT MEDICAL**
19 **EXPENSE DIFFERENCES BETWEEN COMPANY AND STAFF**
20

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

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

6
7 By way of background, Staff had recommended in direct testimony that APS be
8 required to effectively true-up pension expense and post-retirement medical
9 benefits expense based upon the 2006 actuarial study that was not available at
10 the time Staff was preparing its direct case. APS did, in fact, reflect the
11 recently-issued 2006 actuarial study results in rebuttal testimony, which Staff in
12 turn, reflected within the Joint Accounting Schedules that were revised and
13 updated in surrebuttal testimony.

14
15 In direct testimony Staff had also opposed the Company's pension and post-
16 retirement medical benefits expense adjustment that had been included as a
17 subcomponent of the Company's payroll adjustment. In the exhibits filed with
18 rebuttal testimony the Company did, in fact, withdraw that element of its payroll
19 adjustment related to pensions and post-retirement medical benefits expense –
20 though no specific mention of this withdrawal was made in the rebuttal
21 testimony.

22

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

10
11 **"CONSOLIDATED" VERSUS "STAND ALONE" COST-OF-**
12 **SERVICE INCOME TAX EXPENSE DEVELOPMENT**
13

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

18
19 A. First, as the name implies, when utilizing the "stand alone" approach to
20 developing cost-of-service income tax expense, the tax calculation entails
21 simply utilizing the revenues and expense from regulated "stand alone" utility
22 operations. It has been my experience that the vast majority of regulatory
23 jurisdictions employ the "stand alone" approach to developing cost-of-service
24 income tax expense.

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

10

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

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

15

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

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

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

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

16
17 Some may refer to the use of parent company interest in the cost-of-service
18 income tax calculation as a form of a "consolidated" tax approach. Without
19 getting into the semantics argument of whether use of parent company interest
20 is or is not a form of a "consolidated" income tax expense calculation, I would
21 simply summarize that to the extent that utility rate payers are indirectly paying
22 the interest cost on parent company debt, they should in turn, receive the tax
23 benefits stemming from such parent company interest cost.

1 **IMPACT OF FERC TRANSMISSION CASE**

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

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

7
8 Q. Is the fact that APS is purportedly “under earning” on its transmission
9 investment relevant to this proceeding?

10
11 A. Normally it would not be. However, in the rebuttal phase of this case the
12 Company effectively abandoned its entire adjusted historic test year cost of
13 service, and now essentially recommends that this Commission set the retail
14 revenue requirement based upon the results of its 2007 and 2008 financial
15 forecast. Because those forecasts which APS would now have the Commission
16 set rates in this proceeding are based on APS’ “total company” operating results
17 – including its FERC-regulated transmission operations – the degree to which
18 APS is “under earning” on its transmission rate base is very relevant to this
19 proceeding.

20
21 Q. Do you know how much APS is earning on its transmission investment, or how
22 much rate relief might be justified within a FERC transmission rate application?

23

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

6

7 Q. Have you undertaken such calculation?

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

15

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

18

19 A. No. A more refined calculation is required. Further, I note that the APS
20 amounts used in the simplified calculation undertaken on Attachment
21 Supplemental JRD-1 include components with which the APS Staff can be
22 expected to object – similar to objections being made within this retail docket.
23 Rather, this calculation simply supports a conclusion that 1) some amount of

1 transmission rate relief is required, and 2) part of the forecasted "total company"
2 earnings short fall that APS would have this Commission consider in adopting
3 its "attrition adjustment" is apparently being caused by earnings shortfall
4 occurring with APS' operations which are not regulated by this Commission.

5
6 Q. If APS files at FERC, and receives a transmission rate increase, can such costs
7 be passed onto retail customers outside the context of a retail rate application?

8 A. Pursuant to this Commission's order approving the settlement in Docket No. E-
9 01345A-03-0437, APS was authorized to establish a transmission cost adjustor
10 ("TCA") wherein APS may file for approval of a new TCA rate outside the
11 context of a retail rate case so long as the change in the TCA rate exceeds the
12 amount currently included in retail base rate development (i.e., \$.000476) by
13 five percent.

14
15 Q. If this Commission were to accept APS' proposed attrition adjustment based
16 upon the unaudited 2007 and 2008 forecasts over the objections of Staff and
17 other parties, would such finding have any impact on the APS FERC
18 transmission proceeding?

19 A. No. Even if this Commission attempts in this case to help APS' "total
20 company" operations out by adopting an attrition adjustment based upon "total
21 company" forecasted results, I do not believe such facts would be relevant in a
22 FERC proceeding. Or in other words, I do not believe the ACC or other parties
23 to a FERC proceeding could successfully argue that any earnings shortfall for

1 transmission operations had effectively been totally or partially remedied by this
2 Commission's adoption of an attrition adjustment that had been based upon
3 APS' "total company" operations.

4

5 Q. Does this conclude your Supplemental Testimony?

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

8

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
Page 1 of 1

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	<u>(815)</u>
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		<u>94.212%</u>
15	ACC Jurisdictional Adjustment to APS' Proposed		
16	ACC Jurisdictional Pension Expense	Line 12 * Line 14	<u>\$ (39,815)</u>

Witness: J. Dittmer

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

Revised
Schedule C-7
Page 1 of 1

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	<u>(469)</u>
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		<u>94.212%</u>
12	ACC Jurisdictional Adjustment to APS' Proposed		
13	ACC Jurisdictional Pension Expense	Line 9 * Line 11	<u>\$ (3,448)</u>