

ORIGINAL



0000064062

BEFORE THE ARIZONA CORPORATION COMMISSION

RECEIVED

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

COMMISSIONERS

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

2006 NOV 22 P 3:20

AZ CORP COMMISSION  
DOCUMENT CONTROL

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 22<sup>nd</sup> day of November, 2006.

Arizona Corporation Commission  
**DOCKETED**  
**NOV 22 2006**

DOCKETED BY

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

1 Original and 17 copies of the foregoing filed  
this 22<sup>nd</sup> day of November, 2006 with:

2 Docket Control  
3 Arizona Corporation Commission  
4 1200 West Washington  
5 Phoenix, AZ 85007

6 Copy of the foregoing mailed this  
7 22<sup>nd</sup> day of November, 2006 to:

8 Deborah R. Scott  
9 Kimberly A. Grouse  
10 SNELL & WILMER  
11 One Arizona Center  
12 400 East Van Buren Street  
13 Phoenix, AZ 85004-2202

14 Thomas L. Mumaw  
15 Karilee S. Ramaley  
16 PINNACLE WEST CAPITAL  
17 CORPORATION  
18 Post Office Box 53999, MS 8695  
19 Phoenix, AZ 85072-3999

20 C. Webb Crockett  
21 Patrick J. Black  
22 FENNEMORE CRAIG, P.C.  
23 3003 North Central Avenue, Suite 2600  
24 Phoenix, AZ 85012-2913

25 Michelle Livengood  
26 UniSource Energy Services  
27 One South Church Street, Suite 200  
28 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 39<sup>th</sup> 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 25<sup>th</sup> Street  
Phoenix, AZ 85016

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

1 Amanda Ormond  
The Ormond Group LLC  
2 Southwest Representative  
Interwest Energy Alliance  
3 7650 South McClintock, Suite 103-282  
Tempe, AZ 85284  
4  
5 Joseph Knauer, President  
Jewish Community of Sedona  
6 and the Verde Valley  
100 Meadowlark Drive  
7 Post Office Box 10242  
Sedona, AZ 86339-8242  
8  
9 David C. Kennedy, Esq.  
818 East Osborn Road, Suite 103  
10 Phoenix, AZ 85014  
11 S. David Childers, Esq.  
LOW & CHILDERS  
12 2999 North 44<sup>th</sup> Street, Suite 250  
Phoenix, AZ 85018  
13  
14 Tracy Spoon  
Sun City Taxpayers Association  
15 12630 North 103<sup>rd</sup> Avenue, Suite 144  
Sun City, AZ 85351  
16  
17 Tammie Woody  
10825 West Laurie Lane  
18 Peoria, AZ 85345  
19 Douglas V. Fant  
Law Offices of Douglas V. Fant  
20 3655 West Anthem Drive, Suite A-109  
Anthem, AZ 85086  
21  
22 Walter W. Meek, President  
Arizona Utility Investors Association  
23 2100 North Central Avenue, Suite 210  
Phoenix, AZ 85004  
24  
25 Sein Seitz, President  
Arizona Solar Energy Industries Association  
26 3008 North Civic Center Plaza  
Scottsdale, AZ 85251  
27  
28

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 17<sup>th</sup> Place  
Phoenix, AZ 85022

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

1 Jon Poston  
2 AARP Electric Rate Project  
3 6733 East Dale Lane  
4 Cave Creek, AZ 85331

5 Coralette Hannon  
6 AARP Government Relations & Advocacy  
7 6705 Reedy Creek Road  
8 Charlotte, NC 28215

9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28  
*Roseann Corio*

**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**

1  
2  
3  
4  
5  
6  
7

**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>