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BEFORE THE ARIZONA CORPORATION COMMISSION 325

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AZ CORP COMMISSION  
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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 Direct Testimony Summary of Ralph C. Smith in the above-referenced matters.

RESPECTFULLY SUBMITTED this 21 day of November, 2006.

Arizona Corporation Commission  
**DOCKETED**

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## DIRECT TESTIMONY OF RALPH C. SMITH EXECUTIVE SUMMARY

My testimony addresses the following issues:

- The Company's proposed depreciation rates.

My findings and recommendations for each of these areas are as follows:

- The depreciation rates proposed by APS presented in Mr. White's Attachments REW-1 and REW-2 should be adopted for use in this case. The depreciation rates proposed by APS were developed in a manner that is consistent with the Commission's rules for depreciation rates. My review of the details provided in Mr. White's Attachments REW-1 and REW-2 and other information indicates that those new rates proposed by APS are consistent with a "technical update" approach to the depreciation rates that the Commission approved in Decision 67744. The net change in percentage terms resulting from APS's technical update in composite terms is fairly small, an increase of 0.06 percentage points for APS plant and a decrease of 0.20 percentage points for plant that APS acquired from PWEC.
- Each of the new depreciation rates proposed by APS should be clearly broken out between (1) a service life rate and (2) a net salvage rate, similar to the rates shown in Appendix A to the Commission's Decision No. 67744. By doing this, the depreciation expense related to the inclusion of estimated future cost of removal in depreciation rates can be tracked and accounted for by plant account.
- APS's depreciation rates include estimated future cost of removal. In contrast with APS's approach, a normalized expense allowance approach better conforms with the generally accepted accounting principles articulated in SFAS 143 by not treating estimated inflated future removal costs as if they were a current obligation and a current expense. Additional advantages offered by the normalized expense allowance approach include that it is simple, straight-forward and easy to implement, provides an opportunity for the Company to recover a normalized allowance for cost of removal based on recent actual cost, and avoids charging current customers for estimated future inflation. However, the Commission's rules at R14-2-102 in their present state would appear to preclude this alternative for purposes of this case. Rule R14-2-102 is a rule of general applicability to electric utilities in the state of Arizona. Because I believe there is no compelling reason to treat cost of removal (where there is no current obligation to incur such cost) differently from other normalized operating expenses, I recommend that the Commission consider amending Rule R14-2-102 to allow treatment of cost of removal in the manner recommended by Staff's consultant in the prior APS rate case.