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BEFORE THE
ARIZONA CORPORATION COMMISSION

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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
E-01345A-05-0826
E-01345A-05-0827

Arizona Corporation Commission
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REPLY BRIEF OF THE KROGER CO.

The Kroger Co. ("Kroger") submits this Brief in reply to the Initial Post-Hearing Brief of the Arizona Public Service Company ("APS" or "the Company").

1. The Particular Methodology Used To Conduct A Cost Of Service Study Is Irrelevant If The Allocation Of Rates Between The Customer Classes Ignores The Results Of That Cost Of Service Study.

On pages 90 through 92 of its Brief, APS defends the reasonableness of its cost-of-service study and engages Staff in a debate concerning the relative merits of using a "4 coincident peak" ("4CP") cost of service methodology versus the "peak and average" cost of service methodology. Although Kroger has previously noted that it supports the Company's use of the 4CP method[1] the controversy concerning which method is more appropriate is entirely academic if the Company's rate allocation proposal is accepted because the Company simply ignored the results of its own cost of service study when it designed its rates. In its Brief, APS concedes that its proposal does not take cost of service into account:

> "[U]*nder APS's proposed rate design, the major classes of customers - Residential, General Service, Irrigation, Street Lighting, and Dusk to Dawn - would each receive a percentage increase that is approximately the same as the overall requested increase, even though strict adherence to the results of the cost-of-service study would indicate higher increases are supportable.*"[2]

[1] Initial Brief of Kroger pp. 2-3.
[2] Initial-Post Hearing Brief of Arizona Public Service Company p. 86.

The Company's cost of service study reveals that the General Service customer class is currently paying over $40 million in subsidies to the Residential class. However, APS's proposal ignores these results and recommends a rate increase to every customer class that is "*approximately the same as the overall requested increase.*" This would increase the subsidy paid by the General Service class from over $40 million to over $60 million.[3] Whether the Commission accepts APS's or Staff's cost of service methodology is immaterial if the results of those studies are disregarded in setting rates.

It seems that everyone is in agreement that "*strict adherence*" to the cost of service results in setting rates is inappropriate given the impact such a policy would have on the rates of the Residential class. However, it is also imperative that the cost of service results not be ignored as the Company has done in its proposal. Kroger and Phelps Dodge Mining Company ("Phelps Dodge")/Arizonans for Electric Choice and Competition ("AECC") have submitted proposals that address the subsidy problems revealed by the cost of service results while keeping with the principle of gradualism so as to not levy a sudden and drastic increase to the subsidized customers.[4] Kroger recommends that the Commission take the incremental, but vitally important step of addressing interclass subsidies as proposed by Phelps Dodge/AECC and Kroger.

Respectfully submitted,

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[3] Initial Brief of Kroger p. 6.
[4] Kroger's rate allocation proposal is summarized in its Initial Brief at pp. 2-9. Phelps Dodge/AECCs' rate allocation proposal is summarized in its Closing Brief at pp. 23-25.