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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MIKE GLEASON
KRISTIN K. MAYES
GARY PIERCE

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 NOS. E-01345A-05-0816 E-01345A-05-0826 E-01345A-05-0827

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Reply Brief
on Behalf of
Arizona Utility Investors Association

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The Arizona Utility Investors Association ("AUIA" or the "Association") submits this Reply Brief on the Arizona Public Service Company ("APS" or the "Company") request for rate increase. AUIA will primarily focus its comments and responses on the same issues discussed in its Initial Brief—namely, the appropriate return on equity ("ROE"), capital structure and an ROE attrition allowance; construction work in progress ("CWIP") and accelerated depreciation allowances; and Power Supply Adjustor ("PSA") issues.

INTRODUCTION

An erroneous, but persistent theme throughout the Staff and RUCO opening briefs is that the Commission need only address APS' recent fuel and purchased power cost recovery issues to restore the Company's financial standing and creditworthiness. For example, Staff states that "[a]ny 'attrition' that may have occurred was related to the delay in the recovery of fuel and purchased power costs."[1] RUCO opines that a "strong and stable PSA mechanism is a better way to address the financial difficulties that APS has recently experienced..."[2] Thus, notwithstanding, among other things, a $1 billion increase in rate base and a $450 million equity infusion since the Company's 2002 test year in the last rate decision,[3] Staff and RUCO advance the completely counter-intuitive positions that APS' non-fuel cost of service has actually declined.[4]

AUIA certainly agrees that PSA improvements are a critical part of this case. But, the evidence is overwhelming that the twin problems this Commission must address are not only a stronger PSA, but, as well, a financially stronger APS. Moody's Investor Services' negative outlook is based on the credit challenge of "increasing amounts of capital expenditures" and the

[1] Staff's Post Hearing Brief ("Staff Brief"), p. 5, ll. 13-14.
[2] RUCO's Initial Closing Brief ("RUCO Brief"), p. 38, ll. 15-16.
[3] Decision No. 67744 dated April 7, 2005.
[4] Staff Brief, p. 5, ll. 2-5; RUCO Brief, p. 32, ll. 5-7.

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need for significant rate increases to recover those costs—not just timely recovery of prudent fuel and purchased power expense.[5] S&P's has stressed precisely the same point:

> APS's rating is premised on the ACC continuing to provide sustained regulatory support that addresses permanent rate relief and manages the [fuel] deferral balances downward over a reasonable time frame.[6]

Similarly, former Michigan PSC Chairman Steven Fetter noted: "Arizona is competing with other jurisdictions all the time [for debt and equity investments]. Competitiveness in this context is measured by fair returns and timely processes."[7] Investors, including the nearly 7,000 members of AUIA, are willing to place their capital at risk, but only if APS is given a complete set of financial tools to be competitive in the investment market.

RETURN ON EQUITY

11.5% ROE

APS current S&P/Moody's ratings reside precipitously at the lowest rung of the investment-grade ladder, making one of this case's most important aspects an adequate ROE award. Mr. Fetter stressed why an adequate ROE is important to equity and debt investors as well as the rating agency evaluations which will quickly follow the Commission's decision:

> The existence of equity in a utility capital structure provides a company with the capacity to tolerate the normal ups and downs that come with operational business risks, while also providing a cushion to a company's lenders and bondholders (fixed-income investors). Fixed-income investors look to the earnings of shareholders as an additional margin available for the payment of interest and principal under adverse business circumstances.[8]

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[5] AUIA 1, p. 18, ll. 19-21.
[6] APS 5, DEB-5RB (emphasis supplied).
[7] Fetter Rebuttal, APS 24, p. 18, ll. 6-7 (emphasis supplied).
[8] *Id.*, p. 9, ll. 8-13.

AUIA's witness Julie Cannell put it this way: "An anemic ROE award at the current time would quickly reverse the earnings prospects for the utility and eliminate the progress achieved in [last] year's [Commission PSA] decisions."[9]

Staff suggests the Commission approve a 10.25% ROE.[10] RUCO asks the Commission[11] to approve an ROE of only 9.25%—more than 1.25% below the return authorized recently by any regulatory commission.[12] Several factors demonstrate the inadequacy of either recommendation.

The primary problem with both positions is they ignore recent regulatory and earnings history, negative ratings developments and corresponding APS risk elevation. Less than two years ago, based upon Staff, RUCO and other parties' agreement, the Commission authorized an ROE of 10.25% in Decision No. 67744. Since that time, APS' actual returns have never approached that level and, in fact, have ranged from about 2% to more than 4.5% below it.[13] Since that time, all three rating agencies have downgraded. S&P's and Moody's ratings rest just above "junk" status. Finally, since entry of that decision, the Company's business risk profile has also been raised, Moody's ratings outlook has been shifted to negative and APS still is below investment grade requirements on the crucial FFO/Debt metric.

Despite those factors, together with capital needs approaching $1 billion annually for the foreseeable future, Staff recommends that investors require the same return as, while RUCO suggests that investors actually require 100 basis points less return than, the ROE authorized in the spring of 2005. APS has to compete every day with utilities which are facing considerably

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[9] Cannell Direct, AUIA 1, p. 33, ll. 10-12.
[10] Staff Brief, pp. 41-44.
[11] RUCO Brief, pp. 31-32.
[12] Hill Hearing Testimony, TR Vol. IX, p. 2035, ll. 1-20.
[13] APS Initial Post-Hearing Brief ("APS Brief"), Exhibit 4.

less risk, have much smaller capital requirements and which offer greater compensation. Neither Staff's nor RUCO's ROE positions create anything close to the playing field on which it must do that.

Further buttressing the inadequacy of the Staff and RUCO recommendations are recent historic ROE awards, general utility industry expected awards and specific investor expectations. Based on the most recent data available, Regulatory Research Associates reports nationally allowed ROEs of 10.54%.[14] While that exceeds both the Staff and RUCO positions, that historic average is expected to rise even higher. Industry wide, Lehman Brothers is projecting annual allowed ROE awards of 11.3% through 2010.[15] Value Line anticipates overall electric utility returns of 11.5% through 2011.[16] Finally, three investment firms have stated specific ROE expectations for this case ranging from 10.5-11.5%.[17]

Another major weakness in the Staff and RUCO positions is the fact that neither Mr. Parcell's nor Mr. Hill's ROE recommendations were supported by the allowed returns for the proxy groups of utilities which they selected as being most comparable to APS. Authorized returns for both groups averaged 10.9%—results well in excess of either Staff's or RUCO's ROE recommendations.[18]

The cost of capital discussion in a rate case is laden with lots of statistics and highly technical discussions of things like the growth rates used in the DCF model or the market risk premium necessary to apply the CAPM. Dr. Avera presented over 160 pages of pre-filed

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[14] APS 44, WEA-4.
[15] AUIA 1, p. 28, ll. 3-5.
[16] Value Line Investment Survey (Sept. 1, 2006); APS 42, p. 9.
[17] AUIA 2, p. 12, ll. 12-19.
[18] Avera Rebuttal, APS 42, p. 8, l. 22-p. 9, l. 5.

testimony discussing these methods and fully justifying his recommendation as to why 11.5% is a fair and reasonable ROE. But, he also noted the following:

> [F]ocusing on these more technical debates masks the salient issue; namely, "What is a fair ROE for APS given its risks and the financial realities that the Company faces?" The answer to this question is of more than theoretical interest. If the allowed ROE does not maintain the ability of APS to obtain capital on reasonable terms from real world investors, then the real world customers of APS will suffer the consequences.[19]

An 11.5% ROE is the only result which affords both the Company and its customers the chance to avoid those consequences.

1.7% Attrition Allowance

Equally important is approval of a 1.7% attrition allowance to afford APS an opportunity, not a guarantee, to earn that authorized return. No party argues that the law requires anything else. Staff Counsel Mr. Kempley phrased it this way on opening:

> Rates are set to allow the recovery of a utility's reasonable operating expenses and provide the opportunity to earn a fair rate of return on the fair value of its property devoted to public service at the time of the inquiry.[20]

The evidence, both historic and projected, demonstrates conclusively that, absent at least a 1.7% attrition factor, APS will have neither the opportunity nor the ability to raise capital on reasonable terms to meet the growth challenges of the nation's fastest growing state. Absent that opportunity and ability, the Company and its customers will suffer the "real world" consequences Dr. Avera described.

The unfortunate, but persistent, historic fact is that APS has consistently earned less than its authorized ROE for several years. The earnings shortfall reached $134 million as of June 30,

[19] Avera Rejoinder, APS 43, p. 2, l. 24-p. 3, l. 3.
[20] TR Vol. I, p. 71, ll. 21-25.

2006.[21] As discussed previously, the 200 to more than 450 basis point earning deficiency since APS' last April 2005 rate order confirms the conservative nature of the 170 basis point allowance. Forecasts paint precisely the same picture. The Company's F-1 schedules, filed with the Amended Application on January 31, 2006, demonstrated that if the Commission granted the full rate request, including the 11.5% ROE on the adjusted historic test year, the return on average common equity would actually be only 9.8%.[22] Mr. Brandt's Exhibits DEB-1RB to DEB-3RB show that APS' projected 2007 ROE would be only 8%, 6.8% and 6% on the Company's, Staff's and RUCO's proposed rates, respectively.

Staff, RUCO and AECC argue against either attrition adjustments generally or an ROE allowance specifically on several grounds. Staff and RUCO maintain that forecasts are unreliable.[23] First, as just discussed, the 1.7% attrition allowance is fully supported by both actual as well as projected earnings experience. Second, Commission rules require forecast results as part of the required R14-2-103 schedules. Both Mr. Wheeler and Mr. Brandt confirmed that the forecasts filed initially and during case processing followed the same methods used routinely as part of APS' normal and ordinary course of business.[24] Third, Staff witness John Antonuk and Liberty Consulting conducted a thorough review of the Company's fuel/purchased power forecast which independently confirmed that forecast was "comprehensive and logically structured."[25] Fourth, former Fitch utilities analyst Steven Fetter testified that the ratings agencies will use forecasts to determine, after the Commission issues its final order,

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[21] Brandt Rebuttal, APS 5, DEB-10RB, p. 4.
[22] Schedule F-1, Proposed Rates Year Ending 12/31/2007, l. 23.
[23] Staff Brief, pp. 2-3; RUCO Brief, pp. 46-47.
[24] Wheeler Hearing Testimony, TR Vol. I, pp. 113-115; Brandt Hearing Testimony, TR Vol. IV, p. 769.
[25] Antonuk Supplemental, Staff 30, p. 23.

whether to improve, confirm or downgrade APS' rating to "junk" status.[26] Staff's and RUCO's forecast objections deprive the Commission of arguably the most important data which will inform this case's most critical outcome.

Staff and RUCO also maintain that current conditions are different than those in the 1980s when Palo Verde was under construction and the Commission authorized an attrition adjustment.[27] AUIA agrees—they are worse. The $900 million total and $700 million generation, distribution and general plant capital expenditures yearly for the foreseeable future are two to three times the Company's annual capital outlays during Palo Verde construction.[28] Dr. Avera discussed extensively at hearing the reasons why APS' current situation is far worse than the challenges faced during the base-load building era of the 1980s.[29] Federal tax credits and accelerated depreciation to make the investment less burdensome are no longer in effect. The current situation of many small projects instead of one large sustained project supported throughout by AFUDC, when combined with regulatory lag, creates a systematic shortfall in revenues to support on-line investment. Finally, unlike Palo Verde, there is no light at the end of this tunnel given Arizona's rapid, steady growth rate and the Company's huge construction requirements to meet it. As Dr. Avera stated, unlike the Palo Verde period, APS "can't say to the investment community, just stick with us a little bit longer and everything is going to be okay."[30]

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[26] Fetter Hearing Testimony, TR Vol. VI, p. 1246, l. 13-p. 1247, l. 13.
[27] Staff Brief, p. 4; RUCO Brief, pp. 47-48.
[28] Wheeler Hearing Testimony, TR Vol. I, pp. 112-113.
[29] TR Vol. IX, pp. 1851-1855.
[30] *Id.*, p. 1855, ll. 6-8.

Finally, RUCO opposes attrition adjustments because they differ from what it maintains are the methods historically relied upon by the Commission,[31] and Staff and AECC offer the additional argument that APS' initial case was not developed on such issues.[32] On the first issue, the Commission previously approved a much larger 4% ROE attrition adjustment when APS' credit rating was higher and its capital requirements less demanding.[33]

On the second issue, since APS' direct testimony was filed more than a year ago, two more ratings agencies have issued downgrades and one has placed APS on negative outlook. The rating agencies' and investment analysts' focus on both earnings quantity and quality has increased exponentially. On July 21, 2006, noting that "ratepayers stand to save money in long-term borrowing costs if your credit ratings hold or improve," the Chairman asked APS for testimony on measures the Commission could take to help gradually improve creditworthiness. The Company responded to these developments in September at its first opportunity and over more rounds of testimony, discovery and some nine weeks of hearing, the parties have had a more than reasonable opportunity to develop and debate these issues. This record refutes Staff's charge that APS "laid in wait" on these issues.[34]

Actual experience as well as reliable forecasts confirm the need for—as well the conservative nature of—the 1.7% ROE attrition allowance. This Commission has used that technique before when the Company faced less severe credit and construction challenges and its creditworthiness was more sound. Commission approval (1) affords APS the opportunity the law requires to earn a reasonable rate of return on its fair value and (2) sends an important

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[31] RUCO Brief, pp. 2-3.
[32] Staff Brief, p. 1; AECC Brief, p. 16.
[33] Wheeler Hearing Testimony, TR Vol. I, p. 109, ll. 11-19.
[34] Staff Brief, p. 2, ll. 10-11.

message to the debt and equity markets that Arizona's largest utility will have the regulatory support and financial ability to meet the needs of this growing state.

Capital Structure

Staff supports the Company's actual test year capital structure, as adjusted, of 54.5% common equity to 45.5% long-term debt.[35] As discussed at pages 7-8 of the Association's Initial Brief, the equity infusion which produced that capital structure was approved by this Commission. It was and remains absolutely critical in attempting to protect APS' credit ratings from further downgrade.

RUCO recommends a hypothetical capital structure of 50/50.[36] That position should be rejected on various grounds. Among other things, it ignores S&P's increase in APS' business risk profile slightly more than a year ago and the corresponding requirement that it maintain a higher, not lower, equity ratio as RUCO suggests.[37] It counters Moody's warning that APS should have stronger financial metrics such as its debt/equity ratio than other comparably rated utilities to guard against further negative ratings actions.[38]

RUCO's primary argument that use of APS' actual capital structure would somehow result in the Company cross-subsidizing Pinnacle West was refuted by Dr. Avera who, among other things, pointed out that both Pinnacle West and APS have precisely the same S&P business risk profile.[39] Finally, it's a sleight of hand. On the one hand, RUCO argues for an unrealistic and rock-bottom 9.25% ROE citing reduced financial risk because of APS' 54/46 capital structure. Then, it promptly argues to increase financial risk by asking the Commission

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[35] Staff Brief, p. 41, ll. 5-6. AUIA believes there is a typographical error in the Staff Brief at line 6, i.e., "common equity - 55.5 percent" which should read 54.5%. *See* Staff witness Parcell's Hearing Testimony, TR Vol. XVII, p. 3272, l. 23-p. 3273, l. 2.
[36] RUCO Brief, p. 26.
[37] Brandt Rebuttal, APS 5, p. 9.
[38] AUIA 1, Cannell Direct, p. 22, ll. 13-15.
[39] Avera Rebuttal, APS 42, pp. 65-66.

hypothetically to create a lower 50/50 capital structure. The Commission should decline the offer.

It's undisputed that a vital $450 million in equity was infused into APS at a particularly critical moment to shore up its credit standing. The Commission should use the Company's capital structure of 54.5%/45.5%. As Dr. Avera stated, the capital structure "is just one reflection of the Company's ongoing efforts to enhance its credit standing and maintain access to capital on reasonable terms in order to ensure its ability to meet its obligations to customers."[40]

CWIP AND INCREASED DEPRECIATION ALLOWANCES

At pages 9-10 of its Initial Brief, the AUIA outlined the reasons why it supports APS' request for CWIP and increased depreciation allowances. Although resistant to attrition adjustments generally, Staff agrees that these two provide consumer benefits:

> If the Commission were inclined to adopt an "attrition adjustment," it should at least choose an alternative that will eventually be credited to ratepayers. Both the CWIP proposal and the accelerated depreciation proposal affect the recovery period for fixed assets. Each of these proposals results in accounting changes that will eventually yield reductions in rates for future ratepayers.[41]

Several of the parties' objections to attrition adjustments, including these, have already been addressed in the ROE section of this reply[42] and will not be repeated here. RUCO refers to them as "extraordinary" proposals.[43] They are not. As for CWIP, the Commission has authorized CWIP allowances previously and two decisions of the Arizona Supreme Court have specifically approved their use.[44] Under Commission rules, requests for depreciation rate changes such as the request here are specifically authorized in rate cases. A.A.C. R14-2-202.C.

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[40] *Id.*, p. 70, ll. 7-9.
[41] Staff Brief, p. 5, ll. 21-25 (citations omitted).
[42] *Supra*, pp. 6-8.
[43] RUCO Brief, p. 47.
[44] *Ariz. Corp. Com'n. v. Arizona Public Service,* 113 Ariz. 368, 555 P.2d 326 (1976); *Ariz. Comm. Action Assoc. v. Ariz. Corp. Com'n,* 123 Ariz. 228, 599 P.2d 184 (1979).

Approval of the CWIP and Increased Depreciation Allowances do not increase Company earnings, but they do improve APS cash flow and quality of earnings which have been and remain critical issues at this critical juncture. Together, they increase the Company's FFO/Debt metric by 1.2%—a valuable insurance policy, particularly considering that if the Commission approves APS' modified proposed rates, that metric will rise only to 1.2% above junk bond criteria this year.[45] A key investment analyst for Credit Suisse has commented specifically that adoption "would mark a constructive evolution of Arizona regulatory policy, demonstrating a willingness to provide support for APS's efforts in meeting AZ's robust population growth."[46] Finally, they also provide future customer rate benefits.

POWER SUPPLY ADJUSTOR

In their Opening Briefs, all parties agree on the need for changes to the PSA—but disagree as to precisely what changes. The AUIA supports Staff's "forward looking" PSA:

> In evaluating APS' rate case, Staff recognized that the public interest would be served by addressing any aspects of APS' existing PSA that may have contributed to the build-up of significant deferrals. Staff believes that the changes it is recommending will lead to more timely recovery by APS of its costs for fuel and purchased power. Staff also believes that these changes will address the rating agencies' concerns...[47]

APS also indicates that it can support the Staff PSA proposal with the changes discussed at hearing and stated at pages 38-39 of its Initial Post-Hearing Brief.

AECC opposes Staff's PSA proposal in part because it includes a prospective component and alters several elements of the clause negotiated and then approved in the last rate decision.[48] RUCO supports the changes to the current clause structure which APS proposes, differs slightly

[45] Brandt Rebuttal, APS 5, DEB-1RB.
[46] Brandt Rejoinder, APS 6, DEB-2RJ.
[47] Staff Brief, p. 39, ll. 7-11.
[48] AECC Brief, p. 17.

on the base fuel cost and raises objections similar to AECC on the Staff's "forward looking" PSA.[49]

Turning first to the arguments in opposition to Staff's PSA proposal:

- RUCO and AECC are correct that Staff's PSA proposal is a substantially different process than the current one. However, just as there is no doubt that the parties negotiated and the Commission modified and approved that process with the best of intentions based on then available data, the hard lessons of the past 18 months demonstrate it is materially flawed and, as Staff states, the public interest will be served by a shift to this new model. "Tweaks," as RUCO puts it, simply don't suffice.[50]

- RUCO and AECC also criticize Staff's proposal to delete the 90/10 sharing mechanism in the current clause—maintaining it would remove an incentive for the Company to control its fuel and purchased power costs. First, APS will continue to have every incentive to control costs in order to avoid additional deferrals and their credit ratings implications. Second, the Commission now has the benefit of both Liberty Consulting and R.W. Beck's validations of the soundness of the Company's fuel procurement and hedging programs. Third, as discussed at pages 14-15 of AUIA's initial brief, the realities faced by APS turn what RUCO and AECC describe as an incentive instead into a constant punishment—what Staff witness Antonuk described as "a one-sided effort [which does not promote] positive performance for customers."[51]

- Finally, RUCO's arguments on increased volatility[52] simply miss one of the key advantages of Staff's "forward looking" PSA. By forecasting costs and rigorously testing the forecast as has been done here and will be done in the future, the process sends the most current and, therefore, <u>least</u> potentially volatile fuel and purchased power cost expected experience and price signal.

The AUIA urges the Commission to approve the Staff's PSA proposal.

If, however, the Commission instead chooses to make modifications to the existing PSA, the Association recommends the changes discussed at pages 36-38 of the APS Brief. Particularly critical to customer rate stability as well as Company creditworthiness is adoption of

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[49] RUCO Brief, pp. 37-44.
[50] RUCO Brief, p. 40, ll. 12-13.
[51] TR Vol XXI, p. 4000.
[52] RUCO Brief, pp. 42-44.

the Company's base fuel cost of $0.032491/kWh. If, instead, the Staff, RUCO or AECC lower base fuel costs are selected, annual PSA deferrals increase by roughly $30 million for every mill below that level.[53] Authorizing a fuel base which virtually guarantees reduced earnings and increased deferrals is clearly not in the Commission's, the Company's or the customers' best interests.

OTHER ISSUES

Palo Verde

Staff's position is that approximately $16.2 million of the $44.6 million plus accumulated interest requested in APS' Step 2 PSA surcharge should be disallowed as imprudent.[54] The vast majority of the recommended disallowance pertains to the Units 2 and 3 Refueling Water Tank Inoperability outages in October of 2005 ("RWT Outages"). Neither meets the imprudence standards stated by Staff's witness, Dr. Jacobs, or required by the Commission's Rules.

Dr. Jacobs phrased the prudence standard as follows:

> [T]he actions and decisions of Palo Verde personnel must be judged on what they knew, or reasonably should have known, at the time the action was taken or the decision was made without benefit of hindsight.[55]

That standard is generally consistent with the Commission's definition of prudent investment in A.A.C. R14-2-103(A)(3)(l). As importantly, the Rule also includes a presumption of prudence which may only be set aside on clear and convincing evidence.

The basis for Staff's recommended RWT Outages disallowance is that the "Company—instead of the NRC—should have identified this issue because of the NRC's yellow finding in

[53] APS Brief, p. 34, ll. 1-3.
[54] Staff Brief, p. 46, ll. 11-13.
[55] Staff 45, p. 19.

2004 on a related issue."[56] The NRC's yellow finding, however, was not related to the question asked by the NRC contract inspector which led to the RWT Outages.

The NRC's yellow finding and its subsequent inspection in October 2005 concerned a design implementation issue, i.e., the failure operationally to maintain water in certain sump piping as arguably required by the approved design.[57] In the case of the RWT Outages, however, APS had more than fully implemented the approved design—exceeding in construction by 150% the 16 feet of elevation difference the NRC-approved design required.[58] There simply was no way Palo Verde personnel could have known or reasonably could have anticipated that the NRC contract inspector would inexplicably shift from a design implementation inspection to a design adequacy question which had been answered and more than adequately implemented decades ago.

That is why NRC Region IV Administrator Bruce Mallet assured this Commission that the question which led to the RWT Outages was new and APS should not have found it beforehand.[59] There certainly is no clear and convincing evidence of imprudence and, to the contrary, this record conclusively demonstrates that the Company's actions were prudent.

Environmental Improvement Charge

Staff objects to APS requested Environmental Improvement Charge ("EIC") on two primary grounds: (1) it would collect revenues from ratepayers based predominantly upon estimated costs and (2) it's unique.[60] RUCO adds that the Commission does not need to "foster"

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[56] Staff Brief, p. 49, ll. 8-9 (emphasis supplied). The yellow cornerstone was actually issued on April 8, 2005, not in 2004. Mattson Rebuttal, APS 87, p. 40.
[57] *Id.*
[58] *Id.* at pp. 50, 53-54.
[59] APS 104, pp. 45-46.
[60] Staff Brief, p. 54, ll. 1-5.

environmental improvements, because they are compelled by various laws and regulations.[61] AECC's criticism revolves primarily around "single-issue ratemaking."[62]

On Staff's issues, the EIC contains a true-up mechanism which assures that only actual costs will be recovered. Mr. Fox testified as to several jurisdictions which have implemented similar environmental recovery mechanisms.[63] As to RUCO's point, all of the environmental mandates it identifies reinforce the need for a timely EIC mechanism to assure the financial capability to comply. AECC acknowledges that a compelling public interest justifies single issue ratemaking. Here, the multiple compelling public interests are furthering environmental goals, protecting APS' valuable coal generation fleet for the benefit of its customers, including AECC members, and assuring the Company's financial ability to comply—particularly given the stiff competition for new capital in all areas of APS' operations.

The impact of the EIC is 19 cents a month for the average APS residential customer.[64] That small amount will support important, but non-revenue producing environmental improvements to the Company's fossil fuel plants. Their base-load importance to customers is growing exponentially and more than fully justifies the EIC.

CONCLUSION

Arizona needs a stronger APS to meet its growth challenges. Keys to that strength are an award of adequate revenue requirements, an 11.5% ROE, an attrition adjustment of 1.7%, CWIP and accelerated depreciation allowances and a stronger PSA. Complaints about forecasts or unique ratemaking procedures don't alter the powerful financial vise-grip the Company is in or the very real dangers lurking in the credit agencies' analyses of the decision in this case. If a

[61] RUCO Brief, p. 45, ll. 4-11.
[62] AECC Brief, p. 15.
[63] Fox Direct, APS 34, pp. 17-18.
[64] DeLizio Rebuttal, APS 38, p. 2.

stronger APS does not emerge from this proceeding, the losers are not only the Company and its shareholders, but all of its more than one million customers.

RESPECTFULLY SUBMITTED this 16th day of February, 2007.

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