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BEFORE THE ARIZONA CORPORATION COMI.

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- 6 GARY PIERCE
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- 7

2007 DEC -6 P 1:52

AZ CORP COMMISSIONER
DOCKET CONTROL

8 IN THE MATTER OF THE APPLICATION OF
 9 ARIZONA PUBLIC SERVICE COMPANY
 10 FOR A HEARING TO DETERMINE THE
 11 FAIR VALUE OF THE UTILITY PROPERTY
 12 OF THE COMPANY FOR RATEMAKING
 13 PURPOSES, TO FIX A JUST AND
 14 REASONABLE RATE OF RETURN
 15 THEREON, TO APPROVE RATE
 16 SCHEDULES DESIGNED TO DEVELOP
 17 SUCH RETURN, AND TO AMEND
 18 DECISION NO. 67744

Docket No. E-01345A-05-0816

Arizona Corporation Commission

DOCKETED

DEC - 6 2007

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13 IN THE MATTER OF THE INQUIRY INTO
 14 THE FREQUENCY OF UNPLANNED
 15 OUTAGES DURING 2005 AT PALO VERDE
 16 NUCLEAR GENERATING STATION, THE
 17 CAUSES OF THE OUTAGES, THE
 18 PROCUREMENT OF REPLACEMENT
 19 POWER AND THE IMPACT OF THE
 20 OUTAGES ON ARIZONA PUBLIC SERVICE
 21 COMPANY'S CUSTOMERS.

Docket No. E-01345A-05-0826

22 IN THE MATTER OF THE AUDIT OF THE
 23 FUEL AND PURCHASED POWER
 24 PRACTICES AND COSTS OF THE
 ARIZONA PUBLIC SERVICE COMPANY.

Docket No. E-01345A-05-0827

**RUCO'S RESPONSE TO
COMMISSIONER MAYES' LETTER**

The Residential Utility Consumer Office ("RUCO") provides this response to
Commissioner Mayes' November 28, 2007 letter requesting responses from RUCO and others

1 to questions about Arizona Public Service Company's ("APS") recent proposal to treat funds
2 collected under its Tariff Schedule 3 as revenue for ratemaking purposes.

3 RUCO appreciates Commissioner Mayes' concerns regarding APS' request that the
4 Commission predetermine the ratemaking treatment it will ultimately afford any monies
5 generated as a result of the proposed changes to APS Tariff Schedule 3. RUCO agrees that
6 this is too important of an issue to decide without an evidentiary record and a full vetting.
7 That is why RUCO also agrees with the November 2, 2007 Staff report that opposes
8 embedding resolution of a ratemaking issue in a routine compliance filing.¹ The ratemaking
9 treatment that ultimately is afforded the line extensions that are the subject of Tariff Schedule 3
10 will materially affect the both the Company and its ratepayers and, as a result, should not be
11 determined outside of a proceeding that fully analyzes the issue. The process afforded for
12 review of a compliance filing is inadequate to address an issue of this magnitude and
13 importance. The Commission is already exploring the issue of hook-up fees for electric and
14 gas utilities in a generic proceeding, Docket No. E-00000K-07-0052. The issue of whether
15 funds received from any such hook-up fees should be treated as revenues is under
16 consideration in that proceeding.

17 Further, the details of APS's proposal are unclear, making a complete analysis difficult.
18 Specifically, it is unclear whether APS proposes that its Tariff Schedule 3 revenues would be in
19 addition to the revenues collected pursuant to its current tariffs (which were designed to collect
20 the revenue requirement authorized by the Commission in Decision No. 69663), or if the

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22 ¹ Decision No. 69663 granted APS variances to A.A.C. R14-2-207.C.1 and C.2 which require an
23 electric utility to provide a specified footage of distribution line at no charge, and required APS to file, "as a
24 compliance item," a revised line extension tariff that eliminates any free footage or free equipment allowance,
and removes any requirement for any economic feasibility analysis in its line extension policy. (Decision No.
69663 at 97, 156). APS' original and amended filing of its revised Tariff Schedule 3 were in response to
those provisions of Decision No. 69663.

1 remaining tariffs would be adjusted downward such that the total dollars collected under all
2 APS' tariffs would be equal the approved revenue requirement. APS' statements in support of
3 its Tariff Schedule 3 proposal appear contradictory in this respect. For example, APS'
4 November 16, 2007 exceptions includes a numerical example demonstrating that its proposal
5 to treat the payments received under Schedule 3 as revenues is more tax advantageous than
6 Staff's suggestion to treat those funds as Contributions in Aid of Construction (CIAC). APS'
7 numerical analysis portrays its "revenue" proposal as having zero tax consequences. This
8 could only be the case if the currently-authorized tariffs are reduced to accommodate the
9 revenue recovered via Schedule 3. However, APS' October 24, 2007 amended filing indicates
10 that its "revenue" proposal would "mitigate future rate increases," suggesting that it would not
11 result in a decrease in the rates currently in effect pursuant to Decision No. 69663. Further,
12 the October 24 filing suggests that treating the Schedule 3 funds as revenue "enhances the
13 Company's ability to finance its remaining construction requirements at a reasonable cost
14 because of the FFO/Debt improvement." From this language, it appears that APS expects that
15 treating Schedule 3 funds as debt would immediately result in a higher FFO figure, which
16 would only be possible if revenues from other tariffs are not reduced.²

17 Finally, the only data that APS has provided that would allow any analysis to its revenue
18 proposal is in its November 16, 2007 exceptions to the Recommended Order and confidential
19 data provided on November 21, 2007 in a letter to Commission Staff member, Steve Olea.
20 Thus, by necessity any analysis RUCO could provide would be limited to the scope of data
21 from these two documents.

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² RUCO would question the lawfulness of treating the Schedule 3 funds as revenues at this time without a corresponding decrease in other tariffs' revenues, as it would allow the Company to recover revenues in excess of the revenue level authorized by Decision No. 69663.

1 For all of these reasons, RUCO believes that the ratemaking treatment to be afforded
2 the monies generated through the Tariff Schedule 3 changes should not be addressed in this
3 proceeding. That being said, RUCO will do its best to offer the analysis requested by
4 Commissioner Mayes' letter.

5 Commissioner Mayes' letter refers to a comment by APS President Don Brandt,
6 suggesting that APS would receive \$50 million to \$150 million in additional funds from the
7 removal of the free footage allowance. The confidential data provided with APS' November 21
8 letter to Steve Olea is consistent with that suggestion (although it does indicate that the
9 amount recovered would vary by year). However, as noted above, if APS' other tariffs are
10 reduced so that all the tariffs together generate only the operating income authorized by
11 Decision No. 69663, it is not clear that there would be any incremental revenue above the
12 current rates. Further, it is not clear whether the \$50 million to \$150 million range considers
13 any increased income tax liability that would result from any increased revenue level.

14 APS alleges in the November 16, 2007 exceptions that treating the Tariff Schedule 3
15 monies as revenues will benefit customers in future years in the form of lower rates. First, this
16 is true only if growth holds out indefinitely. If growth dries up, so will this revenue stream.
17 Unlike a CIAC that is amortized over the life of the plant thereby providing benefits even after
18 growth slows, under APS' proposed treatment the benefit tapers off if growth slows. Second,
19 as discussed earlier, ratepayers will receive no benefit from this revenue treatment until such
20 time as the existing rates are adjusted for the additional Tariff Schedule 3 revenue stream.

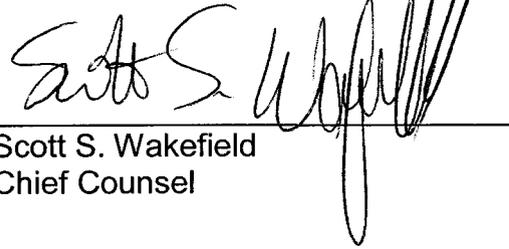
21 As discussed earlier, APS claims that one benefit of treating Tariff Schedule 3 monies
22 as revenues would be an improved FFO/debt ratio. However, the FFO/debt ratio would only
23 increase if APS' existing rates were not adjusted to account for the additional revenue
24 generated by the Tariff Schedule 3 changes. As noted above, RUCO questions the lawfulness

1 of authorizing tariffs that permit the Company to recover more than the authorized revenue
2 requirement. Thus, it is doubtful whether such a benefit could be achieved.

3 APS' November 21, 2007 letter to Staff provides three years of projections of Tariff
4 Schedule 3 revenues, projected returns on equity, and projected FFO/Debt ratios under its
5 proposed treatment of Tariff Schedule 3 as revenue. The data was provided to RUCO
6 pursuant to the terms of a protective agreement, and thus RUCO is not free to disclose it
7 publicly. The data is apparently already in the possession of the Commission's Staff, and
8 therefore RUCO presumes that the Commissioners themselves will have access to it.
9 However, RUCO cannot assess either the accuracy or reasonableness of these projections
10 since APS has not revealed all the assumptions used, the source of the data used, or the
11 algorithms used to derive these amounts.

12 In summary, RUCO cannot at this time reach a conclusion on whether it would be
13 appropriate to treat the funds APS receives from Schedule 3 as CIAC or as revenue. There is
14 little data available to RUCO at this time to permit a sufficient examination of the matter, but
15 the question is currently under consideration in the Commission's generic docket on hook-up
16 fees. However, if the Commission were to permit APS to treat the Schedule 3 funds as
17 revenue, APS should also be required to re-file its other tariffs to provide a corresponding
18 decrease in the Company's total revenue, consistent with the revenue requirement established
19 in Decision No. 69663. Because this would negate what appears to be the short-term benefit
20 APS hoped to achieve by its proposal, RUCO recommends that the Commission defer making
21 such an important policy shift at this time, and instead address the question in the generic
22 proceeding, or in a subsequent APS rate case.

1 RESPECTFULLY SUBMITTED this 6th day of December 2007.

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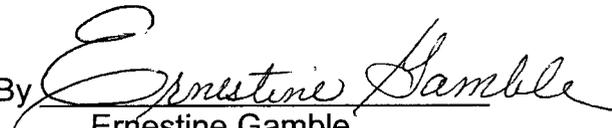
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