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BEFORE THE ARIZONA CORPORATION COMMISSION
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2008 SEP -2 P 3: 38

AZ CORP COMMISSION
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11 IN THE MATTER OF THE APPLICATION OF
 12 ARIZONA PUBLIC SERVICE COMPANY
 13 FOR A HEARING TO DETERMINE THE
 14 FAIR VALUE OF THE UTILITY PROPERTY
 15 OF THE COMPANY FOR RATEMAKING
 16 PURPOSES, TO FIX A JUST AND
 17 REASONABLE RATE OF RETURN
 18 THEREON, TO APPROVE RATE
 19 SCHEDULES DESIGNED TO DEVELOP
 20 SUCH RETURN.

Docket No. E-01345A-08-0172

Arizona Corporation Commission

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NOTICE OF FILING

The Residential Utility Consumer Office ("RUCO") hereby provides notice of filing the Direct Testimony of Stephen Ahearn in the above-referenced matter.

RESPECTFULLY SUBMITTED this 2nd day of September 2008

Daniel W. Pozefsky
Chief Counsel

1 AN ORIGINAL AND THIRTEEN COPIES
2 of the foregoing filed this 2nd day
3 of September 2008 with:

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

6 COPIES of the foregoing hand delivered/
7 mailed this 2nd day of September 2008 to:

8 Lyn Farmer
9 Chief Administrative Law Judge
10 Hearing Division
11 Arizona Corporation Commission
12 1200 West Washington
13 Phoenix, Arizona 85007

11 Janice Alward, Chief Counsel
12 Legal Division
13 Arizona Corporation Commission
14 1200 West Washington
15 Phoenix, Arizona 85007

14 Ernest Johnson, Director
15 Utilities Division
16 Arizona Corporation Commission
17 1200 West Washington
18 Phoenix, Arizona 85007

17 Timothy M. Hogan
18 Arizona Center for Law in the
19 Public Interest
20 202 E. McDowell Road, Suite 153
21 Phoenix, AZ 85004

20 Jeff Schlegel
21 SWEEP Arizona Representative
22 1167 W. Samalayuca Dr.
23 Tucson, AZ 85704-3224

22 David Berry
23 Western Resource Advocates
24 P. O. Box 1064
Scottsdale, AZ 85252-1064

Jay I. Moyes, Esq.
Karen E. Nally, Esq.
Moyes Sellers & Sims
1850 N. Central Avenue, Suite 1100
Phoenix, Arizona 85004

Jeffrey J. Woner
K.R. Saline & Assoc., PLC
160 N. Pasadena, Suite 101
Mesa, AZ 85201

Michael M. Grant
Gallagher & Kennedy, P.A.
2575 East Camelback Road
Phoenix, Arizona 85016-9225

Lawrence V. Robertson, Jr.
Theodore Roberts
Attorneys At Law
P. O. Box 1448
Tubac, AZ 85646

Michael L. Kurtz, Esq.
Boehm, Kurtz & Lowry
36 East Seventh Street, Suite 1510
Cincinnati, Ohio 45202

Corporate Energy Manager (G09)
The Kroger Co.
1014 Vine Street
Cincinnati, Ohio 45202

1 Scott Canty, General Counsel
The Hopi Tribe
2 P. O. Box 123
Kykotsmovi, AZ 86039
3
4 C. Webb Crockett
Patrick J. Black
Fennemore Craig, P.C.
5 3003 N. Central Avenue, Suite 2600
Phoenix, AZ 85012-2913
6
7 Kevin Higgins
Energy Strategies, LLC
Parkside Towers
8 215 South State Street, Suite 200
Salt Lake City, Utah 84111
9
10 Gary Yaquinto, President
Arizona Investment Council
2100 N. Central Avenue, Suite 210
11 Phoenix, Arizona 85004
12
13 Thomas L. Mumaw
Pinnacle West Capital Corporation
Law Department
14 P. O. Box 53999
Mail Station 8695
Phoenix, Arizona 85072-3999
15
16 Barbara Klemstine
Zachary Fryer
Susan Casady
17 Pinnacle West Capital Corporation
P.O. Box 53999
18 Mail Station 9708
Phoenix, Arizona 85072-3999
19
20 Robert Metli
Snell & Wilmer
One Arizona Center
21 400 East Van Buren Street
Phoenix, Arizona 85004-2202
22
23
24

Michael A. Curtis
William P. Sullivan
Larry K. Udall
Curtis, Goodwin, Sullivan, Udall
& Schwab, P.L.C.
501 East Thomas Road
Phoenix, Arizona 85012-3205

By 
Ernestine Gamble
Secretary to Daniel Pozefsky

ARIZONA PUBLIC SERVICE COMPANY

DOCKET NO. E-01345A-08-0172

DIRECT TESTIMONY

OF

STEPHEN AHEARN

ON BEHALF OF

THE

RESIDENTIAL UTILITY CONSUMER OFFICE

SEPTEMBER 2, 2008

1 **INTRODUCTION**

2 Q. Please state your name and business address for the record.

3 A. My name is Stephen Ahearn. My business address is 1110 West Washington,
4 Suite 220, Phoenix, Arizona 85007.

5
6 Q. Please state your educational background and qualifications in the utility
7 regulation field.

8 A. I have been employed by the state of Arizona as the Director of the Residential
9 Utility Consumer Office ("RUCO") since January 2003. From 1998 through 1999,
10 I was employed at the Arizona Corporation Commission in the capacity of
11 Executive Consultant. From 1990 to 1998, I was actively involved with utility
12 regulation at the Commission and utility policy-making at the Legislature in my
13 role as the Manager of Planning and Policy at the Department of Commerce
14 Energy Office. Additionally, I have had training in utility ratemaking and
15 telecommunications policy conducted by NARUC and New Mexico State
16 University, respectively. Finally, I have an MBA in Finance from UCLA.

17
18 Q. Please state the purpose of your testimony.

19 A. The purpose of my testimony is to present recommendations resulting from my
20 review of the Arizona Public Service Company's ("Company" or "APS") request
21 for an emergency interim rate increase.

22

23

1 **INTERIM RATE REQUEST - BACKGROUND**

2 Q. Please discuss the Company's emergency interim rate request.

3 A. The Company claims it needs \$115 million in interim relief in order "to help
4 staunch a growing financial threat to itself and its customers."
5

6 Q. Wasn't APS granted several rate increases over the last few years?

7 A. Yes. Most recently, APS was granted a \$322 million rate increase in Decision
8 No. 69663, dated June 28, 2007. The increase was awarded pursuant to a
9 traditional rate case where there was a finding of fair value. Approximately one
10 year prior to that increase, APS requested an emergency rate increase of \$299
11 million. In Decision No. 68685, dated May 5, 2006, the Commission found that
12 APS' situation did not constitute an emergency under the Arizona Constitution.
13 However, the Commission did find that rate relief was warranted utilizing APS'
14 Power Supply Adjustor (PSA) mechanism, thus avoiding the fair value
15 requirement. In April of 2005, in Decision 67744, the Commission granted APS a
16 \$75.5 million increase via a settlement agreement of an underlying traditional
17 finding-of-fair-value rate case filing. APS currently has a rate case pending where
18 it has requested a \$488 million rate increase.
19

20 ..

21 ..

1 Q. With the numerous recent rate increases and with an application pending, why is
2 APS again deviating from the traditional rate case process in order to request
3 these interim rates?

4 A. APS answers with a variant of the same theme it employed in its "emergency"
5 filing in 2006. The main arguments include:

- 6 • The impending threat of a credit rating downgrade due to poor
7 credit metrics, particularly the oft-cited FFO/Debt ratio
- 8 • The high cost of infrastructure to serve load growth while
9 maintaining reliability
- 10 • That revenue generated from growth is insufficient to pay for the
11 growth
- 12 • The consequences of regulatory lag

13 All of these arguments have served APS well in past rate requests, as the
14 Commission has granted significant rate relief and favorable adjuster mechanism
15 treatment on each occasion. These arguments, however, were used
16 unsuccessfully by the Company when it attempted to establish that an
17 emergency existed two years ago in their filing for interim rates at that time. In
18 the instant case, the Company is again in effect claiming an emergency because
19 of the high cost of infrastructure development, regulatory lag and the threat of a
20 credit rating downgrade.

21 A pattern is developing in the Company's filings: for the second rate filing in a
22 row, the Company has followed up its traditional application with a request to
23 speed up collection using a variant of the "emergency" or interim application.

1 Further, in the instant matter, rather than file a case that is predicated on a year's
2 worth of expense and revenue data from a year's experience with new rates, the
3 Company is filing a case that requires the use of projections.
4

5 **INTERIM RATES - CRITERIA**

6 Q. What criteria are used in Arizona regarding interim rates?

7 A. The Arizona Office of the Attorney General issued Opinion No. 71-17 on May 25,
8 1971 regarding interim rates. In that opinion, the attorney general concluded that
9 "the Commission may approve interim rates only upon a finding that an
10 emergency exists"¹
11

12 Q. What specifically does the opinion state regarding the need to qualify as an
13 emergency?

14 A. At page 11 and 12, the opinion states:

15 [E]mergency rates would not be justified, except as a condition is
16 shown which, if not relieved from, will imperil the property of the
17 company and its service to the public, such as might subject the
18 company at once to proceedings in bankruptcy or receivership; that
19 mere inability to make profits or pay dividends would not create an
20 emergency. (quoting Omaha & Council Bluffs Street Railway Co. v.
21 Nebraska City Railway Commission, 173 N.W. 690 Neb. 1919).
22
23

24 And at page 13:

25 [I]n general, courts and regulatory bodies utilize interim rates as an
26 emergency measure when sudden change brings hardship to a

¹ There are other situations, which are not applicable here, where interim rates may be appropriate. For example, when final rates are not put into effect within the statutory timelines, the Commission may establish interim rates subject to refund pursuant to AAC R14-2-103(ii)(h).

1 company, when the company is insolvent, or when the condition of
2 the company is such that its ability to maintain service pending a
3 formal rate determination is in serious doubt.
4

5
6 **INTERIM RATES – THE VALIDITY OF THE COMPANY’S ARGUMENTS**
7

8 Q. The Company argues that interim rates are necessary to mitigate "timing
9 differences" that arise as a result of the lag between the plant construction period
10 and the time when the plant enters service and is included in rates. Please
11 comment.

12 A. Such "timing differences" do not constitute an emergency, therefore the
13 Company's arguments do not justify interim rates because there have been no
14 sudden changes, the Company is not insolvent, and there is no question that the
15 Company can continue to maintain service.
16

17 Q. Please explain.

18 A. The "timing differences" referred to by the Company are a normal result of
19 regulation. All regulated utilities experience "timing differences" as part of the
20 regulatory process. Accordingly, "timing differences" alone do not constitute an
21 emergency for which interim rates are warranted. Furthermore, such "timing
22 differences" historically work both for and against a utility and therefore, tend to
23 offset each other over time.
24
25
26

1 Q. When the Commission denied APS' emergency interim rate request in May 2006
2 what criteria did they rely on?

3 A. The Commission relied primarily on the Arizona Constitution Article 15, which
4 requires a finding of fair value in order to increase rates, and Attorney General
5 Opinion 71-17, which opines that the Commission may approve interim rates only
6 upon a finding that an emergency exists. Decision No. 68685 specifically states
7 that the criteria necessary for the granting of emergency interim rates, as set
8 forth in Opinion 71-17 was not met by APS in its request.

9
10 Q. Are the circumstances any different in APS' current emergency interim rate
11 request than they were back in 2006 when the Commission denied the
12 Company's request?

13 A. No. The Company is claiming the threat of credit downgrade, large capital
14 expense budget, regulatory lag and high fuel and purchased power costs. These
15 are the same arguments APS made in its last plea of an emergency. The
16 Commission correctly determined in that case that the circumstances did not
17 meet the criteria for an emergency. Since nothing has changed in the current
18 case the Commission should reach the same conclusion, and deny APS'
19 request.

20
21 Q. Are there issues in this case that go beyond the emergency rate request?

22 A. Yes. This APS request is yet another example of how Arizona utilities are
23 attempting to redefine the regulatory paradigm in Arizona, which has

1 worked fairly and rationally for decades. Utilities, through requests for
2 automatic adjustors, interim/emergency rates, single issue ratemaking,
3 decoupling mechanisms, and "ACRM-like" mechanisms would like to
4 create a new regulatory system that shifts the risk from their shareholders
5 to their ratepayers. Consideration of these types of schemes is a very
6 slippery slope that could easily lead to a situation where monopoly
7 enterprises could operate in the absence of any effective or meaningful
8 regulation.

9 Moreover, requests for these types of schemes have become the norm
10 and not the exception. This case is a perfect example – two years ago
11 APS requested interim rates. While APS was not successful on its
12 argument that an "emergency" existed at that time APS was still afforded a
13 rate increase through its PSA mechanism. Extraordinary relief, if ever,
14 should only be allowed in extraordinary situations. The Commission
15 should not allow non-traditional ratemaking practices to become the norm.

16
17 Q. Does this conclude your direct testimony?

18 A. Yes.

19

20

21

22

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