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**BEFORE THE ARIZONA CORPORATION COMMISSION**

COMMISSIONERS

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

Docket No. E-01345A-08-0172

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.

RECEIVED  
 OCT 10 2008  
 ARIZONA CORPORATION COMMISSION

**RESPONSE BRIEF OF**  
**ARIZONA INVESTMENT COUNCIL**

October 8, 2008

Arizona Corporation Commission  
**DOCKETED**

OCT 10 2008

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1 The Arizona Investment Council (“AIC”) submits this response brief in relation to APS’  
2 request for \$115 million in interim rate relief.

3 Following five days of hearings from September 15-19, 2008, six parties submitted initial  
4 closing briefs: (1) AIC; (2) Arizona Public Service Company (“APS” or the “Company”);  
5 (3) Mesquite Power, LLC, Southwest Power Group II, LLC and Bowie Power Station, LLC  
6 (“Mesquite Group”); (4) Freeport-McMoRan Copper & Gold Inc. and Arizonans for Electric  
7 Choice and Competition (collectively, “AECC”); (5) the Residential Utility Consumer Office  
8 (“RUCO”); and (6) the Utility Division Staff (“Staff”).

9 **Summary of the Parties’ Positions**

10 Four of the six parties who actively participated in the interim case support, in whole or  
11 in part, APS’ request for \$115 million in interim relief. The Company summarized its request as  
12 follows:

13 APS is seeking in this interim proceeding only the relief that it believes is  
14 minimally necessary to preserve its financial viability and stave off a credit  
15 ratings downgrade until a final decision in the general rate case. And, besides  
16 shielding customers from the harmful long-term impact of a downgrade to junk  
17 status, the Commission now has the opportunity to grant the necessary interim  
18 relief in a way that will moderate the effect on customers, more accurately reflect  
19 the true costs of service, and reduce the rate impact upon the conclusion of the  
20 general rate case.<sup>1</sup>

21 In supporting the \$115 million interim relief request, the Mesquite Group emphasized the  
22 impacts of a loss of APS’ investment grade rating:

23 [A] downgrading of APS’ credit rating to “junk” status would be to the substantial  
24 detriment of APS and its ratepayers, in the form(s) of (i) reduced access to and  
increased cost of capital, (ii) reduced operating flexibility in dealing with  
suppliers and vendors, and (iii) a prolonged passage of time before an investment  
grade quality credit rating status could be regained...<sup>2</sup>

<sup>1</sup> APS Initial Brief, p. 4, ll. 18-25.

<sup>2</sup> Mesquite Group Closing Brief, p. 6, ll. 15-19.

1 AECC agreed that the grant of some interim relief is required to “preserve the financial  
2 health of APS during the pendency of APS’ general rate proceeding.”<sup>3</sup> Finally, the AIC stressed,  
3 as did several others, the significantly elevated peril and importance which the current credit  
4 crisis has brought to this utility and this proceeding:

5 [W]hat this crisis has underlined is the critical need to make sure  
6 Arizona’s power needs and electricity fate is not left in the hands of others,  
7 including ratings agencies...An absolutely vital first step...is approval of this  
8 Interim Relief Request.<sup>4</sup>

8 RUCO opposes the Interim Relief Request. While acknowledging that the ongoing  
9 financial crisis has “certainly [given] reason for pause and concern,”<sup>5</sup> RUCO’s opposition is  
10 premised primarily on its beliefs that no emergency exists and regulatory reform initiatives it  
11 thinks are involved in the request are best dealt with in a generic proceeding.

12 The Utilities Division Staff also is not persuaded that an emergency exists under Arizona  
13 law. But, it quickly adds:

14 Staff does acknowledge that recent events on Wall Street and in the financial  
15 community have substantially altered the financial landscape. While it remains to  
16 be seen, it is likely, in light of the current financial crisis on Wall Street, that the  
17 Company’s access to capital may be more restricted and its cost of debt may be  
18 higher...[G]iven the gravity of the recent financial crisis, the Commission  
19 certainly has the discretion to find that these circumstances create the prospect of  
20 an impending emergency such that the granting of some interim relief would [be]  
21 appropriate.<sup>6</sup>

22 <sup>3</sup> AECC Post-Hearing Brief, p. 2, ll. 3-4.

23 <sup>4</sup> AIC Opening Brief, p. 4, ll. 7-11.

24 <sup>5</sup> RUCO’s Post-Hearing Brief, p. 2, l. 3.

<sup>6</sup> Staff’s Initial Post-Hearing Brief, p. 2, ll. 5-16. (Emphasis supplied.)

1 Because of what it calls this Wall Street meltdown, Staff concludes that Arizona law recognizes  
2 the Commission's ability to avert this impending crisis "which could have a significant adverse  
3 impact on rates."<sup>7</sup>

#### 4 **Response to RUCO Brief**

5 RUCO's filed opposition to the interim rate request sharply contrasts with its Director's  
6 hearing testimony. At hearing, Mr. Ahearn agreed that a poor APS credit rating—at only one  
7 step above junk—is clearly not in the best interests of consumers; the effects of a rating agency  
8 downgrade to non-investment grade would be detrimental and long-lasting; and recent financial  
9 market developments had dynamically impacted the downgrade risk.<sup>8</sup> He went on to agree that  
10 even a 25% chance of a downgrade would cause him to seek an option to reduce that likelihood,  
11 i.e., the granting of emergency or interim relief.<sup>9</sup> Finally, Mr. Ahearn agreed that the examples  
12 of emergency circumstances described in Attorney General Opinion No. 71-17 were not all-  
13 inclusive of the situations which would justify interim relief.<sup>10</sup>

14 In marked contrast to Mr. Ahearn's agreement with that position, RUCO's filed  
15 opposition and its suggestion to "narrowly" construe "emergency" is premised on either a basic  
16 misunderstanding or misreading of Opinion No. 71-17. In its conclusion, RUCO cites to only  
17 part of the Attorney General's conclusion, i.e., that erosion of a utility's return over time cannot  
18 justify interim relief.<sup>11</sup> But, the full conclusion states as follows:

19 Perhaps the only valid generalization on this subject is that interim rate  
20 relief is not proper merely because a company's rate of return has, over a period  
21 of time, deteriorated to the point that it is unreasonably low. In other words,

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22 <sup>7</sup> Staff Brief, p. 42, ll. 18-19.

23 <sup>8</sup> HR TR, Vol. V, pp. 1063-1066.

24 <sup>9</sup> *Id.* at pp. 1073-1074.

<sup>10</sup> *Id.* at pp. 1069-1071.

<sup>11</sup> RUCO Brief, p. 10.

1 interim rate relief should not be made available to enable a public service  
2 corporation to ignore its obligations to be aware of its earnings position at all  
3 times and to make timely application for rate relief... (Emphasis supplied.)

4 Obviously, RUCO does not and cannot offer any argument that APS' Interim Relief Request  
5 should be denied for either of the reasons the Attorney General states.

6 RUCO's argument at pages 7-8 of its brief that the ratings agencies' latest reports are  
7 "positive" is an exercise in very selective reading. Because, to the contrary, each of the  
8 agencies' most recent reports have pointedly highlighted the downgrade potential.

9 Moody's July 28, 2008 report explicitly states that a downgrade could result if Moody's  
10 only "expects a sustained weakening" of the FFO/Debt ratio "in the mid-teens for an extended  
11 period."<sup>12</sup> To that point, "mid-teens," or more precisely 15.8%, is exactly what APS-6 shows the  
12 FFO/Debt Ratio will be in 2009 if the Company does not receive interim relief.

13 Similarly, the S&P June 25, 2008 report discusses the continuing challenge of regulatory  
14 lag, the Company's pending interim request and the fact that ratings "could be lowered to  
15 speculative grade if the company is not able to overcome the challenge of ensuring timely  
16 recovery" of costs.<sup>13</sup>

17 Consistent with that, Fitch notes that 2009 earnings and cash flows' attrition due to  
18 regulatory lag could lead to "credit rating downgrades."<sup>14</sup> The Moody's, S&P and Fitch reports  
19 directly refute RUCO's characterization that the agencies' latest reports are positive.

20 Lastly, RUCO thinks interim relief should be denied because APS' application raises  
21 larger public policy issues about this state's regulatory process.<sup>15</sup> This case obviously does  
22 present issues and options concerning Arizona's regulatory paradigm. There is nothing unusual

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23 <sup>12</sup> S-5 at p. 5. (Emphasis supplied.)

24 <sup>13</sup> S-5 at p. 4.

<sup>14</sup> S-4 at p. 1.

<sup>15</sup> RUCO Brief, pp. 8-9.

1 about that. Those are being and will be addressed further in the permanent portion of this  
2 docket. They are, as well, being taken up in other venues.<sup>16</sup> None of those discussions,  
3 however, provides any reason to delay the urgent need for interim relief presented here and now.

4 **Response to Staff Brief**

5 As just explained in response to RUCO's arguments and at pages 7-10 of its Opening  
6 Brief, the AIC does not agree with Staff's position that "the motion and testimony in this case do  
7 not meet the criteria for an emergency specified in the Attorney General's Opinion."<sup>17</sup> But,  
8 given the fact that the Staff expressly acknowledges that (1) "recent events on Wall Street and in  
9 the financial community have substantially altered the financial landscape"<sup>18</sup> and (2) the  
10 Commission's authority is sufficiently broad to grant interim relief in circumstances like these,  
11 no useful purpose will be served by continuing to tally the quantity of angels dancing on this  
12 particular pin's head.

13 The AIC agrees completely with Staff that "the Commission should not have to stand  
14 back and wait for an actual emergency to occur prior to taking some action."<sup>19</sup> Two questions,  
15 however, remain. Should the Commission use the authority which Staff agrees it has to grant  
16 APS interim rate relief? If so, in what amount?

17 In light of the facts, among others, that equity and debt markets remain very volatile and  
18 are likely to stay unstable for some time despite passage of the \$700 billion-plus Financial  
19 Rescue Plan; APS' \$2 billion dollar need for capital from those markets over the next five years;  
20 the Company's subpar financial indicators in various categories ranging from return on common  
21

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22 <sup>16</sup> For example, *see* the docket which has been established as a result of Commissioner Mundell's recent  
correspondence on utility incentive mechanisms.

23 <sup>17</sup> Staff Brief, pp. 11-14.

23 <sup>18</sup> Staff Brief, p. 2.

24 <sup>19</sup> *Id.*

1 equity through stock price performance; the current downward trend of the FFO/Debt ratio; the  
2 drop of that credit metric well into junk territory next year; and each of the rating agencies'  
3 explicit references to downgrade scenarios in APS' most recent reports, interim relief is  
4 unquestionably in the Company's, its customers' and the public's best interests. Former  
5 Wisconsin Public Service Commission Chairman Charles Cicchetti summarized it this way:

6 [T]here's so much uncertainty and so much risk out there. And the full effect of  
7 people not being able to borrow money has not been fully worked through the  
8 economy. And when companies like AA-rated banks can't borrow money...that  
9 makes it really difficult for a BBB-minus utility to borrow money. And therefore,  
10 I would say I'm worried about a downgrade if for no other reason than just what  
11 is out there.<sup>20</sup>

12 As to how much relief should be granted, the safest harbor in these economic  
13 circumstances obviously is the slightly more than \$166 million which APS-9 indicates would be  
14 required to allow APS to achieve an FFO/Debt ratio of only 18.25% next year. At the other end  
15 of the spectrum, the most risky award is the \$42.4 million in interim relief suggested by AECC at  
16 a time when it believed that amount would provide an FFO/Debt ratio above the 18% minimum.

17 Resting between those two amounts is the Staff's alternate recommendation of \$65  
18 million and the Company's request of \$115 million. Given these extraordinary times, the severe  
19 consequences of inadequate action, the timing of the interim increase to coincide with the shift  
20 from summer to winter rates so as to cushion consumer bill impact and the moderation of the rate  
21 impact the interim increase will provide at the conclusion of the general case next year, the AIC  
22 urges the Commission to approve interim relief at the \$115 million level.

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24 <sup>20</sup> HR TR, Vol. IV, p. 864, l. 25-p. 865, l. 8.

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**CONCLUSION**


It is not election-year hyperbole that America’s economy is facing its most daunting financial challenge in eight decades. With all great risks, however, comes great opportunity. APS Chairman of the Board Bill Post described it this way:

This proceeding can send a powerful signal that only a healthy, financially strong company will be able to fully participate in the public-private model needed to achieve our combined goals. A signal that APS must begin to build the financial strength necessary to deliver our shared goals...If not, our company will spiral down, unable to meet even fundamental service levels, let alone modify energy policy, consumer habits, or environmental results.<sup>21</sup>

The Commission should blunt the risk and seize the opportunity by granting APS’ Interim Relief Request.

RESPECTFULLY SUBMITTED this 8<sup>th</sup> day of October, 2008.

GALLAGHER & KENNEDY, P.A.

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<sup>21</sup> HR TR, Vol. IV, p. 706, ll. 11-21.



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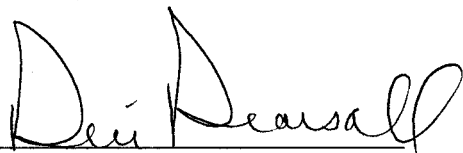
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