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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

MIKE GLEASON, Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
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.	Docket No. E-01345A-08-0172 **AIC'S EXCEPTIONS TO RECOMMENDED OPINION AND ORDER**

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The Arizona Investment Council ("AIC") files these exceptions to the Recommended Opinion and Order dated November 12, 2008 (the "ROO").

The AIC strongly urges the Commission to amend the ROO to authorize emergency relief in the amount of $115 million. Given (1) the country's current and expanding debt/equity market and credit crises, (2) APS' poor credit ratings and metrics, (3) the significant risks of an APS ratings downgrade to junk and (4) the billion-dollar-plus consequences of that downgrade to Arizona, Arizona Public Service and its customers, the Commission must act to assure that Arizonans—not rating agencies—remain firmly in control of Arizona's fate.

The Chief Administrative Law Judge does a comprehensive job of reviewing several decades of regulatory and appellate law in the ROO's Analysis section. The AIC, however, respectfully disagrees with the conclusion that the Commission would have to "adopt a new

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exception to the constitutional fair value finding requirement" in order to grant APS its requested interim relief.[1]

The reasons we disagree are while the *Scates* decision[2] does state an emergency must justify interim relief, it never defines "emergency." Instead, *Scates* discusses favorably the conclusions of Attorney General Opinion 71-17. That Opinion gives examples of what can constitute an emergency and the Opinion also makes clear that these are only examples, not an exhaustive list of situations limiting when the Commission can act.

Finally, the ROO's statement that it would be necessary to carve a new exception in order to act on APS' request flies directly in the face of this Commission's conclusion only two years ago that: "[O]ur authority to determine emergencies is not limited to specific, narrowly tailored facts, and...our ratemaking authority is sufficiently broad to enable us to grant relief tailored to many different situations."[3]

These key facts fully support the Commission's exercise of that emergency ratemaking authority—the risks of a downgrade are substantial and the consequences of that drop are enormous:

- APS' credit ratings are only one level above non-investment grade or "junk" status.
- APS' FFO/Debt ratio will drop to 15.6% by the end of 2009, more than two full percentage points below the 18% required to avoid a downgrade to junk.

[1] ROO, p. 26.
[2] *Scates v. Arizona Corp. Comm'n,* 118 Ariz. 531, 535, 578 P.2d 612, 616 (1978).
[3] Decision No. 68685 at p. 23 (May 5, 2006).

- Each of the ratings agencies' latest reports on APS has pointedly highlighted its downgrade potential. Moody's July 28 report explicitly states a downgrade could result if Moody's only "expects a sustained weakening" of its FFO/Debt ratio.
- S&P's June 25 report discusses the Company's pending interim request and the fact that ratings "could be lowered to speculative grade if the company is not able to overcome the challenge of ensuring timely recovery" of costs.
- Consistent with that, Fitch notes that 2009 earnings and cash flows' attrition due to regulatory lag could lead to "credit rating downgrades" of APS.
- Although APS has trimmed expenditure plans over the next three years, the Company still needs some $2 billion in external financing over the next five years. Former Wisconsin PSC Chairman Charles Cicchetti estimated $1.3 billion in higher consumer costs for that level of 30-year borrowing in the next five years if the Company's credit ratings drop to junk.
- The impacts of a drop to speculative grade are not just monetary. One example—APS will not be able to finance, or even plan, necessary large-scale solar, clean coal or nuclear facilities.

At September's hearing, several witnesses stressed the impact just the early stages of the economic crisis were having on APS' risk profile and matters have clearly worsened since then. Staff witness David Parcel listed the economic convulsions as a major uncertainty in the Company's rating prospects and said he could not directly answer the question of whether APS faced a substantial risk of downgrade. RUCO Director Stephen Ahearn agreed that the risk of a downgrade had become much more dynamic given those early market developments.

Dr. Cicchetti explained in very practical terms why APS' risk of a drop to junk had risen exponentially as a result of the developments:

> [W]hat you have is the credit rating agencies being in a sense accused of not doing their job by predicting things soon enough so that investors might have either avoided investment or gotten their capital out...Those credit rating agencies, I think, are going to be on a very sort of hair pull trigger that will make them more likely than they were a week ago to put out the news of a downgrade or a threat sooner than later.[4]

Dr. Cicchetti's September assessment quickly became remarkably accurate. Five weeks after he testified here, rating agencies executives were called before Congress to explain why credit ratings had been inflated for thousands of mortgage-related securities and why they hadn't acted more quickly to downgrade and warn investors of the investment risk.[5]

This is a tremendously dangerous "soup" of continuously weakening markets, APS' marginal investment grade credit ratings, bad metric trend lines, explicit discussions of further downgrade possibilities by all agencies and, most importantly, those agencies set on a "hair pull trigger" to show they are doing their job—no matter what the significant, long lasting costs to APS and the more than one million Arizonans who rely on its service. It's difficult to conceive a stronger set of circumstances which not only meets but clearly exceeds any definition of emergency and which compels this Commission to use its ratemaking power to protect the public interest.

APS consumers will be fully protected by a rate case inquiry and the assurance of a refund should any portion of the $115 million in interim relief be found later to have been unjustified. If the Commission doesn't act and the rating agencies do, nothing will protect the Company and its customers from the significant, long-lasting consequences of a downgrade to

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[4] HR TR, Vol. IV, p. 823.

[5] **Lawmakers grill credit raters.** Business Section Headline and Story, *Arizona Republic*, October 23, 2008.

junk as well as the long and winding road back up. The Commission must grant emergency relief.

DATED this 21st day of November, 2008.

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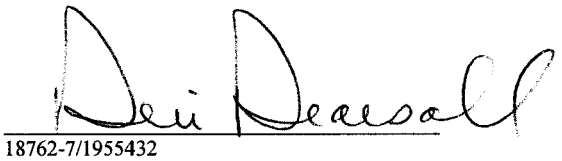

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