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AZ CORP COMMISSION  
DOCKET CONTROL

August 14, 2009

Docket Control  
Arizona Corporation Commission  
1200 west Washington  
Phoenix, Arizona 85007

RE: WITNESS SUMMARIES OF ARIZONA PUBLIC SERVICE COMPANY TESTIMONY IN  
SUPPORT OF SETTLEMENT AGREEMENT  
DOCKET NO. E-01345A-08-0172

Pursuant to the Procedural Order dated May 11, 2009:

" IT IS FURTHER ORDERED that the parties shall prepare a brief, written summary  
of the pre-filed testimony of each of their witnesses and shall file each summary at least  
two working days before the witness is scheduled to testify."

Attached are witness summaries of Settlement Direct and Reply Testimony of Arizona Public Service  
Company for witnesses Jeffrey B. Guldner, James R. Hatfield, Barbara D. Lockwood, James M. Wontor,  
David J. Rumolo and Peter M. Ewen.

Sincerely,

Leland R. Snook

LS/dst

Attachments

CC: Brian Bozzo  
Terri Ford  
Barbara Keene  
Parties of Record

Arizona Corporation Commission

DOCKETED

AUG 14 2009

DOCKETED BY

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## **Summary of Settlement Testimony Given By Jeffrey B. Guldner**

### **I. Direct**

The Agreement being presented to the Commission is supported by advocates of all of the customer classes served by APS—residential, commercial, industrial, and low income—as well as by representatives of virtually every interest in the case, including renewable resource proponents, energy efficiency and demand response supporters, merchant generators and competitive suppliers, schools, individual large customers, military bases, investors and unions. That such a broad spectrum of diverse interests supports the Agreement is remarkable. The Agreement is a constructive resolution that, quite simply, could not be achieved in litigation both because of the adversarial nature of that process and because many of the provisions of the Agreement are either unlikely to have been adopted or could not be mandated outside of a settlement.

The Agreement proposes an incremental rate increase of 5.4% above the interim rate increase authorized by the Commission in 2008. Together, the total amount of the base rate increase resulting from this rate case, net of fuel, is 7.9%. This level of rate increase was less than sought by APS in its Direct Testimony, but more than that recommended by Staff and RUCO in their Direct Testimonies. It reflects a compromise that, when balanced with all other provisions of the Agreement, was minimally adequate for APS to both improve its financial strength and undertake the commitments it has made in the Agreement, including the infusion of significant amounts of new equity required for the Company to make and support investments in Arizona's energy future.

In addition to proposing rate levels, the Agreement creates a framework for future rate cases. The framework is intended to avoid the situation where APS immediately files another rate case after the conclusion of this one. Instead, it proposes a schedule for rate cases to 2015, providing more structure and predictability to the Commission, the parties and our customers. The Agreement also institutes performance measures, reporting requirements and a benchmarking process that reflects the alignment of APS's management objectives with Commission policies and attempts to ensure that the Commission has information on which to judge APS's operational and cost management performance during this timeframe.

Finally, the Agreement contains detailed and far-reaching provisions necessary to promote a sustainable energy future for Arizona. These include provisions for new and expanded commitments for renewable resources, the first energy efficiency goal for any electric utility in Arizona, demand response programs, and new rate options for customers. But it is not just the commitment to pursue these resources and programs that is reflected in the Agreement—it is the financial support to achieve that vision that is equally critical. Having a desire or even a proposal to advance a sustainable energy future is not enough without the stable financial base from which such a future can be built.

Like all good settlements, no party left the process with everything that they sought or would have sought in litigation. And, certain provisions of the Agreement include commitments by APS that could not be imposed on the Company in a normal litigated rate case. But the Signatories, including APS, ultimately concluded that the Agreement

reached after four months of negotiation, discussion, and compromise was appropriately balanced and in the public interest. APS believes that this Agreement is in the public interest, and I urge the Commission to approve the Agreement.

## **II. Reply**

None filed.

## Summary of Settlement Testimony Given By James R. Hatfield

### I. Direct

This case is about the future of energy in Arizona and the investment required not only to maintain safe and reliable service for APS customers but also to provide APS with the necessary means of implementing a sustainable energy policy for the State. APS takes its role in providing for Arizona energy's future quite seriously. Indeed, the Company's business model has at its core a vision of "creating a sustainable energy future for Arizona" – one that brings long-term benefits to the State's environment, economy, and communities.

APS is the largest electric utility in the State of Arizona and, as I will describe, has a statewide presence and influence. As such, APS's financial health is critical to help the Commission implement a forward-looking, sustainable statewide energy policy. To be "sustainable," however, such a policy must not only support the strategies and business practices that provide the foundation for a healthy environment, vibrant economy, and strong community. It must also allow APS to meet its basic business needs – including the ability to actually earn a reasonable rate of return – while investing in the resources necessary to achieve those important goals.

The Settlement Agreement reached in this case takes a critical step in the right direction. Significantly, it represents the hard work and impressive alignment of the often-disparate interests of the many Signatories – a fact that the financial community understandably views as supportive of Arizona's regulatory environment. The Agreement also buttresses the Company's financial condition in the short term and contains various provisions – including a rate case cycle and rate case process improvements – that can be a starting point for implementing other mechanisms that will reduce the impact of regulatory lag in between rate cases and improve the Company's financial condition in the long run.

But although APS believes that the Settlement is a positive step toward improvement, it still provides no more than the minimal level of rate relief APS needs to support investment grade financial metrics and allow the Company to continue providing reliable electric service at reasonable prices. Even in the short run, before the allowed effective date of rates from APS's next rate case under the proposed rate schedule, the revenue requirement contained in the Agreement allows for only marginal financial metrics. APS will still significantly under-earn its cost of equity capital during this initial period, projecting ACC-Jurisdictional returns on equity ("ROE") of only 9.4% in 2010, 8.4% in 2011, and 8.1% in 2012 – far below both APS's current authorized ROE of 10.75% and the Agreement's proposed ROE of 11%, and below even the 8.75% return APS investors required on the Company's recent debt issuance (a much less risky investment, for which investors would expect and require a lower return compared to equity investment).

Moreover, although the additional revenue that APS will receive under the Agreement as proposed combined with the required expense reductions is projected to support APS's Funds from Operations to Debt ("FFO to Debt") ratio at current BBB- investment grade levels in 2010 (at 18%), that level is the **very cusp** of the 18% threshold into non-investment grade. There is no margin remaining to hedge the impact of unexpected

events that may drive that metric down into junk levels. For the later years, APS projects that its FFO to Debt ratio will fall below that 18% threshold even under the Agreement as proposed, to 17.6% in 2011 and 17.9% 2012.

For purposes of this Settlement, APS accepts the significant challenges presented by these marginal figures, but emphasizes that there is no room for further degradation in the Company's financial metrics without placing the Company at a real and material risk of downgrade. Simply put, it is critical to APS's financial condition, the viability of this Settlement, and a robust energy future for this State that the Company receives the full amount of the increased revenue and other financial supports proposed in the Agreement. To the extent the Commission makes any change to the Agreement's provisions, such change must be revenue- and financially-neutral to the Agreement. In sum, APS envisions a future of working with the Commission to create a sustainable energy future for Arizona, but currently lacks the resources and tools it needs to do so. APS is not alone in its need for base rate increases – utilities nationwide share that need in their respective efforts to meet the many policy and other challenges facing electric utilities today. What is different regarding APS is the lack of sufficient mechanisms to reduce the impact of regulatory lag and maintain the Company's financial condition in between rate cases. Such tools will allow APS and the Commission to avoid the distraction of a constant string of rate cases, focusing instead on putting in place the important policies that will shape this State's energy future. The Settlement Agreement is a crucial first step toward this important goal.

## **II. Reply**

None filed.

## **Summary of Settlement Testimony Given By Barbara D. Lockwood**

### **I. Direct**

One of the goals of the Settlement Agreement is to advance sustainable decisions related to Arizona's energy future. APS strongly supports the Settlement Agreement and continues to promote renewable energy development and implement initiatives that go beyond the requirements in the Renewable Energy Standard ("RES") Rules. Under the Settlement Agreement, APS will acquire by the end of 2015 new renewable resources that provide 1,700 gigawatt hours ("GWh") of renewable energy annually. Along with existing commitments, this is double the amount of energy required under the RES. In meeting that objective, APS will develop a plan to adopt a utility scale photovoltaic project, issue a request for proposal ("RFP") for an in-state wind generation project, develop a proposal for distributed solar projects for Arizona K-12 schools, and develop a proposal for distributed solar energy projects aimed at governmental institutions. The Settlement Agreement also provides for timely cost recovery through existing rate mechanisms.

### **II. Reply**

None filed.

## **Summary of Settlement Testimony Given By James M. Wontor**

### **I. Direct**

Through this Settlement, Arizona and APS are taking another major step forward in advancing Arizona's sustainable energy future through the enhancement of DSM programs and measures. This Settlement establishes the first energy savings goals for any Arizona utility, a step that further integrates energy efficiency into the portfolio of resources that APS uses to serve the energy needs of its customers. The energy savings goals embodied in the Settlement modify the current approach to DSM implementation, which is now based on annual spending targets. The annual savings goals begin in 2010 and will accumulate to an overall savings of approximately 3.75% of the Company's total energy resources needed to meet retail load in 2012.

Concurrent with these aggressive energy efficiency goals, the Settlement also modifies the current DSM performance incentive. The proposed incentive encourages performance over and above the annual efficiency savings goals by offering increased incentives as the goals are met and exceeded. It also provides for reduced incentives if the savings goals are not met. The proposed performance incentive is calculated as a percent share of benefits delivered to customers, but it is also capped at a percent of program cost to ensure certainty.

Meeting these higher efficiency targets will clearly require enhancement to some current DSM programs, as well as the implementation of new energy saving measures. The proposed program enhancements include the following:

- Residential High Performance New Homes
- Residential Existing Home Performance
- Low Income Weatherization
- Non-Residential High Performance New Construction
- Non-Residential Customer Repayment Financing
- Schools Program Target
- Large Customer Self-Direction

To implement these and future program enhancements in an efficient and timely manner, the Settlement requires APS to submit an annual Energy Efficiency Implementation Plan for Commission consideration, which will include proposed programs along with the estimated funding levels needed to reach the proposed energy savings targets and a proposed DSMAC rate to achieve such funding.

The Signatories to this Settlement also have agreed that it is reasonable to modify APS's DSMAC in order to achieve more current recovery of program costs, similar to the DSM adjustment mechanism the Commission has approved for Tucson Electric Power Company. This change is an important first step in addressing the regulatory challenges associated with increasing the energy efficiency impacts that are inherent for a regulated utility.

**II. Reply**

None filed.

## **Summary of Settlement Testimony Given By David J. Rumolo**

### **I. Direct**

Yes, my testimony describes the rate changes that implement the Agreement. The changes for residential customers include implementing what are generally "across the board" increases, i.e., the same percentage increase for each rate element of each rate schedule. Within the general service class, Rate Schedule E-32, there are changes that attempt to move the pricing so that it better tracks the results of the cost of service study prepared by APS in support of the rate case application. I also discuss revisions to APS's service schedules including Schedule 3, which is the APS Line Extension Policy. The revisions to Service Schedules 1, 4, 5, 8, 10, and 15 are the changes that had been proposed in the direct testimony of Mr. DeLizio and had no opposition from parties in the rate case. APS is proposing one change in Schedule 1 in addition to the changes proposed in the Direct Testimony of APS Witness Greg DeLizio. The additional change is to delete a provision regarding APS energy audits. This change will eliminate any potential confusion between that provision and energy assessments offered with Commission-authorized demand side management energy efficiency programs. APS is proposing additional modifications to Service Schedule 8, Bill Estimation, that updates bill estimation factors based on current data and adds language to address the methods of estimating bills for customers on new rate schedules that have been introduced since Schedule 8 was initially adopted.

The proposed revisions to Schedule 3 are all consistent with the Agreement and include modifications to the schedule language that eliminates the instruction to book Schedule 3 proceeds as Contributions in Aid of Construction ("CIAC"), clarifies what equipment is included in Local Facilities, adds language that allows refunds to a customer when an additional customer connects directly to an extension funded by the first customer, and adds provisions, including a Statement of Charges, regarding the preparation of the estimates and billing statements for customers who will be funding extensions.

My testimony also discusses revisions to Plans of Administration for the Power Supply Adjustor ("PSA") and Demand Side Management Adjustor Charge ("DSMAC"). The revisions implement changes in accordance with provisions of the Agreement.

### **Supplemental**

My Direct Settlement Testimony included several bill comparisons of typical customer bills before and after the implementation of rates proposed in the Agreement. Those bill comparisons included estimated impacts of proposed changes for the recovery of energy efficiency and demand response program costs through the Demand Side Management Adjustment Charge ("DSMAC") and renewable energy program costs through the Renewable Energy Standard Adjustor ("RES"). In the time since my Direct Settlement Testimony was prepared, APS filed new implementation plans for renewable energy programs and energy efficiency programs. These plans implement the renewable/energy efficiency goals and objectives that are significant elements of the Agreement. They also

identify the required changes in the DSMAC and RES needed to fund the programs described in the plans. The revised bill comparisons (Attachment DJR-1-S (Supplemental)) include the proposed DSMAC and RES charges that were included in the implementation plans. These updated bill comparisons supersede the bill comparisons that were provided by the Settlement Parties on May 15, 2009 and the bill comparisons that were attached to my Direct Settlement Testimony.

My Supplemental Direct Settlement Testimony also proposes additional modifications to Service Schedule 8, Bill Estimation. As before, these modifications are needed because of the introduction of new rate designs as part of the Agreement. The modifications address the procedures that will be followed if APS cannot obtain a meter reading for a customer on the new residential super-peak rate schedule or the new residential critical peak pricing schedule. These are new rate schedules that will be offered to customers after Commission approval of the Agreement.

### **Additional Supplemental**

My Direct Settlement Testimony discussed the Plan of Administration (“POA”) for the Demand Side Management Adjustment Charge (DSMAC) and the POA for the Power Supply Adjustment (“PSA”). The proposed Agreement rate schedules and service schedules were filed in this docket for review and comment. APS has received comments on the DSMAC POA and the PSA POA from the Staff of the Arizona Corporation Commission (“Staff”). Staff comments have been incorporated into the respective POAs.

My Additional Supplemental Testimony also provides a revised proposed line extension policy, Service Schedule 3. This revised policy incorporates comments APS has received from Staff.

## **II. Reply**

None filed.

**Summary of Settlement Testimony Given By  
Peter M. Ewen**

**III. Direct**

None filed.

**IV. Reply**

I have seen no reports, analyses, or other information demonstrating that the Company's current line extension policy is in any material way affecting growth in Arizona. Neither the Pollack Report nor the other testimony filed by the opposing parties has provided any additional evidence that indicates, let alone proves, that Schedule 3 is having any quantifiable or material negative impact on state incomes, tax revenues or housing demand, or that the policy is somehow undermining the ability of the state to recover from the economic recession being felt around the country. Mr. Merritt, the author of the Pollack Report, acknowledges that he ". . . did not conduct any analysis of land values or the potential impact of the . . . changed Service Schedule 3 on the value of land."<sup>1</sup> The Pollack Report also fails to consider the positive economic benefits likely created by keeping base rates lower than they otherwise would need to be for other customers. I conclude that housing demand has been primarily affected by the overall poor economy and in particular by the real estate bubble in Arizona.

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<sup>1</sup> Deposition of Richard Charles Merritt and Deposition of Daniel Court, dated August 3, 2009, page 37 lines 2-5. See Attachment PME-1-S.