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**BEFORE THE ARIZONA CORPORATION COMMISSION**

COMMISSIONERS

KRISTIN K. MAYES, Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

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| 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<br><br>**NOTICE OF FILING TESTIMONY** |

Notice is given that the Arizona Investment Council has filed the Direct Testimony of its President, Gary Yaquinto, on its behalf in the above-entitled docket.

RESPECTFULLY SUBMITTED this 1st day of July, 2009.

GALLAGHER & KENNEDY, P.A.

By [signature]
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Service List for this Docket

18762-7/2132823

**BEFORE THE ARIZONA CORPORATION COMMISSION**

COMMISSIONERS

KRISTIN K. MAYES, Chairman
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**Direct Testimony of**

**Gary Yaquinto**

**on Behalf of**

**Arizona Investment Council**

**July 1, 2009**

**Q. Please state your name, position and business address.**

A. Gary M. Yaquinto. I am the President of the Arizona Investment Council ("AIC"). Our offices are located at 2100 North Central Avenue, Phoenix, Arizona 85004.

**Q. Please summarize your educational background and professional experience.**

A. I earned B.S. and M.S. degrees in Economics in 1974 from Arizona State University. Following college, I was employed by the State of Wyoming as an economist responsible for evaluating the economic, fiscal and demographic effects of resource development in Wyoming. From 1977 to 1980, I was Chief Research Economist for the Arizona House of Representatives. From 1980 to 1984, I was employed as an economist in the consulting industry.

Since 1984, I have worked in various capacities in government and the private sector in the area of utility regulation, including positions with the Utilities Division Staff of the Arizona Corporation Commission, a competitive local exchange telephone carrier and as a consultant. I have also served as the Chief Economist at the Arizona Attorney General's Office (2003-2005) and as the Director, Office of Strategic Planning and Budgeting under Governor Janet Napolitano (2005-2006). I became the AIC President in December of 2006.

**Q. What is the Arizona Investment Council and what is its mission?**

A. The AIC is a non-profit association organized under Chapter 501(c)(6) of the Internal Revenue Service Code. AIC's membership includes approximately 6,000 individuals—

many of whom are debt and equity investors in Arizona utility companies and other Arizona businesses.

AIC's mission is to advocate on behalf of its members' interests before regulatory and legislative bodies. AIC also works with business leadership, policymakers, community leaders and educators to improve the investment climate in Arizona and to support the planning for and development of essential infrastructure to meet the needs of Arizona.

**Q. What is the Arizona Investment Council's interest in this docket?**

A. Very simply, AIC's interest is that Arizona Public Service Company ("APS" or the "Company") be positioned as financially strong and able to attract capital on reasonable terms, so that it can adequately fund operations and build the infrastructure necessary to meet the electric needs of its customers and this State. As APS indicated in its Resource Plan Report filed with the Commission on January 29, 2009, the Company needs approximately 6,500 megawatts of new resources by 2025—most of that being required to meet peak loads. The Resource Plan also estimates that APS' total system energy requirement will increase by 50% or 17,000 gigawatt hours by 2025. In both its Resource Plan and in the Settlement Agreement, APS commits to meeting these demands in a variety of ways, including significant increases in renewable resource investments and substantial commitments to energy efficiency.

However, to meet these demands, make these investments and carry through on these commitments, APS must be fiscally strong and have ready access to capital on reasonable terms. For APS to succeed in serving its customers today and tomorrow, it must demonstrate to the capital markets its ability to repay debt obligations and to generate earnings at levels sufficient to attract and retain equity investors. Especially in light of the recent and very dramatic instability in the debt and equity markets, the outcome of this rate case is critical for APS' access to these capital markets as well as its ability to compare positively against other utility companies for competitive rates and terms.

**Q. Is AIC a signatory to the Settlement Agreement dated June 12, 2009 (the "Settlement Agreement")?**

A. Yes. We participated with the other signatories in the discussions and negotiations which led to the execution of the Settlement Agreement by most of the intervenors in this case.

**Q. Generally, why does AIC support the Settlement Agreement?**

A. For several reasons. First, while the Settlement Agreement provides for a revenue increase which is well below APS' original request, the total non-fuel base rate increase of slightly more than $196 million appears adequate to meet the Company's near-term debt/equity market and financial challenges.

Second and equally important, the Settlement Agreement recognizes the need for earnings stability beyond just the present by incorporating a schedule for filing and processing rate adjustments in 2012 and 2014. The scheduling of future rate cases combined with procedures aimed at reducing regulatory lag promotes earnings stability and reduces uncertainty. Investors view both as a positive sign.

Finally, the fact that the ACC Staff, RUCO and a broad array of intervenors with a variety of different interests signed and support the Settlement Agreement also is a positive signal to the markets concerning the Company, its regulators, customers and stakeholder groups.

**Q. What other aspects of the Settlement Agreement does AIC want to stress?**

A. The flexibility afforded APS and Pinnacle West Capital Corporation ("Pinnacle West") in infusing equity capital is an excellent feature. The Settlement Agreement calls for $700 million of new equity infusions through 2014. (Section VIII.) This authorization allows Pinnacle West to select the most appropriate time and amounts for issuing stock in order to secure the best possible price and to minimize potential dilutions in value for existing stockholders. Another positive feature of that section is the preparation of a plan by APS for maintaining and improving its financial ratings.

Several other provisions of the Settlement Agreement also support the Company's financial performance over a longer term. For example, the treatment of proceeds generated from line extensions under Schedule 3 as revenue helps support the Company's earnings picture and achieved return on equity ("ROE") over the next few years. Also, APS' ability to defer a portion of pension and other post-retirement benefits increases in 2011 and 2012 is positive and the potential 2012 depreciation expense treatment of any Palo Verde license extension (if secured) will also help support earnings and hopefully a reasonable ROE through the term of the Settlement Agreement.

Finally, although AIC believes the Company has done a good job of controlling costs, the Settlement Agreement requires APS to further reduce expenses by $150 million over the next five years. APS' commitment to this high level of additional cost reductions is commendable and will benefit both shareholders and customers.

**Q. Are there any areas of the Settlement Agreement which concern the AIC?**

A. Yes. While AIC recognizes the fact that the PSA the Commission has approved includes several positive features, the Settlement Agreement maintains the 90/10 PSA sharing provision. AIC believes this "sharing" mechanism simply represents a disallowance of prudently incurred costs. We hope the Commission will revisit this issue in the next case.

AIC is also concerned that Section XIV's commitment to achieve certain levels of energy savings will also result in the Company's inability to recover a portion of its prudently incurred fixed costs, thereby reducing its earned return and weakening its financial profile. While aggressive efforts to lower electricity demand are an important tool in meeting future resource requirements, the Company must also be afforded a realistic opportunity to recover all of its prudent costs in providing service. AIC is disappointed that the Settlement Agreement (Section 14.7) does not include a provision allowing APS the opportunity to recover its full costs in combination with the energy efficiency goals. We hope that the Commission will affirmatively address this issue in the docket established to consider energy efficiency mandates and incentives for electric and gas utility companies.

**Q. On June 9, 2009, Chairman Mayes filed a letter addressed to all parties to the docket. Several of her questions are better addressed by the Company or other parties with particular expertise on certain subjects. But, one of the areas she asked the parties to address in testimony relates to the scheduling of APS' next two rate cases. Please respond.**

A. Chairman Mayes asks for comment on whether the rate case stability provisions of the Settlement Agreement are a "true benefit" to consumers. I believe these provisions do represent a "true benefit" primarily for several reasons. Scheduling regular, periodic rate cases promotes gradualism. Consumers are better able to plan and budget for smaller rate increases rather than a larger increase that impacts at one time. The rate case stability provisions also reduce regulatory uncertainty and improve predictability. This helps consumers in budgeting matters and improves investor confidence in APS' financial situation. Additionally, that leads to lower costs of capital, which benefits consumers.

The rate case stability provisions are an extremely important and a well-balanced condition of the Settlement Agreement. Given the investment requirements facing APS over the next several years together with its critical need to improve its financial strength, any more lengthy stay-out period would be a significant negative for APS as well as its current and potential debt and equity investors.

Without these provisions and other Settlement Agreement terms, APS would have no choice but to pancake additional filings into the foreseeable future. The processing efficiencies that benefit the Company and the Commission would be lost and investor risk and uncertainty would be greatly increased. This would lead to higher costs of capital for APS and higher rates for the consumer.

**Q. Chairman Mayes also asks the parties to address the justification for the 11% ROE and whether a longer stay-out period is warranted because of that. Please comment.**

A. First, I think it's important to put the 11% ROE in context. Both it and the base rate increase of $196.3 million are below the $264.3 million base rate increase requested by APS and less than the Company's requested ROE. The 11% ROE is also consistent with the recommendation of Staff witness David Parcell.

Additionally, the ROE award represents only the Commission's "authorized" return on equity. The actual or earned rate of return for APS when the new rates become effective next year is likely to be less—possibly substantially less than the authorized ROE if recent history is any guide.

Most importantly, however, the authorized ROE is particularly appropriate given APS' current financial condition, its need to improve its financial metrics and the current state of the debt and equity markets. Utilities much stronger than APS, which don't face its same capital needs and growth challenges, are still having trouble raising necessary capital on reasonable terms in these times. I believe all the parties agree that an 11% ROE award is in the best interests of the Company <u>and</u> its customers and is vital to the long-term interests of all stakeholders. For these same reasons, I don't believe the ROE award justifies any longer stay-out provision.

**Q. Finally, please respond to the energy efficiency and renewables questions posed by Chairman Mayes.**

A. On the energy efficiency issue, the Signatories did provide in Section 14.1 that should the Commission adopt higher efficiency goals in another docket those higher goals would supersede the levels stated in the Settlement Agreement. AIC does not believe that the Commission should require APS to meet renewable energy standards that are different than those established in the RES rules. Finally, AIC has no expertise on the capped feed-in tariff and carbon trust fund issues raised by the Chairman. I will defer to the Company response on those subjects.

**Q. Mr. Yaquinto, what is AIC's recommendation for the Commission in relation to the Settlement Agreement?**

A. AIC believes that the Settlement Agreement has reached a very appropriate and productive balance among the often widely divergent views of the parties on a broad and challenging set of issues. In so doing, the AIC is confident that the Agreement resolves these issues in a way which fairly addresses the needs of consumers, investors, other stakeholders and the Company. We recommend that the Commission enter its Order approving the Settlement Agreement.

**Q. Does that conclude your testimony?**

A. Yes, it does.

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