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BEFORE THE ARIZONA CORPORATION COMMISSION

2009 AUG -6 P 12: 59

COMMISSIONERS

KRISTIN K. MAYES, Chairman
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SANDRA D. KENNEDY
BOB STUMP

AZ CORP COMMISSION
DOCKET CONTROL

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

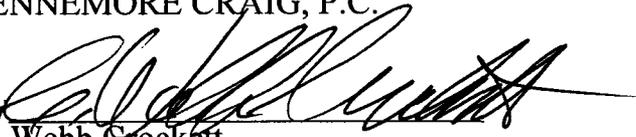
Docket No. E-01345A-08-0172

**NOTICE OF FILING REPLY
TESTIMONY OF KEVIN C.
HIGGINS ON BEHALF OF
FREEPORT-MCMORAN
COPPER & GOLD INC. AND
ARIZONANS FOR ELECTRIC
CHOICE AND COMPETITION
(SETTLEMENT AGREEMENT)**

Freeport-McMoRan Copper & Gold Inc. and Arizonans for Electric Choice and
Competition (collectively "AECC") hereby submit the Reply Testimony of Kevin C.
Higgins (Settlement Agreement) on behalf of AECC in the above captioned Docket.

RESPECTFULLY SUBMITTED this 6TH day of August 2009.

FENNEMORE CRAIG, P.C.

By 
C. Webb Crockett
Patrick J. Black
3003 N. Central Avenue, Ste. 2600
Phoenix, AZ 85012-2913

Attorneys for Freeport-McMoRan Copper & Gold Inc.
and Arizonans for Electric Choice and Competition

Arizona Corporation Commission

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1 **ORIGINAL** and **13 COPIES** of the foregoing
2 **FILED** this 6th day of August 2009 with:

3 Docket Control
4 ARIZONA CORPORATION COMMISSION
5 1200 West Washington
6 Phoenix, Arizona 85007

7 **COPY** of the foregoing was
8 **MAILED/OR *E-MAILED**
9 this 6th day of August 2009 to:

10 *Lyn Farmer
11 Chief Administrative Law Judge
12 Hearing Division
13 Arizona Corporation Commission
14 1200 West Washington
15 Phoenix, Arizona 85007
16 lfarmer@azcc.gov

17 *Thomas Mumaw
18 Arizona Public Service Company
19 P.O. Box 53999
20 Phoenix, AZ 85072-3999
21 Thomas.Mumaw@pinnaclewest.com

22 -and-

23 *Deborah R. Scott
24 Pinnacle West Capital Corporation
25 400 North 5th Street
26 P.O. Box 53999, Ms 8695
Phoenix, AZ 85072-3999
Deb.Scott@pinnaclewest.com
Attorneys For Arizona Public Service Company

*Michael L. Kurtz
*Kurt J. Boehm
Boehm, Kurtz & Lowry
36 East Seventh Street, Suite 1510
Cincinnati, OH 45202
mkurtz@BKLawfirm.com
kboehm@BKLawfirm.com
Attorneys for The Kroger Company

*Lawrence V. Robertson, Jr.
Attorney at Law
P.O. Box 1448
Tubac, AZ 85646
tubaclawyer@aol.com
Attorney for Mesquite/SWPG/Bowie

1 *Michael A. Curtis
*William P. Sullivan
2 Curtis, Goodwin, Sullivan,
Udall & Schwab, P.L.C.
3 501 East Thomas Road
Phoenix, AZ 85012-3205
4 mcurtis401@aol.com
wsullivan@cgsuslaw.com
5 Attorneys for the Town of Wickenburg

6 *Timothy M. Hogan
Arizona Center for Law
7 in the Public Interest
202 East McDowell Road, Suite 153
8 Phoenix Arizona 85004
THOGAN@aclpi.org
9 Attorney for Western Resource Advocates
and Southwest Energy Efficiency Project
10 Arizona School Boards Association, and
Arizona Association of School Business Officials

11 *Daniel W. Pozefsky, Chief Counsel
12 RUCO
1110 W. Washington St., Suite 220
13 Phoenix, AZ 85007
dpozefsky@azruco.com

14 *Michael M. Grant
15 Gallagher & Kennedy
2575 E. Camelback Road
16 Phoenix, AZ 85016-9225
MMG@gknet.com
17 Attorney for Arizona Investment Council

18 *Gary Yaquinto
Arizona Investment Council
19 2100 N. Central Ave., Suite 210
Phoenix, AZ 85004
20 gyaquinto@arizonaaic.org

21 *Jay Moyes
Moyes Sellers & Sims
22 1850 N. Central Ave., Suite 1100
Phoenix, AZ 85004-0001
23 jimoyes@lawms.com
Attorneys for AZ-AG Group

24
25
26

1 *Jeffrey J. Woner
K. R. Saline & Assoc., P.L.C.
2 160 N. Pasadena, Suite 101
Mesa, AZ 85201
3 jjw@krsaline.com

4 *Karen S. White
Air Force Utility Litigation & Negotiation Team
5 AFLOA/JACL-UTL
139 Barnes Drive
6 Tyndall AFB, FL 32405
Karen.White@tyndall.af.mil

7 *Barbara Wyllie-Pecora
8 27458 North 129th Drive
Peoria, AZ 85383
9 bwylliepecora@yahoo.com

10 *Carlo Dal Monte
CATALYST PAPER COMPANY
11 65 Front Street, Suite 201
Nanaimo, BC V9R 5H9
12 Carlo.dalmonate@catalystpaper.com

13 *Steve Morrison
SCA Tissue North America
14 14005 West Old Hwy 66
Bellemont, AZ 86015
15 steve.morrison@sca.com

16 *Janice Alward, Chief Counsel
Legal Division
17 Arizona Corporation Commission
1200 West Washington Street
18 Phoenix, AZ 85007-2927
jalward@cc.state.az.us

19 *Ernest G. Johnson, Director
20 Utilities Division
Arizona Corporation Commission
21 1200 West Washington Street
Phoenix, AZ 85007-2927
22 ejohnson@cc.state.az.us

23

24

By: *Mary Bollington*

25

26

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2
3 In the Matter of the Application of Arizona)
4 Public Service Company for a Hearing to)
5 Determine the Fair Value of the Utility)
6 Property of the Company for Ratemaking)
7 Purposes, to Fix a Just and Reasonable)
8 Rate of Return Thereon, to Approve Rate)
9 Schedules Designed to Develop Such Return)

Docket No. E-01345A-08-0172

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14 **Reply Testimony of Kevin C. Higgins**

15
16 **on behalf of**

17 **Freeport-McMoRan Copper & Gold Inc. and**

18 **Arizonans for Electric Choice and Competition**

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21 **Settlement Agreement**

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25
26 **August 6, 2009**

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1 **Overview and Conclusions**

2 **Q. What is the purpose of your reply testimony in this phase of the proceeding?**

3 A. I am responding to the testimony submitted by Barbara Wyllie-Pecora and
4 other individuals in opposition to the Proposed Settlement Agreement
5 (“Agreement”).

6 **Q. What recommendations do you offer in your reply testimony?**

7 A. In general, the parties in opposition to the Agreement are proposing to
8 modify Service Schedule 3 to include a provision for 1,000 feet of “free footage”
9 for residential line extensions, up to a cost of \$25,000. I recommend that these
10 proposals be rejected, and that the Agreement as submitted by its signatories be
11 approved by the Commission.

12
13 **Service Schedule 3**

14 **Q. What is Service Schedule 3?**

15 A. Service Schedule 3 sets out the terms for line extensions in the Arizona
16 Public Service Company (“APS”) service territory.

17 **Q. What aspect of Service Schedule 3 is the primary source of the objection for
18 the parties in opposition to the Agreement?**

19 A. The parties in opposition to the Agreement have indicated their objections
20 to the provision in Service Schedule 3 that requires an APS residential customer
21 seeking a line extension to bear the full cost of it themselves. This requirement
22 was previously approved by the Commission and has been in place since July
23 2007. Prior to that date, an APS residential customer seeking a line extension was

1 granted a “free allowance” for 1,000 feet, so long as the cost did not exceed
2 \$25,000. Generally, the parties in opposition to the Agreement are seeking a
3 return to the prior “free allowance” policy for residential customers.

4 **Q. Is a return to the prior “free allowance” policy consistent with the**
5 **Agreement?**

6 A. No. The Agreement proposes to maintain the Commission’s current
7 policy regarding customer payments for line extensions, with modifications to
8 provide for: (1) a clarified definition of Local Facilities, (2) a schedule of charges,
9 (3) provision for itemization of quotes, and (4) procedures for refunding amounts
10 to customers when additional customers connect to the line extension. In
11 addition, the Agreement provides that “Schedule 3 shall expressly permit
12 customers to hire contractors for trenching, conduit, and backfill necessary for the
13 extension, as is currently permitted.” Thus, while these modifications clarify and
14 improve Schedule 3, the principle underlying the current policy that assigns costs
15 to the cost causers is preserved in the Agreement.

16 **Q. Are there other implications for the Agreement associated with the “free**
17 **allowance” proposal?**

18 A. Yes. Significantly, the Agreement provides that the Schedule 3 proceeds
19 will be recorded as revenues by APS during the period from January 1, 2010
20 through either the earlier of December 31, 2012 or the conclusion of APS’s next
21 general rate case. If the proceeds are reduced as a result of Commission
22 modifications to Schedule 3, then the Agreement provides that “offsetting revenue
23 changes should also be ordered that would make any such modification(s)

1 revenue neutral” with respect to the provisions of the Agreement, i.e., the
2 Agreement provides that the shortfall should be made up through a bigger rate
3 increase than is already provided in the Agreement.

4 **Q. As a matter of ratemaking principle, do you concur with the current**
5 **Schedule 3 policy?**

6 A. Yes, I do. One of the fundamental principles in ratemaking is that costs
7 should be assigned to cost causers to the greatest extent practicable. This
8 objective is accomplished under the general policies in place in current Schedule
9 3. The Agreement identifies a number of areas in which the Schedule 3
10 provisions can be improved or clarified, while remaining true to this basic
11 principle. In contrast, under the “free footage” concept, the footage is only free to
12 the cost causer; the costs incurred to extend the lines are simply shifted to the
13 other customers on the system. Frankly, such an approach is inequitable to
14 existing customers. It is also inefficient, in that the true cost of extending power
15 lines is understated to the private decision maker.

16 **Q. Please explain what you mean by this last point.**

17 A. If the true cost of extending power lines is not included in the decisions
18 made by individuals purchasing land and building homes, but instead is socialized
19 to other parties, then it can result in more expensive options being selected than
20 would otherwise occur. This point is even alluded to in the report filed by Ms.
21 Wyllie-Pecora entitled, “Arizona Utilities – Modifications to Infrastructure
22 Extension Policies Impact Analysis.” On page 25 of the report, the authors note
23 that one consequence of assigning line extension cost responsibility to the land

1 developer is that customers may instead “purchase a home where electrical
2 service extensions are already paid for or are not as costly.” In my opinion, these
3 considerations are exactly what *should* take place under a rational policy. It is *not*
4 sound public policy to mask these costs so that they are not taken into account in
5 private decision making.

6 **Q. Has your record of participation in this case been one that is generally**
7 **adverse to the interests of new customers?**

8 A. No. While I believe that it is just and reasonable for new customers to be
9 responsible for the direct cost of line extensions to reach their premises, I am not
10 adverse to the concerns of new customers. I support a balanced approach. In its
11 initial filing, APS proposed even greater fees for new customers to recover
12 incremental distribution system costs. In my direct testimony, I opposed this
13 concept, arguing that such an approach raises many policy and economic
14 questions and can result in unintended consequences, including the undue stifling
15 of economic development. As part of the Agreement, APS’s proposed impact
16 fees are withdrawn. Further, the Agreement proposes some improvements to the
17 Schedule 3 terms that are beneficial to new customers, which I fully support,
18 including procedures for refunding amounts to customers when additional
19 customers connect to the line extension.

20 In my opinion, the current Schedule 3 approach as modified by the
21 Agreement, which assigns to new customers the direct cost of extending service
22 to their premises, but which does not include an additional impact fee, strikes the

1 correct balance between fair consideration of the interests of new customers and
2 existing customers.

3 **Q. You referred to the report filed by Ms. Wyllie-Pecora entitled, “Arizona**
4 **Utilities – Modifications to Infrastructure Extension Policies Impact**
5 **Analysis.” In your opinion, does the report provide a reasonable basis for**
6 **modifying Service Schedule 3 to provide for 1,000 feet of “free footage” for**
7 **residential line extensions?**

8 A. No, it does not. The report does not draw any specific conclusions
9 regarding the change in Service Schedule 3 and impacts on the Arizona land
10 market. In particular, the report makes no attempt to separate any impacts
11 attributable to changes in Schedule 3 from the impacts of the global recession and
12 the associated suppression of real estate values that has occurred nationwide
13 during the past year.

14 The primary analysis in the report is hypothetical in nature, in that it
15 examines certain economic and fiscal impacts associated with the construction (or
16 non-construction) of 100 houses. The report does not conclude that the absence
17 of a free-footage allowance has caused or will cause a change in the rural housing
18 stock of this magnitude. Moreover, even the hypothetical analysis presented in
19 the report does not present *net* impacts of a 100-house change, but only the *gross*
20 economic impacts from construction of 100 houses, viewed in isolation.

21 **Q. Please elaborate.**

22 A. Presenting only the gross impacts of constructing 100 houses overstates
23 the net fiscal benefit to local taxing jurisdictions as well as the net benefit to the

1 state economy as a whole. For example, the report estimates the local tax
2 revenues that could be generated from the construction of 100 new homes – but
3 without netting out any additional costs to the local governments of providing
4 services to these new residences. Thus, the limited presentation of the gross
5 impacts overstates the net fiscal impact on local government revenues. Further,
6 the analysis in the report does not consider that re-instituting the line extension
7 subsidy would cause a rate increase for remaining APS customers, and, thus it
8 fails to consider the economic effect associated with the diversion of these
9 customers' expenditures away from other goods and services toward higher utility
10 rates.

11 **Q. Are there other reasons for not relying on the report to modify Service**
12 **Schedule 3?**

13 A. Yes. The most important reason for not relying on the report to modify
14 Schedule 3 is that the report sidesteps the fundamental question of why other
15 electric power customers should be responsible to pay the line extension costs of
16 those seeking new service in the first instance. Even if the construction of new
17 homes could be spurred through the reintroduction of a line extension subsidy, I
18 see no reasonable basis for assigning the subsidy burden to the other electric
19 customers throughout the APS system. If indeed, local governments in the
20 affected areas were convinced that subsidizing line extensions would produce a
21 net fiscal gain, then it would be rational for those entities to consider funding the
22 subsidy themselves, as according to the thrust of the argument advanced by
23 subsidy proponents, these taxing entities would stand to gain. It does not follow

1 from this line of argument that responsibility for funding the subsidy should fall
2 somehow to the average electric power customer on the APS system.

3 **Q. Does this conclude your reply testimony?**

4 **A. Yes, it does.**

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