APS

0000110221

Leland R. Snook
Director
State Regulation & Pricing

Tel. 602-250-3730
Fax 602-250-3003
e-mail Leland.Snook@aps.com

Mail Station 9708
PO Box 53999
Phoenix, Arizona 85072-3999

ORIGINAL

April 16, 2010

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

RE: Notice of Inquiry Regarding Line Extension Policies of Electric Utilities
Docket No. E-00000J-10-0044

Arizona Public Service Company ("APS") submits the following comments in response to Commissioner Pierce's letter regarding line extension policies of electric utilities issued March 9, 2010 in the above-referenced matter.

If you have any questions regarding the infonnation contained herein, please contact David Rumolo at (602)250-3933.

Sincerely,

Leland Snook/SC

Leland R. Snook

LS/sl
Attachment

cc: Steve Olea
Janice Alward
Lyn Farmer
Parties of Record

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AZ CORP COMMISSION
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Copies of the foregoing mailed/delivered
this 16th day of April, 2010, to:

Steve Olea
Director, Utilities Division
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

Janice Alward
Chief Counsel, Legal Division
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

Lyn Farmer
Administrative Law Judge
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

Phlip Dion
Tucson Electric Power/ UniSource Energy
Corporation
One South Church Avenue, Mail Stop
UE2003, P.O. Box 711
Tucson, AZ 85702

Ray Heyman
Sr. VP and General Counsel
UNS
1 South Church Ave., Suite 1820
Tucson, AZ 85701

John Wallace
GCSECA
120 N. 44th St., Suite 100
Phoenix, AZ 85034-1822

Kelly Barr
Salt River Project
P.O. Box 52025
Phoenix, AZ 85072-2025

Meghaen Duger
255 E. Osborn Road, Suite 200
Phoenix, AZ 85012-2327

Spencer Kamps
16430 N. Scottsdale Rd., Ste. 150
Scottsdale, AZ 85254

David Godlewski
Southern Arizona Homebuilders Association
2840 N. County Club Road, Suite 104
Tucson, AZ 85716

Mike Wyllie
Arizonans for Fair Power Policy
27458 N. 128th Dr.
Peoria, AZ 85383

Barbara Wyllie-Pecora
27458 N. 128th Dr.
Peoria, AZ

Tom Farley
Arizona Association of Realtors
255 E. Osborn Road, Suite 200
Phoenix, AZ 85012-2327

Jodi Jerich
Residential Utility Consumer Office
1110 W. Washington, Ste. 220
Phoenix, AZ 85007

Gary Yaquinto
Arizona Investmenmt Council
2100 N. Central, Ste. 210, P.O. Box 34805
Phoenix, AZ 85067

Michael Grant
Arizona Investmenmt Council
2100 N. Central, Ste. 210, P.O. Box 34805
Phoenix, AZ 85067

C. Webb Crockett
Fennemore Craig
3003 North Central Avenue
Phoenix, AZ 85012-2902

Tom Martin
Electric District 2, P.O. Box 548
Coolidge, AZ 85128

Sandy Pierce
Supervisor
La Paz County
1108 Joshua Ave.
Parker, AZ 85344

John Drum
Supervisor
La Paz County
1108 Joshua Ave.
Parker, AZ 85344
Holly Irwin
Supervisor
La Paz County
1108 Joshua Ave.
Parker, AZ 85344

Jerry Brownlow
Supervisor
Navajo County
P.O. Box 668
Holbrook, AZ 86025

Jonathan Nez
Supervisor
Navajo County
P.O. Box 668
Holbrook, AZ 86025

Jesse Thompson
Supervisor
Navajo County
P.O. Box 668
Holbrook, AZ 86025

J.R. DeSpain
Supervisor
Navajo County
P.O. Box 668
Holbrook, AZ 86025

David Tenney
Supervisor
Navajo County
P.O. Box 668
Holbrook, AZ 86025

Shirley L. Dawson
Supervisor
Gila County
1400 E. Ash St.
Globe, AZ 85501

Gary Watson
Supervisor
Mohave County
700 W. Beale St.
Kingman, AZ 86401

Tom Sockwell
Supervisor
Mohave County
700 W. Beale St.
Kingman, AZ 86401

Buster Johnson
Supervisor
Mohave County
700 W. Beale St.
Kingman, AZ 86401

Pete Rios
Supervisor
Pinal County
P.O. Box 827
Florence, AZ 85132

Steve Pierce
Senator
1700 W. Washington St.
Phoenix, AZ 85007

Russell Pierce
Senator
1700 W. Washington St.
Phoenix, AZ 85007

Sylvia Allen
Senator
1700 W. Washington St.
Phoenix, AZ 85007

Frank Antenori
Senator
1700 W. Washington St.
Phoenix, AZ 85007

Sandy Bahr
202 W. McDowell Rd., Suite 277
Phoenix, AZ 85004

Jeff Schlegel
SWEEP
1167 W. Samalayuca Dr.
Tucson, AZ 85704

James J. Kuliesh
Executive Director
Alliance of Construction Trades
465 W. St. Mary's Rd., Ste. 100
Tucson, AZ 85701

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In the matter of the Commission's inquiry and potential rulemaking regarding line extension policies of electric utilities, including but not limited to, alternative rate designs related to apportionment and rate recovery of costs of construction and installation of electric utility line extensions, the use of free footage and/or dollar allowances in line extension tariffs, the treatment of proceeds associated with line extensions as contributions in aid of construction (CIAC) and/or revenue, and the ability for third-party vendors to contract to install line extensions for electric utilities.

> *1) What factors should the Commission consider when establishing policies governing electric line extensions?*

There are two main categories of factors that should be considered when establishing a line extension policy. First, how does line extension policy relate to overall ratemaking practices, energy policy, and statewide economic policy? Second, how does one design a policy that is straightforward to administer, while being fair, equitable and understandable to customers?

As to the first category, line extension policies are today and have been for over a century, an important ratemaking tool to address the rate impacts of new customers connecting to an electric system. As a ratemaking issue, line extension policies directly affect customer rates—if the policy collects less than the cost of the extension, rates for existing customers must increase to provide the revenue requirement needed by the utility for the new facilities. On the other hand, new customers and growth help pay for other embedded costs of the utility system.

One example of a ratemaking issue that should be considered when designing a line extension policy is the general principle that cost responsibility generally should be aligned with cost causation. In the line extension context, when new customers line extensions are at higher than the embedded cost reflected in a utility's rate structure, the collection of fees from such new customers can offset these higher marginal costs of the extension and reduce the rate impact to existing customers. On the other hand, new customers do generate new revenues for the utility. So, some line extension policies reflect a credit or allowance to recognize this fact. In both cases, these practices would reflect with the ratemaking principle that cost responsibility should align with cost causation at least as to distribution line extension costs.

As was discussed in prior workshops at the Commission on Hook-Up Fees, growth can result in costs to the utility and its existing customers beyond just the cost of new distribution facilities. Thus, in some cases, utilities have established hook-up fees that collect from new customers additional funds to offset the cost of new electric system, generation and general plant required to serve growth. Although perhaps beyond the scope of the discussion in this docket, the Hook-Up Fee example illustrates the broad ratemaking impacts that can result from implementing line extension and other similar policies. Similarly, the use of revenue treatment of the proceeds from line extension fees in the recent APS Settlement Agreement allowed the rate increase approved in that case to be significantly lower than would have otherwise been required without changing the charges to new customers from the then-existing line extension policy.

Another broad policy issue that could be considered is overall state economic policy and objectives. The historical practice of providing line extensions where the new customer has not contributed the full cost of the extension has provided a benefit to the segment of Arizona's economy that depends on new construction and growth. Of course, that has required that existing electric utility customers shoulder the cost of that new growth. But that may be an acceptable tradeoff to a policy maker that wants to support growth. Similarly, extension and other costs of electric service are often evaluated by new businesses seeking to locate to the state and compared against those of other states. A policy maker could conclude that it is reasonable to provide a cost-subsidized extension to a large company bringing many high paying jobs to the local economy, because of the overall economic benefits to the local economy.

The second main category of factors, while narrower in scope, is no less important. Line extension policies are inherently complex and can be difficult for both customers and the utility to implement. Getting the initial design right can obviate many problems in implementing new policies. That way, even if customers end up paying for the cost of the line extension, an easy to understand line extension policy with features that make it equitable broadly across customer situations will result in fewer complaints and allow new customers and developers to better plan for their extensions. Fairness across the many situations that can arise in the context of line extension requests is important.

Finally, the details of the line extension policy necessarily will depend on the overall structure adopted by the Commission. For example, the structure should address the development of policies that differ based on the type of applicant requesting the extension. Differing policies for individual residential extensions, extensions to subdivisions or master planned communities, or extensions to commercial/industrial customers should be considered.

Ultimately, both the broad policy issues that are implicated by line extension policies, and the more narrow issues of simplicity, fairness and ease of administration illustrate the many different factors that should be considered in designing such a policy.

> *2) Should the principles of cost-causation be the predominant consideration (i.e. requiring costs to be borne by the cost-causer)? If not, what should be the predominant consideration?*

Yes, but not to the exclusion of the other factors listed above. In theory, costs should be recovered from those whose actions cause the costs to be incurred, and indeed the principle of cost causation is the key factor considered in evaluating the majority of cost recovery mechanisms such as line extension policies.

3) Is it possible for the Commission to devise line extension policies that will result in existing customers subsidizing growth? If so, please provide an example.

Yes. Until the APS policy change implemented on July 1, 2007, the previous extension policies (which provided up to the first 1000 feet free for individual residential applicants) relied upon existing customers to subsidize growth through rates. Whenever the cost to extend service to a new customer is more than the cost recovered through the unbundled distribution components of base rates, existing customers will pay the difference.

4) Is it possible for the Commission to devise line extension policies that will result in growth subsidizing existing customers? If so, please provide an example.

Although theoretically possible, this would be highly unlikely. The only time an extension policy will result in growth subsidizing existing customers is if the marginal cost to serve the new customer less any extension proceeds is lower than the cost recovered through base rates.

5) Should growth pay for growth or should it be subsidized by existing customers?

As noted above, this is a key public policy issue. APS believes that the current Commission-approved line extension policy for APS achieves the goal of growth paying for growth. Absent other policy objectives that must also be considered, this best aligns with the general ratemaking principle of cost responsibility following cost causation.

If you believe growth should be subsidized by existing customers, in what amount and by what mechanism?

In general, the issue of subsidies needs to be addressed in the context of cost causation, i.e. new customers should be carrying their fair share of the costs of service. However, in some instances, and on a case by case basis, there may be societal reasons for providing an initial subsidy to attract new customers. For example, if providing a cost-subsidized extension to a new industrial customer results in the development of high-paying jobs or improves the utilities economies of scale in the long run, such a subsidy could be considered.

Should growth costs be included in base rates and allocated to all customers or should they be allocated to specific customer classes?

Line extension policies should be designed so that, to the degree the Commission finds appropriate, the local incremental costs to serve new customers are paid by those growth customers. This is consistent with cost of service principles and would be reflected in APS's class cost of service analyses. The larger issue is whether "system growth cost" should also be recognized and charged to customers causing growth. In this context, "system growth costs" may include backbone distribution feeders, substations, incremental generation/resource costs, and supporting infrastructure such as customer centers, computer system upgrades, and personnel additions required to support growth.

> *6) Should growth be required to pay for more than growth? If not, why not? Does APS' existing line extension policy require growth to pay for more than growth?*

No. The existing APS line extension policy requires applicants to pay fees based on the average cost of facilities added to the APS system required to provide service to the applicant. Any additional costs necessary to support additional growth are considered system improvements and are not funded through the extension policy.

> *7) Should certain customer groups (such as low income customers, Native Americans on Native American lands, rural customers, etc.) be exempted from an otherwise generally applicable line extension policy? If so, what groups should be exempted and why?*

Technically, such groups are not exempted from paying for APS line extensions, but are subject to a different policy regarding such payments. Nevertheless, this is a public policy issue for the Commission to determine. Generally, APS believes its tariff should be applied equitably across all customer classes and groups. Currently, the APS line extension policy has provisions that provide special treatment to customers on Native American lands and to customers who meet certain low-income criteria. While these special provisions do meet Commission policy objectives, they may prove to be cumbersome to implement and administer.

> *8) Should new line extensions have excess capacity?*

New extensions are constructed to meet the requirements of the applicant requesting the extension. However, extension designs also recognize other factors such as:

- Standard engineering practices that provide for consistent construction practices.
- Efficient inventory control. Most utilities inventory standard sizes of wire, poles and underground equipment. This is necessary to manage inventory costs.

> *If so, should new customers be required to pay for that excess capacity?*

Customers should be required to pay the cost to extend service based on standardized equipment and designs.

> *Is there a minimum level of electric capacity that all new customers should be required to have irrespective of their own electric demand?*

Customers are required to size their equipment based on the National Electric Code adopted by their local jurisdiction. Utilities size facilities using standard equipment and design practices to meet the expected load of the customers.

If so, what is that minimum electric capacity and what is the potential incremental cost of installing electric lines at the minimum electric capacity versus the customer's actual electric demand?

There are many factors that determine the size of equipment that may be installed to serve a customer. The factors include where the customer connects to the grid, the size and characteristic of the load, and the distance from the source (substation). For example, when sizing distribution transformers, the connected load is an important element and the utility installs a standard-size transformer that meets the applicant's load.

What percentage of line extensions are single-customer installations, versus those that 'grow the grid' to further extend company service capability?

APS does not "grow the grid" to further extend company service capability. We extend facilities to meet the needs of specific applicants who are requesting service. Historically, approximately 12% of residential extensions have been made to serve individual customers, the balance of residential construction serves customers in subdivisions.

9) Explain how any applicable line extension charges should be calculated. Under what circumstances and on what basis, are customer refunds of customer-financed line extensions appropriate?

The current commission-approved APS Service Schedule 3 line extension policy provides a Statement of Charges that are based upon unit costs of materials and unit labor charges. This standardized approach allows for more transparent pricing.

The current APS line extension policy provides an opportunity for refunds under certain circumstances. When applicable, refunds are made on a pro rata, cost-sharing, basis. The refund potential is limited to the first two additional customers to allow for practical administration of the policy. One of the factors regarding refund provisions that is frequently overlooked is the administrative difficulty in tracking which customers may be eligible and the amount of potential refunds. In lieu of refund provisions, it may be possible to address the issue of extension cost sharing through mechanisms such as equipment allowances.

Should the initial applicant be required to pay the total cost with a refunding mechanism if subsequent applicants use any common facility paid for by the original applicant or should the initial customer only be required to pay for the common plant constructed on a pro rata basis?

APS currently collects the total cost from the initial applicant and refunds a pro-rata share of common plant elements if a second or third new applicant connects. This method can be difficult to administer. Under the alternative expressed in the question, i.e. collecting only a pro-rata share of common plant from the first customer in anticipation of future customers, the risk of no additional customers is shifted to the utility and its customer base. An additional customer may never request service.

> *10) Should line extension policies vary depending on the type of customer? In other words should line extension policies vary among the following types of customers:*
>
> *- An individual owner, or a small group of owners, of land who will not subdivide their respective properties and are seeking service exclusively for a future residence and not for a development.*
>
> *- Larger developments, residential subdivisions, or master-planned communities.*
>
> *- Commercial and/or industrial customers.*

APS believes that it is appropriate to have variations in an extension policy to address the different types of extensions that may be requested. For example, an extension that is made for a specific residential applicant will, by its very nature, be different than one made for a speculative land developer. Existing customers should not bear any of the risk of investment to serve speculative development. If an equipment allowance approach is adopted, the equipment allowance should have allowances that differ based on the type of customer and/or the amount of investment that is supported in base rates. Similarly, economic feasibility studies are suitable for commercial and industrial customers.

> *11) What were the original considerations for establishing a 1,000 foot line extension policy for APS, and why wasn't the same line extension policy adopted for the other electric utilities?*

The "1,000 ft free" residential line extension policy was adopted in 1954, We were unable to find any documentation as to why that specific extension length was adopted nor can we comment on why other utilizes have adopted other free footage policies in the past.

> *12) Has the changed character of APS's service territory, i.e. rural/urban mix, removed the need for a line extension subsidy? Given the fact that APS' line extension policy was in place for 50+ years prior to 2006, has the original purpose of this subsidy been served?*

While the urbanization of many parts of the APS service territory has resulted in an increase in residential subdivision and commercial line extensions, the service territory still includes very rural areas throughout the state. The policy should include provisions that address the needs of the rural community. However, that does not mean that the historic 1,000 ft free policy is appropriate today. The original policy may have been in place to provide electrification in rural area in the same way the Rural Electrification Administration program was started by the federal government. That program has been modified over the years as the nature of rural development has changed.

13) What is the appropriate time interval for examining subsidy costs? I.e., should subsidies be re-examined every 50 years, 10 years, 5 years or less? Should subsidies be set on a downward glide path or is it appropriate for customers to expect their perpetual existence?

Line extension policies and inherent subsidies, if any, should be reviewed from time to time but changes should be made in the context of a rate case in which all stakeholders have the opportunity to provide input. APS does not believe that any customer should expect that a subsidy be continued in perpetuity. The economics of providing electric service change over time, and policies should be reviewed and kept current with those changes.

14) Is it inconsistent for the Commission to establish some subsidies that decline over time and some subsidies that do not decline over time? Should the Commission pursue an across-the-board phase out of all subsidies?

The issue of subsidies is a fundamental social policy issue on whether growth should pay for itself, socialized across a system or somewhere in between. As discussed in the previous response, subsidies should be reviewed from time to time and should decline or disappear entirely as the perceived need for them declines or disappears. No single policy will apply in all circumstances.

15) Should line extension policies for electric utilities be uniform across the state and established via rulemaking or should they be decided on a case by case basis? Should electric cooperatives be treated differently than investor-owned electric utilities? If so, how and why or why not?

There are rules set forth in the Arizona Administrative Code (R14-2-207) that specify the requirements all utilities must follow. However, the application of the rules can be examined in the context of the unique characteristics of each utility.

16) Should line extension policies for electric utilities be uniform with line extension policies for telecommunications, gas, water and sewer utilities?

Line extension policies should be specific to each type of utility. Each type of utility service (i.e. telecommunications, electric, water, wastewater) has specific infrastructure needs and characteristics. For example the construction of electric distribution facilities requires a highly-skilled, specialized work force.

17) If the Commission reinstates a free footage allowance for utilities, should the Commission make the new policy retroactive? Should existing customers be compensated who were previously negatively affected by the" no free allowance" policy? If so, how? If one is opposed to retroactive application, is that opposition based in law, policy or both?

No. This would (1) constitute retroactive ratemaking, something prohibited by the due process provisions of both the Arizona and United States Constitutions; (2) violate the APS Settlement unless APS was compensated for any such action; and (3) violate the contract clause of the United States Constitution (Article 1, Section 10) and its analogous state provision (Article 2, Section 25 of the Arizona Constitution). These principles have been consistently recognized in each of the 11 versions of APS Service Schedule 3, none of which have ever been applied retroactively. Finally, to the extent retroactive application of a more lenient line extension policy imposes increased burdens on APS customers (which it would), APS believes this to be fundamentally unfair.

18) What costs should be captured in line extension policies? In other words, should line extension policies consider the costs of local facilities, system or backbone facilities, and upgrades to existing facilities?

Line extension costs should include the costs of local facilities to serve the applicant and perhaps costs related to backbone facilities that may be required to serve the applicant. For example, if an industrial applicant requests service in a rural area where the existing facilities are all of single-phase construction, the extension cost to the applicant should include the reconstruction of the existing system to three-phase. Similarly, APS receives requests from customers where due to the nature of the customer's service requirements it is necessary to provide a dedicated feeder. Since the dedicated feeder does not provide any benefits to other APS customers, it is arguably appropriate to recover the costs of the dedicated feeder from the new customer.

19) What are the comparative advantages and disadvantages of free footage allowance versus a dollar allowance policies?

A properly designed equipment allowance reflects the costs that are recovered through base rates. Costs above that amount are collected from the customer requesting the extension. While a footage-based allowance can have the same objective, it does not reflect the variations in construction costs that occur from site to site and over time.

What would be the cost to ratepayers if the policy were changed to include an "equipment allowance" of a specified amount for only individual residential homeowners?

The equipment allowance approach that provides each residential service applicant with a certain dollar allowance in lieu of a footage approach has positive attributes in that it can be designed to reflect the average investment that is recovered in base rates. This would largely mitigate any impacts on other customers.

20) If you are an electric utility, what is your current line extension policy and how has your line extension policy changed over the last fifty years?

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APS's current line extension policy, Service Schedule 3 (Revision 11) reflects the Commission-directed changes that have occurred over the course of several rate cases. The policy has several improvements over previous versions. Of most significance, it includes a Statement of Charges. The Statement of Charges provides per unit pricing of the construction elements used to extend service to most individual residential customers, real estate developments, and commercial customers. This allows the applicant to have a clear understanding of the extension costs. As previously described, it also adopted a limited refund provision that is applicable to instances where additional customers are served from an extension. The policy provides that project specific cost estimates are provided to large commercial/industrial customers where specialized design considerations are necessary.

The policy in effect over the past 50 years at APS has evolved from a footage and revenue/economic feasibility analyses method into the current policy that requires applicants to provide proceeds equivalent to the cost of the extension. The attached exhibit lists the specific changes that have occurred over the period.

> *For APS, what percent of line extensions are installed inside Maricopa County versus outside of Maricopa County?*

In the response to this question, we have assumed that each new meter set required an extension of some sort. Based upon meter set data from the three year period of 2007-2009, approximately 69% of all new meters set were within Maricopa County.

> *What percentage of line extensions are for residential service versus commercial and industrial service?*

Approximately 80% of new meter sets are for residential customers and 20% for commercial & industrial customers.

> *How many residential line extension estimates has APS provided since 2007 that did not result in a subsequent payment and request for a line extension and service?*

APS receives many inquiries regarding line extensions that result in no action by the customer so there is no tracking or filing system for such estimates. Project work orders and tracking are initiated when the customer elects to move forward with the project.

> *21) Please describe the optimal line extension policy that, in your view, best balances the interests of existing and future customers. If you believe that a historical line extension policy (e.g., APS' 1000 free feet line extension policy) is the best, please explain why you believe it is better than alternative proposals (e.g., why is 1000 free feet better than 500 free feet, why is 1000 free feet better than 2000 free feet, etc.)*

The optimal line extension policy is one that balances the interests of all stakeholders. APS's historical extension policy under which individual customers could receive free extensions up to 1000 ft in length and cost many thousand dollars disadvantaged APS customers as a whole and caused continuing financial stress on APS. APS believes that a fair policy would include equipment allowances or some equivalent for residential customers, residential subdivisions and small general service customers. Most other extensions should be made based on an economic feasibility basis. The policy must also provide for addressing special circumstances such as temporary services, line relocations, and overhead to underground conversions.

> *22) If the optimal line extension policy is different than existing and/or historical line extension policies, should the Commission transition to the optimal policy? If so, how?*

Extension policy changes should be made in the context of rate cases in which all stakeholders have the opportunity to examine the issues and provide input. If the policy adopted in a case is radically different than the current policy, a transition plan with specific milestones is appropriate. In fact, when the Commission ordered recent changes to the APS extension policy, the revised policy included a transition plan to allow customers who had been engaged in completing extension agreements under a prior policy to complete the process under the earlier policy.

The primary issue concerning transitions between versions of extension policies is one of customer communication. For example, customers who have projects well under way should have the opportunity to remain on the then current policy or be given the opportunity to choose between the then current or new policy. However, APS is opposed to "grandfathering" customers who have simply purchased land for future sale or use. Government agency policies, building codes, etc. all change over time and someone who has held land for many years must conform to the rules at the time the decision to move forward with construction.

> *23) Please estimate the impact on the economy and new construction from the current line extension policies. What is the impact on land values?*

Testimony given in the recent APS rate case greatly disputed the idea that the current line extension policy has any direct effect upon the economy, new construction activity, or land values. We believe a financially strong utility has a far greater impact on the long-term economy of Arizona.

> *24) Should the Commission be concerned about the potential for new line extensions becoming idle (i.e., "building a line to nowhere")?*

APS only constructs extensions in response to customer requests. Therefore, "building a line to nowhere" is unlikely. Prudent utility practice would not result in building facilities until such time that customers exist that are willing and able to pay for extensions and receive utility service.

If so, what provisions should be made to protect against such contingencies?

Requiring signed extension agreements and securing advances for the cost of construction prior to beginning construction are the most appropriate ways to protect against such contingencies

25) Should an economic model be used to determine the benefits of new customers versus the costs associated with providing line extensions?

Prior versions of the APS line extension policy, included provisions for an economic feasibility study (EFS) process to determine if an extension to new customers was supported by the revenue that would be generated by the customer. An EFS tool can be an effective tool to evaluate whether commercial, industrial, or subdivision development extensions were economically justified.

26) What prompted the changes to line extension policies that go beyond the elimination of free footage allowances? For example, what prompted the change in categorizing line extensions associated with subdivisions from "advances in aid of construction" to "contributions in aid of construction"? If the policy was changed back to an "advance" what would be the impact on electric utility rates? What would be the impact on electric utilities' financial condition?

No change was made by APS in the characterization of extension proceeds as between contributions and advances. Contributions in aid of construction ("CIAC") and advances in aid of construction are distinct accounting concepts that have long been a part of regulation. If a customer makes an advance in aid of construction, the advance would be recorded in the utilities books as an advance. Payments received as an advance of construction will get reclassified as CIAC when an advance is no longer subject to refund. Advances that are refunded increase rate base. CIAC is never included in rate base and reduces depreciation expense.

27) How much, if any, additional funding has the change in line extension policies brought to electric utilities?

APS has been collecting to date approximately $1.7 million per month in 2010.

28) Is it possible to change line extension policies without affecting rates? If so, how?

The recent Settlement Agreement prevents such a change before 2012. Even aside from the settlement, any change in line extension policy will impact rates.

29) How do the costs of construction of electric lines compare today with the costs of construction in 2006?

Comparing the present overall construction costs to those of 2006 indicates costs have increased over 20%. Basic component costs like copper are up over 40% since 2006.

How are adjustments made to the costs of construction?

The Statement of Charges contained in APS Service Schedule 3 cannot be updated until the next rate case. However, APS's computerized cost system is updated continuously as new inventory is received. Therefore, the actual costs of construction are always current costs.

Are adjustments made to these costs pursuant to a tariff?

Please see prior answer.

30) If the actual costs associated with construction are less than the amounts paid in advance by the developer, are those overages refunded?

APS extension charges are based on the Commission-approved Statement of Charges for the vast majority of extensions. The Statement of Charges is fixed until the next rate case. Therefore, there is no "overage".

Can ratepayers obtain the actual costs for materials and the actual labor costs?

Please see previous answer

What is the linear cost difference between buried electric line extensions and overhead, pole-attached line extensions?

Per the APS Statement of Charges, the cost of a single-phase overhead extension is $15.32 per foot. The cost of a single-phase underground extension is $5.75 per foot. However, for underground extensions the customer is required to furnish all trench and conduit.

31) Should the Commission adopt a separate line extension policy for "extraordinary" customers, waiving costs or the like for developer commitments such as, all electric subdivisions, Energy Star homes, or solar installation programs, etc? If so, what should be the criteria for establishing such waivers?

Establishing exemptions or waivers creates administrative burdens for the utilities and Commission and opens the potential for claims of discrimination.

32) What flexibility does a utility or cooperative have in interpreting and implementing line extension policies? What flexibility should they have?

APS and other utilities under the Commission's jurisdiction must follow the Commission approved line extension policies without exception (unless such exception as been authorized by the Commission). That being said, there are always factual situations that arise that may not have been anticipated in drafting the verbiage for a line extension policy. In such instances, the utility must reason by analogy to effectuate the overall intent of the policy. If that is not possible, the utility can seek guidance from Commission Staff or, if necessary, the Commission itself as to how this unanticipated circumstance should be addressed.

33) What changes in line extension policies can occur in a generic docket? What changes must occur in a rate case?

Any desired changes a utility's line extension policy can be identified in a generic docket. Thus, the question is what changes can be implemented in a generic docket and which must await a general rate case. In APS's situation, it is difficult to see any substantive changes that could be implemented until the Company's next rate case without undermining the economic and legal basis for the 2009 Commission-approved settlement.

34) Would a change in the line extension policy be detrimental to energy efficiency or DSM goals?

In most cases, line extensions are required for to provide service where no electrical facilities exist. Therefore, energy efficiency or DSM goals do not negate the need for such an extension. DSM and energy efficiency goals may impact distribution designs over time, and that will be reflected in the cost of the extension. In certain cases, line extension policy provisions are applied when an existing customer requires increased capacity due to adding electrical equipment or expansion of facilities. Energy efficiency or DSM may eliminate or reduce the need for facility additions under the extension policy. On the other hand, in an extension policy regime based on EFS, energy efficiency could make a particular extension less economical.

35) Would a change in the line extension policy provide an economic incentive to build homes in Arizona? If so, does the benefit of increased construction outweigh the costs of increased rates for all ratepayers? Can any increase in new home construction be quantified?

The home buying and home building market relies upon many factors. The issue of the relationship between line extension policies and residential construction activities was thoroughly vetted in the last APS rate case. There was no evidence that the line extension policies of utilities impact the housing market.

Accounting Treatment of Line Extension Proceeds:

36) Are the funds associated with line extensions treated as contributions in aid of construction (CIAC) or as revenue in your electric utility?

For APS, funds associated with line extensions are treated as revenue per Decision No 71448.

37) Should the accounting treatment for any funds collected for line extensions be treated as revenues, as contributions-in-aid of construction, or determined on a case-by-case basis?

APS believes that the accounting for line extension proceeds should be determined on a case by case basis.

38) To what extent is the accounting treatment of line extension proceeds relevant to the over-arching policy discussion regarding who pays for the cost of the line extension and whether growth pays for growth?

The policy discussion is independent of the accounting treatment. The applicant requesting an extension will pay the same amount whether the proceeds are booked as revenue, a non-refundable contribution in aid of construction, or an advance.

39) Does the shift in accounting treatment from CIAC to revenue result in growth subsidizing existing customers? In answering this question please respond to the following scenarios.
The Commission recently authorized Arizona Public Service Company (APS) to treat all Schedule 3 proceeds as revenue instead of CIAC. Under the settlement agreement approved by the Commission, APS will be allowed to treat as revenue all line extension funds collected during January 1, 2010 and the earlier of December 31, 2012 or the conclusion of its next general rate case. Thereafter, Schedule 3 proceeds will be recorded as CIAC unless otherwise ordered by the Commission. APS' next base rate change from its next rate case will be effective no sooner than July 1, 2012. Assuming that the test year of APS' next general rate case ends on December 31, 2011 and that the Commission allows Schedule 3 proceeds to revert back to CIAC, please answer the following:

A. A hypothetical new customer pays APS $25,000 to extend a line 1000 feet to his new home in 2011.
Would such a customer be better off having his $25,000 treated as revenue instead of CIAC?

There is no difference to the customer paying the advance; in either case the customer is paying the $25,000.

From a longer term perspective, said customer should benefit from lower ongoing monthly retail rates if the line extension proceeds are accounted for as revenue, as such treatment should reduce the need /amount of future base retail price increases.

Will such a customer begin to pay for his line "again" once it is placed into rate base and put into APS' rates on July 1, 2012?

The customer does not pay for the extension "again". The plant investment is included in rate base and recovered from all customers. The customer will experience lower rates than would have otherwise been in place since the revenue treatment approved in the settlement allowed the settling parties to agree to a lower base rate increase.

To what extent, can it be said that existing customers have been insulated from the costs of growth, if the $25,000 paid by the new customer, is still placed into APS' rates on July 1, 2012?

Existing customers will have experienced lower rates for the period 2010 to 2012 than would otherwise have been the case.

To what extent, if any, has this new customer benefitted by having his $25,000 treated as revenue instead of CIAC?

As noted above, the revenue treatment enables the setting parties to agree to a lower base rate increase, thus benefitting all customers including the new customer.

Will this new customer receive any benefits under a revenue approach if he first begins taking service from APS on December 31, 2011?

Same as above.

What if he first begins taking service from APS on June 30, 2012, the day before the next APS rate case is decided?

While the customer will have not experienced the lower rates that resulted from revenue treatment in this case, the impact going forward will depend on commission treatment of line extension proceeds in the next APS general rate case.

To the extent that this new customer is not benefitted by treating his $25,000 as revenue instead of CIAC, are there other customers who are benefitted?

APS customers in general will have benefited from the revenue treatment since the rate increase effective as a result of Decision No. 71448 was lower than it would otherwise have been.

Who are these customers and how have they benefitted?

All other customers benefit by not paying for higher rates.

Has the change in accounting treatment resulted in this new customer subsidizing these other customers?

No.

Does the shift in accounting treatment result in growth subsidizing existing customers?

No. Growth does not subsidize current customers. All customers pay the same rates, regardless of vintage.

B. A hypothetical developer is developing a new community along the East Verde River, ten miles west of Payson and is paying the full cost (approximately $6 million) for extending electric services from Payson to the new community. The developer pays the full $6 million to APS in 2011 and the lines are constructed, and become used and useful to the new community by December, 2011.

Are the developer and the residents of this new community better off having the $6 million treated as CIAC or revenue?

The developer is indifferent to the accounting treatment. Residents in the community will experience lower rates as will all customers.

Will existing customers have to pay for the $6 million "again" after it is put into rate base and APS' new rates become effective on July 1, 2012?

No. See previous response to the same question.

Once APS' new rates go into effect will APS begin to earn a rate of return on the $6 million that was paid by the developer?

Yes.

<u>Third Party Vendors:</u>

40) Should third-party contractors or vendors be allowed to install electric line extensions? If so, under what circumstances and conditions?

Third party contractors may be allowed to install electric line extensions provided they meet the following requirements:

- Third-party contractor is licensed in the State of Arizona and in good standing with the Registrar of Contractors (ROC).
- Host utility to qualify the third party licensed contractor.
- Host utility to provide materials.
- Customer to be assessed costs for material & equipment as well as material handling/delivery costs and project inspection fees.
- Host utility would coordinate process and witness final connection to existing energized facilities.
- Third party contractors would be prohibited from performing the following activities:
- Meter scheme installations.
- Network installations.
- Substation work.
- Working in energized manholes
- Third party contractors limited to 21kV or less.

41) What are the potential cost-savings of third-party vendors?

There may be potential cost savings associated with third party vendors (labor) based on worker classifications, equipment used, commercial structure, and market rates. The host utility would provide the coordination, design, engineering and inspection of the installation in accordance with all APS procedures, which would be a cost to the customer that could negate any savings.

42) What should be the scope of third-party involvement? (e.g., design; construction; right-of-way acquisition; licenses and permits, etc.)

Construction and design services could be provided by qualified and licensed third parties.

43) How should the host utility ensure quality control? How should warranty, insurance and liability issues be resolved?

Quality control would be administered via the third party contractor qualification process, inspection of all installations, and providing materials that meet the host utility's standards.

Who would bear responsibility for accidents, injuries, and fatalities among patrons and workers resulting from substandard work from third-party contractors?

During construction, the customer and contractor are responsible for the activity being undertaken, the work site, and the safeguarding of material & equipment issued to the customer by the host utility. After the project is complete, inspected and accepted by the host utility, they, (the host utility) bears the responsibility.

44) Can we be certain that any benefits from a third-party contractor option will not be offset by safety and reliability issues?

While it cannot be said for certain that benefits would be offset by other issues, the host utility will provide quality control for safety and reliability concerns. Measures such as third party contractor qualifications, inspections of installations and the use of host-utility provided materials that meet the utility's standards are the tools needed to alleviate safety and reliability concerns.

45) Would the inclusion of a third-party option generally promote the "convenience, comfort, and safety, and the preservation of the health, of the employees and patrons" of electric utilities?

No, it would not promote the cited issues.

46) Have other jurisdictions permitted third-party contractors to construct line extensions?

Yes, other jurisdictions permit third party contractors to varying degrees. In some cases, third party work is limited to site improvements while in other cases third party work is used as means to supplement the utility's work force.

If so, what has been their experience? Have there been any "hidden costs" (e.g., design, inspection, and repair costs borne by utilities and ratepayers, but not captured in contractors' prices), delays, and complaints associated with such work?

There is no hard evidence regarding hidden costs. In general, the developers are responsible for paying for the utility's costs such as construction inspection expenses. Requiring the third party to use the utility's construction standards and equipment that meets the utility's equipment standards should avoid future unanticipated costs.

Catch-all Question:
47) What other questions or issues should be answered or addressed in connection with this inquiry?

In addition to the discussion of line extensions to new service applicants, extension policies address other issues such as overhead to underground conversions, relocations and upgrades pursuant to customer requests.

ACC Orders on Electric Line Extensions for Arizona Public Service Company

PLEASE NOTE: This research reflects a review of ACC Decisions in the possession of Arizona Public Service Company. There are historical gaps in the files where decisions are not available; to date no attempt has been made to determine if any of the missing decisions pertain to line extension policy.

Date	Decision No.	Extension Policy or Change to Policy	Notes and/or Commission discussion
8/12/1955	Docket No. U-1345 Decision No. 29168	No extension policy changes.	This decision was the result of a formal complaint. The Commission declined to order APS to build a line extension to a private individual because "It appears to this Commission that the amount of revenue which would be derived from the extension of this line for service would be very small in proportion to the cost of construction, and that the Commission is without authority to order such an installation."
4/30/1962	Docket No. U-1345 Decision No. 33864	Revision to Line Extension policy: • Underground customers pay only for the difference between overhead and underground plus $1.35 per month • Increase the cap on revenue basis extensions to $10,000	Previously, the Company had been charging underground customers the full cost of a line extension. The Commission states that this change "lightens the burden on customers desiring the same by substantially decreasing the initial amount of cash required from them, and it continues to avoid the danger of discrimination against customers not receiving such service by substantially recovering the additional costs thereof from those who do."
7/26/1982	Docket No. U-1345-82-196 Decision No. 53146	Revisions to APS electric line extension policy: • Residential Footage Allowance: 1,000 ft, with a maximum of 2,000 ft per customer or 10,000 ft maximum or a maximum cost of $25,000 • Per foot charge moved from policy to administrative sheets • Revenue Allowance: increased to $25,000	No discussion in the Decision. These schedules were filed to comply with wholesale changes to the Commission's Rules and Regulations that became effective 3/1/1982. All schedules were reworked, reformatted and refiled. This is Electric Line Extension Policy No. 3647.
5/23/1984	Docket No. U-1345-84-068 Decision No. 54036	Revisions to Administrative Rules Governing Electric Extension Policies to revise certain costs.	NOTE: Decision No. 53969 suspended the filing for 60 days to allow Staff more time to review the changes. "The Commission…concludes that the adjustment is appropriate and necessary to recover portions of the company's costs."
2/4/1986	Docket No. U-1345-85-286 Decision No. 54872	Revisions to Line Extension Policy: • Anticipated revenue from extensions shall not be differentiated between dual-fuel and all electric	This decision was the result of a formal complaint from Southwest Gas. The Commission required APS to refile its extension policy, saying "APS' electric line extension policies, as implemented by its tariff on file with the Commission , are unlawful for the reason that they result in discrimination among applicants for electric service who are similarly situated and who receive a like and contemporaneous service under similar conditions." APS filed its revised policy, which was approved in Decision No. 54940. This is Electric Line Extension Policy ACC No. 4239.
1/26/1989	Docket No. U-1345-88-222 Decision No. 56320	No changes to Extension Policy.	This Decision dismisses a complaint from a private individual that APS charged an excessive amount for a line extension. The parties reached an agreement and requested the matter be dismissed.

ACC Orders on Electric Line Extensions
for Arizona Public Service Company

Date	Decision No.	Extension Policy or Change to Policy	Notes and/or Commission discussion
4/1/2005	Docket No. E-01345A-03-0437 Decision No. 67744	Revisions to Line Extension Policy: • Definition of "economic feasibility" changed to include 6x estimated annual distribution revenue • Other wording changes	This Decision adopted a settlement between the parties. "Several APS customers made public comment about the line extension policy and how it has not been modified in a long time. We will direct Staff to work with APS to review its line extension policy and determine whether the construction allowance should be modified." This is Electric Line Extension Policy ACC No. 5622. Schedule 3 Rev 08
6/28/2007	Docket No. E-01345A-05-0826 et al Decision No. 69663	Revisions to Line Extension Policy: • All extensions are to be made on an economic feasibility basis, with an allowance of $5,000	"...in view of the unprecedented growth in APS' service territory, granting APS variances to AAC R-14-2-207.C.1 and C.2, which require a company to provide a specified footage of distribution line at no charge, is a necessary and appropriate measure to shift the burden of rising distribution infrastructure costs away form the current customer base to growth." This is Electric Line Extension Policy ACC No. 5683. Schedule 3 Rev 09.
2/27/2008	Docket No. E-01345A-07-0713 Decision No. 70185	Revision to Line Extension Policy: • All allowances removed	This filing was made to comply with the requirements of Decision No. 69663, where the Commission required APS to file "...revised line extension tariffs that eliminate any free footage or free allowance and remove any requirement for economic feasibility analysis as otherwise required...". This is Electric Line Extension Policy ACC No. 5695. Schedule 3 Rev 10.
1/1/10	Docket No. E-01345A-08-0172 Decision No.71448	Revisions to Line Extension Policy: • Implemented Statement of Charges	This decision was the result of a settlement agreement. This is Electric Line Extension Policy ACC No. 5766 Schedule 3 Rev 11.