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BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION  
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Arizona Corporation Commission

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OCT 14 2011

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IN THE MATTER OF THE APPLICATION  
OF ARIZONA PUBLIC SERVICE  
COMPANY FOR AUTHORIZATION FOR  
THE PURCHASE OF GENERATING  
ASSETS FROM SOUTHERN CALIFORNIA  
EDISON AND FOR AN ACCOUNTING  
ORDER.

DOCKET NO. E-01345A-10-0474

STAFF'S RELY BRIEF

**I. INTRODUCTION.**

Arizona Public Service Company ("APS" or "Company") is seeking two things in its application. First, APS is requesting that the Arizona Corporation Commission ("Commission") waive the self-build moratorium set forth in Decision No. 67744 so that it can pursue the acquisition of Southern California Edison's ("SCE") share of Units 4 and 5 of the Four Corners Power Plant ("Four Corners").<sup>1</sup> The Utilities Division ("Staff") of the Commission believes that APS has addressed all of the requirements of the moratorium set forth in that decision and recommends that the Commission waive the moratorium so that APS can pursue the this transaction if it so desires. Second, APS is seeking authorization for an accounting order to defer for consideration of future recovery costs relating to the transaction, and assurance that it will be able to continue to recover capital carrying costs, depreciation, decommissioning, mine reclamation, and other obligations that may arise relating to Four Corners Units 1-3.<sup>2</sup> Staff and the Company appear to be in agreement regarding APS' request for an accounting order, with one exception. The Company believes the accounting order should include the deferral of carrying costs associated with the investment and the application of a cost of money on all of the deferred balances whereas Staff does not believe the facts

<sup>1</sup> APS Appl. at 4.

<sup>2</sup> *Id.*

1 and circumstances of the proposed transaction warrant the inclusion of an carrying costs until such  
2 time as the transaction is completed, the prudence determined and the asset is included in rate base.<sup>3</sup>

3 **II. APS' REQUEST FOR AN ACCOUNTING ORDER SHOULD BE GRANTED IN**  
4 **PART.**

5 Staff agrees with APS that the Commission should authorize the Company to defer certain  
6 costs for consideration of recovery in a subsequent rate case. However, Staff does not believe that it  
7 is appropriate to authorize APS to defer any capital carrying charges or apply a cost of money factor  
8 to any of the deferred balances.

9 **A. The Commission Should Grant APS' Request for An Accounting Order But**  
10 **Should Not Allow APS to Either Defer Capital Costs or to Apply a Cost of Money**  
11 **to Any Deferred Balances.**

12 It appears that APS is seeking to include in its accounting order a deferral of capital carrying  
13 charges as well as authorization to capitalize a return on all of the deferred costs, including the  
14 deferred capital carrying charges.<sup>4</sup> Staff continues to recommend that the Commission grant APS'  
15 request for an Accounting Order,<sup>5</sup> but does not believe it is appropriate for that order to include **any**  
16 capital costs, either debt or equity in this case. Among other reasons discussed herein, Staff believes  
17 it is premature to address any cost of capital issues associated with this transaction since it is not clear  
18 when APS would actually take ownership of SCE's share of Units 4 and 5 and at what cost. In other  
19 words, Staff believes that the imprecise nature of the costs APS is seeking to defer makes it  
20 inappropriate to allow the Company to either defer a return or apply a cost of money factor to the  
21 deferred balances.<sup>6</sup>

22 APS bases its request to capitalize a return on all deferred amounts by comparing it to the  
23 treatment of Allowance for Funds Used During Construction ("AFUDC").<sup>7</sup> The Company  
24 acknowledges that AFUDC is utilized on constructed assets, and inappropriately equates that to  
25 allowing the Company to apply a cost of money factor to the deferred cost that would be included in  
the accounting order.<sup>8</sup> The comparison of AFUDC is inapplicable for the very reason that this

26 <sup>3</sup> Ex.S-3 at 7-8, Michlik Direct.

27 <sup>4</sup> APS Br. at 27.

28 <sup>5</sup> Ex. S-3 at 11-13, Michlik Direct.

<sup>6</sup> *Id.* at 12.

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

1 transaction involves the purchase of generating assets (or more precisely SCE's share of Units 4 and  
2 5), and not the construction of a generating asset. During the construction of a generating asset the  
3 asset is not able to provide service to customers, and the Company is not able to earn any revenues  
4 from those assets unless the Commission authorizes rate base treatment of the Construction Work In  
5 Progress ("CWIP") or authorizes AFUDC. Conversely, with a purchased generating asset like Four  
6 Corners, APS would be able to earn revenues from the plant once it is placed in service. In this case,  
7 similarly to the circumstances in Decision No. 67504 ("PPL Sundance"), APS' purchase of SCE's  
8 share of Units 4 and 5 is a replacement for Units 1 through 3 which are already included in APS'  
9 rates. The Company acknowledges that there may be a time after SCE's share is purchased and when  
10 Units 1 - 3 are still included in rates even though they are retired.<sup>9</sup> Further, the Company will be able  
11 to take advantage of regulatory lag, not only with Units 1-3, after those units are retired but before  
12 they are removed from rate base, but APS will also be able to take advantage of regulatory lag once  
13 APS' increased ownership in Units 4 and 5 is included in rates.<sup>10</sup> The Commission should prohibit  
14 APS from recovering retroactively to the point of purchase. While each Commission Decision does  
15 not have any precedential effect, this treatment is consistent with the treatment that the Commission  
16 authorized in Decision No. 67504.

17 **B. Prior Commission Decisions Do Not Provide Regulatory Precedent.**

18 Staff does not believe that Commission decisions provide any precedential effect. The  
19 Company nonetheless cites to four Commission decisions in support of its request for the inclusion of  
20 capital costs in its accounting order for this transaction. Specifically, APS cites to Decision No.  
21 55325 ("PV-II") from December 5, 1986, Decision No. 55939 ("PV-III") from April 6, 1988,  
22 Decision No. 57586 ("Springerville Unit 2") from October 11, 1991, and Decision No. 67504 ("PPL  
23 Sundance") from January 20, 2005. However, to the extent the Company is suggesting these  
24 decisions provide some precedent or even support for its request, these decisions are either factually  
25 distinguishable or the Company, not Staff, reinterprets the decision.

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28 <sup>9</sup> Tr. Vol. V at 890.

<sup>10</sup> *Id.* at 905-09.

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**1. PV-II and PV-III.**

Decision Nos. 55325 and 55939 should not be considered by the Commission in determining whether to allow APS to include the deferral of any capital costs within the accounting order it is requesting. These decisions were issued by the Commission over 20 years ago, and involved the monumental construction of the Palo Verde Nuclear Generating Station ("Palo Verde"). The construction of Palo Verde cost billions of dollars over more than a ten year period. The instant application involves the purchase of SCE's share of Four Corners Units 4 and 5. The circumstances are not comparable. It is important to note that in Decision No. 55939, the Commission did not allow APS to earn a return on the deferral order that it authorized.<sup>11</sup>

**2. Springerville Unit 2.**

As noted by APS in its brief, in Decision No. 57586, the Commission did authorize an accounting order for Tucson Electric Power ("TEP"). However, this decision is very fact specific, and the same reasoning used by the Commission in that case does not seem applicable to this case for several reasons. First, that matter involved a settlement agreement, and the terms of the accounting order were presumably arrived at through the negotiation of the parties. Second, it is clear from that decision that TEP was on the verge of bankruptcy, and while it is not discussed in any detail, the rationale for the accounting order may have been to prevent the bankruptcy from proceeding any further. In fact, the settlement that included the deferral recommendation was contingent on dismissal or withdrawal of the bankruptcy petition.<sup>12</sup> Third, it appears the deferral only applied to 55% of Unit 2 that the Commission apparently determined was not used and useful at the time and only allowed those capital costs for that not used and useful portion.<sup>13</sup> This case does not involve a settlement agreement, and to the best of Staff's knowledge there are no pending involuntary bankruptcy petitions that have been filed against APS. The facts that existed in Decision No. 57586 that warranted the deferral of capital costs in that case do not exist in this case.

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<sup>11</sup> Decision No. 55939 at 8.  
<sup>12</sup> Decision 57866 at 6.  
<sup>13</sup> Decision No. 57586

1                   3.     **PPL Sundance.**

2             Finally, APS cites to the Commission's decision in PPL Sundance in support of its request for  
3 the inclusion of the deferral of a return on the Four Corners acquisition.<sup>14</sup> However it appears that  
4 APS is misinterpreting the scope of the accounting order that that the Commission authorized in that  
5 case. The Commission made it clear in that case that "[o]nce the prudently incurred costs of the  
6 Sundance Plant have been determined in the context of a rate case in which all factors have been  
7 considered, APS should certainly be authorized to earn a return on its prudent investment, **but it**  
8 **should not earn that return retroactively to the acquisition date.** Allowing **deferral of a return**  
9 on the deferred balance in addition to deferral of the costs prior to the plant's inclusion in rate base  
10 would unreasonably skew the benefits of regulatory lag. . . ."<sup>15</sup> APS appears to be seeking both a  
11 deferral of a return as well as a return on the deferral in this case. The Company's request is clearly  
12 not supported by Decision No. 67504. The Company refers to Staff's testimony and post-hearing  
13 briefs in an effort to reinterpret the PPL Sundance decision. Again the Company does not appear to  
14 understand Staff's position in that case.<sup>16</sup> It was Staff's position in that case, and is Staff's position in  
15 this case that no cost of money should be applied to either the investment (i.e., the purchase of SCE's  
16 share of Units 4 and 5) or to any other deferred amounts that the Commission my authorize APS to  
17 include in the accounting order.

18             **C.     APS' Reference To Other Jurisdictions Does Not Provide Guidance In This Case.**

19             The Company refers to a handful of instances where Commissions from five other  
20 jurisdictions allowed a utility to defer capital costs in a deferral order.<sup>17</sup> Most notably, the decisions  
21 from these other jurisdictions have no precedential effect, and at best the Commission can use them  
22 for guidance. Staff does not dispute that the Commissions in those jurisdictions allowed the utility to  
23 defer those costs. However, each case is very fact specific. Just as this Commission has allowed  
24 deferral of capital costs in some case (i.e. PV-II and PV-III), it has also disallowed the deferral of  
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26 <sup>14</sup> APS Br. at 30.

27 <sup>15</sup> Decision No. 67504 at 30.

28 <sup>16</sup> Tr. at 723, Vol. IV [Company witness Guldner indicated on cross examination that "maybe we were wrong" in how they read the Sundance decision].

<sup>17</sup> See APS Br. at 31-32.

1 those costs in other cases (i.e. PPL Sundance). However, APS has not provided any substantive facts  
2 from these cases that would allow this Commission to determine whether the facts and circumstances  
3 of this case warrant similar treatment to that afforded these other jurisdictions. Staff recommends  
4 that the Commission give little weight to how these other jurisdictions treated the deferral of capital  
5 costs in six cases.

6 **D. Miscellaneous Accounting Order Issues.**

7 The Company seems to be under the misconception that it is automatically entitled to an  
8 accounting order and a deferral of capital costs within that accounting order.<sup>18</sup> That is simply not the  
9 case. Staff believes that accounting orders are a variance from normal ratemaking that should only be  
10 used sparingly to balance inequities that may exist.<sup>19</sup> Staff believes that APS has demonstrated that  
11 inequities exist in this case that warrant the authorization of an accounting order, but they do not rise  
12 to the level of necessitating the inclusion of a deferral of capital costs.<sup>20</sup> The Company claims that if  
13 cost of capital is not included in the deferral that it will “forever lost the opportunity to recover it.”<sup>21</sup>  
14 Staff believes the Company’s assertion is disingenuous. Public service corporations normally make  
15 investments without the ability to recovery any capital costs until those investments are included in  
16 rates within the context of a rate case.<sup>22</sup> This is the regulatory framework that exists in Arizona.  
17 Staff does not believe that this presents a “lost opportunity” for the Company nor that the Company  
18 has demonstrated that the inclusion of a deferral of capital costs is warranted.<sup>23</sup>

19 Finally, APS asserts that Staff has offered no principled reason for deviating from past  
20 Commission accounting order language in this case.<sup>24</sup> That is incorrect. Staff indicated during the  
21 hearing that the Company’s proposed language moves closer to making a predetermination of  
22 prudence, and therefore is inappropriate.<sup>25</sup> As discussed more fully in Staff’s initial closing brief, the  
23 Company’s proposed language was apparently developed in the context of a settlement and involved

24 <sup>18</sup> APS Br. at 26-40.

25 <sup>19</sup> Ex. S-3 at 5, 3 Michlik Direct.

26 <sup>20</sup> *Id.* at 11-13.

27 <sup>21</sup> APS Br. at 34.

28 <sup>22</sup> Ex. S-3 at 7, Michlik Direct.

<sup>23</sup> *Id.*

<sup>24</sup> APS Br. at 38.

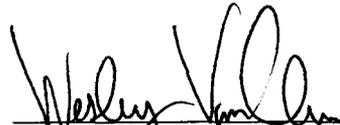
<sup>25</sup> Tr. at 1067, 1073, Vol. V.

1 bark beetle remediation costs. For these reasons, Staff does not believe it is appropriate to utilize that  
2 same language in this case. Further, the Company did not indicate that Staff's proposed language  
3 would not be acceptable to its auditors.<sup>26</sup> For these reasons, Staff continues to recommend that the  
4 Commission adopt its proposed language, or in the alternative, that the Commission utilize the  
5 language authorized in the PPL Sundance matter.

6 **III. CONCLUSION.**

7 Staff recommends that the Commission waive the moratorium set forth in Decision No. 67744  
8 so that APS may pursue the acquisition of SCE's share of Four Corners Units 4 and 5. Staff believes  
9 that the Company has addressed all of the requirements set forth that decision. Staff further  
10 recommends that the Commission grant APS' request for an accounting order subject to Staff  
11 conditions, and that the accounting order not include the deferral of any capital costs associated with  
12 the investment or the application of a cost of money factor on any of the deferred balances.

13 RESPECTFULLY SUBMITTED this 14<sup>th</sup> day of October, 2011.

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21 **Original and thirteen (13) copies**  
22 **of the foregoing filed this 14<sup>th</sup> day**  
23 **of October, 2011, with:**

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28 <sup>26</sup> *Id.* at 758.

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