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BEFORE THE ARIZONA CORPORATION

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COMMISSIONERS

2014 JUL 21 P 4: 42

BOB STUMP - Chairman
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH

AZ CORP COMMISSION
DOCKET CONTROL

ORIGINAL

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, AND TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN.	DOCKET NO. E-01345A-11-0224 **STAFF'S NOTICE OF FILING SURREBUTTAL TESTIMONY**

Staff of the Arizona Corporation Commission ("Staff") hereby files the Surrebuttal Testimony of Dennis Kalbarczyk, in the above-captioned docket.

RESPECTFULLY SUBMITTED this 21st day of July, 2014.

Maureen A. Scott, Senior Staff Counsel
Charles H. Hains, Attorney
Janet Wagner, Assistant Chief Counsel
Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

Original and thirteen (13) copies of the foregoing filed this 21st day of July 2014, with:

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

Arizona Corporation Commission
DOCKETED
JUL 21 2014
DOCKETED BY

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Copies of the foregoing Emailed this 21st day of July 2014 to:

ALL PARTIES LISTED BELOW

Copies of the foregoing mailed this 22nd day of July 2014 to:

Meghan H. Grabel
Thomas L. Mumaw
Pinnacle West Capital Corporation
400 North 5th Street, MS 8695
Phoenix, Arizona 85004
Attorneys for Arizona Public Service Company

C. Webb Crockett
Patrick J. Black
Fennemore Craig, PC
3003 North Central Avenue, Suite 2600
Phoenix, Arizona 85012-2913
Attorneys for Freeport-McMoRan and Arizonans for Electric Choice and Competition (AECC)

Daniel W. Pozefsky, Chief Counsel
Residential Utility Consumer Office
1110 West Washington, Suite 220
Phoenix, Arizona 85007
Attorneys for RUCO

Michael A. Curtis
William P. Sullivan
Curtis, Goodwin, Sullivan, Udall & Schwab, PLC.
501 East Thomas Road
Phoenix, Arizona 85012-3205
Attorneys for the Town of Wickenburg and Town of Gilbert

Timothy M. Hogan
Arizona Center for Law in the Public Interest
202 East McDowell Road, Suite 153
Phoenix, Arizona 85004
Attorneys for WRA, SWEEP, ASBA/AASBO

Jeff Schlegel
SWEEP Arizona Representative
1167 West Samalayuca Drive
Tucson, Arizona 85704

David Berry
Western Resource Advocates
Post Office Box 1064
Scottsdale, Arizona 85252-1064

Barbara Wyllie-Pecora
14410 West Gunsight Drive
Sun City West, Arizona 85375

Kurt Boehm
Jody M. Kyler
Boehm, Kurtz & Lowry
36 East Seventh Street, Suite 1510
Cincinnati, Ohio 45202
Attorneys for The Kroger Co.

Jeffrey W. Crockett, Esq.
Brownstein Hyatt Farber Schreck LLP
One East Washington Street, Suite 2400
Phoenix, Arizona 85004
Attorneys for Arizona Association of Realtors

Michael W. Patten
Roshka DeWulf & Patten, PLC
One Arizona Center
400 East Van Buren Street, Suite 800
Phoenix, Arizona 85004
Attorneys for Tucson Electric Power Company

Bradley S. Carroll
UniSource Energy Services
Legal Department - MS HQE 910
Post Office Box 711
Tucson, Arizona 85702

Cynthia Zwick
1940 East Luke Avenue
Phoenix, Arizona 85016

Michael M. Grant
Gallagher & Kennedy, PA
2575 East Camelback Road
Phoenix, Arizona 85016-9225
Attorneys for AIC

Gary Yaquinto, President & CEO
Arizona Investment Council
2100 North Central Avenue, Suite 210
Phoenix, Arizona 85004

Karen S. White
Samuel T. Miller
Air Force Utility Law Field Support Center
AFLOA/JACL-ULFSC
139 Barnes Drive
Tyndall AFB, Florida 32403

Greg Patterson, Of Counsel
Munger Chadwick
2398 East Camelback Road, Suite 240
Phoenix, Arizona 85016
Attorneys for Arizona Competitive Power Alliance

Nicholas J. Enoch
Jarrett J. Haskovec
Lubin & Enoch, PC
349 North Fourth Avenue
Phoenix, Arizona 85003
Attorneys for IBEW Locals 387, 640 & 769

Lawrence V. Robertson, Jr.
Post Office Box 1448
Tubac, Arizona 85646
Attorney for Southwestern Power Group II, LLC; Bowie Power Station, LLC; Noble Americas Energy Solutions LLC; Constellation NewEnergy, Inc.; Direct Energy, LLC and Shell Energy North America (US), LP

Jay I. Moyes
Steve Wene
Moyes Sellers & Hendricks
1850 North Central Avenue, Suite 1100
Phoenix, Arizona 85004
Attorneys for AzAg Group

Jeffrey J. Woner
K.R. Saline & Assoc., PLC
160 North Pasadena, Suite 101
Mesa, Arizona 85201

Scott S. Wakefield
Ridenour, Hienton & Lewis, PLLC
201 North Central Avenue, Suite 3300
Phoenix, Arizona 85004-1052
Attorneys for Wal-Mart Stores, Inc.

Steve W. Chriss
Senior Manager, Energy Regulatory Analysis
Wal-Mart Stores, Inc.
2011 S.E. 10th Street
Bentonville, Arkansas 72716-0550

Craig A. Marks
Craig A. Marks, PLC
10645 North Tatum Boulevard
Suite 200-676
Phoenix, Arizona 85028
Attorney for AARP

John Moore, Jr.
7321 North 16th Street
Phoenix, Arizona 85020

Douglas V. Fant
Law Offices of Douglas V. Fant
3655 West Anthem Way
Suite A-109, PMB 411
Anthem, Arizona 85086

Amanda Ormond
Southwest Representative
Interwest Energy Alliance
7650 South McClintock Drive
Suite 103-282
Tempe, Arizona 85284

Travis Ritchie
Nellis Kennedy-Howard
Sierra Club Environmental Law Program
85 Second Street, 2nd Floor
San Francisco, California 94105

Kevin Higgins
Energy Strategies, L.L.C.
215 South State St., Suite 200
Salt Lake City, UT 84111

Monica A. Martinez

BEFORE THE ARIZONA CORPORATION COMMISSION

BOB STUMP
Chairman
GARY PIERCE
Commissioner
BRENDA BURNS
Commissioner
BOB BURNS
Commissioner
SUSAN BITTER SMITH
Commissioner

IN THE MATTER OF THE APPLICATION OF THE ARIZONA PUBLIC SERVICE COMPANY FOR A REQUEST TO APPROVE A FOUR CORNERS RATE RIDER AS DEFINED IN APPROVED SETTLEMENT AGREEMENT AT DECISION NO. 73183 TO ALSO INCLUDE AMORTIZATION OF RELATED DEFERRALS AUTHORIZED IN DECISION NO. 73130	)	DOCKET NO. E-01345A-11-0224

SURREBUTTAL

TESTIMONY

OF

DENNIS M. KALBARCZYK

CONSULTANT

ON BEHALF OF THE

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

JULY 21, 2014

TABLE OF CONTENTS

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Dennis M. Kalbarczyk. My business address is 910 Piketown Road, Harrisburg, Pennsylvania 17112.

Q. Have you previously submitted testimony in this proceeding?

A. Yes. I previously submitted direct testimony on behalf of the Utilities Division ("Staff") of the Arizona Corporation Commission ("ACC" or "Commission") regarding the application of Arizona Public Service Company ("APS" or "Company") for approval of a Four Corners Rate Rider ("Rider") in this proceeding. My direct testimony addressed the appropriate calculation of the Rider as it relates to: (1) the rate base and expense effects associated with APS's acquisition of the Southern California Edison ("SCE") interest in Four Corners Units 4 and 5, (2) the rate base and expense effects associated with the retirement of Units 1-3; and (3) recovery of the cost deferrals authorized in Decision No. 73130.

Q. What is the purpose of your surrebuttal testimony?

A. The purpose of my surrebuttal testimony is to reply to rebuttal testimony of APS witnesses Jeffrey B. Guldner, Leland R. Snook and Elizabeth Blankenship regarding calculation of the Four Corners Rider; and to the rebuttal testimony of APS witness Snook, Walmart witness Steve W. Chriss and witness Kevin C. Higgins, who presents testimony on behalf of Freeport-McMoRan Copper & Gold Inc. ("Freeport-McMoRan"), Arizonans for Electric Choice & Competition ("AECC"), Noble Americas Energy Solutions ("Noble") and The Kroger Company ("Kroger"), regarding a rate design issue involving application of the Four Corners Adjustment Schedule to AG-1 customers. Finally, I will also comment on the updated revenue requirement and surcharge rate calculation provided by Ms. Blankenship.

Q. Do you agree with Mr. Guldner that there is primarily one significant issue in dispute

regarding the calculation of the Four Corners Rider?

A. Yes, that appears to be the case. APS advocates the use of the Weighted Average Cost of Capital ("WACC") of 8.33 percent as the return on fair value rate base; Staff advocates the use of the Fair Value Rate of Return of 6.09 percent as set forth in Section 5 of the Settlement Agreement approved by the Commission in Decision No. 73183; and the Residential Utility Consumer Office ("RUCO") recommends the use of the incremental cost of debt of 4.725% as the appropriate return.

Q. What difference in revenue requirement do these three different positions produce?

A. Ms. Blankenship summarizes the effects of the APS, Staff and RUCO positions on page 4 of her rebuttal testimony. APS's position results in an increase of $65.44 million; Staff's position results in an increase of $57.05 million; and RUCO's position results in an increase of $49.20 million. So, the Staff's proposal results in a revenue reduction of $8.39 million to APS's updated revenue requirement and RUCO's proposal results in a $16.24 million revenue reduction.

II. DISCUSSION OF ISSUES

Issue Relating to the Appropriate Rate of Return

Q. Have you reviewed the APS rebuttal testimony and proposed recommendations related to the appropriate rate of return?

A. Yes. APS's witnesses reject my proposed use of the FVROR of 6.09 percent, which is specifically set forth in Section 5 of the Settlement approved by the Commission in Decision No. 73183. The APS witnesses continue to recommend application of the 8.33 percent WACC to APS's fair value rate base. APS witnesses Blankenship, Guldner, and Snook address this matter. Referring to Section 10.2 of the Settlement, Mr. Snook (Rebuttal at p. 3) states that use of the 6.09% return on rate base "ignores the Settlement's express intent that the Rate Rider reflect the 'rate base and expense' effects of the Four Corners acquisition." I do not agree. It is well recognized in public utility setting that required revenues of the firm are equal to its rate base times its rate of return plus expenses. In this case, the Settlement contemplates changes to rate base and expenses in recognition of APS's acquisition of SCE's interest in Four Corners units 4 and 5. I believe that the rate base and expense effects of the acquisition have all been appropriately recognized. What APS appears to seek is a change to the third part of the formula as well, the rate of return, which was not contemplated in Section 10.2 of the Settlement.

Q. Doesn't Mr. Snook argue that FVROR is an output of a formula whose components will change with rate base additions or subtractions?

A. Yes. Mr. Snook argues that FVROR is simply the mechanical output of a formula whose components will change with rate base additions or subtractions. Thus, he opines that the FVROR must be recalculated, which here would produce equivalent FVRORs and WACCs; *i.e.*, 8.33 percent. He also argues that applying the 6.09 percent FVROR would contravene Section 5 of the Settlement Agreement. There are several flaws with this position, which I discuss below.

Q. What are those flaws?

A. Rather than a rate base issue, Staff's original testimony in this docket viewed the derivation of the FVROR as a financing and related capital structure issue. See Ralph Smith Direct Testimony, Attachment RCS-2, page 12 of 40. Thus, the addition of an asset should not necessarily mean that the WACC or FVROR must change to reflect each individual asset addition. If such a recalculation were desired, then all elements of the FVROR analysis should be reconsidered.

Q. What other problems do you see with Mr. Snook's position?

A. The Commission approved a Settlement Agreement in this case. The Agreement provides for a FVROR of 6.09 percent. I do not believe that recalculations are required for purposes of developing the appropriate FVROR or that a failure to do so contravenes Section 5 of the Settlement Agreement. To the contrary, recalculating the FVROR (to adopt a FVROR other than 6.09 percent) would appear to cancel the result achieved through Section 5 of the Settlement Agreement. That provision simply and clearly states that it adopts a fair value rate of return of 6.09 percent.[1]

Simply put, the 6.09 percent FVROR is not set forth as a value that results from a rote calculation, but as the appropriate fair value rate of return duly authorized under the Settlement Agreement. If one accepted Mr. Snook's contention that fair value rate of return is in all cases simply the by-product of a mathematical formula where the Commission does not have the ability or discretion to structure a return that is fair in any given case, the significant discretion afforded the Commission would be severely limited. But even if the FVROR were merely the by-product of a formula, a point with which I disagree, that would not change the fact that the FVROR was agreed to by the settling parties and ultimately approved by the Commission as one fixed point among many that led to a determination that the Settlement Agreement set forth a reasonable basis for disposing of the matter before the Commission.

Section 10, of the Settlement Agreement only makes reference to the rate base and expense effects associated with the transaction. As discussed above, I believe that those have been appropriately recognized.

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[1] Decision No. 73183 at page 11.

Q. Do you have any other comments with regard to Mr. Snook's rebuttal testimony regarding the appropriate rate of return?

A. Yes. APS stated that the 'fair value' of this asset from an accounting 'fair value' perspective is in this case the same as the 'fair value' rate base concept typically discussed in Arizona rate cases; or at least that they "are mathematically equivalent." The price (including the acquisition adjustment paid by APS) is the product of an arm's length transaction and in Staff's opinion represents the best indicator of fair value for purposes of determining the revenue requirement in this case.

Mr. Snook's rebuttal testimony implies that the almost $226 million of rate base claimed for the total acquisition is the original cost rate base value. He goes on to indicate that recalculation to reflect reconstructed values would produce a much higher fair value than that of the original cost.

It is not correct to assert that APS's approximate $226 million of acquisition value for the referenced facilities reflects the original cost value. Rather, it reflects the fair value of the facilities as acquired by APS. As explained in my direct testimony, the approximate $226 million of rate base includes an acquisition adjustment. This adjustment reflects the fact that APS paid far in excess of the $52 million book value of Units 4 & 5. That $226 million also includes over $8 million for Southern California Edison's ("SCE") share of the new auxiliary boiler that recently went into service.

Q. What about Mr. Snook's comments about the use of RCND for this plant?

A. Mr. Snook poses the following question: "Why did APS assume in its Direct Testimony that fair value, original cost and RCND were all the same for the Four Corners Asset." Mr. Snook then states that "APS made a simplifying assumption to reflect just the cost of acquiring SCE share of the Four Corners Units 4 and 5 because the asset was new to APS." I agree with APS's Direct Testimony to the extent that fair value and RCND are the same in this case. The best indicator of fair value for this plant is the purchase price paid by APS in this case. Further, one cannot base reconstruction value upon the acquisition value of $226 million, which includes amounts paid far in excess of the book value of $52 million.

Q. Do you have any other concerns with use of the WACC of 8.33 percent as the return in this case?

A. Yes. From Figure A included on page 5 of Mr. Snook's testimony, adoption of APS's position would increase the FVROR from 6.09 percent to 6.14 percent. The plain language of the Settlement Agreement simply does not support this redetermination of FVROR from 6.09 percent to 6.14 percent or the application of the WACC of 8.33 percent to the fair value of this plant.

Q. What do you recommend if the Commission were to adopt APS's position?

A. If APS wants to update and recalculate the fair value rate of return for its acquisition of Four Corners Units 4 and 5, Staff believes that all aspects of the fair value rate of return should be subject to examination. In other words, APS derives significant benefit from the Rider, and its risk is reduced, which should be reflected in the equity component of its rate of return. Additionally, the debt component and the capital structure would also need to be reevaluated given APS has just recently obtained new debt financing.

APS's Updated Revenue Requirement and Surcharge Rate Calculation

Q. What is your opinion on the updated surcharge rate calculation amounts cited in the APS rebuttal testimony?

A. Ms. Blankenship updated APS's rate base and operating income claims to reflect known and measurable costs as of April 30, 2014. She proposed an adjusted jurisdictional rate base of approximately $225.93 million and operating income shortfall of approximately $20.680 million. These amounts produced an overall revenue requirement of approximately $65.436 million and would result in a 2.33 percent monthly increase to customers' bills. Her rebuttal testimony uses the same 8.33 percent WACC discussed above.

My direct testimony generally found that APS has accurately calculated and appropriately supported the other revenue requirement elements it has proposed (except for use of the 8.33% WACC rather than the 6.09% FVROR). My preliminary review of APS's updated amounts to reflect known and measurable changes as of April 30, 2014, leads to the same conclusions. The table below compares Staff's rate base value position in my direct testimony to the updated values provided by APS, which we accept.

Four Corners Pro Forma Rate Base	**Amounts Projected To 6/30/14**	**Amounts Projected To 11/30/14**
Plant in Service:		
Acquired Plant	$605,364,014	$606,431,941
Acquisition Adjustment	254,787,393	252,509,950
Auxiliary Boiler-Plant	8,623,930	8,793,031
Auxiliary Boiler-Startup Steam Supply	2,694,978	2,747,822
Deferred Cost-O&M Expense (12/30/13 to -----)	38,252,000	47,066,287
Deferred Cost-Depr & Amort Exp. (12/30/13 to ----)	4,694,000	7,703,000
Deferred Cost-Property Taxes (12/30/13 to ----)	3,208,000	5,883,000
Deferred Cost-Debt Return (12/30/13 to ----)	4,533,268	8,311,000
Total Plant in Service	**$922,157,582**	**$939,446,031**
Accumulated Depreciation:		
Acquired Plant	$-539,326,651	$-553,352,949
SCE Additional Reserve (9/1/13 - 12/31/13)	-14,738,975	
APS Additional Reserve (1/1/14 to ---)	-1,088,271	-2,042,193
Cost of Removal Reserve	916,566	

Boiler Depreciation (5/1/13 to ----)	-286,000	-476,562
Total Accumulated Depreciation	**$-554,523,331**	**$-555,871,704**
Plus Deferred Debits:		
Plant, Materials & Operating Supplies	$4,468,827	$4,633,133
Total Deferred Debits	**$4,468,827**	**$4,633,133**
Less Deferred Credits:		
Deferred Taxes	$-20,026,580	$-27,247,000
Asset Retirement Obligation Liability	-34,123,498	-34,123,498
Other Deferred Credits (Including Coal Reclamation)	-92,950,926	-92,950,926
Total Deferred Credits	**$-147,101,004**	**$-154,321,424**
Total Company Rate Base	**$225,002,074**	**$233,886,036**
APS Allocation Rate	96.60%	96.60%
APS Rate Base	**$217,352,003**	**$225,933,911**

Q. Describe how APS determined the updated jurisdictional $65.436 million annual revenue deficiency and the resulting 2.33 percent monthly surcharge, and describe Staff's proposed jurisdictional revenue deficiency and surcharge rate.

A. The methods relied upon for the calculations of the jurisdictional revenue deficiencies under the Company's and Staff's proposals did not change. The following table illustrates the resultant revenue deficiencies and surcharge rates based upon the rates of return proposed by APS and Staff.

Staff recommends that the Company's computed jurisdictional revenue deficiency of $65.436 million be reduced by $8.39 million to $57.05 million. The revised revenue deficiency therefore reduces the surcharge rate from 2.33 percent to 2.03 percent.

Item	APS Updated Pro Forma Adjustments	Liberty Updated Proposed
Adjusted Rate Base	$225,934,000	$225,934,000
Adjusted Operating Income	-20,680,000	-20,680,000
Current Rate of Return	-9.15%	-9.15%
Rate of Return	8.33%	6.09%
Required Return	$18,820,000	$13,759,381
Operating Income Deficiency	$39,500,000	$34,439,381
Gross Revenue Conversion Factor	1.6566	1.6566
Total Revenue Deficiency	**$65,436,000**	**$57,052,279**

2010 Adjusted Base Revenues	$2,810,916,000	$2,810,916,000
Percentage Rate Surcharge	**2.33%**	**2.03%**
Change in Revenue Deficiency		**($8,383,721)**

Q. Please summarize the changes to APS's adjusted operating income claim.

A. The APS initial as-filed jurisdictional operating income deficiency was $19.617 million, which it updated to $20.680 million. The next table summarizes the cost components at APS's claimed values, and summarizes the changes. The changes occurred in depreciation and amortization expenses and in income taxes. The change from a 6-month to 11-month time period projected for this proceeding (from June 30, 2014 to November 30, 2014) drives these changes.

Item	APS As-Filed Pro Forma Adjustments	APS Updated Pro Forma Adjustments	Change
Elec. Fuel & Purc. Pwr.	$4,318,000	$4,346,000	28,000
O&M Excl. fuel expenses	5,411,000	5,412,000	1,000
Depr. & Amort. Expenses	20,679,000	22,564,000	1,885,000
Income Taxes	-16,990,000	-17,842,000	-852,000
Other Taxes	6,199,000	6,200,000	1,000
Total Change	**$19,617,000**	**$20,680,000**	**$1,063,000**

Q. What is your view of the need for future review of APS's updated values?

A. I accept the updated values as provided by APS as of April 30, 2014, for purposes of calculating the surcharge rate for the instant proceeding.

AG-1 Rate Design Issue

Q. Have you reviewed the testimony of Walmart Witness Steve Chriss and Witness Kevin Higgins on behalf of Freeport-McMoRan, AECC, Kroger and Noble?

A. Yes. These are large AG-1 customers of APS who do not believe that the Four Corners Rate Rider should apply to them. As Witness Chriss describes it, AG-1 is a buy through rate for large commercial and industrial customers, which allows them to purchase generation service from a third party. These large customers do not believe that the Rider should apply to them since they do not take generation service from APS. They argue that only those ratepayers who take generation service from APS and will benefit from the acquisition of those assets should bear the costs. They further argue that APS's proposal to apply this to even the "APS" portion of their bills is a violation of the Settlement approved by the Commission.

Q. How is the surcharge applied?

A. According to Section 10.3 of the Settlement, the recovery mechanism would recover the rate base and non-PSA ("Power Supply Adjustor") related expenses associated with the Four Corners transaction on an equal percentage basis across all rate schedules. APS has proposed to apply the surcharge to only a portion of the bills paid by customers taking service under AG-1. As proposed by APS, the charge would apply only to the non-generation portion of AG-1 customers' bills.

Q. What is Staff's position with regard to the application of the surcharge rate to AG-1 customers?

A. Since APS proposes to apply the surcharge rate only to the non-generation portion of the AG-1 customer's bill, and not the portion representing a pass-through of charges from Alternative Generation Providers, Staff believes that this approach provides a reasonable balance of the interests of all customer concerns.

Q. Do you believe that APS's proposal is inconsistent with the Settlement approved by the Commission and with the Company's Tariff as Mr. Higgins and Mr. Chriss suggest?

A. No. With respect to the Settlement, had the parties intended to exclude AG-1 customers from the application of the surcharge, language could have easily been included in the relevant portions of the Settlement, but it was not. APS's application of the surcharge to only the APS portions of the AG-1 customers' bills is a reasonable result in light of the Settlement and the Company's Tariff.

Q. What impact would Mr. Higgins' and Mr. Chriss' proposal to exclude AG-1 customers entirely have on other customers?

A. Mr. Higgins notes that the rider would increase by approximately 0.02 percent, or about 2 cents per month, for a typical customer with a base energy bill of $125 per month.

Q. If the impact is so small, why is Staff opposed to Mr. Higgins' and Mr. Chriss' proposal?

A. Staff's objective is to achieve the appropriate balance between customer classes. We believe that APS's proposal in this case does that.

Units 1-3 Rate Base Issue

Q. What do you conclude with respect to rate base costs associated with Units 1-3?

A. My direct testimony noted that we were in the process of examining the potential removal from base rates of any rate base costs associated with Units 1-3. That review process is now complete. We are satisfied that the Company has demonstrated that these facilities have, in fact, been removed from rate base consideration, and are not reflected in current rates or in the proposed surcharge rate.

III. SUMMARY OF RECOMMENDATIONS

Q. Please summarize your recommendations.

A. I recommend that the Commission:

- Reject APS's requested 8.33 percent return to be applied to the Four Corners fair value rate base.

- Accept Staff's direct testimony position that the appropriate rate of return associated with the development of the surcharge rate be the Fair Value Rate of Return ("FVROR") of 6.09 percent contained in the Settlement Agreement approved by the Commission in Decision No. 73183.
- Approve APS's updated cost values, including (1) rate base and expenses associated with the acquisition of SCE's share of Units 4 and 5; (2) the rate base and expense effects associated with the retirement of Units 1-3; and, (3) related cost deferrals provided for in Decision No. 73130 for purposes of calculating the surcharge rate.
- Approve a total jurisdictional revenue increase of no more than $57.05 million.
- Require that the Four Corners Adjustment Schedule include updated language agreed to by APS in order to make clear that the surcharge rate will only remain in effect until the conclusion of APS's next rate case.
- Make the surcharge rate applicable to customers as described in APS's proposed Four Corners Adjustment Schedule.
- Approve a surcharge rate of 2.03 percent.

Q. Does that conclude your direct testimony?

A. Yes, it does.

Arizona Public Service Company
Capital Structure & Cost Rates

Docket No. E-01345A-11-0224
Schedule D
Page 1 of 1

Test Year Ended December 31, 2010
(Thousands of Dollars)

Line No.	Capital Source	Capitalization Amount (A)	Capitalization Percent (B)	Cost Rate (C)	Weighted Avg. Cost of Capital (D)
	APS - Proposed				
1	Short-Term Debt	$ -			0.00%
2	Long-Term Debt	$ 3,382,856	46.06%	6.38%	2.94%
3	Common Stock Equity	$ 3,961,248	53.94%	11.00%	5.93%
4	Total Capital	$ 7,344,104	100.00%		8.87%
	ACC Staff - Proposed				
5	Short-Term Debt	$ -			0.00%
6	Long-Term Debt	$ 3,382,856	46.06%	6.38%	2.94%
7	Common Stock Equity	$ 3,961,248	53.94%	9.90%	5.34%
8	Total Capital	$ 7,344,104	100.00%		8.28%
9	Difference				-0.59%
10	Weighted Cost of Debt				2.94%
	ACC Staff - Proposed Fair Value Rate of Return - Alternative 1				
11	Short-Term Debt	$ -	0.00%	0.00%	0.00%
12	Long-Term Debt	$ 2,608,502	31.94%	6.38%	2.04%
13	Common Stock Equity	$ 3,054,497	37.40%	9.90%	3.70%
14	Capital financing OCRB	$ 5,662,998			
15	Appreciation above OCRB not recognized on utility's books	$ 2,504,128	30.66%	0% [a]	0.00%
16	Total capital supporting FVRB	$ 8,167,126	100.00%		5.74%
	ACC Staff - Proposed Fair Value Rate of Return - Alternative 2				
17	Short-Term Debt	$ -	0.00%	0.00%	0.00%
18	Long-Term Debt	$ 2,608,502	31.94%	6.38%	2.04%
19	Common Stock Equity	$ 3,054,497	37.40%	9.90%	3.70%
20	Capital financing OCRB	$ 5,662,998			
21	Appreciation above OCRB not recognized on utility's books	$ 2,504,128	30.66%	1.00% [b]	0.31%
22	Total capital supporting FVRB	$ 8,167,126	100.00%		6.05%

Notes and Source
Lines 1-4, APS filing D-1.
Line 15, Col.A:

23	Fair Value Rate Base	$ 8,167,126	Schedule A
24	Original Cost Rate Base	$ 5,662,998	Schedule A
25	Difference	$ 2,504,128	

Difference is appreciation of Fair Value over Original Cost that is not recognized on the utility's books.

[a] The appreciation of Fair Value over Original Cost has not been recognized on the utility's books. Such off-book appreciation has not been financed by debt or equity capital recorded on the utility's books. The appreciation over Original Cost book value is therefore recognized for cost of capital purposes at zero cost.

[b] Per Staff witness David Parcell