

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

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7  
8 IN THE MATTER OF THE APPLICATION OF  
9 ARIZONA PUBLIC SERVICE COMPANY  
10 FOR A HEARING TO DETERMINE THE  
11 FAIR VALUE OF THE UTILITY PROPERTY  
12 OF THE COMPANY FOR RATEMAKING  
PURPOSES, TO FIX A JUST AND  
REASONABLE RATE OF RETURN  
THEREON, TO APPROVE RATE  
SCHEDULES DESIGNED TO DEVELOP  
SUCH RETURN.

Docket No. E-01345A-08-0172

13 **RUCO'S INITIAL CLOSING BRIEF**

14 **INTRODUCTION**

15 By all accounts this rate case is exceptional. It produced a Settlement Agreement  
16 ("Settlement") that is comprehensive and far reaching, and is supported by parties  
17 representing diverse interests. Arizona's energy future is at a cross-roads and it is no longer  
18 enough to go about business as usual. The time has come for the State to move forward  
19 with a road map that will assure reliable service, at reasonable rates, in an environmentally  
20 friendly fashion. There is no question that the Arizona Corporation Commission  
21 ("Commission") has made great strides in the areas of renewable resources and demand  
22 side management, but Arizona's largest utility, Arizona Public Service Company, ("APS" or  
23

1 “Company”), can only reach and maintain the Commission’s noteworthy and admirable goals  
2 if it is in a financial position to do so.

3 The Residential Utility Consumer Office (“RUCO”) recognizes the delicate position in  
4 which the State, APS and all of the competing interests are, and wants to make sure that no  
5 matter how the Commission proceeds, Arizona’s ratepayers are protected. The burden of  
6 moving forward at this point should not be solely on the back of Arizona’s ratepayers in the  
7 form of a large rate increase. With all of this in mind, RUCO believes the right approach at  
8 this time is a comprehensive long-term plan which requires some extraordinary measures by  
9 the Company’s shareholders and management – as well as by its ratepayers. The  
10 Settlement is the culmination of hours and hours of negotiations by twenty parties with  
11 competing interests, all of whom agree that a comprehensive long-term plan is the right  
12 approach in this case. APS-12 at 5.<sup>1</sup> The Settlement represents a fair and well balanced  
13 approach to move this Company toward financial security while securing Arizona’s energy  
14 future. The Commission should approve the Settlement as proposed.

15  
16 **1) THE SETTLEMENT WILL PLACE THE COMPANY IN A BETTER FINANCIAL  
17 POSITION WHICH SHOULD ENABLE THE COMPANY TO MEET ITS RENEWABLE AND  
18 ENERGY EFFICIENCY GOALS.**

19 In its direct case, RUCO originally calculated a \$13.4 million revenue decrease based  
20 on the 2007 test year. RUCO-6, Schedule BJ-1. RUCO, however, was sensitive to the  
21 Company’s weak credit metrics and, despite its calculations, did not recommend a rate

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23 <sup>1</sup> For ease of reference, trial exhibits will be identified similar to their identification in the Transcript of  
24 Proceedings. The Transcript volume number and page number will identify references to the Transcript. Case  
citations will be footnoted.

1 reduction. Id. at 73. RUCO now supports a Settlement that incorporates a non-fuel base  
2 rate increase of \$196.3 million. Settlement at 13.

3 To come this far on the revenue requirement, RUCO recognized that a rate increase  
4 that is larger than is justified by a strict interpretation of the historical test year is necessary to  
5 place this Company in a better financial position so, among other things, it can continue to  
6 provide quality service at a reasonable price, meet ambitious energy efficiency goals, and  
7 expand its renewable energy commitment. RUCO does not believe it is in the ratepayer's  
8 best interests to force the Company to continue to operate with marginal financial metrics.  
9 The Company would undoubtedly apply for another rate case as soon as possible with the  
10 effect being a continued pan-caking of rate cases without an improvement in the Company's  
11 financial health.

12 From RUCO's perspective, there are three core provisions which RUCO considered  
13 essential in its decision to become a signatory. These three priorities are clearly defined: 1)  
14 a rate stability plan; 2) a roadmap to financial health; and 3) meaningful performance  
15 measures.

16 **A) RATE STABILITY PLAN**

17 The first essential core provision of the Settlement that was critical to gaining RUCO's  
18 support relates to rate stability. Ratepayers are tired of what seems like an endless  
19 succession of APS rate cases and other ratepayer funded revenue enhancements. This  
20 seemingly never ending series of proceedings seems to always center on the same theme –  
21 the Company's marginal financial metrics and the threat of an imminent downgrade to its  
22 credit rating. The Settlement freezes base rates for the next 2 ½ years, delays the filing of  
23 the Company's next rate case, and ensures that base rates will not increase earlier than July  
24

1 1, 2012. Settlement at 10. This respite certainly has value for the beleaguered residential  
2 ratepayers during these trying economic times.

3 The Settlement offers a reasonable assurance that base rates will not increase for  
4 several years. This not only offers some financial relief, but it also offers some hope to  
5 already overburdened ratepayers. Rate stability will enable ratepayers to plan their budgets  
6 and know what their bill will be if they consume the same amount of electricity.

7 Moreover, while this Settlement will result in a rate increase, the average residential  
8 customer will only ultimately see only a \$1.22, or a little under a 1 percent increase not  
9 including the increases for the DSM adjustor and renewable energy projects. Transcript at  
10 2318. The \$1.22 is arrived at by taking the \$6.24 average estimated monthly increase and  
11 offsetting it by the reduction related to the PSA reset<sup>2</sup> of \$5.02. Including the estimated  
12 average increase of 24 cents for the RES surcharge and either \$1.71 or \$1.27 increase in the  
13 DSM adjustor, depending on which method of recovery the Commission chooses, the total  
14 estimated monthly increase to the average ratepayer should be either \$2.73 or \$3.17.<sup>3</sup>

15 Rate stability is a benefit to ratepayers.

16 With the economy in this poor state, there is value in providing ratepayers with some  
17 assurance that they will not have to worry about their electric bill increasing during these  
18 difficult times. Like many of the other concessions that the Company has made, had this  
19 matter gone to litigation the Company could not have been forced to agree to a rate freeze.

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22  
23 <sup>2</sup> The Settlement also provides that if at the time new rates are implemented there is an over-collected balance  
in the PSA account, the PSA reset would be accelerated from February 1, 2010 so that the reduction in the PSA  
level would partially offset the increase in rates. Settlement at 11.

24 <sup>3</sup> Assumes average monthly consumption of 1,169 KWh RUCO-1, Exhibit 1 page 1 of 4.

1 Moreover, this rate freeze provides time for the NRC to take action on the Palo Verde life  
2 extension, as well as time for more of the benefits of renewables and increased energy  
3 efficiency to emerge – helping to moderate or offset future cost increases. These timing  
4 issues are important aspects of this Settlement, which could not have been achieved through  
5 litigation.

6 **B) ROADMAP TO FINANCIAL HEALTH**

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8 The second core provision is the Company's commitment to improve its financial  
9 health. The Settlement commits the Company to strive toward the achievement of a capital  
10 structure of no more than 52% total debt by December 2012. Settlement at 22. The  
11 Company's current total debt level is around 57%, which has made it difficult to achieve an  
12 adequate FFO to Debt ratio, which, in turn, has left the Company on the borderline for  
13 maintaining an investment grade bond rating. RUCO-5 at 29. Reinforcing this important  
14 commitment is a specific guarantee that the Company will receive equity infusions of at least  
15 \$700 million by December 31, 2014. Settlement at 16. While the Settlement provides the  
16 Company with considerable discretion with respect to the timing of specific stock issuances,  
17 RUCO anticipates substantial equity infusions will begin later this year, or during the first part  
18 of 2010, in order to achieve the reduction in the Company's debt to capital ratio called for in  
19 the Settlement, as well as related improvements in the Company's financial metrics as set  
20 forth in the Settlement. Transcript at 1957-1959.

21 The Settlement also commits the Company to reduce expenses of at least \$150  
22 million over the next five years. Settlement at 15. This commitment will also improve the  
23 Company's FFO/debt ratio. Facing the likelihood of a substantial rate increase in this case,  
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1 RUCO focused on finding ways to ensure that shareholders shoulder some of the burden of  
2 making this Company financially healthy.

3 **C) MEANINGFUL PERFORMANCE MEASURES**

4 The final essential core provision is the Company's commitment to a list of specific  
5 performance measures which will improve the Company's financial strength, encourage  
6 energy efficiency, increase reliance on renewable energy and reduce operating expenses.  
7 Settlement at 21-23. RUCO believes these Performance Measures will better ensure that  
8 the Company is working toward serving not only its stockholders' interests, but also the broad  
9 public interest. RUCO believes that in years to come, these provisions will prove to be very  
10 helpful in focusing management's attention on issues of particular concern to ratepayers and  
11 the public generally, ensuring that future rate increases are held to a reasonable minimum,  
12 and helping to improve efficiency and cut costs.

13 RUCO would not have agreed to a rate increase of any magnitude without the  
14 Company's commitment to an agreed upon set of long term objectives, as well as a firm  
15 commitment to provide the information necessary for the Commission to monitor the  
16 Company's performance with respect to these long term objectives. Moreover, these  
17 performance measures are not to be taken lightly– there are reasonable consequences if the  
18 Company does not perform well. In particular, the Settlement will prevent APS from  
19 recovering from ratepayers, in the next rate case, any increase in annual cash incentive  
20 compensation for its executives if the Company falls short on these performance measures.  
21 Settlement at 20-21.

22 Among the numerous performance measures, the Company shall comply with the  
23 energy efficiency goals that are set forth in the Settlement, including annual energy savings  
24

1 of 1% of total energy resources needed to meet retail load in 2010, 1.25% in 2011 and 1.5%  
2 in 2012. Energy efficiency has always been a priority for RUCO and the Commission. This  
3 Agreement helps ensure that energy efficiency is a priority for the Company as well.  
4 Settlement at 21, 27.

5 Another aspect of Demand Side Management provided for in the Settlement is the  
6 Company's commitment to not seek recovery of unrecovered fixed costs as a component of  
7 DSM program costs until its next general rate case. Settlement at 29. This is another  
8 measure to keep the rate increase low.

9 APS will make renewable energy projects another important priority. APS has  
10 previously accepted renewable energy projects in general terms, but the Settlement goes  
11 further in setting forth a plan for action. Moreover, the agreement requires the Company to  
12 provide information to the Commission by which it can verify that this plan is being carried  
13 out. Settlement at 22 and 31. The Settlement includes some specific requirements as well,  
14 including a commitment by the Company to place renewable energy projects at Arizona  
15 schools and government institutions. Id. at 21, 33. By the end of 2015, when combined with  
16 existing projects, these new projects will result in approximately 10% of APS' retail sales  
17 coming from renewable resources. Id. at 31, 32. This is double the REST requirement. The  
18 benefits of these performance obligations to ratepayers cannot be readily quantified in money  
19 terms, but RUCO believes these provisions will yield substantial long term benefits, and this  
20 is another reason why RUCO believes this Settlement is a good thing for ratepayers and the  
21 state of Arizona.

22 Another performance measure requires the Company to reduce its expenses by an  
23 average of \$30 million per year for the 5 year plan term. Settlement at 22. The interim case  
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1 Decision already required APS to reduce its operational expenses by \$20 million for 2009.  
2 The Settlement extends and increases this requirement with a voluntary cost-cutting  
3 commitment for another 5 years. Id. Today's economic climate has forced most companies  
4 to cut expenses and operate their business in a leaner, more efficient manner. Although  
5 APS is shielded from the pressures faced by competitive firms, it too should be finding ways  
6 to cut costs during this difficult economic time. Under this Settlement, APS will be forced to  
7 pare down and make difficult budgeting decisions. The commitment to cut expenses by an  
8 average of \$30 million per year while simultaneously improving its financial metrics will be a  
9 substantial challenge for the Company – one that will require management to work both  
10 harder and smarter.

11 RUCO noted in its direct case that the Company's weak credit metrics are a key  
12 consideration in this case. RUCO-6 at 23. The reasons for these poor credit ratings are  
13 varied, and applying the normal ratemaking approach to this rate case is likely to be  
14 counterproductive at this point. Traditional ratemaking treatment that would result in  
15 disallowances would hurt the Company's cash flow and other credit metrics. Id. A credit  
16 downgrade to junk status will ultimately result in higher rates, which is exactly what RUCO  
17 wants to discourage.

18 The core essentials discussed above were designed to provide a solution to a problem  
19 that requires a non-traditional ratemaking perspective. Strict adherence to a historical test  
20 year would not solve the problem. RUCO-1 at 20. RUCO is by no means advocating that  
21 the non-traditional ratemaking treatment recommended in this case shall become RUCO's  
22 agency policy on these matters. On the contrary, in this case RUCO is supporting the non-  
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1 traditional ratemaking here because of the unique situation in which the State and Company  
2 are placed due to the Company's financial condition.

## 3                   **2)     THE BENEFITS OF THE SETTLEMENT OUTWEIGH THE COSTS**

4                   Throughout the hearing on the Settlement, many of the benefits of the Settlement's  
5 provisions were discussed and analyzed. One of the more contentious issues appears to be  
6 the handling of the Schedule 3 proceeds. The Settlement provides that the Schedule 3  
7 proceeds will be treated as revenues through the earlier of December 31, 2012 or the  
8 conclusion of the Company's next rate case. Settlement at 17-18. There has been a lot of  
9 time spent on Schedule 3 and this particular type of ratemaking. In order to understand  
10 RUCO's position, a little background is necessary.

11                   The overall revenue requirement proposed in the Settlement was arrived at through  
12 lengthy and heated negotiation. The Company had presented calculation after calculation  
13 showing what its financial metrics would look like now and into the future under a wide array  
14 of revenue scenarios. RUCO, like all the other parties, analyzed the calculations, came up  
15 with its own calculations and negotiated accordingly. Ultimately, RUCO was convinced that  
16 the revenue requirement agreed upon was the minimum necessary to improve the  
17 Company's financial metrics, move it toward financial security and keep rates frozen for 2 ½  
18 years.

19                   Treating the Schedule 3 proceeds as revenues was one revenue neutral way of  
20 arriving at the minimum revenue requirement. Admittedly, from RUCO's perspective, **when**  
21 **viewed independently**, the preferential treatment of these revenues would be as CIAC and  
22 correspondingly as a reduction to rate base. But none of the provisions of this Settlement  
23 were ever intended to be viewed in isolation. Many of the provisions of this Settlement  
24

1 weave into other provisions of the Settlement. It is the totality of the Settlement that must be  
2 considered--and not one provision alone. In RUCO's opinion, creative and short-term  
3 treatment of Schedule 3 proceeds in exchange for keeping the rate increase as low as  
4 possible, for as long as possible, was an acceptable negotiation and in the residential  
5 ratepayer's best interests.

6 Moreover, creative ratemaking elements in this Settlement - like the Schedule 3  
7 treatment - will keep rates low while the nation climbs out of its recession. RUCO believes  
8 that by the next rate case in 2012, the economy will have improved, the Company's health  
9 should be fortified and there should be no need for continued use of these creative  
10 accounting measures.

11 Another aspect of the Settlement that has been called into question is the language in  
12 many provisions that allows the Company wiggle room to meet its obligation for renewable  
13 energy. For example, the discretionary language associated with the renewable energy  
14 projects to be built by the Company under the Settlement does not obligate the Company to  
15 build the projects. Settlement at 31-32. This is not really a weakness, because only the  
16 Commission and not the parties can approve of such projects. The Settlement requires the  
17 Company to file plans for the implementation of these projects. Id. That is as far as the  
18 Settlement can go because beyond that, it is the Commission that reviews the plans and then  
19 approves the projects.

20 There is also a practical consideration here. The Company can operate in bad faith  
21 and not comport with its commitments under the Settlement. The Company can make less  
22 than its best attempt to acquire new renewable energy resources with annual generation or  
23 savings of 1,700,000 MWh to be in service by December 31, 2015. The Company can be a  
24

1 bad actor. But why would it? The Settlement provides additional and significant reporting  
2 requirements. The Commission will know if the Company is not acting in good faith. The  
3 Company would open itself up to a lawsuit, but more importantly, the Company would  
4 alienate itself from the Commission and all the interested parties who dealt with the Company  
5 in good faith. Granted, ratepayers would lose, but more than likely, the Company will lose a  
6 lot more.

7 The rate case stay out provision has been questioned for being too short. There is no  
8 question that a longer stay out provision would have been better from a ratepayer's  
9 perspective. But again, only by a Settlement can the Company be committed to a stay out.  
10 The Company is in a precarious financial situation. While RUCO believes that the Settlement  
11 will ultimately improve the Company's financial situation, RUCO understands the need for  
12 flexibility down the road should the Company be unable to achieve financial security despite  
13 good faith efforts. Again, the stay out provision provides ratepayers' benefit, and when  
14 considered in total, is a fair provision.

15 Finally, the proposed equity infusions have come into question because of the lack of  
16 a specific, metered timeframe. The provision requires \$700 million of equity infusions  
17 through December 31, 2014. Settlement at 16. RUCO believes it is not in the ratepayer's  
18 interest to establish specific dates for the Company to make the infusions as it would be likely  
19 to signal the market and could affect the Company's stock price. The Settlement provides a  
20 built in mechanism that almost assures that the Company will issue equity long before its  
21 deadline. The Settlement provides that the Company will strive to reach a 52% total debt  
22 ratio. Settlement at 22. In order to do so, the Company will have to issue equity and they will  
23 likely do it at a time when they perceive their stock price is relatively high. Transcript at 1959.

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1 This will allow for less dilution of stock for existing stockholders. The expectation is that the  
2 Company, in order to comply with its commitment to lower its total debt ratio, will issue equity  
3 within the next few years. Transcript at 1958. In fact, at least one expert expects the  
4 Company to issue a significant “chunk” of the equity infusions right after the Settlement is  
5 approved, if it is approved. Id.

## 6 **CONCLUSION**

7 The Settlement is a comprehensive strategy that provides a guiding hand for APS to  
8 improve its financial condition in both the short and long term. It is far more than an  
9 agreement that merely increases the Company’s revenues. The revenue increase is one  
10 aspect, but the \$700 million equity infusion, the reduction of total debt to capital, the  
11 performance requirements and the other provisions in the Settlement provide ratepayers with  
12 assurance that this is not just a short-sighted attempt to solve more systemic problems. The  
13 Settlement helps to align the interests of stockholders and ratepayers, and it sets forth a  
14 reasonable and rational strategy that is likely to improve APS’ financial metrics and, in the  
15 long run, stem the constant flow of rate increases that would be likely to occur if the  
16 Commission were simply to continue to increase rates incrementally without addressing the  
17 root of the Company’s weak financial position. It is by no means perfect, but it is an even-  
18 handed strategy that addresses the reality that ratepayers, stockholders and all the  
19 competing interests currently face. The Settlement is in the public interest and should be  
20 approved.

1 RESPECTFULLY SUBMITTED this 9th day of October, 2009

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4 \_\_\_\_\_  
5 Daniel W. Pozefsky  
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7 AN ORIGINAL AND THIRTEEN COPIES  
8 of the foregoing filed this 9th day  
9 of October, 2009 with:

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