

ARIZONA PUBLIC SERVICE COMPANY

DOCKET NO. E-01345A-08-0172

**DIRECT TESTIMONY
IN SUPPORT OF SETTLEMENT AGREEMENT**

OF

JODI A. JERICH, DIRECTOR

ON BEHALF OF

THE

RESIDENTIAL UTILITY CONSUMER OFFICE

JULY 1, 2009

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1 **INTRODUCTION**

2 **Q. Please state your name, occupation and business address for the**
3 **record.**

4 A. My name is Jodi Jerich. I am the Director of the Arizona Residential Utility
5 Consumer Office (RUCO). My business address is 1110 W. Washington
6 Street, Suite 220, Phoenix, Arizona 85007.

7
8 **Q. Please state your educational background and qualifications in the**
9 **utility regulation field.**

10 A. Governor Brewer appointed me to serve as the Director of the RUCO in
11 February 2009. The State Senate found my qualifications met the
12 statutory requirements found in Arizona Revised Statutes §40-462 and
13 confirmed my appointment. As Director, I was the main negotiator for
14 RUCO during the settlement process.

15
16 From 2003 through 2005, I was employed at the Arizona Corporation
17 Commission as the Policy Advisor to Corporation Commissioner Mike
18 Gleason. In that role, I advised the Commissioner on matters coming
19 before the Commission. I was actively involved in the utility policy-making
20 decisions of that Commissioner's office. During my tenure at the
21 Commission, I advised the Commissioner on the 2005 APS rate case
22 settlement that resulted in Decision No. 67744. Many of the issues in that

1 matter are once again before the Commission in the pending APS rate
2 case and corresponding Settlement Agreement.

3
4 Except for the time I was employed by the Commission, from 1997
5 through 2008, I was employed at the Arizona House of Representatives. I
6 held several positions during my tenure, eventually becoming Chief of
7 Staff and Counsel to the Majority Caucus. Relevant to the question at
8 hand, I advised Legislators on matters involving water, energy,
9 Commission jurisdiction and utility security.

10
11 In 2006, when Governor Janet Napolitano appointed Barry Wong to fill the
12 Commission seat vacated by Commissioner Marc Spitzer's appointment to
13 the Federal Energy Regulatory Commission (FERC), I took a leave of
14 absence from the Legislature for a short time in order to assist
15 Commissioner Wong establish his office.

16
17 Finally, I am a Phi Beta Kappa graduate of Indiana University. I also have
18 a law degree from Indiana University and am a member of the Arizona
19 and Tennessee bars.

20

21 **Q. What is the purpose of your testimony?**

22 A. The purpose of my testimony is to explain RUCO's support of the
23 Settlement Agreement.

1 **THE SETTLEMENT PROCESS**

2 **Q. Was the negotiation process that resulted in the Settlement**
3 **Agreement a proper and fair process?**

4 A. Yes. The Settlement Agreement is the result of numerous hours of
5 negotiation and a willingness among the parties to compromise. The
6 negotiations were conducted in a fair and reasonable way that allowed
7 each party the opportunity to participate. All intervenors had an
8 opportunity to participate in every step of the negotiation and notice for
9 each scheduled meeting was sent to all parties electronically. Persons
10 were able to participate via teleconference if necessary. In total, the
11 parties met 21 times from January 30, 2009 to June 11, 2009 before
12 finalizing the Settlement Agreement. Each participant was able to engage
13 in meaningful negotiations. All parties were allowed to express their
14 positions fully.

15
16 Twenty entities signed the Settlement Agreement. These entities
17 represent a wide range of interests from environmental advocate groups,
18 agricultural interests, governmental entities, business and industrial
19 interests, low income advocates, union representatives, Commission Staff
20 and RUCO.

21
22

1 **Q. Why is a negotiated settlement process an appropriate way to**
2 **resolve this matter?**

3 A. The Settlement Agreement results in clarity and regulatory certainty,
4 without the risk of protracted litigation and appeals. The Settlement
5 Agreement guarantees that RUCO will get what it believes is most
6 important – a well thought out plan which should improve the Company's
7 financial metrics over the short and long term, while at the same time
8 keeping rates as low and stable as possible while providing benefits to
9 ratepayers. Settlement negotiations began only after each party had the
10 opportunity to analyze the Company's Application, file its Direct Testimony
11 and read the Direct Testimony of other Intervenors. Of course, the
12 Settlement Agreement in no way eliminates the Commission's
13 constitutional right and duty to review this matter and to make its own
14 determination whether the Settlement is truly balanced and the rates are
15 just and reasonable.

16
17 **Q. Please summarize your testimony.**

18 A. The Settlement Agreement reflects an outcome that is fair to both the
19 consumer and the Company. Furthermore, this is a comprehensive
20 Settlement Agreement. Its terms settle a wide range of issues that were
21 of significant interest to several of the Intervenors. RUCO supports this
22 Agreement in its entirety because it contains numerous benefits to the

1 consumer as well as putting the Company on a true path to financial
2 health.

3
4 **SETTLEMENT PROVISIONS**

5 **Q. In summary, what are the main provisions of the Settlement?**

6 A. The Settlement Agreement is a comprehensive document that resolves
7 numerous and divergent issues. As detailed below, the Settlement
8 Agreement provides a \$196.3 million non-fuel base rate increase for the
9 Company and \$11.2 million associated with establishing new base fuel
10 levels. The \$196.3 million increase includes the \$65 million already
11 authorized by the Commission in interim rates. The Settlement
12 Agreement also freezes rates for at least 2 ½ years (no earlier than July 1,
13 2012) and restricts APS from filing future general rate cases until certain
14 dates listed in the Settlement Agreement. The Settlement Agreement also
15 establishes a five year “roadmap” for the Company to regain its financial
16 health. It must reduce its expenses by \$150 million, make equity infusions
17 of \$700 million, strive to reduce its total debt from 57% to 52%, achieve
18 specified performance measures, limit its executive cash incentive
19 compensation in certain situations, meet identified energy efficiency goals
20 and expand its renewable energy commitment so that 10% of its retail
21 sales are from renewable energy by 2015. Furthermore, the Settlement
22 Agreement addresses the needs of low income ratepayers as well as
23 issues specific to large commercial and industrial users.

1 **Q: In summary, what are the benefits to the residential consumer?**

2 A. The benefits to the residential consumer are:

- 3 • Rates frozen for approximately 2 ½ years (no new rates before July
4 1, 2012).
- 5 • Accelerated reset of PSA to offset a portion of the rate increase.
- 6 • Maintain 90/10 sharing of PSA.
- 7 • APS will strive to achieve a capital structure with no more than 52%
8 total debt by December 31, 2012.
- 9 • Equity infusions of \$700 million which are designed to improve
10 APS' financial metrics by strengthening APS' credit rating and
11 reducing APS' future debt costs.
- 12 • \$150 million reduction of APS expenses over the next five years
13 forcing APS to operate more efficiently.
- 14 • Restrictions on executive cash incentive compensation.
- 15 • Periodic evaluation of APS through the use of Performance
16 Measures with a meaningful consequence for failure to meet these
17 Measures.
- 18 • Increased transparency in APS operations through annual and
19 quarterly reporting on its financial health, credit ratings, earned
20 ROE, FFO/debt ratio, management expenses, O&M expenses and
21 dividend payout ratio.

- 1 • Benchmarking study comparing APS to other similarly situated
2 utilities across the nation.
- 3 • Revenue spread agreement that requires all rate schedules to
4 absorb equal amounts of the total rate increase even though the
5 cost of service studies indicate the residential class's increase
6 should be higher than the increase for commercial or industrial
7 classes.
- 8 • Renewable energy projects at schools that serve to reduce school
9 utility bills allowing schools to shift funds from utility bills into the
10 classroom, or possibly resulting in lower property taxes.
- 11 • Energy efficiency program establishing efficiency goals through
12 2012, a new customer financing plan to encourage participation,
13 and a prohibition to seek unrecovered fixed costs until APS' next
14 general rate case.
- 15 • Time of Use, super peak and critical peak pricing demand response
16 programs.
- 17 • Corresponding decreases to the PSA and SBC (Systems Benefits
18 Charge) upon the granting of the Palo Verde Life Extension.
- 19 • More timely recovery of DSMAC program costs to eliminate interest
20 expense paid by ratepayers under the delayed DSMAC recovery
21 program.
- 22
- 23

1 **Q. In summary, what are the benefits to the Company?**

2 A. The benefits to the Company are:

- 3 • Non-fuel rate increase of \$196.3 million (This *includes* the \$65 million
4 interim rate increase previously approved in Decision No. 70667.).¹
- 5 • A roadmap to better financial health that should improve APS' credit
6 ratings, make APS more attractive to investors, allow APS to borrow
7 money on more favorable terms and stop the cycle of constant rate
8 case litigation.
- 9 • A clear signal to investors and Wall Street that, in the Plan Term set
10 forth in the Settlement Agreement, APS has a defined path toward
11 reduced expenses, a meaningful rate of return, increased equity and a
12 plan for renewable energy projects.
- 13 • Continuation of the PSA.
- 14 • An authorized return on equity of 11.0%.
- 15 • Adoption of APS' proposed depreciation rates.
- 16 • Adjustment of depreciation rates for Palo Verde License Extension.
- 17 • Deferral of a portion of APS pension and OPEB costs up to \$42.5
18 million.
- 19 • Ability to treat Schedule 3 proceeds as revenue.
- 20 • Tiered incentives to meet energy efficiency goals.

¹ The Settlement Agreement also increases the amount of fuel costs recovered in base rates, shifting these revenues currently recovered through the PSA. Since the PSA has a 90/10 sharing mechanism that is not recognized when fuel costs are recovered in base rates, an additional \$11.2 million is retained by the Company. This is the amount that would have gone to the ratepayers had those fuel costs been recovered through the PSA.

- 1 • More timely recovery of DSMAC program costs.
- 2 • Recovery of capital carrying costs for renewable energy projects to
- 3 encourage utility-owned renewable energy generation instead of
- 4 merely purchasing renewable energy from other – possibly out of state
- 5 – sources (this also serves to encourage least cost renewable
- 6 resources for the benefit of the customer).
- 7 • A commitment of a good faith effort to process future rate cases within
- 8 12 months of a sufficiency finding.

9

10 **PUBLIC INTEREST**

11 **Q. How is the public interest satisfied by the Settlement Agreement?**

12 A. At the most fundamental level, the settlement satisfies the public interest
13 from RUCO's perspective in that it provides a framework that should
14 improve APS' financial metrics and credit ratings. As APS noted, out of a
15 total of 139 rated utilities, only five companies are rated lower than APS.
16 (Brant Direct, p. 39)

17

18 RUCO is deeply concerned with APS' continuous marginal credit rating
19 and constant claims that a downgrade to "junk bond" status is imminent.

20 This strategy has been successful in the past to receive rate and other
21 forms of relief from the Commission based on these claims. Yet, despite

22 the relief, APS' financial metrics have not improved and its credit rating
23 still threatens to put the Company below investment grade categories. If

1 APS' credit rating is downgraded and it loses its investment grade rating,
2 its cost to borrow money will increase significantly and ratepayers will
3 ultimately pay more in the form of higher rates for the entire term of the
4 debt issuance – typically 20 years. As RUCO witness, Dr. Ben Johnson
5 noted in his Direct Testimony, “In this regard, it is important to note that
6 issuance of additional debt bearing a high interest rate will weaken the
7 firm’s credit metrics, particularly its FFO to interest ratio, increasing the
8 firm’s financial risk, and potentially leading to a further bond downgrading.”
9 (Johnson Direct, p. 17) This downward spiral is not in the ratepayers’ best
10 interest. Additionally, as Dr. Johnson noted, it is entirely possible that a
11 downgrade would prevent APS from finding financing under any terms.
12 “The market for newly issued junk-rated debt is limited.” (Johnson Direct,
13 p. 16)

14
15 RUCO understands that for APS to improve its financial health, it will
16 require more than just increasing APS’ revenues. It will require a short
17 and long term strategy that is likely to place the Company in a better
18 financial posture. RUCO further understands that improving the
19 Company’s financial condition will not happen overnight. It will take years.
20 For that reason, the Settlement Agreement establishes a five year “Plan
21 Term” that creates a roadmap to rate stability and an improved financial
22 condition. This goal is necessary to ensure that APS, the state’s largest

1 energy provider, will continue to provide reliable service at reasonable and
2 affordable rates.

3 The Settlement Agreement is a comprehensive strategy that provides a
4 guiding hand for the utility to improve its financial condition in both the
5 short and long term. It is far more than an Agreement that merely
6 increases the Company's revenues. The revenue increase is one aspect,
7 but the \$700 million equity infusion, the reduction of total debt to capital,
8 the performance requirements and the other provisions in the Settlement
9 Agreement provide ratepayers assurance that this is not just a short
10 sighted attempt to solve a more systemic problem. The Settlement
11 Agreement helps to align the interests of stockholders and ratepayers, and
12 it sets forth a reasonable and rational strategy that is likely to improve
13 APS' financial metrics and, in the long run, stem the constant flow of rate
14 increases that would be likely to occur if the Commission were simply to
15 continue to increase rates incrementally without addressing the root of the
16 Company's weak financial position. The Settlement Agreement is in the
17 public interest.

18

19 ..

20

21 ..

22

23 ..

1 **RATE INCREASE/RATE STABILITY**

2 **Q Why is rate stability an important element in this Settlement**
3 **Agreement?**

4 A. The Settlement Agreement provides there will be no new base rate
5 increases prior to July 1, 2012. Ratepayers will know their base rates will
6 not change for at least the next 2 ½ years.

7
8 The Settlement Agreement also informs ratepayers that the Company will
9 not file its next two rate cases prior to June 1, 2011 and June 1, 2013.
10 There is value in knowing that rates will remain the same for an extended
11 period. Rate stability is a benefit to ratepayers and is in the public interest.

12
13 **RATE IMPACT**

14 **Q. What will be the impact on the average residential customer's bill if**
15 **the Commission approves the Settlement Agreement?**

16 A. I would call the Commission's attention to the Bill Impact Statement filed
17 May 15, 2009. That Statement provides the rate impact for two types of
18 residential customers: 1) the average residential customer for all
19 residential rates; and 2) the average E-12 customer.

20
21 For the reader's convenience, I have attached a copy of the filed Bill
22 Impact Statement as Attachment A to my testimony.

23

1 The Bill Impact Statement shows that the residential rates will experience
2 a 12.82% increase in base rates. Once the rates go into effect, the
3 average residential customer will see a \$6.32 (4.83%) increase in their
4 monthly bill. The average E-12 customer's monthly bill will increase \$4.88
5 (5.28%).

6

7 **Q. How can there be a 12.82% rate increase with only a 4.83% increase**
8 **in the average residential monthly bill?**

9 A. As described on page 2 of the Bill Impact Statement, there is a 12.82%
10 increase in the residential **base** rate. This increase in the base rate rolls
11 in several charges that customers are already paying as separate line
12 items on their monthly bill. 2.27% of the 12.82% base rate increase
13 reflects the \$65.2 million interim rate surcharge that the Commission
14 approved in December 2008 in Decision No. 70667. 5.11% of the 12.82%
15 base rate increase shifts fuel costs currently captured in the PSA into the
16 base rate. The remaining 5.44% of the 12.82% base rate increase reflects
17 the additional increase in non-fuel costs to the customer associated with
18 this rate case.²

19

20 It may be simpler to reference Section 3.3 of the Settlement Agreement
21 which states that the total non-fuel base rate increase represents an

² In the 2007 APS rate case, the Commission awarded a 12.33% increase over test year revenues. As in this matter, a significant portion of that increase moved fuel costs from the PSA into base rates.

1 approximate 7.9% increase in base rate revenue. The 7.9% consists of
2 the 1) \$65.2 million in interim rates already granted by the Commission; 2)
3 \$11.2 million associated with establishing new base fuel levels³; and 3)
4 \$131.1 million of additional revenue negotiated through this Settlement
5 Agreement.

6

7 **Q. So then residential customers can expect that they will only see on**
8 **average a \$6.32 increase in their total monthly bill?**

9 A. Not quite. As noted below the charts showing the proposed bill impact for
10 all residential customers and E-12 customers, this \$6.32 increase does
11 not include increases to the DSMAC and RES adjustors for projects
12 contemplated by the Settlement Agreement. Changes in the rate of these
13 two adjusters are made annually and reflect the added costs for the DSM
14 and renewable energy projects contemplated by this Settlement
15 Agreement. In 2010, the Bill Impact Statement projects that the DSMAC
16 would increase by an additional \$0.51 (39%) for a total DSMAC cost of
17 \$1.22 and the RES adjustor would increase by an additional \$0.86 (66%)
18 for a total cost of \$4.03. Section 3.9 of the Settlement Agreement points
19 out:

20 "The presently estimated impact of this Agreement on the
21 amount to be collected from the DSMAC and RES in
22 2010 is approximately an additional \$15 million and \$2
23 million respectively. Although the Signatories agree that

³ As explained in footnote 1, the Settlement Agreement shifts recovery of fuel costs from the PSA to base rates. Since the PSA has a 90/10 sharing mechanism that is not recognized when fuel costs are recovered in base rates, an additional \$11.2 million is retained by the Company.

1 the amounts collected under the DSMAC and RES will
2 likely increase after 2010, there is no consensus as to the
3 level of such increase.”
4

5 **Q. Why should customers accept a 39% increase in their DSMAC**
6 **charge and a 66% increase in their RES charge?**

7 A. RUCO believes it is in the customers’ interest to support DSM / energy
8 efficiency measures and the accelerated promotion of renewable energy
9 generation. The DSM / energy efficiency measures found in Section XIV
10 serve an important purpose. These measures have the effect of reducing
11 energy consumption. A reduction in energy consumption delays the need
12 to build additional plant and purchase additional fuel. In many ways,
13 paying for energy efficiency can be actually less expensive than paying to
14 build and operate new power plants or purchase energy on the wholesale
15 market.

16
17 The Settlement Agreement provides for an expanded and comprehensive
18 energy efficiency program including: 1) energy efficiency goals through
19 2012 with a tiered performance incentive program; 2) a commitment to
20 install DSM elements in at least 100 schools by 2010; 3) a goal to serve
21 1,000 homes through a “Residential Existing Homes Program” by 2010; 4)
22 additional incentives for increased efficiency construction in new homes;
23 5) a fully integrated non-residential customers repayment/financing

1 program to encourage greater participation; and 6) second tier high
2 performance new construction elements.

3 RUCO believes that there are numerous benefits to the renewable energy
4 projects listed in the Settlement Agreement. The Settlement outlines
5 important investments in Arizona's renewable energy future including: 1)
6 renewable energy generation of 1.7 million megawatts in service by 2015
7 which equates to 10% of retail sales; 2) renewable energy projects for
8 schools; 3) an in-state wind generation project and 4) a utility scale
9 photovoltaic generation project. Without discounting the numerous
10 environmental benefits of renewable energy, there are strong financial
11 reasons for promotion of these renewable energy projects. There is a
12 possibility that Congress may impose a "cap and trade" program or a
13 carbon tax that would significantly increase the cost of coal-fired
14 generation. If so, APS' baseload plants such as Four Corners and Cholla
15 may face significantly increased costs. Then, the renewable energy
16 projects envisioned in this Settlement may serve, *in part*, to replace coal-
17 fired generation instead of relying more on APS' expensive natural gas
18 peaking plants. A diverse fuel portfolio with more renewable energy
19 components will help shield APS from any federal legislation that
20 adversely impacts the price of coal-fired generation. The Settlement
21 Agreement envisions approximately 10% of APS' retail sales to be from
22 renewable energy by 2015 which exceeds the goals established by the
23 Commission's REST rules. Furthermore, Governor Brewer has

1 announced that \$20 million from federal stimulus funds will be available
2 through the School Facilities Board for energy efficiency and renewable
3 energy projects at Arizona's schools. Money collected from the RES
4 adjuster can be used to leverage these stimulus funds to maximize
5 renewable energy project dollars. An additional \$0.86 per month may be
6 a wise investment in Arizona's energy future.

7

8 **Q. What was RUCO's position in its direct case?**

9 A. Page 13 of the Settlement Agreement details the revenue requirement
10 positions of APS, Staff, RUCO and AECC in its respective direct cases.
11 Originally, RUCO did not recommend any increase to non-fuel base rates.
12 RUCO's direct testimony made a concerted effort to illustrate the effects of
13 a pure application of a historical test year to this rate case application.
14 RUCO held to a firm cut-off date of December 31, 2007 and rejected *all*
15 post test year plant – even \$92 million of plant placed in service on
16 January 19, 2008 (Palo Verde Unit 3 steam generator).

17

18 **Q. What made RUCO diverge from its original position and agree to a**
19 **\$196.3 million non-fuel base rate increase in the Settlement**
20 **Agreement? (\$131.1 million in addition to the already-approved \$65.2**
21 **million interim rate)**

22 A. Even at the time of filing its Direct Testimony, RUCO noted that the
23 Commission may wish to veer from a hard-line, pure historical test year

1 analysis. RUCO witness Dr. Johnson stated, “I realize the Commission
2 might conclude that some deviation from a strict historical test year is
3 warranted...Accordingly, I have provided an appendix to my testimony in
4 which I discuss the attrition issue in more depth, and I describe an
5 alternative approach to attrition compensation which is not based on a
6 series of arbitrary adjustments to the historical test year.” (Johnson Direct,
7 p. 33) On the very first page of the filed testimony, former Director
8 Stephen Ahearn noted, “I strongly urge the reader...to also pay attention
9 to the Appendix.”

10

11 In Appendix B, Dr. Johnson addressed the issue of attrition. “Attrition”
12 refers to a utility’s profitability eroding over time. As Dr. Johnson noted,
13 there is reason to accept APS’ contention that the Company is suffering
14 from attrition and may be a factor in the Company’s earnings shortfall of
15 \$321 million between 2003 and 2007 and a projected shortfall of \$384
16 million to \$454 million through 2010. Dr. Johnson explained, “Assuming
17 the utility is allowed to pass fuel and purchased power cost increases
18 through to consumers, the most likely circumstance in which a utility might
19 experience continued erosion of its profitability (attrition) is when the utility
20 is investing substantial amounts in additional plant and equipment with
21 higher unit costs than its existing facilities – assuming the adverse impact
22 of inflation on these new investments outweighs the beneficial impact of
23 increased economies of scale that often accompanies such growth.” APS

1 construction costs were \$808 million in 2005, \$660 million in 2006 and
2 \$897 million in 2007. APS projects construction expenditures totaling
3 approximately \$1 billion per year from 2008 to 2010. (Johnson, Appendix
4 B, pp. 2-3).

5
6 While RUCO takes note of APS' attrition argument, it also recognizes that
7 the cause of APS' strained financial condition may also be the result of
8 poor business practices and management decisions. RUCO finds that the
9 Settlement Agreement addresses these possible causes of lost profitability
10 as well. The Settlement Agreement requires APS to reduce its expenses
11 by \$150 million over the next five years, meet specified performance
12 goals, limit its executive cash incentive compensation if it fails to meet
13 these performance goals, improve its capital structure by reducing its total
14 debt from 57% to 52%, and make equity infusions of at least \$700 million.

15
16 The Settlement Agreement also requires APS to conduct a benchmarking
17 study. This study will identify how APS compares to other similarly
18 situated utilities regarding debt/equity ratios, FFO/debt ratios and debt
19 ratings. This study can show how APS' financial condition has improved
20 under the terms of the Settlement Agreement and how much farther it has
21 to go toward complete financial health.

22

1 Under these circumstances, RUCO finds that the \$196.3 million increase
2 (which includes the \$65 million the Commission already authorized
3 through interim rates) is reasonable. Furthermore, RUCO finds that the
4 revenue requirements in the Settlement Agreement appropriately address
5 RUCO's concerns that failure to address attrition will result in a utility filing
6 a series of back-to-back rate cases in an effort to "catch up" with attrition.
7 Furthermore, this non-fuel base rate increase is only a single aspect of the
8 Settlement Agreement. Placed with all of the other components listed
9 above, the Settlement Agreement provides APS the tools needed to
10 regain its financial strength and become attractive to investors, improve its
11 credit rating and lower its cost of debt.

12
13 **Q. Why would RUCO agree to non-traditional ratemaking elements to**
14 **enhance APS' financial viability?**

15 A. As discussed above, RUCO is deeply troubled by APS' financial condition.
16 RUCO believes that it is not in the best interest of the consumers to have
17 APS facing a credit rating downgrade, having trouble attracting investors
18 and acquiring debt at less than attractive interest rates. Strict adherence
19 to a historical test year would not solve the problem. The Settlement
20 Agreement recognizes post test year plant 18 months beyond the test
21 year. Furthermore, the Settlement Agreement contains provisions that
22 allow APS to increase its earnings such as 1) defer pension and OPEB
23 expenses; 2) treat Schedule 3 as revenue; and 3) adjust depreciation

1 rates for Palo Verde license extension. While not traditional ratemaking
2 elements, RUCO accepted these provisions because their treatment
3 allows APS to improve its revenues ***without having to increase rates at***
4 ***this time.***

5

6 **EQUITY INFUSIONS/TOTAL DEBT TO CAPITAL**

7 **Q. Explain why RUCO believes it's important that APS "strive to achieve**
8 **a capital structure with no more than 52% total debt" as indicated in**
9 **the Settlement Agreement?**

10 A. RUCO finds this provision to be critical to improving APS' financial
11 condition. As Dr. Johnson noted, "The debt to capital ratio computed by
12 S&P is significantly worse than the analogous debt ratio which was
13 approved by the Commission in the last rate case. This 57% debt ratio
14 places APS near the unfavorable end of the range for the "Aggressive"
15 financial risk category." (Johnson Direct at p. 15)⁴ The higher the total
16 debt percentage the more a company is leveraged. The more a company
17 must focus on a disproportionate debt repayment obligations, the less
18 likely it will be to attract equity investors seeking dividends.

19

20 Reducing APS' total debt will improve the Company's financial position
21 and increase the likelihood of improved credit ratings. Improved credit

⁴ Section 4.1 adopts a capital structure of 46.21% debt and 53.79% equity for ratemaking purposes. However, this is for ratemaking purposes only and does not reflect APS' imputed debt levels.

1 ratings allow APS to borrow (or refinance debt) on more favorable terms.
2 Since ratepayers must pay these costs, it is definitely in the best interests
3 of the ratepayers that APS be able to issue debt on favorable terms.

4

5 **Q. Why is the requirement that APS make \$700 million of equity**
6 **infusions an important consumer benefit?**

7 A. Section VIII of the Settlement Agreement requires APS to complete equity
8 infusions of at least \$700 million by December 31, 2014. Increasing the
9 amount of equity in APS is an important element in improving the
10 Company's financial metrics. In fact, the Commission recognized its
11 importance in Decision No. 70454 when is authorized APS to increase its
12 equity by up to \$400 million. Increased equity and the reduction in total
13 debt to capital are intertwined. As Dr. Johnson mentions in his testimony,
14 they "reinforce" one another.

15

16 **APS LINE EXTENSION POLICY**

17 **Q. What is RUCO's position regarding the "free footage" line extension**
18 **issue for single residential customers as discussed in letters to the**
19 **docket filed by Commissioners Kennedy, Mayes, Newman and**
20 **Stump?**

21 A. As RUCO articulated in its May 15, 2009 letter filed in this docket, there is
22 no such thing as a "free" line extension. Costs that are not paid by the
23 party receiving the extension are paid by all other ratepayers.

1 The previous “free footage” policy allowed single residential landowners to
2 receive the first 1,000 feet of line without cost as long as that cost did not
3 exceed \$25,000. (Business and commercial properties, and those
4 residential landowners who needed connections as part of a planned
5 subdivision were not eligible for this 1,000 feet/\$25,000 “free footage”
6 allotment.) If the cost exceeded \$25,000, the single residential landowner
7 had to pay the entire cost of the extension – not just the incremental cost
8 over \$25,000. This policy had been in place for several decades before
9 being changed in the Company’s last rate case to remove the subsidy in
10 base rates paid by all ratepayers and place the cost on the person
11 receiving the benefit of the line extension.

12
13 RUCO understands that the Commission has received several complaints
14 regarding this policy change. Opponents of the current policy contend that
15 it hinders development and economic growth and suppresses property
16 values. The Commission has received letters from County Supervisors,
17 County Assessors and a State Senator expressing these concerns.

18
19 RUCO supports Section 10.3 of the Settlement Agreement to maintain the
20 current line extension policy that requires a residential landowner to pay
21 the entire cost of a line extension to his or her property. RUCO believes
22 this is an appropriate policy decision of the Commission that applies not
23 only to APS but to line extensions in the TEP service territory as well. Any

1 change in this docket would have the two largest electric service territories
2 treating line extensions differently for their single, residential customers.
3 Furthermore, RUCO believes that the clarifications to the line extension
4 policy found in Section 10.7 may help customers understand the policy, its
5 costs and options and can reduce the number of complaints.

6
7 In light of the revenue requirements of the Settlement Agreement any
8 change to allow some degree of “free footage” would increase all
9 customers’ bills and exacerbate the rate increase. However, since four of
10 the five Commissioners have filed letters in the docket on this issue, it
11 appears to RUCO that there is an interest in re-examining the line
12 extension policy. Therefore, if the Commission finds it appropriate to
13 return to some version of the previous free line extension policy, RUCO
14 would not object to the following:

- 15 1. That the policy change only be in effect for a temporary period of
16 time to recognize the unique economic times the State and its
17 residents currently face. A temporary departure from the current
18 policy may ameliorate the economic hardships residential
19 landowners are facing during this recession. Furthermore, a
20 temporary change will give the Commission information to
21 determine whether the elimination of the free footage allotment truly
22 affected property values or hindered development.

1 2. Adopt a modified and limited “free footage” policy that allows a
2 sizeable portion of single residential landowners to extend power to
3 their property while minimizing the rate increase to the rest of the
4 customers. Any change certainly should not be more generous
5 than the previous 1,000 feet/\$25,000 policy.⁵

6

7 **Q. Does your silence on issues not addressed in your testimony imply**
8 **any disfavor or reluctance of RUCO’s support?**

9 A. No. RUCO supports the Settlement Agreement and urges the
10 Commission to adopt it in its entirety. RUCO understands that other
11 parties will address other provisions in greater detail.

12

13 **Q. Does this conclude your testimony?**

14 A. Yes.

15

16

⁵ For illustrative purposes, if the Commission were to adopt a temporary line extension policy of no more than 500 feet/\$10,000, according to information filed on June 25, 2009 by APS, ratepayers would pay an additional \$2.76 million in 2010, \$3.14 million in 2011 and \$4.55 million in 2012. Also according to APS, for every \$5 million paid by other ratepayers to provide some sort of “free footage” the average residential ratepayer bill would increase by \$0.20. Therefore a 500 feet/\$10,000 policy would increase the average residential ratepayer’s bill by \$0.11 in 2010, \$0.13 in 2011 and \$0.18 in 2012.

ATTACHMENT A

ORIGINAL



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BEFORE THE ARIZONA CORPORATION COMMISSION

RECEIVED

2009 MAY 15 P 4:13

AZ CORP COMMISSION
DOCKET CONTROL

2 COMMISSIONERS

- 3 KRISTIN K. MAYES, Chairman
- 4 GARY PIERCE
- 5 PAUL NEWMAN
- 6 SANDRA D. KENNEDY
- 7 BOB STUMP

8 IN THE MATTER OF THE APPLICATION OF
 9 ARIZONA PUBLIC SERVICE FOR A
 10 HEARING TO DETERMINE THE FAIR
 11 VALUE OF THE UTILITY PROPERTY OF
 THE COMPANY FOR RULEMAKING
 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

STAFF'S NOTICE OF FILING CUSTOMER BILL IMPACT STATEMENT


12 Staff of the Arizona Corporation Commission ("Staff"), on behalf of the Settling Parties in
 13 this case, hereby files the Customer Bill Impact Analysis referred to in Item O of the Term Sheet filed
 14 by the Settling Parties on May 4, 2009. The Analysis was prepared with the input of all Settling
 15 Parties using the agreements in principle reached between the Settling Parties as set forth in the Term
 16 Sheet. The narrative explanation that precedes the actual bill comparison is intended to provide
 17 clarity and additional detail on the development of the rates and percentage increases for each
 18 customer class.

19 RESPECTFULLY SUBMITTED this 15th day of May, 2009.

Arizona Corporation Commission

DOCKETED

MAY 15 2009

DOCKETED BY 



Janet Wagner, Assistant Chief Counsel
 Maureen A. Scott, Senior Staff Counsel
 Charles Hains, Attorney
 Amanda Ho, Attorney
 Legal Division
 Arizona Corporation Commission
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27 ...
28 ...

1 Original and thirteen (13) copies
2 of the foregoing filed this
3 15th day of May, 2009 with:

3 Docket Control
4 Arizona Corporation Commission
5 1200 West Washington Street
6 Phoenix, Arizona 85008

6 Copies of the foregoing mailed this
7 18th day of May, 2009 to:

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- 28

APS Rate Case Settlement Proposal Bill Impact Analysis

May 15, 2009

PURPOSE AND SCOPE: An important consideration in any proposal to change rates is how the change impacts customer bills. Key factors to be considered in allocating revenue responsibility and designing rates include: the cost of providing service, rate stability, encouraging conservation, and other public policy objectives. The Settling Parties considered such factors in their pre-filed testimony and in reaching a comprehensive settlement.

A bill impact analysis is intended to provide policymakers and customers with a general sense of how rate changes will affect typical bills for different classes of customers. When only one bill element is changed, such as the basic service charge, a bill impact analysis is relatively straightforward. However, when multiple billing elements are involved in a change to rates, the bill impact analysis is necessarily more complex. This is because the multiple billing elements comprising an overall base rate change affect customer classes differently, depending on things such as load factor (average energy used by a customer expressed as a percentage of their maximum usage) and overall electric consumption levels. This is true even when the overall base rate percentage increase is the same for all customer classes. A typical bill analysis for residential customers is set forth on page 3 of this document.

THE PROPOSED SETTLEMENT: The Settling Parties propose that all customer classes bear roughly the same increase to the 2007 Test Year base rates—which on a percentage basis is 13.07%.¹ In addition, the parties propose to spread the impact of holding low income E-3 and E-4 customers harmless from the base rate increase across all other customers. As a result, there are four elements that affect the base rate increase and the bill impact analysis in this case:

- Designing rates such that E-3 and E-4 low income customers are held harmless, by spreading those costs across customer classes on a per kWh basis;
- Moving a portion of fuel and purchased power costs from the PSA to base rates;
- Eliminating the separate interim base rate surcharge and incorporating that charge into base rates; and

¹ In APS's 2005 Settlement Agreement, Commercial and Industrial customer classes were allocated proportionally less of the base rate increase and the Residential class was allocated proportionally more of the base rate increase to move rate design closer to the results of the cost of service study. Although the cost of service study in the current rate case continues to show that Commercial and Industrial classes are paying proportionally more than their cost of service relative to Residential customers, the parties agreed that no further rate design changes towards cost of service would be performed in this case. Such a change would have required Residential customers to pay more than the average base rate increase.

- Including the non-fuel increase necessary to bring base rates to the agreed upon 13.07% customer class average increase.

THE IMPACT BY CLASS: Some of these bill elements, such as fuel and purchased power, affect classes of customers differently. Commercial and industrial customers, for example, will pay a higher proportion of fuel and purchased power costs in their 13.07% base rate increase because as a class they consume more energy as a proportion of their overall bill. Although the Settling Parties did not strictly follow the cost of service in designing rates, this result is consistent with the cost of service study, which shows that the cost of service for commercial and industrial customers includes a higher percentage of fuel-related costs than the cost of service study for residential customers. Similarly, the interim base surcharge was established earlier this year as a kWh-based surcharge, which means that it currently represents a higher proportion of a typical commercial and industrial customer's bill, than that of a residential customer. Thus, the effect of an equal percentage increase in base rates will result in each class of customers paying a different proportion of each element in order to reach the overall 13.07% increase on a class basis.

A summary of the average cost (expressed on a percentage basis) for customers of each class associated with each element of the base rate increase, after accounting for the rate design effect of holding E-3 and E-4 customers harmless,² is shown in the following table:

	Beginning Base Rate Revenue Increase	Class Impact of E-3/E-4 Hold Harmless Rate Design	Increase in Base Rates After E-3/E-4 Rate Design (A)+(B)+(C)	Fuel-Related Increase (A)	Non-Fuel Related Increase (B)	Increase Related to Interim (C)
Residential (All Rates)	13.07%	-0.25%	12.82%	5.11%	5.44%	2.27%
Commercial (E-32)	13.07%	0.24%	13.31%	5.69%	5.09%	2.53%
Industrial	13.07%	0.24%	13.31%	5.67%	5.12%	2.52%

As the table shows, commercial and industrial customers will typically pay a higher proportion of the base rate increase for fuel-related costs, as these customers consume proportionally more fuel than residential customers. In turn, residential customers will pay less of the base rate increase in fuel-related costs and more in non-fuel related costs, reflecting the class average cost of service.

THE IMPACT ON TYPICAL BILLS: Finally, the bill impact analysis involves comparing a change in base rate (and associated billing elements) to a total monthly bill. The total monthly bill includes not just base rates, but also different charges such as the RES Adjustor and the DSM Adjustment Clause, which also represent a larger or smaller

² From a customer class standpoint, E-3 and E-4 customers are part of the Residential class. Thus, the column entitled "Increase in Base Rates After E-3/E-4 Rate Design" reflects the fact that customers in the Commercial and Industrial classes are contributing rate design revenues associated with the hold harmless provision for these low income rates to the Residential class.

overall component of the bill for a given customer class. For example, residential and industrial customers pay proportionately less than commercial customers for the RES, while industrial and commercial customers pay proportionately more for the DSM Adjustment Clause. Thus, the percentage of total bill impact depends not only on the level of the overall base rate increase, but also the relative levels of other line items on the bill.

Attached are bill impact analyses for each major customer class. To provide for better comparability of percentage bill impacts, the commercial and industrial analysis presented reflect an E-32 and E-34/35 customer with a similar load factor to that of the residential class. Also, a bill impact analysis for a typical E-12 residential customer, which is the non time-of-use rate, with 763 kWh of average monthly consumption is included.

For example, for a typical residential customer, with average monthly consumption of 1,408 kWh during summer months and 930 kWh for winter months, the increase would be \$8.98 per month in the summer and \$3.67 per month in the winter or an annual average of \$6.32 per month. In the case of a residential customer on rate E-12 with average monthly consumption of 880 kWh during summer months and 645 kWh for winter months, the increase would be \$6.67 per month in the summer and \$3.11 per month in the winter, or an annual average of \$4.88 per month. For an E-12 customer with median monthly usage of 664 kWh during summer months and 499 kWh for winter months, the increase would be \$3.19 per month during the summer and \$3.26 per month during the winter for an annual average of \$3.22 per month.

The settlement also proposes approval of new demand response programs and increased energy efficiency programs. These new programs, as well as existing programs (such as TOU rates) provide customers with the opportunity to mitigate all or a portion of the proposed rate increase by managing their energy usage.

Additionally, some provisions of the settlement involve costs recovered through adjustment mechanisms. Thus, estimates of 2010 DSM Adjustment Clause and the 2010 RES are provided for illustrative purposes, but would not be implemented at the same time as base rates increase.

ARIZONA PUBLIC SERVICE COMPANY
 Preliminary Estimated Monthly Bill Impacts of Proposed Settlement Rates 5/4/09

	Current Rates	Proposed Rates	Current Rates	Proposed Rates	Current Rates	Proposed Rates
	Annual Average Monthly Bill (1)	Annual Average Monthly Bill (2)	Summer Monthly Bill	Summer Monthly Bill	Winter Monthly Bill	Winter Monthly Bill
Residential (Average - All Rates)						
Average kWh per Month	1,169	1,169	1,408	1,408	930	930
Base Rates	\$ 116.20	\$ 131.10	\$ 150.41	\$ 169.72	\$ 81.99	\$ 92.48
PSA- Forward Component	5.94	-	7.15	-	4.72	-
PSA - Historical Component	0.30	0.30	0.36	0.36	0.24	0.24
Interim Rate Adjustor (January 2009)	2.64	-	3.18	-	2.10	-
TCA (July 1, 2008)	1.42	1.42	1.70	1.70	1.13	1.13
CRCC (April 2005)	0.40	0.40	0.48	0.48	0.31	0.31
EIS (July 2007)	0.19	0.19	0.23	0.23	0.15	0.15
RES (Jan 1, 2009)	3.17	3.17	3.17	3.17	3.17	3.17
DSMAC (April 2009)	0.71	0.71	0.85	0.85	0.56	0.56
Total	\$ 130.97	\$ 137.29	\$ 167.53	\$ 176.51	\$ 94.37	\$ 98.04
Bill Impact (3)		\$ 6.32		\$ 8.98		\$ 3.67
Percent Bill Impact		4.83%				
Reduction from accelerated reset of PSA Historical Component		TBD	TBD	TBD		TBD
Increase from Projected 2010 DSMAC		\$ 0.51	0.39%	\$ 0.61		\$ 0.40
Increase from Projected 2010 RES (4)		\$ 0.86	0.66%	\$ 0.86		\$ 0.86

	Annual Average Monthly Bill (1)	Annual Average Monthly Bill (2)	Summer Monthly Bill	Summer Monthly Bill	Winter Monthly Bill	Winter Monthly Bill
Residential (Rate E-12)						
Average kWh per Month	763	763	880	880	645	645
Base Rates	\$ 81.71	\$ 92.20	\$ 102.11	\$ 115.24	\$ 61.30	\$ 69.15
PSA- Forward Component	3.88	-	4.47	-	3.28	-
PSA - Historical Component	0.20	0.20	0.23	0.23	0.17	0.17
Interim Rate Adjustor (January 2009)	1.73	-	1.99	-	1.46	-
TCA (July 1, 2008)	0.92	0.92	1.06	1.06	0.78	0.78
CRCC (April 2005)	0.26	0.26	0.30	0.30	0.22	0.22
EIS (July 2007)	0.12	0.12	0.14	0.14	0.10	0.10
RES (Jan 1, 2009)	3.17	3.17	3.17	3.17	3.17	3.17
DSMAC (April 2009)	0.46	0.46	0.53	0.53	0.39	0.39
Total	\$ 92.45	\$ 97.33	\$ 114.00	\$ 120.67	\$ 70.87	\$ 73.98
Bill Impact (3)		\$ 4.88		\$ 6.67		\$ 3.11
Percent Bill Impact		5.28%				
Reduction from accelerated reset of PSA Historical Component		TBD	TBD	TBD		TBD
Increase from Projected 2010 DSMAC		\$ 0.33	0.36%	\$ 0.38		\$ 0.28
Increase from Projected 2010 RES (4)		\$ 0.86	0.93%	\$ 0.86		\$ 0.86

ARIZONA PUBLIC SERVICE COMPANY
Preliminary Estimated Monthly Bill Impacts of Proposed Settlement Rates 5/4/09

	Current Rates	Proposed Rates	Current Rates	Proposed Rates	Current Rates	Proposed Rates
	Annual Average Monthly Bill (1)	Annual Average Monthly Bill (2)	Summer Monthly Bill	Summer Monthly Bill	Winter Monthly Bill	Winter Monthly Bill
Commercial (Rate E-32)						
Average kWh per Month	8,663	8,663	9,628	9,628	7,698	7,698
Base Rates	\$ 773.63	\$ 876.58	\$ 912.51	\$ 1,033.82	\$ 634.75	\$ 719.34
PSA- Forward Component	44.01	-	48.91	-	39.11	-
PSA - Historical Component	2.24	2.24	2.48	2.48	1.99	1.99
Interim Rate Adjustor (January 2009)	19.58	-	21.76	-	17.40	-
TCA (July 1, 2008)	15.03	15.03	16.72	16.72	13.33	13.33
CRCC (April 2005)	2.93	2.93	3.25	3.25	2.60	2.60
EIS (July 2007)	1.39	1.39	1.54	1.54	1.23	1.23
RES (Jan 1, 2009)	68.76	68.76	76.42	76.42	61.10	61.10
DSMAC (April 2009)	6.44	6.44	7.16	7.16	5.71	5.71
Total	\$ 934.01	\$ 973.37	\$ 1,090.75	\$ 1,141.39	\$ 777.22	\$ 805.30
Bill Impact (3)		\$ 39.36		\$ 50.64		\$ 28.08
Percent Bill Impact		4.21%				

Reduction from accelerated reset of PSA Historical Component		TBD	TBD	TBD	TBD	TBD	
Impact from Projected 2010 DSMAC	\$	3.75	0.40%	\$	4.17	\$	3.33
Impact from Projected 2010 RES	\$	18.63	1.99%		20.70		16.55

	Annual Average Monthly Bill (1)	Annual Average Monthly Bill (2)	Summer Monthly Bill	Summer Monthly Bill	Winter Monthly Bill	Winter Monthly Bill
Industrial (Rate E34/35 Medium Load Factor)						
Average kWh per Month	2,250,284	2,250,284	2,344,877	2,344,877	2,155,690	2,155,690
Base Rates	\$ 201,730.06	\$ 228,573.49	\$ 210,208.60	\$ 238,180.24	\$ 193,251.52	\$ 218,966.74
PSA- Forward Component	11,431.45	-	11,911.98	-	10,950.91	-
PSA - Historical Component	580.58	580.58	604.98	604.98	556.17	556.17
Interim Rate Adjustor (January 2009)	5,085.64	-	5,299.42	-	4,871.86	-
TCA (July 1, 2008)	2,666.44	2,666.44	2,778.52	2,778.52	2,554.35	2,554.35
CRCC (April 2005)	760.60	760.60	792.57	792.57	728.62	728.62
EIS (July 2007)	360.05	360.05	375.18	375.18	344.91	344.91
RES (Jan 1, 2009)	353.78	353.78	353.78	353.78	353.78	353.78
DSMAC (April 2009)	2,106.39	2,106.39	2,194.93	2,194.93	2,017.84	2,017.84
Total	\$ 225,074.99	\$ 235,401.33	\$ 234,519.96	\$ 245,280.20	\$ 215,629.96	\$ 225,522.41
Bill Impact (3)		\$ 10,326.34		\$ 10,760.25		\$ 9,892.45
Percent Bill Impact		4.59%				

Reduction from accelerated reset of PSA Historical Component		TBD	TBD	TBD	TBD	TBD	
Impact from Projected 2010 DSMAC	\$	1,507.55	0.67%	\$	1,570.92	\$	1,444.18
Impact from Projected 2010 RES	\$	95.83	0.04%		95.83		95.83

Notes:

- (1) Bill excludes regulatory assessment charge, taxes and fees. Adjustor levels and interim base rate surcharge in effect as of May 1, 2009.
- (2) Bill impacts reflect the proposed increase in base rates, reset of interim adjustor to zero, and reset of PSA Forward Component charge to zero.
- (3) Bill impacts for commercial and industrial customers are less than residential on a percentage basis because these customer classes were assessed proportionally more for the interim adjustor and the PSA. The base rates reflect approximately the same percentage increase as residential.
- (4) RES impacts are based on a preliminary estimate. Actual bill impacts will be filed with the 2010 implementation plan to be filed in July 2009. Of the projected increase in the RES budget for 2010, only about \$1 to \$2 million is attributable to the settlement.

Increase Over Base Rates for Representative Customers

	Beginning Base Rate Revenue Increase	Impact of E-3, E-4 Hold Harmless Rate Design	Increase in Base Rates After E-3, E-4 Rate Design (A) + (B) + (C)	Fuel Related Increase (A)	Non-Fuel Related Increase (B)	Increase Related To Interim (C)
Residential (All Rates)	13.07%	-0.25%	12.82%	5.11%	5.44%	2.27%
Residential (Rate E-12)	13.07%	-0.23%	12.84%	4.75%	5.97%	2.12%
Commercial (Rate E-32)	13.07%	0.24%	13.31%	5.69%	5.09%	2.53%
Industrial (Medium Load Factor)	13.07%	0.24%	13.31%	5.67%	5.12%	2.52%

Monthly Bill
 Rate Case Settlement Proposal
 May 14, 2009

INPUT TO BILL COMPS

Proposed Increase - GRC Settlement Proposal

	Increase (\$000)	%
Base Rate	196,300	7.44%
Fuel - base rates	11,203	0.42%
Total base rate increase	207,503	7.87%
Adjusted base cost of fuel increase	137,235	5.20%
Total base rate increase	344,738	13.07%
 Adjusted Present Revenue - base rates (\$000)	 2,637,447	
 Adjusted TY MWh	 28,855,123	
TY E-3, E-4 MWh	460,909	
net	28,394,214	
 Revenue Requirement E-3, E-4 hold harmless \$	 6,000,000	
rev requirement \$/kwh \$	0.0002113	
Residential TY adjusted kWh	13,556,815,396	
TY E-3, E-4 MWh	460,909,000	
net	13,095,906,396	
residential benefit \$/kWh \$	0.0004582	
	(0.0002468) net residential impact \$/kwh	
	(0.0002468) check from class average assessment	