

ARIZONA PUBLIC SERVICE COMPANY

DOCKET NO. E-01345A-08-0172

**REPLY TESTIMONY
IN SUPPORT OF SETTLEMENT AGREEMENT**

OF

JODI A. JERICH, DIRECTOR

ON BEHALF OF

THE

RESIDENTIAL UTILITY CONSUMER OFFICE

AUGUST 13, 2009

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1 **INTRODUCTION**

2 **Q. Did you file testimony in support of the proposed APS Settlement?**

3 A. Yes.

4

5 **Q. What is the purpose of your reply testimony?**

6

7 A. The purpose of my testimony is to reaffirm RUCO's position regarding the
8 APS line extension policy established by the Corporation Commission and to
9 address the Direct Testimony in Opposition to the Proposed Settlement.

10

11 **Q. Have you read the testimony opposing the settlement including the**
12 **Fiscal Impact Study completed by Elliot Pollack & Company?**

13 A. Yes, I have read the testimony. I also attended the depositions of Rick Merritt
14 and Daniel Court who conducted the Study on behalf of the Company.
15 Additionally, I reviewed the transcripts of those depositions. Members of
16 RUCO staff attended the public comment sessions held in Flagstaff and
17 Prescott where a number of residents voiced their opinions regarding the line
18 extension policy.

19

20 **Q. Briefly summarize RUCO's position on the line extension policy**
21 **proposed in the Settlement Agreement.**

22 A. As I mentioned in my Direct Testimony in Support of the Proposed Settlement
23 Agreement, 20 parties, including RUCO, have committed their support for the
24 proposed Settlement Agreement. That Settlement Agreement preserves the

1 line extension policy established by the Commission in the 2007 APS rate
2 case. Since that previous APS rate case, the Commission has also instituted
3 that same line extension policy to other electric utilities, such as TEP. In an
4 effort to address concerns and confusion about this change in policy, the
5 Settlement requires APS to do a better job in informing its customers about
6 the itemized costs of line extensions. Furthermore, the Settlement requires
7 APS to inform customers that they have the option of “sub-contracting” some
8 non-electrical work (such as trenching) to a vendor other than APS.

9
10 Four of the five Commissioners have filed letters in this docket on this issue.
11 Clearly, there is an interest in re-examining the line extension policy. As
12 stated in my direct testimony, RUCO recognizes that the Commission may
13 find it appropriate to return to some version of the previous free footage
14 allocation for individual landowners. In that direct testimony (pp. 24-25), I
15 noted that any change should not go beyond the previous 1,000 feet/\$25,000
16 policy and that any change should have as little of an impact on ratepayers as
17 possible. There is nothing free about a “free footage” allowance.
18 Furthermore, if the Commission finds a reversal of policy compelling due to
19 current economic conditions, then it would be appropriate for this change in
20 policy to remain in effect only for a temporary period of time in recognition of
21 the unique economic times the State and its residents currently face. At the
22 conclusion of that period of time, there will be sufficient evidence to see if the
23 change has had a positive, quantifiable impact on property values and land

1 development compared to the 2007-2009 time period when there was no free
2 footage allowance in the APS service territory.¹

3

4 **Q. Are you aware of the Commission's decisions to hold a series of**
5 **workshops on the issue of free footage allowances in line extension**
6 **policies?**

7 A. Yes. RUCO understands that in a recent staff meeting the Commissioners
8 directed Commission Staff to set up a series of workshops to reexamine this
9 issue. RUCO supports the Commission's action and believes *if a new policy*
10 *is adopted, it should be fair not only to landowners, but also to the*
11 *ratepayers who will pay for any "free" footage.*

12

13 **Q. Briefly summarize the testimony in opposition to the proposed**
14 **settlement agreement.**

15 A. Several real estate agents and land developers filed testimony in opposition
16 to the current line extension policy. The witnesses provided examples of
17 situations where landowners cannot afford to pay for the line extension to
18 their undeveloped parcel of land. For at least two of the examples, it is
19 apparent that their line extensions would have fallen within the 1,000
20 foot/\$25,000 feet limit (Testimony of Ian Campbell, p. 1 and Debra Morrow, p.

¹ In footnote 5 of my direct testimony, I noted that according to information filed by APS on June 25, 2009, if the Commission were to adopt a modified 500 feet/\$10,000 free footage allowance, the financial impact is estimated to be \$2.76 million in 2010, \$3.14 million in 2011 and \$4.55 million in 2012. If the Commission were to shift the cost burden from the individual landowner to other ratepayers, the average residential ratepayer would see an increase in their monthly bill of approximately \$0.11 in 2010, \$0.13 in 2011 and \$0.18 in 2012 as a result of this policy change.

1 1). It is unclear whether the other examples provided would have benefitted
2 from the previous policy since the previous policy held that if an extension
3 exceeded \$25,000 then the landowner paid the entire cost of the extension –
4 not merely the costs that exceed \$25,000.

5
6 The testimony filed in opposition to the current policy as well as the
7 comments expressed at the public comment meetings make it obviously clear
8 that the 2007 change in the policy has resulted in certain individual
9 landowners not being able to afford to bear the costs of providing electricity to
10 their land. RUCO recognizes that this anecdotal testimony may provide some
11 indication of the impact of the change in the policy. However, consideration
12 of any negative impact that this policy may have for certain individual
13 landowners should not be the only factor considered in evaluating the public
14 interest. It is important to weigh the impact on landowners against the benefit
15 of maintaining lower electric rates for the vast majority of ratepayers.

16
17 The sentiment of all those who filed testimony in opposition to the current line
18 extension policy can best be summed up through the testimony of Chad
19 Fisher:

20 “I support a free footage allowance of 1,000 ft with a
21 \$25,000 cap, which is the same line extension policy that
22 was in place prior to July 2007. It is my understanding
23 that any changes to service schedule 3 must remain
24 revenue neutral. The testimony of David Rumolo states
25 that estimated impact of returning to the prior service
26 agreement of 1,000 ft free (if under \$25,000) to be

1 \$5,950,000 in 2010 and increased to \$10,000,000 in
2 2012. Also in his testimony he stated that in order to
3 remain revenue neutral, APS estimates that each
4 \$5,000,000 of reduced schedule 3 revenues would
5 require an additional rate increase of roughly \$.20 per
6 month.” (Fisher at p. 1)
7

8 **Q. Does the Impact Study that was filed with the testimony alter RUCO’s**
9 **position?**

10 A. No. For the most part, the Study is not focused on the critical issues that
11 need to be evaluated in deciding who should pay for a line extension.

- 12 • Is it in the broad public interest for all APS ratepayers to pay for the
13 costs to individual parcels for a small number of landowners?
- 14
- 15 • Alternatively, is it a better policy to keep rates as low as possible for all
16 ratepayers and have these costs borne by those who directly benefit
17 from the line extension?
- 18
- 19 • Do the consequential benefits of developed land--arguably higher
20 property values and better resale prices for undeveloped land--provide
21 enough of a general, societal benefit to warrant the subsidization of
22 individual line extensions by having all ratepayers pick up the costs for
23 qualifying extensions?
24

25 The Study provides little consideration to these important public policy
26 considerations. While RUCO sympathizes with the individual landowners
27 who are affected by the 2007 elimination of the free footage allowance,
28 RUCO believes that the benefit of maintaining lower electric rates for the
29 majority of the ratepayers outweighs the interests of a few. For this reason,
30 RUCO supports the provision in the Settlement Agreement that maintains the
31 current line extension policy.
32

1 While the Study comes to the conclusion that the change in the line extension
2 policy may negatively impact land values (Study at p. i), there is no
3 quantifiable data presented to show the amount of the impact. Furthermore,
4 there is nothing in the Study that distinguishes the impact the economic
5 recession and the fallout of the real estate market have had on property
6 values in comparison to the change in the line extension policy.

7 The Study itself states:

8 "It is unclear the extent that any increase in the cost of
9 energy and electrical infrastructure will impact builders'
10 and businesses' perceptions about Arizona. It is also not
11 clear the extent to which these perceptions will result in
12 slower economic growth, fewer business expansions, or
13 less homebuilding activity in the State...There is no way
14 of knowing with complete certainty the extent to which
15 the increased capital costs of extending power to a given
16 site will result in fewer homes being built over the long
17 run. Therefore, it is not possible to provide specific
18 estimates of economic losses as a result of this new
19 policy." (pp. 23-24)
20

21 Rick Merritt's deposition further illuminated the lack of correlation between the
22 line extension policy and land values.

23 "A. ...We did not conduct any analysis of land values or
24 the potential impact of the service schedule, the changed
25 Service Schedule 3 on the value of land.

26
27 Q. You did not analyze the potential impact of Service
28 Schedule 3 on the value of land?

29 A. Correct.

30
31 Q. Your study is thus not intended to present evidence
32 that the change in line extension policies actually caused the
33 economic impact you described in section 5 of your report?

34 A. Correct...
35

1 Q. Do I take it then that your study is not intended to
2 present evidence that the change in line extension policies
3 actually caused the impacts described in section 5?

4 A. Our analysis says that there is not enough information
5 available to determine what the impact would be of Service
6 Schedule 3. But for every 100 homes that may not be built
7 in this, in the APS service area or other service areas, there
8 is a particular impact on jobs and revenue that would be
9 developed and generated to cities, state, counties.

10
11 Q. Do you have any evidence that 100 homes will not be
12 built as a result of the changes to Service Schedule 3?

13 A. No, we do not.

14
15 Q. Do you have any evidence that 10 homes will not be
16 built as a result of the change to Service Schedule 3?

17 A. No, we do not.”

18
19 While the Study does not provide concrete and quantifiable data on the
20 financial impact of the change to the line extension policy, it does reflect the
21 same sentiment expressed by those who filed testimony, the authors of
22 several letters filed in this docket and the ratepayers who have attended the
23 public comment meetings.

24 “More than anything, the elimination of the no cost
25 extension and other policies that helped to subsidize
26 growth by these electric utility providers is an issue of
27 *fairness.*” (Study at p. 35).

28
29 As discussed in the Study and voiced at the public comment meetings, some
30 landowners feel trapped in their undeveloped lots due to increased costs of
31 construction that resulted with the 2007 policy change. Realtors and
32 developers whose ability to earn a living has been severely restricted due to
33 the economy feel that their troubles have only been magnified by the 2007
34 policy. Homebuilders who are looking for any advantage they can find to

1 keep their business doors open are seeking every opportunity to make it more
2 affordable to build homes. The statistical data might be lacking, but the
3 emotional tug of this issue is clear.

4

5 **Q. Is there more to be considered in deciding whether the line extension**
6 **policy should be changed again?**

7 A. This Settlement Agreement is just like any other settlement in that it consists
8 of numerous concessions, compromises and negotiated positions. For
9 example, one provision of the Settlement may be directly linked to another
10 provision and amending that one provision impacts the other. Such is the
11 case with the issue of the line extension policy. In an effort to minimize the
12 amount of the rate increase but still give APS sufficient operating revenues to
13 construct a healthy ROE, improve its credit ratings and enhance its FFO/Debt
14 ratio, the parties to the Settlement agreed that proceeds from Schedule 3 (line
15 extensions) would be treated as revenue for the next few years (Section X).
16 Currently, Schedule 3 proceeds are treated as Contributions in Aid of
17 Construction.

18 ...

19 ...

1 **Q. If the Commission decides to revise the line extension policy in this**
2 **rate case to include some sort of equipment allowance or free**
3 **footage allowance, how would that decision impact other**
4 **components of the Settlement Agreement?**

5 A. Treatment of Schedule 3 proceeds as revenue is a material provision of the
6 Settlement Agreement. APS estimates Schedule 3 revenues to be \$23
7 million in 2010, \$25 million in 2011 and \$49 million in 2012. These sums
8 were a significant consideration in reaching an agreement on the revenue
9 requirement and overall magnitude of the rate increase. Without this
10 treatment of Schedule 3 proceeds, there was very little chance that the
11 parties could have come to a mutually acceptable agreement on the size of
12 the revenue increase. To further complicate the consideration of altering the
13 existing line extension policy, Section X of the Settlement Agreement is
14 directly linked to Section II. Section II prevents new base rates until at least
15 July 1, 2012. Section II is particularly important to RUCO. Without sufficient
16 revenue in years 2010, 2011 and 2012, APS would not be able to “stay out”
17 for 2 ½ years without another rate case application. After a continuous string
18 a rate cases, RUCO believes that the ratepayer deserves a break from
19 increasing utility bills.

20
21 If the Commission does decide to alter the line extension policy to allow for
22 some form of free footage or equipment allowance, it should recognize
23 economic realities and find a viable alternative way to pay for these costs. If

1 the Commission does not allow the Company to recover the costs associated
2 with a free footage allowance, the results will not be in the best interests of
3 the residential ratepayer for three closely related, very important reasons.

4
5 First, if the Commission does not allow the Company to recover the expenses
6 associated with line extensions in base rates or some other form of recovery,
7 then the Company will pay for the costs of these line extensions from
8 investor-provided capital. Typically, capital assets that are paid for in this
9 manner will enter the rate base and the Company will receive a rate of return
10 on these capital assets as well as reimbursement of the cost through the
11 depreciation process. Over the long haul, this treatment will burden other
12 ratepayers by substantially more than \$0.20 per month (as mentioned earlier
13 in my testimony) which is calculated based on immediate cost recovery.

14
15 Second, if the Settlement is rejected and a protracted and litigated rate case
16 becomes necessary, it could produce detrimental consequences for **APS and**
17 **its ratepayers** on Wall Street. It is certain that APS' credit ratings would not
18 be upgraded and they may possibly be downgraded while the case is
19 pending. This would affect APS' ability to borrow money at reasonable rates
20 and even hamper its ability to attract investors to infuse equity into its capital
21 structure (See RUCO direct testimony, Johnson at pp. 18-28, Jerich at pp.9-
22 11). The Settlement Agreement requires APS to maintain investment grade
23 ratios and to strengthen its capital structure with no more than 52% debt/total

1 capital, as well as a commitment to invest at least \$700 million of equity into
2 the Company (Section VIII). RUCO fought hard for these very important
3 provisions. A change in the line extension policy without a corresponding
4 increase in revenue could lead to the collapse of the Settlement Agreement.
5 If this happens, a ratings downgrade may make it difficult – if not impossible –
6 for APS to make the required improvements to its financial health as set forth
7 in the Settlement Agreement. (Johnson Direct Testimony pp. 28-29).²

8
9 Third, it is possible that one or more parties may withdraw from the
10 Settlement Agreement because of the material change to the revenue
11 agreement. Such action would result in a protracted, litigated rate case with
12 the potential for appeal. Unraveling the Agreement would bring about a
13 cascade of other consequences. With this Settlement Agreement, the
14 Commission has a great opportunity to bring important and far reaching
15 energy efficiency and renewable energy goals to Arizona. While some of
16 these measures are being contemplated in the energy efficiency workshop,
17 the cost recovery mechanism in the Settlement Agreement is more ratepayer
18 friendly than the options being proposed in the workshop. Furthermore, while
19 the Commission may decide to increase RES minimum requirements, the
20 Commission has the opportunity to bind APS to higher goals **now** through the
21 Settlement Agreement. Finally, if the Commissioners want to adopt some

² APS noted that upon announcement of the Settlement Agreement, Pinnacle West's outlook was upgraded from "Neutral" to "Outperform". (See Hatfield Direct at p.9). It is logical that if reaching a settlement was beneficial, then the unraveling of the settlement would have a corresponding negative impact.

1 sort of free footage allowance in the APS line extension policy in this case,
2 then that decision can be placed in effect sooner if the changes are
3 effectuated in a manner that allows the Settlement Agreement to remain
4 intact, thereby achieving a resolution to the rate case without lengthy (and
5 appealable) litigation.

6

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

8 A. Yes.

9