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August 25, 2005

Re: APS Application for Surcharge; Operation of the Surcharge and Purchase Supply Adjustor; $100 million surcharge cap. Docket No. E-01345A-05-0526

Dear Parties to the Docket:

I am in receipt of APS and RUCO's responses to my August 4 letter in which I posed a number of questions regarding the Company's request for a surcharge in advance of the adjustor rate portion of the PSA. I appreciate APS and RUCO's prompt attention to my concerns but a number of my questions remain unanswered. I also have one additional question regarding implementation of the PSA.

Prudence of expenses related to Palo Verde Nuclear Generating Station ("PVNGS") outages and the fairness of assessing them against ratepayers

The Company acknowledges in its letter that the forced outages which occurred at PVNGS from May 23 to June 24 and July 6 to July 13 did have an impact on the Company's fuel and purchased power costs. APS believes that those costs should nevertheless be included in the surcharge and passed on to ratepayers.

First, I would like for APS to specifically detail how much of the surcharge request is associated with higher costs resulting from the PVNGS outages, broken down by day and market purchases. Please include estimated power replacement costs associated with the most recent outage at PVNGS Unit 2, which began on Monday and was attributed to a software malfunction, as well as the shut-down of Unit 1 beginning on Aug. 12, which was determined to be due to a problem with a valve.

Second, the Company asserts that such outages are a fact of life and that the Commission's rules posit a presumption of prudence for utility procurements of fuel and purchased power, citing A.A.C. R14-2-102 (A) (3) (l) (The Company mistakenly cited this rule; the correct citation is A.A.C. R-14-2-103). APS also suggests that if the Commission would like to conduct an examination of the prudence of its actions, it should only be done after these charges are passed on to ratepayers, in the context of a full rate case.

However, the rule that APS cites was promulgated in the 1970s, before the proliferation of adjustors and at a time when companies – not ratepayers – bore the burden associated with fuel volatility. Under the terms of the Settlement Agreement, that burden was reversed, and today, nearly all fuel costs are passed directly on to ratepayers. Given that ratepayers are now required to cover the vast majority of the Company's fuel costs, I would like the parties to address the applicability of A.A.C. R-14-2-103 to the present day operation of adjustors and surcharges.

Moreover, if the Commission were to determine that the presumption of prudence applies here, why wouldn't there be time to conduct an examination of the PVNGS-related costs either prior to November, when APS has asked for the surcharge to be approved, or prior to the time the adjustor rate portion of the PSA is scheduled to go into effect in April 2006?

Finally, if the Commission were to do as APS suggests, and allow the surcharge to pass on up to $100 million in fuel costs immediately, and it was later determined that some of those costs were not prudent, how would the Company propose to return those funds to its customers? RUCO suggests that this could be done through the PSA. Do the other Parties agree?

APS response to the evidentiary record and Open Meeting record

In response to the questions I asked regarding the evidentiary and Open Meeting records, APS stated that it does not interpret the record as suggesting that the surcharge could never operate before the adjustor. Rather than address each instance of the record cited in my letter in which a witness or judge seems to suggest that the surcharge would come after the adjustor rate portion of the PSA, the Company writes that no one ever states on the record that the surcharge could *never* come before the adjustor rate portion of the PSA. The Company also cites Commissioner Hatch-Miller's amendment, which was designed to prevent the surcharge from ballooning out of control, in particular relying on its provision that "in no event" should the surcharge bank balance be allowed to reach $100 million. The Company suggests that if the Commission wanted to ensure that the surcharge would come after the adjustor rate portion of the PSA, it should have qualified the words "in no event" to specify its intentions. But couldn't it also be the case that the Commission did not feel the need to qualify the words of Commissioner Hatch-Miller's amendment because the totality of the record was clear on this point and that the Commission was operating based on that record? Could the amendment be read to mean that the balancing account was not to be permitted to exceed $100 million, once the adjustor rate portion of the PSA was in place and operational?

Surcharges are adjustors to adjustors

The Company in its response also sidesteps my question about whether traditionally surcharges have been considered adjustors to adjustors. Instead, APS states that "The regular April adjustment is intended to better reflect and recover ongoing fuel and purchased power costs by using the preceding year's fuel and purchased power cost per kWh. The PSA surcharge is to recoup past fuel and purchased power costs in excess of the base fuel amount plus the annual PSA factor." This statement may or may not be an accurate reflection of the feelings of the parties, but how does it address the temporal question I raised about whether surcharges are ever intended to go before their adjustors?

Additionally, can the Parties to this case cite any instance in which this Commission has permitted a surcharge to operate prior to the underlying adjustor mechanism?

$100 million surcharge – hard-capped, one-time event or perpetual recovery

In my letter to the Parties I asked whether they believed the Commission intended for the surcharge to be capped at $100 million. In response the Company states that nowhere in the record do the Parties or the Commission indicate that the surcharge was to be capped, and that the "discussion was to the contrary." Like APS, I have exhaustively reviewed the record in this case and nowhere in it have I come across evidence that the Parties *didn't* intend for the surcharge to be capped. Could APS or the other Parties specifically provide a citation to the record demonstrating that the surcharge was intended to be a perpetual recovery?

Interpretation of the starting time of the PSA

Upon further reflection and review of the Settlement Agreement, I would like the Parties to address a key underlying question regarding when the adjustor rate portion of the PSA was actually meant to be initiated. According to the terms of the Settlement Agreement, the adjustor rate portion of the PSA would be initially set at zero and then reset on April 1, 2006. It appears that in order to determine whether a surcharge is appropriate at this time, we will first have to decide whether the adjustor rate portion of the PSA was meant to be initiated in 2005, with the signing of the Order, or whether it was designed to be effective as of April 1, 2006. Do the Parties believe that the adjustor rate portion of the PSA was to be in place in 2005, or April 1, 2006? If the latter is the case, then do the Parties believe that the PSA would kick in at that point, followed by the surcharge? In addition, if the adjustor rate portion of the PSA was not in place until April 1, 2006, how would APS then calculate the adjustor rate portion and surcharge portions of the PSA at that time?

I look forward to the Parties' further consideration of these questions. Your responses will aid me in my consideration of the surcharge Application.

Sincerely,

Kris Mayes
Commissioner

Cc: Chairman Jeff Hatch-Miller
Commissioner Marc Spitzer
Commissioner William Mundell
Commissioner Mike Gleason
Ernest Johnson
Stephen Ahearn