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October 6, 2006

Chairman Hatch-Miller
Commissioner Gleason
Commissioner Mayes
Commissioner Wong
Parties to the Docket

Re: APS' Application for a Rate Increase; Docket No. E-01345A-05-0816
Palo Verde Nuclear Outages During Summer 2005; Docket No. E-01345A-0826
Fuel and Purchased Power Practices of APS; Docket No. E-01345A-05-0827

Dear Colleagues and Parties to the Docket:

I am aware that this Commission has traditionally allowed the calculation of a utility's income taxes on a stand-alone basis for ratemaking purposes. I am also aware that some commissions in other states take a different approach.

At the upcoming hearing in APS' general rate case, I want the parties to be prepared to answer questions about APS' and Pinnacle West's income taxes. APS collects taxes calculated on a stand-alone basis through rates. Does it pay this amount directly to the IRS or does it forward the amount to Pinnacle West for preparation of a consolidated return? Does APS' participation in a consolidated return reduce its actual income tax liability? If that is the case, then how much is the tax savings? If there is tax savings, then how is it allocated between the parent and its subsidiaries?

The parties should also be prepared to take part in a discussion of the merits of the calculation of taxes on a stand-alone basis, the method that this Commission has historically followed, as opposed to the "actual taxed paid" concept which has been followed by the commissions in Pennsylvania[1] and Oregon.[2]

Thank you for your attention to this matter.

Sincerely,

William A. Mundell

William A. Mundell, Commissioner
Arizona Corporation Commission

cc: Brian McNeil
Ernest Johnson
Lyn Farmer
Chris Kempley
Heather Murphy

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[1] *Barasch v. Pennsylvania Public Utility Commission*, 493 A.2d 653 (1985).
[2] Oregon Public Utility Commission Order No. 06-532.