

120 FERC ¶ 61,262
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Philip D. Moeller,
and Jon Wellinghoff.

Arizona Public Service Company

Docket No. ER07-1142-000

ORDER ACCEPTING AND SUSPENDING PROPOSED FORMULA RATES
SUBJECT TO CONDITIONS AND ESTABLISHING HEARING AND SETTLEMENT
JUDGE PROCEDURES

(Issued September 21, 2007)

1. On July 10, 2007, Arizona Public Service Company (APS) filed revisions to its Open Access Transmission Tariff (OATT) to implement new formula rates. APS requests that the revised rates be accepted for filing 60 days after the date of filing, with billing at the new rates to be effective on the first day of the month following such acceptance for filing, October 1, 2007.
2. As discussed below, we accept the proposed revisions to the OATT and suspend them for five months to become effective on March 1, 2008, subject to refund. In addition, we direct a compliance filing and establish hearing and settlement judge procedures.

I. Background

3. APS is a wholly owned subsidiary of Pinnacle West Capital Corporation and a public utility incorporated in the state of Arizona. APS engages in the generation, transmission, distribution and sale of electricity in interstate commerce, and owns facilities used for the sale and transmission of electric energy in interstate commerce. APS provides point-to-point transmission service, network integration transmission service, and ancillary services to wholesale jurisdictional customers under its OATT. The present rates for transmission services were established by settlement in Docket No. ER96-2401,¹ and use 4-Coincident Peak and seasonal rate methodologies. APS also

¹ *Arizona Public Service Co.*, 87 FERC ¶ 61,314 (1999) (letter order approving settlement).

provides for retail network integration transmission service and ancillary services to retail customers under Schedule 11 of its OATT. The present rates for transmission services for retail customers were established in Docket No. ER99-4577.²

II. Instant Filing

4. In its July 10, 2007 filing, APS seeks to implement formula rates for wholesale and retail transmission services to more accurately reflect the costs that APS incurs in providing transmission services.³ The proposed formula rate will automatically update annually based on FERC Form No. 1 (Form 1) data for the previous calendar year and planned capital expenditures for the current year.

5. Specifically, APS's proposed formula calculates APS's prior year costs to own, operate, and maintain its transmission facilities using traditional cost components. The formula uses Form 1 data and records and produces an annual transmission revenue requirement that includes return and income taxes based on a year-end rate base, operation and maintenance expense, depreciation and amortization expense, amortization of other expenses, and taxes other than income tax expense. The rates would change on June 1 of each year, based on the prior year's costs. APS will use this annual transmission revenue requirement, together with the prior year's 4-Coincident Peak load, to calculate the rate for network and point-to-point transmission service. APS has proposed the following modifications to its OATT to implement this change.

6. APS proposes to change Schedules 7, 8 and 11 and Attachment H of its OATT. APS modified Schedule 7 to reflect the formula rate for firm point-to-point transmission service and Schedule 8 to reflect the formula rate for non-firm point-to-point transmission service. APS changed Schedule 11 to reflect the formula rate for retail network integration transmission service and to split the General Service 0 to 2999 kW into two separate classes consisting of General Service 0 to 20 kW and General Service greater than 20 kW to less than 3000 kW in order to conform with current retail rate design. APS modified Attachment H so that it sets forth the rate formula methodology for determining APS's Total Transmission Revenue Requirement and provides for an annual informational filing. In addition, the definition for "Service Year" has been added to Section 1 of the OATT.

7. APS is not seeking authorization for any specific plant additions to earn incentives. However, APS does propose to include in rate base 50 percent of all Construction Work in Progress (CWIP) (without return on equity (ROE) incentive)

² *Arizona Public Service Co.*, 89 FERC ¶ 61,226 (1999).

³ In this filing, APS does not propose any changes to ancillary service charges or its loss factors.

associated with all transmission investment in lieu of recording Allowance for Funds Used During Construction (AFUDC) on such amounts. APS states that it anticipates a transmission plan totaling approximately \$1 billion over the next ten years. APS contends that inclusion of 50 percent of CWIP will help ensure APS's financial health during this construction period and describes how APS will account for inclusion of CWIP in rate base.⁴

8. APS states that, to the extent feasible, it has complied with the Commission's filing requirements for the inclusion of CWIP in rate base. APS explains that its filed testimony, along with APS's 2007-2016 Ten Year Plan, and the Arizona Corporation Commission's Fourth Biennial Transmission Assessment⁵ all support the need for the major transmission projects APS is proposing over the next ten years. APS requests a waiver of the Commission's requirement for forward-looking ratios and requests waiver of the other applicable CWIP filing requirements if it does not adequately meet them. APS also requests waiver of any requirements to submit a Period II cost of service study.

9. APS explains that the formula rate includes a return on equity of 11.3 percent. APS states that this ROE percentage is within the range of reasonableness, considering APS's capital expansion plan and weakened credit standing.⁶

10. APS asserts that the formula rate methodology it proposes is consistent with the methodologies previously approved by the Commission. APS requests that the revised rates be effective on the first day of the month following the acceptance of the filing, October 1, 2007. APS requests that to the extent the Commission determines the filing requires further investigation, that any suspension of the rates be for a nominal period.

III. Notice of Filing, Interventions and Protests

11. Notice of APS's filing was published in the *Federal Register*, 71 Fed. Reg. 40,849 (2007), with interventions and protests due on or before July 31, 2007. Timely motions to intervene were filed by the Public Service Company of New Mexico, Tucson Electric Power Company and UNS Electric, Inc. The Arizona Corporation Commission (ACC)

⁴ See APS filing, Appendix F, Exhibit No APS-17, Testimony of Jason C. LaBenz.

⁵ Arizona's line siting statute requires utilities to file ten year plans regarding the construction of transmission lines and requires the Arizona Corporation Commission to review the plans biennially, a process called the Biennial Transmission Assessment (BTA). See A.R.S. § 40-360.02(G).

⁶ See APS filing, Appendix E, Exhibit No APS-11, Testimony of William Avera.

filed a notice of intervention and protest. The Arizona Districts⁷ filed a joint motion to intervene out of time. On August 15, 2007, APS filed an answer to ACC's protest.

12. The ACC, which regulates APS as a public service corporation in Arizona, requests that the Commission suspend implementation of APS's proposed rates for an appropriate period, subject to refund, and set the matter for hearing. The ACC also requests an extension of time to more fully address the merits of APS's rate filing. The ACC maintains that it cannot timely evaluate the filing within the twenty-one day comment period.⁸ The ACC states that it would like to retain a consultant to evaluate APS's filing and requests that the Commission establish a procedural conference after its consultant has concluded the evaluation. In addition, the ACC states that it would like to meet with APS personnel to assess the relationship between APS's transmission cost adjuster and its proposed formula rates.⁹ The ACC explains that after a more complete review of APS's filing, it will submit additional comments or protests. Until then, the ACC requests that the Commission not issue any rulings in this matter.

13. As an initial protest, the ACC states it is concerned by APS's proposed use of forward-looking costs, such as including 50 percent of CWIP and forecasted transmission plant in its rate base calculation. The ACC argues that such methodologies may violate Arizona case law requiring the use of historic test year data in implementing transmission cost adjusters. The ACC asserts that APS's current transmission cost adjuster is based on historic data and assumes a fixed rate. Further, the ACC argues that APS appears to justify the use of formula rates with reasons previously rejected by the ACC.

⁷ The Arizona Districts include: Aguila Irrigation District, Buckeye Water Conservation & Drainage District, Electrical District No. 6 of Pinal County, Electrical District No. Seven of Maricopa County, Electrical District No. 8 of Maricopa County, Harquahala Valley Power District, Maricopa County Municipal Water Conservation District No.1, McMullen Valley Water Conservation & Drainage District, Roosevelt Irrigation District, and Tonopah Irrigation District.

⁸ The ACC states that its request for an extension of time is based in part on the requirement established in ACC Decision No. 67744, *Re: Arizona Public Service Co.*, 241 P.U.R. 4th 181, 2005 WL 1163264 (Ariz.C.C.) that APS notify the ACC if it files a request to changes its transmission rates with the Commission. The ACC contends that despite APS's notification to the ACC of its filing, APS did not give the ACC staff sufficient time to prepare for participating in this proceeding.

⁹ In Decision No. 67744, the ACC required APS to establish a transmission cost adjuster to ensure that any potential direct access customers pay the same for transmission as standard offer customers. On August 8, 2007, the ACC notified the Commission that on August 2, 2007, it met with representatives from APS to discuss the instant filing.

Specifically, the ACC contends that APS's justification for formula rates in this proceeding is similar to APS's request for an "attrition adjustment," which the ACC rejected in Decision No. 69663.¹⁰

14. The ACC also objects to APS's reliance on the BTA as a reason for approval of the formula rates. The ACC states that its BTA is not a process for pre-approval of the construction of transmission lines and clarifies that, pursuant to Arizona's line siting statute, APS must still apply for and receive a Certificate of Environmental Compatibility prior to constructing a transmission line of 115 kV or higher.¹¹ The ACC objects to what it views as an attempt by APS to obtain inappropriate pre-approval for \$1 billion in transmission projects and requests that the Commission not rely on the BTA to approve APS's formula rates.

15. Finally, the ACC opposes APS's request to waive the Commission's requirements for a full Period II cost of service study and for forward-looking allocation ratios. The ACC is concerned that the use of forward-looking ratios would result in retail customers subsidizing wholesale customers with regard to CWIP recovery. As a result, the ACC requests that the Commission deny APS's request for waiver of the CWIP filing requirements, but states that it would like additional time to evaluate APS's waiver requests.

16. In its answer, APS requests that the Commission defer action on the filing until September 30, 2007,¹² so that the ACC may conduct additional review of the filing, as the ACC requests. However, APS opposes an indefinite extension of time and states that it fully complied with the procedures established in ACC Decision No. 67744, as well as Commission rules, by timely filing a notice of the instant filing with the ACC.

17. APS asserts that, contrary to the ACC's position, APS's requested waivers are consistent with Commission precedent and should be granted. APS also opposes the ACC's request for a full evidentiary hearing. APS contends that there are no genuine

¹⁰ See ACC Decision No. 69663, *Re: Arizona Public Service Co.*, 2007 WL 2126363 (Ariz.C.C.) In Decision No. 69663, APS requested an "attrition adjustment" to compensate for the alleged tendency of utilities' rates of return to diminish over time because of operating costs that increase faster than revenue, capital costs growing faster than earnings, or a combination of both. The ACC rejected APS's request because it was an "attempt to account for unmeasurable and unknown future actions and events [and] would necessarily create unjust rates and charges immediately in order to possibly achieve just and reasonable rates at some unknown point in the future."

¹¹ See A.R.S. § 40-360.07(A).

¹² APS still requests an effective date of October 1, 2007.

issues of material fact, and that the allegation the formula rates are inconsistent with ACC precedent is irrelevant given the Commission's exclusive jurisdiction over interstate transmission. APS contends that its request for formula transmission rates is consistent with Commission precedent and that the inclusion of 50 percent of CWIP in rate base achieves a suitable balance between the APS's need to recover costs in a timely manner and the customer's desire to reduce the financial impact of new transmission projects. APS also points out that the Commission has approved the use of formula rates and 50 percent CWIP for a transmission provider whose proposed expansion plans cost two to three times what APS's plans costs.¹³ In addition, APS states that its filing is not a request for pre-approval of all present and future transmission costs because it includes a true-up mechanism and review procedures. Third, APS asserts that despite the ACC's contention, APS properly included the BTA in its filing. APS explains that its purpose for including the BTA in the filing was to provide further information in support of Statement BM,¹⁴ and not to imply that all of the projects described were already approved.

IV. Discussion

A. Procedural Matters

18. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2007), notices of intervention and the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

19. Pursuant to Rule 214(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214(d) (2007), the Commission will grant the Arizona Districts' late-filed motion to intervene given their interest in the proceeding, the early stage of the proceeding, and the absence of undue prejudice or delay.

20. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2007), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept APS's answer because it has provided information that assisted us in our decision-making process.

¹³ See *American Transmission Co.*, 105 FERC ¶ 61,388 (2003), *order approving settlement*, 107 FERC ¶ 61,117 (2004).

¹⁴ Statement BM requires a utility to describe its long-range program for providing reliable and economic power, include and assessment of the relative costs of adopting alternative strategies, and provide and explanation of why the program adopted is prudent and consistent with a least-cost energy supply program. See Order No. 298, FERC Stats. & Regs. ¶ 30,455 (1983).

B. Proposed Formula Rate Filing

21. For the reasons discussed below, we will accept APS's formula rate proposal and suspend the tariff for a full five months, to become effective March 1, 2008, subject to refund, and require a compliance filing to address certain deficiencies in the filing. In addition, we will establish hearing and settlement judge procedures.

1. Suspension

22. Our preliminary analysis of APS's proposed formula rate indicates that certain components of the proposed formula have not been shown to be just and reasonable, and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. In *West Texas Utilities Company*,¹⁵ the Commission explained that when its preliminary examination indicates that the proposed rates may be unjust and unreasonable, and may be substantially excessive, as defined in *West Texas*, the Commission would generally impose a five-month suspension. In the instant proceeding, we find that the proposed rates may be substantially excessive. Therefore, we will suspend APS's proposed change for the maximum five month period.

2. Hearing and Settlement Judge Procedures

23. APS's proposed formula rates raise issues of material fact that cannot be resolved based on the record before us, and that are more appropriately addressed through the hearing and settlement judge procedures.

24. Accordingly, among the issues to be examined at hearing are: (1) the proposed return on equity; (2) allowance for extraordinary property losses;¹⁶ (3) summer and non-summer coincident peak data;¹⁷ (4) retained revenues associated with secondary uses of the company's transmission assets;¹⁸ (5) revenue credit data for "Point to Point Service revenues for which the load is not included in the divisor received by Transmission Owner";¹⁹ (6) the meaning of the reference that "revenues related to transmission...will be included as a revenue credit or included in the peak";²⁰ (7) use of end-of-year rate

¹⁵ 18 FERC ¶ 61,374-75 (1982) (*West Texas*).

¹⁶ APS filing, Appendix D, Exhibit APS-10 at lines 64, 65.

¹⁷ *Id.* lines 172, 174.

¹⁸ APS filing, Appendix D, Exhibit APS-10, Attachment 3 at line 16.

¹⁹ *Id.* line 5.

²⁰ *Id.* line 14.

balances; (8) the proposed inclusion in rate base 50 percent of all transmission CWIP; and (9) the calculation of AFUDC.²¹ The hearing shall address all issues raised by the filing, and is not limited to those mentioned in this order.

25. In setting APS's proposed inclusion of CWIP in rate base, we note that APS has not adequately justified its request. While APS's testimony and Ten Year Plan includes summary information on several transmission projects, APS provides limited information to support its estimated \$1 billion transmission investment and fails to explain which projects will add a total of 2,000 MW of transmission capability. It is not clear from the filing whether APS assessed the relative costs of alternative strategies. APS also does not adequately explain why its program is prudent and consistent with a least-cost energy supply program. We will, therefore, provide APS an opportunity at the hearing to demonstrate that it meets the requirements of Order No. 298 in order to include 50 percent CWIP in rate base for the ten-year period.

26. The Commission has recently allowed regulated utilities to include incentive placeholders in their rate formula.²² APS's filed formula contains no values with respect to these placeholders, and we direct APS to maintain a value of zero in its formula template. APS must apply for authorization to recover incentives through the formula under a future section 205 filing. Furthermore, we direct the parties at the hearing to ensure that the formula components, including the placeholders for future incentives, follow Commission-approved methodologies, work as intended and calculate the incentives correctly when authorized for specific projects.

27. Finally, we direct APS to submit a compliance filing within 60 days of the issuance of this order with the following modifications.

- Attachment H provides that the annual transmission revenue requirement and the gross rate for network integration transmission service and retail network integration transmission service are equal to "the results of the formula shown in Attachment H-1." We find that this tariff language does not specify which of the 181 lines of the formula in attachment H-1 represents the results used to determine the annual transmission revenue requirement and the gross rate. We therefore

²¹ See *Amendments to Uniform System of Accounts for Public Utilities and Licensees and for Natural Gas Companies (Classes A, B, C and D) to Provide for the Determination of Rate for Computing the Allowance for Funds Used During Construction and Revisions of Certain Schedule Pages of FPC Reports*, Order No. 561, 57 FPC 608 (1977), *reh'g denied*, Order No. 561-A, 59 FPC 1340 (1977), *order on clarification*, 2 FERC ¶ 61,050 (1978).

²² *San Diego Gas & Electric Company*, 118 FERC ¶ 61,073 at P 23 (2007); *American Electric Power Service Corp.*, 120 FERC ¶ 61,205 at P 36 (2007).

direct APS to revise Attachment H to specify the line numbers from the formula and include a definition of gross rate as this term is not defined in the tariff.

- Consistent with *Duquesne Light Company*,²³ we direct APS to add to section 1.b of the Formula Rate Implementation Protocols²⁴ (Protocols) that APS will make an informational filing with the Commission when it calculates its annual update to its transmission revenue requirement.
- We direct APS to amend section 1.g of the Protocols to include a requirement that APS will submit as part of its annual update to its transmission revenue requirement any proposed changes to the amount of CWIP in rate base.²⁵
- We find that language in section 2.e of the Protocols on depreciation expense is unclear. We therefore direct APS to modify language in this section to simply state that the project's depreciation expense should be calculated on capitalized AFUDC for plant in service.
- Section 5 of the Protocols contains erroneous references to the Commission's regulations and should be corrected to refer to section 35.19a.

28. While we are setting all issues raised by the filing for a trial-type evidentiary hearing, we encourage the participants to make every effort to settle their dispute before hearing procedures are commenced. To aid the parties in their settlement efforts, we will hold the hearing in abeyance and direct that a settlement judge be appointed, pursuant to Rule 603 of the Commission's Rules of Practice and Procedure.²⁶ If the parties desire, they may, by mutual agreement, request a specific judge as the settlement judge in the proceeding; otherwise, the Chief Judge will select a judge for this purpose.²⁷ The settlement judge shall report to the Chief Judge and the Commission within 30 days of

²³ *Duquesne Light Company*, 118 FERC ¶ 61,087 at P 74 (2007)

²⁴ APS FERC Electric Tariff, Thirteenth Revised Volume No. 2, Attachment H-2.

²⁵ See *Southwestern Electric Power Company*, 36 FERC ¶ 61,081 (1986), *Boston Edison Company*, 111 FERC ¶ 61,266 (2005).

²⁶ 18 C.F.R. § 385.603 (2007).

²⁷ If the parties decide to request a specific judge, they must make their joint request to the Chief Judge by telephone at (202) 502-8500 within five days of this order. The Commission's website contains a list of Commission judges and a summary of their background and experience (www.ferc.gov – click on Office of Administrative Law Judges).

the date of the appointment of the settlement judge, concerning the status of settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions or provide for commencement of a hearing by assigning the case to a presiding judge.

The Commission orders:

(A) APS's proposed formula rates are hereby accepted for filing and suspended for five months, to become effective March 1, 2008, as requested, subject to refund, as discussed in the body of this order.

(B) APS is hereby directed to submit a compliance filing, within 60 days of the date of this order, as discussed in the body of this order.

(C) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and by the Federal Power Act, particularly sections 205 and 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the Federal Power Act (18 C.F.R. Chapter I), a public hearing shall be held concerning APS's proposed formula rates. However, the hearing shall be held in abeyance to provide time for settlement judge procedures, as discussed in Paragraphs (D) and (E) below.

(D) Pursuant to Rule 603 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.603 (2007), the Chief Administrative Law Judge is hereby directed to appoint a settlement judge in this proceeding within fifteen (15) days of the date of this order. Such settlement judge shall have all powers and duties enumerated in Rule 603 and shall convene a settlement conference as soon as practicable after the Chief Judge designates the settlement judge. If the parties decide to request a specific judge, they must make their request to the Chief Judge within five (5) days of the date of this order.

(E) Within thirty (30) days of the appointment of the settlement judge, the settlement judge shall file a report with the Commission and the Chief Judge on the status of the settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions, if appropriate, or assign this case to a presiding judge for a trial-type evidentiary hearing, if appropriate. If settlement discussions continue, the settlement judge shall file a report at least every sixty (60) days thereafter, informing the Commission and the Chief Judge of the parties' progress toward settlement.

(F) If settlement judge procedures fail and a trial-type evidentiary hearing is to be held, a presiding judge, to be designated by the Chief Judge, shall, within fifteen (15) days of the date of the presiding judge's designation, convene a prehearing conference in

these proceedings in a hearing room of the Commission, 888 First Street, N.E., Washington, DC 20426. Such a conference shall be held for the purpose of establishing a procedural schedule. The presiding judge is authorized to establish procedural dates and to rule on all motions (except motions to dismiss) as provided in the Commission's Rules of Practice and Procedure.

By the Commission. Commissioner Spitzer not participating.

(S E A L)

Kimberly D. Bose,
Secretary.