APS Direct Testimony
Executive Summary

Theodore N. Geisler
President
Arizona Public Service Company

Direct Testimony Overview

Mr. Geisler provides a general overview of the Company's rate request. He discusses APS's commitment to serve all customers with safe, reliable, and clean energy, as well as the steps the Company is taking to ensure that the APS energy grid is resilient to meet any challenges it faces. He explains the importance of the Company's financial stability to customers. Finally, he discusses the proposed changes to the Company's adjustment mechanisms.

Direct Testimony Key Points

- APS proudly serves more than 1.3 million homes and businesses in 11 of Arizona's 15 counties spanning roughly 35,000 square miles.

- APS customers are at the center of the work we do, and we have made and are continuing to make investments to serve and support our customers with safe, reliable, and clean energy. On average, the Company invests approximately $1.5 billion annually in building a reliable, more resilient energy grid for our customers. APS customers' average rates have remained flat and below the national average since 2018. Given rapid load growth in our service territory, and based on current and projected economic conditions, APS's rate proposal will allow us to improve our financial stability so we can cost-effectively access the capital needed to meet our customers' needs. Restoring financial stability reduces credit rating risk, improves equity investor confidence in the Company, and ensures that APS can access lower-cost capital, which in turn reduces overall costs for customers.

- APS continues to experience substantial customer growth in our service territory that has required significant additional investment during the Test Year. We expect growth to continue, while at the same time customers will experience increasing needs for energy resiliency and grid reliability. The requested rate relief will enable APS to continue to meet the following commitments to its customers: (1) ensure reliability and resilience of the energy grid; (2) secure a clean, balanced energy supply for Arizona; and (3) improve customer support.

- In order to meet these commitments to customers, APS is requesting an overall net customer rate increase of $460 million which represents a 13.6% increase to base revenues. In this case, the Company is requesting this increase to become effective on December 1, 2023. Our request is based on a Test Year ending June 30, 2022, a return on equity of 10.25%, and results in a 7.17% weighted average cost of capital. APS is also requesting a return on the fair value increment of 1%, resulting in a proposed fair value rate of return of 4.92%. Based on revisions APS is proposing to its current set of seven rate adjustment mechanisms, the day-one net bill impact of the requested rate increase on all customers is an average of 13.6%.

- Included in this case are several modifications to our adjustment mechanisms to simplify them, while maintaining the financial benefits of timely recovery of specified costs that promote rate gradualism and reduce the frequency of rate case filings. This includes the consolidation of seven current adjustors to four active and one inactive adjustor as follows:
    - Eliminate the Environmental Surcharge Adjustor and collect costs through base rates;
    - Eliminate the Lost Fixed Cost Recovery Mechanism and collect costs through base rates and the Demand Side Management Adjustor Mechanism;
    - Enhance the Renewable Energy Adjustor Charge to allow recovery of clean energy generation and storage investments to support balanced, clean investment while also promoting parity between APS-owned resources and purchased power agreements;
    - Maintain the Power Supply Adjustor to ensure timely recovery of fuel and purchased power costs;
    - Maintain as inactive the Tax Expense Adjustor Mechanism; and
    - Maintain the Transmission Cost Adjustor.

APS Direct Testimony
Executive Summary

Jacob Tetlow
Executive Vice President of Non-Nuclear Operations
Arizona Public Service Company

Direct Testimony Overview

Mr. Tetlow provides testimony on the Company's safety and reliability performance, its post-Test Year plant (PTYP) request, and its Coal Community Transition (CCT) proposal. He explains electric vehicle (EV) infrastructure efforts underway in support of the Statewide Transportation Electrification Plan, along with other generation and non-generation infrastructure investments projected to be necessary as APS increases its reliance on clean energy resources.

Direct Testimony Key Points

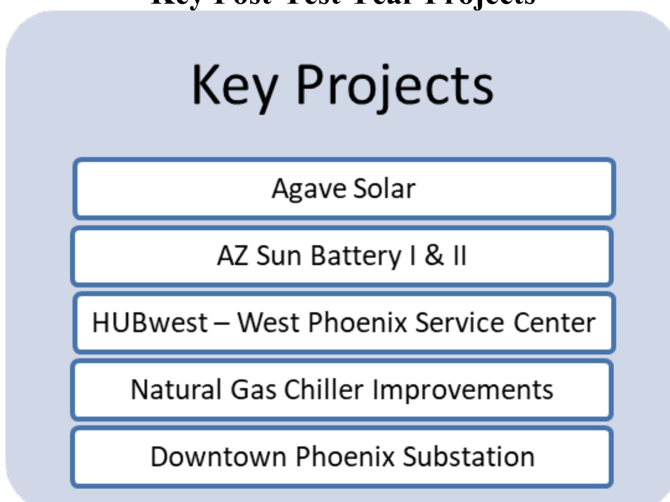
- The first and highest priority for all APS employees is to work safely and ensure the safety of the communities they serve. APS has a rigorous safety program and Safety Management System in place and continually looks to improve the effectiveness of its safety culture and ensure regulatory compliance.

- APS has over 35,000 square miles of service territory with an infrastructure spanning one of the most geographically diverse regions in the country. This area includes a variety of elevations, climates, and jagged terrains that can be challenging to navigate. The expansive territory over which this infrastructure must operate requires continual system maintenance to ensure the reliability customers expect in all weather conditions.

- APS provides industry-leading reliability and consistently delivers at or better than annual Edison Electric Institute (EEI) top-quartile reliability when compared to peer utilities across the country. Specifically, the Company has achieved top quartile System Average Interruption Frequency Index (SAIFI) performance nine out of the last ten years and top quartile System Average Interruption Duration Index (SAIDI) performance for eight out of the last ten years. It was also ranked in the top five among all U.S. utilities for "Perfect Power" at the end of 2021, a measure of the J.D. Power residential survey. This reliability performance is the result of many programs and strategies requiring significant investment to enhance grid resiliency.

- APS is requesting $1.5 billion in total Company gross capital expenditures for the 12-month period ending June 30, 2023, which is the 12-month period immediately after the Test Year in this case. In addition, APS will roll forward accumulated depreciation and taxes during the PTYP period, which further reduces its PTYP request by approximately $689 million. Thus, APS is requesting $788.8 million be added to rate base for PTYP. It is projected that all assets in the Company's PTYP request will be serving customers prior to the anticipated rate effective date in this case. The Figure below highlights a few of the projects included in the PTYP.

Key Post-Test Year Projects



- The investments that make up the Company's PTYP request are focused on the following: (1) securing a clean and balanced energy supply for Arizona through investments in renewable energy and energy storage projects in addition to improvements to APS's existing generation resources; (2) improving the information technology and physical facilities that support efficient and safe work processes, while also making them more sustainable; (3) ensuring that Palo Verde Generating Station—the nation's largest power producer of any kind for more than 25 years, all of it carbon-free—continues to provide safe and reliable service; (4) improving the resiliency, sustainability, and efficiency of APS's electricity delivery systems; and (5) ensuring that APS's non-nuclear generation provides clean, efficient, and top quartile performance that balances and maintains a reliable electricity grid.

APS Direct Testimony
Executive Summary

Monica Whiting
Vice President, Customer Experience and Communications
Arizona Public Service Company

Direct Testimony Overview

Ms. Whiting provides a summary of APS's recent customer service improvements and discusses the Company's proposals to meet its customer's evolving needs and expectations.

Direct Testimony Key Points

- APS's customers have experienced positive improvements as it relates to the customer experience. The Company's most recent J.D. Power results have APS in the second quartile for overall residential customer satisfaction and in the first quartile for overall business customer satisfaction.

J.D. Power Quartile Improvements to Attributes and Key Indicators Shaped by Communications

J.D. Power Customer Satisfaction Attributes and Key Indicators Shaped by Communications	2021 Quartile	Q3 2022 Quartile	Trend
Efforts to Communicate Changes that Affect Account/Service	4	2	↑
Creating Messages that Get Your Attention	4	3	↑
Recall of Utility Communications	3	2	↑
Ease of Understanding Your Pricing Options	4	2	↑
Efforts to Help You Manage Your Monthly Usage	4	2	↑
Customer Awareness of Energy Efficiency/Conservation Programs	2	1	↑

- APS is proposing to enhance the Company's Energy Support Program by establishing a tiered approach to limited-income customer support based on energy burden. The proposed structure has two tiers based on income level. Customers earning between 0-75% of the Federal Poverty Level (FPL) would receive a 60% discount off of their monthly bill, capped at $165 per month. Customers earning between 75%-200% of the FPL would receive a 25% discount, capped at $95 per month. Customers with qualifying medical equipment who earn between 75%-200% of the FPL would continue to receive the 35% discount they receive today. This proposal significantly enhances APS's already high levels of discounts for limited-income customers within the Company's service territory.

- Today, payment fees charged by vendors are passed onto customers directly when they make their payments. In this case, APS proposes to eliminate these payment fees for APS network payment types, and recover the vendor charges for individual transactions in base rates.

- To align with the federal holidays, APS also proposes to add two additional off-peak holidays for customers on time-of-use rates: Juneteenth and Indigenous Peoples' Day/Columbus Day.

APS Direct Testimony
Executive Summary

Andrew Cooper
Senior Vice President and Chief Financial Officer
Arizona Public Service Company

Direct Testimony Overview

Mr. Cooper explains how customers of regulated utilities benefit from a financially stable utility and describes the Company's current financial condition and its importance to Arizona. He provides testimony on the Company's fair value increment proposal, discusses some financial implications of APS's planned retirements of coal-fired resources, and shares information on a clean energy proxy group for the Company and its relationship to APS's proposed return on equity (ROE).

Direct Testimony Key Points

- Cost-effectively meeting the needs of APS's customers requires a balance between ensuring APS's access to capital on reasonable terms and maintaining a stable Arizona regulatory environment. Credit ratings and investor confidence in a financially stable utility company have a direct impact on how much customers pay for electricity. Additionally, establishing the opportunity to earn a fair and reasonable ROE and reducing regulatory lag on infrastructure investments benefits customers by supporting the development of clean, balanced, and resilient infrastructure.

- APS must seek rate relief to sustain the level of investment required to meet the growing needs of its customers. If current trends continue, APS will not have access to cost-effective capital—either debt or equity—to finance the investments necessary to keep up with growing demand within the Company's service territory. This has a direct impact on customers by leading to increases in costs. For instance, the Company has experienced recent credit rating downgrades that have placed upward pressure on APS's cost of short-term debt and its embedded cost of long-term debt, as new long-term debt securities will need to be issued at higher interest rates, which in turn will result in higher cost of debt going forward. That higher cost of debt increases the cost of capital necessary to finance APS's delivery of safe, reliable, and clean electricity and gets passed on to customers through electricity rates.

- The overwhelming trend for the 79 Investor-Owned Utilities in APS's Clean Energy Proxy Group is to retire legacy coal generation and replace that generation capacity with clean resources. Advanced-technology, clean-resource investments are not only a high-value and cost-effective means to provide service to customers, but they also leverage both capital-market preferences for more sustainable investing and recently expanded federal tax credits under the 2022 Inflation Reduction Act.

- Regulatory adjustment mechanisms provide benefits to both customers and the Company. Customers benefit from reduced frequency of rate cases, rate gradualism, the matching of costs and benefits, the ability to pass savings or benefits to customers faster, and the promotion of public policy goals that support customer programs such as energy efficiency, demand response, and access to renewable energy, among others. Investors, lenders, and credit rating agencies favorably recognize the benefits of regulatory adjustment mechanisms and their contribution to predictable and timely cash flows. These entities acknowledge the importance of adjustment mechanisms in reducing regulatory lag and supporting credit quality, which in turn reduces regulatory risk and APS's cost to access capital, which are reflected as customer cost savings.

- APS proposes a 1% return on the fair value increment, which is the difference between the original cost rate base and the fair value rate base.

APS Direct Testimony
Executive Summary

Justin M. Joiner
Vice President, Resource Management
Arizona Public Service Company

Direct Testimony Overview

Mr. Joiner provides an overview of the Company's resource planning and procurement processes, APS's near-term resource needs, and the importance of a diverse energy mix that includes clean energy resources. He describes how APS manages fuel and purchased power expenses and provides a near-term outlook on costs. Finally, Mr. Joiner outlines some of the Company's proposed changes to its AG-X program.

Direct Testimony Key Points

- Across western electricity markets, utility companies are facing serious resource deficiencies. For APS, these challenges are coupled with rapidly growing customer load and extreme weather events that in recent summers have strained electric grids across the Western United States. While neighboring regions have experienced generation reserve and capacity events, APS has been able to ensure that energy is available when customers need it, due to thoughtful resource planning and high performance from its generation resources.

- APS determines resource needs by developing an Integrated Resource Plan (IRP) based on forecasted loads and the resources projected to be necessary to service that load. APS's forecasts project that the Company's load will grow by 1,400 MW by 2026. APS plans to issue All-Source Requests for Proposals (RFPs) to meet the Company's future resource needs over that near-term period, which are being driven by the Company's growing customer demand, the retirement of the Cholla Power Plant, and the expiration of several third-party power purchase agreements (PPAs). APS expects this need to be met by a mix of APS-owned resources and PPAs and makes this determination on a case-by-case basis by evaluating multiple factors.

- A diverse energy mix helps ensure affordability through a balanced portfolio that hedges against commodity and price volatility of generation resources, and enhances resilience with respect to supply chain disruptions, weather patterns, and market conditions.

- Clean energy and storage resources are critical components of APS's diverse energy mix as they provide numerous customer benefits. These include resource cost competitiveness, enhancements to APS's resource diversity, protections for APS's customers from fuel price volatility, the ability to leverage tax incentives to reduce customer costs, and support access to and preservation of APS's access to low-cost capital. In addition, because of substantial customer demand for these resources and APS's high solar resource potential, these investments help create tremendous economic growth opportunities within APS's service territory.

- Natural gas-fired resources remain an important part of APS's energy mix as the Company works to incorporate more renewable resources into its portfolio, especially over the near-term as energy storage technology matures to increase storage durations and supply chains stabilize. Fast-ramping natural gas facilities enable the Company to meet the changing load needs throughout the day and when solar and wind energy resources fluctuate in output.

- The overall cost of fuel and purchased power has increased dramatically over the last two years since the Company's current base cost of fuel was calculated. Over that period, APS has continued its aggressive strategies to mitigate and hedge against the impacts on customers from purchased fuel and power. As of August 31, 2022, the Company's hedging program is expected to save customers $338 million related to natural gas prices in 2022 and approximately $221 million in 2023.

- APS is proposing changes to its large commercial customer electricity buy-through program, AG-X. To ensure resource adequacy, the Company proposes to provide AG-X customers the option to choose from two reserve capacity rates depending on whether they will rely on APS for resource adequacy or provide their own. The proposal also requires AG-X customers who supply their own resource adequacy to provide three years notice to leave the program versus the one year required by AG-X customers who rely upon APS to ensure resource adequacy for their buy-through transactions.

APS Direct Testimony
Executive Summary

Jessica E. Hobbick
Director of Regulation and Pricing
Arizona Public Service Company

Direct Testimony Overview

Ms. Hobbick's testimony provides an overview of the Company's proposed revenue increase and discusses the impact of the increase by customer class. She also explains the Company's proposed changes to its adjustment mechanisms, service schedules, and the AG-X program.

Direct Testimony Key Points

- A summary of the Company's proposed increase, inclusive of adjustor transfers, is summarized in the table below[1].

Net Impact = Net Base Rate Increase + Net Adjustor Changes	**Dollars**	**Bill Impact**
Base Rate Increase		
Total Revenue Deficiency	$772.27M	22.87%
Adjustor Transfers	($107.83M)	(3.19%)
Base Rate Increase Net of Adjustors	$664.44M	19.68%
Day-One Power Supply Adjustment (PSA) Revenue Reduction	($220.59M)	(6.53%)
Day-One Renewable Energy Adjustment Charge (REAC) CCT Revenue Increase	$16.09M	0.48%
Day-One Net Rate Impact	**$459.94M**	**13.62%**

[1] Numbers in this figure have been rounded for ease of presentation.

- APS proposes the following changes to its existing adjustors:

    - Eliminate the Lost Fixed Cost Recovery (LFCR) adjustor, by transferring $58.5 million of Test Year lost fixed cost revenues into base rates and recovering future lost fixed cost revenues in the Demand Side Management Adjustment Charge (DSMAC).
    - Eliminate the Environmental Improvement Surcharge and transfer $10.3 million into base rates.
    - Transfer the Test Year amount of $39.4 million collected in the DSMAC into base rates, which currently recovers $20 million of approved Demand Side Management (DSM) expenses and refine the existing performance incentive to include demand response program net benefits. Based on these changes, the total base rate collections for DSM would be $59.4 million going forward.
    - Revise the Renewable Energy Adjustor Charge (REAC):
        (i) to clarify the Plan of Administration (POA) to allow recovery of carrying costs associated with renewable energy generation and energy storage investments; and
        (ii) to recover Coal Community Transition (CCT) obligations.
    - Retain the Power Supply Adjustor (PSA) and reset the base fuel and chemical rate with a corresponding reduction to the adjustor.
    - Retain the Transmission Cost Adjustment (TCA) mechanism.
    - Leave the Tax Expense Adjustor Mechanism (TEAM) inactive and set at zero.

- APS is proposing to allocate the rate increase in similar proportions across customer classes. The impacts to each customer class are shown in the figure below.

Class	Requested Increase to Retail Revenue	Transfer from Adjustor Rates to Base Rates	Requested Increase to Base Rates	Day 1 PSA/REAC Changes	Day 1 Impact
Residential	22.79%	-3.7%	19.1%	-5.5%	13.6%
General Service					
Extra-Small, Small	23.75%	-3.0%	20.8%	-4.9%	15.9%
Medium	23.58%	-3.2%	20.4%	-7.0%	13.4%
Large	22.30%	-1.7%	20.6%	-7.6%	13.0%
Extra-Large	20.88%	-1.6%	19.3%	-10.1%	9.2%
Schools	24.17%	-5.2%	18.9%	-5.7%	13.3%
House of Worship	23.75%	-5.3%	18.5%	-4.8%	13.7%
Irrigation/Municipal	27.59%	-6.0%	21.6%	-7.9%	13.6%
Outdoor-Lighting	17.67%	-0.8%	16.9%	-3.3%	13.6%
Total Retail	**22.87%**		19.7%		13.6%

- Ms. Hobbick discusses the impacts of the Company's Energy Support Program, the two new off-peak holidays for time-of-use (TOU) customers, and payment fee removal proposals.

- Ms. Hobbick discusses APS's proposed modification to its AG-X program, including modifying the administrative charge, creating options for reserve capacity charges based on the customer's choice of resource adequacy, and expanding the eligibility guidelines to allow E-32 medium and small classes to participate.

- APS proposes to modify its service schedules as follows:

    - **Service Schedule 1** — Simplify and update existing language, including revisions to Section 12 (Limitations on Liability of Company) to make the language consistent with previously approved tariffs of peer electric and to eliminate inapplicable terminology.

    - **Service Schedule 3** — Simplify the construction process for customers by modifying the Statement of Charges methodology to a price per linear foot calculation and also reflect actual equipment costs at the end of the Test Year.

    - **Service Schedule 9** — Increase the availability of the economic incentive for rural applications by 25 MW and use job growth and capital investment criteria to determine the incentive eligibility in Section 4.3 (Effects on Competitors) in place of North American Industry Classification System (NAICS) codes (eliminating these references).

APS Direct Testimony
Executive Summary

Jamie R. Moe
Manager of Regulatory Affairs
Arizona Public Service Company

Direct Testimony Overview

Mr. Moe's testimony outlines APS's Cost of Service Study (COSS) used to support rate design in the Company's Application, as well as the jurisdictional allocation of costs. He also explains the Company's base fuel and purchased power pro formas and the fair value rate base calculation. In addition, Mr. Moe's testimony includes the results of APS's COSS using three methods to calculate costs to serve customers.

Direct Testimony Key Points

- The Company proposes to adjust the current base fuel and purchased power rate of 3.1451 ¢/kWh to 3.8321 ¢/kWh, an increase of 0.6870 ¢/kWh, with an equal and concurrent offset in the fuel costs recovered through the Power Supply Adjustor (PSA at the time rates determined in this proceeding go into effect.

- Mr. Moe sponsors the Company's embedded COSS. As directed by the Commission in its last rate case, APS utilized the Average and Peak (A&P) methodology to allocate production demand costs. The Company maintains that the A&P method does not adequately consider peak demand, which is the key driver for these costs, and requests that the Commission re-examine its preferred method to allocate production demand costs and adopt the Average & Excess (A&E) or 4-CP methods rather than the A&P method.

- APS also performed three separate COSS evaluations for residential solar classes as directed in Decision No. 78317: one using site load, another using delivered load, and a third combining solar customers with non-solar customers within their general rate class.

- Using the Commission-approved methodology of averaging the Original Cost Rate Base (OCRB) and the Reconstruction Cost New Less Depreciation (RCND), the calculated Fair Value Rate Base (FVRB) for APS is $16.6 billion and the current fair value rate of return is 1.43%. The fair value increment is $82.8 million.

APS Direct Testimony
Executive Summary

Elizabeth A. Blankenship
Vice President, Controller and Chief Accounting Officer
Arizona Public Service Company

Direct Testimony Overview

Ms. Blankenship provides the Company's historical and forecasted accounting information and pro forma adjustments required by the Arizona Corporation Commission's Standard Filing Requirements (SFRs) in support of this rate case filing. She sponsors historical financial information for the 12-month period that ended June 30, 2022, which was used as the Test Year in this proceeding, as well as financial information for any prior years or projected information presented on certain SFR Schedules.

She explains the capital structure of the Company and provides APS's actual overall cost of capital.

Direct Testimony Key Points

- APS's filing includes historical accounting data, including the actual data for the Test Year. The majority of this information is disclosed directly or indirectly in both the consolidated APS and consolidated Pinnacle West Capital Corporation audited and reviewed financial statements. This same information is included in filings made with the Federal Energy Regulatory Commission and Securities and Exchange Commission for the relevant years.

- The Total Company adjusted Original Cost Rate Base (OCRB) of $13.2 billion is included as well in APS's filing. The amount of the adjusted OCRB allocated to the Commission jurisdiction is $10.5 billion. APS is proposing a return on common equity of 10.25%, which is supported by testimony from APS witness Dr. Morin.

- Ms. Blankenship sponsors various rate base and income statement pro forma adjustments. These are consistent with prior filings and include normalizations, annualization, and out-of-period adjustments. All of the pro forma adjustments discussed in Ms. Blankenship's testimony reflect Total Company amounts prior to any jurisdictional allocation.

- Finally, APS's filing proposes a change to the allocation of the annual decommissioning funding between the three units at Palo Verde Generating Station.

APS Direct Testimony
Executive Summary

Dr. Roger A. Morin
Principal, Utility Research International

Direct Testimony Overview

Dr. Morin provides recommendations for APS's return on equity (ROE). Dr. Morin concludes that a minimum ROE of 10.25% is required for APS to attract capital on reasonable terms, maintain its financial integrity, and maintain an opportunity to earn a return commensurate with comparable risk investments.

Direct Testimony Key Points

- The standard for establishing a fair ROE requires that a regulated utility be allowed to earn a return equivalent to what an investor could expect to earn on an alternative investment of equivalent risk. Dr. Morin's approach to estimating the cost of equity for APS focuses on measuring the expected returns required from investments into companies that face business and financial risks comparable to those faced by APS. In accordance with recent trends across the market, risk perceptions of the electric utility industry have intensified dramatically, which is why cost of equity estimates for businesses operating in this sector are escalating.

- In developing his ROE recommendation, Dr. Morin applied a number of rigorous and generally-accepted cost of capital estimate methodologies, including the Discounted Cash Flow (DCF) model, the Capital Asset Pricing Model (CAPM), and a Risk Premium Model. Multiple methods are used, because no one single method provides the necessary level of precision for determining a fair return. Nonetheless, each method provides useful evidence to facilitate an informed judgment based on sound, generally-accepted methods across the industry.

- Dr. Morin concludes that a minimum ROE of 10.25% is required for APS to attract capital on reasonable terms, maintain its financial integrity, and maintain an opportunity to earn a return commensurate with comparable risk investments. This ROE is conservative, given the higher relative risks APS confronts by virtue of its significant external financing requirements from its large construction program, a rising interest rate environment, generally heightened industry risk across North American electric utilities, and operating within what is generally considered to be a high-risk regulatory environment.

- Dr. Morin explains that authorizing an ROE below the level required for investment into a comparably-risky enterprise can negatively impact customers. A low ROE ultimately leads to the utility having to rely on more debt financing, which results in investor uncertainty about future dividends and earnings. This in turn results in APS equity becoming a riskier investment. The risk of default on a company's bonds also increases, making the utility's debt a riskier investment. Collectively, the conditions resulting from an ROE set lower than comparable-risk enterprises increase the cost to the utility for both debt and equity financing. Ultimately, the increased cost to access capital increases costs for customers, while also increasing the risk that APS would not be able to access the capital needs for financing customer infrastructure needs.