DIRECT TESTIMONY OF ELIZABETH A. BLANKENSHIP

On Behalf of Arizona Public Service Company

Docket No. E-01345A-25-0105

June 13, 2025

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ATTACHMENT LIST

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ON BEHALF OF ARIZONA PUBLIC SERVICE COMPANY
(Docket No. E-01345A-25-0105)

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, POSITION, AND BUSINESS ADDRESS.

A. My name is Elizabeth A. Blankenship. I am the Vice President, Controller and Chief Accounting Officer for Arizona Public Service Company (APS or Company), a subsidiary of Pinnacle West Capital Corporation (Pinnacle West). I am primarily responsible for overseeing the financial accounting and reporting functions of the Company and Pinnacle West. My business address is 400 N. 5th Street, Phoenix, Arizona 85004.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL AND EDUCATIONAL BACKGROUND.

A. I received a Bachelor of Science degree in Business with a major in Accounting from Arkansas State University in 1993. From 1993 to 2000, I was employed as an accountant for two companies in the long-term healthcare service industry. I joined APS in October 2000 as a Senior Accountant, and during my 25 years at APS, I have worked in Accounting in various roles, with increasing levels of responsibility.

Prior to my current position as the Vice President, Controller and Chief Accounting Officer, I was responsible for overseeing the accounting functions of the generation, transmission, distribution, customer service, and corporate resource areas, as well as the accounting systems and budget governance functions at Pinnacle West and APS as the Director of Accounting Operations. Prior to that position, I was responsible for the revenue and regulatory accounting, asset accounting, accounts receivable, and cash control functions at APS as the Manager of the Revenue/Regulatory Accounting Department. I am a Certified Public Accountant and a member of the Arizona Society of Certified Public Accountants.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE ARIZONA CORPORATION COMMISSION (COMMISSION)?

A. Yes. I provided testimony in several of the Company's rate cases, including APS's most recent rate case, which was filed in 2022 in Docket No. E-01345A-22-0144 (2022 Rate Case).

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to discuss the various pro forma adjustments requested in the Company's rate case application, the reasoning for these adjustments, and how they impact the Company's expenses and overall rate request for the 12-month period ended December 31,2024 (Test Year).

II. SUMMARY

Q. PLEASE SUMMARIZE YOUR DIRECT TESTIMONY.

A. My testimony addresses the historical and forecasted accounting information and pro forma adjustments required by the Standard Filing Requirements (SFRs) of the Commission in support of the Company's rate case filing. I sponsor historical information for the 12-month period ended December 31, 2024, which was used as the Test Year in this proceeding, as well as any prior years and projected information presented as part of the following SFR Schedules:

- A-2 through A-5 – Summary Schedules;
- B-1, B-3 through B-5 – Rate Base Schedules;
- C-1 – Test Year Income Statements;
- C-3 – Computation of Gross Revenue Conversion Factor;
- E-1 through E-9 – Financial Statements and Statistical Schedules; and
- F-1 through F-4 – Projections and Forecasts

APS witness Jamie R. Moe jurisdictionalizes the Total Company data to separate those items that fall within the Commission's regulatory jurisdiction from those that do not.

I will also provide direct testimony on certain pro forma adjustments made to the Test Year on SFR Schedules B-2 and C-2. Specifically, I will be sponsoring the "Total Co." column for the following pro formas on SFR Schedule B-2:

- Include West Phoenix Unit 4 Regulatory Disallowance
- Adjust Cash Working Capital for Cost of Service
- Include Cloud Computing
- Include Accumulated Deferred Income Taxes (ADIT) Impact from Navajo Generating Station (NGS) Amortization Disallowance
- Include Wildfire Mitigation Operations and Maintenance Cost Accumulation
- Include E-3/E-4 Customer Bill Payment Fees Deferral
- Include Cholla Power Plant (Cholla) Unrecovered Costs Net of Ongoing Expense Recovery
- Include Palo Verde Lease Buyback
- Include Federal Energy Regulatory Commission (FERC) Order 898 Implementation Impacts
- Remove Buckeye Service Center from Rate Base

Additionally, I will be sponsoring the "Total Company" columns for the following pro formas on SFR Schedule C-2:

- Adjust for Post-Test Year Plant Additions
- Remove, Transfer and Annualize Test Year Surcharge Revenue and

Expense

- Include Residual Environmental Improvement Surcharge (EIS) Amortization
- Include West Phoenix Unit 4 Regulatory Disallowance
- Include Interest Expense on Customer Deposits
- Include and Annualize E-3/E-4 Customer Bill Payment Fees Deferral Amortization
- Adjust Depreciation Expense
- Annualize Payroll Expense
- Normalize Employee Benefits
- Remove Supplemental Excess Benefit Retirement Plan (SERP) Expense
- Remove Stock Compensation
- Include Active Union Medical Trust Interest Income and Realized Gains
- Normalize Cash Incentive Expense
- Normalize Income Tax Expense/Interest Synchronization
- Annualize Property Tax Expense
- Remove and Annualize Property Tax Deferrals Amortization
- Annualize Four Corners Power Plant (Four Corners) Coal Reclamation Costs
- Remove Navajo Generating Station Coal Reclamation Costs
- Adjust Cash Working Capital for Cost of Service
- Normalize Nuclear Maintenance Expense
- Normalize Fossil Maintenance Expense
- Annualize Sundance Power Plant (Sundance) Maintenance Expense Accrual
- Include Removal Costs Associated with the Saguaro Power Plant (Saguaro)
- Include Removal Costs Associated with the Ocotillo Power Plant (Ocotillo)

- Remove Buckeye Service Center
- Include Navajo Regulatory Asset Amortization Disallowance
- Include and Annualize Ocotillo Modernization Project (OMP) Deferral Amortization
- Include OMP Equity Return Disallowance
- Annualize Four Corners Selective Catalytic Reduction (SCR) Deferral Amortization
- Adjust and Annualize Four Corners Inventory
- Remove Four Corners Units 1, 2, and 3 Amortization
- Remove Non-Recoverable Advertising Expense
- Remove Out of Period and Miscellaneous Items
- Annualize Tax Expense Adjustment Mechanism (TEAM) Balancing Account Liability Amortization
- Annualize COVID Customer Relief Deferral Amortization
- Include Wildfire Mitigation O&M Cost Accumulation Amortization
- Normalize Wildfire Mitigation O&M Costs
- Remove Cholla Costs from Test Year
- Include Amortization of Cholla Decommissioning Costs
- Adjust Cholla Unit 2 Cost of Removal
- Adjust for Palo Verde Lease Buyback Costs

These adjustments are consistent with prior filings and represent "normalizations" and "annualizations" as discussed later in my testimony. These operating income pro formas are tax-affected; that is, they include an income tax calculation at the adjusted Test Year federal and state statutory income tax rates, expected to be in place when new retail rates go into effect. The SFR Schedule C-2 pro formas that have a related rate base pro forma also include a calculation for synchronization of interest expense, which in turn is used in determining overall jurisdictional federal and state income tax expense.

I will discuss and explain the "Gross Revenue Conversion Factor" that is used to gross-up operating income to account for income taxes as well as an estimate of uncollectible revenue, as presented on SFR Schedule C-3, consistent with the Commission Utilities Division Staff's (Staff) recommendations in prior rate cases. In addition, I will sponsor the various schedules relating to the Company's financial statements on SFR Schedules E-1 through E-9. SFR Schedule E-6 refers only to "combination" utilities (*e.g.*, electric and gas) and thus is not applicable to APS. Finally, I will sponsor the data on SFR Schedules F-1 through F-4. These schedules also include projected income statements and projected changes in financial position.

III. <u>HISTORICAL AND TEST YEAR ACCOUNTING DATA</u>

Q. PLEASE EXPLAIN THE ACCOUNTING INFORMATION USED TO COMPILE THE SFR SCHEDULES THAT YOU ARE SPONSORING.

A. My testimony covers historical accounting data, including the actual data for the Test Year. The majority of this information is disclosed directly or indirectly in both the unconsolidated APS audited financial statements, which are included in filings made with FERC, and the consolidated APS and consolidated Pinnacle West audited financial statements filed with the Securities and Exchange Commission (SEC) for the relevant periods.

Additionally, all of the accounting information provided in my testimony complies with Generally Accepted Accounting Principles (GAAP), which are required by the SEC for publicly traded companies. These are the principles that accounting professionals use to prepare public financial statements. One major goal of GAAP is to make financial statements comparable from period to period, from firm to firm, and from industry to industry. It also provides consistency from jurisdiction to jurisdiction. In addition to GAAP, APS's accounting practices comply with other applicable utility accounting standards, such as the FERC Uniform System of Accounts, which this Commission has adopted for electric and gas utilities.[1] My testimony also covers the forecasted accounting statements and financial results, which are periodically supplied to investors and filed with the SEC. All of the accounting projections provided in my testimony follow GAAP and comply with other applicable utility accounting standards, as mentioned above. As part of rebuttal testimony, where appropriate, APS will update forecasted and other necessary financial information to reflect the more current cost estimates.

In large part, my testimony supports the direct testimony of other APS witnesses. The testimony of Mr. Moe focuses on the jurisdictional allocation of APS revenues, costs, and rate base items for the actual Test Year and all pro forma adjustments. APS witness Jessica E. Hobbick's Direct Testimony addresses adjustor mechanisms and related financial impacts. APS witness James M. Coyne's Direct Testimony addresses the Company's proposed return on equity (ROE) and return on the fair value rate base (FVRB).

A. *Summary Schedules*

Q. PLEASE DESCRIBE THE HISTORICAL AND FORECASTED INFORMATION ON SFR SCHEDULES A-2 THROUGH A-5.

A. These summary schedules provide the "Summary Results of Operations," the "Summary of Capital Structure," the "Construction Expenditures, Net Plant Placed in Service and Gross Utility Plant in Service," and "Summary Changes in Financial Position" for the Test Year, the prior two calendar years, and the next three calendar

[1] *See* A.A.C. R14-2-212(G)(2).

years. These schedules include historical and projected information. While the schedules have been prepared assuming a rate effective date of October 1, 2026, any difference in timing impacting projected amounts utilized will be addressed, to the extent known, in the Company's subsequent rounds of responsive testimony in this rate case, or in a future rate case proceeding.

B. *Rate Base Schedules*

Q. PLEASE DESCRIBE THE INFORMATION ON SFR SCHEDULES B-1 THROUGH B-5.

A. These schedules provide summary and detailed information of APS's Original Cost Rate Base (OCRB) and Reconstructed Cost New less Depreciation (RCND) rate base, including the related pro forma adjustments needed to present an adjusted rate base as of the end of the Test Year. I am sponsoring the "Total Company" portion of these schedules and certain pro forma adjustments. Mr. Moe is sponsoring the ACC portion, and his testimony will present the allocation of "Total Company" figures to the ACC jurisdiction.

Q. PLEASE SUMMARIZE THE ADJUSTED TEST YEAR OCRB PROPOSED BY APS.

A. As of December 31, 2024, APS is proposing a Total Company Adjusted OCRB of $15.3 billion. This represents an increase of $359.4 million over the unadjusted amount. The amount of the adjusted OCRB allocated to the ACC jurisdiction is $12.5 billion. The requested adjustments to the Test Year amounts are summarized in SFR Schedule B-2, page 5.

Q. HAS THE COMPANY INCLUDED PENSION AND OTHER POST-EMPLOYMENT BENEFITS (OPEB) IN RATE BASE?

A. Yes. The Company has included pension and OPEB assets and liabilities in rate base. As stated in Decision No. 78317 (November 9, 2021), "Pension expense must be recognized as accounted for under GAAP as an operating expense, and plan assets, pension benefit obligations ("PBO"), and the pension components of [Other Comprehensive Income] OCI must be included in rate base to recognize the time value of money invested in pension plans."[2] The Commission determined through this decision that inclusion of pension and OPEB assets and liabilities in rate base is appropriate.[3] It was further determined that the return allowed on these assets and liabilities in rate base should be at the Company's weighted average cost of capital (WACC).[4] In Decision No. 79293 (March 5, 2024), the Commission once again concluded "that it is appropriate to allow APS a return set at the Company's WACC on its net prepaid pension asset and its net OPEB liability."[5] As such, the Company has included the total pension asset, the net OPEB liability, and the net SERP liability in rate base, along with the offsetting associated ADIT within SFR Schedule B-1.

Q. HOW DOES THE COMPANY'S PREPAYMENT OF PENSION COSTS BENEFIT CUSTOMERS VIA ITS IMPACT ON THE EXPECTED RETURN ON ASSETS (EROA) COMPONENT OF ANNUAL PENSION COST?

A. Pension expense is reduced by income generated from the pension assets. The EROA percentage is multiplied by the value of the assets in the pension trust, and the product of that calculation is subtracted from the annual pension cost. Therefore, customers receive the benefit of the earnings on the entire amount of the assets in the pension trust, not just the amount that has been recognized in annual pension cost. Stated another way, customers are receiving a return on

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[2] *In re Application of Ariz. Pub. Serv. Co. for a Hr'g to Determine the Fair Value of the Util. Prop. of the Co. for Ratemaking Purposes*, Docket No. E-01345A-19-0236, Decision No. 78317 (Nov. 9, 2021) (Decision No. 78317) at 181-82.
[3] *Id*. at 182.
[4] *Id*. at 183.
[5] *In re Application of Ariz. Pub. Serv. Co. for a Hr'g to Determine the Fair Value of the Util. Prop. of the Co. for Ratemaking Purposes*, Docket No. E-01345A-22-0144, Decision No. 79293 at 66 (Mar. 5, 2024) (Decision No. 79293) at 66.

amounts that they have not yet paid through recognized pension cost (the prepaid pension asset). In effect, the Company has made a prepayment of pension contributions, and customers are earning a return on that prepayment through the EROA. Additionally, due to shareholder capital contributions to the trust, customers are also benefiting from a higher EROA as a result of lower Pension Benefit Guaranty Corporation (PBGC) premiums assessed to the pension plan. The premiums the pension plan pays to the PBGC are assessed as a percentage of the unfunded liability. Therefore, the better funded the plan, the lower the premium expense assessed to and paid by the plan. In calculating the EROA for the plan, expenses such as the PBGC premiums are netted against expected returns, and therefore the EROA would be lower had the Company not provided this level of funding to the plan. Every dollar of additional investor funding reduces the pension unfunded liability dollar for dollar, reduces the PBGC premiums paid, and results in a higher EROA, which directly benefits the customers through lower cost of service.

Q. WHAT IS MEANT BY THE TERMS "RCND" AND "RCN" AS USED IN YOUR TESTIMONY?

A. The Commission regulations define RCND as:

> An amount consisting of the depreciated reconstruction cost new of the property (exclusive of contributions and/or advances in aid of construction) at the end of the test year, used and useful, plus a proper allowance for working capital and including all applicable pro forma adjustments. Contributions and advances in aid of construction, if recorded in the accounts of the public service corporation, shall be increased to a reconstruction new basis.[6]

Thus, Reconstructed Cost New (RCN) refers to the estimated cost of utility property that would be incurred if APS were to reproduce or reconstruct the property as new, using current cost levels. RCND is the net amount that results

[6] A.A.C. R14-2-103(A)(3)(n).

after deducting accumulated depreciation and amortization (both of which are also restated in current dollars) from the RCN amount.

Q. WHAT DOES SFR SCHEDULE B-4 PRESENT?

A. SFR Schedule B-4 presents the RCN and RCND amounts of APS's utility properties. These amounts were determined by performing an RCN study using Handy-Whitman indices (or Consumer Price Index indices for transportation equipment and general plant not covered by Handy-Whitman).[7] Using these indices has been a long-standing practice by all major utilities in Arizona and accepted by the Commission and the industry in general for determining the RCN amount.

Q. BASED ON YOUR STUDY, WHAT IS THE RCN OF APS'S UTILITY PROPERTY DEVOTED TO SERVICE TO THE PUBLIC AS OF THE END OF THE TEST YEAR?

A. Total RCN for APS's utility property is $65.8 billion. This total amount is shown in column (A) of SFR Schedule B-4, page 2 of 2.

Q. WOULD YOU PLEASE EXPLAIN HOW RCND WAS CALCULATED AS SHOWN ON SFR SCHEDULE B-4?

A. To arrive at RCND, the RCN column (A) is multiplied by a "condition percent," also known as a net book value percent, which is shown in column (B). The RCND is shown in column (C). The condition percent used to convert RCN to RCND is calculated by first determining the net book value (original cost less accumulated depreciation and removal costs) for all depreciable plant by each FERC plant account. This amount is then divided by the original cost for each FERC account

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[7] The Handy-Whitman Index of Public Utility Construction Costs is an annually published index for trends in utility construction costs. The index is designed to collect publicly available data reported to the FERC, as that data is a reasonably accurate measure of the cost of reproducing actual plant. The index is widely used by regulatory bodies, valuation experts, and regional transmission organizations to estimate cost trends, which are then applied to known original costs of similar plant and property to determine the fluctuation of costs.

to arrive at the condition percent. In other words, the condition percent is the percentage that results when comparing net book value to the original cost of plant in service.

For example, assume that distribution lines have an original cost of $400,000, and accumulated depreciation and removal costs of $250,000. The net book value would be $150,000 ($400,000 less $250,000). Also, assume the distribution lines were purchased in 1985 and have an RCN value of $632,000. Using these assumptions, the condition percent is calculated by dividing original cost less accumulated depreciation and removal costs by original cost, or $150,000/$400,000, resulting in a condition percent of 37.5%. Multiplying the RCN of $632,000 by the condition percent of 37.5% yields $237,000 of RCND.

Q. ARE THERE ANY OTHER RELATED ADJUSTMENTS NECESSARY TO DETERMINE FVRB?

A. Yes. Plant-related ADIT were also adjusted. Plant-related ADIT arise primarily as a result of differences between book depreciation recorded for GAAP purposes and tax depreciation used for income tax purposes. Since RCND trending results in a change in accumulated book depreciation, a corresponding change was made to original cost ADIT. To make this adjustment, the Company trended plant-related ADIT using the relationship between the OCRB less depreciation and RCND.

Q. WOULD YOU PLEASE EXPLAIN SFR SCHEDULE B-4A?

A. SFR Schedule B-4a shows the computation of adjusted jurisdictional RCND rate base as of December 31, 2024. Column (A) presents data for Total Company RCND rate base. Mr. Moe provides the jurisdictional allocations of the RCND Rate Base split between "ACC" and "Other," which is presented in columns (B) and (C), respectively.

Q. HOW DID YOU ARRIVE AT THE AMOUNTS SHOWN ON LINES 9 THROUGH 31 OF SFR SCHEDULE B-4A?

A. The amounts shown on lines 9 through 31 of SFR Schedule B-4a for other rate base elements were obtained from SFR Schedule B-1, page 2 of 2, column (A). Consistent with past Commission practice, the RCND of these specific rate base elements are stated at their original cost levels, as these elements are assumed not to change in value with the passage of time, with the exception of deferred income taxes and regulatory liabilities as a result of excess deferred tax amortization.

Q. WOULD YOU PLEASE EXPLAIN LINES 32 AND 33 OF SFR SCHEDULE B-4A?

A. The amounts shown on line 32 represent the RCND rate base as of December 31, 2024. However, the end of the Test Year data must be adjusted to more closely reflect the value of certain items of property when the proposed rates become effective. Therefore, it is necessary to also reflect the pro forma rate base adjustments in the RCND rate base. The RCND pro forma adjustments are shown in detail in SFR Schedule B-3. The total pro forma adjustments are shown on line 33 of SFR Schedule B-4a.

Q. WHAT IS THE TOTAL ADJUSTED RCND RATE BASE?

A. The Total Company RCND rate base, as adjusted, is $37.2 billion. This is shown in SFR Schedule B-4a, column (A), line 34.

Q. PLEASE EXPLAIN THE COMPUTATION OF CASH WORKING CAPITAL ON SFR SCHEDULE B-5.

A. SFR Schedule B-5 outlines the computation of the allowance for cash working capital of $484.1 million that is included in the Company's rate base. Cash working capital is a measure of investor funding of daily operating expenditures and a variety of non-plant investments that are necessary to sustain ongoing operations. Cash working capital includes materials and supplies, fuel inventories, prepayments, and cash working capital. Cash working capital is an investment, just like other capital requirements, such as power plants and transmission and distribution infrastructure; thus, it is part of APS's rate base. My testimony presents the calculation of the allowance for cash working capital, which includes a cash working capital component that is determined using a lead/lag study. The lead/lag study is required by Decision No. 55931 (April 1, 1988).[8]

Q. HOW WAS CASH WORKING CAPITAL CALCULATED?

A. As mentioned above, APS calculated cash working capital by performing a lead/lag study. A lead/lag study establishes the amount of investor funds used to maintain utility operations from the time expenditures are made to the time revenues are collected, as a reimbursement for that utility service. The Company used the number of lead/lag study days derived from a 12-month period ending December 31, 2024, and applied this information to the Test Year income statement expenses.

In addition, the Company considered the pro forma adjustments to the Test Year income statement expenses and computed a rate base pro forma adjustment to reflect the related change in cash working capital (*see* Section IV, Pro Forma Adjustments to Test Year).

C. *Test Year Income Statements*

Q. PLEASE DISCUSS THE INFORMATION THAT YOU ARE SPONSORING ON SFR SCHEDULE C-1.

A. SFR Schedule C-1 is a summary of the Company's adjusted Test Year income statement. I am sponsoring the actual Test Year data in the first column of SFR Schedule C-1, page 1. Mr. Moe sponsors the ACC jurisdictional data in the first

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[8] *In re the Decommissioning of the Ariz. Pub. Serv. Co.'s Palo Verde Nuclear Generating Station, et al.,* Docket Nos. U-1345-86-062, U-1345-85-367, Decision No. 55931 (Apr. 1, 1988).

column on page 2. This information provides the baseline from which pro forma adjustments are made and shows operating income and net income for the Test Year.

Q. ARE YOU SPONSORING ANY OTHER RELATED SFR SCHEDULES?

A. Yes. I am sponsoring the Total Company amounts for certain pro forma adjustments on SFR Schedule C-2, which presents pro forma adjustments to the Company's Test Year operating income. Mr. Moe sponsors the ACC jurisdictional amounts on this schedule. I will discuss these adjustments in detail later in my testimony (*see* Section IV, Pro Forma Adjustments to Test Year). I am also sponsoring SFR Schedule C-3, which provides the "Computation of Gross Revenue Conversion Factor."

Q. PLEASE DESCRIBE SFR SCHEDULE C-3.

A. SFR Schedule C-3 calculates the factor applied to "gross-up" income to account for income taxes as well as an estimated percentage of uncollectible revenue. The Company applies this factor to operating income to ensure income tax expense is reflected in the requested revenue requirement. The Gross Revenue Conversion Factor of 1.3358 (line 8) is an algebraic transformation of gross revenue adjusted for uncollectable revenue and the Test Year Composite Tax rate of 24.61% (line 6). This factor is used on SFR Schedule A-1 (line 7) to arrive at the increase or decrease in revenue requirements necessary to account for income taxes.

D. *Financial Statements and Statistical Schedules*

Q. PLEASE SUMMARIZE THE INFORMATION PRESENTED ON SFR SCHEDULES E-1 THROUGH E-9.

A. These schedules relate to historical financial and accounting information as well as the footnotes to the financial statements. As noted earlier in my testimony, SFR Schedule E-6 is only required for combined electric and gas utilities and therefore does not apply to APS.

Q. PLEASE DISCUSS SFR SCHEDULES E-1 THROUGH E-4.

A. These schedules represent APS's balance sheets, income statements, statements of changes in financial position, and changes in stockholder's equity for the Test Year and the two prior calendar years. As discussed earlier, these financial statements continue to reflect APS's unconsolidated results, consistent with previous rate filings. The APS FERC Form 1 filings that support these schedules, and are provided in SFR Schedule E-9, reflect APS's unconsolidated regulated financial statements.

Q. PLEASE DISCUSS SFR SCHEDULE E-5.

A. SFR Schedule E-5 is a detailed statement of utility plant included in the Company's rate base, broken out by FERC account under the Uniform System of Accounts. The first page of SFR Schedule E-5 is a summary of gross plant in service, accumulated depreciation and amortization, nuclear fuel, construction work in progress (CWIP), plant held for future use, and plant acquisition adjustment. The remainder of the schedule presents supporting details for each FERC plant account.

Q. WHAT INFORMATION IS PROVIDED ON SFR SCHEDULE E-7?

A. SFR Schedule E-7 provides detailed information concerning APS's sales (in kWh), average number of customers, average kWh usage per customer, and average annual revenue per residential customer over the last three years, including the Test Year. This information is contained in, or derived from APS's FERC Form 1 filings for the applicable periods. This information in SFR Schedule E-7 is separated by customer classes to show residential, commercial, industrial, irrigation, public street and highway lighting, other sales to public authorities, and sales for resale.

Q. PLEASE DISCUSS SFR SCHEDULE E-8.

A. SFR Schedule E-8 provides a breakdown of APS's tax expense incurred during the Test Year and the two prior calendar years for federal and state taxes.

Q. PLEASE DISCUSS SFR SCHEDULE E-9.

A. SFR Schedule E-9 presents the Company's unconsolidated financial statements and footnotes as filed in the Company's FERC Form 1 for 2024. The footnotes include, but are not limited to, the Company's accounting policies for depreciation, Allowance for Funds Used During Construction (AFUDC), and income taxes. The footnotes also provide additional detailed information related to the income statements, balance sheets, and statements of cash flows.

E. *Projections and Forecasts*

Q. PLEASE DISCUSS THE INFORMATION THAT YOU ARE SPONSORING ON SFR SCHEDULES F-1 THROUGH F-4.

A. SFR Schedule F-1 presents income statements for projected calendar years compared with actual Test Year results, at present and proposed rates. As I have previously indicated, SFR Schedule F-1, like SFR Schedule A-2, shows key information related to the Company's actual and projected ROE. As SFR Schedule F-1 shows, under APS's present rates, the Company's ROE on end-of-year equity falls from 7.8% at the end of the Test Year to 5.8% by 2027 – well below any reasonable ROE found in Mr. Coyne's testimony that would be required to maintain the financial stability of APS to support investment necessary to meet customers' needs. It is important to note that even with the Company's proposed rates, the Company's ROE in 2027 would still be below the cost of equity capital, but significantly better than the 5.8% projected under present rates. APS witness Chris R. Bauer's and Ms. Hobbick's testimonies discuss the importance of APS's formula rate proposal and its ability to reduce the regulatory lag associated with the timely realization of the Company's authorized ROE.

SFR Schedule F-2 shows projected changes in the financial position of the Company for future calendar years compared with the Test Year, at present and proposed rates.

SFR Schedule F-3 presents projected annual capital expenditure requirements, by property classification, for three years subsequent to the Test Year.

Finally, SFR Schedule F-4 presents the key assumptions used in developing the projections.

IV. <u>PRO FORMA ADJUSTMENTS TO TEST YEAR</u>

A. *Types of Pro Forma Adjustments*

Q. WHAT IS A PRO FORMA ADJUSTMENT?

A. Pro forma adjustments are adjustments made to a historical test year to reflect conditions during the period in which rates are to be in effect. Because the Company has used a historical test year, it is necessary to adjust recorded revenues and expenses for known and measurable changes. Pro forma adjustments commonly include normalizations, annualizations, and out-of-period adjustments. All of the pro forma adjustments discussed in my testimony reflect Total Company amounts prior to any jurisdictional allocation and are reflected on either SFR Schedule B-2 or SFR Schedule C-2.

Q. WHAT ARE NORMALIZATION ADJUSTMENTS?

A. Normalization adjustments compensate or adjust for unusual levels of operations experienced during the Test Year period. These adjustments generally relate to items that are abnormal in amount or nonrecurring in nature and are made to better reflect what is representative of an ongoing level of operations.

Q. WHAT ARE ANNUALIZATION ADJUSTMENTS?

A. Annualization adjustments recognize that some events occurring during the Test Year period are ongoing and must be adjusted to reflect their impact over an entire 12-month period. One example of an annualization is payroll costs. Since payroll costs can be higher or lower on an ongoing basis than what was recorded during the Test Year, an adjustment must be made to reflect the prospective level of costs.

Annualization adjustments are also required as a result of the historical Test Year containing 9.8 months of updated rates effective March 8, 2024, as ordered in Decision No. 79293. Several pro forma annualization adjustments were made to reflect an on-going annualized level of costs that were approved for recovery from this decision, of which 12 months were not contained in the Test Year. These pro forma adjustments reflect a full 12 months, or an annualized amount.

Q. WHAT IS AN "OUT-OF-PERIOD" OR MISCELLANEOUS ADJUSTMENT?

A. Out-of-period adjustments remove expenses or revenues properly recorded during the Test Year but are associated with operations from another year. Miscellaneous adjustments remove costs from the Test Year for items which the Company does not seek to collect from customers.

B. *Pro Forma Adjustment Descriptions*

1. Adjust for Post-Test Year Plant Additions

Q. WHAT ADJUSTMENTS HAVE THE COMPANY MADE TO ACCOUNT FOR POST-TEST YEAR PLANT (PTYP) ADDITIONS?

A. APS witness Jacob Tetlow addresses the details of the Company's capital investments in his Direct Testimony. The Company is proposing to include plant additions that go into service after the Test Year (January 1, 2025 through December 31, 2025), but well before new base rates are expected to be in effect.

My testimony covers the mechanics of the pro forma adjustments, as discussed below:

Step 1: CWIP was extracted from the general ledger as of December 31, 2024, for non-transmission plant that is expected to go into service on or before December 31, 2025;

Step 2: The forecasted plant in-service cost of each project that is expected to go into service on or before December 31, 2025 was compiled (projects in CWIP at December 31, 2024, and projects that began after December 31, 2024 but are expected to be completed and in service within 12 months);

Step 3: The identified plant was classified by functional area: nuclear generation, energy storage, non-nuclear generation, distribution, and information technology/facilities;

Step 4: Annual accumulated depreciation and amortization, net of ADIT, and tax credits (where applicable), were offset against the PTYP additions adjustment;

Step 5: The sum of the forecasted plant in-service costs, less accumulated depreciation, deferred income taxes, and other associated tax credits, as applicable, was presented by functional unit and included in the rate base pro forma adjustments. These pro forma adjustments increase rate base at December 31, 2024 by $306.7 million (see SFR Schedule B-2, pages 1 and 2, columns 2 through 6); and

Step 6: Property taxes and depreciation expense were calculated and reflected as a reduction to pre-tax operating income of $57.7 million (*see* SFR Schedule C-2, pages 1 and 2, columns 1 through 5).

APS will true-up this adjustment with actual plant placed in service, net of retirements, throughout this case.

2. Remove, Transfer, and Annualize Test Year Surcharge Revenues and Expenses

Q. PLEASE EXPLAIN THE ADJUSTMENT TO REMOVE, TRANSFER, AND ANNUALIZE TEST YEAR SURCHARGE REVENUES AND EXPENSES.

A. This pro forma captures several types of adjustments made to revenue and expense to account for the amounts collected or refunded during the Test Year under adjustor mechanisms, including regulatory assessments. Adjustor mechanisms and regulatory assessments are not collected or refunded as part of base rates, so they must first be excluded from Test Year revenue to calculate new base rates, with the exception of those adjustor revenues and expenses that are either in total or in part proposed to be transferred into base rates. Ms. Hobbick's testimony supports the Company's adjustor mechanisms, and any related proposed changes requested in this case. This results in a reduction to pre-tax operating income of $88,539,000 (*See* SFR Schedule C-2, pages 4 through 7, columns 11 through 19).

3. Include Residual EIS Amortization

Q. PLEASE EXPLAIN THE ADJUSTMENT TO INCLUDE RESIDUAL EIS AMORTIZATION.

A. This adjustment includes the residual amounts of the EIS regulatory asset balancing account. This balance represents net trailing EIS adjustor balancing account amounts that arose after the adjustor mechanism was set to zero. APS proposes to amortize this residual balance over a three-year period. This pro forma adjustment results in a reduction to pre-tax operating income of $316,000 (*see* SFR Schedule C-2, page 22, column 60).

4. Include West Phoenix Unit 4 Regulatory Disallowance

Q. PLEASE EXPLAIN THE RATE BASE PRO FORMA ADJUSTMENT FOR THE WEST PHOENIX UNIT 4 REGULATORY DISALLOWANCE.

A. This disallowance was recorded for regulatory purposes as ordered by Decision Nos. 67744 (April 7, 2005)[9] and 69663 (June 28, 2007),[10] but did not qualify as a disallowance for GAAP purposes. Consequently, a pro forma adjustment is needed to reduce rate base by the disallowed amount. Accordingly, the rate base reduction for the West Phoenix Unit 4 regulatory disallowance at December 31, 2024 is $4,210,000 *see* SFR Schedule B-2, page 3, column 7).

Q. IS THERE A CORRESPONDING OPERATING INCOME ADJUSTMENT FOR THE DEPRECIATION EXPENSE RELATED TO THE WEST PHOENIX UNIT 4 REGULATORY DISALLOWANCE?

A. Yes. The operating income pro forma adjustment reflects an annual reduction in depreciation expense. This results in an increase to pre-tax operating income of $329,000 (*see* SFR Schedule C-2, page 8, column 21).

5. Include Interest Expense on Customer Deposits

Q. PLEASE DESCRIBE THE ADJUSTMENT FOR INTEREST EXPENSE ON CUSTOMER DEPOSITS.

A. This pro forma adjustment reflects the annualized interest cost associated with customer deposits as an operating expense. This treatment conforms to the approach approved by the Commission in the Company's previous rate cases. This

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[9] *In re Application of Ariz. Pub. Serv. Co. for a Hr'g to Determine the Fair Value of the Util. Prop. of the Co. for Ratemaking Purposes*, Docket No. E-01345A-03-0437, Decision No. 67744 (Apr. 7, 2005).

[10] *In re Application of Ariz. Pub. Serv. Co. for a Hr'g to Determine the Fair Value of the Util. Prop. of the Co. for Ratemaking Purposes, et al.* Docket No. E-01345A-05-0816, Decision No. 69663 (Jun. 28, 2007) (Decision No. 69663).

adjustment was calculated by applying the 4.17% annual 2025 interest rate to the December 31, 2024, outstanding deposit balance. The annual interest rate is the rate required by APS Schedule 1 for customer deposits – the established one-year Treasury Constant Maturities rate, effective on the first business day of each year (in this instance, January 1, 2025), as published on the Federal Reserve website. The result of this pro forma adjustment is a reduction to pre-tax operating income of $1,760,000 (*see* SFR Schedule C-2, page 8, column 22).

6. Include and Annualize E-3/E-4 Customer Bill Payment Fees Deferral

Q. PLEASE DESCRIBE THE ADJUSTMENT TO INCLUDE THE E-3/E-4 CUSTOMER BILL PAYMENT FEES DEFERRAL.

A. The Company was authorized in Decision No. 78317 to track and defer for future recovery the amounts paid on behalf of customers under certain limited-income discount programs, Rate Riders E-3 and E-4, including credit card processing fees.[11] The "[c]ontinuation of the accounting order allowing APS to defer the limited income programs' discounts (fees or credits)" was uncontested and reaffirmed in the 2022 Rate Case.[12] This rate base pro forma adjustment includes actuals (where available) and estimated E-3/E-4 customer bill payment fee deferral amounts from January 1, 2025 through October 1, 2026 (estimated rate effective date). This pro forma adjustment results in a rate base increase for the E-3/E-4 Customer Bill Payment Fees Deferral of $555,000 (*see* SFR Schedule B-2, page 4, column 12).

[11] Decision No. 78317 at 365, 440.

[12] Decision No. 79293 at 46.

Q. IS THERE A CORRESPONDING OPERATING INCOME ADJUSTMENT FOR THE AMORTIZATION RELATED TO E-3/E-4 CUSTOMER BILL PAYMENT FEES DEFERRAL?

A. Yes. There are operating income adjustments required to capture the updated amortization amount based on forecasted costs through the expected rate effective date of October 1, 2026. This pro forma adjustment estimates the expected balance in the account at rate implementation date (expected October 1, 2026), and removes the Test Year amortization authorized in Decision No. 79293 in order to reset the amortization amount based on the updated balance at rate implementation. The Company is requesting to amortize the deferral over a three-year period. This pro forma adjustment results in a reduction to pre-tax operating income of $381,000 (*see* SFR Schedule C-2, page 9, column 25).

7. Adjust Depreciation Expense

Q. WHAT ADJUSTMENTS HAVE THE COMPANY MADE TO DEPRECIATION AND AMORTIZATION EXPENSE?

A. For this filing, APS witness Dr. Ronald E. White performed a 2024 Depreciation Rate Study using data as of December 31, 2023. These rates were then applied to asset balances as of December 31, 2024. Using Dr. White's study, APS has updated depreciation rates from the rates authorized in Decision Nos. 78317 and 79293. APS is asking for Commission approval of these depreciation rates in this proceeding. Please refer to Dr. White's testimony for further discussion. This pro forma adjustment increases depreciation expense and thus results in a reduction to pre-tax operating income of $76,660,000 (*see* Attachment REW-2DR and SFR Schedule C-2, page 10, column 26).

Q. DOES THIS INCREASE MATCH THE 2024 DEPRECIATION RATE STUDY AS SHOWN IN APS WITNESS DR. RONALD WHITE'S TESTIMONY?

A. No. It does not match the specific numbers in Dr. White's 2024 Depreciation Rate Study, nor should it. The difference between the 2024 Depreciation Rate Study adjustment of $48.8 million and the pro forma adjustment can be attributed to the annualization of depreciation expense as well as the inclusion of depreciation/amortization expense for some General/Intangible assets not included in Dr. White's study, such as software.

8. Annualize Payroll Expense

Q. PLEASE DESCRIBE THE ADJUSTMENT TO ANNUALIZE PAYROLL EXPENSE.

A. This pro forma adjustment increases Test Year expenses, mainly as a result of an increase in average wage levels and employee headcount. This pro forma adjustment annualizes the Test Year payroll and payroll tax expense to April 2025 employee and wage levels for non-union and union employees (per the current union contract finalized in 2023 and in effect until 2026). Any subsequent changes in union payroll as a result of a renegotiated contract will be reflected in rebuttal testimony. This results in a reduction to pre-tax operating income of $17,647,000 (*see* SFR Schedule C-2, page 10, column 27).

Q. DOES THIS TOTAL PAYROLL ADJUSTMENT ONLY AFFECT O&M?

A. Yes. This adjustment excludes capitalized payroll costs. This O&M adjustment was estimated by calculating the percentage of APS's O&M payroll to total payroll during the Test Year. The total payroll and payroll taxes were allocated to O&M based on the same Test Year O&M percentage payroll amounts.

9. Normalize Employee Benefits

Q. PLEASE EXPLAIN THE NEED FOR THE NORMALIZE EMPLOYEE BENEFITS PRO FORMA ADJUSTMENT.

A. This adjustment is necessary to appropriately recognize the costs associated with pension and other OPEB plans, which primarily consist of medical benefits for eligible retirees. In APS's 2022 Rate Case, the Commission authorized normalization of OPEB and pension costs based on the full 2022 calendar year.[13]

Q. HOW WAS THE NORMALIZE EMPLOYEE BENEFITS PRO FORMA ADJUSTMENT DETERMINED?

A. The total change in pension and OPEB expense is the difference between the Test Year expense and the 2025 level of that expense, as determined by APS's actuaries, Willis Towers Watson. As noted below, this calculation resulted in an increase to employee benefits expense.

Q. HOW DID YOU DETERMINE THE AMOUNT OF INCREASED BENEFITS COSTS PROPERLY ALLOCABLE TO APS'S O&M?

A. An APS allocation factor was calculated and applied to the total Pinnacle West change in benefit expenses. This allocation factor was determined by dividing APS's 12 months ended December 31, 2024 actual O&M employee benefits by the total actual employee benefits costs for Pinnacle West for the same 12-month period. This results in a reduction to pre-tax operating income of $39,576,000 (*see* SFR Schedule C-2, page 11, column 28).

[13] Decision No. 79293 at 107.

10. Remove SERP Expense

Q. PLEASE EXPLAIN THE PRO FORMA ADJUSTMENT TO REMOVE SERP EXPENSE.

A. This pro forma adjustment removes from expense the associated costs of Test Year operations SERP. This results in an increase to pre-tax operating income of $6,891,000 (*see* SFR Schedule C-2, page 11, column 29).

11. Remove Stock Compensation

Q. PLEASE EXPLAIN THE PRO FORMA ADJUSTMENT TO REMOVE STOCK COMPENSATION.

A. This pro forma adjustment removes the Test Year level of expense associated with stock compensation. This results in an increase to pre-tax operating income of $21,814,000 (*see* SFR Schedule C-2, page 11, column 30).

12. Include Active Union Medical Trust Interest Income and Realized Gains

Q. PLEASE EXPLAIN THE PRO FORMA ADJUSTMENT TO INCLUDE THE ACTIVE UNION MEDICAL TRUST INTEREST INCOME AND REALIZED GAINS.

A. This pro forma adjustment reflects the Test Year level of interest income and realized gains on investments in the Active Union Medical Account. This results in an increase to pre-tax operating income of $5,358,000 (*see* SFR Schedule C-2, page 12, column 31).

13. Normalize Cash Incentive Expense

Q. PLEASE EXPLAIN THE PRO FORMA ADJUSTMENT TO NORMALIZE CASH INCENTIVE.

A. This pro forma adjustment normalizes the associated costs of the Test Year operations for the cash incentive program over a three-year period. The use of this three-year normalization of cash incentive expense was first proposed by Staff and adopted by the Commission in Decision No. 71448 (December 30, 2009).[14] Further, Staff accepted normalization of the cash incentive expense in Decision No. 78317.[15] This adjustment results in an increase to pre-tax operating income of $6,768,000 (*see* SFR Schedule C-2, page 12, column 32).

14. Normalize Income Tax Expense/Interest Synchronization

Q. WHAT METHODOLOGY DID YOU USE TO DETERMINE THE FEDERAL AND STATE INCOME TAX PRO FORMA ADJUSTMENT?

A. The Company used a "top down" approach in computing cost of service income tax expense. This calculation, which was also adopted in Decision No. 69663 and consistently used thereafter, uses the statutory rate and estimated Test Year levels of various tax credits and other permanent tax items, adjusted for known changes (*e.g.* amortization of excess deferred taxes resulting from the Tax Cuts and Jobs Act), reflecting the Company's best estimate of on-going income tax expense. It also considers the deduction of interest expense synchronized to the end of the Test Year's rate base. The total federal and state income tax pro forma adjustment reduces income tax expense by $16,848,000 (*see* SFR Schedule C-2, page 12, column 33).

15. Annualize Property Tax Expense

Q. PLEASE DESCRIBE HOW PROPERTY TAXES ARE CALCULATED.

A. Property taxes are calculated using December 31, 2024 property values as filed with the Arizona Department of Revenue in April 2025. These property values are then multiplied by the most current approved assessment ratios. Finally, that assessed value is multiplied by the actual current estimated composite tax rate. APS

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[14] *In re the Application of Ariz. Pub. Serv. Co. for a Hr'g to Determine the Fair Value of the Util. Prop. of the Co. for Ratemaking Purposes*, Docket No. E-01345A-08-0172, Staff Exhibit 2, Direct Testimony of Ralph Smith (Dec. 19, 2008) at 52; Decision No. 71448, Exhibit A, Proposed Settlement Agreement (Dec. 30, 2009) at 20-21.

[15] Decision No. 78317 at 187.

will update the expected composite tax rate with the actual rate when it becomes available near the end of the fourth quarter of 2025. This adjustment results in a reduction to pre-tax operating income of $5,731,000 (*see* SFR Schedule C-2, page 13, column 34).

16. Remove and Annualize Property Tax Deferral Amortization

Q. IS THE COMPANY REQUESTING A PROPERTY TAX DEFERRAL MECHANISM?

A. No. The Company is not requesting a rate base pro forma adjustment or on-going property tax deferral approval. However, as discussed below, there is a pro forma adjustment needed to reflect prior Commission decisions.

Q. PLEASE EXPLAIN THE PRO FORMA ADJUSTMENT TO ANNUALIZE THE PROPERTY TAX DEFERRAL AMORTIZATION.

A. This pro forma adjustment reflects the annual level of amortized refund that was authorized in Decision No. 79293, since the Test Year in this case only includes 9.8 months of that allowed amortization (due to the March 8, 2024 rate implementation date). This pro forma also adjusts Test Year expense to remove the property tax deferral amortization from Decision No. 76295 (August 18, 2017),[16] which was fully refunded to customers in November 2024. This pro forma adjustment results in a net reduction to pre-tax operating income of $3,876,000 (*see* SFR Schedule C-2, page 13, column 35).

17. Annualize Four Corners Coal Reclamation Costs

Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENT TO ANNUALIZE FOUR CORNERS COAL RECLAMATION COSTS.

A. This pro forma adjustment annualizes the estimate for final coal mine reclamation costs, the costs to account for inflation, and the amortization period. The estimate

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[16] *In re the Application of Ariz. Pub. Serv. Co. for a Hr'g to Determine the Fair Value of the Util. Prop. of the Co. for Ratemaking Purposes*, Docket No. E-01345A-16-0036, Decision No. 76295 (Aug. 18, 2017) (Decision No. 76295).

for final reclamation costs is based on a study performed by WSP USA as of December 2024.[17] The costs within the WSP USA study were presented on a December 2024 dollar basis. Due to the long-term nature of these costs, APS escalated the cost estimates for Four Corners through June 2031, which is aligned with the terms of the coal supply agreement. In an effort to reduce customer bill impacts, the Company has extended the amortization period through June 2038. The result is an increase to pre-tax operating income of $5,049,000 (*see* SFR Schedule C-2, page 14, column 37).

Q. HOW WAS THE ESCALATION CALCULATED?

A. Total estimated costs from the WSP USA study were used to derive APS's share of Four Corners coal reclamation (in 2024 dollars). The reclamation costs for Four Corners are adjusted using an annual rate of 4.0% over 6.5 years to reflect second quarter 2031 costs. Per the current coal supply agreement, APS shall fund Final Reclamation in 13 equal annual installments, on August 1 of each Contract Year (beginning August 2018), into an irrevocable escrow account, solely dedicated to the Final Reclamation Costs of the Navajo Mine (the Escrow Account). The funding will be based on the initial reclamation estimates with true-ups for updates of estimates made periodically. The Company is using an amortization period through June 2038.

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[17] WSP USA is a nationally recognized engineering and consulting firm with expertise in mine reclamation, site remediation, and closure cost estimation. The firm supports utilities and regulatory agencies in assessing decommissioning and final reclamation obligations for coal-fired generation facilities.

18. Remove NGS Coal Reclamation Costs

Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENT TO REMOVE NGS COAL RECLAMATION COSTAMORTIZATION.

A. The final NGS coal reclamation cost amortization was authorized for recovery over the original plant life, through June 2026, in Decision No. 78317.[18] Due to the expected timing of this rate case implementation (estimated October 1, 2026), this pro forma adjustment is necessary to exclude these amortization expenses from the Test Year as amounts will be fully recovered on or near that time. This results in an increase to pre-tax operating income of $2,978,000 (*see* SFR Schedule C-2, page 14, column 38).

19. Adjust Cash Working Capital for Cost of Service

Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENT TO ADJUST CASH WORKING CAPITAL.

A. The cash working capital rate base pro forma adjustment includes the effects of all applicable cost of service pro forma adjustments. As discussed earlier in my testimony, the cash working capital in SFR Schedule B-5 includes a cash working capital component determined using a lead/lag study. The expense levels in that study reflect the actual expense in the Test Year. This pro forma adjusts the cost-of-service study to take into consideration the pro formas which adjust actual Test Year levels of expense. This pro forma adjustment reduces rate base at December 31, 2024 by $20,372,000 (*see* SFR Schedule B-2, page 3, column 8).

Q. IS THERE A CORRESPONDING OPERATING INCOME ADJUSTMENT RELATED TO CASH WORKING CAPITAL?

A. Yes. Since the rate base pro forma adjustment affects total rate base, there is a corresponding operating income pro forma adjustment necessary to reflect the income tax impacts of interest. This pro forma adjustment was calculated using the

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[18] Decision No. 78317 at 198.

rate base adjustment above and the weighted cost of debt. This adjustment increases income tax expense by $102,000 (*see* SFR Schedule C-2, page 14, column 39).

20. Normalize Nuclear and Fossil Maintenance Expenses

Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENTS TO NORMALIZE NUCLEAR AND FOSSIL MAINTENANCE EXPENSES.

A. These pro formas adjust for both planned maintenance and unplanned outages so that the level of maintenance expense included in the Test Year is consistent with an average year. In Decision No. 79293, the Commission determined "that it is appropriate to normalize those expenses using the calendar years and Test Year period used."[19] These adjustments are necessary because outage time at each of the power plants in the Test Year for planned routine maintenance and unplanned forced outages is not indicative of the normal levels of availability. APS adjusted Test Year O&M expenses to normalize maintenance levels for the Company's production plant in service as of December 31, 2024. This was done separately for the Company's nuclear and fossil facilities. Cholla maintenance expenses have been excluded from this pro forma adjustment, as the plant ceased operations in March of 2025, and these costs were removed from the Test Year via a separate Cholla pro forma adjustment discussed elsewhere in my testimony.

The nuclear generation maintenance adjustment increases pre-tax operating income by $659,000 and the fossil generation maintenance adjustment increases pre-tax operating income by $8,778,000. The O&M expense adjustments include the impacts of the outage time normalization for all of the units (*see* SFR Schedule C-2, page 15, columns 40 and 41).

[19] Decision No. 79293 at 99.

Q. HOW DID YOU ADJUST THE OUTAGE TIME TO NORMALIZE THE TEST YEAR RESULTS?

A. Planned maintenance time for each non-nuclear generating plant is an average over the routine overhaul cycle for each plant type. For example, the Company's fossil plants are on a six-year overhaul cycle, which means that each of the fossil units should experience a major overhaul once in every six-year period. The specific six-year period applicable to the normalization includes the historical years of 2019 through 2024.

Normalized Palo Verde Generation Station outage time is calculated in a similar manner, using a three-year period spanning 2022 through 2024, but the rationale is slightly different than the one applicable to the fossil outage time normalization. The nuclear units are each on an 18-month refueling cycle, so a three-year period ensures that each unit's maintenance time is reflected in equal proportion in the normalization period. Any single year, such as the Test Year, does not represent the average maintenance time and associated expense levels that can reasonably be expected when rates established in this case will be in effect.

Q. HOW DID YOU ADJUST THE MAINTENANCE EXPENSES TO NORMALIZE THE TEST YEAR RESULTS?

A. The maintenance expenses were normalized in a similar fashion to the outage time. For fossil generating units, normal maintenance levels are determined by averaging the historical maintenance expense at each power plant using the six-year average maintenance cycle. Normal PVGS expenses are based on historical expenses for a three-year period.

Labor costs, including overtime costs, have been adjusted to reflect historical labor cost increases. Non-labor maintenance costs were adjusted to current cost levels using the relevant Handy-Whitman cost indices.

21. Annualize Sundance Maintenance Expense Accrual

Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENT TO ADJUST THE SUNDANCE MAINTENANCE EXPENSE ACCRUAL.

A. This pro forma adjustment annualizes the accrual of the overhaul maintenance costs associated with the Sundance Units as authorized in Decision Nos. 69663, and accepted in Decision Nos. 78317, and 79293.[20] This pro forma adjustment forecasts maintenance costs through the plant end of life of 2044, calculates the average monthly increase in these costs, and adjusts Test Year expenses to reflect the annualized updated maintenance forecast. This adjustment results in a reduction to pre-tax operating income of $3,976,000 (*see* SFR Schedule C-2, page 15, column 42, line 15).

22. Include Removal Costs Associated with the Saguaro Power Plant

Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENT TO INCLUDE SAGUARO COSTS.

A. This adjustment compares the actual cost of removal incurred in the Test Year to dismantle Saguaro with the cost of removal reserve in the regulatory liability at December 31, 2024. Since all decommissioning work has been completed, this adjustment proposes to return the remaining amounts previously collected back to customers over a three-year period, and results in an increase to pre-tax operating income of $288,000 (*see* SFR Schedule C-2, page 9, column 23).

[20] Decision No. 69663 at 17; Decision No. 78317; Decision No. 79293.

23. Include Removal Cost Associated with the Ocotillo Power Plant

Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENT TO INCLUDE OCOTILLO REMOVAL COSTS.

A. This adjustment compares the actual cost of removal incurred in the Test Year to dismantle Ocotillo with the cost of removal reserve in the regulatory asset at December 31, 2024. Since all decommissioning work has been completed, this adjustment requests collection of the remaining amounts from customers over a three-year and three-month period, resulting in a reduction to pre-tax operating income of $1,969,000 (*see* SFR Schedule C-2, page 21, column 57).

24. Remove Buckeye Service Center from Rate Base

Q. PLEASE DESCRIBE THE RATE BASE PRO FORMA ADJUSTMENT TO REMOVE BUCKEYE SERVICE CENTER FROM RATE BASE.

A. The Buckeye Service Center ceased operations in May of 2023. This pro forma adjustment adjusts rate base to remove the net book value of the Buckeye Service Center, resulting in a reduction to rate base of $534,000 (*see* SFR Schedule B-2, page 6, column 16).

Q. IS THERE A CORRESPONDING OPERATING INCOME ADJUSTMENT RELATED TO THE BUCKEYE SERVICE CENTER?

A. Yes. The removal of Buckeye Service Center from rate base results in an associated impact to depreciation expense. This pro forma adjustment removes depreciation expense associated with the Buckeye Service Center from the Test Year, resulting in an increase to pre-tax operation income of $31,000 (*see* SFR Schedule C-2, page 23, column 62).

25. Include Navajo Regulatory Asset Amortization Disallowance

Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENT TO INCLUDE THE NGS REGULATORY ASSET AMORTIZATION DISALLOWANCE.

A. This adjustment reflects the 15% regulatory disallowance of the NGS regulatory asset amortization that was ordered in Decision No. 78317.[21] Because this does not qualify as a disallowance for GAAP purposes, a pro forma adjustment is needed to the Test Year to reflect the reduction in depreciation expense. This results in an increase to pre-tax operating income of $1,441,000 (*see* SFR Schedule C-2, page 16, column 43).

Q. IS THERE A CORRESPONDING RATE BASE PRO FORMA ADJUSTMENT RELATED TO THE NGS REGULATORY ASSET AMORTIZATION DISALLOWANCE?

A. Yes. As a result of the 15% regulatory disallowance of the NGS regulatory asset amortization that was ordered in Decision No. 78317, there must also be a corresponding rate base pro forma adjustment to ADIT, which was also approved in Decision No. 78317, to avoid an IRS normalization rule violation.[22] This results in a rate base increase of $1,237,000 (*see* SFR Schedule B-2, page 4, column 10).

26. Include and Annualize Ocotillo Modernization Project Deferral Amortization and Include Equity Return Disallowance

Q. PLEASE EXPLAIN THE OPERATING INCOME PRO FORMA ADJUSTMENTS FOR THE OMP DEFERRAL.

A. In Decision No. 76295, APS was allowed to defer for later recovery all non-fuel costs of owning, operating, and maintaining the OMP; retiring the existing steam generation at Ocotillo; and accruing interest at the cost of debt approved in the 2016 Rate Case.[23] In the Company's 2019 Rate Case, APS requested recovery of

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[21] Decision No. 78317 at 201-202; 444.
[22] Decision No. 78317 at 203, 432.
[23] Decision No. 76295 (Exhibit A, Settlement Agreement, Section X) at 13.

the OMP deferral in rate base with a corresponding increase to operating expenses to reflect an annual level of amortization over ten years. Decision No. 79293 accepted the requested rate base inclusion and corresponding operating income increase — however, with a return set at the 4.10% embedded cost of debt, as established in Decision No. 78317.[24]

There are two operating income adjustments related to the OMP deferral that were authorized in Decision No. 79293. The first pro forma adjustment reflects the annual level of amortization that was authorized in Decision No. 79293, since the Test Year in this case only includes 9.8 months of that allowed amortization. The second pro forma adjustment reflects the equity return disallowance on the deferral, as authorized in Decision No. 78317. These pro forma adjustments result in a reduction to pre-tax operating income of $984,000, related to the OMP deferral amortization, and an increase to pre-tax operating income of $4,052,000 (*see* SFR Schedule C-2, pages 16 and 17, columns 44 and 45).

27. Annualize Four Corners SCR Deferral Amortization

Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENT TO ADJUST THE SCR DEFERRAL AMORTIZATION.

A. This adjustment annualizes the SCR deferral amortization expense as authorized in Decision Nos. 78317 and 79293, since the Test Year includes 9.8 months of that allowed amortization.[25] This adjustment results in an increase to pre-tax operating income of $417,000 (*see* SFR Schedule C-2, page 18, column 47).

[24] Decision No. 78317 at 124, 444; Decision No. 79293 at 441.
[25] Decision No. 78317 at 116-17, 425; Decision No. 79293 at 441.

28. Adjust and Annualize Four Corners Inventory

Q. PLEASE EXPLAIN THE PRO FORMA ADJUSTMENT TO ANNUALIZE FOUR CORNERS INVENTORY.

A. This pro forma adjustment is necessary to reflect the annualized level of amortization related to Four Corners material and supplies inventory as accepted in Decision Nos. 78317 and 79293. Estimated salvage recovery was also included in this calculation and netted with the forecasted balance. The pro forma then adjusts the Test Year Four Corners inventory amortization to reflect this updated inventory balance forecast. This adjustment results in a reduction to pre-tax operating income of $923,000 (*see* SFR Schedule C-2, page 19, column 49).

29. Remove Four Corners Units 1, 2, and 3 Amortization

Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENT TO REMOVE AMORTIZATION OF FOUR CORNERS UNITS 1, 2, AND 3 FROM THE TEST YEAR.

A. The amortization for Four Corners Units 1, 2, and 3 was authorized for recovery through December 2024 in Decision Nos. 74876 (December 23, 2014) and 76295.[26] This adjustment is necessary to exclude the amortization of these expenses from the Test Year, as amounts have been fully recovered as of the end of the Test Year. This results in an increase to pre-tax operating income of $7,922,000 (*see* SFR Schedule C-2, page 22, column 59).

30. Remove Advertising Expense

Q. PLEASE EXPLAIN THE PRO FORMA ADJUSTMENT TO REMOVE CERTAIN ADVERTISING EXPENSES.

A. In Decision No. 79293, the Commission directed APS "not [to] use ratepayer-derived funds on marketing, advertising, media production, advertising retainers,

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[26] Decision No. 74876 (Exhibit A, Proposed Settlement Agreement, Section X) at 15; Decision No. 76295 (Exhibit A, Settlement Agreement, Section IX) at 12.

or advertising research, or for any other marketing- or advertising-related purposes, (collectively "marketing/advertising") unless the content of the marketing/advertising is educational and directly related to a specific Commission-approved program, rate plan, or tariff."[27] This adjustment isolates the costs that will not be requested for recovery from customers and removes those costs from Test Year expenses. This results in an increase to pre-tax operating income of $2,422,000 (*see* SFR Schedule C-2, page 19, column 50).

31. Remove Out of Period and Miscellaneous Items

Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENT TO REMOVE OUT OF PERIOD AND MISCELLANEOUS.

A. In any test year, there are some items recorded that relate to periods other than the test year, or conversely, items recorded in other time periods that correctly belong in the test year. For the Test Year, APS is removing costs associated with certain executive compensation, consulting fees, injury claims, as well as shareholder funded customer bill assistance and other general expenses that are not reflective of on-going costs or costs that APS does not intend to collect from customers. This adjustment results in an increase to pre-tax operating income of $31,092,000 (*see* SFR Schedule C-2, page 20, column 52).

32. Include Cloud Computing

Q. PLEASE DESCRIBE THE RATE BASE PRO FORMA ADJUSTMENT TO INCLUDE THE IMPACTS OF CLOUD COMPUTING.

A. As accepted in Decision Nos. 78317 and 79293, this rate base pro forma adjustment includes the impacts associated with cloud computing, in alignment with the National Association of Regulatory Utility Commissioners (NARUC's) Resolution Encouraging State Utility Commissions to Consider Improving the Regulatory

[27] Decision No. 79293 at 453.

Treatment of Cloud Computing Arrangements.[28] This pro forma adjustment is calculated by taking the annual level of cloud computing costs associated with applications in which contracts have been entered into and multiplying that by the average contract term of 2.42 years. This pro forma increases rate base by $25,649,000 (*see* SFR Schedule B-2, page 3, column 9).

33. Annualize TEAM Balancing Account Liability Amortization

Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENT TO ANNUALIZE TEAM BALANCING ACCOUNT AMORTIZATION.

A. Since the Test Year in this case includes 9.8 months of authorized cost recovery (due to the March 8, 2024 rate implementation), this pro forma adjustment is necessary to reflect the annualized level of amortization related to the TEAM Balancing account liability as accepted in Decision No. 79293.[29] This results in an increase to pre-tax operating income of $112,000 (*see* SFR Schedule C-2, page 20, column 54).

34. Annualize COVID Customer Relief Deferral Authorized Amortization

Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENT TO ANNUALIZE THE COVID CUSTOMER RELIEF DEFERRAL AUTHORIZED AMORTIZATION.

A. Since the Test Year in this case includes 9.8 months of authorized cost recovery (due to the March 8, 2024 rate implementation), this pro forma adjustment is necessary to reflect the annualized level of amortization related to the COVID Customer Relief Deferral amortization accepted in Decision No. 79293. This

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[28] See NARUC's Resolution Encouraging State Utility Commissions to Consider Improving the Regulatory Treatment of Cloud Computing Arrangements, November 16, 2016, *available at*: 2E54C6FF-FEE9-5368-21AB-638C00554476.

[29] Decision No. 79293 at 438.

results in a reduction to pre-tax operating income of $111,000 (*see* SFR Schedule C-2, page 21, column 55).

35. Include Wildfire Mitigation O&M Cost Accumulation Amortization

Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENT TO INCLUDE THE WILDFIRE MITIGATION O&M EXPENSE ACCUMULATION IN RATE BASE.

A. In August 2024, APS filed an application with the Commission requesting the ability to defer, for future recovery in rates, the Company's wildfire management O&M expenses, including increased insurance costs. The purpose of the request was not only to allow the Company the ability to recover the significantly increased incremental costs that it is incurring during 2025 and forecasted through the estimated rate effective date of this case that would otherwise be lost absent this deferral order, but also to spread out the collection of those costs over a longer period to ease impact to customers. In alignment with Staff's Recommended Order issued on May 28, 2025,[30] the Company is including this adjustment to seek recovery of the accumulation of costs outside the Company's Test Year that have already been or will be incurred prior to the conclusion of this case and would otherwise result in loss of recovery. Mr. Tetlow discusses the increased risk of wildfires and the Company's mitigation efforts, and Mr. Bauer further discusses the deferral request and inclusion in this case. This rate base pro forma adjustment includes incremental wildfire mitigation O&M costs from January to March 2025 and forecasted wildfire mitigation operations and maintenance costs from April 2025 through October 1, 2026 (estimated rate effective date). The Company plans to update the forecasted amounts with actuals known at that time in its rebuttal testimony. Accordingly, the rate base increase for the Wildfire Mitigation O&M

[30] *In re Application of Ariz. Pub. Serv. Co. for an Accounting Deferral Order for Recovery of a Non-Capital and Operation & Maintenance Fire Mitigation Expenses*, Docket No. E-01345A-24-0186, Utilities Division Memorandum and Proposed Order (May 28, 2025).

Expense Accumulation is $28,792,000 (*see* SFR Schedule B-2, page 4, column 11).

Q. IS THERE A CORRESPONDING OPERATING INCOME PRO FORMA ADJUSTMENT ASSOCIATED WITH THE WILDFIRE MITIGATION O&M EXPENSE ACCUMULATION?

A. Yes. The Company is requesting to amortize the fire mitigation O&M expense accumulation over a five-year period. This pro forma adjustment results in a reduction to pre-tax operating income of $5,758,000 (*see* SFR Schedule C-2, page 17, column 46).

36. Normalize Wildfire Mitigation O&M Costs

Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENT TO NORMALIZE WILDFIRE MITIGATION O&M COSTS.

A. In addition to the Wildfire Mitigation O&M Expense Accumulation pro forma adjustment as described above, the Company is also proposing to normalize the Test Year in this case to be more reflective of costs that the Company will be experiencing when rates go into effect, which is estimated to be October 1, 2026 (aligning future cost levels with future recovery). The 2024 Test Year level of wildfire mitigation O&M expenses is approximately 500% lower than that which the Company is incurring today. Since the Test Year levels are typically what would establish recovery in future rates absent a normalization pro forma adjustment, future rates established at the conclusion of this case would result in a significant under-recovery by the Company when they go into effect. This pro forma adjustment normalizes the associated costs of the Test Year wildfire mitigation O&M costs to capture the increase in these costs. This normalization adjustment uses the 2025 wildfire O&M mitigation costs to adjust the Test Year expenses to reflect wildfire mitigation O&M cost increases. The Company plans to update these costs in its rebuttal testimony through 2026, as these amounts will be known and measurable. This results in a reduction to pre-tax operating income of $12,278,000 (*see* SFR Schedule C-2, page 18, column 48).

37. Include Cholla Unrecovered Costs Net of Recovery

Q. CAN YOU PLEASE INDICATE HOW THE COMPANY IS PROPOSING TO ADDRESS THE CLOSURE OF CHOLLA?

A. As described in Mr. Tetlow's Direct Testimony, since the cessation of coal-fired generation at Cholla in mid-March 2025, the Company has begun to incur (and will continue for the next several years to incur) a substantial increase in costs necessary to comply with EPA regulations governing the remediation of coal-combustion residual (CCR) disposal operations. Such costs are not reflected in current rates for service. Additionally, while the Company's modest amounts of unrecovered costs and net book value remain to be recovered, primarily due to factors beyond APS's control, such as inflation and rising interest rates, the federally-required CCR remediation costs significantly dwarf these unrecovered expenses.

In August 2024, the Company filed an application with the Commission requesting a deferral order that would allow it to defer for future recovery both the (a) expenses necessary to eventually decommission coal-fired power plant infrastructure at Cholla, including but not limited to any and all near-term work necessary for legally-required site environmental remediation, CCR corrective actions, and the closure of CCR management facilities, and (b) any unrecovered plant investment and operating costs incurred through and after April 30, 2025.[31] This request also included a proposal to spread out the collection of these costs over a longer period of time to mitigate customer rate impacts. In addition, this deferral and subsequent elongated recovery period will provide the Company with

[31] *In re the Application of Ariz. Pub. Serv. Co. for an Accounting and Deferral Order Associated with Unrecovered Book Value and Closure Costs of Cholla Power Plant. Power*, Docket No. E-01345A-24-0185.

time to effectively pursue the utilization of securitization, as legislation was recently passed and signed into law in Arizona, which may be used to further reduce the impact of these expenses on APS's customers.[32]

Q. PLEASE DESCRIBE THE RATE BASE PRO FORMA ADJUSTMENT RELATED TO CHOLLA RETIREMENT COSTS.

A. At this time, the Company has a relatively small amount of unrecovered net book value that has yet to be recovered from customers but — at the same time — is able to derive significant savings for customers, given that cessation of operations effectively eliminates the incurrence of actual expenses associated with plant O&M. Upon the cessation of plant operations, the remaining unrecovered net book value was transferred from plant in service and inventory to a regulatory asset. This regulatory asset contains the remaining net book value of Cholla Units 1 and 3 and Common equipment and facilities that have not been recovered through customer rates as of the end of the Test Year. However, ongoing recovery in current rates of the operating costs of Cholla Units 1 and 3 is anticipated to continue beyond the closure of the plant and until updated rates in this preceding are established, which is estimated to be October 1, 2026. Therefore, this pro forma adjustment reflects the offsetting reduction in unrecovered costs as a result of this ongoing recovery and ultimately results in a net regulatory liability that the Company is requesting to return to customers over a ten-year period (described below). The Company intends to update all cost estimates (including final closure costs and updates from future studies), net of recovery, in its rebuttal testimony. The result is the establishment of a net regulatory liability of $51,346,000, and a net decrease to total rate base of $162,858,000 (*see* SFR Schedule B-2, page 5, column 13).

[32] Ariz. H.B. 2679, 57th Leg., 1st Reg. Sess. (May 13, 2025).

38. Include Amortization of Cholla Decommissioning Costs

Q. IS THERE A CORRESPONDING OPERATING INCOME ADJUSTMENT RELATED TO THE CHOLLA RETIREMENT COSTS?

A. Yes. APS has begun incurring and will continue to incur over the next several years substantial costs, not currently reflected in rates, for the closure and remediation of CCR disposal units at Cholla, which is required under federal law. A modest amount of unrecovered net book value also remains. For this reason, the income statement pro forma adjustment includes requested amortization over a ten-year period for the estimated costs that the Company has started to, and will continue to, incur in the coming years to address the decommissioning and dismantlement of the plant and the CCR obligations, in accordance with EPA mandates to close the ash ponds. In addition, this income statement pro forma adjustment similarly amortizes the small amounts of Cholla unrecovered net book value, net of ongoing recovery amounts discussed in my previous response, over the same ten-year period. This results in a reduction to pre-tax operating income of $11,782,000 (*see* SFR Schedule C-2, page 22, column 58).

39. Remove Cholla Costs from Test Year

Q. IS THERE AN ADDITIONAL OPERATING INCOME ADJUSTMENT RELATED TO CHOLLA COSTS INCURRED DURING THE TEST YEAR?

A. Yes. There is an additional pro forma adjustment related to Cholla non-capital costs. This adjustment removes the Test Year property tax, O&M, and depreciation costs incurred during the year to ensure that customers do not continue to pay for the operating costs of the plant in future rates as a result of its closure. This adjustment results in an increase to pre-tax operating income of $79,472,000 (*see* SFR Schedule C-2, page 19, column 51).

40. Adjust Cholla Unit 2 Cost of Removal

Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENT TO INCLUDE CHOLLA UNIT 2 COST OF REMOVAL.

A. The pro forma adjustment for the Cholla Unit 2 cost of removal was originally authorized in Decision No. 76295.[33] Subsequently, in Decision Nos. 78317 and 79293, the Commission accepted APS's request to amortize $932,153 annually for Cholla Unit 2 cost of removal.[34] This pro forma adjustment is necessary to reflect the updated cost of removal forecast related to Cholla Unit 2, primarily related to estimated Cholla ash pond removal costs, based on a 2024 updated study by AECOM.[35] This updated study forecasts removal costs for Unit 2 through June 2033, resulting in an annual removal cost estimate of $15,699,083. This adjustment reflects this additional annual removal cost estimate over the 2024 Test Year authorized amortization amount, resulting in a reduction to pre-tax operating income of $14,767,000 (*see* SFR Schedule C-2, page 23, column 61).

41. Include FERC Order 898 Implementation Impacts

Q. PLEASE SUMMARIZE FERC ORDER 898.

A. FERC Order 898 was issued on June 29, 2023, with an effective date of January 1, 2025.[36] The order updates the Uniform System of Accounts to address the rapid changes in technology and resource mix in the power industry. The order adds accounts within the various functional categories (such as Fossil, Nuclear, Transmission, Distribution, Solar, and Energy Storage categories) in the Uniform System of Accounts, which allows for account distinctions between renewable

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[33] Decision No. 76295 (Exhibit A, Settlement Agreement, Section VI) at 9.

[34] This adjustment was an uncontested pro forma income statement items and, as a result, was not discussed in Decision Nos. 78317 and 79293.

[35] AECOM is an infrastructure consulting firm that provides engineering and environmental services to address complex infrastructure and environmental projects, including site remediation and decommissioning of energy facilities.

[36] FERC Order 898, *available at*: Order No. 898 | Federal Energy Regulatory Commission.

energy, energy storage, computer hardware, software, and communications equipment, which were previously recorded in the General/Intangible functional category.

Q. PLEASE DESCRIBE THE PRO FORMA ADJUSTMENT TO ADJUST FOR FERC ORDER 898 IMPLEMENTATION IMPACTS.

A. As a result of this order, a variety of APS plant assets were reclassified to the new FERC Order 898 accounts on January 1, 2025. The primary impact of this reclassification on cost recovery relates to Transmission functional computer hardware, software, and communications equipment assets that, prior to FERC Order 898 implementation, were recorded to the General/Intangible functional category. Transmission functional category assets are recovered fully through the FERC Formula Rate and the Transmission Cost Adjustment, which is set through FERC Formula Rates. As a result of these FERC Order 898 transfers between functional categories, certain jurisdictional recovery differences resulted, primarily moving from ACC recovery to FERC recovery.

This adjustment calculates the impacts of the FERC Order 898 transfers to remove the new Transmission categories from ACC recovery. These Transmission assets will be included in the FERC Formula Rate for the 2025 test year, with FERC rates that take effect in June 2026. While the assets that were transferred from General/Intangible to Transmission compose the largest portion of the pro forma adjustment impacts, asset transfers between other functional categories, with resulting changes in recovery methodology, are also included (such as offsetting transfers from General/Intangible to Generation or Distribution). Total Company rate base nets to zero as a result of this adjustment, as the FERC and ACC jurisdictional transfers net to zero. This adjustment results in a reduction to ACC jurisdictional rate base of $87,716,000 (*see* SFR Schedule B-2, page 5, column 15).

42. Include Palo Verde Lease Buyback

Q. PLEASE DESCRIBE THE RATE BASE PRO FORMA ADJUSTMENT ASSOCIATED WITH THE PALO VERDE LEASE BUYBACK.

A. As discussed by Mr. Tetlow, APS has reached agreement with the lessors involved in two of the three sale leaseback agreements for Palo Verde Unit 2 to exercise its option to purchase the lease assets associated with these agreements.[37] As a result of the Palo Verde lease buyback, APS will record the $198.7 million purchase price as a capital asset upon purchase and will eliminate $11.9 million in annual lease payments. This results in an increase to rate base of $198.7 million (*see* SFR Schedule B-2, page 5, column 14).

Q. IS THERE A CORRESPONDING OPERATING INCOME ADJUSTMENT ASSOCIATED WITH THE PALO VERDE LEASE BUYBACK?

A. Yes. The Palo Verde lease buyback requires adjustment to operating income associated with the removal of the lease payment on the two purchased leases from the Test Year, the addition of property tax expense related to these purchased leases, and the adjustment of depreciation expense to reflect the annual cost of the newly acquired assets. In addition, prior to the lease buyback, leasehold improvements were amortized through 2033 in alignment with the term of the lease. As a result of the lease buyback, the amortization period of these leasehold improvements is extended to 2066, resulting in an offsetting reduction to annual amortization expense. These adjustments result in a net increase to pre-tax operating income of $9,921,000 (*see* SFR Schedule C-2, page 21, column 56).

V. <u>ADJUST NUCLEAR DECOMMISSIONING COSTS</u>

Q. IS THE COMPANY SEEKING AN ADJUSTMENT FOR NUCLEAR DECOMMISSIONING FUNDING AND THE CORRESPONDING EXPENSE?

[37] This development does not affect APS's interest in the third lease agreement.

A. APS is not proposing a change to the total annual amount of funding in the Test Year ($2,281,000), nor is the Company proposing a change to the allocation of the annual funding between the three Palo Verde units as demonstrated in Attachment EAB-01DR. It is important to note that while earnings assumptions and decommissioning study cost estimates reflect an expected increase in costs and a need for elevated funding levels in Palo Verde Unit 2, a pro forma adjustment is not necessary at this time if Test Year levels are maintained. As such, there are no adjustments to the Nuclear Decommissioning Funding being proposed in this case, but the Company requests that the Commission include the following specific language in their final decision:

> "The decommissioning costs as recommended by APS are adopted as set forth in the decommissioning contribution schedule attached as Appendix X to this Decision."

VI. CONCLUSION

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

ARIZONA PUBLIC SERVICE COMPANY
SCHEDULE OF PALO VERDE DECOMMISSIONING AMOUNTS INCLUDED IN COST OF SERVICE

	6/1/2045	4/24/2046	11/25/2047	
YEAR	UNIT 1	UNIT 2	UNIT 3	TOTAL
2025	-	2,281,000	-	2,281,000
2026	-	2,281,000	-	2,281,000
2027	-	2,281,000	-	2,281,000
2028	-	2,281,000	-	2,281,000
2029	-	2,281,000	-	2,281,000
2030	-	2,281,000	-	2,281,000
2031	-	2,281,000	-	2,281,000
2032	-	2,281,000	-	2,281,000
2033	-	2,281,000	-	2,281,000
2034	-	2,281,000	-	2,281,000
2035	-	2,281,000	-	2,281,000
2036	-	2,281,000	-	2,281,000
2037	-	2,281,000	-	2,281,000
2038	-	2,281,000	-	2,281,000
2039	-	2,281,000	-	2,281,000
2040	-	2,281,000	-	2,281,000
2041	-	2,281,000	-	2,281,000
2042	-	2,281,000	-	2,281,000
2043	-	2,281,000	-	2,281,000
2044	-	2,281,000	-	2,281,000
2045	-	2,281,000	-	2,281,000
2046	-	570,250	-	570,250
2047	-	-	-	-
	$ -	$ 48,471,250	$ -	$ 48,471,250