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Re: The Effect of Lower Natural Gas Prices on Arizona Public Service Company's General Rate Case; Docket No. E-01345A-05-0816

Dear Colleagues and Parties to the Docket:

In recent weeks and months, the price of natural gas has declined throughout the country. When Arizona Public Service ("Company") filed its general rate case in November, 2005, gas costs for the Company's proposed test year were $7.20/MMBtu. Since that time, natural gas prices have fallen to around $3.70/MMBtu at the San Juan basin and $3.92/MMBtu at the Permian basin. Henry Hub future prices for the winter range from $5.73/MMBtu in November to $7.77/MMBtu in February.

While I am cognizant of the volatility of the natural gas market, I believe that these lower prices necessitate an updated analysis of the overall rate increase the Company is seeking, and testimony from the Parties to the case on this question.

The Parties' testimony to date demonstrates that the case will undoubtedly center in part upon financial ratios that rely on a dynamic analysis of the Company's current <u>and projected</u> financial picture. Obviously APS' financial health is affected by the price it pays for natural gas, a point the Company has made repeatedly over the past year.

In his direct testimony on this matter, APS' Executive Vice President Steven M. Wheeler tied the need for rate relief to natural gas prices. He stated:

> "The increased cost of fuel and purchased power is the most significant reason why the Company has filed this request for rate relief. In this proceeding, APS is requesting a 21.34% base rate increase, or approximately $450 million. Of this amount, approximately $299 million (which is approximately 70% of the total requested relief), is attributable to higher fuel and purchased power costs."[1]

Furthermore, in his rebuttal testimony, APS' Chief Financial Officer Donald E. Brandt testified regarding APS' credit quality. He stated:

> "In the best interests of customers and the State's economy, the Commission should not aim to establish rate levels such that APS just barely qualifies for an investment grade rating. Such a goal, ***given our dynamic and fluid situation*** and the increasingly and

[1] See Direct Testimony of Steven M. Wheeler, pg. 4, line 3.

> relentlessly critical view of the credit rating agencies, places APS in substantial peril of missing that goal at great cost."[2] (emphasis supplied)

I look forward to a full evidentiary hearing where the Parties provide an analysis of the impact of lower natural gas prices on the Company's rate request. Specifically, I would like the parties to be prepared to tell the Commission whether the lower gas prices would alter the Company's FFO/Debt ratio, whether and how it would affect the ratings agencies' assessments of APS' financial condition, and whether the Company's and Staff's proposed base rates and changes to the PSA, which partially reflect gas prices, should be changed to take into account the new gas prices.

Sincerely,

Kris Mayes
Commissioner

Cc: Chairman Jeff Hatch-Miller
Commissioner William A. Mundell
Commissioner Mike Gleason
Commissioner Barry Wong
Brian McNeil
Ernest Johnson
Heather Murphy
Docket

[2] See Rebuttal Testimony of Donald E. Brandt, pg. 18, line 6.