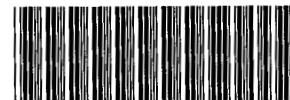



PINNACLE WEST
CAPITAL CORPORATION
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ARIZONA CORPORATION COMMISSION
DOCUMENT CONTROL

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August 7, 2003

Arizona Corporation Commission
DOCKETED

AUG 07 2003

Hon. Mike Gleason, Commissioner
ARIZONA CORPORATION COMMISSION
1200 West Washington
Phoenix, Arizona 85007

DOCKETED BY	<i>CM</i>
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Re: APS Rate Case; Docket No. E-01345A-03-0437

Dear Commissioner Gleason:

I have reviewed your letter of July 24, 2003. After consultation with the appropriate Arizona Public Service Company ("APS" or "Company") personnel, I am able to provide you with the following response.

As a matter of pure arithmetic, the annual revenue requirement impact of the requested inclusion in APS rates of new generation is approximately \$106,648,000. The mathematical formula by which incremental changes in test period rate base and operating income are translated into changes in APS revenue requirements is $[(\Delta \text{ Rate Base} \times \text{Rate of Return}) \pm \Delta \text{ Operating Income}] \times \text{Revenue Conversion Factor} = \Delta \text{ Annual Revenue Requirement}$. This formula is from Schedule A-1 of the Company's application. Expressed in words, an incremental change in rate base from Schedule B-2 is multiplied by the required rate of return (Schedule A-1, line 5). That product would then be adjusted upward or downward by the incremental change in operating income taken from Schedule C-2. The resulting sum is then multiplied by the revenue conversion factor (Schedule A-1, line 7). By referring then to Schedule B-2, page 1 of 3 (rate base), and Schedule C-2, page 3 of 10 (operating income), the pro forma adjustment to annual revenue requirements for inclusion of the new generation in the Company's rate base is $[(\$889,237,000 \times .0867) - \$12,575,000] \times 1.6529 = \$106,648,000$.

The same formula will calculate the incremental annual revenue requirement impact for any of the Company's proposed pro forma adjustments. However, I would caution against

APS • APS Energy Services • Pinnacle West Energy • SunCor • El Dorado

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APS Energy Services and APS are subsidiaries of Pinnacle West Capital Corporation; however, APS Energy Services is not the same company as APS. You do not have to be an APS Energy Services customer to receive quality regulated services from APS.

Commissioner Mike Gleason
Arizona Corporation Commission
August 7, 2003
Page 2 of 2

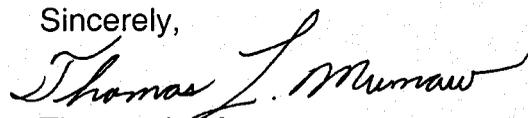
viewing any proposed pro forma adjustment or set of adjustments in total isolation. As you know, ratemaking is more than just mathematics.

Without the assumption that the new generating units would be included in rates (an assumption consistent with APS' stated intentions for the past year), APS would not have simply submitted the present rate filing less the revenue requirements impact of the new generation. The entire rate application would have been significantly different. In Mr. Robinson's Direct Testimony, he references cost-of-service adjustments that could legitimately have been made that would have further increased the APS revenue requirement but which were not requested by APS in the original application. Other proposed cost-of-service adjustments were stretched out over an extended number of years. Both of these reflect our desire to ameliorate the overall request. In Dr. Olson's Direct Testimony, it is also indicated that the cost of capital recommended for APS was influenced by the reduced risk to APS from owning the new generation instead of being overly dependent on the market, a market which utility investors regard as both risky and undependable.

These are but a sampling of changes that would be necessary to reflect an entirely new and different Company rate request, one APS does not believe would be in the best long-term interests of APS customers. Moreover, the requested rate base treatment is a significant step in the Company's efforts to address before this Commission the impacts of the Track A decision, which decision left the new generation stranded at Pinnacle West Energy. It further reflects the role this new generation has served and will continue to serve in preserving the reliability of APS service to its customers. Ignoring the history that has led to the present circumstances faced by APS and its affiliates would present the Commission a truly incomplete picture of this important issue.

I hope this explanation has been responsive to your inquiry. Please let me know if there are any additional questions you may have concerning the Company's rate application.

Sincerely,



Thomas L. Mumaw
Attorney for Arizona Public Service
Company

cc: Chairman Marc Spitzer
Commissioner Jim Irvin
Commissioner Bill Mundell
Commissioner Jeff Hatch-Miller
Docket Control and Parties of Record