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May 10, 2004

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Arizona Corporation Commission
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**Re: UniSource Energy Services – Status of Purchased Power
Contract with PWCC; Docket No. E-01032C-00-0751 et al. and
Reorganization of UniSource; Docket No. E-04230A-03-0933**

E-01032C-00-0751
G-01032A-02-0598
E-01933A-02-0914
E-01032C-02-0914
G-01032A-02-0914
G-01032E-03-0515

Dear Colleagues:

Commissioner Mundell's April 19 letter urges us to expand the scope of the public comment sessions for the proposed UniSource reorganization matter to include discussions of UniSource's attempts to renegotiate its purchased power contract with Pinnacle West (PWCC). I believe a review of these contract negotiations is outside the purview of the reorganization docket. Alternatively, if we do decide to include this matter, we should also discuss why the Commission decided to limit UniSource's bargaining position by rejecting, on a split vote, an amendment to allow UniSource to retain 40% of any cost savings from a renegotiated contract.

Decision No. 66028 allows UniSource to retain 10% of any cost savings from a renegotiated contract with PWCC. The original Agreement proposed that it keep 40%. If we had accepted the original provision, UniSource may have had additional bargaining leverage in these negotiations.

Upon acquiring Citizens' gas and electric assets, UES assumed Citizens' obligations under an existing purchased power contract with PWCC. In Decision 66028, the Commission ordered UniSource to negotiate a more favorable contract.

"We agree with the Joint Applicants, Staff and RUCO that the price contained in the New Contract is not an unreasonable rate for electricity considering all relevant factors. As described by the Staff and Joint Applicant witnesses, the appropriate evaluation of market prices must include consideration of the full requirements, load-following nature of the contract, and the inclusion of necessary transmission and ancillary services. Based on all of these factors, as

well as the Stipulation's requirement that the Joint Applicants may not seek recovery of PPFAC costs for a more than two-year period under the New Contract (June 1, 2001 to the expected closing date of July 28, 2003), we find that the new purchased power adjustor rate of \$0.01825 is not unreasonable. Given current market conditions, we believe that UniSource should continue to negotiate with PWCC for additional concessions." (Decision No. 66028 at pp. 12-13)

To date, UES has filed status reports on these discussions on February 2, March 15 and April 2. All the letters repeat the same message: They have not been able to reach consensus.

Changing a contract has to be *mutually* beneficial to both UniSource and PWCC. Each side must find that, taken as a whole, the terms of a new agreement are at least as acceptable as the terms of the old one. A party to a contract cannot unilaterally change the terms of that contract. If we are concerned about the lack of productive discussions, perhaps our inquiry should not be directed solely to just one of the parties.

The public comment sessions should focus on the several issues surrounding the proposed UniSource acquisition. There is plenty to talk about in that docket alone. If we do discuss UES's negotiations with PWCC, however, we should provide a complete picture to the public.

Sincerely,



Mike Gleason

c: Docket Control
Parties to the docket
Jim Pignatelli, Unisource
Bill Post, Pinnacle West