

ORIGINAL



PINNACLE WEST
CAPITAL CORPORATION
RECEIVED



0000011146

06

2004 AUG 17 A 11: 53

August 12, 2004

AZ CORP COMMISSION
DOCUMENT CONTROL

William J. Post
Chairman of the Board &
Chief Executive Officer

Arizona Corporation Commission
DOCKETED

The Honorable Trent Franks
House of Representatives
CONGRESS OF THE UNITED STATES
1237 Longworth Building
Washington, DC 20515

AUG 17 2004

DOCKETED BY

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

Dear Representative Franks:

Thank you for your letter of July 8, 2004. As you are no doubt aware, we have been talking to both Guardian Industries Corp. ("Guardian") and UniSource Energy Corporation ("UniSource") on the issues raised by that letter. Consequently, I want to provide you with the most up-to-date information on where all this stands, which is why I could not get back to you sooner.

I also want to take this opportunity to applaud you for your interest in and concern for economic development within the Second District. Although APS does not serve any customers in Mohave County, we fully support those efforts. To that end, and even though Guardian is not our customer or within our certificated retail service area, we have met several times with Guardian representatives, both in person and by phone, to provide whatever advice and information we can on the options discussed below. We are also in active discussions with UniSource to explore those same options.

Before addressing possible solutions to the situation faced by Guardian, let me share with you several observations concerning the situation itself. First, I do not know the extent to which Guardian was or was not given any rate assurances by Citizens Communications ("Citizens"), which was the sole state-authorized provider of electric service in that portion of Mohave County at the time Guardian located its facility in Kingman. I do know that neither Pinnacle West Capital Corporation ("Pinnacle West") nor its regulated electric utility subsidiary, Arizona Public Service Company ("APS"), made, or could have been in a position to make, any representations to Guardian. Second, it would appear that the only logical party to assume any unmet obligations of Citizens to Guardian would be Citizens' successor in interest and not Pinnacle West or APS.

Aside from the issues of cause and responsibility, what are the going forward options available to Guardian? Fortunately, there are several. I will address them in no particular order of either their efficacy or their practicality.

As noted in your letter, one option is to restructure the existing wholesale power supply contract between Pinnacle West and UniSource in such a way as to allow for lower supply costs to Guardian.¹ Pinnacle West has engaged in good faith negotiations with UniSource on this point, with our most recent discussion occurring last week. This wholesale contract has no direct connection to the retail tariff under which Guardian receives electric service. The goal of these discussions, like all contract renegotiations, is to preserve the economics of the agreement initially negotiated by both parties but in a different "win/win" manner – not to impose unilateral concessions on either party – particularly since Pinnacle West has no contractual relationship with Guardian and was not a party to any commitments that may have been made to Guardian at the time it decided to locate in Mohave County. However, it would be the responsibility of UniSource to request a special rate application to modify the existing retail tariff, which would then require approval by the Arizona Corporation Commission ("ACC").

A second, and more targeted solution, might be the direct negotiation of a special contract between Guardian and UniSource. That had apparently been the original intent of Guardian and Citizens, and it could still be possible today. Such a special contract would, of course, have to be approved by the ACC, just as would an agreement between Citizens and Guardian of the kind referenced in your letter. APS has considerable past experience with "economic development" rates of the type we are discussing here, and it believes they can be useful tools to enhance job opportunities for Arizonans and increase the tax base supporting local Arizona government.

A third option might be to consider a competitive electric service provider ("ESP") as an alternative to UniSource. When representatives of APS met with Guardian to discuss these same issues, it was made clear to us that Guardian was considering this option and had met or intended to meet with ESPs. As to our ESP, APS Energy Services, they met with Guardian and explained they would consider providing them service; however, they did not believe they could improve on their existing tariff.

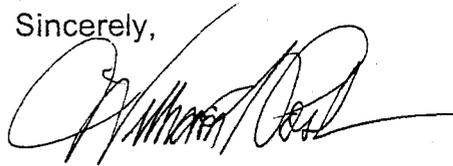
¹ In that regard, I should note that this agreement is not responsible for the 38% increase referenced in your letter. Much of that increase was to recover the accumulated costs incurred by Citizens under a previous power supply agreement or which had been incurred under the new agreement but not previously flowed through to customers. On a going forward basis, the charges to UniSource under the existing power supply agreement, considering the lack of any price or volume risk to UniSource, are not only reasonable, they are below even today's depressed market prices under similar circumstances.

The Honorable Trent Franks
August 12, 2004
Page 3

Finally, there is at least the theoretical possibility that the area encompassing the Guardian facility could be deleted from the UniSource service area and added to that of an existing electric utility. This would require the permission of both UniSource and the ACC, in addition to a willing successor utility, and I'm not convinced the new utility could service them at a lower rate.

I hope this has been responsive to your inquiry. Over the last 20 years we have negotiated and received approval of several economic development contracts which have benefited both our existing customers and the new facility. I believe it is important that existing customers also benefit from special contracts, and in every request we made to the ACC we documented the expected benefits to both parties. Please do not hesitate to call me if you have any additional questions.

Sincerely,

A handwritten signature in black ink, appearing to read "William J. Post", written in a cursive style.

William J. Post

WJP:DN

cc: Chairman Marc Spitzer, Arizona Corporation Commission
Steven J. Glaser, Sr. VP, Tucson Electric Power
Peter S. Walters, Group VP, Guardian Industries Corp.