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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
MARC SPITZER
WILLIAM A. MUNDELL
MIKE GLEASON
KRISTIN K. MAYES

IN THE MATTER OF THE GENERIC PROCEEDING CONCERNING ELECTRIC RESTRUCTURING ISSUES.	DOCKET NO. E-00000A-02-0051
IN THE MATTER OF THE GENERIC PROCEEDING CONCERNING THE ARIZONA INDEPENDENT SCHEDULING ADMINISTRATOR.	DOCKET NO. E-00000A-01-0630

NOTICE OF FILING TESTIMONY

Arizona Public Service Company ("APS") hereby files the Direct Testimony of Jeffrey B. Guldner, which includes at Schedule JBG-1 the APS Proposed Code of Conduct, pursuant to the Procedural Order dated May 3, 2005.

RESPECTFULLY SUBMITTED this 29th day of July, 2005.

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CORPORATION LAW DEPARTMENT

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All parties of record.

Vicki DiCola

Vicki DiCola

TESTIMONY OF JEFFREY B. GULDNER

On Behalf of Arizona Public Service Company

Docket No. E-00000A-02-0051

Docket No. E-00000A-01-0630

July 29, 2005

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TESTIMONY OF JEFFREY B. GULDNER
ON BEHALF OF ARIZONA PUBLIC SERVICE COMPANY
(Docket No. E-00000A-02-0051)
(Docket No. E-00000A-01-0630)

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.

A. My name is Jeffrey B. Guldner. I am the Director of Regulatory Compliance for Arizona Public Service Company ("APS" or "Company"). In that role, I supervise the implementation of the Code of Conduct at APS, as well as supervise APS' compliance with the Federal Energy Regulatory Commission's ("FERC") Standards of Conduct and the FERC Codes of Conduct applicable to APS and its affiliates. My business address is 400 North 5th Street, MS 9795, Phoenix, Arizona, 85004.

Q. WHAT IS YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND?

A. I received a B. A. in Political Science from the University of Iowa in 1987. I received a J. D., *magna cum laude*, from the Arizona State University College of Law in 1996. From 1996 until 2004, I was an associate and then a partner with the law firm Snell & Wilmer LLP, in Phoenix, Arizona. My practice was concentrated in energy law, energy project finance, and public utility law. While practicing law, I represented APS, other public utilities, and investors in state and federal regulatory proceedings and transactions involving utility rate and service matters, generation and transmission facilities siting, electric industry restructuring, resource planning and prudence reviews. Prior to attending law school, I was a Surface Warfare Officer in the U.S. Navy. I served on active duty from 1987 to 1993 and in the Naval Reserve from 1993 to 1998.

II. SUMMARY OF TESTIMONY

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. There have been many changes since APS' original Code of Conduct was approved in 2000 (the "2000 Code of Conduct"). In the Track A Order, Decision No. 65154 (September 10, 2002), the Arizona Corporation Commission ("Commission") directed APS to submit modifications to the 2000 Code of Conduct to expand its application to APS' interactions with an affiliate from which it wants to purchase power, as opposed to just APS' retail electric affiliate. APS submitted a proposed Code of Conduct on November 12, 2002 (the "November 2002 Code of Conduct") and the Commission's Utilities Division Staff filed a Staff Report on the November 2002 Code of Conduct on August 13, 2003. Prior to a hearing on the November 2002 Code of Conduct, a stay was issued until after the Commission decided APS' then-pending rate case and ruled on APS' request to acquire and rate base the Pinnacle West Energy Corporation ("PWEC") Arizona assets.

The acquisition and rate basing of PWEC's Arizona assets was approved in Decision No. 67744 (April 7, 2005). In addition, PWEC and its subsidiary GenWest, LLC ("GenWest") have an agreement in place to sell their Silverhawk Power Plant in Nevada to Nevada Power Company.[1] When these transactions are complete, PWEC will no longer own any generation. These changes dispel much of the concern reflected in the Track A and Track B decisions about APS' dealings with wholesale electric affiliates. Also, the rate case settlement as

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[1] At the time this testimony was prepared, the agreement was pending Nevada Public Utilities Commission and FERC approval.

approved by the Commission included specific requirements relating to competitive wholesale procurement by APS.

Another issue impacting this proceeding is the uncertain status of retail electric competition in Arizona. As a result of the Arizona Court of Appeals' *Phelps Dodge* opinion in 2004,[2] many of the Electric Competition Rules were either vacated or remanded. Also as a result of that ruling, there currently are no certificated Electric Service Providers ("ESPs") in Arizona. Through the Electric Competition Advisory Group, the Commission has commenced a process to review and potentially modify the rules.

APS considered all of these developments in revising the November 2002 Code of Conduct. APS also sought to simplify and streamline the November 2002 Code of Conduct to create a more practically functional and understandable document. The Code of Conduct that APS is proposing is attached to my testimony as Schedule JBG-1 (the "Proposed Code of Conduct").

The vast majority of the substantive provisions in the 2000 Code of Conduct and the November 2002 Code of Conduct are unchanged. However, the Proposed Code of Conduct reflects the following:

- The Code is divided into four sections – Definitions, Basic Principles, Retail Electric Competition, and Competitive Procurement – to facilitate better training, implementation, and employee understanding of the Code.

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[2] *Phelps Dodge Corp. v. Arizona Corporation Commission*, 1 CA-CV 01-0068 (January 27, 2004), review denied (2004).

- References to specific Electric Competition Rules have been eliminated. This provides flexibility for incorporating changes to these rules that the Commission may make in the future.

- Some definitions have been revised to make them simpler to understand or have been eliminated because they were duplicative or could be included directly in the text.

- Certain provisions were modified or reorganized to promote straightforward application when possible.

- A new section specifically covering Competitive Procurement has been added to reflect the procurement-related provisions in Decision No. 67744.

With these changes, the Proposed Code of Conduct continues to address retail electric affiliate concerns that were the core of Rule 1616[3] – potential cross-subsidization and unfair discrimination – and addresses the affiliate issues discussed in the Track A and Track B proceedings relating to wholesale procurement.

III. PROCEDURAL BACKGROUND

Q. PLEASE DISCUSS THE PROCEDURAL BACKGROUND OF APS' PROPOSED CODE OF CONDUCT.

A. APS currently has in place the 2000 Code of Conduct that was approved by the Commission in Decision No. 62416 (April 3, 2000). The 2000 Code of Conduct primarily governs APS' interactions with its competitive retail ESP affiliates.

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[3] A.A.C. R14-2-1616 (Code of Conduct).

The only ESP affiliate of APS was APS Energy Services ("Energy Services"). As discussed previously, Energy Services is no longer authorized to provide, and does not provide, competitive retail electric service in Arizona, although it does provide other services.

In the Track A Order, Decision No. 65154 (September 10, 2002), the Commission directed APS to submit modifications to the 2000 Code of Conduct to address certain recommendations made by Staff. Those modifications were to expand the 2000 Code of Conduct to govern APS' interactions with all of its competitive electric affiliates, not just retail ESP affiliates. The Commission also directed Tucson Electric Power Company ("TEP") to submit similar modifications to its Code of Conduct.

APS proposed modifications to its 2000 Code of Conduct in the November 2002 Code of Conduct. Staff submitted a Staff Report that addressed APS' proposed modifications on August 13, 2003. The Staff Report included Staff's suggested changes to APS' November 2002 Code of Conduct. The Staff Report also included Staff's recommendations on changes to the Code of Conduct following the Track B competitive solicitation, in which an APS affiliate had participated. Finally, the Staff Report concluded that no changes to TEP's Code of Conduct were necessary, based on the conclusion that TEP had no competitive retail or wholesale affiliates. A hearing on APS' Code of Conduct was scheduled for November 2003.

In late 2003, however, the APS rate case was pending before the Commission. That rate case included a proposal by APS to acquire and rate base the PWEC Arizona assets. Recognizing that if the Commission approved APS' rate-basing

proposal, some issues that had prompted the need to submit modifications to the 2000 Code of Conduct could be eliminated or at least narrowed, APS proposed and the other parties supported a procedural stay until after the rate case. On October 3, 2003, the Administrative Law Judge issued a procedural order that adopted the parties' recommendation that the hearing on proposed modifications to APS' Code of Conduct be delayed until after the Commission's decision in the then-pending APS rate case.

The Commission issued its final decision in APS' rate case in Decision No. 67744. Following a procedural conference in this docket held on April 27, 2005, the current schedule for submitting the Proposed Code of Conduct was adopted. APS provided a draft of its Proposed Code of Conduct to Staff, RUCO, TEP, Panda Gila River, and the Arizona Competitive Power Alliance prior to filing this testimony to seek and consider comments from these parties. Changes to the draft were made to incorporate some of the comments that APS received or to make clarifications based on these comments.

Q. IN ADDITION TO THE RATEBASING DECISION, HAVE OTHER CHANGES OCCURRED THAT RELATE TO THE CODE OF CONDUCT?

A. Yes. Three other significant developments relate to APS' modifications to the Code of Conduct. First, the Arizona Court of Appeals issued a final opinion on the appeals to the Electric Competition Rules litigation from 1998 to 2002. Although that decision did not vacate Rule 1616, it reversed some of the Rules on substantive grounds and reversed other rules on procedural grounds. It also voided the Certificates of Convenience and Necessity that had been issued to ESPs under the Electric Competition Rules. The Commission's Electric Competition Advisory Group is currently reviewing the Rules.

Second, a key component of the Settlement that the Commission approved in Decision No. 67744 was the inclusion of several provisions addressing APS' competitive wholesale procurement going forward. If competitive procurement is to be addressed in the Proposed Code of Conduct, it should reflect these provisions from the Settlement Agreement.

Third, PWEC and its subsidiary, GenWest, LLC, have announced the sale of the Silverhawk Power Plant to Nevada Power Company. When consummated, this sale means that neither PWEC nor GenWest will own any generation assets or wholesale contracts.

IV. THE PROPOSED CODE OF CONDUCT

Q. IS APS PROPOSING TO CHANGE ANY OF THE CORE PRINCIPLES FROM EITHER ITS 2000 CODE OF CONDUCT OR ITS NOVEMBER 2002 CODE OF CONDUCT?

A. No. The Proposed Code of Conduct includes provisions to address each of the specific requirements set forth in Rule 1616. This rule embodies two fundamental principles – the prevention of both potential cross-subsidization of competitive electric affiliates by APS and unfair discrimination. Other than some reorganization and clarification, the Proposed Code of Conduct contains the same provisions regarding cross-subsidization and unfair discrimination included in the 2000 Code of Conduct and the Company's November 2002 proposal.

Q. WHAT ARE THE CHANGES IN APS' PROPOSED CODE OF CONDUCT?

A. Like the November 2002 Code of Conduct, the Proposed Code of Conduct expands the scope of the original 2000 Code of Conduct to include both retail and wholesale electric affiliates as "Competitive Electric Affiliates." The most

significant changes from the November 2002 Code of Conduct are the new provisions regarding Competitive Procurement that reflect the procurement principles in Decision No. 67744. The other changes in the Proposed Code of Conduct are primarily organizational, with some simplification of language. APS also attempted to broaden some of the terms to allow a future Commission rulemaking proceeding to revise the Electric Competition Rules without requiring significant changes to the Proposed Code of Conduct.

Q. HOW DOES THE PROPOSED CODE OF CONDUCT DEFINE COMPETITIVE ELECTRIC AFFILIATES?

A. The Proposed Code of Conduct defines Competitive Electric Affiliates as affiliates of APS engaged in Competitive Retail Services or Competitive Wholesale Services. Competitive Retail Services are essentially retail services that would be provided by ESPs. Energy Services was the only affiliate that provided Competitive Retail Services. Competitive Wholesale Services are defined as the provision of energy products or services to the wholesale market. As intended by the Proposed Code of Conduct, this would include actively selling products such as generation or purchased power agreements in wholesale electric markets. Historically, PWEC, GenWest and Energy Services have provided Competitive Wholesale Services. It would not, however, include an affiliate that holds existing wholesale contracts but does not actively market these contracts. Thus, although Pinnacle West Capital Corporation has several wholesale contracts not used in providing service to APS customers, it would not be a Competitive Electric Affiliate unless it actively marketed those contracts to APS or others in the wholesale market.

Q. ARE SHARED SERVICES INCLUDED IN THE CODE OF CONDUCT?

A. Yes. As in the 2000 Code of Conduct and the November 2002 Proposed Code of Conduct, shared services is a core provision. The Proposed Code of Conduct recognizes that shared support services, which are defined in the Proposed Code of Conduct, may be provided by Pinnacle West or APS as long as the costs of such services are accounted for in accordance with the Code of Conduct and the Policies and Procedures. Consistent with the November 2002 Proposed Code of Conduct, APS may provide shared services to affiliates. This is necessary because in the corporate restructuring following the Commission's Track A decision most of the shared services that had been at Pinnacle West were moved back to APS.

Q. HOW ARE SHARED SERVICES ADDRESSED IN THE PROPOSED CODE OF CONDUCT?

A. The Proposed Code of Conduct identifies a number of specific activities that are recognized as shared services. These services, if provided to Competitive Electric Affiliates by APS, require appropriate cost allocations. In addition, there are restrictions on information sharing to protect against confidential information of APS being provided to Competitive Electric Affiliates. These types of restrictions are very similar to the restrictions imposed by FERC under its Standards of Conduct for transmission providers. Some shared services will require additional discussion in the Policies and Procedures to address specific procedures regarding confidential information.

Q. IS RISK MANAGEMENT AN APPROPRIATE SHARED SERVICE?

A. Yes, but there are really two types of risk management in the Code of Conduct. The first, which is "risk and insurance management, claims services and public

safety" is simply the shared service that handles corporate insurance policies and claims. It is very similar to shared human resources or shared health and safety types of services and does not address energy risk management.

Energy risk management is a distinct, specialized risk-management function. It is necessary to ensure that overall portfolio structure and exposure to energy counterparties is appropriate and manageable on an *enterprise* basis and that a default by an unaffiliated third party supplier will not cause a catastrophic impact to APS or Pinnacle West. For example, corporate oversight of energy risk management ensures that the enterprise is not subject to a massive dollar loss or a credit downgrade because a Competitive Electric Affiliate has excess exposure on an unsecured contract with a defaulting counterparty. Such an approach is consistent with established best practices for overseeing energy risk management and is an important element of the overall control environment required to comply with the Sarbanes Oxley Act. The necessity of such consolidated risk management was highlighted by the defaults the shook the industry after Enron and other trading firms collapsed, defaulting on billions of dollars of contracts.

Both FERC and the Committee of Chief Risk Officers, which has taken a lead role in addressing energy risk management issues in the post-Enron era, have recognized the need for common corporate oversight of enterprise energy risk management, acknowledging the need for appropriate protections on information sharing. For example, the enterprise risk management function is functionally separate from the trading floor. It can be provided at the enterprise level without disclosing confidential information of APS to Competitive Electric Affiliates.

Q. IS LAW A SHARED SERVICE?

A. Yes. Law was an appropriate shared service under the Commission-approved 2000 Code of Conduct and still is. FERC also recognizes legal services as an appropriate shared service under the FERC Standards of Conduct. Like other shared services, there are restrictions on information sharing that would also apply to the Law Department. For example, the Competitive Procurement provisions of the Proposed Code of Conduct require that personnel conducting or advising APS in a competitive solicitation cannot have contact with a Competitive Electric Affiliate bidding in such a solicitation. Thus, if a Competitive Electric Affiliate were in the future to submit a bid to APS, a lawyer in the Pinnacle West Law Department could not represent both APS and the Competitive Electric Affiliate, nor could lawyers act as a conduit of information regarding the bid. In addition, lawyers providing shared services are, of course, subject to ethics rules and standards that apply to all practicing lawyers.

Q. DO BOTH THE 2000 CODE OF CONDUCT AND THE PROPOSED CODE OF CONDUCT PERMIT COMMON OFFICERS AND DIRECTORS?

A. Yes. The appointment of common officers and directors, with some restrictions, was recognized as appropriate in the original 2000 Code of Conduct. It is even more important in today's environment of increased corporate accountability and oversight and measures such as Sarbanes-Oxley. As in any corporate structure, officers and the Board of Directors are accountable for the activities of the enterprise. To balance the need for corporate governance and the protection of confidential information, the Proposed Code of Conduct continues to prohibit APS officers and directors that are directly responsible for operational matters from serving as officers or directors of a Competitive Electric Affiliate. Thus,

the Vice President of Fossil Generation could not also be a director of Energy Services. Such a structure is similar to how the FERC Standards of Conduct address common officers and directors. In addition, the Proposed Code of Conduct prohibits common officers and directors, and every other employee, from acting as a conduit of confidential information to a Competitive Electric Affiliate, or from directly participating in a competitive procurement process if a Competitive Electric Affiliate were a bidder.

Q. WHAT NEW PROVISIONS HAS APS INCLUDED IN THE PROPOSED CODE OF CONDUCT REGARDING COMPETITIVE PROCUREMENT?

A. The competitive procurement provisions are set forth in Part Four of the Proposed Code of Conduct. These provisions are divided into three sections. The first section, "Applicability," discusses when the competitive procurement provisions apply. The competitive procurement provisions apply to all wholesale purchases of energy, capacity or physical hedges for APS Standard Offer customers, except in an emergency or in cases where system reliability requires a deviation. The "Applicability" section also clarifies that the competitive procurement provisions do not apply to the participation of a competitive electric affiliate in Demand Side Management ("DSM") programs or Environmental Portfolio Standard ("EPS") programs. The Proposed Code of Conduct specifically states, however, that APS cannot give preferential treatment to an affiliate in any DSM or EPS procurement. The second section discusses acceptable procurement methods, and restates the Track B Secondary Procurement Protocols that were incorporated into the competitive procurement provisions in Decision No. 67744. The only change to those Protocols is to clarify that Requests for Proposals and auctions are acceptable procurement

methods, rather than just descending clock auctions referenced in the original Secondary Procurement Protocols. The third section addresses the requirements that apply if an affiliate participates in a competitive procurement. As provided in the Settlement Agreement, such participation would require an independent monitor. Also, this section includes recordkeeping requirements, separation requirements, and a requirement for disclosure of bid-related communications with an affiliate to other bidders.

Q. ARE THE COMPETITIVE PROCUREMENT PROVISIONS OF THE PROPOSED CODE OF CONDUCT INTENDED TO CHANGE ANY PROVISION OF THE RATE CASE SETTLEMENT AGREEMENT?

A. No. Affiliates could not bid in the 1,000 MW Request for Proposals that is in progress, nor is the Proposed Code of Conduct intended to alter the self-build restrictions reflected in Decision No. 67744.

Q. IS THERE AN AFFILIATE OF APS THAT COULD PARTICIPATE IN A FUTURE COMPETITIVE PROCUREMENT PROCESS?

A. Because PWEC will no longer own generation after the Silverhawk sale is closed, it is unlikely that an affiliate of APS could or would bid in a competitive procurement process such as the reliability request for proposals currently pending. It is possible that an affiliate of APS could propose or participate in a DSM program or an EPS project. In any event, because the Proposed Code of Conduct is intended to be a long-term document, APS was seeking to incorporate principles for potential affiliate involvement in competitive procurement processes in the Proposed Code of Conduct as we believe was intended by the Track B order.

Q. HOW IS THE PROPOSED CODE OF CONDUCT ORGANIZED?

A. The Proposed Code of Conduct now is organized into four parts – Definitions, Basic Principles, Retail Electric Competition, and Competitive Procurement.

Q. WHY DID APS REORGANIZE THE PROPOSED CODE OF CONDUCT INTO THESE FOUR PARTS?

A. This reorganization was viewed as important because of the expanded scope and application of the Code. An employee in APS' call center who has contact with APS customers must know and understand the retail competition provisions of the Code, but would have no involvement in competitive power procurement. Similarly, an APS accountant needs to understand affiliate pricing issues, but not how a competitive procurement process must be implemented. Separating the Code into four parts allows for more focused training where possible and better employee understanding of the Code provisions relevant to their specific job responsibilities. Certain employees, of course, will continue to require training on all sections of the Code.

Q. PLEASE DISCUSS WHAT IS INCLUDED IN EACH OF THESE FOUR PARTS.

A. The definitions used in the Proposed Code of Conduct are consolidated in Part One. Part Two, "Basic Principles," includes key principles that apply generally to APS employees and activities. For example, the affiliate pricing, separation, confidentiality, compliance and administrative requirements for the Proposed Code of Conduct are all included in Part Two. Part Two also contains a general statement that APS shall not give preferential treatment to a Competitive Electric Affiliate. Specific non-discrimination provisions are then included in both the Retail Competition provisions and the Competitive Procurement provisions. Also, Part Two discusses the applicability of the Proposed Code of

Conduct, and provides an exception for system emergencies. Part Three contains specific requirements that apply to Retail Electric Competition activities. Finally, as discussed earlier in my testimony, Part Four addresses Competitive Procurement of wholesale power.

Q. DID APS MAKE CHANGES TO THE DEFINITIONS?

A. Yes, but those changes were not intended to be substantive changes. In some cases, definitions were simplified to allow better employee understanding. In other cases, APS eliminated a definition that was only used in one particular section of the Code. For example, the November 2002 Code of Conduct had a definition for "Bill" but it only applied to the consolidated billing provisions of the Code. The meaning of the term is more likely to be understood if it can be explained in the provision to which it applied. Thus, we defined what was meant by the "bill" in the specific provisions for consolidated billing.

Q. THE EARLIER CODES OF CONDUCT CONTAINED SPECIFIC REFERENCES TO SOME OF THE ELECTRIC COMPETITION RULES IN DEFINITIONS. WHAT DID APS DO WITH THESE DEFINITIONS?

A. One of APS' objectives in the Proposed Code of Conduct is to include enough flexibility that the Commission and the Electric Competition Advisory Group can modify the Electric Competition Rules without requiring significant revisions to the Proposed Code of Conduct. Employee understanding and knowledge of the Code of Conduct, as well as training methods, will be better if the document adopted in this proceeding requires no or minimal modifications to reflect any changes to the Electric Competition Rules. Because the basic principles of retail electric competition are generally understood, it should be possible to use generic definitions even though the Commission's rules may in the future provide more precision. For example, we are proposing to define

"Competitive Retail Services" as "unbundled generation, unbundled metering, unbundled meter reading, and any other retail electric services that have been determined to be competitive services in a Commission Rule." Under this definition, once the Commission finalizes a rule that defines "Competitive Retail Services" to include any of the listed services, those services would be subject to the Code of Conduct without having to modify the Proposed Code of Conduct. Of course, if the Commission determines that a change to the Code of Conduct is necessary as a result of future changes to the Electric Competition Rules, APS will prepare modifications to reflect that change.

Q. IN THE 2000 CODE OF CONDUCT, CERTAIN DEFINITIONS AND PROVISIONS ARE FURTHER CLARIFIED IN THE POLICIES AND PROCEDURES. DO YOU ANTICIPATE THE SAME WITH THE PROPOSED CODE OF CONDUCT?

A. Yes. As with the 2000 Code of Conduct, APS anticipates that certain definitions and provisions will be further clarified in the Policies and Procedures, which provide the details for implementing the Code of Conduct. For example, the definition of "Shared Services" would be clarified as needed in the Policies and Procedures as it was for the 2000 Code of Conduct. Also, restrictions on information sharing for such activities as energy risk management, shared legal services and common officers and directors would be clarified in the Policies and Procedures.

Q. WHAT OTHER CHANGES WERE MADE TO THE PROPOSED CODE OF CONDUCT?

A. As I noted earlier, many of the changes are just streamlining and clarifications. For example, the November 2002 Code of Conduct contained a section titled "Treatment of Similarly Situated Persons" with provisions relating to non-discrimination in the application of APS' retail tariffs and non-discrimination in

wholesale competitive procurement. To streamline this section, the Proposed Code of Conduct contains a section in Part Two, Basic Principles entitled "No Discrimination in Service," which generically states the non-discrimination principle. The specific non-discrimination provisions relating to retail tariffs were then moved to the Retail Electric Competition part of the Proposed Code of Conduct, and specific provisions for non-discrimination in competitive procurement were included in the Competitive Procurement part of the Proposed Code of Conduct.

Q. THE PROPOSED CODE OF CONDUCT ELIMINATES A SECTION OF THE NOVEMBER 2002 CODE OF CONDUCT REGARDING "FINANCING ARRANGEMENTS." WHY?

A. That is another example of streamlining the Proposed Code of Conduct and making it more accessible for the typical employee that will read it. The "Financing Arrangements" provision stated that "APS shall comply with the applicable provisions of A.R.S. §§ 40-285; 40-301, et seq.; and A.A.C. R14-2-804 with respect to any financing arrangement between it and its Competitive Electric Affiliates." That provision is simply a statement of the law, which applies to APS regardless of the Code of Conduct. The employees and lawyers who prepare such financing arrangements are aware of the law, and APS believed it was unnecessary to risk confusing other employees with statutory and rule references to these already-applicable provisions.

Q. HOW WOULD TRAINING ON THE PROPOSED CODE OF CONDUCT BE PROVIDED?

A. The training plan would be addressed in a Policy and Procedure. I expect that it would be similar to (and in some cases combined with) the FERC Standards of Conduct training. A computer-based training ("CBT") module would be

developed, similar to the one used for the 2000 Code of Conduct. After presenting the training material, the CBT course will require employees to answer a series of questions correctly to ensure they understand the material. It also requires employees to acknowledge that they understand and will comply with the Code of Conduct. A shorter module may be developed for periodic refresher training. For employees with more direct exposure to Code of Conduct issues, such as call center employees or lawyers or personnel working on APS competitive procurements, more detailed and targeted training is provided through seminars, presentations, or even individually in some cases. In addition, basic Code of Conduct information is provided in Pinnacle West's "Doing the Right Thing" ethics training, to new employees at employee orientation, and in leadership academies. This training is complemented by written materials that are periodically prepared such as Frequently Asked Questions documents or articles in internal publications. In all cases, a significant emphasis is placed on ensuring that employees know who or where to call to ask questions and receive guidance on complying with the Code of Conduct.

Q. HAS APS PROPOSED CHANGES TO ITS POLICIES AND PROCEDURES RELATING TO THE CODE OF CONDUCT?

A. Not at this time. APS has had Policies and Procedures that provide more detail on the implementation of specific provisions of the Code of Conduct. Because most of the substantive provisions remain unchanged in the Proposed Code of Conduct, I do not believe that many changes to the Policies and Procedures will be required. As I mentioned above, however, the Policies and Procedures would be revised as necessary to make them consistent with the Proposed Code of Conduct. In addition, it is possible that a new Policy and Procedure will be developed for the Competitive Procurement part of the Proposed Code of

Conduct. In any event, because the Policies and Procedures depend on the final Code of Conduct approved in this proceeding, any changes to the Policies and Procedures should be made after a Code of Conduct is approved in this proceeding.

V. CONCLUSION

Q. DO YOU HAVE ANY CONCLUDING REMARKS?

A. The Proposed Code of Conduct that APS is submitting preserves the underlying principles of the 2000 Code of Conduct, while addressing the issues raised in Track B. To assist in the implementation and enhance our employees' understanding of the Code's requirements, APS has restructured the Code of Conduct and simplified certain provisions while retaining the substantive requirements that address the two fundamental goals of the Code – precluding cross-subsidization and unfair discrimination. APS believes that the Proposed Code of Conduct achieves both of those goals.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes.

CODE OF CONDUCT
FOR THE
ARIZONA CORPORATION COMMISSION

APS

July 29, 2005

Part One - Definitions

"APS" means Arizona Public Service Company.

"Commission" means the Arizona Corporation Commission.

"Commission Rule" means a final rule of the Commission effective at the time in question.

"Competitive Electric Affiliate" means those affiliates of APS engaged in either Competitive Retail Services or Competitive Wholesale Services.

"Competitive Procurement" means a process by which power is procured by APS.

"Competitive Retail Affiliate" means any affiliate of APS that is engaged in Competitive Retail Services within this state and is an Electric Service Provider.

"Competitive Retail Services" means unbundled generation, unbundled metering, unbundled meter reading, and other retail electric services that have been determined to be competitive services in a Commission Rule.

"Competitive Wholesale Services" means the provision of energy products or services to the wholesale electric market.

"Confidential Customer Information" means any non-public customer-specific information obtained by APS as a result of providing Noncompetitive Services. Confidential Customer Information also includes non-public customer-specific information obtained by APS from customers of special districts and public power entities on behalf of such special districts and public power entities.

"Confidential Information" means Confidential Customer Information and any other nonpublic information regarding Competitive Retail Services or Competitive Wholesale Services obtained solely through the provision of Noncompetitive Services or in a Competitive Procurement process. Confidential Information shall not include information that is otherwise available to non-affiliated third parties or information necessary for a Competitive Electric Affiliate to provide or receive Shared Services.

"Distribution Information" means information about available distribution capability, transmission access, and curtailments.

"Electric Service Provider" means an entity authorized by a Certificate of Convenience and Necessity to provide Competitive Retail Services in Arizona.

"Extraordinary Circumstance" means any situation that requires APS to act in a manner contrary to this Code of Conduct to ensure the reliability of APS' system, or ensure the safety of employees or the public, or to respond to any other emergency where such action is required.

"FERC" means the Federal Energy Regulatory Commission.

"Noncompetitive Services" means unbundled distribution service, Standard Offer Service and other services that have been determined to be noncompetitive services in a Commission Rule.

"Pinnacle West" means Pinnacle West Capital Corporation.

"Policies and Procedures" means those policies and procedures developed by APS to implement this Code of Conduct.

"Shared Services" means those support services provided by Pinnacle West or any of its affiliates, including but not limited to: human resources; accounting; tax; insurance; risk and insurance management, claims services, and public safety; energy risk management; audit services; contract management; information and communication technology; communications; environmental, health and safety; regulatory services; system dispatch; transportation; security; facilities; shareholder services; law and business practices; public affairs; and enterprise finance.

"Standard Offer Service" means the bundled provision of retail electric service.

"Third Party" means any Electric Service Provider or market participant other than a Competitive Retail Affiliate that may lawfully provide Competitive Retail Services in Arizona.

Part Two - Basic Principles

I. Applicability of Code of Conduct

A. The Code of Conduct applies to APS as a provider of Noncompetitive Services and its interactions with its Competitive Electric Affiliates, unless an Extraordinary Circumstance excuses compliance.

B. Regardless of any provision in this Code of Conduct, in an Extraordinary Circumstance APS may take whatever steps are necessary to ensure the reliability of APS' system, to protect the public interest, or to ensure safety for employees and the public. APS shall notify the Commission within 24 hours of or the next business day after an Extraordinary Circumstance and shall post on a public Website a description of the Extraordinary Circumstance and the actions taken by APS.

II. No Discrimination in Service

APS shall not give preferential treatment to its Competitive Electric Affiliates and shall treat affiliated and non-affiliated entities in a nondiscriminatory manner in providing service.

III. Confidential Information

A. APS shall not provide Confidential Customer Information to any Competitive Electric Affiliate or a Third Party without the customer's prior authorization. Such information may be provided only to the extent specifically authorized.

B. APS shall not provide Confidential Information to a Competitive Electric Affiliate unless such information is also made available to Third Parties under similar terms and conditions. This restriction shall not apply to Customer Confidential Information provided with the customer's prior authorization.

C. If Customer Confidential Information is properly requested by a Third Party, APS shall not unreasonably delay or withhold the release of the requested Customer Confidential Information.

IV. Separation Requirements

A. APS shall be a separate corporate entity from its Competitive Electric Affiliates.

B. Unless otherwise permitted by the Code of Conduct, APS shall operate separately from its Competitive Electric Affiliates to the extent practical.

C. APS shall keep separate books and records and shall keep accounting records that set forth appropriate cost allocations between APS and its Competitive Electric Affiliates, which shall be made available to the Commission in accordance with A.A.C. R14-2-804(A).

D. APS and its Competitive Electric Affiliates may share equipment and facilities only in accordance with the functional separation requirements set forth in this Code of Conduct and the Policies and Procedures.

E. APS and its Competitive Electric Affiliates shall not jointly employ the same employees, except that APS and its Competitive Electric Affiliates may utilize common officers and directors for corporate support, oversight, and governance. APS officers directly responsible for operational matters shall not serve as officers or directors of a Competitive Electric Affiliate. Common officers and directors shall not be utilized to circumvent the prohibition on providing Confidential Information to a Competitive Electric Affiliate, nor shall such common officers or directors be permitted to participate during the development or conduct of any Competitive Procurement process, or in any subsequent negotiations, in which a Competitive Electric Affiliate employing the common officer or director participates as a bidder.

F. Contracts for services accounted for in conformance with Part 2, Section V of this Code of Conduct shall not constitute prohibited joint employment if measures are taken to prevent the transfer of Confidential Information between APS and any Competitive Electric Affiliate.

G. APS and its Competitive Electric Affiliates may utilize Shared Services in accordance with Part 2, Section V of this Code of Conduct but Shared Services shall not act as conduit for Confidential Information to Competitive Electric Affiliates.

V. Transfers of Goods and Services

A. APS shall not subsidize its Competitive Electric Affiliates through any rates or charges for Noncompetitive Services and, except as otherwise provided below, all transactions between APS and its Competitive Electric Affiliates shall be arm's length transactions. An arm's length transaction is a transaction between or among parties, each of whom acts in its own interest and where the final decision on the transaction is not made by a single individual or group of individuals with direct management control or other authority over both parties.

B. Shared Services may be provided by APS to its Competitive Electric Affiliates, and such services shall be accounted for in accordance with the Policies and Procedures.

C. APS may acquire Shared Services from Pinnacle West and such services shall be accounted for in accordance with the Policies and Procedures.

D. Any services provided by APS or its Competitive Electric Affiliates that are subject to a filed tariff shall be provided at the rates and under the terms and conditions set forth in the tariff, unless an exception is permitted by the governing body with jurisdiction over such tariff. APS shall not be required to charge its Competitive Electric Affiliates more than its authorized tariff rate for any Noncompetitive Service.

E. If APS sells to its Competitive Electric Affiliates non-tariffed goods or services, the transfer price shall be the higher of cost or market.

F. If APS' Competitive Electric Affiliates sell to APS non-tariffed goods or services, the transfer price shall be at a price not to exceed market.

VI. Compliance, Dissemination and Education

A. Compliance with the Code of Conduct is mandatory.

B. The failure or refusal of an employee of APS or its affiliates to abide by or to act according to the Code of Conduct or the Policies and Procedures may subject the employee to disciplinary action, up to and including discharge from employment.

C. Copies of this Code of Conduct shall be provided to employees and agents of APS and its Competitive Electric Affiliates that are likely to be engaged in activities subject to the Code of Conduct.

D. A copy of the Code of Conduct shall be made available to all employees of APS and its Competitive Electric Affiliates on the corporate Intranet site.

E. Training on the provisions of the Code of Conduct and its implementation shall be provided to the employees of APS and its Competitive Electric Affiliates and those authorized agents of APS and its Competitive Electric Affiliates that are likely to be engaged in activities subject to the Code of Conduct.

F. Any activity that would constitute engagement in unlawful anticompetitive behavior shall constitute a violation of this Code of Conduct.

G. APS shall provide a means for employees to raise questions and report concerns regarding this Code of Conduct.

VII. Modifications to the Code of Conduct or Policies and Procedures

A. APS may request modifications to the Code of Conduct by filing an application with the Commission. The application shall set forth the proposed modifications and the reasons supporting them.

B. APS may not make and implement any material change to the Policies and Procedures, including modifications to allocation methods or the direct and indirect allocators used in the Policies and Procedures, without filing an update with the Commission or its designee. Once notification is made by APS of an intended modification, if no action is taken by the Commission or its designee within 30 days of its filing, the modification shall be deemed approved.

VIII. Reporting Requirements

APS shall submit the following information to the Commission on an annual basis each April 15th, which shall be treated in accordance with A.R.S. § 40-204:

A. A list of all Extraordinary Circumstances that explains the nature, cause, and duration of each incident.

B. A report summarizing the charges associated with all non-tariffed transactions between APS and its Competitive Electric Affiliates, with the associated charges reported separately for each Competitive Electric Affiliate and for each category of service.

C. A report detailing (i) how many non-Standard Offer Service customers were provided metering services or meter reading services and (ii) how many Electric Service Providers received consolidated billing services from APS.

D. A report identifying all transfers between APS and its Competitive Electric Affiliates of employees at the manager level or above.

IX. Dispute Resolution

To the extent permitted by law, complaints concerning violations of this Code of Conduct shall be processed under the procedures established in A.A.C. R14-2-212.

Part Three - Retail Electric Competition

I. Non-Discrimination

A. If a retail tariff provision allows for discretion in its application, APS shall apply that provision in a non-discriminatory manner between its Competitive Retail Affiliates and Third Parties and their respective customers.

B. APS shall process requests for service by Competitive Retail Affiliates and Third Parties and their respective customers in the same manner and within the same time period.

C. APS shall offer access to Distribution Information to its Competitive Retail Affiliates and Third Parties concurrently and under the same material terms and conditions.

II. Consolidated Billing and Promotions within the Bill Envelope

A. If APS includes charges for Competitive Retail Services in its bills for Noncompetitive Services, APS shall offer the same service to any Third Party on the same material terms and conditions.

B. This provision shall not prevent a Competitive Retail Affiliate or any Third Party from including amounts due for Noncompetitive Services in its own consolidated billing statement if authorized by the customer.

C. If APS includes with its bills for Noncompetitive Services advertising or promotional materials from its Competitive Retail Affiliate, APS shall offer the same service to any Third Party on the same material terms and conditions.

III. Company Contact Information

Telephone numbers and websites used by APS for the provision of Noncompetitive Services shall be different from those used by its Competitive Retail Affiliates.

IV. Prohibition on Suggestion of Utility Advantage

A. APS shall not state in any advertising, promotional materials, or sales efforts that a consumer who purchases services from APS' Competitive Retail Affiliates will receive preferential treatment in the provision of Noncompetitive Services or have any other advantage regarding the provision of Noncompetitive Services nor may APS require the purchase of any Competitive Electric Service from APS' Competitive Retail Affiliates as a condition to providing Noncompetitive Services.

B. The name or logo of APS as a utility distribution company shall not be used in promotional advertising material circulated by a Competitive Retail Affiliate.

C. APS personnel shall not state to any retail customer or potential retail customer a preference for any Competitive Electric Service provided by APS' Competitive Retail Affiliates or any Third Party.

D. APS shall either direct Customers who inquire about Competitive Retail Services to the Commission for a list of Electric Service Providers or may provide such customers with a copy of the current Commission list of such providers. APS and its employees may not state any recommendation or preference or otherwise attempt to influence a potential customer in their choice of an Electric Service Provider.

E. APS may not enter into special contracts which provide generation service at a discount to Standard Offer Service customers without the express authorization of the Commission.

V. Joint Marketing

APS and its Competitive Retail Affiliate shall not jointly market their respective retail services.

Part Four – Competitive Procurement

I. Applicability

A. These Competitive Procurement principles shall apply to wholesale acquisition of energy, capacity and physical hedge transactions for APS Standard Offer Service customers.

B. These Competitive Procurement principles do not apply in cases of emergencies or for short-term acquisitions to maintain system reliability, nor unless otherwise stated to transactions to satisfy APS' obligations under the Commission's Environmental Portfolio Standard and Demand Side Management programs.

II. Acceptable Procurement Methods

A. Purchases through third party, on-line trading systems, including but not limited to the Intercontinental Exchange, Bloomberg, California Independent System Operator, New York Mercantile Exchange, or other similar on-line third party systems.

B. Purchases from qualified, third party, independent energy brokers.

C. Purchases from non-affiliated entities through auctions or a request for proposals process administered by APS.

D. Bilateral contracts with non-affiliated entities.

E. Bilateral contracts with affiliated entities, provided that if APS proposes to procure energy or capacity from an affiliate through a bilateral contract APS will provide, through its Competitive Procurement Website, non-affiliated entities an opportunity to beat any proposed contract before executing the transaction.

F. Any other Competitive Procurement process approved by the Commission.

III. Participation of Competitive Electric Affiliate

A. APS shall not give preferential treatment to its Competitive Electric Affiliates in any Competitive Procurement or in the procurement of Demand Side Management or Environmental Portfolio Standard resources.

B. If a Competitive Electric Affiliate participates as a bidder in a Competitive Procurement request for proposals or auction process, an independent monitor will oversee the process.

C. If a Competitive Electric Affiliate participates as a bidder in a Competitive Procurement, APS shall keep detailed records of any and all contacts with the Competitive Electric Affiliate, including employees and contractors, regarding the Competitive Procurement for the life of the contract plus five years.

D. If a Competitive Electric Affiliate participates as a bidder in a Competitive Procurement, personnel involved in the preparation of a Competitive Electric Affiliate's bid in the solicitation process shall not have contact with personnel conducting the solicitation or advising APS in the solicitation concerning any business matter related to the Competitive Procurement except as provided below.

E. The content of any communication between a Competitive Electric Affiliate that is a bidder in a Competitive Procurement and APS personnel (including contractors and agents) conducting the Competitive Procurement must be contemporaneously posted on the Competitive Procurement Website. A Competitive Electric Affiliate may, however, attend bidder's conferences and other public meetings regarding a Competitive Procurement.

F. Copies of all bilateral power contracts between APS and Competitive Electric Affiliates shall be retained by APS for a minimum of the life of the contract plus five years.