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APS

A subsidiary of Pinnacle West Capital Corporation

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August 20, 2002

HAND-DELIVERED

Commissioner Marc Spitzer
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, AZ 85007

RE: ***Docket Nos. E-00000-02-0051, E-01345-01-0822, E-00000A-01-0630, and E-01933A-02-0069 (Electric Restructuring Generic Proceeding)***

Dear Commissioner Spitzer:

Arizona Public Service Company ("APS" or "Company") believes it necessary to respond to the letter to you from the Arizona Competitive Power Alliance ("Alliance") dated August 12, 2002. The Alliance's letter unfortunately either misstates, or fails to fully present, the facts concerning several issues, including the Company's environmental record, the extent of the contribution of merchant generators to resolving the transmission issues raised in the Commission's 2002 Biennial Transmission Assessment ("BTA"), and the status of negotiations among the parties.

Environmental Issues

APS has repeatedly heard vague and generalized allusions from the Alliance and its members to the Company's "aged and highly polluting plants." These unidentified plants are invariably contrasted with "modern, efficient and clean generation" being offered by the Alliance. APS will match its environmental record against any utility, let alone the Alliance members. For example, in a recent analysis of relative environmental performance of U.S. electric utilities by Innovest, Pinnacle West was cited (along with FPL Group) as being at the top of the list, ranking above any of the Alliance members. Attached is a copy of Innovest's press release on this environmental study of the electric utility industry. Also, age alone is largely irrelevant to the economics of a power plant. With proper maintenance, the essential components of a power plant can remain in service almost indefinitely, consistent with applicable environmental requirements. The long and continuing record of reliable operation from APS units is blunt testimony to that fact. Finally, the Company's older West Phoenix, Yucca and Ocotillo units, although needed to maintain reliable service to APS customers in the Valley and Yuma, will produce relatively little generation on an annual basis. Thus, their decommissioning or mothballing, as is perhaps proposed in the Alliance letter, would have minimal impact on the APS load available for the Alliance's members.

If, as was suggested by Mr. Patterson at the recent Workshop on Track B Issues, the Alliance's repeated references to "aged and highly polluting plants" are really advocating displacement of coal-fired generation such as the Company's interests at Four Corners, Cholla and Navajo, APS would note that nowhere does the Alliance present any evidence that this displacement would benefit either customers or the environment. Indeed, such a proposal would be ruinously expensive for customers, would adversely affect reliability, and would be damaging to this state's economy, especially in the rural areas in which these plants operate. Coal-fired facilities provide nearly half the energy used by APS customers, and a substantially higher percentage of the energy used by Tucson Electric Power ("TEP") customers. For APS, they do so at a cost roughly half that of power produced from new combined-cycle gas units. Replacing just the Four Corners' generation with gas could cost APS customers over $100 million per year, even assuming the gas for such displacement were available. In exchange for that additional cost, APS customers would receive a less fuel-diverse, less geographically-diverse and more operationally-unstable system. Nor would there be any beneficial environmental impact from such a displacement. Any coal-fired generation not used by APS for serving their retail customers would be sold off-system or claimed by co-owners of the plants under terms of existing participation agreements. These same coal-fired plants would then continue to operate at full power for the benefit of other, largely non-Arizona customers. However, if these facilities <u>were</u> to be closed, it would devastate the economies of Apache, Navajo and Coconino Counties, as well as the Navajo Indian Community, and cripple the finances of some local governmental units.

Transmission

The Alliance's statement that merchant plants have been "significant participants" in efforts to solve transmission constraints is an unfortunate overstatement. The transmission investments that merchant generators have thus far made in Arizona are mostly related to interconnecting their plants, not adding to the capabilities of the state's transmission system. For example, Panda Gila River asked APS to construct the 20-mile long Gila River Transmission Project, which APS did expeditiously. However, those facilities are radial lines that only interconnect Panda's plant to the transmission system; they do not enhance the reliability of APS' system and do not represent additional capacity to move that facility's power to an Arizona load center. Similarly, the investment by merchant plants in the Hassayampa Switchyard is merely investment in interconnection facilities through an expansion of the existing Palo Verde Switchyard, not an investment in the broader Palo Verde transmission system itself.

Although many parties, including merchant generators, participated in the CATS discussions on this project, when it came time to commit dollars it was only Arizona load serving entities (including APS, SRP, and TEP) that shouldered any financial responsibility. Further, if the merchant plants did want to relieve transmission constraints in Arizona, as the Alliance's letter contends, more would have sited at least some capacity inside the Valley constraint, as did Pinnacle West Energy with its West Phoenix Expansion project and SRP with its Kyrene and

San Tan Expansion projects. After all, it was the merchants who chose where to site their facilities, and although APS has never denied network service designation to any facility actually serving APS load, the Company cannot be expected to reconfigure its transmission system overnight or change the laws of physics simply to accommodate the merchants' voluntary siting decisions.

Settlement

APS convened the first settlement discussions in this proceeding, presented a broad settlement proposal for both Track A and Track B (which was rejected by the Alliance) and has continued to negotiate in good faith with the Alliance and its members both before and after the Track A hearing. APS remains ready and willing to meet with the merchant generators, as well as Staff and other parties, to continue any effort that might result in further consensus. But consensus means more than simply agreement among the Alliance's members and must address, at a minimum, each of the three issues set forth in your July 18 letter. APS believes that the impending final resolution of the Track A proceeding, including the generation asset transfer issue, along with the progress made to date in the Track B proceeding, can help create precisely the sort of consensus referenced in both your July 18 letter and the recent letter from the Alliance.

Sincerely,

Steven M. Wheeler

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Attachment
cc: Chairman William A. Mundell
Commissioner Jim Irvin
ACC Docket Control
and
Parties of Record in
Docket No. E-00000A-02-0051, *et al.*

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Annual Stock Market Outperformance of 10% is Achieved by Environmental Leaders in the U.S. Electric Utility Sector

FPL Group, Pinnacle West Win Highest EcoValue'21® Ratings

New York, May 30TH, 2002 – Innovest Strategic Value Advisors, Inc., the global leader in intangible value analysis, has released a new 118 page report on the relative corporate environmental performance among 28 companies in the U.S. electric utility sector. The analysis showed that environmental leaders, taken as a group, had a 10% average greater annual total shareholder return than that of the lower rated companies over the past three years. These findings are consistent with Innovest's research in nearly every other sector. The analysis was conducted using Innovest's EcoValue'21® environmental performance rating model. The model analyzes over 60 aspects of environmental risk exposure, management quality and business development.

Investor risk exposure related to environmental issues is growing in the electric utility sector as deregulation shifts responsibility for environmental costs from ratepayers to investors. Other factors raising investor risk exposure include increasing regulations, growing consumer demands for environmentally responsible products and services, increasing public concerns about global warming and other environmental problems, and expanding information transparency through the internet, which makes it easier for stakeholders to identify a firm's negative impacts on the environment.

Innovest's report extensively analyzes key environmental issues having the potential to impact investor returns, including the Bush Administration's Clear Skies Initiative, public health studies detailing premature deaths from coal plant emissions, existing Clean Air Act provisions that will require emission reductions of as much as 75% over the next ten years, state regulations requiring reductions in carbon dioxide emissions, nuclear waste disposal, and strategic profit opportunities related to distributed generation, renewable energy and other areas. In addition, the report provides summaries of each firm's relative risk exposure, management strategy and systems, and environmentally-favorable business activities.

FPL Group and Pinnacle West Capital received the highest ratings in the sector. TECO Energy and Allegheny Energy received the lowest. Innovest's report found that failure to proactively address environmental issues indicates the presence of less sophisticated management that will probably underperform the market. As the financial impact of environmental issues further increases in the electric utility sector, investors have the opportunity to increase returns and reduce risk by shifting investments from environmental laggards to leaders.

Innovest Strategic Value Advisors is an internationally recognized independent investment research firm specializing in environmental finance and investment opportunities. Innovest's clients include the leading industrial companies and institutional investors throughout the world. Founded in 1995 by Dr. Matthew Kiernan, Innovest is headquartered in New York, with offices in London and Toronto. The company is chaired by Jim Martin, former Chief Investment Officer for North America's largest pension fund, TIAA-CREF. For further information please visit the company's website at www.innovestgroup.com.