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BEFORE THE ARIZONA CORPORATION COMMISSION

MARC SPITZER
Chairman
JAMES M. IRVIN
Commissioner
WILLIAM MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
MIKE GLEASON
Commissioner

Arizona Corporation Commission

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IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR AN ORDER OR ORDERS AUTHORIZING IT TO ISSUE, INCUR, OR ASSUME EVIDENCES OF LONG-TERM INDEBTEDNESS; TO ACQUIRE A FINANCIAL INTEREST OR INTERESTS IN AN AFFILIATE OR AFFILIATES; TO LEND MONEY TO AN AFFILIATE OR AFFILIATES; AND TO GUARANTEE THE OBLIGATIONS OF AN AFFILIATE OR AFFILIATES.

DOCKET NO.E-01345A-02-0707

PANDA GILA RIVER, LP NOTICE OF ERRATA

Panda Gila River, LP, ("Panda"), through its undersigned counsel, hereby submits this Notice of Errata to its February 6, 2003 Post-Hearing Reply Brief of Panda Gila River, LP in which page 4 of this filing was inadvertently omitted. Attached is a complete Post-Hearing Reply Brief of Panda Gila River, LP.

DATED: February 7, 2003

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All Parties of Record

BEFORE THE ARIZONA CORPORATION COMMISSION

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Chairman

JIM IRVIN
Commissioner

WILLIAM A. MUNDELL
Commissioner

JEFF HATCH-MILLER
Commissioner

MIKE GLEASON
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**POST-HEARING REPLY BRIEF OF
PANDA GILA RIVER, LP**

FEBRUARY 6, 2003

1 I. INTRODUCTION

2 It is clear from the opening briefs in this case that APS's argument rests entirely
3 on the wholly unsupported and uncorroborated testimony of APS witness Barbara Gomez.
4 Although APS's Initial Brief suggests that five other witnesses also support the Financing
5 Application, as explained below, all five of these witnesses rely on Ms. Gomez's unproven
6 assertion that APS will suffer a credit downgrade if the financing application is denied.
7 However, since Ms. Gomez could not offer any substantiation for her speculation, PGR
8 respectfully submits that APS has failed to meet the statutory requirement of demonstrating
9 that approval of the Application by the Commission would be in the best interests of APS's
10 ratepayers.

11 Indeed, other than PGR, no party in this docket attempted to pierce APS's
12 rhetoric by performing an independent analysis of APS's assertions. No party, therefore,
13 can be said to have presented any reliable, nor even relevant, basis for claiming that
14 approval of the Application is in the public interest.¹ In fact, Staff and RUCO actually
15 admitted that APS's claims were "speculative," yet they threw their support behind APS's
16 Application here nevertheless, apparently in order to achieve goals that are completely
17 outside this docket: Staff, to resolve the APS appeal of the Track A Decision, and RUCO,
18 to further its objective of returning to complete regulation and entirely eliminating the
19 state's wholesale competitive market, the existence of which the Commission repeatedly has
20 sought to preserve precisely to best protect the interests of APS's ratepayers. As one
21 Commissioner stated in questioning RUCO's lack of independent analysis before

¹ Interestingly, while Staff witness Thornton did not independently analyze the central assertions that APS and PWCC are subject to imminent credit downgrade, for the unrelated APS assertions that Staff did independently analyze, it disagreed with APS's conclusions. Staff Brief at 4; Exh. S-1 at 1, 3, 5.

1 supporting the 1999 APS Settlement, this is not the manner in which APS ratepayers
2 should be "protected."

3 The various parties' opposition to a corporate guarantee instead of a loan
4 likewise lacked any basis in the record. Their expressed concerns regarding the complexity
5 of a corporate guarantee or its timing were nebulous, self-serving arguments that the
6 Commission must reject. Plainly, APS is now distancing itself from pursuing the corporate
7 guarantee alternative because a properly structured guarantee would not advance APS's
8 ultimate goal of burdening APS's ratepayers with the costs of PWEC's merchant generation
9 investments by including those assets in APS's rate base. Consideration of APS's ultimate
10 goal for the merchant assets must await another day. Assuming, then, one were to accept
11 that APS had to do something to help PWCC, the only relevant inquiry in this case is
12 whether a loan, as opposed to a guarantee, would better protect the utility's ratepayers
13 while also maintaining the nascent, but growing, wholesale market, and advancing the day
14 when PWEC can stand on its own, completely separated from APS. The record evidence in
15 this case admits of but one conclusion: only a corporate guarantee achieves all of the
16 Commission's goals.

17 **II. APS HAS NOT MET ITS BURDEN OF PROVING THE**
18 **APPLICATION IS IN THE PUBLIC INTEREST**

19 **A. The Commission Should Reject APS's Attempt to Shift the Burden**
20 **of Proof to the Merchant Intervenors**

21 As discussed in PGR's initial brief in this proceeding, APS bears the burden of
22 proving that its financing proposal complies with the statutory and regulatory requirements
23 for utility debt obligations and investments in non-utility affiliates. PGR Brief at 6. In its
24 pre-filed testimony and presentation at the hearing, APS apparently agreed. Exh. APS-8 at 9.
25 However, in its Initial Brief APS argues that, in assessing its financing proposal, the

1 Commission must ask two questions: (1) who has presented the greater, more substantial
2 and compelling fact and opinion evidence to support its position and (2) what are the
3 consequences if the Commission is wrong? APS Brief at 4. In short, APS now attempts to
4 shift its burden to PGR and to the other merchant intervenors, arguing that the
5 Application must be approved because PGR has not proven that the proposed transaction
6 would harm APS, and because PGR was not willing to indemnify APS's ratepayers against
7 the possibility that denying the Application *would* harm APS. APS Brief at 4, 12.

8 The Commission, however, must apply the law and reject APS's effort to shift
9 the burden of proof. The statutory and regulatory requirements governing utility debt
10 offerings and the relationship between regulated and unregulated affiliates exist solely to
11 protect utility ratepayers from holding company abuses, and because affiliate transactions
12 are not to be generally accepted *per se*. The Commission should hold APS strictly to its
13 burden. If APS has not proven that the Application is consistent with the public interest
14 and in the best interest of APS's ratepayers, then the Commission must reject the
15 Application, regardless of what PGR or any other party has or has not proven. Hence, it is
16 not PGR's obligation to prove that granting the Application would harm APS, nor is it
17 PGR's burden to prove that denying the Application would be in the public interest,
18 although, in fact, PGR believes it would be found to have satisfied these burdens had that
19 been its obligation.

20 Even if the Commission were to place the burden of proof on those that oppose
21 the Application, it is clear that all of the evidence presented in the hearing shows that APS
22 would be harmed if it made a direct loan to PWEC, and that APS would not be harmed if
23 PWCC instead refinanced or renegotiated the existing bridge debt. APS's arguments to
24 the contrary rely on undocumented and unsubstantiated conversations between Ms.

1 Gomez and unspecified investors and rating agency personnel. PGR's case, on the other
2 hand, relies on voluminous contemporaneous evidence and the testimony of an experienced
3 ratings analyst (the only witness in this proceeding with any experience analyzing and rating
4 publicly-traded companies).

5 **B. APS Still Has Not Proven That Its Proposal Meets The Applicable**
6 **Statutory Standard**

7 In its initial brief, unlike in the hearing, APS discusses the statutory requirements
8 it must satisfy for the Commission to approve the Application. APS Brief at 20-22.

9 However, APS's discussion is not compelling. APS acknowledged that it must prove that
10 the Application is compatible with the public interest. APS Brief at 20. APS cites a single
11 New Hampshire Supreme Court order, entered in a nuclear plant prudency proceeding, for
12 the proposition that a public utility must not be unreasonably denied the rights accorded to
13 other corporations, and that the Commission should merely determine whether a proposed
14 action "is a thing reasonably to be permitted." *Id.*

15 APS offered no reason for this Commission to adopt its interpretation of the
16 "public interest" standard, nor any analysis of the relevant statutes. It also is clear, that
17 other states do not defer to public utilities as APS now proposes. For example, in rejecting
18 Western Resource's proposed separation of its regulated and non-regulated businesses
19 through a public stock offering of the unregulated affiliate (essentially shifting market
20 capitalization from the utility to the affiliate), the Kansas Corporation Commission noted
21 that "commissions are generally empowered to act in areas seemingly reserved to
22 management prerogative where the regulated action is 'impressed with the public
23 interest.'" *In the Matter of the Investigation of Actions of Western Resources, Inc. to Separate*
24 *its Jurisdictional Electric Public Utility Business from its Unregulated Businesses*, 2001 Kan.

1 PUC LEXIS 872, *50 (2001). The Kansas Commission went on to reject the application,
2 concluding that

3 The Commission is not required to subject customers to known risks
4 until likely ill-effects are certain and irreversible. Rather, the
5 Commission must use rational analysis and make reasonable
6 assumptions or inferences.

7 *Id.* at *18. In a subsequent order, the Kansas Commission stated that any reorganization
8 of the utility must “protect . . . utility customers from harm caused by [the holding
9 company’s] investment in unregulated businesses.” *In the Matter of the Investigation of*
10 *Actions of Western Resources, Inc. to Separate its Jurisdictional Electric Public Utility Business*
11 *from its Unregulated Businesses*, 2002 Kan. PUC LEXIS 1271, *8 (2002). Thus, the
12 Kansas Commission looked to whether utility ratepayers were harmed by a proposed
13 transaction and whether the ratepayers were adequately protected from future harm. Put
14 more simply, are the utility ratepayers better off under a proposed financial transaction?

15 The Kansas Commission concluded that its purpose was not to protect the
16 unregulated holding company from its mistakes, but rather, to protect ratepayers. The
17 same, obviously, is true for this Commission. As stated by the Arizona Supreme Court,
18 “[the] Commission was not designed to protect public service corporations and their
19 management but, rather, was established to protect our citizens from the results of
20 speculation, mismanagement, and abuse of power.” *Arizona Corp. Comm’n v. State ex rel*
21 *Woods*, 830 P.2d 807, 817 (1992). Hence, in this proceeding, the Commission should
22 look at all the evidence with an eye to seeing how APS and its ratepayers will be affected,
23 and not be distracted by any other issue that APS or its supporters have raised. *See*, APS

1 Brief at 8 (Staff, RUCO, APS and AUIA alone represent the Commission's core
2 "constituency groups").²

3 C. APS Has Presented No Credible, Much Less Compelling, Evidence
4 To Support Its Application

5 1. There was no proof that APS will be downgraded if PWCC is
6 downgraded

7 APS essentially has asked the Commission to conduct a head count, apparently
8 on the theory that the six witnesses generally supporting the Application obviously must
9 outweigh the single opposing witness (PGR witness Abbott). APS Brief at 4.³ But the
10 Commission's inquiry will focus on the weight of the relevant evidence, not on which side
11 has the greatest number of witnesses. Not even six wrongs make a right.

12 APS argues that the Commission must approve the Application in order to
13 protect APS's credit rating, asserting that the Application "will protect the credit ratings of
14 both PWCC and APS, without significantly affecting APS's fundamental credit quality and
15 without risk to APS customers." APS Brief at 20. APS's Application thus centered on the
16 speculation that APS will suffer a credit downgrade if PWCC should suffer a downgrade.
17 Ultimately, Staff's, RUCO's and AUIA's support for the Application adopted this same
18 speculation, but not based on any independent analysis. Rather, they relied entirely on Ms.

² Notwithstanding APS's comment, during the public comment segment of the hearing, Barbara Sherman of the Arizona Consumer's Council, clearly a core constituent of the Commission, stated her group's opposition to APS's proposal, asserting that she believed APS ratepayers were being "steamrolled." Tr. at 11-13.

³ It's not even clear that the three non-APS witnesses actually did "support" the Application. Staff witness Thornton ultimately supported the Application with conditions, but only after expressing serious doubts about the effect of approving the Application on APS, while RUCO witness Diaz-Cortez recommended transferring the PWEC assets to APS and eliminating wholesale competition. Neither entirely supported APS's vision of the Arizona market going forward. Finally, it is hardly surprising that AUIA, an organization funded in part by APS and representing PWCC shareholders, would support PWCC's and APS's proposal.

1 Gomez's assertion. It could not be clearer, though, that Ms. Gomez did not present any
2 actual evidence to support her assertion, but instead relied entirely on hyperbole and on
3 anecdotal, undocumented and otherwise uncorroborated conversations with unidentified
4 third parties that took place on an unspecified number of occasions. At best, then, APS's
5 entire case rests on the unsubstantiated speculation of these unknown parties, none of
6 whom testified here and none of whom, therefore, can be considered to be an "expert" on
7 the issues now before the Commission.

8 **a. Ms. Gomez's testimony must be rejected**

9 Ms. Gomez asserted that APS will suffer a credit downgrade if PWCC is
10 downgraded. She further asserted that PWCC will be downgraded if the Application is not
11 approved and it is required to refinance the outstanding obligations itself, or otherwise is
12 forced to sell the PWEC assets. Exhs. APS-1 at 10, APS-2 at 18; *see also*, APS Brief at 9.
13 But as Staff's brief recognizes, in order for the Application to be approved, APS had to
14 prove "the likelihood of PWCC and ultimately APS actually suffering a credit downgrade."
15 Staff Brief at 3. APS proved neither of these assertions.

16 As PGR will demonstrate below, there is absolutely no basis for concluding that
17 if the Application is denied, PWCC would be downgraded. Even more, there is no credible
18 evidence that APS will be downgraded even if PWCC were downgraded. Again, APS's
19 entire argument on this point is based on the opinion of Ms. Gomez. APS Brief at 10-11.
20 In its brief, APS argues that the S&P enterprise methodology inevitably means that a
21 downgrade of PWCC will result in a downgrade of APS. APS Brief at 11. Yet Ms.
22 Gomez provided no examples of holding company downgrades that were responsible for
23 affiliated utility operating company downgrades. And she provided only a single example
24 of Moody's downgrading a utility subsidiary following a downgrade of its corporate parent,

1 but even then provided no analysis to suggest that even this was germane here, nor any
2 other reason for the Commission to conclude that the situation facing APS and PWCC is
3 analogous to Allegheny Energy's current situation.

4 It is also important to distinguish between Ms. Gomez's unsupported opinion as
5 to what a rating agency "might" do, and the 20 years of experience Ms. Abbott relied upon
6 in testifying to what agencies have done and likely will do. Ms. Abbott provided an analysis
7 that no party has rebutted in this case. Ms. Gomez, on the other hand, relied entirely upon
8 the aforementioned undocumented and uncorroborated conversations she said she had
9 with unspecified lenders and analysts. Even this anecdotal level of inquiry allowed her to
10 testify only to such things as what analysts probably mean when they use the word "could."
11 Tr. at 297, lines 5-12. Plainly, since Ms. Gomez herself is not a ratings expert, if this
12 matter were before Arizona courts, nearly all of Ms. Gomez's testimony would have been
13 rejected as impermissible "hearsay."⁴ Admittedly the Arizona Rules of Evidence are not
14 strictly applied in proceedings before this Commission; yet these rules do provide the
15 Commission with an excellent gauge to weigh the probative value of Ms. Gomez's
16 testimony. APS asks the Commission to accept Ms. Gomez' characterizations of these
17 conversations at face value, without any supporting evidence and with no opportunity for
18 any party, let alone the Hearing Officer, to cross examine these analysts.⁵ The Commission

⁴ See Arizona Rule of Evidence 801 (c), defining hearsay as "a statement, other than one made by the declarant [i.e., the person alleged to have made the statement] while testifying at the trial or hearing, offered in evidence to prove the truth of the matter asserted." Rule 802 declares "hearsay is not admissible except as provided by applicable constitutional provisions, statutes, or rules."

⁵ Further examples of the lack of probative value of Ms. Gomez's testimony are the assertions made by her that were supposed to be within her personal knowledge. However, when pressed on issues about which she testified in her written testimony, Ms. Gomez repeatedly deferred to Mr. Davis and PWCC's attorneys, *see, e.g.*, Tr. at 83 (lines 21-22), 109, 138, 152, 173, and 239, lines 19-21; or she simply stated that she was not an "expert" on the subject matter set forth in her testimony and therefore could not explain

1 should not allow a party bearing the burden of proof to satisfy that burden on the basis of
2 such insubstantial proof.

3 **b. The other “supporting” witnesses rely on Ms. Gomez’s**
4 **unsubstantiated assertions**

5 On the key assertion that APS will be downgraded if PWCC is, Staff and RUCO
6 each cite Ms. Gomez’s assertion as proof. Staff Brief at 3; RUCO Brief at 4. Thus,
7 contrary to APS’s claim that six witnesses support its case, the entirety of APS’s case rests
8 on Ms. Gomez alone.

9 While Staff did not perform an independent analysis, and merely accepted APS’s
10 assertions as true, Staff’s comments on the quality of the proof are telling. Even though it
11 ultimately relied on APS’s assertions, the most Staff could muster was tepid support for the
12 assertions, concluding that “there is some risk of ratings downgrade to PWCC and, as a
13 consequence, to APS.” Staff Brief at 3-4 [emphasis added]. Staff also referred to the
14 potential downgrade of APS as “somewhat speculative,” and noted that the evidence on
15 the issue of an APS downgrade was “clothed in conjecture and speculation.” *Id.* Simply
16 put, this Commission should not base a precedent-setting decision to obviate its own
17 Affiliated Interest Rules by approving a half-billion dollar loan to PWEC based on
18 speculative risks and conjecture.

19 While Staff’s witness Thornton independently reviewed some of APS’s financial
20 assertions, disagreeing with most, that was significantly more than RUCO’s analysis.
21 RUCO’s brief cites APS’s unsupported conclusions and Staff witness Thornton for all of its

the basis for her conclusions, *see, e.g.*, Tr. at 106-107 and 239, line 8-13, (not an expert on PWEC or generation markets), Tr. at 109, line 9 (not an expert on whether APS could build to serve its load), Tr. at 124, line 5 (not an expert on the value of the PWEC assets), Tr. at 186, line 11-12, 187, lines 12-13, and 201, lines 12-14 (not an expert on what others in the industry do from a financial ratings perspective); Tr. at 199-200 (not qualified to address claim that lenders would prefer a loan over a guarantee).

1 currently has good credit that would survive a downgrade of PWCC, and, further, that a
2 loan of \$500 million would erode that good credit position. All parties agree that APS
3 currently has good credit. The Commission must ask itself, then, why, with such good
4 credit, would a downgrade of APS be imminent if APS does not make the affiliate loan.
5 The proof is not in the record in this case and the Commission must, therefore, reject
6 APS's assertion.

7 In the independent analysis he did conduct, Staff witness Thornton agreed with
8 Ms. Abbott that APS's credit metrics would erode if its Application is approved. Tr. at
9 992, lines 15-20. While he did not explain why he concluded that APS would be
10 downgraded if PWCC is downgraded, he did discuss the ultimate example of impacts on a
11 holding company not affecting the utility subsidiary. As Mr. Thornton discussed, the
12 collapse of Enron into bankruptcy did not result in a downgrade of Portland General
13 Electric. Tr. at 918, lines 3-8. Certainly, PWCC's situation is much less dire than Enron's.
14 APS provides the Commission with no reason to believe that the Allegheny Energy result
15 discussed by Ms. Gomez is more likely than the Enron result discussed by Mr. Thornton.

16 Lastly APS argues again, attempting to shift the burden of proof from itself to
17 the Application's detractors, that PGR is asking the Commission to take on unnecessary
18 risk, and that PGR has not guaranteed that APS's customers will be unharmed if the
19 Commission denies the Application. APS Brief at 4. PGR submits that there is substantial
20 evidence that APS's customers will not be harmed if the Commission denies the
21 Application, but ultimately, it remains APS's burden to prove that its approval of its
22 Application is in the best interests of its ratepayers, a burden it has not met.

1 2. **There is no evidence that PWCC cannot refinance the bridge**
2 **debt or that it will be downgraded if it does**

3 As noted above, the speculative assertion that APS will suffer a downgrade is
4 based on the equally speculative assertion that PWCC will suffer a downgrade if the
5 Financing Application is denied. In its Brief, APS argued that “there [is] no credible
6 evidence contradicting the inescapable conclusion that PWCC would be downgraded if the
7 Commission were to deny the Application, forcing PWCC to repay or refinance all of the
8 bridge debt.” APS Brief at 9. Again, APS is attempting to turn the burden of proof on its
9 head, assuming, without evidence, that it is an “inescapable conclusion” that PWCC will be
10 downgraded if it refinances the bridge debt, putting the onus on PGR and the other
11 merchant intervenors to prove that this assumption is not true. But again, it is APS’s
12 burden to prove, by credible evidence, that PWCC would be downgraded if it refinanced
13 or renegotiated the bridge debt.⁷ Ms. Gomez’s hearsay assertions simply are not enough.

14 APS points to S&P and Moody’s releases that it asserts show that the agencies
15 will downgrade PWCC if the Commission denies the Application. APS Brief at 9-10.
16 However, the rating agencies did not say that they would downgrade PWCC if the
17 Application is denied, only that they were assuming that, given Staff’s apparent support for
18 the Application, the Application would ultimately be approved. As PGR explained in its
19 initial brief, all the evidence in this proceeding demonstrates that PWCC can refinance the
20 bridge debt, and that it should not be downgraded if it does. Ms. Abbott, the only witness
21 with any rating agency experience, testified that PWCC could refinance or extend the debt,

⁷ Staff’s Brief appears to accept this shift in the burden of proof, chastising Ms. Abbott for not proving a negative and not providing an analysis of PWCC’s credit metrics if it refinanced the debt. Staff Brief at 3. Staff fails to recognize that APS provided no analysis of PWCC credit at all, before or after the bridge debt is refinanced. In any event, Ms. Abbott did testify that PWCC’s credit profile should not change if the financing application is denied, as the debt is already at PWCC.

1 and that the rating for PWCC should not change, in that it would only be exchanging
2 interim bridge debt for an equal amount of permanent financing. Mr. Davis and Ms.
3 Gomez supported Ms. Abbott's conclusion that PWCC could refinance the debt, testifying
4 that PWCC plans to independently obtain \$300 million for its Nevada generation and that
5 PWCC's SunCor Development subsidiary is expected to contribute up to \$100 million per
6 year in cash flow to the parent. Tr. at 283, 760. APS has provided no evidence to rebut
7 Ms. Abbott's conclusions. And Ms. Abbott was the only person who could offer expert
8 testimony in this regard.

9 Staff and RUCO each conclude that PWCC cannot refinance the bridge debt
10 itself, and that PWCC will be downgraded if the Application is not approved. Staff Brief at
11 3; RUCO Brief at 4. However, neither Staff nor RUCO cited any evidence at the hearing
12 or in their briefs to prove that PWCC would be downgraded, even though each received
13 thousands of pages of documents from APS in response to Data Requests.⁸ If there is no
14 evidence to support Ms. Gomez' testimony, and there is not, then there is likewise no
15 evidence to support Staff and RUCO, who merely rely upon Ms. Gomez.

16 **D. The Evidence Shows That APS Will Be Harmed If The Application**
17 **Is Approved**

18 APS argues that recent S&P and Moody's statements demonstrate that APS will
19 not be downgraded if it issues \$500 million in new debt to support its merchant generation
20 affiliate. However, these rating agency statements are contingent upon the information
21 APS provided to the agencies. By sending the agencies copies of her written testimony,
22 Ms. Gomez informed the agencies that APS intended to seek inclusion of the PWEC assets
23 in APS's rate base, who then relied on this statement. If, however, the Commission

⁸ In fact, Staff witness Thornton referred to APS witness Tildesley's assertions about PWCC credit quality suffering as "speculative and unsupported by documentation." S-1 at 10.

1 ultimately does not allow the assets into rate base, there is no reason to believe that the
2 rating agencies' prior prognostications will remain true.

3 Of course, had APS presented a rating agency witness, the parties could have
4 explored the role future rate-basing of the PWEC assets played in the agency opinions, but
5 APS did not do so, leaving Ms. Abbott as the only witness with relevant experience. Ms.
6 Abbott testified that, based on her two decades of experience rating companies like PWCC
7 and APS, a loan by APS to PWEC should result in a downgrade of APS, whereas
8 refinancing of the bridge debt by PWCC should not result in a downgrade of PWCC, or
9 more importantly, APS. Where was APS's expert testimony on this point?

10 Furthermore, as Mr. Thornton made clear, even if the rating agency opinions
11 APS presented are accurate, and APS is not downgraded upon approval of the Application,
12 APS's credit quality will still decline, with all of the consequences attendant to a
13 deteriorating credit profile, including an increased cost of capital and an increased
14 probability that any future problems will result in a downgrade. Tr. at 992. APS presented
15 no evidence in the hearing and no argument in its Brief to rebut Mr. Thornton's
16 testimony.

17 **E. APS Presented No Evidence Of Any Real Benefit To Its Ratepayers**
18 **From The Proposed Transaction**

19 APS argues that the Application is in the public interest because it provides
20 benefits to APS ratepayers. PGR agrees that the Commission's primary focus should be
21 whether APS's proposal benefits APS ratepayers, not whether it benefits PWEC, PWCC or
22 PWCC's shareholders. PWCC and PWEC are unregulated entities that elected to enter
23 lines of business that face inherent risks; PWCC shareholders invested in the holding
24 company with full awareness of the business risks attendant upon such operations and the
25 risk that this Commission could change direction. Staff Brief at 7, *see also* Exh. P-11. Only

1 APS's ratepayers were without choices, dependent upon the Commission to protect their
2 best interests. Therefore, the only benefits that are in any way relevant in this proceeding
3 are benefits to APS and its ratepayers. APS presented no evidence of any real benefit to its
4 ratepayers.

5 In its initial brief, APS argues that the proposed loan will (1) provide interest
6 income from PWEC to APS, which will be passed on to APS's ratepayers; (2) narrow the
7 remaining issues subject to APS's appeal of the Commission's Track A order; (3) increase
8 investor confidence in the Commission; (4) preserve PWCC's ability to seek to transfer the
9 PWEC assets to APS and ultimately include the assets in APS rate base; (5) retain PWEC as
10 a viable competitor in the wholesale market while not impairing the Track B solicitation
11 process; and (6) increase regulatory insulation through Staff's proposed limitation of
12 dividends from APS to PWCC. As discussed in PGR's initial brief, there is no evidence to
13 support any of these alleged "benefits," and even if there were, the benefits have nothing to
14 do with the applicable statutory and regulatory standards.

15 It is notable that the only direct benefit APS claims will be provided by the
16 financing proposal that will accrue directly to APS's ratepayers is the interest income
17 attributable to Staff's proposed risk premium.⁹ This premium, however, provides no real
18 benefit to APS's ratepayers, even if the interest income is eventually passed on to ratepayers.
19 As Mr. Thornton made clear at the hearing, the purpose of the risk premium is not to
20 provide additional income to APS and ultimately the ratepayers, but to keep the utility and
21 its customers "whole" for the additional risks they face in making a half-a-billion dollar loan

⁹ Staff proposed that PWEC pay a premium of 264 basis points over the cost of equivalent APS debt; APS does not dispute that a premium is necessary, but argues that it should be nearly 100 basis points lower. Staff Brief at 4; APS Brief at 23.

1 to PWEC. Tr. at 991, lines 14-24. The premium is not a benefit in any sense, but an
2 attempt to mitigate the harm of the transaction.¹⁰

3 Likewise, Staff's proposed dividend condition, which APS apparently grudgingly
4 accepts (APS maintains that payment of dividends is a matter exclusively within the purview
5 of the APS Board of Directors), provides no benefit to APS ratepayers, but limits the
6 opportunity for APS to substantially increase its dividends to PWCC in order to allow
7 PWEC to service the APS loan. Far from increasing regulatory insulation, the dividend
8 condition demonstrates that the proposed loan substantially decreases regulatory insulation,
9 requiring APS to mitigate additional potential harm to its customers. That the risk
10 premium and dividend limitation are even necessary shows that the financing proposal is
11 exactly the sort of transaction that the Affiliated Interest Rules were designed to prevent.
12 The Rules were promulgated "to ensure that ratepayers do not pay rates for utility service
13 that include costs associated with holding company structure, financially beleaguered
14 affiliates, or sweetheart deals with affiliates intended to extract capital from the utility to
15 subsidize non-utility operations." A.A.C. R14-2-804; Decision No. 56844 (emphasis
16 added); *see also*, PGR Brief at 6.

17 In essence, APS now argues that the conditions Staff proposes to limit the harm
18 of the Application are a "benefit" to APS and its ratepayers. The Commission should not
19 be fooled – attempts to prevent a bad deal from becoming worse do not a good deal make,
20 and attempts to ensure that ratepayers are not harmed in no way means that they will be
21 helped.

¹⁰ *See also* Staff Initial Brief at 4 stating that the "seven conditions . . . are designed to protect APS and its ratepayers from any potential harm that might result from this transaction."

1 **F. Staff's Proposed Conditions Do Not Insulate Ratepayers From**
2 **Harm If The Application Is Approved**

3 APS and Staff argue that the conditions Staff recommends for approval of the
4 Application, which APS generally concedes are necessary, will protect APS's ratepayers from
5 any adverse consequences of approval of the Application. APS Brief at 14. However,
6 Staff's proposed conditions are inadequate to protect APS's ratepayers from the harm
7 caused by approving the Application. First, the condition APS relies upon, which excludes
8 from any future rate case any increase in APS's cost of capital demonstrably attributable to
9 the \$500 million financing, is speculative at best. It is unclear what evidence will be
10 available to prove that an increase in APS's cost of capital is attributable solely to the
11 financing. It is unlikely that investors or analysts will be this direct, and it is likely that APS
12 will argue that any increase in its cost of capital is attributable to other factors and therefore
13 the increased cost should be appropriately included in its rate case.

14 In addition, Staff's condition addresses only the rate impacts of an increase in
15 APS's cost of capital, and ignores other ways approval of the Application will likely harm
16 APS's ratepayers. As PGR explained in its initial brief, approval of the loan option will
17 directly harm the competitive market by making it that much more likely that APS will
18 ultimately be able to include the PWEC assets in its rate base. PGR Brief at 26-27. APS
19 provided no evidence in its brief to rebut this conclusion. The Commission stated in its
20 Track A order that increased wholesale competition will benefit APS's retail customers.
21 Decision No. 65154 at 29. The contrary is also true – limiting wholesale competition will
22 hurt ratepayers. Mr. Thornton testified that Staff did not consider whether approval of the
23 Application would increase wholesale power prices or how increased wholesale power prices
24 would affect APS customers. Tr. at 957, lines 21-24. Therefore, APS and Staff simply
25 cannot say with any certainty that approval of the Application will not harm APS customers,

1 or, conversely, that approval of the Application is in the public interest. APS relies on Mr.
2 Thornton's statement that he had seen no evidence that approval of the Application would
3 lead to an increase in wholesale prices. APS Brief at 18. However, this is yet another
4 example of APS attempting to shift the burden of proof from itself to PGR. The fact
5 remains that the evidence shows that approval of the Application will harm wholesale
6 competition, and neither APS nor Staff made any effort to quantify how this market impact
7 will affect APS's retail customers.

8 **G. There Is No Evidence That The PWEC Assets Were Built As**
9 **Reliability Assets To Serve APS Customers**

10 Although APS now appears to have backed away from its original claim that the
11 Commission should grant the Application because the PWEC assets were built for, and
12 dedicated to, APS's customers, thus obligating the Commission to do whatever is necessary
13 to protect the assets, APS continues to refer to the PWEC facilities as "reliability assets,"
14 implying that PWEC constructed the facilities solely to maintain APS's system reliability.
15 *See, e.g.*, APS Brief at 5. Remarkably, APS cites neither a single document or page of the
16 hearing transcript for this proposition, even though APS witness Jack Davis testified at
17 length regarding the purpose and origin of PWEC. As PGR discussed in its initial brief, all
18 of the contemporaneous evidence indicates that PWEC was formed to be a merchant
19 generator, and that PWEC constructed Redhawk and the West Phoenix expansion as
20 merchant generation facilities intent on sales to the broad wholesale market, including APS.
21 PGR Brief at 15-19; *see also* Exhs. P-10, P-14, P-15, P-19, P-20, P-21. This business
22 model was no different than any of the other merchant generation built in Arizona.

1 **III. APS'S AND STAFF'S OPPOSITION TO THE USE OF A GUARANTEE**
2 **IS MISPLACED**

3 As PGR discussed in its initial brief, if, despite the lack of proof, the Commission
4 determines that some credit support for PWEC is necessary from APS, it should approve
5 only the corporate guarantee. The guarantee would better maintain the goals identified in
6 prior Commission orders, protect the wholesale competitive market, and not make it more
7 likely that the PWEC assets would eventually be included in APS's rate base. PGR Brief at
8 21. APS and Staff now oppose the guarantee, but as with their support for the loan
9 proposal, their objections to an APS guarantee do not hold up under scrutiny.

10 APS claims that the loan option is preferable because it would be less complex,
11 take less time to set up, and would better suit Staff's proposed conditions. APS Brief at 24.
12 Staff likewise asserts that it "opposes the guarantee because it is unidentified, impractical, ill
13 suited to the circumstances of this case and unsupported by the record." Staff Brief at 6.

14 **A. The Guarantee, Not The Loan, Is Supported By The Record**

15 Staff is simply incorrect that the corporate guarantee is "unsupported by the
16 record." There was far more discussion in the record concerning the merits of a corporate
17 guarantee than there was any proof that APS will suffer a downgrade if PWCC is
18 downgraded, or that PWCC will even be downgraded. Likewise, neither APS nor Staff
19 produced any proposed terms for the loan option or in any manner discussed proposed
20 terms on the record, save for Staff's risk premium condition. Thus, if the Commission
21 applies Staff's argument regarding the quality of the record, it should do so to deny APS
22 Application in its entirety, not simply the guarantee alternative.

23 **B. The Guarantee, Not The Loan, Suits The Circumstances Facing**
24 **PWEC**

25 Next, Staff claims that the guarantee is "ill suited" to the circumstances of this
26 case. Far from it. Even APS's initial testimony acknowledged that the guarantee was best

1 suited for the circumstances of this case as it would provide PWEC with an avenue to stand
2 on its own two feet. Exh. APS-1 at 15. Likewise, PGR witness Ms. Abbott testified that “a
3 guarantee as opposed to an outright loan is probably a better option should the
4 Commission approve the request, in that APS’s credit quality wouldn’t suffer quite as much
5 as with a direct loan, since there would be no interest obligation attached to a guarantee.”
6 Tr. at 741.

7 The record is also clear that a guarantee will provide better separation between
8 APS and its affiliates. Exh. APS-1 at 15 (the guarantee allows PWEC to get its feet wet in
9 the financial markets), APS-3 at 8 (the guarantee has the benefit of notes issued directly by
10 PWEC). Staff acknowledges that separation between APS and PWEC/PWCC is an
11 appropriate goal, stating that in “an ideal world, we would have complete separation
12 between APS and its affiliates.” Staff Brief at 7. Staff nevertheless determines that this
13 “single goal” is an insufficient basis to prefer the guarantee. Staff Brief at 7. PGR never
14 identified this as a “single goal” warranting the use of a guarantee; rather, PGR presented,
15 via record evidence, a variety of reasons as to why the guarantee is the best choice for
16 ratepayers.

17 Nevertheless, the Commission must not lose sight of the fact that separation of
18 regulated and unregulated functions is a fundamental tenet of the Commission’s rules. As
19 APS, more than once, pointed out, we would not even be in this proceeding if the
20 Commission’s Affiliated Interest Rules did not prohibit the requested transaction and
21 demand separation between APS and its unregulated affiliates. Tr. at 398, lines 1-8. The
22 Commission went even further in explaining those rules to demand that the separation
23 occur to prevent precisely what APS claims will occur here, namely, APS’ credit rating
24 being adversely impacted by the unregulated activities of APS’s affiliates. Decision No.

1 56844, Attachment B at 2. Having already allowed the credit rating of APS to be tied to
2 PWCC, Staff should not be heard to argue that we have to live with the cards we've been
3 dealt and that separation is not a fundamental goal of this Commission. While we must, in
4 fact, deal with the facts as they exist, the Commission's primary goal must be to get those
5 facts back to the way "we would like them to be." Staff Brief at 7.

6 Staff seems also to assert that the guarantee is "ill-suited" to the circumstances of
7 this case as it infringes on Staff's conditions. Staff's conditions are in place to mitigate harm
8 to APS ratepayers from the proposed transaction. If that harm can be eliminated through
9 use of a corporate guarantee, then the Staff conditions are not necessary. That is in fact a
10 benefit, not a burden, of a guarantee. In any event, even Staff's conditions fit within a
11 guarantee.

12 First, Staff prefers a loan at a "stated interest rate that expressly sets forth the risk
13 to which APS will be exposed." *Id.* at 6. The guarantee can do just that. PWEC will
14 negotiate the price of its own loan so there is no need for Staff to price that transaction. If,
15 however, Staff wants to continue to collect a risk premium, now commensurate with the
16 risk that APS would be called upon to pay the difference between the underlying PWEC
17 obligation and the value of the PWEC assets, the transaction can certainly be structured
18 that way. As PGR stated in its initial brief, the risk premium can be a direct payment, or
19 simply an escrow account to be drawn upon if there is a default. PGR Brief at 25.

20 Staff also suggests that the guarantee interferes with Staff's condition that APS
21 hold a security interest in the PWEC assets and that Staff believes that a secondary security
22 interest is contrary to ratepayer interests. *Id.* at 7. This could only be true if Staff's goal is
23 APS's ultimate ownership of the PWEC assets or if Staff believes that the PWEC assets are
24 not worth at least \$500 million (the amount of the loan to be guaranteed). It was assumed

1 when Staff proposed the security interest that it was to protect ratepayers by giving them an
2 opportunity to exercise on the collateral in order to recover their loan. The guarantee does
3 even better. Under a guarantee, when structured as suggested by PGR, APS will bear no
4 risk of making any payment, unless and until, PWEC defaults on its obligations, and if its
5 assets are then sold for less than the deficiency amount. APS witness Davis testified to his
6 belief that the assets were worth twice the proposed loan amount. Tr. at 570, lines 14-15.
7 Staff witness Thornton also believed the assets were valued at more than the loan amount.
8 Tr. at 940, lines 8-9 If, however, the assets are worth less than the loan amount, the assets
9 would have provided no better protection for APS ratepayers had the security interest been
10 held by APS directly and ratepayers exposed to a deficiency. Furthermore, Staff can protect
11 ratepayers from any deficiency by revising its condition 7.

12 **C. The Guarantee Would Not Take Longer To Establish Than A Loan**

13 Staff also asserts that the guarantee is impractical, largely because “APS claims it
14 needs to complete the transaction as soon as possible” and “because of the additional time
15 it will take to develop its terms and complete the necessary regulatory reviews.” Id. at 6.
16 Even if one were to assume that these claims would not be equally true of the loan
17 alternative, concerns over the alleged impracticality of a guarantee are misplaced for two
18 reasons. First, it was APS that chose not to define the terms of the guarantee. If the
19 guarantee is the best choice for protecting ratepayers, and it is, APS should not be able to
20 avoid that alternative by its own failure to offer proof. This is particularly true given that it
21 was APS that proposed the guarantee in the first instance. Second, APS’s witnesses said
22 repeatedly throughout the hearing that if this Commission determined that it should use a
23 guarantee, APS would do so. Tr. at 200.

1 APS also asserts a timing argument by asserting that the guarantee would be
2 more complex and take more time in that while the credit markets are familiar with APS,
3 the markets are not familiar with PWEC, and thus would require additional time to analyze
4 PWEC before proceeding with the PWEC loan that underlies the guarantee option. There
5 is no evidence in the record to support this rather surprising assertion. Certainly investors
6 and analysts examining PWCC over the last four years considered all of PWCC's holdings,
7 including PWEC and its merchant generation facilities. In fact, as Ms. Gomez was quick to
8 testify, the markets know PWEC well enough to give it a contingent credit rating. There is
9 no reason to believe, and APS provided no evidence for the proposition, that lenders would
10 require such significant additional due diligence that PWCC and PWEC would collapse in
11 the meantime, particularly where, as here, the holding company has already borrowed to
12 finance the construction of the assets at PWEC. APS first proposed the use of a guarantee
13 in September 2002. Presumably APS has been "educating" lenders from that time in the
14 event the Commission accepted its proposal. Finally, APS's own lender witness, Mr.
15 Tildesley, testified that his firm would be happy to place the guarantee and underlying
16 PWEC debt, expressing no real concerns regarding the alleged complexity of the guarantee
17 option. Tr. at 366, line 22 – 367, line 3.

18 **D. Terms Of The Guarantee Can Be Easily Defined**

19 Finally, as to Staff's assertion that the guarantee was not defined, Staff is of
20 course correct. APS chose for strategic reasons not to define the guarantee because the
21 guarantee did not support its desire to acquire and rate-base the PWEC assets. Clearly,
22 ratepayers should not be prejudiced by APS's refusal to identify the elements of the better
23 alternative.

1 To provide Staff, and the Commission, some guidance as to what the terms of a
2 guarantee may look like, attached hereto, as Exhibit A, is a form of guarantee that could be
3 used if the Commission determines that some credit support of PWEC is necessary. These
4 terms clearly show that, contrary to APS' assertions, it is APS and Staff that are the "just-
5 say-no" parties when it comes to a guarantee. The terms show that while Staff's proposed
6 security condition would have to be modified to provide that any APS security interest in
7 the assets would be subordinate to the security interest of PWEC's lender on the
8 underlying debt, the remaining Staff conditions would apply equally to a guarantee and a
9 loan. In addition, to the extent a particular condition is not easily adapted to a guarantee
10 scenario, there also is likely to be less need for such conditions in a guarantee, where a third
11 party makes the underlying loan to PWEC secured primarily by the PWEC assets, as
12 opposed to in a loan between affiliates, where the Commission must be vigilant to prevent
13 affiliate abuse, cross-subsidization, extraction of utility capital for non-utility operations and
14 other forms of self-dealing. These terms are offered to add definition for Staff's
15 consideration. PGR remains willing to meet with Staff or any other party, at any time to
16 discuss these terms or other alternatives.

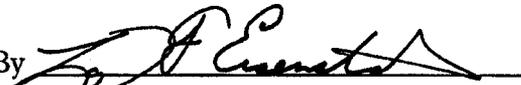
17 **IV. CONCLUSION**

18 As discussed herein, rather than meeting the statutory burden it must prove to
19 support its Application, APS attempted to shift its burden to PGR, arguing that PGR did
20 not prove that the proposed financing would harm APS and its ratepayers. The
21 Commission should reject this tactic, and hold APS strictly accountable to its burden of
22 proof. In any event, though, regardless of who bears the burden of proof, there is no
23 evidence in the record to support APS's central contention that the Commission must
24 approve the Application in order to protect APS's and PWCC's credit ratings. To the

1 contrary, APS, Staff, RUCO and AUIA rely entirely on APS's unsupported and
2 uncorroborated assertions. There is, evidence, on the other hand, that the Application
3 provides no benefit to APS's ratepayers and will harm both APS and the wholesale
4 competitive market. The Commission should, therefore, reject APS's application.

5 In the alternative, if the Commission determines some credit support of PWEC
6 is appropriate in order to protect APS's ratepayers and remain consistent with prior
7 Commission orders, it should approve only the corporate guarantee option, not the loan
8 alternative, as a direct inter-affiliate loan would eviscerate the wholesale competitive market
9 and make it significantly more likely that the PWEC merchant facilities eventually will be
10 transferred to APS and included in APS's rate base.

11 RESPECTFULLY SUBMITTED, Thursday, February 6, 2003

12
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2 foregoing hand-delivered for filing,
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28 COPY of the foregoing mailed, faxed or
29 Transmitted electronically,
30 Thursday, February 6, 2003, to:
31
32 All parties of Record
33

Exhibit A

COLLECTION GUARANTY

This COLLECTION GUARANTY is dated as of _____, 2003 (this "Guaranty") and is made by ARIZONA PUBLIC SERVICE COMPANY, an Arizona corporation (the "Guarantor") to _____ (the "Lender").

Recitals

WHEREAS, pursuant to a [loan agreement] (the "Loan Agreement") the Lender has made a loan (the "Loan") in the principal amount of \$ _____ to [Pinnacle West Energy Corporation], an Arizona corporation (the "Borrower");

WHEREAS, the Borrower provided the Lender with collateral security (the "Collateral") for the Loan pursuant to the terms of [insert description of security documents] (the "Security Documents");

WHEREAS, the Borrower is an indirect subsidiary of the Guarantor, and as such the Guarantor acknowledges that it is in its best interests for the Borrower to enter into the Loan Agreement;

WHEREAS, the Lender has requested the Guarantor to guarantee the obligations of the Borrower under the Loan Agreement to repay the Loan, subject to the terms of this Guaranty;

NOW, THEREFORE, in consideration of the foregoing, and for other good and valuable consideration received, the receipt and adequacy of which is hereby acknowledged, the Guarantor agrees with the Lender as follows:

1. Guarantee. The Guarantor hereby guarantees to the Lender, for its benefit and that of its permitted successors and assigns under the Loan Agreement, the collection of the principal of and interest on the Loan, subject to the Lender first using due diligence and reasonable legal means to exercise its rights under the Security Documents to have the Collateral sold and the proceeds of such sale applied pursuant to the terms of the Security Documents.

2. Survival of Obligations. The obligations of the Guarantor hereunder shall remain in full force and effect so long as the principal of and interest on the Loan have not been paid. The liability of the Guarantor hereunder shall in no way be affected or impaired by any sale, pledge, surrender, compromise, settlement, release, renewal, extension, indulgence, alteration, substitution, exchange, change in, modification or other disposition of, or other modification in any way, any of the Borrower's obligations under the Loan Agreement, either express or implied.

If any payment received by the Lender under the Loan Agreement is thereafter set aside, recovered, rescinded or required to be returned for any reason (including, without limitation, the bankruptcy, insolvency or reorganization of the Borrower), the

Borrower's obligations under the Loan Agreement to which such payment was applied shall for the purposes of this Guaranty be deemed to have continued in existence, notwithstanding such application, and this Guaranty shall be enforceable as to such obligations as fully as if such application had never been made.

4. Representations and Warranties. The Guarantor represents and warrants to the Lender that:

Organization and Powers. The Guarantor (i) is a corporation, duly organized and validly existing under the laws of the State of Arizona and has all requisite power and authority to perform all of its obligations under this Guaranty; and (ii) is duly qualified to do business and is in good standing in each other jurisdiction where the character of its properties or the nature of its activities makes such qualification necessary, except where the failure to so qualify or be authorized would not materially and adversely affect its ability to perform its obligations hereunder.

Authorization. The execution, delivery and performance by the Guarantor of this Guaranty has been duly authorized by all necessary action and this Guaranty constitutes a legal, valid and binding obligation of the Guarantor enforceable in accordance with its terms, subject to bankruptcy, reorganization, insolvency, moratorium or other similar laws of general application relating to the enforcement of creditors' rights and general principles of equity.

Compliance with Laws and Contracts. The execution, delivery and performance by the Guarantor of this Guaranty does not and will not: (i) violate any provision of any law, rule, regulation, order, writ, judgment, injunction, decree, determination or award as currently in effect to which the Guarantor is subject; (ii) conflict with, breach or contravene the provisions of the organizational documents of the Guarantor or any material contractual obligation of the Guarantor, or (iii) result in the creation of a condition or event that constitutes (or that, upon notice or lapse of time or both, would constitute) an event of default under any material contractual obligation of the Guarantor.

Governmental Approvals. The Guarantor has obtained all authorizations, consents, approvals, licenses, exemptions of or filings or registrations, with all commissions, boards, bureaus, agencies and instrumentalities, domestic or foreign, available as of the date hereof, necessary for the due execution, delivery and performance by the Guarantor of this Guaranty.

Litigation. There are no actions, suits or proceedings pending or, to the knowledge of the Guarantor, threatened against the Guarantor or any of its property, before any court, arbitrator or governmental department, commission, board, bureau, agency or instrumentality which if determined adversely to the Guarantor, would singly or in the aggregate, have a material adverse effect on the ability of the Guarantor to perform its obligations under this Guaranty that have not been disclosed in writing to the Lender.

5. Covenants by the Guarantor. So long as any obligation of the Guarantor under this Guaranty is outstanding, the Guarantor covenants and agrees with the

Lender that to the extent necessary to avoid a material adverse effect on Guarantor's ability to perform its obligations under the Guaranty, the Guarantor shall (i) preserve and maintain its legal existence and form and all of its rights, privileges and franchises, if any, necessary for the operation of its business and the maintenance of its existence and (ii) not change its form of organization or its business or liquidate or dissolve itself or transfer all or substantially all of its assets.

6. Waivers by Guarantor. No failure or delay on the part of the Lender in exercising any right or remedy hereunder shall operate as a waiver thereof nor shall any single or partial exercise of any power or right preclude other or further exercise thereof or the exercise of any other right or remedy.

All presentment, demand, protest and/or notice, as to any and everyone, whether or not the Borrower or the Guarantor or others, of dishonor and of default and of non-performance, non-payment and of the creation and existence of any and all of the Borrower's obligations under the Loan Agreement, and of the acceptance of this Guaranty, and of any indulgence or the modification of, or creation of additional obligations of the Borrower under the Loan Agreement, are expressly waived except to the extent required under the Loan Agreement.

Until the Borrower's obligations under the Loan Agreement have been satisfied in full, any claim or other rights which Guarantor may now or hereafter acquire against the Borrower that arise from the payment, performance or enforcement of the Guarantor's obligations hereunder, including, without limitation, any right of subrogation, reimbursement, exoneration, contribution, indemnification, or any right to participate in any claim or remedy of the Lender against the Borrower whether or not such claim, remedy or right arises in equity, or under contract, statute or common law, including, without limitation, the right to take or receive from the Borrower directly or indirectly, in cash or other property or by set-off or in any other manner, payment or security on account of such claim or other rights, shall be fully subordinated to the rights of the Lender and its assignees.

The Guarantor waives any and all of its defenses, claims and discharges and those of the Lender, or any other obligor, pertaining to the Borrower's obligations under the Loan Agreement or its obligations hereunder, except the defense of discharge by payment in full, including, without limitation any defenses which may constitute a legal or equitable discharge of a surety or guarantor.

7. Modification of this Guaranty. No amendment, modification or waiver of any provision of this Guaranty shall be effective unless the same shall be in writing and signed by the Guarantor and the Lender, and then such waiver or consent shall be effective only in the specific instance and for the specific purpose for which given.

8. Severability. In case any one or more of the provisions of this Guaranty shall be invalid, illegal or unenforceable in any respect, the validity, legality and enforceability of the remaining provisions contained herein shall not in any way be affected or impaired hereby. The parties shall endeavor in good-faith negotiations to replace the invalid, illegal or unenforceable provisions with valid provisions the

economic effect of which comes as close as possible to that of the invalid, illegal or unenforceable provisions.

9. Governing Law. This Guaranty shall be governed by and construed in accordance with the applicable laws of the State of _____.

10. Remedies. No remedy herein conferred upon or reserved to the Lender is intended to be exclusive of any other available remedy or remedies, but each and every such remedy shall be cumulative and shall be in addition to every other remedy given under this Guaranty or now or hereafter existing at law or in equity or by statute. In order to entitle the Lender to exercise any remedy reserved to it in this Guaranty, it shall not be necessary to give any notice, other than such notice as may be expressly required by this Guaranty. No notice to or demand on the Guarantor in any case shall entitle it to any other or further notice or demand in the same or similar circumstances.

11. Dispute Resolution. The Guarantor (A) agrees that any suit, action or other legal proceeding arising out of this Guaranty may be brought in the courts of the State of _____ or the courts of the United States located within the State of _____; (B) consents to the jurisdiction of each such court in any such suit, action or proceeding; and (C) waives any objection it may have to the laying of venue of any such suit, action or proceeding in any of such courts. The reasonable costs of both parties (including counsel fees) related to any such suit, action or other legal proceeding shall be paid for by the non-prevailing party.

12. Notices. Any notices or communications required or permitted hereunder shall be in writing and shall be sufficiently given if telexed or cabled, delivered in person, or sent by certified or registered mail, return receipt requested postage prepaid, as follows:

If to the Guarantor:

If to Lender:

with a copy to:

Changes in the respective addresses to which such notices may be directed may be made from time to time by any party by written notice to the other party. All other notices shall be deemed to have been given upon receipt.

14. Successors and Assigns. This Guaranty shall be binding upon the Guarantor and its successors and inure to the benefit of the Lender and its successors and assigns. This Guaranty may not be assigned by the Guarantor.

15. Headings. The captions in this Guaranty are for convenience of reference only and shall not define or limit the provisions hereof.

16. Counterparts. This Guaranty may be executed by one or more of the parties to this Guaranty on any number of separate counterparts and all of said counterparts taken together shall be deemed to constitute one and the same instrument.

IN WITNESS WHEREOF, the parties hereto have duly authorized the execution and delivery of this Guaranty as of the date first written.

ARIZONA PUBLIC SERVICE COMPANY.

By: _____
Name:
Title:

[LENDER]

By: _____
Name:
Title: