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BEFORE THE 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)

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**AUIA'S EXCEPTIONS TO THE RECOMMENDED OPINION
AND ORDER IN THE APS FINANCING APPLICATION**

The Arizona Utility Investors Association (AUIA) hereby files its exceptions to the Recommended Opinion and Order (Order) issued on March 11, 2003, in the above captioned proceeding by Chief Administrative Law Judge Lyn Farmer.

Introduction

At the outset, AUIA would like to express its gratitude to the Commission and Judge Farmer for acknowledging the critical importance of this matter to the applicant and its ratepayers and shareholders. We commend the Staff and Judge Farmer for thinking outside of the regulatory box in order to craft a solution to a grave financial dilemma.

AUIA may not agree completely with the Commission's final order, but we sincerely appreciate that this application has been handled with diligence and alacrity.

Nevertheless, there are three elements of the proposed Order, which AUIA believes should receive different treatment based on the evidence presented at hearing. These elements are 1) the proposed restrictions on the disposition of non-jurisdictional assets; 2) the recommended preliminary investigation relative to electric competition;

Arizona Corporation Commission

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1 and 3) the proposed interest premium of 264 basis points to be paid by PWCC to Arizona
2 Public Service Co. (APS).

3 **1. Disposition of Assets**

4 The Order, at P. 33, L. 24, states: "We believe that as a condition to our approval
5 of the financing herein, and in order to protect APS' security interests in PWEC's
6 generation assets and to promote the public interest, neither PWCC nor PWEC shall
7 reorganize or restructure, acquire or divest assets, or form, buy or sell affiliates, or pledge
8 or otherwise encumber the PWEC generation assets during the duration of the
9 loan/guarantee without prior Commission approval." (Emphasis supplied. Similar
10 language appears in Finding of Fact #25, P. 39, L. 13.)

11 The conditions for approval of the APS loan/guarantee already require APS to
12 obtain a security interest in the PWEC generation assets that are to be refinanced and
13 AUIA understands why the Commission would want to guard those assets. However, the
14 prohibition against acquiring or divesting assets would also apply to assets that are not
15 under the Commission's jurisdiction and could produce serious negative consequences.

16 For example, PWEC's assets include its interest in the Silverhawk combined
17 cycle facility under construction in Nevada. That plant is not being refinanced by the
18 loan in question here, nor would it be included in the APS security interest. Not only is
19 that plant not under Commission jurisdiction, but also 25 percent of its output is owned
20 by a government entity that is certainly beyond Commission jurisdiction.

21 There could be critical business reasons why PWEC might need to acquire other
22 partners or divest its ownership in Silverhawk and the need for non-jurisdictional
23 approval by the Commission could be a serious impediment.

24 Another potentially important consequence could involve Suncor Development
25 Corp., a wholly owned subsidiary of PWCC. As APS witness Barbara Gomez testified,
26 the proposed \$500 million APS loan/guarantee to refinance PWEC assets is just one
27 component of a plan to deal with PWCC's total debt.

28 Ms. Gomez testified that the overall plan is to lower PWCC's total debt from
29 about \$1.1 billion to \$400 million by 2005 and the sale of Suncor assets is expected to
30 contribute \$80 to \$100 million per year toward that objective. However, the plan would

1 be in jeopardy if the restriction proposed by Judge Farmer were interpreted to include
2 Suncor's assets.

3 In addition to being outside the Commission's jurisdiction, many of Suncor's
4 properties are in partnerships or subject to performance contracts, release agreements or
5 other complex arrangements. A requirement for Commission pre-approval of any change
6 of ownership interest might seriously impair Suncor's ability to complete asset sales.

7 AUIA recommends that this prohibition be eliminated or clarified to apply only to
8 those assets that are covered by the APS loan or guarantee.

9 **2. Preliminary Investigation**

10 In the Order, at P. 34, L. 25, Judge Farmer recommends, in pertinent part, that the
11 Staff should undertake "a preliminary investigation into APS, PWCC and PWEC's
12 actions related to the transition to electric competition..." (Similar language appears in
13 Finding of fact #28, P. 39, L.24, and in an ordering paragraph, P. 42, L. 1.)

14 Before attempting to analyze this issue, AUIA strongly recommends that the
15 Commissioners read the small blocks of testimony cited by Judge Farmer in support of
16 this recommendation. We believe the Commission will conclude, as AUIA has, that what
17 we have here is a failure to communicate; that Judge Farmer was confused by a
18 combination of artless questioning by all parties and less than clear responses from APS
19 witnesses Barbara Gomez and Jack Davis

20 Judge Farmer apparently is disturbed by the appearance that PWEC was obtaining
21 favored treatment from APS, in violation of the electric competition rules, as evidenced
22 by statements made to rating agencies early in 2001. At that time, PWEC was seeking an
23 investment grade credit rating from the agencies because it was commencing construction
24 on new generating facilities that would eventually require permanent financing.

25 The assumptions underlying the rating agency presentations were: 1) that APS
26 generation would be transferred to PWEC in 2001 and 2002 and that during those years,
27 APS customers would be served by the combined APS/PWEC generation portfolio
28 (which is exactly what happened); 2) that, beginning in 2003, APS would be required to
29 obtain all of its power requirements from the open market, half by competitive bid and
30 half by arms length negotiation; 3) and that in 2003 and 2004, PWEC would be able to

1 compete successfully for the bid portion and negotiate for the rest of APS' needs at a
2 market price, resulting in a purchased power agreement (PPA).

3 These were only assumptions given to the rating agencies for financial modeling.
4 and the agencies accepted them. As Ms. Gomez testified more than once, there was no
5 PPA contract in existence when the presentations were made and the rating agencies were
6 so informed (Tr. P. 274, L.4-10, P. 277, L. 15-22).

7 It is apparent to AUIA that Judge Farmer was led by these assumptions to suspect
8 that a contractual obligation was being hatched between APS and PWEC in violation of
9 the electric competition rules.

10 But, in the spring of 2001, these assumptions were reasonable. There was no
11 assurance then (or even now, for the most part) that any of the merchant plants that had
12 been announced would be built in time to serve APS load in 2003 or even later. Under
13 the rules then in place, PWEC would have been able to focus its entire portfolio on
14 serving APS competitively and PWEC would have had the advantage in the market,
15 based on price, reliability and diversity.

16 The rating agency presentations were largely hypothetical exercises. When the
17 time eventually came, if the assets weren't transferred to PWEC from APS, or if PWEC
18 did not compete successfully for APS' load and its cash flow was deficient, the
19 investment grade ratings would have evaporated.

20 AUIA fails to see how the Commission's time and resources could be spent
21 productively today in trying to uncover the intentions more than two years ago of parties
22 that were struggling to adapt to a deregulation scheme that has since turned to rubble.
23 We urge the Commission to refrain from launching such an investigation.

24 **3. Interest Premium**

25 The Order, at P. 25, L. 3, adopts Staff's proposed Condition No. 3, which would
26 require PWCC (or PWEC) to pay APS an interest premium of 264 basis points above
27 APS' cost of money. PWCC shareholders would pay the premium and the proceeds --
28 approximately \$60 million over four years -- would accrue to APS ratepayers.

29 At hearing, APS witness Barbara Gomez argued for a premium of 150 basis
30 points, which she said would approximate the differential in PWEC's cost of money
31 based on its investment grade credit rating before the Commission acted to prevent the

1 A copy of these exceptions was provided
2 this 20th day of March, 2003, to:

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9 All Parties of Record

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Walter W. Meek