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BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL
Chairman
JIM IRVIN
Commissioner
MARC SPITZER
Commissioner

IN THE MATTER OF THE GENERIC PROCEEDINGS CONCERNING ELECTRIC RESTRUCTURING	DOCKET NO. E-00000A-02-0051
IN THE MATTER OF ARIZONA PUBLIC SERVICE COMPANY'S REQUEST FOR VARIANCE OF CERTAIN REQUIREMENTS OF A.A.C. 4-14-2-1606	DOCKET NO. E-01345A-01-0822
IN THE MATTER OF THE GENERIC PROCEEDING CONCERNING THE ARIZONA INDEPENDENT SCHEDULING ADMINISTRATOR	DOCKET NO. E-00000A-01-0630
ISSUES IN THE MATTER OF TUCSON ELECTRIC POWER COMPANY'S APPLICATION FOR A VARIANCE OF CERTAIN ELECTRIC COMPETITION RULES COMPLIANCE DATES.	I **E-00000A-02-0051** **E-01345A-01-0822** **E-00000A-01-0630** **E-01933A-02-0069**

RESPONSE OF ARIZONA PUBLIC SERVICE COMPANY TO THE ALLIANCE'S NOTICE OF SUPPLEMENTAL DISCLOSURE

Arizona Public Service Company ("APS" or "Company") hereby files this Response to the Notice of Supplemental Disclosure ("Notice") submitted by the Arizona Competitive Power Alliance ("Alliance") on Thursday, August 22, 2002. The Alliance's clearly untimely submission—made two business days prior to the Special Open Meeting scheduled on Track A—is an incomplete and demonstrably inaccurate recitation of the relevant facts on issues that the Alliance has had ample opportunity (but declined) to

address. And, like many of the Alliance's litigation arguments, the pleading ultimately ignores the well-established, clearly-documented factual background surrounding the 1999 APS Settlement Agreement. The Notice certainly fails to understand the equitable nature of the Company's proposal to unify certain of the Pinnacle West Energy ("PWEC") generation assets with those of APS. That proposal was suggested by the Company as long ago as last April as a compromise if the Commission were otherwise inclined to prevent or delay the divestiture of APS generation—the divestiture that was promised in the 1999 Settlement, ordered by the Electric Competition Rules, and which was detrimentally relied upon in good faith by APS and its affiliates. Given the timing of the Alliance's filing and the forthcoming Special Open Meeting, APS is compelled for completeness of the record to submit this Response and to correct some of the various inaccuracies, mischaracterizations, and omissions in the Notice. However, APS urges the Commission to simply reject the Alliance's Notice as procedurally inappropriate.

A. The Unification Issue.

In support of its claim that there is no need to obtain permanent financing for PWEC's Arizona assets and no financial consequences to reversing the divestiture promised in the 1999 Settlement Agreement, the Alliance offers no direct or probative evidence whatsoever. Instead, the Alliance can cite only a portion of a single financial analyst report. But the cited report actually supports Pinnacle West Capital Corporation's ("PWCC") assertion regarding the financing impacts if divestiture is stayed. (*See* Notice at p.7, lines 13-16). As the analyst report noted, PWCC and PWEC had intended to finance generation expansion through a variety of means, including "notes issued by the parent company and Pinnacle West Energy, and tax-exempt debt transferred from the utility to Pinnacle West Energy." (*Id.,* emphasis added.) The problem is—and continues to be—that the cost and feasibility of this permanent financing was explicitly premised on the already-approved transfer of generation from APS to PWEC. In fact, PWEC's

investment grade credit rating was expressly contingent on it obtaining the APS' generating assets. (*See, e.g.,* Fitch rating article, April 9, 2001, attached at Exhibit A.) The attached Fitch rating note—which expressly states that PWEC's debt rating was "contingent upon the successful transfer of a majority of APS' electric generating assets to PWEC"—was provided to Alliance members in discovery, yet omitted from their Notice.

Also, contrary to the Alliance's claim that there is no evidence in the Track A hearing to support APS' contentions, (*see* Notice at p.3, lines 2-5), evidence on the impacts of bifurcation from a rescission of the divestiture provision of the 1999 Settlement Agreement was both presented at the hearings and was uncontroverted by any of the Alliance's witnesses. (*See, e.g.,* J. Davis Direct Test., at pp. 7-9.) In Mr. Davis's Direct Testimony, he specifically identified the bifurcation issue that "has placed an extreme burden on PWCC without the ability to collateralize the APS generating assets." (*Id.* at p. 7, lines 25-26.) In addition to pre-filed written testimony, Mr. Davis was cross-examined about the financing impacts of abrogating the promised divestiture:

> Q. Are you experiencing or likely to experience financial difficulties if you cannot continue in [the divestiture] process?
>
> A. Yes. [A]s we mentioned in our April filing, we financed the reliability assets within Pinnacle West Energy Corporation based upon the transfer of those [APS] assets. In fact, the rating of Pinnacle West Energy Corporation is from Standard & Poor's, Moody's, is based upon a transfer of those assets. And it's all short-term bridge financing at the holding company. And those from the financing markets, they like those debts to be closer to the assets than the holding company.
>
> And so [there is] no question [that] Pinnacle West Energy would probably be faced with some sort of downgrading, and maybe Pinnacle West Capital themselves.
>
> That's why we proposed in our April filing we need to know one way or the other. If it's one way, we transfer the assets and get the appropriate long-term assets with the financing backing. If it's the other way, we have to figure out how to unwind all that and put that back into Arizona Public Service.

(Tr. vol. 1, at pp. 92-93.) Staff's witness also agreed that increased financing costs attributable to bifurcation were legitimate claims. (Tr. vol. VI, at pp. 1347-49.) Until two business days before the Special Open Meeting, the Alliance never even attempted to refute these facts, and they certainly did not contradict or attempt to contradict any of this testimony at the hearing when it was presented.

B. The Nature of the PWEC Assets.

The impacts of continued bifurcation if the Commission changes the divestiture provisions agreed to in the 1999 Settlement Agreement exist irrespective of why the assets were constructed. However, the Notice is also wrong on the substantive issue of whether these assets were constructed to serve APS customers. As discussed below, the Alliance's selective disclosure and use of statements and documents out of context cannot withstand scrutiny.

Specifically, the Alliance's claim that there was no evidence presented in the hearing on APS' position is flatly wrong. In the same paragraph that the Alliance asserts there was no evidence presented on this issue, they proceed to cite Mr. Davis's pre-filed, direct testimony. There, Mr. Davis stated that the PWEC assets were constructed to serve APS' retail customers. Like the financing impacts discussed above, this testimony was not controverted by the Alliance despite being repeatedly raised in cross examination. For example, after Mr. Davis explained how (in contrast to PWEC) the merchant generators had not timed their capacity construction to meet APS' summer 2001 or summer 2002 capacity needs, counsel for Panda/TECO specifically framed the issue:

> Q. I guess, Mr. Davis, we don't need to debate this. The issue is not which units are available....[Y]ou threw out a reliability issue and the point that I want to clarify with you is that from a reliability perspective, they are all the same out there?
>
> A. No, I guess I'm not going to give on that one, because I know our units were built specifically and solely for the reliability of my customers. Whether or not they come through Palo Verde or not, I don't think the other

> generators were built specifically and solely for reliability of my customers. That's the difference we're having.
>
> Q. We can agree to disagree on that issue.

(Tr. vol. I, at p. 127, line 18-p. 128, line 6.) Mr. Davis provided further evidence in response to questions from the Chief Administrative Law Judge:

> Q. At the time that the decision was made to build Redhawk and West Phoenix, did Pinnacle West look to the market to build instead?
>
> A. What Pinnacle West looked at was the needs of our customers. In fact we can, I think it's been produced somewhere, the load and resource programs that we put together for our customers. It shows Redhawk 1 and 2 and the West Phoenix units and Saguaro units needed for our customers, and embarked on that program.

(Tr. vol. I, at p. 239, line 24-p. 240, line 8.) In the same line of questioning, Mr. Davis explained why the Company believed it could not build generation at APS given the Electric Competition Rules, and discussed how PWEC consciously decided not to sell that generation forward in the lucrative California markets because it was needed for APS customers. (Tr. vol. I, at p. 240, lines 13-22.)[1]

The Load and Resources plans of 1999 and 2000 to which Mr. Davis referred in the quotation above was provided to Staff in discovery pursuant to a confidentiality agreement. These plans are contemporaneous, documentary evidence showing that both Redhawk (under its previous name Hedgehog) and West Phoenix were planned to meet APS' capacity and energy needs. (*See* Post-Hearing Brief at p. 38.) Further, APS provided in its Post-Hearing Brief its February 2001 Summer Preparedness presentation, on file with the Commission, which showed West Phoenix 4 meeting APS needs in 2001 and 2002, and Redhawk meeting APS needs in 2002. (*Id.* at Ex. A.)

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[1] These are all essentially the same assertions as in Mr. Post's July 11, 2002 letter, which the Alliance misleadingly claims could not be challenged through cross-examination. Ironically, it is the Alliance's Notice that seeks to introduce unsponsored materials outside the hearing and on the eve of the Special Open Meeting.

In contrast to this evidence and testimony, the Alliance proffers a series of quotations and outtakes that do not contradict the APS' assertion that the generation was constructed to meet the needs of its customers. APS itself pointed out in its Post-Hearing Brief that the units were referred to as "merchant plants" in the Siting Committee hearings that the Alliance quotes. At the time of both the West Phoenix and Redhawk siting hearings, all APS generation was to be divested to PWEC, so all the generation would be "merchant plants" in the sense of no longer being owned by a regulated utility. (*See* Post-Hearing Brief at pp. 37-38.) The point being made at the West Phoenix and Redhawk hearings was that APS customers would not bear the construction risk of the units. And at that time, because the Commission had ordered and agreed to generation divestiture, all power plants were to sell into the "deregulated" wholesale market—a market that clearly includes sales for resale from PWCC or PWEC to APS.

Nothing in the Alliance's transcript quotations contradicts the fact that the plants were constructed for APS customers' reliability needs. For example, part of Redhawk was always intended for regional as opposed to APS needs, and APS has not claimed that all four Redhawk units were built for APS customers. In fact, as noted by the Alliance, part of Redhawk was at one time considered for a joint development agreement with Reliant. And, even for the capacity that was intended to meet APS' reliability requirements, PWEC would still be able to sell excess energy into the regional market just as APS has done and does today with its generation.

What is evident, however, even from the excerpt quoted by the Alliance is that Redhawk was always intended to meet the need present in 1999 for new generation in Maricopa County and Arizona. Indeed, in its cited excerpts, the Alliance chose to omit the most relevant part of the transcript from the West Phoenix siting hearing:

> [By Mr. Ed Fox.] While we will be selling into the marketplace, we do expect that much of the energy will be sold here in Phoenix. We have a 6 percent load growth here in the urban area, a significant demand for import

> of energy during peak times during the summer, and we do expect much of the generation will be sold to meet the expanding needs of the Phoenix metropolitan area.

(Transcript in Docket No. L-00000J-99-92 (Nov. 19, 1999) at p. 17.)

Likewise, the Alliance's argument that PWCC had a regional strategy to become a "major player" in the Southwestern generation market does not contradict the fact that some of the PWEC assets were constructed to ensure reliable service to APS customers. When it was created, PWEC had been promised the APS generating assets and would have—not surprisingly—participated in the wholesale market in the region where those assets are located. PWEC is also constructing a project in Nevada. Further, PWEC had planned part of Redhawk project for the regional market. And, as noted earlier, the fact that capacity that was needed to meet APS' reliability still allows for the sale of energy into the Western wholesale market, just as APS does today. Thus, the buyers of energy from West Phoenix could be and likely will be, as the Alliance quotes, "Arizona Public Service or Salt River Project or any other provider active in the market." But the fact is that, unlike all the merchant generators in this proceeding, West Phoenix was constructed within the Phoenix load pocket and the first unit came online in 2001 precisely when APS required additional capacity for its customers.

The news articles provided by the Alliance are blatantly selective and omit the most relevant articles. For example, an April 26, 1999 Arizona Republic article on the West Phoenix project stated:

> The state-of-the-art, natural gas-fired plant will generate enough electricity for 120,000 homes and prevent the possibility of Valley power shortages in the next few years.
>
> Craig Nesbitt, a spokesman with Pinnacle West's Arizona Public Service Co. subsidiary, said the company does not have enough current generation or transmission capabilities to keep up with projected demand.
>
> "We have no choice but to build more facilities," he said.

> Nesbitt said the project is being developed by Pinnacle West instead of APS in anticipation of electricity deregulation rules that will require utilities to separate generation from their distribution business.

Max Jarman, Arizona Republic, April 26, 1999 (attached at Exhibit A). A Megawatt Daily article of the same day quotes Mr. Post as saying "the new capacity will help APS to meet growing demand and would also help the company to 'pursue new opportunities in competitive generation markets.'" Megawatt Daily, Vol. 4, No. 78, April 26, 1999 (attached at Exhibit A).

Given the uncontroverted testimonial evidence in the record that Redhawk and West Phoenix were constructed to meet the needs of APS customers, the Alliance's claim that this issue is somehow not supported by the record, or was not subject to cross examination, or is a new *post hoc* argument of APS, or should have been supported by additional documentary evidence all ring hollow. In stark contrast, the Alliance witnesses introduced no evidence that their projects were built for APS customers and during discovery could provide no such evidence. Ultimately, if the Alliance believed this issue was so controversial, why (apart from tactical reasons) would they wait until two business days before the Special Open Meeting to voice objection?

C. The Equities.

Perhaps most troubling, however, is the Alliance's utter disregard of the context surrounding the PWEC assets and the unification proposal. The Alliance disparagingly asserts that the financial consequences facing PWCC in this proceeding result from a "business and regulatory strategy gone wrong." (Notice at pp. 7-8.) Thus, they choose to ignore the fact that the Commission is proposing to substantially revise its own regulations and undo the 1999 Settlement Agreement after APS and its affiliates have detrimentally relied on that agreement and provided hundreds of millions of dollars of benefit to consumers. They choose to simply ignore the reasons that PWEC was required to construct generation needed by APS customers, and the financing issues associated

with continued bifurcated ownership of generation assets that would result if the Commission abrogated the divestiture that was agreed to in the 1999 Settlement Agreement. And, they choose to ignore the Chief Administrative Law Judge's recognition that the Commission should "take action in a manner that is fair to all parties" and "minimize the effects" of altering the Settlement. (Recommended Order at p. 22.) Reducing APS customers' rates and providing reliable, uncurtailed service while virtually every other utility company in the West recently faced either significant rate increases, or power curtailments, or both hardly seems to reflect a "business and regulatory strategy gone wrong."

APS has not suggested the unification proposal because it prefers that outcome over what was promised in 1999. In fact, APS repeatedly stated after filing its Variance Request that if the Commission determined that APS' request was not in the best interests of customers, APS would divest its generation and comply with the Electric Competition Rules. However, given the Commission's clearly-articulated concerns over divestiture, APS suggested the unification proposal in the spirit of reconciliation. In return, it was again confronted with the Alliance's spirit of litigation.

D. <u>Conclusion.</u>

The Alliance's Notice, submitted at a time and in a manner that minimizes APS' ability to respond, neither completely nor accurately relates the relevant facts. It ignores the ample record evidence that was subject to cross-examination at the hearing that supports the fact that Redhawk and West Phoenix were constructed to meet the reliability needs of APS customers, regardless of what other complementary purposes they might serve or PWEC's general business strategy. None of the quotations or reports cited in the Notice are ultimately inconsistent with this assertion, or contradict either Mr. Davis or Mr. Post. And all are completely irrelevant to the financing impacts that would result if the Commission abrogates the divestiture provisions of the 1999 APS Settlement Agreement.

The need to reach a solution that is fair to all parties, including APS, warrants consideration of APS proposal—a proposal supported by uncontroverted record evidence. Thus, the Commission should dismiss the Alliance's request that the Commission ignore this important issue.

RESPECTFULLY SUBMITTED this 26th day of August 2002.

SNELL & WILMER L.L.P.

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and

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Original and 18 copies of the foregoing filed this 26th day of August 2002, with:

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Copies of the foregoing mailed, faxed or transmitted electronically this 26th day of August 2002, to:

All parties of record

Vicki DiCola

1218369.1

EXHIBITS

FITCH RATING AGENCY NOTE

BUS Fitch Rates Pinnacle West Energy `BBB+'
Apr 9 2001 10:40

Business Editors

NEW YORK--(BUSINESS WIRE)--April 9, 2001--Fitch has assigned Pinnacle West Energy Corporation (PWEC) an initial implied senior unsecured debt rating of `BBB+'.

PWEC, a subsidiary of Pinnacle West Capital Corporation (PNW), senior unsecured debt rated `BBB', was formed to own and operate the electric generating assets of Arizona Public Service (APS), senior secured debt rated `A-`, which will function in the future as an electricity transmission and distribution business. The generating assets and associated debt will be transferred to PWEC by Dec. 31, 2002. The rating is contingent upon the successful transfer of a majority of APS's electric generating assets to PWEC.

PWEC is under contract to sell its output to PNW under a four-year purchase power agreement. PWEC will bear risk related to generation performance (outages, efficiencies) and replacement power costs. PWEC will continue existing long-term contracts to purchase coal and uranium, while PNW will bear risk related to purchasing natural gas.

Robust financial ratios are forecasted, with EBITDA/Interest expected in the high single digits, and debt/capital of approximately 50%. No one generating station is expected to generate more than 15% of cash flow.

PWEC owns 3,985 mw (39 units) of primarily base load generating assets that are well managed, have a diverse fuel mix and are in full environmental compliance. Capacity factors are high, and exceed national averages. PWEC plans to increase its fleet by approximately 68%, adding 2,729 mw of natural gas-fired units by the end of 2006. The additional capacity will further diversify the fuel mix, but also increase merchant exposure.

The additional capacity will support the region's rapid population growth. Phoenix is the nation's second fastest growing city, and the state's growth is twice the national average. PWEC's generation is favorably located at the major transmission hubs of Palo Verde and Four Corners, and PWEC is one of the largest generators in the West.

PWEC is headquartered in Phoenix, Arizona, and is a wholly-owned subsidiary of Pinnacle West Capital Corporation. PWEC's sister subsidiary, Arizona Public Service Company, had 857,536 customers at Dec. 31, 2000, and its retail customer growth rate was 3.8% in 2000.

--30--jah/at*

CONTACT: Fitch
Lori R. Woodland, 1-312-606-2309, Chicago
or
Robert Hornick 1-212-908-0523, New York

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BUS Fitch Rates Pinnacle West Energy 'BBB+'
Apr 9 2001 10:40

KEYWORD: NEW YORK ARIZONA
INDUSTRY KEYWORD: BOND/STOCK RATINGS ENERGY

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TRACK A PREFILED TESTIMONY

(EXCERPT)

TESTIMONY OF JACK E. DAVIS

On Behalf of Arizona Public Service Company

Docket No. E-00000A-02-0051, et al.

May 29, 2002

Q. WAS DIVESTITURE A KEY ELEMENT OF THE SETTLEMENT?

A. Yes. Divestiture of APS generation was at the very heart of the 1999 APS Settlement Agreement from the time of its original submission to the Commission in May 1999. It was an express part of the Company's bargained-for consideration in the agreement. APS would have never entered into any settlement that did not guarantee its ability to divest its generation to an affiliate or affiliates, that did not require the Commission to make the findings of fact necessary for that affiliate or affiliates to be an "Exempt Wholesale Generator," or that did not allow the recovery of transition costs.

Q. ASIDE FROM THE 1999 APS SETTLEMENT AGREEMENT ITSELF, HAVE APS AND ITS PARENT CORPORATION, PWCC, TAKEN SPECIFIC STEPS IN REGARD TO DIVESTITURE OF APS GENERATING ASSETS TO PWEC?

A. Yes. These include:

1) forming PWEC and subsequently obtaining a financial credit rating (contingent upon transfer of the APS generating assets) for PWEC from major credit rating agencies;

2) reorganization and reassignment of APS personnel to PWM&T and PWEC and the retention by PWEC of new personnel to both operate APS generation and to engage in the construction of new generation;

3) PWEC's initiation of over $1 billion dollars in new generation construction to serve APS retail customers, which decision was wholly dependent upon the ability to acquire existing APS generation under the provisions of the Electric Competition Rules and the 1999 APS Settlement Agreement;

4) provision of interim financing by PWCC for PWEC's construction of new generation to serve APS load, which financing has placed an extreme burden on PWCC without the ability to collateralize the APS generating assets;

TRACK A HEARING TRANSCRIPT

(EXCERPTS)

1 forward with the model that this Commission wanted,
2 and going forward and try to meet -- in fact, these
3 rules will not allow Arizona Public Service to build
4 within itself to meet its own company's reliability,
5 that we need to divest those assets as a backup for
6 the borrowings and the financings of the generators we
7 had on the other side of the fence. So we would not
8 have entered into an agreement of this sort if that
9 had not been allowed.
10 Q. And are you experiencing or likely to
11 experience financial difficulties if you cannot
12 continue in that process?
13 A. Yes. I believe, as we mentioned in our April
14 filing, we financed the reliability assets within
15 Pinnacle West Energy Corporation based upon the
16 transfer of those assets. In fact, the rating of
17 Pinnacle West Energy Corporation is from Standard &
18 Poor's, Moody's, is based upon a transfer of those
19 assets. And it's all short-term bridge financing at
20 the holding company. And those from the financing
21 markets, they like those debts to be closer to the
22 assets than the holding company.
23 And so yeah, no question at PWEC, Pinnacle
24 West Energy would probably be faced with some sort of
25 downgrading, and maybe Pinnacle West Capital

1 themselves.

2 That's why we proposed in our April filing we

3 need to know one way or the other. If it's one way,

4 we transfer the assets and get the appropriate

5 long-term assets with the financing backing. If it's

6 the other way, we have to figure out how to unwind all

7 that and put that back into Arizona Public Service.

8 Q. Mr. Davis, can I take it from your direct and

9 rebuttal testimony that you regard the settlement

10 agreement, or your company regards the settlement

11 agreement as an enforceable contract?

12 A. Yes, we do view the settlement agreement as

13 an enforceable contract.

14 Q. Do you intend to pursue whatever avenues are

15 available to you to have that contract in force?

16 A. Well --

17 Q. That's not a trick question.

18 A. I'm not an attorney to think about all the

19 things the way you asked the question. What I will

20 say, we need to take a look at the situation at the

21 time and decide what actions we need to take. But we

22 think it is a binding contract.

23 Q. Mr. Davis, you may recall at a previous

24 procedural conference, I think that's what the venue

25 was, the Chairman asked you once or twice, I believe,

1 competitive bidding without divestiture.
2 A. Fine. And I said I think, then answered as
3 we stated back in April, if we're not allowed to
4 divest our assets, we need to address all the assets
5 that were built for reliability of our customers.
6 Q. In that respect, from a reliability
7 perspective, at least as I understand it, Red Hawk is
8 no different than any other generation that's
9 interconnected or can flow through Palo Verde from a
10 reliability standpoint; is that correct?
11 A. The reason I'm pausing, you're saying it can
12 flow through Palo Verde. I assume there's other
13 assets that can flow through Palo Verde, but I'll
14 admit this or say this, that certainly Red Hawk are
15 large combined cycle units, and they're similar in
16 many ways to other large combined cycle units being
17 built in the Palo Verde area.
18 There are differences. We happen to use
19 recycled water, so there's less environmental impact
20 there. There's differences, but they're large
21 combined cycle units.
22 Q. I didn't mean to interrupt you, but we were
23 just talking about from a reliability perspective,
24 because you said from a reliability perspective you
25 built these units. And my point was, and I think

1 you'd agree, that from a reliability perspective, Red
2 Hawk is no different than anything else sitting out
3 there?
4 A. No, I don't agree with that. In fact, I
5 don't know many generators that are sitting around the
6 table today that were prepared to meet our peak last
7 summer. We're prepared to meet our peak this summer.
8 In fact, most of them were timed after our peak.
9 Q. Let's go to the peak of 2003 and put it in
10 the same context. From a reliability standpoint Red
11 Hawk is no different than anything else, it's
12 available in the peak of 2003 through the same path
13 that Red Hawk is, which is through Palo Verde?
14 A. Which units are you comparing Palo Verde?
15 You keep on saying through Palo Verde. I know a lot
16 of the units out here that have been discussed are not
17 available for the peak of 2003.
18 Q. I guess, Mr. Davis, we don't need to debate
19 this. The issue is not which units are available. It
20 was a theoretical question, because you said you threw
21 out a reliability issue and the point that I want to
22 clarify with you is that from a reliability
23 perspective, they're all the same out there?
24 A. No, I guess I'm not going to give on that
25 one, because I know our units were built specifically

1 and solely for the reliability of my customers.
2 Whether or not they come through Palo Verde or not, I
3 don't think the other generators were built
4 specifically and solely for reliability of my
5 customers. That's the difference we're having.
6 Q. We can agree to disagree on that issue.
7 Let's go back to what we referred to as
8 potentially out-of-market facilities that you had. I
9 think Dr. Hieronymus, in his testimony, referred to
10 some of the older units that are considered RMR units,
11 and indicated they would be replaced by West Phoenix 4
12 and 5. I think he referred to those as the ones that
13 were being replaced as uneconomic.
14 Are you in agreement with Dr. Hieronymus on
15 that?
16 A. I think you've kind of mischaracterized his
17 testimony a little bit. It's certainly in terms of
18 reliability must-run, and I guess before I get further
19 in that question, would you explain to me what you
20 mean by reliability must-run units.
21 Q. I meant what Dr. Hieronymus meant, ones that
22 had to run when there was insufficient transmission
23 capacity to import.
24 A. Let's talk about that for a second to define
25 that before going farther. In my estimation,

1 organization is a for-profit organization, will be
2 responsible for planning of the interconnected grid
3 over which that RTO has jurisdiction, and responsible
4 for assuring equal and open nondiscriminatory access
5 to the transmission, and is responsible for providing
6 tariff rates that do not hinder or serve wholesale
7 competition. It also has a market monitoring task to
8 monitor the wholesale market for any, I'll use my term
9 Mr. Chairman picked up on, the funny business. That's
10 a legal term.
11 Q. Can you explain for me the ownership of
12 WestConnect?
13 A. The ownership of WestConnect would be those
14 parties that put equity into WestConnect. You can put
15 equity through the infusion of cash or sell your
16 transmission to WestConnect.
17 Q. Who are the current owners of WestConnect?
18 A. There currently aren't any owners because
19 WestConnect doesn't exist.
20 Q. Who is expected to be an owner in
21 WestConnect?
22 A. The expected owners would be at the present
23 Arizona Public Service, Public Service of New Mexico,
24 Tucson Electric Power and El Paso Electric, but also
25 anyone else could also be members of that by injecting

1 equity. And we do have the unique position at this
2 point in time that we have two public power entities
3 who, although they may not be equity owners, will be
4 members of WestConnect and subject to the rules and
5 sanctions of WestConnect, so to speak.
6 Q. You said earlier that Staff wanted to asset
7 transfer in 1998, and has consistently in the past,
8 and that APS did not at that time. Now it seems like
9 APS does and Staff and other parties maybe do or maybe
10 do not. Why the flip-flop?
11 A. Let me correct my statement, if that's the
12 way it was interpreted. In 1998 Staff wanted
13 divestiture between a third party, similar to the
14 California divestitures, and we were against that. We
15 weren't against divestiture per se. That was almost
16 being argued by every party in the proceeding that
17 divestiture was important in order to get elimination
18 of cross subsidization and elimination of vertical
19 market power. So we sort of agreed if we're going to
20 do that, we'll divest to an affiliated entity.
21 Q. You're the president of Pinnacle West Capital
22 Corporation?
23 A. Yes, I am.
24 Q. At the time that the decision was made to
25 build Red Hawk and West Phoenix, did Pinnacle West

1 look to the market to build instead?

2 A. What Pinnacle West looked at was the needs of

3 our customers. In fact we can, I think it's been

4 produced somewhere, the load and resource programs

5 that we put together for our customers. It shows Red

6 Hawk 1 and 2 and the West Phoenix units and Saguaro

7 units needed for the customers, and embarked on that

8 program.

9 Q. Let me ask you a question, because you said

10 this a few times. You said that Pinnacle West looked

11 to what our customers. Are you speaking now on behalf

12 of APS?

13 A. I'm speaking on behalf of APS, but the

14 corporation recognizes, as I said in answer to

15 Chairman Mundell's question, the corporation is

16 concerned about its customers. Since we didn't

17 believe we could build generation in Arizona Public

18 Service, we build it in Pinnacle West Energy. In

19 fact, we forego -- we did not sell it forward to the

20 California market, and actually forgave lots of lost

21 opportunity. We maintained it in accordance with the

22 best interests of our customers' interests.

23 Q. Is that providing power currently, those

24 plants?

25 A. Saguaro 4 started providing power last year.

1 Red Hawk 1 and 2 are providing power now. They're not
2 in commercial operation, they're providing test power
3 and those kinds of things. And the Saguaro combustion
4 turbine I believe started power 10 days ago.
5 MR. MUMAW: I believe, Mr. Davis, you
6 misspoke. Did you mean West Phoenix 4?
7 THE WITNESS: Yes. What did I say?
8 MR. MUMAW: You said Saguaro 4.
9 THE WITNESS: I meant West Phoenix 4.
10 CALJ FARMER: I think I'm almost done, but
11 just let me check.
12
13 FURTHER EXAMINATION
14
15 Q. (BY CHMN. MUNDELL) Mr. Davis, let me ask you
16 this question. Can't APS' generation assets, if they
17 remain undivested and provide the stability you say
18 APS and its customers would receive from the PPA?
19 A. Well, are you talking about the, just the APS
20 assets, or also Pinnacle West Energy assets?
21 Q. You can answer for both.
22 A. It requires both of the assets to do that.
23 Q. My question was could you get the same
24 benefits even if they remained undivested? It goes
25 back to my earlier question about the two issues being

1 A. Yes, but, is the answer. Yes, but, of
2 course, there are also concerns about the Electric
3 Competition Rules, which I do read as being part and
4 parcel of sort of general understandings of 1999. No.
5 1 point.
6 No. 2 point, I don't think Staff is
7 recommending apart from basically issues of timing
8 that the settlement agreement should be set aside. I
9 think what Staff is saying is that -- and what I'm
10 certainly saying now is that in the light of changed
11 circumstances in the marketplace, it's appropriate to
12 proceed with somewhat more caution and somewhat more
13 deliberate speed in the transition, including both the
14 settlement agreement and the Electric Competition
15 Rules.
16 Q. And, again, when you reference those parties
17 who may or may not have relied on the Electric
18 Competition Rules, you're referring to the Electric
19 Competition Rules that have been found
20 unconstitutional by the only court that has --
21 MR. KEMPLEY: Objection.
22 THE WITNESS: I have no knowledge of that.
23 Q. (BY MR. MUMAW) Assuming, Mr. Talbot, that I
24 agree with you that Staff's position on divestiture
25 really is just one of timing rather than substantive

1 opposition to that, you are aware, Mr. Talbot, that
2 there's been testimony in this proceeding that the
3 timing of divestiture does have financial consequences
4 to APS and its affiliates?
5 A. Yes, I'm aware of that. I read Mr. Davis's
6 testimony on that subject. My thought about that is
7 that the amounts of money incurred, specifically
8 related to transfer, if you will, and divestiture to
9 the affiliate are not so large as to be definitive and
10 in any event might not be jeopardized if the issue is
11 more one of timing than canceling transfer completely.
12 I do think that there are bigger issues to do
13 with pricing competitive markets and so on involved.
14 And in those circumstances, it is appropriate to put
15 the amount of money spent by the company with respect
16 to the transitional arrangement so far with respect to
17 transfer into perspective. But I certainly agree that
18 it should be taken into account.
19 Q. And, Mr. Talbot, I'm not arguing that the
20 Commission should necessarily decide one way or the
21 other simply because APS is incurring costs. But,
22 Mr. Talbot, if the company could demonstrate that the
23 Commission's satisfaction that it or its affiliates
24 are incurring additional costs attributable solely to
25 the delay in divestiture, do you believe it would be

1 reasonable for the company to seek recovery of those
2 increased costs?
3 A. I think it could well be reasonable, yes.
4 Q. Can you think of any way it would not be
5 reasonable?
6 A. Not offhand, no.
7 Q. I also have a -- and I'm sorry I was wrong on
8 this. I have one more question on your additional
9 testimony.
10 I believe you also indicated something to the
11 effect that Staff certainly believes that in order to
12 foster competition, there should be an introduction of
13 a greater percentage of competitive procurement during
14 the transition period. Do you recall saying that?
15 A. Yes. I might also have said, or at least the
16 testing out of existing capacity against market
17 alternatives.
18 Q. Greater than what?
19 A. I was thinking of the PPA.
20 Q. You're not necessarily saying greater than
21 the existing rule?
22 A. Well, the existing rule is 100 percent.
23 Q. That's why I was hoping you weren't saying
24 greater than that.
25 A. You can't get over 100 percent.

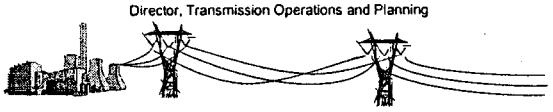
FEBRUARY 2001 SUMMER PREPAREDNESS PRESENTATION

(ON FILE WITH COMMISSION AND ATTACHED TO APS POST-HEARING BRIEF)

Special
Open Meeting of the
Arizona Corporation Commission
Energy Workshop

February 16, 2001

Arizona Public Service Company
Cary B. Deise
Director, Transmission Operations and Planning



Overview

- Reliability
- Service Territory
- Load Forecast
- Resources
- Fuel Supply Plan
- Transmission
- Conclusion

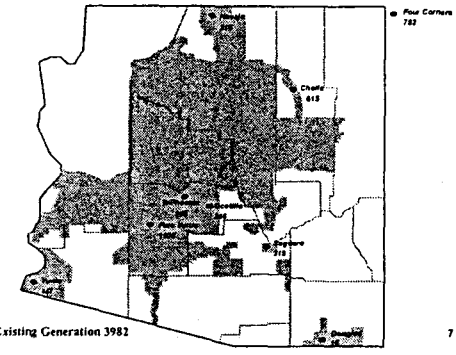
2

Reliability

- To meet customers electric energy requirements on time.
- Factors impacting reliability
  - Customer Requirements
  - Transmission, Generation and Distribution availability
  - Weather
  - Neighboring systems

3

APS Existing Generation
(Nominal ratings in MW)



Existing Generation 3982

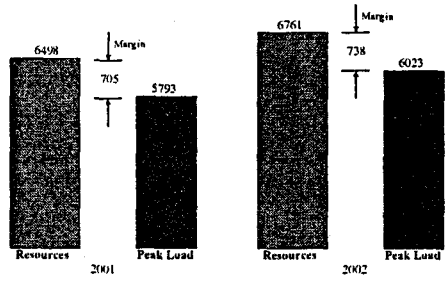
7

Resources

	2001	2002
• **Existing Generation**	3982	4497
Renewable	9	13
• **Additions**		
Upgrade of existing CC&CT	107	-
Reactivate WPhx Steam 4&6	96	-
WPhx CC 4	114	-
Temporary WPhx CT's - 5 units	99	(99)
Temporary Saguaro CT's - 5 units	99	(99)
Redhawk CC 1&2	-	988
Subtotal	515	790
• **Long-term Contracts**		
Pacificorp Exchange	480	480
SRP	336	343
Subtotal	816	823
• **Short-term Contracts**	1176	638
• **Total Resources**	6498	6761

8

APS Load and Resources



9

WEST PHOENIX EXPANSION PROJECT
SITING COMMITTEE HEARING TRANSCRIPT

(EXCERPT)

1 the utility industry moves in the competitive
2 marketplace, part of that competitive marketplace is
3 in the generation of electricity itself. And these
4 facilities will be merchant plants that will be
5 selling into the wholesale market.
6 In this regard, and being part, selling into
7 the wholesale market, the competitive market, being an
8 unregulated subsidiary of Pinnacle West Capital
9 Corporation, the ratepayers will not be at risk for
10 this venture and for this expansion.
11 While we will be selling into the
12 marketplace, we do expect that much of the energy will
13 be sold here in Phoenix. We have a 6 percent load
14 growth here in the urban area, a significant demand
15 for import of energy during peak times during the
16 summer, and we do expect much of the generation will
17 be sold to meet the expanding needs of the Phoenix
18 metropolitan area.
19 CHMN. PIERSON: Mr. Wheeler, excuse me. Do
20 you plan at any point, with any witness, to discuss
21 where transmission fits into the deregulation scheme?
22 MR. WHEELER: Not precisely in that context,
23 although I have gotten a word that at least some of
24 the Siting Committee members may have questions in
25 that regard, and probably Mr. Fox is the best person

ARTICLES

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THE ARIZONA REPUBLIC

April 26, 1999, Monday

KR-ACC-NO: AR-PWR-PLANT

LENGTH: 341 words

HEADLINE: Pinnacle West Capital to Develop Phoenix Power Plant with Calpine Corp.

BYLINE: By Max Jarman

BODY:

Pinnacle West Capital Corp. has formed a joint venture with Calpine Corp. of San Jose, Calif., to develop a $ 220 million power plant near 43rd Avenue and Buckeye Road in Phoenix.

The state-of-the-art, natural gas-fire plant will generate enough electricity for 120,000 homes and prevent the possibility of Valley power shortages in the next few years.

Craig Nesbitt, a spokesman with Pinnacle West's Arizona Public Service Co. subsidiary, said the company does not have enough current generation or transmission capabilities to keep up with projected demand.

"We have no choice but to build more facilities," he said.

Nesbitt said the project is being developed by Pinnacle West instead of APS in anticipation of electricity deregulation rules that will require utilities to separate generation from their distribution business.

While Pinnacle West and Calpine say there are no additional projects planned beyond the initial partnerships, both acknowledge other ventures are possible.

Calpine is building a similar project on land leased from the Fort Mohave Indian Tribe, 28 miles southeast of Bullhead City.

The 500-megawatt Phoenix plant will be built on APS' 100-acre West Phoenix Power station. The project will add 200 Valley jobs during construction and about 25 full-time position after completion in late 2001. Construction is scheduled to start later this year. The new facility will be jointly-owned by Pinnacle West and Calpine.

Calpine's founder and chief executive officer Peter Cartwright said the partnership with Pinnacle West is a good fit in that Pinnacle West and APS have the site and connections in Phoenix and Calpine has the expertise in developing efficient, low-cost power plants. The 15-year-old company has 36 such facilities around the country and has 10 more under construction or in various stages of planning.

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Megawatt Daily

April 26, 1999

SECTION: Vol. 4, No. 78

LENGTH: 249 words

HEADLINE: Calpine, APS plan 500-MW plant in Phoenix

BODY:

Pinnacle West Capital and Calpine announced late Friday a plan to develop a 500-MW, natural gas-fired, combined-cycle power plant in Phoenix for $220 million.

The facility would be located on the site of Arizona Public Service's (APS) West Phoenix Power Station. APS is a subsidiary of Pinnacle West.

The joint project is the second phase of a potential 750-MW expansion at West Phoenix. The first phase of the expansion includes a $60 million repowering of an existing unit to create a 130-MW combined-cycle unit. The remainder of the expansion involves repowering other existing units at the site. They will also install advanced pollution-control equipment to reduce air emissions from the existing units.

Construction on the new plant is scheduled to begin in mid-2000, with commercial operation of the 130-MW unit planned in mid-2001 and the 500-MW plant in late 2001.

Pinnacle West CEO Bill Post said the new capacity will help APS to meet growing demand and would also help the company to "pursue new opportunities in competitive generation markets."

But Pinnacle West said growth in electricity demand has increased by about 6% annually in Arizona, including nearly a 10% jump between 1997 and 1998. Peak demand for power in the Phoenix metropolitan area is expected to continue to increase due to both population growth and increased economic expansion, the company said.

Pinnacle West companies own or operate nearly 8,000 MW in Arizona and New Mexico. RH
URL: http://www.platts.com

LOAD-DATE: May 03, 1999