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DEBORAH R. SCOTT  
Senior Regulatory Attorney  
Telephone: (602) 250-5508  
Facsimile: (602) 250-3393

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Arizona Corporation Commission  
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AZ CORP COMMISSION  
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Commissioner Jeff Hatch-Miller  
Arizona Corporation Commission  
1200 West Washington  
Phoenix, Arizona 85012

SEP 17 2008

DOCKETED BY *MM*

RE: Arizona Public Service Company's Request for Clarification of Biomass Thermal Energy Pursuant to the Renewable Energy Standard Rules  
Docket No. E-01345A-08-0254

Dear Commissioner Hatch-Miller:

I received your letter of August 2, 2008 regarding Arizona Public Service Company's ("APS" or "Company") request for clarification of biomass thermal energy under the Commission's Renewable Energy Standard ("REST") Rules. You indicated that the questions raised in your letter would be discussed at the Commission's August 26<sup>th</sup> Open Meeting. Because this matter was not heard at the August Open Meeting, I am now providing written comments. There are some questions that you have asked that would be better addressed by Drake Cement, the customer that has approached APS about the biomass thermal energy application, so we have forwarded those questions for Drake's consideration. APS's responses to your specific questions are below.

- 1. How important is it that the Commission provide APS with latitude in reaching their obligations under the Renewable Energy Standard (REST) requirements?

Renewable energy is a growing and evolving industry, and as its environmental benefits become more significant, we believe that there will be new innovations in this field. As compared with the prior Environmental Portfolio Standard Rules, the REST Rules greatly expanded the kinds of renewable energy technologies and applications that are eligible to meet the Renewable Energy Standard and receive REST incentives. Nonetheless, even with the diversity/variety embodied in the Commission's REST Rules, there will be circumstances when questions will arise regarding the applicability of the rules.

Providing APS with flexibility in the implementation of the REST Rules allows the Company to timely respond to changing markets for the benefit of our customers and the environment. That being said, it is the Company's obligation to assure that the payments of incentives (which are funded by our customers) are for eligible renewable energy applications. In those circumstances where the Company cannot determine, based on the language of the REST Rules and discussions with Staff, whether a specific renewable energy application is eligible under the rules, the Company also needs the latitude to bring those questions to the Commission for clarification.

2. What are the cost savings involved in the proposed project wherein Drake Cement will utilize biomass instead of coal to generate electricity?

Although Drake Cement has had some discussions with APS regarding the proposed thermal biomass system, the Company does not have information regarding the costs of the plant, including the cost savings that are involved in the proposed project. For that reason, APS has forwarded this question to Drake Cement, and we understand they will be providing a response shortly.

As it relates to the Company's REST funding, this proposed biomass project would be one of the lowest cost methods of displacing fossil fuels and carbon.

3. Is there any inherent societal benefit in saving coal for use elsewhere?

Because coal is a commodity that is generally available in the United States, it is unclear to the Company whether there is a benefit in saving it for use somewhere else.

4. What specifically is the air quality benefit to using biomass instead of coal? Is this benefit quantifiable and has it been quantified?

As a general response to your questions, biomass is a renewable resource that is considered to be carbon-neutral. As related specifically to the Drake Cement plant, APS will defer to Drake. Because Drake Cement will have to obtain an air quality permit for their commercial operations, they would be best able to respond. Therefore, APS has forwarded this question to Drake Cement, and we understand they will be providing a response shortly.

5. How will this project benefit APS in maintaining the reliability of the electricity grid?

The thermal biomass application that Drake Cement has proposed displaces heat rather than electricity; therefore, it has no effect on the reliability of APS's electric grid.

6. How will this project benefit APS in meeting increasing load?

As previously indicated, the thermal biomass application that Drake Cement has proposed displaces heat rather than electricity; therefore, it has no impact on APS's ability to meet its load.

7. How will this pilot program help APS promote the evolution of technologies that will be necessary to meet future energy needs?

The inclusion of a pilot program provision in the REST Rules, where additional technologies can be established as Eligible Renewable Energy Resources, allows the utility and the Commission to respond to new technological developments. As discussed in response to a previous question, APS believes that it will continue to see evolving technologies as the renewable energy industry matures. A Biomass Thermal Energy System Pilot Program, as recommended by Staff, for which

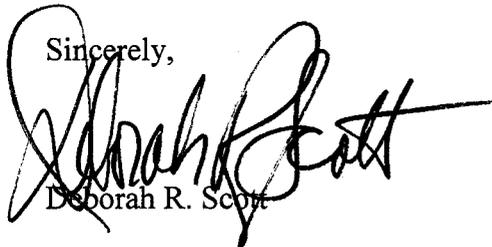
Drake Cement project would be eligible, would further the deployment of biomass generation. The biomass thermal system that is proposed by Drake Cement would be the first in the state to demonstrate the benefits of thermal energy. With the development of this cement plant, more knowledge and experience will be gained regarding this renewable resource, which could foster advancements in the industry. Additionally, because it is a high profile project, there is the potential that other APS customers may learn about this technology and may be encouraged to use it.

8. How important is it that the REST Rules advance certain technologies over others?

APS does not believe that it is the intent of the REST Rules to advance certain technologies over others. The REST Rules significantly expanded the technologies that are eligible as renewable energy resources and they do not indicate a preference for an individual technology. It is APS's opinion that no single technology is the "silver bullet." Diversity in technologies provides the Company with multiple opportunities to get the best value for our customers.

I hope this information is responsive to your inquiry. I look forward to discussing these issues at a future open meeting.

Sincerely,



Deborah R. Scott

DRS/jlj

cc: Mike Gleason, Chairman  
William A. Mundell, Commissioner  
Kristin K. Mayes, Commissioner  
Gary Pierce, Commissioner  
Brian McNeil  
Janice Alward  
Ernest Johnson  
Lyn Farmer  
Terri Ford  
Docket Control  
Parties of Record

COPY of the foregoing was emailed or mailed  
this 17<sup>th</sup> day of September, 2008, to:

Jeff Deyette  
Union of Concerned Scientists  
2 Brattle Square  
Cambridge, Massachusetts 02238-9015

Fred Morse  
Morse Associates, Inc  
236 Massachusetts Ave NW  
Suite 605  
Washington, District of Columbia 20002

Major Allen Erickson  
139 Barnes Dr.  
AFCESA/ULT  
Tyndall AFB, Florida 32406

Michael Kurtz  
Boehm, Kurtz & Lowry  
36 E. Seventh St. Suite 2110  
Cincinnati, Ohio 45202

E. Kenneth May  
Industrial Solar Technology Corp.  
4420 McIntyre St.  
Golden, Colorado 80403

Michael Neary  
Ariseia  
2034 N. 13th St.  
Phoenix, Arizona 85001

Alberta Tippeconnic  
Inter Tribal Council of Arizona  
2214 N. Central, Suite 100  
Phoenix, Arizona 85004

Diane Brown  
Arizona PIRG Education Fund  
130 N. Central, Suite 311  
Phoenix, Arizona 85004

Michael Patten  
Roshka DeWulf & Patten, PLC  
One Arizona Center  
400 E. Van Buren St. Suite 800  
Phoenix, Arizona 85004

Timothy Hogan  
Arizona Center for Law in the Public Interest  
202 E. McDowell Rd. Suite 153  
Phoenix, Arizona 85004

Robert Lynch  
Arizona Transmission Dependent  
Utility Group  
340 E. Palm Lane, Suite 140  
Phoenix, Arizona 85004-4529

Stephen Ahearn  
RUCO  
1110 W. Washington, Suite 220  
Phoenix, Arizona 85007

Janice Alward  
Arizona Corporation  
Commission  
1200 W. Washington  
Phoenix, Arizona 85007

Daniel Pozefsky  
RUCO  
1110 W. Washington St.  
Suite 220  
Phoenix, Arizona 85007

Diane Vosick  
Tom O'Halleran  
Governor's Forest Health  
Oversight Council  
1700 West Washington  
Phoenix, Arizona 85007

Lyn Farmer  
Arizona Corporation  
Commission  
1200 W. Washington  
Phoenix, Arizona 85007-2927

Ernest Johnson  
Arizona Corporation  
Commission  
1200 W. Washington  
Phoenix, Arizona 85007-2927

C. Webb Crockett  
Fennemore Craig  
3003 N. Central Ave. Suite 2600  
Phoenix, Arizona 85012-2913

Robert Liden  
Stirling Energy Systems  
2920 East Camelback Road,  
Suite 150  
Phoenix, Arizona 85016

Michael Grant  
Gallagher & Kennedy, P.A.  
2575 E. Camelback Rd.  
Phoenix, Arizona 85016-9225

Lori Glover  
SOLID Energy, Inc  
10645 N. Tatum Blvd., Suite 200  
Phoenix, Arizona 85028

John Wallace  
Grand Canyon State Electric Cooperative  
120 N. 44th St. Suite 100  
Phoenix, Arizona 85034

Brian Hageman  
Deluge, Inc  
4116 E. Superior Ave, D3  
Phoenix, Arizona 85040

Daniel Musgrove  
c/o Universal Entech LLC  
3330 W Broadway Rd  
Phoenix, Arizona 85041

Robert Baltes  
Distributed Energy Association of Arizona  
P.O. Box 10594  
Phoenix, Arizona 85064

Jessica Youle  
SRP  
MS PAB300  
P.O. Box 52025  
Phoenix, Arizona 85072-2025

Jana Brandt  
Kelly Barr  
SRP  
Mail Station PAB 221  
P.O. Box 52025  
Phoenix, Arizona 85072-2025

Douglas Fant  
Distributed Energy Association of Arizona  
3655 W. Anthem Way  
Suite A-109 PMB 411  
Anthem, Arizona 85086

Jim Combs  
Conservative Energy Systems  
40 W. Baseline, Suite 112  
Mesa, Arizona 85210

Scott Higginson  
New Mexico and Arizona Land  
Company  
3514 E. Presidio Circle  
Mesa, Arizona 85213

Steven Bennett  
City of Scottsdale  
3939 North Drinkwater Blvd.  
Scottsdale, Arizona 85251

Tom Alston  
Amerecian Solar Electric  
3008 North Civic Center Plaza  
Scottsdale, Arizona 85251

David Berry  
Western Resource Advocates  
P.O. Box 1064  
Scottsdale, Arizona 85252-1064

Joe McGuirk  
ME Consultants  
10202 N. 58th Pl  
Scottsdale, Arizona 85253

Robert Annan  
The Annan Group  
6605 E. Evening Flow Dr.  
Phoenix, Arizona 85262

Mike Billote  
United Dairymen of Arizona  
P.O. Box 26877  
Tempe, Arizona 85285-6877

Robert Jackson  
Colorado River Indian Tribes  
Route 1- Box 23B  
Parker, Arizona 85334

Jeff Schlegel  
SWEEP  
1167 W. Samalayuca Dr.  
Tucson, Arizona 85704-3224

Bruce Plenk  
Renewable Energy Consultant  
2958 N. St. Augustine Pl  
Tucson, Arizona 85712

David Deibel  
City of Tucson  
P.O. Box 27210  
Tucson, Arizona 85726-7210

Robert Walkup  
City of Tucson  
P.O. Box 27210  
Tucson, Arizona 85726-7210

Valerie Rauluk  
Greater Tucson Coalition for Solar Energy  
P.O. Box 42708  
Tucson, Arizona 85733

Maria Courter  
Future Forest, LLC  
1630 E. White Mountain Blvd.,  
Suite C3  
Pinetop, Arizona 85935

Hiram Smith  
Greater Flagstaff Forests Partnership  
1300 S. Milton Rd. Suite 218  
Flagstaff, Arizona 86001

Elizabeth Archuleta  
Coconino County Board of Supervisors  
219 E. Cherry Ave  
Flagstaff, Arizona 86001-4695

Amy LeGere  
NetGenuity  
4850 Reata Rd  
Flagstaff, Arizona 86004

David Calley  
Southwest Windpower, Inc  
2131 N. First St.  
Flagstaff, Arizona 86004

Jerry Brownlow  
Navajo County Board of Supervisors  
P.O. Box 668 100 E. Carter Dr.  
Holbrook, Arizona 86025

Rick Tewa  
The Hopi Tribe  
P.O. Box 123  
Kykotsmovi, Arizona 86039

Steven Brown  
Yavapai Tribe  
530 E. Merritt  
Prescott, Arizona 86301

Mark Randall  
Daystar Consulting, LLC  
P.O. Box 761  
Clarksdale, Arizona 86324

Kevin Davidson  
3162 Courtney Ave  
Kingman, Arizona 86401

Jerry Payne  
USDA Forest Service  
333 Broadway SE  
Albuquerque, New Mexico  
87102

Mark Skowronski  
Solargenix Energy, LLC  
3501 Jamboree Rd, Suite 606  
Newport Beach, California  
92660

Adam Browning  
The Vote Solar Initiative  
182 Second Street, Suite 400  
San Francisco, California 94105

Wayne Byrne  
Foresight Energy Company  
692 Haight St. Suite B  
San Francisco, California 94117

Arturo Riberta  
Atlantis Energy Systems, Inc.  
9275 Beatty Dr. Suite B  
Sacramento, California 95826