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September 19, 2008

Arizona Corporation Commission
DOCKETED
SEP 19 2008
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BY HAND DELIVERY

Commissioner Jeff Hatch-Miller
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, Arizona 85012

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

Dear Commissioner Hatch-Miller:

I am writing on behalf of Drake Cement, LLC ("Drake Cement"), a subsidiary of Cementos Lima, which is building a new state of the art cement production facility in Drake, Arizona utilizing coal as the primary heat source for the kiln and pre-calciner. As you are aware, Drake Cement has been working in conjunction with Forest Energy and Arizona Public Service Company ("APS") to develop a biomass thermal project ("Project") that would reduce the amount of coal burned at the facility by up to approximately 33,000 tons on an annual basis.

Drake Cement received a copy of your August 21, 2008 letter to APS, in which you present several issues regarding matters of public policy, as well as specific questions about the Project. Before addressing your specific questions, I would like to provide a brief overview of the facility and the Project itself.

The facility is scheduled to be on line in the first semester of 2010. The air quality permit has been issued, project design is complete and construction began in May of this year. Drake Cement is interested in modifying this facility to enable utilizing biomass residues from restoration of the surrounding forests to co-fire with the coal for the fuel. An effort to match the available long-term supply of renewable biomass residues with the cement plant energy demand has lead to a solution of providing up to 50% of the plant's thermal energy needs from biomass sources provided by Forest Energy Corporation ("Forest Energy"). This will require approximately 44,000 dry tons of wood annually, providing 217,486 MWhr of energy. The wood will displace 33,000 tons of coal combustion, reducing fossil emissions, carbon emissions,

and the dependence on fossil fuels, with a very good possibility of reducing sulfur and nitrogen-oxide emissions. It would also create the ability to derive a major portion of the energy needs from local renewable resources while enabling much needed forest restoration, fire hazard mitigation and local economic development in Yavapai County, Arizona.

With respect to your specific questions, Drake Cement offers the following responses.

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

Drake Cement does not foresee any direct cost savings in choosing wood rather than coal to burn at its facility. Forest Energy estimates that the initial capital expense for constructing the Project will cost approximately $8 million, which will be recovered through wood commodity charges, operation and maintenance fees and APS incentives. Despite no real cost savings to Drake Cement, the advantages of using wood rather than coal reside mainly in the environmental benefits achieved, which is in agreement with the company's corporate philosophy of social responsibility. On that same line, Drake Cement is also interested in promoting the local economy since the source of fuel will be from the surrounding areas to the plant. Finally, the Project will allow Drake Cement to have less dependence on just one source of fuel (coal), which is produced in another state and significantly affected by fluctuations in the international markets.

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

The air quality permit issued by Arizona Department of Environmental Quality for the cement facility is very strict. To achieve the level of emissions Drake Cement has committed to, the company has incorporated into its plant design the most advanced technologies in the industry, particularly in the control of nitrogen and sulfur oxides (NOx and SOx). With regards of the latter, the company has chosen to limit the content of Sulphur in the coal to very low levels, thus, limiting the sources of this fuel for the kiln firing.

Biomass fuels are inherently lower in nitrogen which may lead to less formation of NOx. Furthermore, the lower temperature at which wood ignites as compared to coal may also lead to less formation of NOx from nitrogen in the air. Similarly, biomass in general has significantly lower amounts of sulfur than coal, including coal with the lowest levels of sulfur.

Another and very important advantage of using biomass instead of coal will be the reduction in greenhouse gas emissions. Carbon dioxide is the major greenhouse gas of concern

in the combustion of coal, a fossil fuel that contains carbon that was captured from the atmosphere many million years ago. Biomass fuel, on the other hand, is considered a renewable or sustainable energy source because of its dosed carbon cycle. Since trees use as much carbon dioxide during their growth as they add to the atmosphere when burned, there is no net gain in carbon dioxide when burning wood – thus it is carbon neutral.

The direct air quality benefits are quantifiable, but cannot be quantified for the Project until the specific design has been finalized. Drake Cement is willing to provide APS and the Commission any air quality information necessary for reporting purposes should the Project move forward.

Drake Cement is aware that the number of Renewable Energy Credits ("RECs") generated by the Project would be enough to satisfy APS' non-residential distributed generation portion of its REST requirements for the next few years. The company understands that some balance must be given to the Project so that other technologies, such as photovoltaic solar applications, are given opportunities to develop and succeed with applicable APS incentive funding mechanisms. To this end, Drake Cement supports a reasonable limit on the number of RECs that APS can use to satisfy its renewable requirements - provided that funding is still available to make the Project economically viable. While the number of RECs required from other technologies may be reduced, APS should still have ample funding to support the development of other projects. From Drake Cement's point of view, the Project represents an opportunity for APS to *exceed* the annual minimum standards set forth in the REST rules at a relatively low cost, which is a benefit not only to APS' ratepayers, but to the state as well.

Thank you for the opportunity to respond to your questions, and to provide comments about the Project as a whole. We look forward to discussing these issues during the September 24, 2008 Open Meeting, and provide information responsive to any questions or concerns expressed by the Commission.

Sincerely,

Patrick J. Black

cc: Chairman Mike Gleason
Commissioner William A. Mundell
Commissioner Kristin Mayes
Commissioner Gary Pierce
Janice Alward
Ernest Johnson
Lyn Farmer
Marco Gomez-Barrios
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Docket Control

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