APS

0000093190

Leland R. Snook
Director
State Regulation & Pricing

Tel. 602-250-3730
Fax 602-250-3003
e-mail Leland.Snook@aps.com

Mail Station 9708
PO Box 53999
Phoenix, Arizona 85072-3999

ORIGINAL

Arizona Corporation Commission
DOCKETED
JAN 29 2009
DOCKETED BY

RECEIVED
2009 JAN 29 P 1: 30
AZ CORP COMMISSION
DOCKET CONTROL

January 29, 2009

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

RE: APS COMPLIANCE WITH DECISION NO. 70667 – APS/PINNACLE WEST COMMUNICATIONS WITH CREDIT RATING AGENCIES
Docket No. E-01345A-08-0172

Attached please find copies of Arizona Public Service Company (APS) and Pinnacle West's available past communications with credit rating agencies as instructed per Decision No. 70667 (December 24th, 2008):

> "Arizona Public Service Company shall file all currently existing communications within 10 days of the effective date of this Decision and shall file future communication on a monthly basis. The first such monthly report shall be due on February 1, 2009, and the monthly filing shall continue until the conclusion of Arizona Public Service Company's general rate case. Thereafter, Arizona Public Service Company shall make such filings on a six month basis, with the first filing due by January 1, 2010."

This monthly filing covers the communications with rating agencies from December 25, 2008 through January 27, 2009. If you have any questions or concerns please contact David Rumolo (602)-250-3933.

Sincerely,

Leland R. Snook

LS/dst

Attachments

CC: Ernest Johnson (unredacted)
Brain Bozzo (unredacted)
Barbara Keene(unredacted)
Terri Ford (unredacted)

Rating Agency Communication Log

Date	Person	APS/PNW Personnel	Subject	Comment
12/31/2008	Tony Bettinelli, S&P	Jim McGill	Tony sent e-mail requesting final interim order	
1/6/2009	Tony Bettinelli, S&P	Jim McGill	Sent e-mail with final interim order	
1/7/2009	Tony Bettinelli, S&P	Jim McGill	E-mail from Tony re: sending final interim order	
1/8/2009	Tony Bettinelli, S&P	Jim McGill	E-mail from Tony re: liquidity survey	
1/8/2009	Tony Bettinelli, S&P	Jim McGill	E-mailed Tony liquidity survey	Confidential attachment
1/21/2009	Phil Smyth, Fitch	Investor Relations (IR)	IR sent press releases on Post's retirement and dividend declaration and earnings conference call	
1/21/2009	Tony Bettinelli, S&P	IR	IR sent press releases on Post's retirement and dividend declaration and earnings conference call	
1/21/2009	Laura Schumacher, Moody's	IR	IR sent press releases on Post's retirement and dividend declaration and earnings conference call	
1/21/2009	Scott Solomon, Moody's	Jim McGill	E-mail from Scott regarding Bad Debt Expense	
1/21/2009	Tony Bettinelli, S&P	Jim McGill	E-mail from Tony requesting update on SunCor	
1/21/2009	Tony Bettinelli, S&P	Jim McGill	E-mail from Tony requesting information on bad debt expense	
1/22/2009	Tony Bettinelli, S&P	Jim McGill and Chris Froggatt	Called to discuss SunCor - revolver renewal, real estate market	
1/22/2009	Laura Schumacher, Moody's	Jim McGill	E-mail to set up call to discuss SunCor	
1/22/2009	Phil Smyth, Fitch	Jim McGill	E-mail to set up call to discuss SunCor	
1/22/2009	Phil Smyth, Fitch	Jim McGill	E-mail from Phil regarding call to discuss SunCor	
1/23/2009	Laura Schumacher, Moody's	Jim McGill	E-mail from Laura regarding call to discuss SunCor	
1/23/2009	Laura Schumacher, Moody's	Jim McGill	E-mail to set up call to discuss SunCor	
1/23/2009	Phil Smyth, Fitch	Jim McGill	E-mail to Phil to set up call to discuss SunCor	
1/23/2009	Laura Schumacher, Moody's	Jim McGill	E-mail from Laura regarding call to discuss SunCor	
1/23/2009	Laura Schumacher, Moody's	Jim McGill	E-mail to set up call to discuss SunCor	
1/23/2009	Phil Smyth, Fitch	Jim McGill	E-mail from Phil regarding call to discuss SunCor	
1/23/2009	Phil Smyth, Fitch	Jim McGill	E-mail to Phil to set up call to discuss SunCor	
1/23/2009	Laura Schumacher, Moody's	Jim McGill and Chris Froggatt	Called to discuss SunCor - revolver renewal, real estate market	
1/23/2009	Phil Smyth, Fitch	Jim McGill and Chris Froggatt	Called to discuss SunCor - revolver renewal, real estate market	
1/27/2009	Scott Solomon, Moody's	Jim McGill	E-mail from Scott regarding Bad Debt Expense	

McGill, James T(Z71171)

From: Bettinelli, Antonio [Antonio_Bettinelli@standardandpoors.com]
Sent: Wednesday, December 31, 2008 11:02 AM
To: McGill, James T(Z71171)
Subject: Request

Jim,

Would you please send me the entire final order for the interim rate request? Thanks.

Regards,
Tony

McGill, James T(Z71171)

From: McGill, James T(Z71171)
Sent: Tuesday, January 06, 2009 10:54 AM
To: 'Bettinelli, Antonio'
Subject: RE: Request
Attachments: doccontent.pdf

From: Bettinelli, Antonio [mailto:Antonio_Bettinelli@standardandpoors.com]
Sent: Wednesday, December 31, 2008 11:02 AM
To: McGill, James T(Z71171)
Subject: Request

Jim,

Would you please send me the entire final order for the interim rate request? Thanks.

Regards,
Tony

BEFORE THE ARIZONA CORPORATION C

COMMISSIONERS

MIKE GLEASON - Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTIN K. MAYES
GARY PIERCE

Arizona Corporation Commission
DOCKETED
DEC 2 4 2008

DOCKETED BY	ne

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, AND TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN.	DOCKET NO. E-01345A-08-0172 DECISION NO. 70667 **INTERIM RATE CASE OPINION AND ORDER**

DATES OF HEARING: September 11, 2008 (Public Comments), September 15, 16, 17, 18, and 19, 2008.

PLACE OF HEARING: Phoenix, Arizona

ADMINISTRATIVE LAW JUDGE: Lyn Farmer

IN ATTENDANCE: Mike Gleason, Chairman
William A. Mundell, Commissioner
Kristin K. Mayes, Commissioner
Gary Pierce, Commissioner

APPEARANCES: Mr. Thomas L. Mumaw and Ms. Meghan H. Grabel, PINNACLE WEST CAPITAL CORPORATION, and Mr. William J. Maledon, OSBORN MALEDON, on behalf of Applicant;

Mr. Michael M. Grant, GALLAGHER & KENNEDY, on behalf of Arizona Investment Council;

Mr. Daniel Pozefsky, Chief Counsel, on behalf of the Residential Utility Consumer Office;

Mr. C. Webb Crocket, FENNEMORE CRAIG, P.C., on behalf of Freeport-McMoRan and Arizonans for Electric Choice and Competition;

Ms. Karen E. Nally, MOYES, SELLERS & SIMS, on behalf of AZ-Ag Group;

Mr. William P. Sullivan, CURTIS, GOODWIN, SULLIVAN, UDALL & SCHWAB, P.L.C., on behalf of the Town of Wickenburg;

Mr. Lawrence V. Robertson, Jr., on behalf of Mesquite Power, LLC, Southwestern Power Group, II, LLC; and Bowie Power Station, LLC; and

Ms. Maureen Scott, Senior Staff Counsel, and Ms. Amanda Ho and Mr. Charles Hains, Staff Attorneys, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

On March 24, 2008, Arizona Public Service Company ("APS") filed with the Arizona Corporation Commission ("Commission") an application for a rate increase.

On April 2, April 8, and April 14, 2008, The Kroger Company ("Kroger"); Freeport-McMoRan Copper & Gold, Inc. and Arizonans for Electric Choice and Competition (together, "AECC"); and Mesquite Power, L.L.C., Southwestern Power Group II, L.L.C., and Bowie Power Station, L.L.C. (collectively "Mesquite"), respectively, filed Motions to Intervene.

On April 30, 2008, the Town of Wickenburg filed a Motion to Intervene.

By Procedural Orders issued on April 25 and May 19, 2008, the Motions to Intervene were granted.

On June 2, 2008, APS filed an Amended Application.

On June 6, 2008, APS filed a Motion for Approval of Interim Rates and Preliminary Order ("Motion") and requested a procedural conference be scheduled. In its Motion, APS requested the Commission approve an "Interim Base Rate Surcharge" of $.003987 per kWh to be effective upon the expiration of the $.003987 per kWh 2007 Power Supply Adjustor ("PSA") charge granted in Decision No. 69663 (June 28, 2007).

On June 13, 2008, a Procedural Order was issued scheduling a procedural conference on APS' Motion. Also on June 13, 2008, Western Resource Advocates and Southwest Energy Efficiency Project ("WRA/SWEEP") filed a Petition for Leave to Intervene.

On June 16, 2008, the Residential Utility Consumer Office ("RUCO") filed an Application to Intervene.

On June 19, 2008, the Arizona Investment Council ("AIC") filed a Motion to Intervene.

On June 19, 2008, the procedural conference was held as scheduled. Intervention was granted to WRA/SWEEP, RUCO, AIC, and the Az-Ag Group.[1] The parties were directed to meet and discuss the Motion to see if there could be agreement on the procedural timeframes for the actions requested by APS in its Motion and whether the parties could reach any other agreements. The parties were directed to file either a joint recommendation or separate recommendations by June 30, 2008.

On June 30, 2008, the parties filed a Recommended Procedural Schedule.

On July 16, 2008, a Procedural Order was issued scheduling a hearing on the APS Motion to commence on September 15, 2008, and establishing associated procedural requirements and deadlines; setting a public comment session and procedural conference for September 11, 2008; and setting dates for the prefiling of witness testimony.

On July 23, 2008, the Hopi Tribe filed a Motion to Intervene, which was granted by Procedural Order issued on August 4, 2008.

On July 29, 2008, a Procedural Order was issued scheduling the hearing on the permanent rate case to commence on April 2, 2009.

On August 6, 2008, APS filed proof of publication of notice of hearing in compliance with the July 16, 2008, Procedural Order.

On September 16, 2008, Commissioner Mayes docketed a letter requesting the parties to address various issues during the hearing.

The public comment session and the evidentiary hearing were held as scheduled, with the hearing concluding on September 20, 2008. APS presented testimony from William Post, Donald Brandt, Charles Cicchetti, and David Rumolo. AECC presented testimony from Kevin Higgins, RUCO presented testimony from Stephen Ahearn, and Staff presented testimony from Ralph Smith and David Parcell.

On September 26, 2008, APS filed its late-filed Exhibit 22.

On October 3, 2008, Chairman Gleason docketed a letter concerning the cost to ratepayers if APS' credit rating falls to junk status and asking APS to respond.

[1] Counsel for Az-Ag Group orally requested intervention during the procedural conference.

Initial Closing Briefs were filed by APS, AIC, AECC, Mesquite, RUCO, and Staff on October 3, 2008, and Reply Briefs were filed by APS, AIC, AECC, RUCO, and Staff on October 8, 2008.

On October 9, 2008, APS responded to Chairman Gleason's letter.

On October 14, 2008, APS filed its late-filed Exhibit 23.

DISCUSSION

APS' Position

In its Motion, APS requested an interim base rate surcharge of $.003987 per kWh to be effective upon the expiration of the 2007 PSA adjustor charge,[2] which was expected to occur in July or early August 2008. The Motion does not request continuation of a PSA charge, but rather implementation of a new "surcharge" that would collect $115 million in base rates on an annual basis. Like the PSA charge, the interim base rate surcharge would exempt E-3 and E-4 low income customers, E-36 customers, and the solar rate schedules Solar-2 and SP-1. According to the Motion, as of May 31, 2008, APS had expended "over $1.7 billion for new facilities that are not included in current rates," and APS asks to recover on an interim basis the "higher costs of owning and operating such infrastructure investment." APS asserts that its earnings and cash flow are inadequate to finance its capital needs and so it "must borrow huge sums to keep up with the needs of APS customers." According to the Motion, approval of the interim rates would increase APS' return on equity, providing an additional $69 million in earnings on an annual basis that APS says "would be reinvested in infrastructure and technology necessary to serve APS customers and reduce the need for external debt financing."

Donald Brandt, President and Chief Executive Officer of APS and President and Chief Operating Officer of Pinnacle West Capital Corporation ("Pinnacle West") testified in support of the requested interim surcharge. Mr. Brandt testified that APS' distribution, transmission, generation plant improvements, and new environmental control systems infrastructure investment requirements have increased and that the underlying cost of material, commodities, and land for construction of

[2] In Decision No. 69663, the Commission authorized the continuation of the 2007 PSA after January 31, 2008, in order to collect the remaining $46 million of 2007 fuel and purchased power costs.

this infrastructure has also increased. He testified that there are three ways to fund plant: using retained earnings, new debt, or new equity infusions. Mr. Brandt testified that APS did not earn its "authorized return on equity" in 2007 and, with the current rates, expects its "earning shortfall" to continue. He also testified that APS' net cash flow for the past five years shows that APS' financial health has weakened considerably. According to Mr. Brandt, between 1993 and 2003, "APS was able to limit its cash expenditures to the amount of cash the Company took in, resulting in positive net cash flow and a financially strong utility."[3] He testified that beginning in 2003, APS' cash outlays exceeded its cash receipts, resulting in a negative cash flow and weakened credit metrics. Mr. Brandt believes that APS' poor financial performance has caused Pinnacle West's stock value to fall, which could lead to APS' inability to attract sufficient equity investment. According to Mr. Brandt, if APS cannot obtain equity, then it must borrow more funds or delay projects. The cost of the new debt will depend upon the Company's credit ratings. Mr. Brandt testified that "APS's credit ratings on its outstanding debt are currently among the lowest that they can possibly be without being regarded as 'junk,' rated 'BBB-' by Standard and Poor's ('S&P'), 'BBB' by Fitch Ratings ('Fitch'), and 'Baa2' by Moody's Investor's Service ('Moody's')."[4] He testified that to keep a BBB rating, S&P expects APS in its present "business profile" category to maintain a Funds from Operations to Debt ratio ("FFO/Debt") between 18 percent and 28 percent.[5] Mr. Brandt believes that the credit ratings agencies are concerned about APS' credit metrics, including its cash flow and earnings, and will likely downgrade APS if interim rates are not approved. He testified that the "consequences of a downgrade are dramatic and enduring" and will likely cause APS to incur higher interest rates, resulting in increased costs of between $70 million to $145 million per year, or $1 billion over the next ten years.[6] Mr. Brandt also believes that a downgrade might cause APS to lose all access to the credit markets. Mr. Brandt disagrees with Staff's and RUCO's positions that the Company is experiencing ordinary regulatory lag, instead characterizing it as "extraordinary regulatory lag."[7] Mr. Brandt claims that "[s]uch extraordinary delay under the Company's current operating conditions

[3] Ex. APS-1 at 8.
[4] *Id.* at 11.
[5] *Id.* at 12.
[6] *Id.* at 13.
[7] Ex. APS-2 at 6.

institutionalizes economic confiscation of invested capital and causes APS significant financial harm that threatens its already precarious credit metrics."[8] Although Mr. Brandt acknowledged that the Commission has recently approved several adjustment mechanisms for APS, he stated that except for the Transmission Cost Adjustor, they are "simply operating cost pass-through provisions, which do not provide earnings to the Company."[9] Mr. Brandt also claims that the current rates do not allow APS to recover its cost of service and have not for years. In response to Staff's position that no credit rating agency has indicated that a downgrade would result absent an interim increase, Mr. Brandt testified that "[a]s those experienced in the industry are well aware, credit rating agencies do not telegraph or otherwise expressly communicate to the utility or the public what specific impact a potential future event will have on that company's credit rating before the event occurs."[10] However, he also testified that he had participated in conference calls with Moody's personnel and was told that APS needed credit metrics in the upper part of the range and that he had had a separate, in-person, meeting with S&P representatives, who said that after the Commission rules on this interim request, S&P will be reevaluating APS' credit rating status in its ratings committee.[11] Mr. Brandt disagrees with Staff's witness' belief that Value Line and S&P stock evaluations indicate Pinnacle West compares favorably against other electric utilities when evaluating credit worthiness. Mr. Brandt testified that the interim request will benefit customers:

> But even setting aside for a moment the substantial potential for downgrade, there is little question that the requested interim relief will improve the Company's earnings during the course of the general rate proceedings, which result itself will ultimately benefit customers. The belief that any action that inures to the benefit of shareholders must necessarily also be to the detriment of customers is simply wrong. The Company's ability to attract capital at reasonable prices such that it can provide reliable service and invest in customer-beneficial programs and sustainable technologies depends entirely upon its financial strength. The better APS's financial health, the lower the cost of capital that will ultimately be paid by customers to finance the projects from which they importantly benefit.
>
> The converse is also true: the more the Commission artificially depresses electric prices in the short run, the worse the Company's financial health and the harder it

[8] *Id.*
[9] *Id.* at 15.
[10] *Id.* at 26.
[11] *Id.* at 26-27.

> will be for the Company to attract the capital it needs at reasonable prices. Equity capital invariably flows to where it can earn the best risk-adjusted returns, which means that the Company's *actual* rate of return is more important than its *allowed* rate of return. The better the Company's actual ROE, the better the terms on which the Company can issue equity. Because, as I have discussed, the Company's actual rate of return is significantly and negatively impacted by regulatory lag, any measure that reduces that impact and improves the Company's earnings will also improve the Company's chances of attracting needed capital at lower costs, thus keeping customer costs down in the long run. Because granting the Company's interim rate request will mitigate the impact of APS's extensive regulatory lag and improve the Company's ROE, it will also improve the Company's likelihood of being able to finance its necessary capital spending with a lower cost of capital, thus providing substantial benefits to customers.[12]

Mr. Brandt testified that even though the amount of the requested interim surcharge was based upon the then-existing PSA charge, the $115 million increase remains an appropriate amount to recover through interim base rates because it provides a reasonable level of protection against a downgrade; it generates an amount that is less than what APS is likely to receive in the permanent rate case and thus will not likely need to be refunded; and if it is implemented in November, it will coincide with the rate decrease associated with the change to winter rates. In response to Staff's alternative recommendation, APS stated that it believes such an analysis, with two adjustments,[13] supports an even larger increase than requested by APS – somewhere between $95 million and $247 million. Mr. Brandt agreed with Staff's modified alternative recommendation that does not require an equity issuance in order to implement interim rates.

Dr. Charles Cicchetti, an economic consultant, and former Chair of the Wisconsin Public Service Commission, testified on behalf of APS in support of its Motion. Dr. Cicchetti believes that APS' declining financial condition is a customer emergency and that the Commission should begin to address it by adopting an interim surcharge to replace the PSA adjustor. In response to Staff's argument that there is no emergency, Dr. Cicchetti testified that the "current financial challenges will only get worse if not addressed before the end of 2009," and "interim relief is clearly warranted from a cost-of-service standpoint and to help keep retail prices lower over time."[14] In response to Staff's

---

[12] *Id.* at 35-36.
[13] Inclusion of book depreciation expense and use of a different time period. *Id.* at 38.
[14] Ex. APS-13 at 3.

arguments about ordinary regulatory lag, Dr. Cicchetti disputed both that the amount not recovered is too small to be an emergency and that such lag can serve as a method to improve a utility's performance.

David Rumolo, APS Manager of Regulation and Pricing, testified concerning the methods for implementing the interim base rate surcharge. The Company analyzed three alternatives for assessing the surcharge: on a per kWh basis similar to the Interim PSA Adjustor, as a percentage adder to base bills using an equal percentage increase for all customers, and on a per kWh basis except for general service customers whose base rates include demand charges. According to Mr. Rumolo, each method collects the same revenue but has different impacts on customer classes. APS is willing to implement any of the methods and noted that the per kWh method tends to benefit small energy users such as residential customers and that the percentage method tends to favor large users. APS does not plan to charge the interim rates to customers who receive service under the low-income and medical equipment rate schedules, since they were exempt from the PSA adjustor. In his rebuttal testimony, Mr. Rumolo presented calculations that modified Staff's alternative recommendation to include revenue requirements associated with additional operating costs (depreciation expense and property taxes) and additional generation investment.

William Post, the Chairman of the Board for APS and Chairman and CEO for Pinnacle West, testified in support of APS' requested interim rate relief. Mr. Post testified that the proceeding provides an opportunity for the Commission and APS to address the state's energy future. He testified that the Commission should grant the Motion to:

> (1) reduce regulatory lag; (2) send a strong message to the capital markets and to the industry as a whole that the Commission shares with APS the goal of acquiring capital at the lowest possible cost consistent with high customer service and reliability; (3) improve APS financial strength consistent with the ability to finance new base load additions; (4) maintain Arizona's energy independence; (5) support the investment necessary to improve efficiency and manage costs; and (6) minimize the impact of price increases by implementing such rates coincident with the change to winter rates in November and reducing the increase in permanent rates determined in the Company's base rate request by a like amount.[15]

[15] Ex. APS-11 at 12.

APS states that established authorities and Commission precedent interpret the Arizona Constitution to give the Commission broad power to tailor and implement rates appropriate for utilities' specific circumstances. As support, APS points to Article 15, § 3 of the Arizona Constitution, granting the Commission "full power to . . . prescribe just and reasonable classifications to be used and just and reasonable rate and charges," and Arizona Attorney General Opinion No. 71-17, providing that "the Commission's powers are not limited to those expressly granted by the Constitution; the Commission may exercise all powers necessary or essential in the performance of its duties."[16]

APS asserts that under Arizona law, the Commission does not need to make a determination of "emergency" to grant interim relief as requested in its Motion. APS relies primarily on *Pueblo Del Sol Water Co. v. Ariz. Corp. Comm'n,* 160 Ariz. 285, 772 P.2d 1138 (Ariz. Ct. App. 1988) ("*Pueblo Del Sol*"); *Ariz. Corp. Comm'n v. Mountain States Tel. & Tel. Co.*, 71 Ariz. 404, 228 P.2d 749 (Ariz. 1951) ("*Mountain States*"); and Arizona Attorney General Opinion No. 71-17 ("Attorney General Opinion") as the basis for its position.

Pueblo Del Sol is a 1988 opinion from the Court of Appeals, Division 2, and is cited by APS as an example where an Arizona court held that the Commission could grant interim rates without making a finding of an emergency.[17] In *Pueblo Del Sol,* the Court of Appeals stated that "[i]nterim rates are not limited to emergency as appellant contends."[18] APS also cites a 1951 Arizona Supreme Court decision, *Mountain States*, stating that it "upheld a utility's right to interim relief where the Commission's normal ratemaking process would not be completed in a reasonable time."[19]

---

[16] Op. Att'y Gen. 71-17 at 3 (referencing *Garvey v. Trew*, 64 Ariz. 342, 346, 170 P.2d 845, 847-48 (1946), *cert. denied*, 329 U.S. 784 (1946)). In *Garvey*, the Arizona Supreme Court stated:

> The corporation commission is one of the departments of the state government created by the Constitution. Art. 15, Const. of Arizona; *Phoenix Ry. Co. v. Lount*, 21 Ariz. 289, 187 P. 933. It has very broad powers conferred upon it by the Constitution.... Nor are the powers of the commission limited to those expressly granted. We have held that the powers conferred by the article are merely the minimum, and that under the constitution, the commission may exercise all powers which may be necessary or essential in connection with the performance of its duties. *Garvey*, 64 Ariz. at 346.

[17] In its Initial Post-Hearing Brief, APS acknowledged that there is a more recent, conflicting opinion from the Arizona Court of Appeals, Division 1, holding that an emergency is required to grant interim rates, but stated that even under that standard, it would be entitled to relief. APS Initial Post-Hearing Brief at 6, note 2.

[18] *Pueblo Del Sol*, 160 Ariz. at 287, 772 P.2d at 1140.

[19] APS Initial Post-Hearing Brief at 6.

APS disagrees with Staff's and RUCO's positions that a finding of an emergency is necessary to implement interim rates. APS argues that the Attorney General Opinion does not clearly require a finding of an actual emergency when an evidentiary hearing has been held and does not give an exclusive list of emergency situations. APS cites Wisconsin and Alaska regulatory decisions to support its claim that other jurisdictions use interim rates or other mechanisms routinely, without first finding an emergency, and "often based on concerns about a utility's continuing financial viability."[20] In response to the statement in the Attorney General Opinion that interim rates are "not proper merely because a company's rate of return has, over a period of time, deteriorated to the point that it is unreasonably low,"[21] APS points to the immediately following sentence which states "[i]n other words, interim rate relief should not be made available to enable a public service corporation to ignore its obligations to be aware of its earnings position at all times and to make timely application for rate relief, thus preserving its ability to render adequate service and to pay a reasonable return to its investors."[22]

If the Commission determines that a finding of emergency is required, APS argues, the Commission has broad authority to consider the circumstances and is not bound by the events described in the Attorney General Opinion. APS discusses past Commission decisions and decisions from other jurisdictions in which APS believes that poor earnings, financial difficulties, and threats of a rating downgrade were reasons to implement interim rates.

Finally, APS argues that although the Attorney General Opinion made it clear that it was not necessary for the Commission to establish the fair value of APS' property to grant interim rate relief, the Commission could make such a temporary or interim fair value finding here. APS relies on the following statement in the Attorney General Opinion to conclude that "interim rate relief is always available to the Commission where, as here, financial difficulties and effective ratemaking dictate that it be implemented":[23]

> The Commission's broad and exclusive legislative power to choose the modes by which it establishes rates . . . 'should be construed broadly enough to permit

---

[20] *Id.* at 7.
[21] Op. Att'y Gen. 71-17 at 20.
[22] *Id.*
[23] APS Post-Hearing Reply Brief at 5.

> the Commission to avail itself of concepts and procedures which are devised from time to time to permit effective utility regulation and to keep pace with constantly changing economic and social conditions'"[24]

Mesquite's Position

Mesquite recommends that the Commission approve the interim relief requested by APS, subject to refund. Citing testimony by APS' witness, Dr. Ciccetti, Mesquite states that the Commission should carefully consider the long-term interests of the ratepayers. Mesquite notes that the parties agree that a downgrade would result in "(i) reduced access to and increased cost of capital, (ii) reduced operating flexibility in dealing with suppliers and vendors, and (iii) a prolonged passage of time before an investment grade quality credit rating status could be regained, if ever."[25]

Mesquite argues that the Commission has the requisite jurisdiction and authority to grant interim relief, citing the Attorney General Opinion and previous Commission decisions. Mesquite argues that the Attorney General Opinion says that a ratepayer does not have a right to notice and an opportunity to be heard when an interim rate request involves a situation of "true emergency," but that such rights may exist in "non-emergency" situations. From this Attorney General Opinion discussion of notice and intervention rights during interim rate proceedings, Mesquite concludes that because intervention was granted in this proceeding and a hearing was held, no demonstration of a financial emergency is required for interim rates to be implemented.[26] Mesquite states that, pursuant to the Attorney General Opinion, the Commission is not required to make a fair value determination in order to set interim rates and that prior Commission decisions from the 1970s and 1980s[27] granted APS interim rate relief without finding an emergency. Mesquite concludes that there is legal jurisdiction and authority, as well as ample precedent, for the Commission to grant interim rate relief as requested by APS.

AIC's Position

AIC recommends that the Commission approve the interim relief requested by APS. AIC believes that although the request was needed at the time of the Motion due to APS' construction

---

[24] *Id.* at 4, (quoting Op. Att'y Gen. 71-15 (use of automatic adjustment clauses)).
[25] Mesquite's Closing Brief at 6.
[26] *Id.* at 3.
[27] Mesquite cited Decision No. 48569 (January 4, 1978) and Decision No. 55228 (October 9, 1986).

budget and need to maintain its FFO/Debt ratio at a level supporting an investment grade credit rating, "the unprecedented economic developments immediately preceding, during and since the hearing have amplified by several times the need to place APS on a stronger financial footing."[28] AIC argues that a downgrade to junk would not only result in higher costs to ratepayers, but would impair APS' ability to finance needed generation facilities. Although APS' current ratings are "stable," AIC argues that indications have been made in recent reports that deterioration in cash flows or a "sustained weakening of financial metrics" could result in a downgrade.[29]

AIC relies upon Article 15, § 3 of the Arizona Constitution, *Mountain States*, the Attorney General Opinion; and a 1949 California Public Utilities Commission ("PUC") decision[30] cited in the Attorney General Opinion; and six interim rate decisions issued by the Commission during 1975-1986. AIC argues that the "ability to grant interim relief to APS is essentially an authority 'sub-set' of the Commission's broader 'full power' to prescribe rates and charges"[31] as set forth in Article 15, § 3 of the Arizona Constitution. AIC quotes the California PUC's finding of implicit authority to grant interim rate increases:

> It is an elementary rule of law that the power to grant a particular relief carries with it all the incidental, necessary, and reasonable authority to grant that which is less. It is apparent that the authority delegated to this Commission by the Public Utilities Act to award rate relief to a public utility carries with it the incidental and implied power to grant interim rate relief, if the facts warrant such summary relief."[32]

AIC concludes that because the Arizona Constitution grants the Commission "full power," the Commission has the necessary "lesser" authority to grant interim relief, and the focus should be on whether the "facts warrant such summary relief." AIC disagrees with RUCO's position that the "emergency" exception should be narrowly construed. AIC also argues that although the procedural posture of APS' request differs from the situation in *Mountain States*, "the basic proposition

[28] AIC Opening Brief at 2.
[29] *Id.* at 7.
[30] *Pacific Tel. & Tel. Co.*, 78 P.U.R. (N.S.) 491, (1949).
[31] AIC Opening Brief at 7.
[32] *Id.* at 8, citing *Pacific Tel. & Tel. Co.*, 78 P.U.R. at 493.

established by the Supreme Court has equal application here," where the Commission is unable to "grant relief in a reasonable time."[33]

AECC's Position

AECC is supportive of interim rate relief because it agrees with APS that it is not in APS' or its ratepayers' best interest for APS to be threatened with a credit downgrade to below investment grade. AECC disagrees with the level of interim rate relief requested by APS, based upon an analysis conducted by AECC witness Kevin Higgins. Mr. Higgins testified that AECC's recommendation is intended to preserve APS' financial health while the permanent rate case is pending. He determined that a $42.4 million increase in interim rates would be sufficient to avoid the threat of a downgrade and would allow APS to maintain an FFO/Debt ratio of 18.25 percent until the pending permanent rate case is resolved. Mr. Higgins testified that an 18.25 percent FFO/Debt ratio is within the investment grade range.[34] Mr. Higgins also testified that given the growth in Arizona and the need for additional infrastructure, there will be a need for new equity. Although he acknowledged that if the new equity is delayed or not issued, it would take a rate increase of more than $42.4 million to achieve an 18.25 percent FFO/Debt ratio, Mr. Higgins did not alter the amount of his recommended interim rate relief:

> And I want to be clear that I am not recommending more than $42.4 million. I do believe that APS should have the latitude to decide when the most propitious moment is for the company to infuse that equity and to go to the capital markets for additional equity. . . my recommendation is that it ought to be left to them to weigh those factors going forward and to act in the best financial interest of the company, and therefore, customers with respect to issuing that new equity.[35]

AECC points out that APS Exhibit 9, "APS' 12/31/1009 Projected FFO to Debt Ratio" does not show the effects of Mr. Higgins' recommended $42.4 million interim increase with the APS $500 million reduction in capital expenditures. According to AECC, even if the $400 million equity infusion is not made, APS' FFO/Debt ratio at the end of 2009 would be about 18.76 percent after the

[33] AIC Opening Brief at 8.
[34] Ex. AECC-1 at 6.
[35] Tr. at 269.

capital reduction and the AECC $42.4 interim rate increase.[36] In response to Staff's "alternative recommendation," AECC states that "[u]nfortunately in this scenario, the interim increase would be based on factors that AECC contends should be more fully addressed in the general rate case proceeding."[37]

AECC recommends that if the Commission grants an interim rate increase, it be applied on an equal-percentage basis across the customer classes subject to the increase. Mr. Higgins explained that it is a fundamental rate design objective for the cost recovery mechanism to reflect the general nature of the costs being recovered and that other regulatory jurisdictions use a rate design method similar to AECC's proposal when implementing interim rate increases. Mr. Higgins testified that no Class Cost of Service Study was conducted for purposes of the Motion and that, because the need for the increase is related to rate base and not fuel and purchased power costs, there is no basis to apply an interim rate increase for base rates on an energy charge. Although AECC agreed with Staff that the appropriate rate design is a public policy determination to be made by the Commission, it disagreed with Staff's and RUCO's preferred rate design, arguing that there is no sound basis to allocate the increase on energy charges and that such an approach would be unjust and unreasonable for higher-load and higher-voltage customers, whether they be commercial or residential.[38]

AECC also asserts that the Commission has authority to grant interim rates, citing the Attorney General Opinion and *Mountain States*. According to AECC, the Attorney General identified two situations when interim rates could be authorized: (1) "as an emergency measure when sudden change brings hardship to a company, when the company is insolvent, or when the condition of the company is such that its ability to maintain service pending a formal rate determination is in serious doubt,"[39] and (2) when the Commission is unable to "grant permanent rate relief within a reasonable time."[40] According to AECC, because a demonstration of "emergency" is not required under the second situation, "it stands to reason that a showing of 'emergency' is not a legal

---

[36] AECC Reply Brief at 3.
[37] *Id.* at 5.
[38] AECC Post-Hearing Brief at 11-12; Ex. AECC-1 at 8 ("For example, at the amount of interim increase proposed by APS, a 75 percent load factor E-35 customer would experience a base rate increase in excess of 7.7 percent under a flat kWh charge – 75 percent higher than the 4.4 percent average increase identified by Mr. Rumolo.").
[39] Op. Att'y Gen. 71-17 at 20.
[40] *Id.*

requirement that would otherwise prohibit the Commission from granting an interim rate increase when the public interest demands it."[41] AECC concludes that if the Commission decides to grant interim rates only upon a finding of an emergency, then it makes that requirement as a matter of public policy, because neither the Arizona Constitution nor other state law imposes such a requirement.

RUCO's Position

RUCO recommends that the Commission deny APS' Motion for interim rates. Stephen Ahearn, Director of RUCO, testified that [APS' claim that] "interim rates are necessary to mitigate 'timing differences' that arise as a result of the lag between the plant construction period and the time when the plant enters service and is included in rates"[42] does not constitute an emergency under Arizona law. Mr. Ahearn explained that the "timing differences" are a normal part of the regulatory process and that they work both ways, tending to offset the effects. Mr. Ahearn believes that:

> This APS request is yet another example of how Arizona utilities are attempting to redefine the regulatory paradigm in Arizona, which has worked fairly and rationally for decades. Utilities, through requests for automatic adjustors, interim/emergency rates, single issue ratemaking, decoupling mechanisms, and 'ACRM-like' mechanisms would like to create a new regulatory system that shifts the risk from their shareholders to their ratepayers. Consideration of these types of schemes is a very slippery slope that could easily lead to a situation where monopoly enterprises could operate in the absence of any effective or meaningful regulation.
>
> Moreover, requests for these types of schemes have become the norm and not the exception . . . . Extraordinary relief, if ever, should only be allowed in extraordinary situations. The Commission should not allow non-traditional ratemaking practices to become the norm.[43]

RUCO argues that the record does not support a conclusion that APS will be downgraded if the Commission does not grant interim relief, as only one credit rating agency is even considering a downgrade.[44] RUCO argues that the emergency exception should be narrowly construed and that the Commission should not find an emergency exists based upon speculation about rating agencies' future actions. If the Commission were to consider APS' claims about the credit rating agencies,

---

[41] AECC Post-Hearing Brief at 14.
[42] Ex. RUCO-4 at 5.
[43] *Id.* at 6-7.
[44] RUCO Post-Hearing Brief at 2.

RUCO notes, it is not clear that a downgrade is imminent because only one rating agency has APS at the lowest investment grade and another just upgraded APS' outlook to "stable," the FFO/Debt ratio is only one financial metric used by rating agencies, and the FFO/Debt projections do not show a decrease to below 18 percent if the interim relief is not granted.[45]

RUCO also argues that the specific amount requested, $115 million, is "not supported by the record and is arbitrary."[46] RUCO finds APS' rationale that the amount would minimize the impact on ratepayers because it would mimic existing rates, to be disrespectful to the Company's customers who should not have to overpay just to keep rates consistent.[47] RUCO concludes its Reply Brief by noting the "great uncertainty" caused by the recent market turmoil and cautioning the Commission to "take their time to allow a reasonable perspective of recent market events to inform the ultimate decision in this matter."[48]

RUCO argues that exceptions to constitutional requirements such as a fair value finding and determination of just and reasonable rates should be narrowly construed. According to RUCO, Arizona courts have recognized limited circumstances when the Constitution's fair value ratemaking provision is not mandatory: (1) when rates change pursuant to an already established adjustor mechanism; and (2) when an emergency exists, provided a bond is posted guaranteeing a refund if necessary once the Commission has considered fair value rate base and made a final determination of just and reasonable rates. RUCO disagrees with APS' argument that a finding of emergency is not required in order to approve interim rates, citing the recent Court of Appeals' conclusion in *Residential Utility Consumer Office v. Ariz. Corp. Comm'n*, 199 Ariz. 588, 20 P.3d 1169 (Ariz. Ct. App. 2001) ("*RUCO*") that the statement in *Pueblo de Sol* that interim rates are not limited to emergency situations had "misstated the test set forth in *Scates*."[49] In *RUCO*, the Court of Appeals stated that "[c]learly, *Scates* contemplated, and we agree, that interim rate making requires all three elements – an emergency situation, the posting of a bond, and a subsequent full rate case – in order to

[45] *Id.* at 7-8.
[46] RUCO argues that the Commission should "only consider facts that are tangible" and not "verbal representations from a third party that have not been authenticated, corroborated or even verified in any legal manner." RUCO Reply Brief at 5.
[47] *Id.*
[48] *Id.* at 6.
[49] *RUCO*, at 199 Ariz. 592, 20 P.3d at 1173.

comport with the constitutional mandate that rates be just and reasonable."[50] RUCO recommends that the Commission not use its broad powers to expand the exceptions to the Arizona Constitution's fair value requirement.

Staff's Position

Staff recommends that the Commission deny APS' Motion for interim rates because APS has not established that interim rate relief is warranted. If the Commission were to find that interim rates are appropriate, Staff presented an alternative recommendation.

Ralph Smith, a Senior Regulatory Consultant, testified on behalf of Staff concerning APS' requested interim rate increase. Mr. Smith testified that APS has not identified any sudden or unanticipated event or circumstance affecting its ability to provide reliable, safe, reasonable, and adequate service while its permanent rate case is being processed; that APS is not facing a financial emergency and continues to obtain financing; and that no downgrade of APS' credit rating appears imminent or probable while the permanent rate case is pending.[51] He concludes that no emergency exists to support the requested interim rate increase.

Mr. Smith agrees that a downgrade to junk status would not be a desirable outcome, but pointed out that no credit rating agency has stated that APS' debt would be downgraded if the interim rates were denied by the Commission. Staff believes that an analysis of APS' financial condition shows that APS' debt is investment grade; the outlook for APS and Pinnacle West is "stable"; APS' FFO/Debt ratio is "well within the 15% to 30% range specified by Standard & Poor's for a BBB- rating for a corporation with a 'strong' business risk profile and an 'aggressive' financial risk profile and within the 10% to 30% range for a U.S. utility with that business and financial risk profile;"[52] the FFO/Debt ratio is 23 percent in 2008; and APS and Pinnacle West have Commission authorization to issue $400 million in equity. Mr. Smith testified that although APS alleges that it is experiencing negative effects from regulatory lag because customer growth is not generating revenues to cover the cost of capital improvements, it is impossible to make such a determination in an interim rate case due to the abbreviated schedule and lack of opportunity to conduct an investigation. He notes that in

[50] *Id.*
[51] Ex. S-1 at 15-16.
[52] *Id.* at 29.

the previous permanent rate case, Staff's investigation concluded that APS' claim was not supported by the evidence, and in any event, ordinary regulatory lag by itself is not the type of circumstance that justifies interim rates.

Mr. Smith explained why regulatory lag is not a reason to implement interim rates:

> Regulatory lag is an ordinary and anticipated feature of regulation. One of the useful functions of regulatory lag is to place financial responsibility upon the utility for fluctuations in costs between rate cases. The regulatory lag feature of Rate Base/Rate of Return regulation is essential to effective and efficient operation of such a regulatory regime. Because of the lag between placing new plant into service and obtaining rate recognition of such plant, the utility may bear the cost of new plant additions temporarily. This can encourage management to emphasize cost control to a higher degree than might be expected if cost responsibility for plant additions during the periods between rate cases were shifted away from the utility and onto ratepayers. In evaluating plant additions, the Company should conduct a cost-benefit analysis to determine if there is a business case for implementing the plant additions on the time frame budgeted by the Company. If the case is compelling and the project is cost-justified, no additional special ratemaking treatment is needed. If the project is not cost-justified or the benefits are too speculative to warrant the commitment of funds, it may be prudent to delay or avoid the related capital expenditures. These incentives that are currently in place would be lessened if ordinary regulatory lag began to be utilized by Arizona utilities as a justification for interim rate increases. Absent some emergency or other exceptional circumstance, ordinary regulatory lag by itself does not warrant the extraordinary relief of an interim rate increase.[53]

In the event that the Commission wants to grant an interim rate increase, Staff presented an alternative basis for determining the amount of increase. Mr. Smith testified that given the limited time to review APS' rate request, one way to find an appropriate increase might be to use the increased investment in net plant with the most recently approved cost of capital. Using the most recently approved cost of capital applied to the approximate $538 million increase in the level of unadjusted jurisdictional rate base proposed in APS' pending rate case over the adjusted level found in Decision No. 69663, Staff calculates an increase of $65.2 million in interim rates. Although initially Staff recommended that this $65.2 million increase be contingent upon APS receiving the

[53] *Id.* at 12-13.

$400 million equity infusion from Pinnacle West, at the hearing, Staff modified its recommendation to eliminate that contingency. Staff recommended that if the Commission decided to implement interim rates, the rate design should be simple and straight-forward to implement and the revenues should be tracked, verified and easy to refund.

David Parcell, Consulting Economist, also testified on behalf of Staff concerning APS' requested interim rate increase. Mr. Parcell testified that although APS focuses on a single financial metric (FFO/Debt), rating agencies indicate that many factors go into the ratings process, that all rating agencies rate APS as "stable,"[54] and only one of the three major rating agencies has APS at the lowest investment grade. Mr. Parcel used other indicators of financial strength and viability to compare APS with other electric utilities and found the stock rankings of Pinnacle West are typically in the above-average categories for electric utilities, indicating below-average risk. He concludes that APS is not presently at any significant risk of a downgrade.

Staff disagrees with APS' claim that interim relief is possible on a "somewhat routine basis,"[55] but also disagrees with RUCO that the Commission can only set interim rates in emergency situations. Staff believes that the Commission can order interim rates if it believes the record supports a finding that an emergency is likely to occur and makes some finding of fair value in the decision granting interim rates. According to Staff, it is reasonable that the Commission would:

> . . . have some ability to act to avert an impending crisis, as long as it finds some measure of fair value. The plenary and exclusive Constitutional authority of the Commission over rates would seem to necessarily encompass the ability to act to prevent an emergency from occurring as much as it encompasses the ability to alleviate an emergency that is in the process of occurring or has occurred.[56]

Staff also cited the Attorney General Opinion statement that the Commission's power to choose the methods used to establish rates should be broadly construed to allow the Commission to use the concepts and procedures it deems necessary for effective utility regulation as economic and social conditions change. Staff also notes that the Attorney General Opinion recognizes the

[54] Moody's recently (July 2008) revised APS' outlook from negative to stable. Ex. S-2 at 11.
[55] Staff Reply Brief at 2.
[56] Staff Initial Post-Hearing Brief at 8.

Mountain States exception to the need to find fair value when the Commission is unable to grant permanent rate relief in a reasonable time. Although Staff agrees with APS' characterization that the Commission "may exercise all powers necessary or essential in the performance of its duties,"[57] Staff believes that APS' position would allow interim rate relief at almost any time, an extreme view with which Staff disagrees. Staff argues that interim rate relief is "intended for extraordinary, unusual, or exigent circumstances," citing *RUCO* and the Attorney General Opinion. Staff states:

> It is not, as APS would apparently prefer, a means to accomplish early rate relief for rate base additions or for perceived shortfalls in equity returns. Interim rate relief should be viewed as an extraordinary remedy because interim rate proceedings are expedited and therefore lack the extended opportunities for discovery and audit that are normally associated with Commission rate cases. Because both the time and the means for processing and evaluating interim rate cases are abbreviated, an interim rate case is not the most thorough or complete means for setting rates. Such procedures should therefore be used sparingly, as the exception instead of the rule.[58]

Staff notes that *RUCO* did not address the issue of what authority the Commission has to set interim rates if it also makes a fair value finding. Staff is concerned that RUCO's position may "significantly restrict the Commission's ability to act in an impending emergency."[59] Staff argues that while the Commission's authority to grant interim rates is "probably not limited to circumstances that present an ongoing emergency, interim rates should nonetheless be regarded as an extraordinary form of rate relief, available only in connection with urgent, unusual, or special circumstances."[60] Staff believes that if an emergency has already occurred or is occurring, the law does not require a fair value finding be made to implement interim rates. However, Staff recommends that if an emergency is not present, the Commission make a fair value finding if it grants interim rates.[61]

ANALYSIS

The Commission's authority to grant a utility emergency rate relief is part of its constitutional ratemaking authority, which has been construed as plenary and exclusive. Ariz. Const. art. 15 § 3;

---

[57] Staff Post-Hearing Reply Brief at 2.
[58] *Id.*
[59] *Id.* at 3.
[60] *Id.*
[61] *Id.*

Arizona Corp. Comm'n v. State ex rel. Woods, 171 Ariz. 286, 830 P.2d 807 (Ariz. 1992); *State v. Tucson Elec. Light and Power Co.*, 15 Ariz. 294, 138 P. 781 (Ariz. 1914).[62]

In May of 1971, upon the request of the Commission's Chairman, Russell Williams, the Arizona Attorney General issued Opinion No. 71-17. Therein, it is explained that interim rates are used to:

> fill a hiatus which occurs between the time that existing rates being charged by a public service corporation have been invalidated by a court or have been determined by the appropriate regulatory body to be confiscatory of the corporation's property, and the time that permanent rates which produce a fair return are established.[63]

The Attorney General Opinion discusses criteria used to determine whether an emergency exists and when interim rates are appropriate:

> The foregoing authorities make it clear that, in general, courts and regulatory bodies utilize interim rates as an emergency measure when sudden change brings hardship to a company, when a company is insolvent, or when the condition of the company is such that its ability to maintain service pending a formal rate determination is in serious doubt.
>
> In addition, under the *Mountain States Telephone* case, *supra*, the inability of the Commission to grant permanent rate relief within a reasonable time would be grounds for granting interim relief.
>
> Perhaps the only valid generalization on this subject is that interim rate relief is not proper merely because a company's rate of return has, over a period of time, deteriorated to the point that it is unreasonably low. In other words, interim rate relief should not be made available to enable a public service corporation to ignore its obligations to be aware of its earnings position at all times and to make timely application for rate relief, thus preserving its ability to render adequate service and to pay a reasonable return to its investors.

In *Scates v. Arizona Corp. Comm'n*, 118 Ariz. 531, 578 P.2d 612 (Ariz. Ct. App. 1978) ("*Scates*"), the Court of Appeals, Division 1, held that the Commission did not have authority to increase rates for select services without making a determination of the utility's investment and how

---

[62] While the state legislature may enlarge the Commission's powers pursuant to Article 15, § 6, it cannot limit that constitutional power. The Commission's "exclusive field may not be invaded by either the courts, the legislative, or executive." *Tucson Elec.*, 15 Ariz. at 306, 138 P. at 786.

[63] Op. Att'y Gen. 71-17 at 1-2.

the substantial increase would affect the utility's rate of return on that investment. The *Scates* Court stated:

> Although all parties before the Commission generally agreed that it would be improper to implement an increase of all rates without such inquiry, we see no justification for permitting the same increase in revenues to be accomplished by raising only some of the tariffs. As special counsel for the Commission's staff pointed out during the course of this hearing, such a piecemeal approach is fraught with potential abuse. Such practice must inevitably serve both as an incentive for utilities to seek rate increases each time costs in a particular area rise, and as a disincentive for achieving countervailing economies in the same or other areas of their operations.[64]

In its decision, the Court also discussed the Attorney General Opinion and the limited circumstances where interim rates should be used to those:

> where an emergency exists, where a bond is posted guaranteeing a refund to the utility's subscribers if any payments are made in excess of the rates eventually determined by the Commission, and where a final determination of just and reasonable rates is to be made by the Commission after it values a utility's property.[65]

The *Scates* Court found that the Commission's decision to increase rates did not fit under either the interim rate or automatic adjustment exception to the Constitution's requirement of a fair value finding..

In *Pueblo Del Sol*, the Court of Appeals, Division 2, decided the issue of whether the Commission had the power to implement "interim rates" when it approved the transfer of assets and Certificate of Convenience and Necessity ("CC&N") from one water utility to another and required the purchasing utility to charge the (higher) rates of the selling utility. subject to refund. The Court stated:

> Interim rates are not limited to emergency situations as appellant contends. In fact, when previous rates are confiscatory the courts are authorized to allow the utility to impose its own increased rates on an interim basis until the Commission imposes reasonable rates. *Arizona Corporation Commission v. Mountain States*

[64] *Scates*, 118 Ariz. At 535, 578 P.2d at 616.
[65] *Id.*

> *Tel. & Tel. Co.*, 71 Ariz. 404, 228 P.2d 749 (1951). Although there is no Arizona authority on the Commission's power to impose interim rates subject to a decrease, it is only logical that they can do so. *United Tel. Co. of Florida v. Mann*, 403 So.2d 962 (Fla.1981). Appellant would have the Commission's power limited to imposing interim rates that are only subject to increases. It appears that appellant wants to have its cake and eat it too. We cannot condone such a result.[66]

In *RUCO*, a water utility filed a request for a surcharge to collect increased costs it was paying for water from the Central Arizona Project ("CAP"). The Commission found that the utility's rate of return was less than its authorized rate of return, but that the utility had not demonstrated that the deterioration in its rate of return was caused by the increase in its CAP water expenses. The Commission also found that the utility's operations had changed significantly since its last rate case, with a 49 percent increase in customers, a 300 percent increase in rate base, and a 57 percent increase in revenues. Because these factors could affect rates and needed to be analyzed during a full rate hearing, the Commission required the utility to file a rate application within six months and granted the surcharge subject to "true-up" at a full rate hearing. On appeal, the Commission argued that its decision was lawfully based on its "constitutionally sanctioned plenary power to prescribe rates"[67] and not on an emergency basis, relying on the *Pueblo Del Sol* decision and a liberal interpretation of *Scates*.[68]

In determining whether the Commission exceeded its constitutional rate-making authority by approving a surcharge without first conducting a fair valuation of the utility's property and determining its rate base, the Court of Appeals, Division 1, summarized the law in Arizona concerning the Commission's interim ratemaking authority:

> Although the Commission's authority to prescribe rates is plenary, *Tucson Elec. Power Co.*, 132 Ariz. at 242, 645 P.2d at 233, the Commission's rate-making authority is subject to the "just and reasonable" clauses of Article 15, Section 3 of the Arizona Constitution. Under most circumstances, the Commission is constitutionally obligated
>
> > to find the fair value of the [utility's] property and use such finding as a rate base for the purpose of calculating what are *just and reasonable*

[66] *Pueblo Del Sol*, 160 Ariz. at 287, 772 P.2d at 1140.
[67] *RUCO* at 590, 1171.
[68] *RUCO* at 592, 1173.

> rates . . . . While our constitution does not establish a formula for arriving at fair value, it does require such value to be found and used as the base in fixing rate. *The reasonableness and justness of the rates must be related to this finding of fair value*. . .
>
> *Simms*, 80 Ariz. at 151, 294 P.2d at 382 (emphasis added); *see also Arizona Corp. Comm'n v. Ariz. Pub. Serv. Co.*, 113 Ariz. 368, 370, 555 P.2d 326, 328 (1976); Ariz. Const. art. 15, § 14. In limited circumstances, the Commission may engage in rate making without ascertaining a utility's rate base. The Commission can exercise its authority when rates are predicated on an interim basis or when the rate changes are pursuant to an automatic adjustment clause. . . .
>
> Relying on the supreme court's decision in *Arizona Corporation Commission v. Mountain State Telephone & Telegraph Co.*, 71 Ariz. 404, 228 P.2d 749 (1951), the Arizona Attorney General acknowledged that the superior court has the authority to order a temporary rate increase without a full rate hearing. Op. Att'y Gen. 71-17 at 10. The Attorney General reasoned that the Commission itself could approve rate increases without first determining the fair value of the utility's property, but "only upon a finding that an emergency exists." *Id.* *Scates* follows the Attorney General's conclusion that, while the Commission has broad authority when setting rates, the interim rate-making authority is limited to circumstances in which (1) an emergency exists; (2) a bond is posted by the utility guaranteeing a refund to customers if the interim rates paid are higher than the final rates determined by the Commission; and (3) the Commission undertakes to determine final rates after a valuation of the utility's property. 118 Ariz. at 535, 578 P.2d at 616 (following the conclusion drawn in Op. Att'y Gen. 71-17).[69]

The Court in *RUCO* discussed the *Pueblo Del Sol* decision, stating that:

> Although depicted as an "interim rate," the rate that was being charged by the selling utility was a final rate set by the Commission for that particular company. *Id.* at 286-87, 772 P.2d at 1139-40. We do not believe *Pueblo Del Sol* to be an "interim rate" case as contemplated by *Scates*. The Commission's approval in *Pueblo Del Sol* was, in effect, an approval of the continued use of a previously authorized rate.
>
> When discussing interim rates, the *Pueblo Del Sol* court restated the test set forth in *Scates* in the disjunctive. The court defined interim rates as "rates charged by the utility for services or products pending the establishment of a permanent rate, in emergency situations, *or* where a bond is posted that guarantees a refund to consumers for any excess paid by them prior to the Commission's final determination." *Id.* at 287, 772 P.2d at 1140 (emphasis added). Although we agree with the result reached in *Pueblo Del Sol*, we believe that the court misstated the test set forth in *Scates*. We agree with the *Scates* court's approval of the circumstances in which interim rates may be considered and approved by the Commission. Clearly, *Scates* contemplated, and we agree, that interim rate

[69] *RUCO*, 199 Ariz. at 591, 20 P.3d at 1172.

> making requires all three elements-an emergency situation, the posting of a bond, and a subsequent full rate case-in order to comport with the constitutional mandate that rates be just and reasonable.[70]

As the parties have set forth in their legal briefs, the Commission has broad and exclusive ratemaking authority under the Constitution. However, the Constitution itself imposes requirements associated with that ratemaking power. Article 15, § 14, provides that the Commission "shall, to aid it in the proper discharge of its duties, ascertain the fair value of the property within the state of every public service corporation doing business therein." As discussed above, several Arizona cases and Arizona Attorney General Opinions have discussed the limited situations in which that constitutional fair value finding is not required to be contemporaneous with the adoption and implementation of new rates.

Given that the requirement of a fair value finding (which protects both the utility and the ratepayer) is contained in the Arizona Constitution, we believe that, appropriately, the law has developed to allow only limited exceptions to that requirement. Based upon the current law, there are three recognized exceptions to the constitutional fair value finding requirement:

(1) emergency rates are lawful when sudden change brings hardship to the utility, when the utility is insolvent, or when the condition of the utility is such that its ability to maintain service pending a formal rate determination is in serious doubt. The utility must post a bond and the Commission must subsequently make a determination of fair value and establish final rates that are just and reasonable.

(2) interim rates are lawful when a court or the Commission has made a determination that a utility's existing rates do not provide a fair and reasonable return on the company's property and result in the confiscation of the company's property, and the Commission is unable to grant permanent rate relief within a reasonable time. The utility must post a bond and the Commission must subsequently make a determination of fair value and establish final rates that are just and reasonable.

(3) rate changes without a fair value finding are lawful when a previously authorized adjustor

70 *RUCO*, 199 Ariz. at 592, 20 P.3d at 1173.

mechanism is modified outside of a general rate case.[71]

For the reasons set forth herein, we decline to adopt a new exception to the constitutional fair value finding requirement.

Although APS relies on the *Pueblo Del Sol* decision as support for its position that a finding of an emergency is not necessary to implement interim rates, the Court of Appeals, Division 1, in the subsequent *RUCO* decision stated that the court[72] in *Pueblo Del Sol* had misstated the *Scates* test and that *Scates* required all three elements for interim ratemaking – "an emergency situation, the posting of a bond, and a subsequent full rate case - in order to comport with the constitutional mandate that rates be just and reasonable."[73]

APS argues that RUCO's "'fair value' argument ignores the nature and purpose of an interim rate" and asserts that a fair value finding is not necessary "because interim rates will eventually become a part of a permanent rate increase or be refunded to ratepayers with interest following a fair value determination made after full examination of all relevant data in the permanent rate case."[74] Although this logic sounds appealing, it ignores the underlying reason why the Constitution requires a fair value finding that must be related to just and reasonable rates. Utility ratemaking begins with an analysis of the cost of providing service and ends with rates that are designed to collect the appropriate costs and allow the utility the opportunity to earn a reasonable return on the fair value of its property necessary to provide that service. All elements that go into the ratemaking formula to set just and reasonable rates have a temporal quality. Once a representative test year's operating costs, revenues, and fair value are analyzed, verified, audited and determined to be prudently incurred and properly matched[75] in a rate case proceeding, just and reasonable rates are set by the Commission. To later modify the rates by changing only one input to that balanced, properly matched ratemaking formula undermines the ongoing justness and reasonableness of the rates, because the rates are no

---

[71] We agree with the *RUCO* court that the rates at issue in *Pueblo Del Sol* were not "interim rates" within the context of the *Scates* analysis.

[72] Court of Appeals, Division 2.

[73] *RUCO*, 199 Ariz. at 592, 20 P. 3d at 1173.

[74] APS Post-Hearing Reply Brief at 4.

[75] "Matched" means that the expenses and revenues are reflective of the same time period – in order to provide service to a customer, the utility incurs a specific cost, and therefore must collect a specific amount of revenue. The test-year establishes the relationship between the cost of providing service and the revenue needed to collect those costs.

longer related to the fair value as required by the Constitution.

Although APS claims that no harm is done to ratepayers because the rates will be examined later in a permanent rate case, the selective use of interim rates to speed recovery of and on plant investment is not fair from a ratepayer perspective. This is exemplified in the following two examples: First, after rates are established by the Commission in a permanent rate case, over time, some of the utility's individual operating expenses may increase, while others may decrease. To the extent that there is a net decrease in operating expenses, a utility will "overearn" (revenue remains the same but expenses decrease, resulting in greater earnings), earning more than the rate of return used to set rates. The ratepayer continues to pay the previously established rates, and the utility is not obligated to refund the "over-earning" in a permanent rate case.[76] Second, even if operating expenses do not change, a utility may "overearn" if it does not continue to invest in plant. For example, in a permanent rate case, operating income is established partly on the net plant value at the end of the test year. The value of net plant continues to decrease as depreciation expense is incurred and recovered as a component of existing permanent rates. However, the operating income provision for net plant stays the same until the next rate case determination. The ratepayer continues to pay the previously established rates and the utility is not obligated to refund the "over-earning" in a permanent rate case. Further, to the extent that a plant asset becomes fully depreciated between rate cases, the utility may continue to collect depreciation expense on a fully depreciated asset. In these examples, the earnings of the company will have increased, but no "interim rate relief" is available to ratepayers.

APS has not articulated why it is fair or appropriate to routinely require ratepayers to pay interim rate increases while permanent rate cases are being processed, but not to require a utility to file for interim rate relief to decrease its rates when it is overearning. As the court in *Pueblo Del Sol* stated, a utility cannot "have its cake and eat it too."[77] Even if the law were to allow additional opportunities for interim rate relief in non-emergency situations, from a fairness perspective, we find

---

[76] *See* Op. Att'y Gen. 89-002.

[77] *See Pueblo Del Sol* 160 Ariz at 287, 772 P.2d at 1140 (disagreeing with appellant's apparent belief that interim rate relief is appropriate only for rate increases). The court noted that any Commission power to implement interim rates works both ways – not only could the Commission require rate increases, it could require rate decreases, too. It is doubtful that APS would agree that the Commission could require an interim rate decrease without also making a finding that rates were excessive or that an emergency existed.

that it is not appropriate to create the opportunity to allow APS to seek non-emergency interim rate increases while a general rate case is pending, because there is no concomitant obligation on APS to file a general rate case when it is overearning, thereby not affording ratepayers the same opportunity for interim rate relief that APS seeks for itself.

Although Mr. Brandt argues that regulatory lag "institutionalizes economic confiscation of invested capital" we note that the Arizona Supreme Court has previously considered whether the use of the historic test year is unfair or lacking in due process. In *Ariz. Corp. Comm'n v. Arizona Public Service Co.*, 113 Ariz. 368, 555 P.2d 326 (Ariz. 1976), APS argued that ""fair value' set by the Commission is prospectively confiscatory because the use of a historic test year produces a rate which is obsolete before it is set."[78] APS appealed an October 1975 Commission rate decision and during the Superior Court trial, APS' then vice-president and treasure testified in support of APS' position that the Commission's rate decision violated due process because it would result in confiscation of APS' property:

> He gave a history of the financial difficulties of the Company resulting in a lower rating of the utility's bonds. The witness then pointed out the descending amount of the rate of return on fair value as time progressed. He stated that the rates set by the Commission are confiscatory and will make the financing of the Company's construction program expensive, and if not impossible, at least much more difficult. He further indicated that in confining the testimony and evidence of fair value to the calendar year of 1974 which had been designated as the historic test year, an unfair and illegal result obtained.
>
> The witness pointed out that by September 30, 1975 plant additions were over \$71,000,000 and that by year end 1976, plant additions in the amount of \$209,000,000 will be in service. None of this evidence was considered by the Commission in determining the Company's fair-value rate base.[79]

The Supreme Court found that the record provided "no evidentiary basis for holding that the rate set by the Commission is at this juncture confiscatory"[80] noting that if the rate were to become confiscatory in the future, the appropriate relief would be to file a rate application. The Court

[78] *Ariz. Corp. Comm'n* 113 Ariz. at 328, 555P.2d at 370.
[79] *Id.* at 327, 369.
[80] *Id.* at 328, 370.

concluded that:

> Although we might be sympathetic to the problems of a rapidly expanding utility in inflationary times, we are restrained by the provisions of the constitution and our interpretations of that document. The determination of the formula to be used by the Commission falls within their legislative function. Only if the determination of the fair value is arbitrary and unfair at the time it is made, can the courts interfere.[81]

The Court did not agree with APS that the Commission's use of the historic test year violated due process or resulted in a confiscation of property.[82]

AIC cites previous Commission decisions[83] from the 1970's and '80's in which the Commission granted APS interim rates. In those cases, the Commission determined that an emergency existed under the law and authorized interim rates, subject to refund. We also note that in addition to authorizing interim rates those decisions required APS to "pay for an in-depth study of the management and operations of the company . . . selected by the Commission" (Decision No. 44920); required APS to make a filing addressing whether APS' "ongoing construction program is justified for its Arizona customers in light of the most recent load data and forecast available . . . and a detailed explanation of whether, and to what extent if any, APS' management has taken steps to improve its efficiency and effectiveness in response to the management study" (Decision No. 51753); and required APS to cease Allowance for Funds Used During Construction ("AFUDC") on an amount of Construction Work in Progress ("CWIP") associated with the first generating unit of Palo Verde, in order to "prevent any possibility of increased shareholder earnings during the existence of [the] emergency and to compensate APS's ratepayers for the increased value of cash earnings over AFUDC earnings" (Decision No. 53909).

APS argues that the Commission authorized interim rate relief for Tucson Electric Power

---

[81] *Id.* at 328-29, 370-71. (referencing *Simms v. Round Valley Light & Power Co.*, 80 Ariz. 145, 294 P.2d 378 (Sup. Ct. 1956) and *Ariz. Corp. Comm'n v. Arizona Water Co.*, 85 Ariz. 198, 335 P.2d 412 (Sup. Ct. 1959).

[82] The Supreme Court also disagreed with Attorney General Opinion No. 74-25 and found that the Commission may consider additional plant under construction at the close of the test year as long as the Commission's method complies with the Constitution and is not arbitrary and unreasonable.

[83] Decision No. 44920 (January 16, 1975); Decision No. 47359 (September 30, 1978); Decision No. 51753 (February 4, 1981); Decision No. 53349 (December 21, 1982) (Arizona Water Co.); and Decision No. 53909 (January 30, 1984).

("TEP") without finding the existence of an emergency in Decision No. 69568 (May 21, 2007). On September 12, 2005, TEP filed a Motion to Amend Decision No. 62103 pursuant to A.R.S. § 40-252. In Decision No. 68669 (April 20, 2006) the Commission ordered that a hearing be held pursuant to A.R.S. § 40-252 to consider amending Decision No. 62103 and TEP's 1999 Settlement Agreement in light of the Commission's Track A and B Orders and a subsequent court decision concerning electric restructuring. In Decision No. 69568, the Commission determined that, in light of the ongoing dockets and discussions concerning TEP's rates, no reduction in rates would occur until the permanent rate case, but implemented a mechanism for refund or credit. Decision No. 69568 involved an A.R.S. § 40-252 proceeding to amend a previous rate order and, therefore, is distinguishable from this Motion made in a pending rate case.

APS' argument that other jurisdictions use interim rates or other mechanisms routinely to address a utility's financial viability and AIC's reference to the California PUC's finding of implicit authority, ignore the fact that, unlike other states, Arizona has a *constitutional* fair value finding requirement. Although we have broad power to use concepts and procedures that adapt to changing social and economic conditions, we still must comply with the Constitution. APS is encouraged to propose concepts and procedures that it believes will assist us in addressing changing conditions, but they must comply with the Constitution.

Although Staff and APS indicate that even if the Commission finds that there is no emergency, the Commission could grant interim rates if it makes a fair value finding as well, we decline to adopt that approach or reach that conclusion in this case. Staff's alternative position seems designed to find a way to allow interim rates in the event that we believed that an emergency does not currently exist, but might in the near future. We prefer to use our broad discretion to determine what constitutes an "emergency" rather than to create a "mini rate case proceeding" using a temporary fair value finding.[84] We believe that under certain circumstances, an "emergency" could be found to exist when the absence of action would cause the emergency event(s) to occur. Accordingly, we decline to adopt interim rates based upon a temporary fair value finding.

[84] *See* Op. Att'y Gen. 71-17 at 15-16.

We cannot ignore the Court of Appeals' recent determination in *RUCO* that interim rate making requires an emergency situation, the posting of a bond, and a subsequent full rate case in order to meet the constitutional mandate that rates be just and reasonable. We find that there must be an "emergency" under the first exception above, and that we have the authority to evaluate the evidence on a case-by-case basis to determine whether an emergency exists.

The Attorney General Opinion discusses the criteria used to determine whether an emergency exists – when a sudden change brings hardship to a company, when the company is insolvent, or when the company's condition is such that its ability to maintain service while a rate case is pending is in serious doubt. Based upon the testimony and evidence presented at the hearing combined with the current economic climate and the Commission's broad authority to determine what constitutes an emergency or whether one is imminent, we find that an emergency exists in this case.

Arizona Attorney General Opinion 71-17 expresses clear guidelines for determining when an "emergency" declaration is appropriate. According to the criteria described in the Opinion, an emergency exists when "sudden change brings hardship to a company, when a company is insolvent or when the condition of the company is such that its ability to maintain service pending a formal rate determination is in serious doubt." See also *RUCO*, in which the court stated that "interim rate making requires... an emergency situation, the posting of a bond, and a subsequent full rate case-in order to comport with the constitutional mandate that rates be just and reasonable."[85]

It is clear that recent sudden changes have dramatically affected global credit markets, impacting the operation of companies nationwide. Events unfolding even as the hearing in this case began illustrate the magnitude of the ongoing economic crisis. On the first day of the hearing, September 15, 2008, Lehman Brothers declared bankruptcy.[86] At the hearing, APS stated that they would be unable to issue a planned $400 million equity issuance because the stock offering would have been below the book value of the Company.[87] Elsewhere, the record reflects news accounts describing the impending financial crunch, including one article entitled, "Ripple spreading in the

[85] *RUCO*, 199 Ariz. at 599, 20 P.3d at 1173.
[86] Tr. Vol. I, Page 130, lines 10-12.
[87] Tr. Vol. I, Page 66, lines 13-18.

financial crisis."[88] In sum, the record in this case reflects the extraordinary and uncertain economic times faced by consumers and businesses in Arizona and across the country.

Given the recent state of the economy, and absent near-term rate relief, APS' bonds could be downgraded from investment to non-investment grade, which could bar the Company from accessing the credit markets, or make the procurement of credit prohibitively expensive.[89] In response to a letter from a Commissioner requesting information regarding the cost impact associated with a bond downgrade, APS filed exhibits demonstrating that such a downgrade to "junk bond" territory would result in higher financing costs across all categories of Company debt, totaling $1 billion of additional costs over the next 10 years.[90] Almost as troubling as the financial impact to APS and its customers associated with a credit downgrade or inability to access credit markets, is the likelihood that such a status could seriously impair APS' ability to continue to build critical electric infrastructure and to deploy the next generation of renewable energy projects in Arizona. APS has assured the Commission that if interim rates are implemented, the earnings generated "would be reinvested in infrastructure and technology necessary to serve APS customers and reduce the need for external debt financing."[91]

This Commission expects the Company to be a major participant in renewable energy and transmission projects throughout its service territory, most of which will only come to fruition if the Company remains a credit-worthy counterparty to the developers of these projects. APS will also be required to invest significantly in traditional forms of energy generation to meet its expected load growth, as APS requires 5,000 megawatts of new resources by 2020. Despite these energy needs, APS has indicated that it will cut or postpone $500 million of spending from its capital expenditure budget over the next four years and has cut its operations and maintenance budget by $50 million. Therefore, in light of the requirement that APS continue to build new infrastructure and be a leader nationally in the production of renewable energy, we believe that the Company's ability to maintain

---

[88] Tr. Vol. II, Page 416, line 17.
[89] See October 17, 2008 APS Response to an October 8, 2008 letter from Commissioner Mayes.
[90] See pages 4 and 13, APS Exhibit 1, as noted in response to an October 3, 2008 letter from Commissioner Gleason.
[91] See APS' June 6, 2008 Motion, p. 6.

the quality of service mandated by the Commission is in serious doubt under the imminent threat of a credit downgrade.

While we find that APS is experiencing an emergency, we wish to make it clear that we strongly disagree with APS that emergency or interim rate increases can be routinely implemented. We believe emergency rate increases should be sparingly utilized, and reserved for the most perilous situations.

The second exception to the constitutional requirement that fair value must be considered in setting just and reasonable rates is the *Mountain States* case where a Commission decision to not grant a rate increase was appealed and the Superior Court found that the Commission had failed to find the fair value of the company's property; that the previous rates did not provide a fair and reasonable return on the company's property and resulted in the confiscation of the company's property; and that pending the Commission's determination of just and reasonable rates, the company must post a bond in order to put into effect temporary rates. The Commission appealed the judgment, arguing that the court had no authority to allow the company to put interim rates into effect. The Supreme Court stated that:

> The sole question, therefore, before this court is one of jurisdiction, for in view of the fact that the record showed the commission had failed for nine months after the company had applied for relief to grant any, and that the trial court had reasons to believe such a situation would continue for an unreasonable time and in fact has continued for almost a year *after* judgment, it is obvious that unless in *some manner* there was immediately established a temporary rate which the company might collect it would have been compelled long since either to operate for an indefinite time with insufficient revenue or to suspend operations during this period, with consequences to business and society in Arizona truly appalling.[92]

The parties' reliance on *Mountain States* as broad support for allowing interim rates absent an emergency is misplaced. The case does not say, as some have implied, that whenever the Commission's normal ratemaking process would not be completed in a reasonable time, the utility has a right to interim rates. The procedural posture of the case involved a determination by a court

[92] *Mountain States* at 71 Ariz. At 408, 228 P.2d at 751.

that the utility's rates were "confiscatory" and that the Commission had not determined fair value. The court sent the case back to the Commission for rate setting in compliance with the court's finding and allowed interim rates after a period of time when the Commission still had not set rates pursuant to the court's decision. The case involved the jurisdictional issue of whether a utility could implement rates after a court had made a determination that rates were unlawful. It did not establish precedent that a utility could implement interim rates due to a belief that the normal ratemaking process would not be completed in a reasonable time.

No determination has been made here by the Commission or a court that current rates and charges are not just and reasonable; therefore, *Mountain States* provides no basis for the implementation of interim rates in this matter. Even if *Mountain States* were interpreted to allow interim rates without an emergency, we do not agree that this pending rate case will not be resolved within a reasonable time. APS has not ignored its obligation to be aware of its earnings, as it has appropriately filed a rate application when it believed that its earnings were insufficient. However, until the parties have audited, analyzed, and verified the data presented by APS, no determination can be made of whether APS is entitled to a rate increase. The rate case application is being processed in accordance with the Commission's adopted timeclock rules, and to date, no requests to extend or delay that process have been made or granted. Further, unlike APS' previous rate cases, this proceeding is not consolidated with other dockets involving substantial additional issues. And to the extent that it is possible, APS and the parties are free to discuss whether agreement can be reached on some or all of the rate case issues, thereby potentially reducing the time needed for hearing and decision. Finally, APS should continue to monitor its financial condition and take steps when necessary to insure that it remains financially strong. Our direction to APS in Decision No. 68685 (May 5, 2006) remains appropriate today:

> However, APS should also look for ways to improve its cash flow, even looking at expenses that are borne by shareholders and not ratepayers, especially when credit rating agencies are focusing on its FFO/Debt ratio. Accordingly, while we are not imposing restrictions on APS dividend payouts or dictating that certain expenses be eliminated in this proceeding, we expect APS to manage its operations in such a manner (including its generation assets) that with the relief

> granted herein, together with the measures that APS itself adopts, its business profile returns to 5, its FFO/Debt ratio continues to improve and its credit rating remains investment grade.[93]

It is not clear why, after more than two years during which we have granted an interim rate increase, modifications to the PSA, a transmission cost adjustor, a permanent rate increase, and other measures, APS is still having problems maintaining its FFO/Debt ratio.

The final exception to the constitutional requirement that rates consider fair value and be just and reasonable is the adjustor mechanism. APS' request cannot be considered a "surcharge" under the adjustment clause exception. The court stated in *RUCO*:

> The surcharge in this case is not the product of an automatic adjustment clause that existed before Rio Verde filed its application for a surcharge, nor does the record reflect the existence of an automatic adjustment clause. We agree with the court in *Scates*, and we acknowledge our concern for "piecemeal" rate making as being "fraught with potential abuse." *Id.* at 534, 578 P.2d at 615.
>
> Here, the Commission argues that the surcharge at issue can be fairly classified as an automatic adjustment, with no showing that an automatic adjustment was ever contemplated or that a clause was ever approved. The Commission appears to argue that it can *sua sponte* declare a rate increase based on an increase in the cost to a utility of a specific operating expense under the guise of an automatic adjustment without there having been consideration or approval of an automatic adjustment clause. Such an *ipse dixit* approach not only offends the *Scates* court's concerns about piecemeal rate making, but it also offends the constitutional mandate that rates be fair and reasonable and made in the context of a fair valuation of all of a utility's assets. *See* Ariz. Const. art. 15, § 3. If ever there was a situation "fraught with potential abuse," *Scates*, 118 Ariz. at 534, 578 P.2d at 615, it occurs when the Commission of its own volition has the ability to declare any rate increase an "automatic adjustment."[94]

APS' Motion requested that the amount of the expiring PSA surcharge be implemented as an "Interim Base Rate Surcharge." Such an Interim Base Rate Surcharge would collect an increase in base rates and increase APS' earnings. As the *Scates* court explained, adjustor mechanisms have been upheld because:

> The clauses are initially adopted as part of the utility's rate structure in

[93] Decision No. 68685 at 29.

[94] *RUCO* 199 Ariz. at 593, 20 P.3d at 1174.

> accordance with all statutory and constitutional requirements and, further, because they are designed to insure that, through the adoption of a set formula geared to a specific readily identifiable cost, the utility's profit or rate of return does not change.[95]

Here, it is clear that the surcharge requested was not adopted in a rate case and accordingly, it does not qualify as an exception to the constitutional fair value finding requirement.

As discussed by Arizona courts, our ratemaking authority is sufficiently broad to enable us to grant relief tailored to many different situations. "In some situations, that may be to grant emergency rate relief, and in other situations, the circumstances or public interest may require other forms of relief."[96]

In Decision No. 68685, we noted that "APS' existing rate structure already has incorporated one exception to the constitutional fair value finding requirement in the form of the PSA mechanism."[97] We are cognizant of the recent turmoil in the financial markets, of the state of the economy in general,[98] and of the risk that a downgrade to non-investment grade credit rating could have on APS and its ratepayers. We agree that it is in the long-term best interests of APS and its customers that APS have access to capital at attractive rates in order to fund needed future plant at a reasonable cost. As discussed above, it is not clear why APS continues to claim it cannot maintain its FFO/Debt ratios. To a large extent, this is within APS' control – it can monitor its cash, adjust its expenditures, and seek an equity infusion when needed and appropriate. However, it is also apparent that APS' FFO/Debt ratio may decline while the rate case is pending, increasing the risk that it will be downgraded.

Based on the above we find that Staff's alternative determination of an increase of $65.2 million is reasonable and appropriate. This will result in a surcharge of $0.00226 per kWh. This will increase the average APS residential customer's bill by $1.99 per month in the summer and $1.46 per month in the winter. The emergency interim surcharge will be subject to refund with interest at 10 percent per annum pending a decision in APS' permanent rate case.

---

[95] *Scates* 118 Ariz. at 535, 578 P.2d at 617.
[96] Decision No. 68685 at 23.
[97] *Id.*
[98] Some indicators suggest that the country is facing or in a recession.

Because the consequences of a downgrade to junk status would negatively impact the rates paid by ratepayers, we believe additional steps could be taken, consistent with the law, to improve APS' cash flow in the short-term while we determine the reasons why APS is apparently continually unable to sustain the desired FFO/Debt ratio. The current PSA has a 90/10 sharing provision that diminishes APS' cash flow because APS is unable to collect ten percent of the purchased power and fuel costs that it incurs above base rates. In APS' last rate case we maintained that provision in order to provide APS incentive to acquire the most economical resources. The results of the recent fuel audit confirm that APS has managed its resource acquisitions appropriately. Recognizing that it is to the long-term benefit of Arizona and APS customers for APS to maintain a healthy financial condition, as the costs for future plant, generation, materials, capital, and service will be affected by APS' ability and cost to access the financial markets, we would be willing to address any appropriate motion or request pursuant to A.R.S. § 40-252 to modify the PSA to eliminate the 90/10 sharing until the permanent rate case where we could evaluate and resolve whether the sharing mechanism is causing or significantly contributing to the FFO/Debt ratio decline. In the rate proceeding we expect the parties to address this issue and to recommend whether the same or another sharing mechanism or other such incentive should be adopted as part of the PSA on a going forward basis. Although this PSA modification would have only a small positive effect on APS' cash flow and its FFO/Debt ratio, our willingness to consider it demonstrates that we are monitoring APS' financial condition and are ready to take appropriate measures to address the risks that APS and its customers are facing.

We also find that in the pending general rate case, APS should also present an analysis of what steps it has taken to improve its FFO/Debt ratio and why, after the Commission has implemented a forward looking PSA, a transmission cost adjustor, an environmental improvement surcharge, new base rates, and other measures, APS cannot improve and sustain that financial ratio. As part of this analysis, APS should present information regarding steps that have been taken, or may be taken in the future, to reduce costs (without diminishing service quality) and thereby increase available cash, including items such as dividend reductions, elimination of management bonuses, and other measures that would require stockholders to share the burden with ratepayers. Finally, we expect APS and Pinnacle West to closely monitor APS' financial condition and to take the steps necessary to maintain its investment grade credit rating.

* * * * * * * * * *

Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

1. APS is a public service corporation principally engaged in furnishing electricity in the State of Arizona. APS provides either retail or wholesale electric service to substantially all of Arizona, with the major exceptions of the Tucson metropolitan area and about one-half of the Phoenix metropolitan area. APS also generates, sells, and delivers electricity to wholesale customers in the western United States.

2. On March 24, 2008, APS filed with the Commission an application for a rate increase.

3. On April 2, April 8, and April 14, 2008, Kroger, AECC, and Mesquite/SWPG/Bowie, respectively, filed Motions to Intervene.

4. On April 30, 2008, the Town of Wickenburg filed a Motion to Intervene.

5. On April 25 and May 19, 2008, by Procedural Orders, the Motions to Intervene were granted.

6. On June 2, 2008, APS filed an Amended Application.

7. On June 6, 2008, APS filed a Motion for Approval of Interim Rates and Preliminary Order and requested a procedural conference be scheduled. In its Motion, APS requested the Commission approve an "Interim Base Rate Surcharge" of $.003987 per kWh to be effective upon the expiration of the $.003987 per kWh 2007 Power Supply Adjustor charge granted in Decision No. 69663.

8. On June 13, 2008, a Procedural Order was issued scheduling a procedural conference on APS' Motion. Also on June 13, 2008, WRA/SWEEP filed a Petition for Leave to Intervene.

9. On June 16, 2008, RUCO filed an Application to Intervene.

10. On June 19, 2008, AIC filed a Motion to Intervene.

11. On June 19, 2008, the procedural conference was held as scheduled. Intervention was granted to WRA/SWEEP, RUCO, AIC, and the Az-Ag Group. The parties were directed to meet and

discuss the Motion to see if there could be agreement on the procedural timeframes for the actions requested by APS in its Motion and whether the parties could reach any other agreements. The parties were directed to file either a joint recommendation or separate recommendations by June 30, 2008.

12. On June 30, 2008, the parties filed a Recommended Procedural Schedule.

13. On July 16, 2008, a Procedural Order was issued scheduling a hearing on the Motion for Interim Rates to commence on September 15, 2008, and establishing associated procedural requirements and deadlines; setting a public comment session and procedural conference for September 11, 2008; and setting dates for the prefiling of witness testimony.

14. On July 23, 2008, the Hopi Tribe filed a Motion to Intervene, which was granted by Procedural Order issued on August 4, 2008.

15. On July 29, 2008, a Procedural Order was issued scheduling the hearing on the permanent rate case to commence on April 2, 2009.

16. On August 6, 2008, APS filed proof of publication of notice of hearing in compliance with the July 16, 2008, Procedural Order.

17. On September 16, 2008, Commissioner Mayes docketed a letter requesting the parties to address various issues during the hearing.

18. The public comment session and evidentiary hearing were held as scheduled, with the hearing concluding on September 20, 2008. APS presented testimony from William Post, Donald Brandt, Charles Cicchetti, and David Rumolo. AECC presented testimony from Kevin Higgins, RUCO presented testimony from Stephen Ahearn, and Staff presented testimony from Ralph Smith and David Parcell.

19. On September 26, 2008, APS filed its late-filed Exhibit 22.

20. On October 3, 2008, Chairman Gleason docketed a letter concerning the cost to ratepayers if APS' credit rating falls to junk and asking APS to respond.

21. The Commission has received substantial public comment concerning the request for an Interim Base Rate Surcharge.

22. Initial Closing Briefs were filed by APS, AIC, AECC, Mesquite, RUCO, and Staff on

October 3, 2008, and Reply Briefs were filed by APS, AIC, AECC, RUCO, and Staff on October 8, 2008.

23. On October 9, 2008, APS responded to Chairman Gleason's letter.

24. On October 14, 2008, APS filed its late-filed Exhibit 23.

25. The pending general rate case is being processed in compliance with the Commission's timeclock rules and no requests for delay have been requested or granted.

26. APS' requested Interim Base Rate Surcharge is not part of an adjustor mechanism adopted in a permanent rate case where fair value was considered.

27. Given the current market conditions and the indication that the country is facing a recession we find that an emergency exists, therefore, it is reasonable to adopt the level of Staff's alternative emergency interim rate increase and to monitor APS' ability to access capital at reasonable terms in the short-term and to acknowledge that steps should be taken to ensure that APS is financially healthy in the long-term, for the future of Arizona and APS ratepayers.

28. APS has not articulated why it is fair or appropriate to routinely require ratepayers to pay interim rate increases while permanent rate cases are being processed, but not to require a utility to file for interim rate relief to decrease its rates when it is over earning.

29. It is not appropriate to create the opportunity to allow APS to seek non-emergency interim rate increases while a general rate case is pending, because there is no concomitant obligation on APS to file a general rate case when it is over earning, thereby not affording ratepayers the same opportunity for interim rate relief that APS seeks for itself.

30. The Commission has the ability to determine what constitutes an emergency under state law, has exercised that ability in previous Commission decisions, and there is no reason to craft or invoke another exception to the constitutional requirement.

31. APS' existing rate structure already has incorporated one exception to the constitutional fair value finding requirement, in the form of the PSA mechanism, which was established to address the timely recovery of fuel and purchased power costs.

32. APS' cash flow is diminished by the 90/10 sharing provision in the PSA.

33. Given APS' assertion that its future cash flow will be insufficient to maintain a

FFO/Debt ratio necessary for investment-grade rating, APS should take any necessary and appropriate steps, consistent with the law, to improve its cash flow in the short-term.

34. The issues of whether a PSA sharing provision is appropriate for the future and whether such provisions cause or significantly contribute to a decline in the FFO/Debt ratio, should be addressed by the parties in the pending rate case.

35. We recognize that it is to the long-term benefit of Arizona and APS customers for APS to maintain a healthy financial condition, as the costs for future plant, generation, materials, capital, and service will be affected by APS' ability and cost to access the financial markets.

36. The discussion in Decision No. 68685 focusing on APS' need to take steps to manage and improve its cash flow remains critical and important today, and we again find that APS and Pinnacle West must take steps to insure that APS' financial ratios remain investment grade.

37. We find that in the pending general rate case, APS should present an analysis of what steps it has taken to improve its FFO/Debt ratio and why, after the Commission has implemented a forward looking PSA, a transmission cost adjustor, an environmental improvement surcharge, new base rates, and other measures, APS cannot improve and sustain that financial ratio. The analysis shall also include information regarding steps that have been taken, or may be taken in the future, to reduce costs (without diminishing service quality) and thereby increase available cash, including items such as dividend reductions, elimination of management bonuses, and other measures that would require stockholders to share the burden with ratepayers.

38. We find that APS should file monthly reports on its and Pinnacle West's cash position and financial ratios, including their projected cash flows, until the pending general rate proceeding is resolved, and that Staff should monitor such filings in the pending general rate proceeding.

39. While APS has stated that it has responded to its current fiscal condition by postponing $500 million in capital expenditures over the next four years, and has cut $50 million from its operations budget, the Company has resisted additional cost savings measures, as outlined in a response to an inquiry from a Commissioner asking APS to detail its cost savings activities.[99]

[99] These figures were provided to the Commission in this docket in response to a November 19, 2008 letter from Commissioner Mayes.

40. In light of the fact that APS is experiencing an emergency for the second time since 2006, and is requesting that its customers pay additional rates prior to a complete investigation by this Commission of the prudency of the investments underlying its proposed permanent rate increase, we believe that it is in the public interest to require the Company to more closely scrutinize its operations and expenses and make additional cuts to these areas of its budget. We believe that the amount of budget cuts APS should target is at least $20 million (annualized pre-tax), or 2.6 percent below its 2007 test year operating and maintenance expense. Adopting these measures provides an additional avenue for APS to improve its finances. Specifically, we believe APS should make use of several easily identifiable short term measures, to further buttress its finances and protect ratepayers until its pendant full rate case is completed. We decline to declare precisely how those cuts should be made, but find that the Company should consider cutting back its lobbying and advertising expenditures, paring back management compensation for 2009, imposing a temporary hiring freeze for all non-essential personnel, examining payroll overhead and implementing a freeze on increases to its dividend, among other measures. Such steps would be similar to those taken by corporations throughout the United States facing emergencies during these difficult economic times. Given its request for an emergency rate increase, we find that APS should be prepared to adjust its practices from business as usual to appropriately reflect the severity of the emergency it has identified. Further, the Company should file a report detailing the cost saving measures taken and associated savings achieved in this Docket no later than March 18, 2009, for Commission review.

41. In this proceeding, APS has consistently pointed to its financial metrics as demonstrative of the Company's deteriorating condition. Because APS' finances have been made a central issue in this proceeding, we believe it is necessary that APS better inform this Commission of its interactions with credit ratings agencies. Accordingly, APS should be required to file all communications between APS/Pinnacle West personnel/representatives and the representatives of credit ratings agencies, including notes, emails, phone messages, presentations (inclusive of memos and PowerPoint), and meeting notes, and that APS should memorialize the substance of any meetings and phone calls between APS and ratings agency representatives, effective the date the Commission votes on this Order. APS shall file all such communications as a compliance item in this docket, until

the conclusion of its general rate case, and thereafter, with Docket control every six months, beginning January 1, 2010.

CONCLUSIONS OF LAW

1. APS is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. §§ 40-203, -204, -221, -250, -251, and -361.

2. The Commission has jurisdiction over APS and Pinnacle West and the subject matter of the application.

3. Notice of the application was provided in accordance with the law.

4. An emergency exists which warrants the implementation of emergency rates at this time.

5. APS' current rates are not confiscatory.

6. The Motion for an Interim Base Rate Surcharge should be approved as discussed herein.

ORDER

IT IS THEREFORE ORDERED that Arizona Public Service Company is hereby granted an emergency interim base rate surcharge of $0.00226 per kwh that shall become effective with all bills issued after December 31, 2008.

IT IS FURTHER ORDERED that the emergency interim base rate surcharge is subject to refund with interest at 10 percent per annum pending a decision in APS' permanent rate case.

IT IS FURTHER ORDERED that this surcharge shall not apply to E-3 and E-4 low income customers, E-36 customers, and the solar rate schedules Solar-2 and SP-1.

IT IS FURTHER ORDERED that Arizona Public Service Company shall notice all its customers, in a form acceptable to Staff, of this surcharge by December 31, 2008.

IT IS FURTHER ORDERED that Arizona Public Service Company shall post a $10 million bond or sight draft letter of credit and provide the original to the Commission's Business Office and file copies in Docket Control as a compliance item in this Docket, prior to December 31, 2008, and such bond or sight draft letter of credit shall remain in effect until a final order is issued by the Commission in Arizona Public Service Company's pending permanent rate case.

IT IS FURTHER ORDERED that Arizona Public Service Company shall file monthly reports on Arizona Public Service Company's and Pinnacle West Capital Corporation's cash position and financial ratios, including their projected cash flows, until the pending general rate proceeding is resolved.

IT IS FURTHER ORDERED that Staff shall monitor such filings in the pending general rate proceeding.

IT IS FURTHER ORDERED that in the pending general rate case, Arizona Public Service Company shall present an analysis of what steps it has taken to improve its FFO/Debt ratio and why, after the Commission has implemented a forward looking PSA, a transmission cost adjustor, an environmental improvement surcharge, new base rates, and other measures, Arizona Public Service Company cannot improve and sustain that financial ratio. The analysis shall also include information regarding steps that have been taken, or may be taken in the future, to reduce costs (without diminishing service quality) and thereby increase available cash, including items such as dividend reductions, elimination of management bonuses, and other measures that would require stockholders to share the burden with ratepayers.

IT IS FURTHER ORDERED that in the pending general rate case, the parties shall address the issues of whether a PSA sharing provision is appropriate for the future and whether such provisions cause or significantly contribute to a decline in the FFO/Debt ratio.

IT IS FURTHER ORDERED that Arizona Public Service Company and Pinnacle West Capital Corporation shall take appropriate steps to insure that Arizona Public Service Company's financial ratios remain investment grade.

IT IS FURTHER ORDERED that Arizona Public Service Company shall examine its operations and expenses and employ short term measures to further buttress its financial position. Arizona Public Service Company shall target additional cuts to its operations and expenses of at least $20 million, or 2.6 percent below its 2007 test year operations and maintenance expense. Arizona Public Service Company shall consider items such as cutting back its lobbying and advertising expenditures, paring back management compensation for 2009, imposing a temporary hiring freeze for all non-essential personnel, examining payroll overhead and implementing a freeze on any increases to its dividend in 2009, among other possible measures.

IT IS FURTHER ORDERED that Arizona Public Service Company shall file a report with the Commission's Docket Control as a compliance item in this docket, detailing the cost cutting measures taken and associated savings, no later than March 18, 2009 for Commission review.

IT IS FURTHER ORDERED that APS shall reinvest the earnings resulting from the additional interim base rate surcharge and any monies achieved from cost savings measures taken pursuant to this Order, in infrastructure and technology necessary to serve APS customers and reduce the need for external debt financing.

IT IS FURTHER ORDERED that APS shall file all communications between Arizona Public Service Company/Pinnacle West Capital Corporation personnel/representatives and the representatives of credit ratings agencies, including notes, emails, phone messages, presentations (inclusive of memos and PowerPoint), and meeting notes.

IT IS FURTHER ORDERED that Arizona Public Service Company shall memorialize the substance of any meetings and phone calls between Arizona Public Service Company/Pinnacle West Capital Corporation personnel/representatives and ratings agency representatives, for past communications and on an ongoing basis, effective the date the Commission votes on this Order.

. . .

. . .

. . .

. . .

. . .

. . .

. . .

. . .

. . .

. . .

. . .

IT IS FURTHER ORDERED that Arizona Public Service Company shall file all such communications as a compliance item in this Docket. Arizona Public Service Company shall file all currently existing communications within 10 days of the effective date of this Decision and shall file future communications on a monthly basis. The first such monthly report shall be due on February 1, 2009, and the monthly filing shall continue until the conclusion of Arizona Public Service Company's general rate case. Thereafter, Arizona Public Service Company shall make such filings on a six month basis, with the first filing due by January 1, 2010.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN COMMISSIONER

COMMISSIONER COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 24th day of Dec., 2008

BRIAN C. McNEIL
EXECUTIVE DIRECTOR

DISSENT

DISSENT ____________________

SERVICE LIST FOR: ARIZONA PUBLIC SERVICE COMPANY

DOCKET NO.: E-01345A-08-0172

Thomas Mumaw
ARIZONA PUBLIC SERVICE COMPANY
P.O. Box 53999
Phoenix, AZ 85072-3999

Michael L Kurtz
Kurt J. Boehm
BOEHM, KURTZ & LOWRY
36 East Seventh Street, Suite 1510
Cincinnati, OH 45202
Attorneys for The Kroger Company

C. Webb Crockett
Patrick J. Black
FENNEMORE CRAIG P.C.
3003 North Central Avenue, Suite 2600
Phoenix, AZ 85012-2913
Attorneys for Freeport-McMoRan Copper & Gold, Inc. and AECC

Lawrence V. Robertson, Jr.
ATTORNEY AT LAW
P.O. Box 1448
Tubac, AZ 85646
Attorney for Mesquite/SWPG/Bowie

Michael A. Curtis
William P. Sullivan
CURTIS, GOODWIN, SULLIVAN, UDALL & SCHWAB, P.L.C.
501 East Thomas Road
Phoenix, AZ 85012-3205
Attorneys for the Town of Wickenburg

Timothy M. Hogan
ARIZONA CENTER FOR LAW IN THE PUBLIC INTEREST
202 East McDowell Road, Suite 153
Phoenix, AZ 85004
Attorney for Western Resource Advocates and Southwest Energy Efficiency Project

Daniel Pozefsky, Chief Counsel
RESIDENTIAL UTILITY CONSUMER OFFICE
1110 West Washington Street, Suite 220
Phoenix, AZ 85007

Michael M. Grant
GALLAGHER & KENNEDY
2575 E. Camelback Road
Phoenix, AZ 85016-9225
Attorneys for Arizona Investment Council

Gary Yaquinto
ARIZONA INVESTMENT COUNCIL
2100 North Central Avenue, Suite 210
Phoenix, AZ 85004

Jay Moyes
Karen E. Nally
MOYES STOREY
1850 N. Central Ave., Suite 1100
Phoenix, AZ 85004-0001
Attorneys for Az-Ag Group

Jeffrey J. Woner
K.R. SALINE & ASSOC., PLC
160 North Pasadena, Suite 101
Mesa, AZ 85201

Scott Canty, General Counsel
THE HOPI TRIBE
P.O. Box 123
Kykotsmovi, AZ 86039

Cynthia Zwick
1940 E. Luke Ave
Phoenix, AZ 85016

Nicholas J. Enoch
LUBIN & ENOCH, P.C.
349 N. Fourth Avenue
Phoenix, AZ 85003
Attorney for IBEW Locals 387, 640 and 769

Janice Alward, Chief Counsel, Legal Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007-2927

Ernest Johnson, Director, Utilities Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, Arizona 85007-2927

McGill, James T(Z71171)

From: Bettinelli, Antonio [Antonio_Bettinelli@standardandpoors.com]
Sent: Wednesday, January 07, 2009 11:32 AM
To: McGill, James T(Z71171)
Subject: RE: Request

Thanks.

-----Original Message-----
From: James.MCgill@pinnaclewest.com [mailto:James.MCgill@pinnaclewest.com]
Sent: Tuesday, January 06, 2009 12:55 PM Eastern Standard Time
To: Bettinelli, Antonio
Subject: RE: Request

From: Bettinelli, Antonio [mailto:Antonio_Bettinelli@standardandpoors.com]
Sent: Wednesday, December 31, 2008 11:02 AM
To: McGill, James T(Z71171)
Subject: Request

Jim,

Would you please send me the entire final order for the interim rate request? Thanks.

Regards,
Tony

McGill, James T(Z71171)

From: Bettinelli, Antonio [Antonio_Bettinelli@standardandpoors.com]
Sent: Thursday, January 08, 2009 2:20 PM
To: McGill, James T(Z71171)
Subject: FW: S&P Liquidity Survey Request
Attachments: Liquidity Survey Template version 2006 01.xls; Comprehensive Liquidity Survey 2006 Version1 modified.doc

Jim,

Were you able to update the liquidity survey? I may have missed it. Thanks.

Tony

From: Bettinelli, Antonio
Sent: Monday, December 15, 2008 12:28 PM
Subject: S&P Liquidity Survey Request

We are currently reviewing S&P liquidity metrics for all issuers and require an updated liquidity survey based on your Nov. 30, 2008 positions. Please return the survey on or before Dec 31. I've attached the template and instructions. Feel free to contact me if you have any questions. Thanks in advance.

Regards,

Tony Bettinelli
Associate

U.S. Utilities & Infrastructure
Standard & Poor's Corporate Ratings
One Market St.
Steuart Tower, 15th Floor
San Francisco, CA 94105-1000
(415) 371-5067 Fax: (415) 371-5090
tony_bettinelli@sandp.com

S&P LIQUIDITY SURVEY (Version 2006 09)

Company:
Date (data as of)

Section I - Sources of Primary Liquidity		**Amount (millions $)**
Question A1	Total Unrestricted Cash	
Question A2	Availablity under committed bank lines (cash and LOC)	
Question A3	Trade collateral posted (cash and LOC) [a]	[a]
Question A4	Market value of discretionary inventory [b]	[b]
Question A	**Total Primary Liquidity (A1+A2+A3+A4)**	0
Question A7	Collateral received from counterparties (cash only)	

Section II - Credit Event Liquidity Calls		Underlying exposure
Question B1	Negative MTM related to credit thresholds	
Question B2	Negative MTM related to adequate assurance	
Question B3	Estimated 60-Day Exposure	
Question B	Net Exposure (net as allowed by contractural terms)	May not eq
Question C	Static Margin	
Question D	Triggers on loans & contracts	
Question E	Commercial Paper outstanding	
	Total Credit Event Exposure (B+C+D+E)	0
CELA Ratio	Credit Event Liquidity Adequacy (A/(B+C+D+E))	**#DIV/0!**

Section III- Credit and Market Event Liquidity Calls		Line 31 after Stress
Question F1	Neg MTM given a Credit Event + 15% price ***increase*** in 1st yr and 20% thereafter	
Question F2	Neg MTM given a Credit Event + 15% price ***decrease*** in 1st yr and 20% thereafter	
Question F	Take larger F1 or F2	0
MCELA Ratio	**Total Market and Credit Event Liquidity Adequacy (A/(C+D+E+F))**	**#DIV/0!**

Section IV - Monthly Volume (realized physical sales and purchases)

Question G1	Natural Gas (mmbtu) Purchases	
Question G2	Natural Gas (mmbtu) Sales	
Question G3	Power (MWh) Purchases	
Question G4	Power (MWh) Sales	
Question G5	Crude Oil (bbl) Purchases	
Question G6	Crude Oil (bbl) Sales	
Question H	Baseline Henry Hub Average One-Year Forward Price of Gas used for this survey ($/MMBtu)?	
Question I	Absent a credit event and assuming a parallel shift of the entire forward curve, how high/low must the average one-year forward price of gas (Henry Hub) move before your company exhausts all sources of primary liquidity reported in Question A? Please consider both the effect of addtional margin calls as well as other working capital items. [c]	[c]

Notes:

(a) Exclude cash collateral posted to back LCs.

(b) Gas inventory used for arbitrage trading will be considered a source of primary liquidity as long as the inventory is not pledged as security under the terms of an existing bank line.

(c) Assume that power and oil prices move in proportion to gas prices. Cash collateral from counterparties should NOT be counted as a source of primary liquidity.

Survey to Assess Liquidity Requirements Related to Credit and Market Events

---

Background

Introduction

In this survey, Standard & Poor's is concerned with liquidity demands generated by the trading/marketing of energy products, particularly under two stress scenarios:

- A dramatic decline in credit quality ("credit event")
- A severe price movement in commodity prices ("market event")

The survey applies to your company as a consolidated entity. Although the survey targets the liquidity demands of trading operations, Standard & Poor's views liquidity on a consolidated basis. Therefore, when filling out the survey, please account for all potential sources of collateral calls, whether they are generated from unregulated subsidiaries, regulated subsidiaries or joint ventures.

If your trading operation has a stand-alone rating or if the sources and uses of some of your subsidiaries should be viewed separately from the consolidated entity, contact Standard & Poor's to discuss your particular situation.

Ratio Definitions:

CELA (Credit Event Liquidity Adequacy):

$$\frac{\text{Primary Liquidity}}{\text{Liquidity Demands During a Severe Downgrade without Price Stress.}}$$

MCELA (Market and Credit Event Liquidity Adequacy):

$$\frac{\text{Primary Liquidity}}{\text{Liquidity Demands During a Severe Downgrade with Price Stress*}}$$

* This will include Negative MTM and 60-Day Exposure given a 15% movement in the forward curve for the 12 month strip and a 20% movement beyond the 12 month strip plus potential collateral calls related to static margin, triggers on loans and contracts, and commercial paper outstanding.

Standard & Poor's believes that investment-grade companies should maintain enough liquidity to address a scenario in which there is a crisis of confidence in the company's financial condition and, at the same time, a 15%/20% adverse movement in power and oil/gas prices. A shortfall from this guideline is just one factor in the overall ratings analysis. However, the degree and magnitude of such a shortfall could have negative ratings implications.

Available Liquidity

QUESTION A. – What is your primary liquidity?

Primary liquidity includes unrestricted cash on hand, unused committed credit facilities, collateral posted, and discretionary inventory.

Cash held as collateral

Cash held as collateral from counterparties, for the purpose of this survey, should be considered restricted cash and should not be considered a source of liquidity. Standard & Poor's believes that cash held as collateral may or may not be available when a company's credit profile is deteriorating quickly. Counterparties usually have the flexibility of requiring the cash collateral to be placed in an escrow account or replace the cash collateral with a letter of credit.

Collateral Posted

Cash that is posted to back outstanding letters of credit should not be included as a primary source of liquidity. Because collateral is added back to available liquidity, please remember to report gross exposures in Questions B so that we avoid double counting.

Discretionary Inventory

Oil and gas inventory that is used for arbitrage trading purposes and that you can easily and quickly sell is considered a source of primary liquidity. *Please exclude inventory that is pledged as collateral under the terms of an existing bank line.*

Supplemental questions related to available liquidity

1. What is your total unrestricted cash on hand?
2. What level of unrestricted cash do you plan to maintain over the next 12 months?
3. How much of your receivables have been factored into cash or sold to generate cash?
4. How much cash collateral have you collected from your counterparties and do you consider this to be unrestricted cash?
5. Do you expect to use your revolving facilities to finance construction projects or as bridge loans to long-term debt?
6. List all credit lines and, for each credit line, provide the following descriptions:
   - Total facility amount and maturity date
   - Type of facility (i.e., 364-day revolver, 3-yr revolver or bilateral loan)
   - Issuing entity, obligor, guarantor, co-guarantor (clarify if different)
   - How much of the facility can be drawn as cash and how much as letters of credit?

- What is the current availability and usage under the line (in cash)?
- What is the current availability and usage under the line (in letters of credit)? Is this a committed or uncommitted credit line?
- Does the credit line have a MAC clause?
- Does the facility have a security interest or springing security interest? If yes, what is the security interest and what is the springing mechanism?

Liquidity Demands

Standard & Poor's has identified five major sources of potential calls on liquidity in the event of severe credit deterioration:

- Negative MTM exposure
- 60-day exposure
- Increase in static margin
- Triggers in loans and contracts
- Commercial paper

QUESTION B. What are your liquidity demands related to negative MTM and 60-day exposure?

What is negative MTM exposure?

The easiest way to think about this is to remember that each contract has either a positive or negative market value. Contracts with positive value are "in-the-money" contracts and have a positive mark-to-market (MTM). Contracts with negative value are "out-of-the-money" and have a negative MTM value.

Because companies may be able to reject their out-of-the-money contracts in a bankruptcy, counterparties may request collateral equal to the negative MTM portion of a contract.

What is 60-day exposure?

Companies with speculative ratings may have to post collateral for their payables to eliminate the collection risk faced by their counterparties. To completely offset the risk to counterparties, the collateral would be equivalent to the difference between accounts payable and accounts receivable. In effect, the company has to prepay its purchases prior to physical delivery, less any sales to the same counterparty for that month.

Standard & Poor's uses a company's estimated net 60-day AR/AP exposure as a proxy for the potential increase in liquidity need in a downgrade event. Companies should report the 60-day exposure (the current month plus the previous month), even though the actual AR/AP exposure as of that date of reporting may be less than 60 days.

How to aggregate Negative MTM and 60-day exposure

Negative MTM exposure should be aggregated on a contract-by-contract basis. Since only contracts with negative value are relevant, the total exposure is a sum of the negative exposures.

60-day exposure (see above section for details) should also be aggregated on a contract-by-contract basis. Similar to negative MTM exposure, exposure is relevant only when there is a deficit. As a result, the total exposure reflects the sum of all the negative exposures.

If a contract allows MTM to be netted against A/R and A/P, the total negative exposure should be aggregated on a contract-by-contract basis and the total exposure should still reflect the sum of the negative exposures of each individual contract. But the value of the contract is determined after netting MTM and AR/AP.

If the A/R is being used as collateral to back a credit line, it should not be counted again as available to offset A/P or negative MTM exposure.

Is exposure calculated as net of collateral posted?

No, do not calculate exposure as net of collateral posted. We are interested in the underlying exposure. Moreover, posted collateral is added back to available liquidity in our liquidity adequacy calculations.

How do master netting agreements affect exposure?

Contracts with positive value can be netted against contracts with negative values, but only if explicit contractual rights to do so exist. S&P is aware that inter-affiliate netting and physical/financial netting may not be enforceable in court, but the focus of this survey is the on-going margin requirements.

Which contracts should be included?

All contracts that have a collateral clause should be included. Collateral clauses include any clause or language in a contract that could result in a collateral call. Do not exclude unit-contingent contracts or contracts that receive accrual accounting treatment (as opposed to mark-to-market accounting treatment). Include positions in the hedge book and any other positions that could generate a relevant exposure.

What is the assumed credit threshold?

Assume credit threshold = $0 for contracts.

What about collateral clauses with soft triggers?

Collateral clauses are designed with a triggering event. If the triggering event is well defined, such as a specific credit rating level (e.g., BBB or BB), it is a hard trigger. If the triggering event is loosely defined, such as a MAC (material adverse change) clause, it is a soft trigger.

Collateral clauses that have a soft trigger are generally known as ***adequate assurance clauses*** because they usually require a company to provide "adequate assurance" (AA) to its counterparty in the event of a MAC.

Adequate assurance clauses are a significant source of confusion for estimating liquidity demands because it is not always obvious what kind of event would constitute a MAC or the amount of collateral that would be sufficient as AA. In your liquidity adequacy calculation, you should estimate exposure based on the entire negative MTM value of the contract. In other words, if a contract is out-of-money by $10, the liquidity demand in a credit event should also be $10.

<u>What about financial triggers in collateral clauses?</u>
If the triggering event in the collateral clause is a financial test, assume you have failed the financial test for the purpose of calculating the potential liquidity demands.

<u>What about customized collateral clauses?</u>
If you have an unusual or customized collateral clause, such as a cap on collateral or if the required collateral is a percentage of the exposure, you should follow the terms of the collateral clause, while assuming that the triggering event has occurred.

<u>What about a company's ability to change trading patterns?</u>
Do not assume flexibility to change trading patterns or the ability to flatten out positions to reduce liquidity exposure.

QUESTION C. What are your liquidity demands related to an increase in static margin?

Static margin is the fixed security deposit posted to exchanges, ISO's, pipelines or other counterparties. It is considered static because it does not vary directly with changes in market prices. However, this amount can go up substantially, sometimes $50 million to $100 million, when a company's credit rating falls below investment grade. In the past, some companies were surprised by the size of the increase in the static margin when downgraded below investment grade.

QUESTION D. What are your liquidity demands related to triggers in loans and contracts?

Companies often have loans and contracts that require them to post collateral when their credit falls below a certain level or some other financial triggering event. The type of contracts include, but are not limited to, loans, surety bonds, structured transactions, and performance-based contracts such as a power purchase agreement or a tolling agreement. The estimate should assume that the triggering event has occurred, whether they are hard triggers, soft triggers, or financial triggers, and it should assume that collateral covers the entire exposure to the counterparty.

QUESTION E. How much commercial paper do you have outstanding?

QUESTION F. What are your liquidity demands related to negative MTM and 60-day exposure <u>with a 15% market price stress</u>?

Calculate liquidity demand related to negative MTM and 60-day exposure assuming the following stress scenarios on your portfolio:

- Stress your portfolio assuming a 15% <u>rise</u> in the 12 month forward strip of power, gas and oil and a 20% <u>rise</u> in the forward strip beyond 12 months (i.e. a parallel shift in the curves, with a kink at 1 year).

- Stress your portfolio assuming a 15% <u>decline</u> in the 12 month forward strip of power, gas and oil and a 20% <u>decline</u> in the forward strip beyond 12 months (i.e. a parallel shift in the curves, with a kink at 1 year).

The response to "QUESTION F" should reflect the higher of the two above scenarios.

Please stress the portfolio first, then add up all the contracts with negative values as opposed to picking out all the contracts with negative values then stressing that subset of the portfolio.

Supplemental Questions

Counterparty exposure table

For each counterparty, list its credit rating, positive exposure (credit exposure) and negative exposure (liquidity exposure). A company can have both credit exposure and liquidity exposure to a counterparty if the contracts between the two counterparties are netted to the maximum possible extent (i.e., netting with AR/AP, cross-commodity netting, financial/physical netting and inter-affiliate netting).

Counterparty	Rating	Positive Exposure	Negative exposure
		Credit Exposure	Liquidity Exposure
Power Co	BBB	+30	-20
Gas Co	A-	+20	-30
Good Netting Co	A	+100	0
Total		+150	-50

Forward Volume

- Provide a summary of your gross long and gross short forward volume by year. Include all contractual assets, accrual or MTM, but do not include positions provided by hard asset that you own (i.e., owned assets) or contracts without a collateral clause. Do not net the longs and the shorts except when they are with the same contract.

Commodity	Long/Short	2004	2005	2006	2007+	Total
Power (MWh)	Long					
Power (MWh)	Short					
Gas (MMBtu)	Long					
Gas (MMBtu)	Short					
Oil (bbl)	Long					
Oil (bbl)	Short					
Coal (ton)	Long					
Coal (ton)	Short					

Monthly Physical Volume

- List your realized physical sales and purchase volumes for energy commodities for the month.
-

Commodity	Amount
Power (MWh) Purchases	
Power (MWh) Sales	
Gas (MMBtu) Purchases	
Gas (MMBtu) Sales	
Gas (MMBtu) Purchase	
Gas (MMBtu) Sales	
Oil (bbl) Purchase	
Oil (bbl) Sales	
Coal (ton) Purchase	
Coal (ton) Sales	

Wholesale Requirements Contracts

List all your requirements contracts or standard offer contracts, or any other wholesale contracts that have variable load characteristics.

Counterparty	Peak MW load obligation (or avg MCF/day obligation for gas)	Maturity	Standard offer contracts/ Negotiated	Contains collateral clause (y/n)

Retail Contracts

What is the total peak MW load obligation or average MCF/day gas delivery obligation of your retail competitive supply business? Please break requirements out by state or region.

Trader compensation

1. What was the total compensation (salary and bonus) of your five highest paid traders (or supervisors of the traders that have trading responsibilities) last year and what is the highest you expect this year?
2. How are traders' bonuses determined? Are they discretionary or based on a formula? Are they based on individual performance or corporate-wide performance? If formula based, please provide.
3. What was the overhead (G&A) of your trading operation (include front, middle and back office) last year (include salaries)?
4. How many *i*) commercial, *ii*) middle- and *iii*) back-office people do you employ?

McGill, James T(Z71171)

From: McGill, James T(Z71171)
Sent: Thursday, January 08, 2009 4:23 PM
To: 'Bettinelli, Antonio'
Subject: 200811 - SP.xls

Attachments: 200811 - SP.xls

Tony,
Attached is the Liquidity Survey.

Jim

200811 - SP.xls (16 KB)

REDACTED

S&P LIQUIDITY SURVEY

Line			Arizona Public Service	Pinnacle West Capital Corp.
1				
2	Company:		Arizona Public Service	Pinnacle West Capital Corp.
3	Date (data as of)		November 30, 2008	November 30, 2008
4				
9	**Section I - Sources of Primary Liquidity**		**Amount (millions $)**	**Amount (millions $)**
10	Question A1	Total Unrestricted Cash	$ [redacted]	$ [redacted]
11	Question A2	Availablity under committed bank lines	[redacted]	[redacted]
12	Question A3	Collateral posted	[redacted]	[redacted]
13				
14	**Question A**	**Total Primary Liquidity (A1+A2+A3)**	$ [redacted]	$ [redacted]
15				
16	Question A4	Market value of inventory	$ [redacted]	$ [redacted]
17	Question A5	Expected cash flow after CapX for next 12 months	[redacted]	[redacted]
18	Question A6	Actual account receivables minus account payables (including Unbilled Revenues)	[redacted]	[redacted]
19	Question A7	Collateral held from counterparties and Uncommitted Lines of Credit	[redacted]	[redacted]
20		Total Secondary Liquidity (A4+A5+A6+A7)	$ [redacted]	$ [redacted]
21				
22	**Section II - Liquidity Calls without Price Stress**		Underlying exposure	Underlying exposure
23	Question B1	Negative MTM related to credit thresholds	$ [redacted]	$ [redacted]
24	Question B2	Negative MTM related to adequate assurance	-	-
25	Question B3	Estimated 60-Day Exposure	[redacted]	[redacted]
26	Question B	Net Exposure (net as allowed by contractual terms)	$ [redacted]	$ [redacted]
27				
28	Question C	Static Margin	-	-
29	Question D	Triggers in loans & contracts	[redacted]	[redacted]
30	Question E	Commercial Paper outstanding (including PC Bonds)	-	-
31		**Total Credit Event Exposure (B+C+D+E)**	$ [redacted]	$ [redacted]
32				
33	CELA Ratio	Credit Event Liquidity Adequacy (A/(B+C+D+E))	[redacted]	[redacted]
34				
35	**Section III- Liquidity Calls with Price Stress**		Line 31 after stress	Line 31 after stress
37	Question F1	Price increase by 15% in 1st yr and 20% thereafter	$ [redacted]	$ [redacted]
38	Question F2	Price decrease by 15% in 1st yr and 20% thereafter	[redacted]	[redacted]
39	Question F	Take larger of the two above (F1 or F2)	$ [redacted]	$ [redacted]
40				
41	MCELA Ratio	**Market & Credit Event Liquidity Adeq (A/F)**	[redacted]	[redacted]
42				
43	**Section IV - Monthly Volume (realized physical sales and purchases)**			
44	Question G1	Natural Gas (mmbtu) Purchases	[redacted]	[redacted]
45	Question G2	Natural Gas (mmbtu) Sales	[redacted]	[redacted]
46				
47	Question G3	Power (MWh) Purchases	[redacted]	[redacted]
48	Question G4	Power (MWh) Sales	[redacted]	[redacted]
49				
50	Question G5	Crude Oil (bbl) Purchases	-	-
51	Question G6	Crude Oil (bbl) Sales	-	-

Sent to IR distribution
including rating agency analysts

McGill, James T(Z71171)

From: Higuchi, Dene C(Z05435) on behalf of Hickman, Rebecca (Z46875)
Sent: Wednesday, January 21, 2009 8:45 AM
Subject: PNW/APS: Press Release Announcing Bill Post's Retirement, Management Changes

This morning, we issued a press release announcing Bill Post's decision to retire from the company effective April 30, 2009. The release also includes announcements regarding promotions of Don Brandt and Don Robinson. The text of the release is included below in this message.

As always, if you have any questions about these announcements or need other information about our company, please contact me or Lisa Malagon (602-250-5671).

Sincerely,

Becky
Rebecca L. Hickman
Director of Investor Relations
Pinnacle West Capital Corporation
400 North 5th Street, Station 9998
Phoenix, Arizona 85004
Telephone: (602) 250-5668
Fax: (602) 250-2789
E-mail: rhickman@pinnaclewest.com

PINNACLE WEST CHAIRMAN BILL POST RETIRES

PHOENIX – The Pinnacle West Capital Corporation (NYSE: PNW) Board of Directors announced today that after 38 years with the Company, Pinnacle West Chairman and Chief Executive Officer Bill Post will retire effective April 30, 2009. Post will remain a member of the board.

The Board of Directors elected current Pinnacle and APS President and APS CEO Don Brandt to the board, effective today, and appointed him Chairman of the Board and Pinnacle CEO, succeeding Bill Post in those capacities, effective April 30, 2009. Brandt will continue to serve as President of Pinnacle and CEO of APS, the operating company. The Company's current Senior Vice President of Planning and Administration, Don Robinson, will become the President and Chief Operating Officer of APS.

Speaking on behalf of the Pinnacle West board, lead Director Kathy Munro said they had worked to develop an orderly succession plan in the executive office for some time.

"The board greatly respects the important contributions that Bill Post has made to the Company and to the community. Of course we regret seeing him depart. However, we respect Bill's plans and have complete confidence that the new management team will take the Company successfully into the next decade."

"I have total confidence that Don Brandt, and his team will successfully navigate what will be a dynamic and new energy environment for APS, Arizona and the country," Post said. "It will be an exciting and challenging time for the electric industry and this team is prepared to succeed for customers and shareholders."

Prior to joining APS in 2002, Don Brandt served as Senior Vice President and Chief Financial Officer at Ameren Corporation, a St. Louis-based energy services company. After initially taking the position of Chief Financial Officer for Pinnacle West and APS, Brandt was promoted to President of APS in 2007. In March of last year, he added the titles of APS Chief Executive Officer and Pinnacle President and Chief Operating Officer.

"Without question, we face a dynamic and rapidly changing energy future," Brandt commented. "We remain dedicated to our communities, customers, employees and standards of energy reliability. These core priorities will, as under Bill Post, continue to shape the way we manage our business going forward."

Executive Vice President and Chief Nuclear Officer Randy Edington will continue to report to Brandt, while all other operational areas will report to newly appointed President Don Robinson.

Robinson joined APS in 1978. He previously held the title of Senior Vice President of Planning and Administration, where he developed major planning strategies, and the Company's future energy resource plans. He also had responsibility for the oversight of risk management, budgeting and forecasting.

Pinnacle West is a Phoenix-based company with consolidated assets of about $11.5 billion. Through its subsidiaries, the Company generates, sells and delivers electricity and sells energy-related products and services to retail and wholesale customers in the western United States. It also develops residential, commercial, and industrial real estate projects.

-30-

Send to IR distribution including rating agency analysts

McGill, James T(Z71171)

From: Higuchi, Dene C(Z05435) on behalf of Hickman, Rebecca (Z46875)
Sent: Wednesday, January 21, 2009 3:51 PM
Subject: PNW: Dividend Declaration and Earnings Conference Call/Webcast

Today, we issued a press release announcing our latest dividend declaration and our 2008 fourth quarter and year-end earnings release conference call and webcast. The text of the release is included below in this message.

As always, if you need any information about our company, please contact me or Lisa Malagon (602-250-5671).

Sincerely,

Becky

Rebecca L. Hickman
Director of Investor Relations
Pinnacle West Capital Corporation
400 North 5th Street, Station 9998
Phoenix, Arizona 85004
Telephone: (602) 250-5668
Fax: (602) 250-2789
E-mail: rhickman@pinnaclewest.com

**PINNACLE WEST DECLARES QUARTERLY DIVIDEND;
ANNOUNCES FOURTH-QUARTER CONFERENCE CALL**

PHOENIX – Pinnacle West Capital Corporation's (NYSE: PNW) board of directors today declared a quarterly dividend of $0.525 per share of common stock, payable on March 2, 2009, to shareholders of record on February 2, 2009.

In addition, Pinnacle West plans to release its 2008 fourth-quarter and year-end results on Friday, February 20, 2009. That same day at 12:00 noon (ET), the Company invites interested parties to listen to a live web cast of management's conference call to discuss the results and recent developments.

The web cast can be accessed at www.pinnaclewest.com/presentations and will be available for replay on the web site for 30 days. To access the live conference call by telephone, dial (877) 356-3961 and enter Conference ID Number 81428217. A replay of the call also will be available until 11:55 p.m. (ET), Friday, February 27, 2009, by calling (800) 642-1687 in the U.S. and Canada or (706) 645-9291 internationally and entering the same Conference ID number as above.

Pinnacle West is a Phoenix-based company with consolidated assets of about $11.5 billion. Through its subsidiaries, the Company generates, sells and delivers electricity and sells energy-related products and services to retail and wholesale customers in the western United States. It also develops residential, commercial, and industrial real estate projects.

-30-

McGill, James T(Z71171)

From: Solomon, Scott [Scott.Solomon@moodys.com]
Sent: Wednesday, January 21, 2009 1:28 PM
To: McGill, James T(Z71171)
Cc: Schumacher, Laura
Subject: Request from Moody's Investors Service
Attachments: Bad_Debt_Study.doc

Dear Jim,

I am a senior analyst at Moody's Investors Service and working on a project that involves polling select utilities, including Arizona Public Service Company, about past due accounts and growing bad debt expenses. We kindly ask that you review and reply to the attached questionnaire no later than Friday, January 30th. We intend to incorporate our findings into a Special Comment that will be shared with you prior to its public dissemination.

Thank you very much for your kind assistance. We look forward to receiving your input and sharing the results of this study with you in the near future.

Should you have any questions, please feel free to contact me directly.
<<Bad_Debt_Study.doc>>
Regards,
Scott Solomon
Vice President, Senior Analyst
Moody's Investors Service
212-553-4358
scott.solomon@moodys.com

Moody's 2009 Regulated Utilities Bad Debt Expense Study:

1. Have you experienced increases in past due payments and bad debt expense from your residential, commercial and industrial customers over the past 12 months? If so, what has been the percentage increase in past due receivables overall and by type of customer (residential, commercial and industrial)? What are the expectations for the next 12 months?

2. Please summarize any energy assistance programs that may be provided in your utility's service territory, including the funding mechanism for such a program. Has funding for the program increased over the past 12 months? Does the program provide mitigation against increases in bad debt?

3. What measures are in place with your public utility commission(s) to enable you to pass through the increased costs of bad debt expenses onto ratepayers or to recover a majority of your customer bad debt expenses from ratepayers?

4. If you have bad debt mitigation measures in your rate design, how long do you expect it would take to recoup these expenses?

McGill, James T(Z71171)

From: Bettinelli, Antonio [Antonio_Bettinelli@standardandpoors.com]

Sent: Wednesday, January 21, 2009 9:03 PM

To: McGill, James T(Z71171)

Jim,

Are you available to chat about Suncor tomorrow? Let me know what works.

Tony

McGill, James T(Z71171)

From: Bettinelli, Antonio [Antonio_Bettinelli@standardandpoors.com]
Sent: Wednesday, January 21, 2009 9:26 PM
To: McGill, James T(Z71171)
Subject: Data request

Jim,

I also have a data request. Would you or someone on your team be able to pull together some items for us? For year end 2007 and 2008 we would like to know the following data points for the metro area: Vacancy rates, foreclosures, unemployment, population, number of meters and past due accounts (number and percentage) by cutomer class. And for each entire year, the total unpaid amounts billed. Let me know if you need any clarifications.

Regards,
Tony

McGill, James T(Z71171)

From: McGill, James T(Z71171)
Sent: Thursday, January 22, 2009 5:41 PM
To: 'Schumacher, Laura'
Subject: SunCor Update

Laura,
Would you be available tomorrow (Friday) for an update on SunCor?

Jim

McGill, James T(Z71171)

From: McGill, James T(Z71171)
Sent: Thursday, January 22, 2009 5:42 PM
To: 'Philip.Smyth@fitchratings.com'
Subject: SunCor Update

Phil,
Would you be available tomorrow (Friday) for an update on SunCor?

Jim

McGill, James T(Z71171)

From: Philip.Smyth@fitchratings.com
Sent: Thursday, January 22, 2009 5:54 PM
To: McGill, James T(Z71171)
Subject: Re: SunCor Update

Hi Jim,

Yes. Earlier in the day would be better. The only thing I have scheduled is a one hour meeting that starts at 9:30AM EST.

Best Regards,

Phil

James.MCgill@pinnaclewest.com

01/22/2009 07:42 PM

To: Philip.Smyth@fitchratings.com

cc:

Subject: SunCor Update

Phil,
Would you be available tomorrow (Friday) for an update on SunCor?

Jim

McGill, James T(Z71171)

From: Schumacher, Laura [Laura.Schumacher@moodys.com]
Sent: Friday, January 23, 2009 5:39 AM
To: McGill, James T(Z71171)
Subject: RE: SunCor Update

Good morning Jim,

Yes, I am available today. What time would you like to call?

Laura

-----Original Message-----
From: James.MCgill@pinnaclewest.com [mailto:James.MCgill@pinnaclewest.com]
Sent: Thursday, January 22, 2009 7:41 PM
To: Schumacher, Laura
Subject: SunCor Update

Laura,
Would you be available tomorrow (Friday) for an update on SunCor?

Jim

McGill, James T(Z71171)

From: McGill, James T(Z71171)
Sent: Friday, January 23, 2009 5:56 AM
To: 'Schumacher, Laura'
Subject: RE: SunCor Update

How about 1:00 NYC time?

From: Schumacher, Laura [mailto:Laura.Schumacher@moodys.com]
Sent: Friday, January 23, 2009 5:39 AM
To: McGill, James T(Z71171)
Subject: RE: SunCor Update

Good morning Jim,

Yes, I am available today. What time would you like to call?

Laura

-----Original Message-----
From: James.MCgill@pinnaclewest.com [mailto:James.MCgill@pinnaclewest.com]
Sent: Thursday, January 22, 2009 7:41 PM
To: Schumacher, Laura
Subject: SunCor Update

Laura,
Would you be available tomorrow (Friday) for an update on SunCor?

Jim

our network free from viruses. You should, however, review this e-mail message, as well as any attachment thereto, for viruses. We take no responsibility and have no liability for any computer virus which may be transferred via this e-mail message.

McGill, James T(Z71171)

From: McGill, James T(Z71171)
Sent: Friday, January 23, 2009 5:56 AM
To: 'Philip.Smyth@fitchratings.com'
Subject: RE: SunCor Update

How about noon your time?

-----Original Message-----
From: Philip.Smyth@fitchratings.com [mailto:Philip.Smyth@fitchratings.com]
Sent: Thursday, January 22, 2009 5:54 PM
To: McGill, James T(Z71171)
Subject: Re: SunCor Update

Hi Jim,

Yes. Earlier in the day would be better. The only thing I have scheduled is a one hour meeting that starts at 9:30AM EST.

Best Regards,

Phil

James.MCgill@pinnaclewest.com

01/22/2009 07:42 PM

To: Philip.Smyth@fitchratings.com

cc:

Subject: SunCor Update

Phil,
Would you be available tomorrow (Friday) for an update on SunCor?

Jim

Email Firewall made the following annotations

NOTICE ---

This email has been scanned by the MessageLabs Email Security System.
For more information please visit http://www.messagelabs.com/email

McGill, James T(Z71171)

From: Schumacher, Laura [Laura.Schumacher@moodys.com]
Sent: Friday, January 23, 2009 6:23 AM
To: McGill, James T(Z71171)
Subject: RE: SunCor Update

That works. Do you want to call me in my office?

-----Original Message-----
From: James.MCgill@pinnaclewest.com [mailto:James.MCgill@pinnaclewest.com]
Sent: Friday, January 23, 2009 7:56 AM
To: Schumacher, Laura
Subject: RE: SunCor Update

How about 1:00 NYC time?

From: Schumacher, Laura [mailto:Laura.Schumacher@moodys.com]
Sent: Friday, January 23, 2009 5:39 AM
To: McGill, James T(Z71171)
Subject: RE: SunCor Update

Good morning Jim,

Yes, I am available today. What time would you like to call?

Laura

-----Original Message-----
From: James.MCgill@pinnaclewest.com [mailto:James.MCgill@pinnaclewest.com]
Sent: Thursday, January 22, 2009 7:41 PM
To: Schumacher, Laura
Subject: SunCor Update

Laura,
Would you be available tomorrow (Friday) for an update on SunCor?

Jim

The information contained in this e-mail message, and any attachment thereto, is confidential and may not be disclosed without our express permission. If you are not the intended recipient or an employee or agent responsible for delivering this message to the intended recipient, you are hereby notified that you have received this message in error and that any review, dissemination, distribution or copying of this message, or any attachment thereto, in whole or in part, is strictly prohibited. If you have received this message in error, please immediately notify us by telephone, fax or e-mail and delete the message and all of its attachments. Thank you. Every effort is made to keep our network free from viruses. You should, however, review this e-mail message, as well as any attachment thereto, for viruses. We take no responsibility and have no liability for any computer virus which may be transferred via this e-mail message.

McGill, James T(Z71171)

From: McGill, James T(Z71171)
Sent: Friday, January 23, 2009 6:25 AM
To: 'Schumacher, Laura'
Subject: RE: SunCor Update

Yes - talk to you then.

From: Schumacher, Laura [mailto:Laura.Schumacher@moodys.com]
Sent: Friday, January 23, 2009 6:23 AM
To: McGill, James T(Z71171)
Subject: RE: SunCor Update

That works. Do you want to call me in my office?

-----Original Message-----
From: James.MCgill@pinnaclewest.com [mailto:James.MCgill@pinnaclewest.com]
Sent: Friday, January 23, 2009 7:56 AM
To: Schumacher, Laura
Subject: RE: SunCor Update

How about 1:00 NYC time?

From: Schumacher, Laura [mailto:Laura.Schumacher@moodys.com]
Sent: Friday, January 23, 2009 5:39 AM
To: McGill, James T(Z71171)
Subject: RE: SunCor Update

Good morning Jim,

Yes, I am available today. What time would you like to call?

Laura

-----Original Message-----
From: James.MCgill@pinnaclewest.com [mailto:James.MCgill@pinnaclewest.com]
Sent: Thursday, January 22, 2009 7:41 PM
To: Schumacher, Laura
Subject: SunCor Update

Laura,
Would you be available tomorrow (Friday) for an update on SunCor?

Jim

Email Firewall made the following annotations

--- NOTICE ---
This message is for the designated recipient only and may contain confidential, privileged or proprietary

----

The information contained in this e-mail message, and any attachment thereto, is confidential and may not be disclosed without our express permission. If you are not the intended recipient or an employee or agent responsible for delivering this message to the intended recipient, you are hereby notified that you have received this message in error and that any review, dissemination, distribution or copying of this message, or any attachment thereto, in whole or in part, is strictly prohibited. If you have received this message in error, please immediately notify us by telephone, fax or e-mail and delete the message and all of its attachments. Thank you. Every effort is made to keep our network free from viruses. You should, however, review this e-mail message, as well as any attachment thereto, for viruses. We take no responsibility and have no liability for any computer virus which may be transferred via this e-mail message.

McGill, James T(Z71171)

From: Philip.Smyth@fitchratings.com
Sent: Friday, January 23, 2009 6:34 AM
To: McGill, James T(Z71171)
Subject: RE: SunCor Update

Can we do it at 11 or 1:30? There is something I need to do at noon, but I have some flexibility if that is a problem.

McGill, James T(Z71171)

From: McGill, James T(Z71171)
Sent: Friday, January 23, 2009 6:37 AM
To: 'Philip.Smyth@fitchratings.com'
Subject: RE: SunCor Update

1:30 your time will work. We'll call you at your desk.

-----Original Message-----
From: Philip.Smyth@fitchratings.com [mailto:Philip.Smyth@fitchratings.com]
Sent: Friday, January 23, 2009 6:34 AM
To: McGill, James T(Z71171)
Subject: RE: SunCor Update

Can we do it at 11 or 1:30? There is something I need to do at noon, but I have some flexibility if that is a problem.

McGill, James T(Z71171)

From: Solomon, Scott [Scott.Solomon@moodys.com]
Sent: Tuesday, January 27, 2009 2:02 PM
To: Solomon, Scott
Subject: Reminder: Request from Moody's Investors Service
Attachments: Bad_Debt_Study.doc

The attached questionnaire was forwarded on January 21, 2009. Could you please have it have completed and returned by Friday, January 30, 2009?

<<Bad_Debt_Study.doc>>

Regards,
Scott Solomon
Vice President, Senior Analyst
Moody's Investors Service
212-553-4358
scott.solomon@moodys.com

<u>Moody's 2009 Regulated Utilities Bad Debt Expense Study:</u>

1. Have you experienced increases in past due payments and bad debt expense from your residential, commercial and industrial customers over the past 12 months? If so, what has been the percentage increase in past due receivables overall and by type of customer (residential, commercial and industrial)? What are the expectations for the next 12 months?

2. Please summarize any energy assistance programs that may be provided in your utility's service territory, including the funding mechanism for such a program. Has funding for the program increased over the past 12 months? Does the program provide mitigation against increases in bad debt?

3. What measures are in place with your public utility commission(s) to enable you to pass through the increased costs of bad debt expenses onto ratepayers or to recover a majority of your customer bad debt expenses from ratepayers?

4. If you have bad debt mitigation measures in your rate design, how long do you expect it would take to recoup these expenses?