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August 13, 2009

Arizona Corporation Commission
DOCKETED
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Kristin K. Mayes, Chairman
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

DOCKETED BY

Re: Your Letter Dated August 5, 2009 Concerning Arizona Public Service
Company's Pending Rate Case; Docket No. E-01345A-08-0172

Dear Chairman Mayes:

In your letter dated August 5th, you requested that additional issues be discussed and exhibits presented, primarily by APS but also by other parties, at the evidentiary hearing scheduled to begin on August 19, 2009. APS will be in a position to address these issues and intends to do so at the outset of the evidentiary process. In advance of such testimony, APS would also like to at least partially respond in this letter to two of your specific requests regarding Schedule 3 and the Saguaro incident. A subsequent letter will address the subject of demand response, which is also referenced in your August 5th letter.

Long-Term Impact of Revenue Treatment of Schedule 3 Proceeds

Your letter references a statement made in the Company's letter dated June 25, 2009 wherein APS indicated that there was eventually a "cross-over" point at which benefits of revenue treatment in a particular APS rate proceeding would have been less than the cumulative impact of continued CIAC treatment. Although APS will be prepared to also discuss this at the hearing, the Company would like to reference its letter dated December 20, 2007, a copy of which is attached for your convenience. As indicated in that letter, even under highly conservative assumptions, revenue treatment provides a much larger and more immediate benefit - producing a net reduction of revenue requirements paid by APS customers in each year for at least 12 years. And there is a significant present value savings to APS customers over the typical 30-year life of the distribution facilities covered by Schedule 3. In any case, there is no doubt that the revenue treatment benefits customers to a greater degree than CIAC during difficult economic times by reducing the size of the base rate increase.

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Kristin K. Mayes, Chairman
August 13, 2009
Page 2

Incident at Saguaro

You have requested that the Arizona Division of Occupational Safety and Health ("ADOSH") report be provided to all Commissioners and presented as an exhibit in this proceeding. You have also requested the results of any internal APS review of this matter. Finally, you have requested a listing of previous ADOSH citations against the Company during the past five years and their resolution.

APS has previously provided your office with the ADOSH citations relative to the accident at Saguaro in late 2008 and is, with this letter, providing additional copies for the Commission, Commission Staff and the parties. APS does not believe that the citations are valid and has filed a formal Notice of Contest, which is also attached, challenging all five of the citations. The Company anticipates an initial meeting with ADOSH regarding the Notice of Contest in the next few weeks.

In addition to the ADOSH citations, APS is providing you, the other Commissioners, the Chief Administrative Law Judge, and Commission Staff with the ADOSH file materials from the ADOSH investigation. APS's own internal review was conducted by and under the direction of APS counsel, and as such is protected from disclosure by the attorney-client privilege. Safeguarding that privilege is critical to fostering the rigorous, open, and candid post-event review that is necessary to fully understand and learn from the facts in an effort to improve safety measures going forward. For that reason, APS does not provide privileged internal reviews of work-related accidents to any agency, including ADOSH. That said, safety is a primary focus and value at APS. Although the Company is constrained from providing the specific information requested, it will obviously cooperate in any Commission review of this incident and has already been in contact with Commission Staff in such respect.

With respect to your final request, in the past five years, APS has received two other OSHA citations. APS received one "Other Than Serious" citation from Federal OSHA in April 2009 for a record-keeping violation resulting from the failure to retain the original 2007 OSHA 300A log, which is an annual summary of OSHA recordables at a site. The original 2007 posted log had been correctly filled out and signed, but the electronically retained copy in the company's electronic file was not signed and did not identify the establishment name. OSHA standards require companies to retain the original signed copy of the 300A log for five years. In April 2005, ADOSH issued a citation for an employee failing to use a body harness in a bucket truck. The citation was not the result of an injury but rather occurred during an inspection. APS took prompt corrective action to remediate both citations to the satisfaction of state and federal authorities.

Kristin K. Mayes, Chairman
August 13, 2009
Page 3

APS looks forward to discussing the other issues identified in your August 5th letter during the upcoming hearing.

Sincerely,

A handwritten signature in cursive script that reads "Thomas L. Mumaw".

Thomas L. Mumaw
Attorney for Arizona Public Service Company

TLM/na
Enclosures

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Commissioner Paul Newman
Commissioner Sandra D. Kennedy
Commissioner Bob Stump
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Steve Olea
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This 13th day of August 2009 to:

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AZ CORP COMMISSION
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DEC 20 2007

AZ CORP COMM
Director Utilities

December 20, 2007

Chairman Mike Gleason
Commissioner William Mundell
Commissioner Jeff Hatch-Miller
Commissioner Kristin K. Mayes
Commissioner Gary Pierce
ARIZONA CORPORATION COMMISSION
1200 West Washington
Phoenix, Arizona 85007

Re: Arizona Public Service Company General Rate Case; Docket Nos. E-01345A-05-0816, E-01345A-05-0826, E-01345A-05-0827; Commissioner Mayes' Letters of November 28, 2007 and December 10, 2007, and Commissioner Pierce's Letter of December 10, 2007.

Dear Commissioners:

Arizona Public Service Company ("APS" or "Company") is pleased to respond to the letters received in this docket from Commissioners Mayes and Pierce related to the Company's pending request to account for fees received under its revised Schedule 3 as Miscellaneous Service Revenues. As the Commission is aware, the Company's requested revenue treatment is the sole difference between the Schedule 3 proposed by APS on October 24, 2007 (in response to the directive contained in Decision No. 69663) and that recommended by Commission Staff in its Memorandum and Proposed Order of November 2, 2007.¹ Importantly, while line extension applicants will pay the *same* amount for service extension under both versions of Schedule 3, treating those fees as revenue compared to contributions-in-aid of construction ("CIAC") has significant benefits to the Company and its customers in both the immediate future and in the long run—benefits not available if the Commission orders CIAC treatment of these proceeds.

¹ Staff submitted a revised Memorandum and Recommended Order on November 15, 2007, but such revision dealt with the transition plan for Schedule 3 and did not affect the issue before the Commission or the substance of Commissioner Mayes' November 28 letter.

The Company's proposed accounting treatment for Schedule 3 fees will benefit the Company's customers in at least four important ways:

1. It will provide a significantly larger shield to customers against both the size and frequency of future general base rate increases than would treatment of the equivalent dollars as CIAC.
2. It will require growth to assume a greater responsibility for paying the Company's increasing cost of providing electric service compared to the Staff proposal.
3. It will improve the Company's financial condition without increasing base rates for electric service.
4. By improving APS's financial condition, it will permit the Company to more easily and economically finance the costs of providing service, including the capital costs associated with new construction—tangible benefits that will ultimately accrue to the benefit of our customers.

There is thus little question that APS's proposed revenue treatment better serves the clear intent of Decision No. 69663 to use Schedule 3 fees to "shift the burden of rising distribution infrastructure costs away from the current customer base to growth" far better than does CIAC treatment. [Decision No. 69663 at 97.] APS provided an analysis of these issues in its October 24 filing and has also given additional detailed analyses to Staff and the Residential Utility Consumer Office ("RUCO"). Below, the Company will expand upon these points in response to the following requests made in the correspondence from Commissioners Mayes and Pierce.

A. Provide a comprehensive analysis of APS's proposal for treating the Schedule 3 proceeds as revenue.

APS would note initially that this letter, in addition to the Company's other submissions on this matter, collectively provide a thorough analysis of APS's proposal for treating the Schedule 3 proceeds as revenue. In that regard, this letter should be read in conjunction with the information that APS provided in the October 24 filing and the APS Exceptions dated November 19, 2007. That being said, APS will take this opportunity to address some potential concerns that may be raised by Staff or other parties.

First, there is no accounting or other rule that would prevent the Commission from authorizing the Company's proposed revenue treatment in this docket. APS rates were just recently established by Decision No. 69663 after a long and exhaustive general rate case proceeding—a proceeding that fully complied with any conceivably arguable Arizona procedural requirement, including an unequivocal and express finding of fair value rate base. That Decision explicitly directed changes to Schedule 3 that significantly increased the fees charged by APS to new electric service applicants. APS is not seeking to change those results in even the slightest degree. To the contrary, its proposed revenue treatment of those fees meets the Commission's intent to shift the burden of rising costs to growth far

better than Staff's proposed treatment. Thus, APS seeks *no* increase in Schedule 3 or any other charges that are in excess of those already established by Decision No. 69663.

While some have questioned whether this docket is the appropriate venue to resolve the issue of what accounting treatment should be afforded Schedule 3 fees, the Company believes that this is *precisely* the right proceeding in which to do so. First, as discussed above, the amount of proceeds that Schedule 3 will generate does not change whether treated as CIAC or revenue, and the Commission expressly considered and approved changes to Schedule 3 in Decision No. 69663. Second, far from requiring one type of accounting treatment or another, Decision No. 69663 is silent on the issue, leaving open the question of whether those funds should be characterized as CIAC, revenue, or some combination of the two.² But while the required accounting treatment was left unclear, the Commission was not ambiguous about its *intent* with respect to Schedule 3 funds, which Decision No. 69663 makes plain was to "shift the burden of rising distribution infrastructure costs away from the current customer base to growth." [Decision No. 69663 at 97.] As demonstrated in detail herein, there is no question that the Company's proposed revenue treatment achieves that intent far better than the alternative CIAC treatment, both immediately and in the long run. Moreover, as described below, no matter whether Schedule 3 fees are characterized as CIAC or revenue, the Company will not earn the allowed return on equity that was exhaustively litigated and finally approved in the recent APS rate case.

The Company's analysis also highlights exactly why prompt determination of this issue in this proceeding is critical to both customers and the Company. The distinction in treating Schedule 3 fees as revenue versus CIAC is one that has important impacts on both the Company's FFO/Debt ratio and its earnings. As shown in the attached Exhibit A, under the CIAC approach, the Company's FFO/Debt ratio (a calculation discussed extensively during the rate case and other APS proceedings) hovers at 18.1% in 2008—dangerously close to the 18% FFO/Debt threshold for non-investment grade—and will fall to 17% in 2009 and 16.4% in 2010 respectively absent additional base rate relief. On the other hand, if treated as revenue, the level of Schedule 3 fees ordered in Decision No. 69663 will improve the Company's financial health and should preserve (for the time being) the Company's financial metrics within the BBB investment grade (though on the low end of the 18% to 28% scale).

The Company's jurisdictional returns on equity ("ROE") also suffer under the CIAC approach compared to the Company's revenue proposal. As Exhibit A also shows, under the CIAC approach, absent rate relief, the Company's ROE rests at just 7.3% in 2008 and falls to less than 6% or under by 2010. The revenue treatment increases the Company's earnings, allowing APS to earn a ROE in the neighborhood of 8-9% between 2008 and 2010 depending on the state of the housing market, but still well below the 10.75% ROE found reasonable in Decision No. 69663. In fact, the Company's projected jurisdictional ROEs under both options are below the ROE recommendation of every party to the rate case having such a recommendation. This analysis fully takes into account the impact of the income tax liability caused by the Schedule 3 revenue treatment.

² As noted in the Company's Exceptions, Schedule 3 proceeds prior to Decision No. 69663 were variously recorded as CIAC, advances-in-aid, or revenue, depending on the specific provisions of that service schedule.

Given the Company's deteriorating financial condition, it is thus clear that, without prompt resolution of this matter in favor of the revenue approach, APS will have no choice but to file another rate case. Delaying resolution of this APS-specific issue to the generic hook-up fee docket (as RUCO has suggested) would be inappropriate and would negate the instant benefit that customers will see if the Commission takes this opportunity to mitigate the level of rate increases going forward. *In fact, the benefit to customers from either the revenue or CIAC treatment of Schedule 3 fees is reduced every day that approval of Schedule 3 is delayed.*

In short, the Company's proposal is entirely consistent with the Commission's stated intent for Schedule 3, produces no greater charges than what Decision No. 69663 would permit, and results in a jurisdictional ROE still significantly below the 10.75% ROE authorized in this docket. As explained below, these analyses suggest that customers will benefit from this treatment not just in the near term, but over a thirty year time horizon, using the same present value analysis routinely used in the Company's planning process.

B. How will APS and its customers be affected by treating Schedule 3 proceeds as revenue versus CIAC? What are the positive and negative impacts to APS and its customers associated with the two options?

There is simply no question that APS's proposed revenue treatment renders significant benefits to both customers and APS compared to CIAC in both the short term and for many years to come. APS previously discussed the impact of its proposal (versus that of Staff) on APS earnings. But the proposed revenue treatment of Schedule 3 fees also improves the Company's credit metrics and, thus, its borrowing capacity. Attached as Exhibit B is an analysis of the relative impact of each proposal (revenue versus CIAC) on APS's FFO/Debt ratio and also the impact of changes in that ratio on the Company's ability to finance new utility infrastructure. Importantly, the income tax impact of increasing Schedule 3 fees (discussed at length during the proceedings in this docket) remains the same irrespective of the accounting treatment of those funds. Nevertheless, as Exhibit B clearly shows, the Company's financial condition and its ability to carry out its public service obligations are enhanced by revenue treatment in comparison to CIAC.

Customers also benefit from the Company's proposal compared to CIAC, both in the near term and for decades to come. Attached as Exhibit C are both a 10 year and a 30 year analysis of these two options (the latter of which is the approximate average life of new distribution plant while

the former captures over 100% of the present value impact on customers³). The analysis is based on the following key assumptions:

- The level of Schedule 3 fees, whether they are CIAC or revenue, is assumed to escalate at 5% per year. This is a conservative estimation, considering that the underlying cost per customer of new distribution plant is estimated to increase 4% and new customers are estimated to increase by roughly 3% per year—with a combined effect more in the 7% range. The higher the rate of increase in Schedule 3 fees, the more advantageous to APS customers is the revenue treatment.
- Rates are assumed to be reset every three years with *no* lag between the test period and the new rates—both highly conservative assumptions given the length of past APS rate proceedings and the degree of historic regulatory lag. Because APS customers only receive the rate base benefit of CIAC after a rate case, less frequent rate proceedings and more extensive regulatory lag would again make revenue treatment more advantageous to APS customers than shown on Exhibit C.
- APS's allowed return is held constant throughout the 10 and 30 year periods. Higher allowed returns by the Commission would make the CIAC option, if one looked solely at the Schedule 3 dollars instead of the Company's total rate base, marginally more attractive. But the higher return, when applied to *all* APS rate base, would dwarf the Schedule 3 stand-alone impact and create substantially *higher* overall revenue requirements.

What are the conclusions that can be drawn from these analyses? First, revenue treatment is advantageous to APS customers during *every* year of the 10 year analysis, producing a present value benefit of some \$380 to \$440 million, depending on the discount rate used and assuming Schedule 3 fees of \$100 million annually. Second, although in the 30 year analysis there is eventually a "cross-over" point in which CIAC treatment becomes more advantageous on a subsequent year-to-year basis (that is, an individual year in which the benefits of the revenue treatment are surpassed by those of CIAC), that point is at least some 13 years from now and depends on the Company's rate of growth, rate of inflation, and how often base rates are reset. Moreover, there is still a relative (to CIAC) present value benefit of \$250 to \$300 million, assuming \$100 million of annual Schedule 3 proceeds. And as noted above, if less conservative assumptions are used concerning the frequency of rate cases,

³ The "present value" analysis is one that looks at the amount of cash today that is equal in value to a payment or series of payments in the future. In other words, it calculates the worth of having that cash in hand today, rather than waiting to collect it later. The Company has computed the present value of Schedule 3 fees in two ways, both of which show significant benefits to customers. In the first set of computations, the Company used a present value rate of 12.07%, which is calculated based on the pre-tax cost of capital that the Commission determined was appropriate in Decision No. 69663. The second set of computations uses an 8% present value rate, which is the rate generally used by APS for resource planning purposes. Either approach yields substantial present value benefits to customers for the next 30 years.

the length of regulatory lag, and the growth rate of Schedule 3 proceeds, that cross-over year would be pushed further out and the present value benefits to APS customers increased.

With regard to new service applicants, both options have the same upfront payment impact—the customer will pay the same amount for a line extension irrespective of the Company's accounting treatment. It should therefore not matter to such an applicant how APS categorizes the amounts paid to APS under Schedule 3. But once a new applicant joins the ranks of APS customers, that customer will enjoy the base rate-mitigation benefits that the revenue treatment affords, and is thus positively affected by the Company's proposed revenue treatment while relatively disadvantaged by CIAC treatment.⁴

The negative impacts of CIAC are merely the converse of these positive benefits from revenue treatment. CIAC results in less of a contribution to revenue requirements from growth than does revenue, and CIAC results in deteriorated FFO/Debt with a resultant loss of financing capacity.

C. Will the money that APS receives be sufficient to mitigate the need for future rate relief, and if so, to what degree?

Yes, Schedule 3 fees will be sufficient to mitigate the need for future rate relief, but only if they are characterized as revenue instead of CIAC. APS customers will not see that benefit if the proceeds are treated as CIAC. Whenever the next rate case is filed, it will be for substantially less money under the Company's revenue proposal because of the dollar for dollar reduction to revenue requirement, compared to the 12 cents to the dollar value of CIAC. The exact degree to which future rate increases will be mitigated depends on a number of factors, including the state of the housing market, the test year used in future rate cases, the rate of growth and inflation, and other factors previously discussed in this letter.

D. Over what time period will customers experience benefits from treating Schedule 3 proceeds as CIAC and revenue?

As previously explained in Part B, above, although the year-over-year net benefit from the revenue approach is not perpetual, with growth, it lasts for *more than a decade*. Present value benefits to APS customers from the APS proposal remain substantial under any viable set of assumptions for the next *thirty years*. Just as APS and other utilities routinely evaluate resource and investment options in terms of relative present value costs, that is also the appropriate way to examine this issue.

⁴ Exhibit E shows projected Schedule 3 fees by customer class.

E. How do Schedule 3 changes impact the Company's revenues over the next three years?

As shown by attached Exhibits A and D, assuming the Commission resolves this matter and approves the proposed transition plan by January 1, 2008, APS estimates that it will receive a total of \$326 million in Schedule 3 fees over the next three years (using the "More Likely Scenario" for 2010). If the housing market recovers 100% by the end of 2009 and APS customer growth returns to pre-2007 levels by then, this could add another \$32 million in Schedule 3 fees. How much new *revenue* this produces for APS is the decision now before the Commission. Under the Company's proposal, both estimated revenues and proceeds would be as indicated by Exhibit D. Under the Staff recommendation, the new revenue to the Company would be *zero* even though new customers would pay the same amount under Schedule 3.

RUCO's suggestion that revenue treatment of Schedule 3 fees might require a corresponding decrease in the electric service rates already authorized by Decision No. 69663 is inappropriate. Not only would this suggestion prevent APS from deferring or moderating another APS rate case, it entirely ignores the expressed intent of the Commission's ordered Schedule 3 revisions. Decision No. 69663 fully authorizes *both* the new base rates that the Company now charges existing customers *and* the modified Schedule 3 proceeds charged to growth. Inherent in the stated intent of the Commission to use Schedule 3 funds to "shift the burden of rising distribution costs away from current customers to growth" is the understanding that the Company's *costs* necessarily are "rising" as growth continues and that the Schedule 3 proceeds should be used to shield existing customers from those rising costs. Reducing the Company's approved electric service rates to "make-up" for the Schedule 3 revenue ignores the fact that the Company's costs *have* risen precisely as Decision No. 69663 contemplated and anticipated, and would result in even more dramatic under-earning of the Company's authorized ROE than what APS is experiencing now. RUCO's suggestion would also require the Commission to re-open the rate case in order to analyze exactly which tariffs, if any, should be reduced, and by what amount—a result that nobody should want and that no one has requested.

F. Are there any alternatives to the Company's revenue proposal and the CIAC treatment?

Although APS strongly believes that its proposal results in a win-win situation for both customers and the Company, it acknowledges that alternative options may exist and is open to discussing other possibilities. For example, one alternative could be the imposition, where feasible, of standardized fees for extensions to each customer class (which fees would also be treated as revenue) rather than a variable fee calculated by the estimated requirements of each individual application.⁵ A uniform fee of this type would facilitate planning by future customers, ease Company and Staff administrative burdens, lessen any possible adverse competitive impact among similar businesses, and effectively focus on the overall Company revenue needs arising from growth rather than individual project costs.

⁵ For example, Schedule 3 fees charged to residential sub-developers could be set at a single flat amount, irrespective of each such applicant's specific extension costs.

In considering alternative approaches, however, the Commission should bear in mind that the beneficial and mitigating rate impacts of the Company's proposal (including the potential delay or moderation of another base rate filing) can be accomplished only through the Commission's approval of revenue treatment at or near the amounts reflected in APS's proposal. For this reason, the Company does not believe that an alternative where Schedule 3 proceeds are not fully reflected as revenue, such as the alternative mentioned in Commissioner Pierce's letter of December 10, 2007, would be as beneficial for either customers or the Company as APS's proposal. In his letter, Commissioner Pierce posits a situation wherein APS accounts for Schedule 3 fees as revenue, but assigns them a zero cost of capital—in other words, that APS treat Schedule 3 fees as a form of interest-free financing. Doing so, however, has roughly the same limited benefit to customers as the proposed CIAC treatment, which would not further the aim, as expressed in the letter, to "maximize the value of [Schedule 3 dollars] to ratepayers." Moreover, a "zero cost of capital" proposal has detrimental impacts on the Company's financial condition, compared even to the CIAC treatment.

To elaborate, when calculating APS's allowed rate of return, the Commission adds the Company's weighted cost of debt and weighted cost of equity to determine its weighted cost of capital. The weighted cost of capital is then multiplied to the Company's rate base in order to determine APS's required pre-tax operating income (the number that will ultimately be used to determine the Company's revenue requirement, on which rates are based). Under the "zero cost" alternative, the Company would add a third component to the weighted cost of capital calculation: the cost of debt, the cost of equity, and a "zero cost" of Schedule 3 fees. The effect of including that zero cost component is to lower the total weighted cost of capital, which lower amount would then be applied to the Company's entire rate base. Under this proposal, the Company's rate base is higher (because it includes Schedule 3 fees) but its weighted cost of capital is lower. However, this yields the same total revenue requirement as applying a higher weighted cost of capital to a lower rate base—the CIAC result. In other words, the Company's revenue requirement – before the Schedule 3 revenue reduction – is the same under both the zero cost of capital approach and the CIAC approach and thus suffers from the same drawback.

For example, assume that the Company has a hypothetical rate base of \$4,000, \$100 of which is Schedule 3 fees, and a weighted cost of capital (assuming an even 50/50 debt to equity balance with a 9% cost of debt and 11% cost of equity) of 10% (4.5% weighted cost of debt plus 5.5% weighted cost of equity). Under the CIAC approach, the Schedule 3 fees would reduce rate base to \$3,900. The required return on the Company's remaining rate base would thus be 10% times \$3,900, or \$390. Under the "zero cost" approach, the Schedule 3 fees remain in rate base, but the cost of capital would be adjusted to include the zero cost of Schedule 3 revenues, resulting in a lower weighted cost of

capital of just under 9.8%.⁶ This lower cost of capital, multiplied by the entire \$4,000 rate base, produces a required return of roughly \$390—the same as if the Schedule 3 proceeds had been treated as CIAC to begin with.

Under APS's revenue proposal, Schedule 3 fees would offset dollar for dollar APS's revenue requirement. If APS were directed to take its proposed approach in addition to the zero cost of capital approach, it would offset from the already reduced revenue requirement (now at CIAC levels) the total amount of Schedule 3 fees. But general regulatory accounting principles would prevent APS from recognizing the full value of that revenue on its income statement and would require the Company to "write-off" as an unrecoverable loss the great majority of the revenue stream coming from Schedule 3 fees. In fact, for every \$1 of Schedule 3 revenue collected, the Company could recognize only *thirty cents*.⁷ By requiring the Company to allocate a set portion of its total revenue requirement to this significantly lower-value Schedule 3 revenue stream, the proposal prevents the Company from recovering the full amount of its legitimately incurred costs through its other rates—rates that would allow the Company to earn a full return on each dollar invested, and not just 30 cents to the dollar. APS is thus detrimentally affected twice by the zero cost proposal: first by requiring a reduction to a revenue requirement that has already been reduced to CIAC levels, and second by forcing a write-off of roughly two thirds of that revenue stream. This would clearly be an unfair result. APS would be financially better off under the CIAC approach, where the same level of revenue requirements could be allocated to rates that would allow the Company full recovery on its investment.

While increasing the return above zero to any figure less than the weighted cost of capital (as calculated without regard to the Schedule 3 fees) would reduce the amount of the required write-off, it would not eliminate the need for it altogether. The only way to avoid that result would be to reduce the amount of that dollar's credit against APS revenue requirements to a level sufficient to avoid the write-off. This would be analogous to treating part of the dollar as revenue (for rate making purposes) and part as CIAC. Although mathematically possible, this would produce significantly less customer benefit than under the Company's proposal.

⁶ To break down this calculation, \$100 of Schedule 3 fees (2.5% of the total rate base) would be included at 0%, and the remaining \$3,900 would be evenly split between debt (with a cost of 9%) and equity (with a cost of 11%). The adjusted weighted cost of capital would be as follows:

<u>Debt:</u>	\$1,950, 48.75% of rate base, with 9% cost, produces a weighted cost of about 4.4%.
<u>Equity:</u>	\$1,950, 48.75% of rate base, with 11% cost, produces a weighted cost of about 5.4%.
<u>Schedule 3:</u>	\$100, 2.5% of weight base, with a cost of 0%, produces a weighted cost of 0%.

Added together, the Company's weighted cost of capital is just shy of 9.8%.

⁷ Generally speaking, a dollar received as revenue generates income on two levels: a rate of return level and a cost-recovery level. If the Commission required the Company to set the rate of return of Schedule 3 proceeds at zero, the Company would be allowed under Generally Accepted Accounting Principles to recognize as revenue *only* the cost-recovery element—roughly 30 cents to every dollar of Schedule 3 fees received. In other words, the Company would be required to write off as a loss everything on that dollar except for the present value of the depreciation return over the life of the asset. By calling the Schedule 3 fees "revenue" for the purpose of calculating revenue requirements but preventing the Company from realizing the benefit of that revenue by forcing them to take a write off, the "zero cost" proposal unnecessarily impairs the Company's earnings at a time when APS's ROE is already well below authorized levels.

As APS understands it, the concern that this identified alternative is intended to address is that APS's revenue proposal may somehow result in a "double-payment" by customers for plant paid for from Schedule 3 fees. However, customers receive the full benefit of Schedule 3 fees being treated as revenue through the dollar-for-dollar reduction to APS's revenue requirement. Moreover, APS (and all other utilities) has always used revenue that it receives from rates to construct new infrastructure, and Schedule 3 revenues would be no different in this regard than revenues APS obtains from, say, its E-12 (residential) or E-32 (general service) rate schedules. Thus, the Company's Schedule 3 proposal does *not* result in "customer-financed infrastructure" from new customers any more than does other plant paid for from money received from existing customers in the form of base rates. Rather, the "estimated cost of facilities" calculation is simply a proxy for determining the amount of the "revenue requirement" that a new customer must pay in order to be connected to the APS system, and should be treated the same way as general base rate revenues.

* * * * *

APS hopes that it has been responsive to the Commissioners' inquiries and that this information will prove useful to the Commission in making this important policy decision. APS is also open to discussing these issues in greater depth at any hearing believed necessary by the Commission in this docket as part of the Company's compliance filing. The Company continues to believe, however, that a full traditional, evidentiary hearing is not necessary. In the end, the issue is a policy decision: Should Schedule 3 be used to shift the burden of rising infrastructure costs away from existing customers or not? If the Commission believes they should—as the Order indicated it did—the Company's proposal undoubtedly presents the best mechanism to do so. Moreover, because prompt resolution of this policy matter is vital to the Company's ability to defer or reduce a future rate case asking and to maximize APS customer benefits, it is critical that any hearing be conducted on an expedited schedule and that this matter is resolved as quickly as possible.

Please do not hesitate to contact me should you wish further analysis or have any questions.

Sincerely,



Thomas L. Mumaw

TLM/

Attachments

- cc: Ernest Johnson
- Elijah Abinah
- Dean Miller
- Lyn A. Farmer
- Christopher C. Kempley
- Parties of Record

Key Financial Metrics with Schedule 3 Fees as Revenue vs. CIAC

(\$ in millions)

Line		2008	2009	2010	
				Best Case (2)	More Likely Case (3)
Schedule 3 Fees					
1	Schedule 3 fees booked as revenue - no ACC base rate increases	\$ 50	\$ 117	\$ 191	\$ 159
2	Schedule 3 fees booked as CIAC - no ACC base rate increases	\$ 50	\$ 117	\$ 191	\$ 159
ACC Jurisdictional Return on Equity					
3	Schedule 3 fees booked as revenue - no ACC base rate increases	(1) 8.2%	8.8%	9.0%	8.4%
4	Schedule 3 fees booked as CIAC - no ACC base rate increases	(1) 7.3%	6.7%	6.0%	5.8%
APS FFO to Debt (4)					
5	Schedule 3 fees booked as revenue - no ACC base rate increases	(1) 19.2%	19.5%	20.3%	19.9%
6	Schedule 3 fees booked as CIAC - no ACC base rate increases	(1) 18.1%	17.0%	16.4%	16.2%

- (1) These assumptions do not include ACC retail base rate increases. A flow through to retail customers of changes in FERC transmission rates is included as are changes in the PSA.
- (2) Assumes complete rebound of housing market by end of 2009 and that all new meter sets will be subject to Schedule 3.
- (3) Assumes housing market continues to improve but has not fully recovered. Also assumes that some meter sets will continue to represent grandfathered line extensions under Staff proposed transition plan.
- (4) Under Standard and Poor's guidelines for U.S. utilities and power companies, the Company must achieve an FFO to Debt ratio of 18% to 28% to maintain its current BBB rating.

**Change in FFO to Debt Ratio and Debt Borrowing Capacity
With Schedule 3 Fees Treated as Revenues vs. CIAC
(\$ in millions)**

\$50 million of Schedule 3 Fees Accounted for as Revenues:

	Starting Point for Example	Impact on FFO and Debt after Income Taxes	Result
FFO	\$ 789	\$ 30	\$ 819
Adjusted debt	\$ 4,300	\$ (30)	\$ 4,270
FFO to debt	18.3%	0.9%	19.2% (1)

(1) Debt capacity would increase \$160m to achieve the same 18.3% FFO to Debt ratio that was the starting point for this example.

\$50 million of Schedule 3 Fees Accounted for as CIAC:

	Starting Point for Example	Impact on FFO and Debt after Income Taxes	Result
FFO	\$ 789	\$ (20)	\$ 769
Adjusted debt	\$ 4,300	\$ (30)	\$ 4,270
FFO to debt	18.3%	-0.3%	18.0% (2)

(2) Debt capacity would decrease \$60m to achieve the same 18.3% FFO to Debt ratio that was the starting point for this example.

**Cumulative Present Value Revenue Requirement Savings From Schedule 3 Fees
Being Treated as Revenue Versus Treated as CIAC**

(\$ in millions)

	<u>First 10 Years</u>	<u>First 30 Years</u>
<u>Discounted to present value at 12.07%</u> (1)		
Per \$1m of Schedule 3 fees	\$ 3.8	\$ 3.0
Per \$50m of Schedule 3 fees	\$ 190.0	\$ 150.0
Per \$100m of Schedule 3 fees	\$ 380.0	\$ 300.0
Per \$200m of Schedule 3 fees	\$ 760.0	\$ 600.0
<u>Discounted to present value at 8%</u> (2)		
Per \$1m of Schedule 3 fees	\$ 4.4	\$ 2.5
Per \$50m of Schedule 3 fees	\$ 220.0	\$ 125.0
Per \$100m of Schedule 3 fees	\$ 440.0	\$ 250.0
Per \$200m of Schedule 3 fees	\$ 880.0	\$ 500.0

Assumptions:

- Schedule 3 fees are collected every year
- Growth rate of 5% in fees
- Rate levels are reset every three years

(1) The 12.07% discount rate represents the pre-tax cost of capital as ordered by Decision No. 69663.

(2) The 8.00% discount rate is typically used by APS as a general planning assumption.

Schedule 3 Treatment CIAC vs. Revenue

Revenue vs. CIAC Treatment for
Multiple Vintages Assuming 5% Growth of
Construction Costs and Schedule 3 Fees

Exhibit C
12/20/07
Page 2

Line	Factor	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12	Year 13	Year 14	Year 15	Year 16	Year 17	Year 18	
	Line 36	-	(881)	117	114	112	108	106	102	100	97	94	90	89	85	82	78	77	74	71	
	Vintage Year 1	-	(925)	(925)	123	120	118	113	111	107	105	102	99	95	93	89	86	83	81	78	
	Vintage Year 2	-	-	-	(972)	129	128	124	119	117	113	110	107	104	99	98	94	90	87	85	
	Vintage Year 3	-	-	-	-	(1,020)	135	132	130	125	123	118	116	112	109	104	103	98	95	91	
	Vintage Year 4	-	-	-	-	-	(1,071)	142	139	136	131	128	124	122	118	114	109	108	103	100	
	Vintage Year 5	-	-	-	-	-	-	(1,125)	149	146	143	138	135	130	128	124	120	115	114	109	
	Vintage Year 6	-	-	-	-	-	-	-	(1,181)	157	153	150	145	142	137	134	130	126	121	119	
	Vintage Year 7	-	-	-	-	-	-	-	-	(1,240)	165	161	158	152	148	144	141	137	132	127	
	Vintage Year 8	-	-	-	-	-	-	-	-	-	(1,302)	173	168	166	160	157	151	148	143	138	
	Vintage Year 9	-	-	-	-	-	-	-	-	-	-	(1,367)	182	177	174	168	165	158	155	151	
	Vintage Year 10	-	-	-	-	-	-	-	-	-	-	-	(1,436)	191	186	183	178	173	166	163	
	Vintage Year 11	-	-	-	-	-	-	-	-	-	-	-	-	(1,508)	200	195	192	185	181	175	
	Vintage Year 12	-	-	-	-	-	-	-	-	-	-	-	-	-	(1,584)	210	205	201	194	191	
	Vintage Year 13	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(1,663)	221	215	211	204	
	Vintage Year 14	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(1,746)	232	226	222	
	Vintage Year 15	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(1,833)	243	237	
	Vintage Year 16	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(1,925)	256	
	Vintage Year 17	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(2,021)	
	Vintage Year 18	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
	Vintage Year 19	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
	Vintage Year 20	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
	Vintage Year 21	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
	Vintage Year 22	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
	Vintage Year 23	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
	Vintage Year 24	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
	Vintage Year 25	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
	Vintage Year 26	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
	Vintage Year 27	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
	Vintage Year 28	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
	Vintage Year 29	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
	Vintage Year 30	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
	Change in New Rev. Req. Needed for Current Year	(881)	(608)	(608)	(735)	(659)	(584)	(508)	(431)	(352)	(272)	(192)	(112)	(28)	54	139	226	313	401	497	
	Cum. Change in New Rev. Req. Needed for All Years	(881)	(1,689)	(2,424)	(3,083)	(3,667)	(4,176)	(4,606)	(4,958)	(5,230)	(5,422)	(5,534)	(5,562)	(5,508)	(5,369)	(5,143)	(4,830)	(4,429)	(3,932)	(3,332)	
	Net Present Value at 12.07% of Cum. Change in New Rev. Req. Needed for All Years																				
	NPV of same stream discounted at 5%																				
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**Future Revenue Requirement Increases Mitigated With Schedule 3
Fees Treated as Revenue vs. CIAC**

(\$ in millions)

	2008	2009	2010 Best Case	2010 More Likely Case
Projected Schedule 3 fees collected	\$ 50	\$ 117	\$ 191	\$ 159

FUTURE REVENUE REQUIREMENT INCREASES MITIGATED:

Schedule 3 fees as revenue	\$ 50	\$ 117	\$ 191	\$ 159
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Schedule 3 fees as CIAC

Schedule 3 fees reducing plant in service	(50)	(117)	(191)	(159)
Deferred tax rate base adder	20	47	76	64
Rate base change from current year's fees	(30)	(70)	(115)	(95)
Cumulative rate base change at year end	(30)	(100)	(215)	(195)
Average rate base change	(15)	(65)	(158)	(148)
Cost of capital with income taxes	12.07%	12.07%	12.07%	12.07%
Cost of capital savings	2	8	19	18
Book depreciation savings on lower average plant in service (1)	1	4	9	8
Property tax savings on lower end of year plant in service (2)	-	1	3	3

Schedule 3 fees as CIAC	\$ 3	\$ 13	\$ 31	\$ 29
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(1) Assuming 30-year book life

(2) Property taxes are based on the prior year end plant balances. Assumes effective rate of 1.5% on change in plant in service.

Revenue from Proposed Schedule 3

	2008	2009	2010 Best Case	2010 More Likely Case
Total Schedule 3 Revenue				
Residential				
Single	\$9,937,777	\$25,295,237	\$31,679,252	\$30,150,439
Subdivision	\$0	\$5,724,003	\$68,475,142	\$38,226,981
Multi-family	\$1,314,894	\$3,320,180	\$4,105,624	\$3,892,624
Total Residential	\$11,252,671	\$34,339,420	\$104,260,018	\$72,270,044
Non-Residential				
Non-Residential	\$38,663,218	\$82,782,753	\$86,871,593	\$86,871,593
Total	\$49,915,889	\$117,122,173	\$191,131,611	\$159,141,637
Average Revenue Per MeterSet				
Residential				
Single	\$10,475	\$10,869	\$11,012	\$11,157
Subdivision	\$0	\$3,025	\$3,058	\$3,092
Multi-family	\$1,273	\$1,311	\$1,325	\$1,339
Average Residential	\$5,678	\$5,086	\$3,675	\$4,021
Non-Residential				
Non-Residential	\$15,638	\$16,053	\$16,204	\$16,358
Average for all customers	\$11,207	\$9,835	\$5,667	\$6,835

Assumptions:

- 1) Meter set counts assumes transition plan in effect; no revenue from subdivisions in 2008
- 2) Local facilities costs based on 2006 average costs, escalated at 4% per year
- 3) System facilities costs based on historical 3 yr average to mitigate the impacts of large projects such as a large substation in one year, escalated at 4% per year



INDUSTRIAL COMMISSION OF ARIZONA

Division of Occupational Safety and Health
P.O. BOX 19070
PHOENIX, AZ 85005
Phone: (602)542-5795 FAX: (602)542-1614
Tucson Office Phone: (520) 628-5478 FAX: (520)322-8008

Citation and Notification of Penalty

To:

Pinnacle West Capital Corporation dba
Arizona Public Service Company
400 N. 5th Street
Phoenix, AZ 85004

Inspection Number: A9339 - 312836141

Inspection Date(s): 12/02/2008 -04/21/2009
Issuance Date: 05/28/2009

Inspection Site:

Saguaro Switchyard M/P 288 on I-10
Red Rock, AZ 85245

The violation(s) described in this Citation and Notification of Penalty is (are) alleged to have occurred on or about the day(s) the inspection was made unless otherwise indicated within the description given below.

An inspection of your workplace was recently conducted in accordance with Arizona Occupational Safety and Health Act (Title 23, Chapter 2, Article 10). The inspection revealed conditions which we believe to be in violation of the Act. The nature of the alleged violation(s) is described in the enclosed Citation(s) with reference to applicable standards, rules and provisions of said Act. Furthermore, you are hereby notified, or will soon be notified, whether or not penalties will be proposed as a result of the cited violation(s). You must abate the violations referred to in this Citation by the dates listed and pay the penalties, unless within fifteen (15) working days (excluding weekends and legal holidays) from your receipt of this Citation and Notification of Penalty you notify, *in writing*, the Division of Occupational Safety and Health, at the address shown above, of your intent to contest.

Posting - The law requires that a copy of this Citation and Notification of Penalty be posted immediately in a prominent place at or near the location of the violation(s) cited herein, or, if it is not practicable because of the nature of your operations, where it will be readily observable by all affected employees. This Citation must remain posted until the violation(s) cited herein has (have) been abated, or for 3 working days (excluding weekends and legal holidays), whichever is longer. **YOU MUST COMPLY WITH THESE POSTING REQUIREMENTS EVEN IF YOU CONTEST THE CITATION.** The penalty dollar amounts need not be posted and may be marked out or covered up prior to posting.

Notification of Corrective Action: - You must certify in writing to the Division that each cited violation has been corrected, in accordance with A.A.C.R20-5-627. This certification must be received within 10 calendar days following the abatement date, for those items which you do not contest. For those items contested, the certification is due immediately following any final order upholding the citation(s). The certification must contain

the following: 1) the employer's name and address; 2) the inspection number; 3) the completion date and method of abatement for each violation; 4) a statement that the information is accurate and, 5) a statement that all affected employees and their representatives have been informed of the completed abatement. The *Abatement Certification Form* accompanying this notice may be used to assist with this requirement. For those items classified as **serious**, **willful** or **repeat**, documentation (photos, copies of receipts, training records, etc.) demonstrating that abatement is complete must accompany the certification. Abatement certification and documentation is **not** required for those violations the inspector observed you or your representative correct during the inspection and marked as "Abated on site" within this citation. For those violations having an abatement date of more than ninety days, abatement plans and progress reports must be submitted to the Division if so indicated on the violation.

A follow-up inspection may be made for the purpose of ascertaining that you have posted the citation(s) as required by the Act and corrected the alleged violations. **Failure to correct an alleged violation within the abatement period may result in further penalties of up to \$7000 for each day each alleged violation has not been corrected. Timely correction of an alleged violation does not affect the initial penalty.**

Note: The Act provides that anyone who knowingly gives false information is guilty of a class 2 misdemeanor.

Informal Conference - Before deciding whether to file a "Notice of Contest", you may request an informal conference with the section supervisor to discuss the Citation and Notification of Penalty. You may use this opportunity to:

- Obtain a better explanation of the violations cited;
- Obtain a more complete understanding of the specific standards that apply;
- Discuss ways to correct the violations;
- Discuss problems with the abatement dates;
- Discuss problems concerning employee safety practices;
- Resolve disputed citation(s) and penalties;
- Present any evidence or views that you believe would support an adjustment to the citations and/or penalties;
- Negotiate and enter into an Informal Settlement Agreement; and
- Obtain answers to any other questions you might have.

An informal conference is not required. However, you are encouraged to take advantage of the opportunity to have a conference if you foresee any difficulties in complying with any part of the citation. If an informal conference is held, be sure to bring with you any and all supporting documentation of existing conditions, as well as any abatement steps taken thus far. If conditions warrant, we can enter into an Informal Settlement Agreement which amicably resolves this matter without litigation or formal contest.

If you are considering a request for an informal conference, you must take care to schedule it early enough to allow time to contest after the informal conference, should you decide to do so. For this reason, an informal conference should be held within the 15 working day contest period (see following section). **The running of this contest period is not interrupted by an informal conference.**

Right to Contest - You have the right to contest this Citation and Notification of Penalty pursuant to A.R.S. Section 23-417. You may contest all citation items or only individual items. You may also contest penalties and/or abatement dates without contesting the underlying violations. To contest, you must notify the Director, in writing, within 15 working days after receipt of the Citation and Notification of Penalty. **Unless you inform the Director in writing that you intend to contest the citation(s) and/or penalty(ies) within the 15 working day period provided by law, the citation(s) and the penalty(ies) shall be deemed a final order of the Commission and not subject to review by any court or agency.**

Note: "Notify[ing] the Director" means that ADOSH must receive your written notice of contest prior to the close of business on the 15th working day following receipt of the citations.

If you contest the citation(s), the abatement period specified therein does not begin to run until the date of the Commission's final order in the case **provided** you have initiated this contest in good faith and not solely for delay or avoidance of penalties.

Penalty Payment - Penalties are due within 15 working days of receipt of this notification unless contested. Please make your check or money order payable to "Industrial Commission of Arizona" and indicate on your remittance the Inspection Number found on Page 1 of this notification. **ADOSH does not agree to any restrictions, conditions or endorsements put on any check or money order and will cash the check or money order as if these restrictions, conditions or endorsements do not exist.**

Employer Discrimination Unlawful - The law prohibits discrimination by an employer against an employee for filing a complaint or for exercising any rights under this Act. An employee who believes that he/she has been discriminated against may file a complaint no later than 30 calendar days after the discrimination occurred with the Division of Occupational Safety and Health at the address shown above.

Notice to Employees - The law gives you or your representative the opportunity to object to any abatement date set for a violation if you believe the date to be unreasonable. The contest must be mailed to the Division Director, P. O. Box 19070, Phoenix, Arizona, 85005-9070 within the abatement period allowed in the citation or within 15 working days from the date of receipt of the citation, whichever is shorter.

Additional Information - You should be aware that Federal OSHA publishes information on ADOSH's inspection and citation activity on the Internet under the provisions of the Electronic Freedom of Information Act. The information related to your inspection will be available 30 calendar days after the Citation Issuance Date. You are encouraged to review the information concerning your establishment at www.osha.gov. If you have any dispute with the accuracy of the information displayed, please contact this office.

ABATEMENT CERTIFICATION

A.A.C. R20-5-627 requires employers to certify to ADOSH, in writing, the abatement of all cited conditions, with the exception of those conditions observed abated by the compliance officer during the course of the inspection. This form is provided to assist you in complying with the abatement certification requirements. Note: For violations classified as willful, repeat or serious, abatement documentation (i.e. photographs, invoices, training records, etc.) must also accompany this certification form.

Arizona Public Service Company
400 N. 5th Street
Phoenix, AZ 85004

The hazard referenced in Inspection Number _____ for the violation identified as Citation _____ and Item _____ was corrected on _____ by _____
(Specify Action Taken) _____

The hazard referenced in Inspection Number _____ for the violation identified as Citation _____ and Item _____ was corrected on _____ by _____
(Specify Action Taken) _____

The hazard referenced in Inspection Number _____ for the violation identified as Citation _____ and Item _____ was corrected on _____ by _____
(Specify Action Taken) _____

The hazard referenced in Inspection Number _____ for the violation identified as Citation _____ and Item _____ was corrected on _____ by _____
(Specify Action Taken) _____

The hazard referenced in Inspection Number _____ for the violation identified as Citation _____ and Item _____ was corrected on _____ by _____
(Specify Action Taken) _____

I attest that the information contained in this document is accurate and that the affected employees and their representatives have been informed of the abatement activities described in this certification.

Signature

Typed or Printed Name



Citation and Notification of Penalty

Company Name: Pinnacle West Capital Corporation dba
Arizona Public Service Company
Inspection Site: Saguaro Switchyard M/P 288 on I-10, Red Rock, AZ 85245

Citation 1 Item 1 Type of Violation: **Serious**

29 CFR 1910.269(a)(3): Existing Conditions: Existing conditions related to the safety of the work to be performed were not determined before work on or near electric lines or equipment was started.

(a) Saguaro Switch Yard, Red Rock, AZ: Existing hazardous conditions related to the work being performed on the high voltage lines and equipment were not thoroughly evaluated before allowing employees to work in these areas such as the induced voltage from the 500kV lines that ran parallel to APS's de-energized lines, the static electrical energy and the stored energy in the Coupled Capacitor Voltage Transformer's (CCVT's).

Date By Which Violation Must be Abated:	06/21/2009
Assessed Penalty:	\$ 7000.00



Citation and Notification of Penalty

Company Name: Pinnacle West Capital Corporation dba
Arizona Public Service Company
Inspection Site: Saguaro Switchyard M/P 288 on I-10, Red Rock, AZ 85245

Citation 1 Item 2 Type of Violation: **Serious**

29 CFR 1910.269(c): Job Briefing: The employer did not ensure that the employee in charge conducted a job briefing with the employees involved before they started each job. The briefing did not cover at least the following subjects: hazards associated with the job, work procedures involved, special precautions, energy source controls, and personal protective equipment requirements.

(a) Saguaro Switch Yard, Red Rock, AZ: The Foreman in charge of the high voltage 2nd Phase work, specifically the Switch and Insulator Repair, did thoroughly brief the exposed employees on the hazards associated with their job, energy source controls or the personal protective equipment required for Work Order #W440155 on 12/1-2/2008.

(b) Saguaro Switch Yard, Red Rock, AZ: The Foreman in charge of the high voltage 3rd Phase work, specifically the corrosion maintenance of the 2250 MCM cables that connect the Wave Trap to the Coupled Capacitor Voltage Transformer, did not brief the victim on the hazards associated with the job, work procedures involved, special precautions, energy source controls, and personal protective equipment requirements.

Date By Which Violation Must be Abated:	06/21/2009
Assessed Penalty:	\$ 7000.00



Citation and Notification of Penalty

Pinnacle West Capital Corporation dba
Company Name: Arizona Public Service Company
Inspection Site: Saguaro Switchyard M/P 288 on I-10, Red Rock, AZ 85245

Citation 1 Item 3 Type of Violation: **Serious**

29 CFR, 1910.269 (d)(6)(vii): Lockout/Tagout Application: Before starting work on machines or equipment that have been locked out or tagged out, the authorized employee did not verify that isolation and de-energizing of the machine or equipment had been accomplished.

(a) Saguaro Switch Yard: An employee was working on the 2250 MCM cables to the 3rd Phase Wave Trap that connect to Coupled Capacitor Voltage Transformer without inspecting or testing to verify that the equipment had been de-energized.

Date By Which Violation Must be Abated:	06/21/2009
Assessed Penalty:	\$ 7000.00

Citation 1 Item 4 Type of Violation: **Serious**

29 CFR, 1910.269(l)(2): Minimum approach distances: The employer did not make sure that no employee approached or took any conductive object closer to exposed energized parts than is set forth in Table R-6 through R-10.

(a) Saguaro Switch Yard: The employer allowed employees to approach and fuzz high voltage lines and equipment and take conductive equipment such as a non-insulated manlift, closer than what was allowed by the minimum distance chart.

Date By Which Violation Must be Abated:	07/01/2009
Assessed Penalty:	\$ 7000.00

Industrial Commission of Arizona
Division of Occupational Safety and Health

Inspection Number: 312836141
Inspection Dates: 12/02/2008 - 04/21/2009
Issuance Date: 05/28/2009
CSHO ID: A9339



Citation and Notification of Penalty

Company Name: Pinnacle West Capital Corporation dba
Arizona Public Service Company
Inspection Site: Saguaro Switchyard M/P 288 on I-10, Red Rock, AZ 85245

Citation 1 Item 5 Type of Violation: **Serious**

29 CFR, 1910.269(w)(1)(iii), Capacitors: Any line to which capacitors are connected shall be short-circuited before it is considered de-energized.

(a) Saguaro Switch Yard: An employee was performing work on the 2250 MCM cables that connect the 3rd Phase Wave Trap to the Coupled Capacitor Voltage Transformer (CCVT), and the Coupled Capacitor Voltage Transformer had not been de-energized of it's stored energy, tested for voltage, or grounded prior to the work.

Date By Which Violation Must be Abated:	06/05/2009
Assessed Penalty:	\$ 7000.00

Assistant Director

See pages 1 through 4 of this Citation and Notification of Penalty for information on employer and employee rights and responsibilities.

Snell & Wilmer

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DENVER

LAS VEGAS

ORANGE COUNTY

PHOENIX

SALT LAKE CITY

TUCSON

June 1, 2009

VIA CERTIFIED MAIL
RETURN RECEIPT REQUESTED

Mr. Darin Perkins, Area Director
The Industrial Commission of Arizona
Division of Occupational Safety and Health
800 West Washington Street
P.O. Box 19070
Phoenix, Arizona 85005-9070

Re: *Pinnacle West Capital Corporation dba*
Arizona Public Service Company ats ADOSH
(Inspection No. A9339-312836141)

Dear Darin:

Please be advised that Pinnacle West Capital Corporation dba Arizona Public Service Company has retained Snell & Wilmer L.L.P. to represent its interests in the above-referenced matter. Please direct all future communication and correspondence to my attention. If any representatives or agents of The Industrial Commission of Arizona wish to discuss this matter with any present or past employee of Pinnacle West Capital Corporation dba Arizona Public Service Company, please contact me first.

Please accept this letter as Pinnacle West Capital Corporation dba Arizona Public Service Company's Notice of Contest, pursuant to A.R.S. § 23-417. Pinnacle West Capital Corporation dba Arizona Public Service Company wishes to specifically contest each and every citation, penalty, classification, and abatement date pertaining to the Citation and Notification of Penalty identified as Inspection No. A9339-312836141.

Very truly yours,

SNELL & WILMER, LLP



Charles P. Keller

CPK:cg

cc: Bruce A. Gardner, Esq.

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