

BEFORE THE ARIZONA CORPORATION

CARL J. KUNASEK, Chairman
JIM IRVIN, Commissioner
WILLIAM A. MUNDELL, Commissioner

Arizona Corporation Commission
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IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR APPROVAL OF ITS PLAN FOR STRANDED COST RECOVERY } A.C.C. - DOCKET CONTROL } Docket No. E-01345A-98-0473

IN THE MATTER OF THE FILING OF ARIZONA PUBLIC SERVICE COMPANY OF UNBUNDLED TARIFFS PURSUANT TO A.C.C. R14-1-1601 } Docket No. E-01345A-97-0773 } ET SEQ.

IN THE MATTER OF COMPETITION IN THE PROVISION OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA } Docket No. RE-00000C-94-0165

APPLICATION OF ENRON CORP. FOR REHEARING OF COMMISSION DECISION NO. 61973

On October 6, 1999, the Arizona Corporation Commission (Commission) issued Decision No. 61973, its Opinion and Order ("Order") in the above-captioned proceeding. By this Order, the Commission approved in part and modified in part a Settlement Agreement filed by Arizona Public Service Company ("APS") and certain other parties on May 17, 1999. The Settlement would govern the opening of APS's market to retail competition and would provide for the recovery of stranded costs related to APS's transfer of its assets to an affiliated company. Enron Corp., on behalf of its affiliates Enron Energy Services Inc. and Enron Capital & Trade Resources Inc., (jointly, "Enron"), participated in the Commission proceedings leading up to the Order. Enron filed a Post-Hearing Brief and also Exceptions to the Chief Hearing Officer's recommended opinion and order. Enron

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1 participated in the Commission Open Meeting on September 23, 1999 in which the proposed
2 Settlement Agreement and the Chief Hearing Officer's recommendations were considered. Enron
3 hereby files this Application for Rehearing of Decision No. 61973.

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5 **I.**
6 **SUMMARY OF POSITION**

7 **A. Overview**

8 The above-captioned proceedings involve a balancing of competing interests: the incumbent
9 utility, the retail consumers and the new entrant competitive energy service providers ("ESPs").
10 Each interest group has a stake in the outcome of the process and each group is essential to the
11 success of a restructured market which is based on free market forces. The needs of ESPs, the
12 desires of the traditional "APS" customer base and the bottom line of what would be acceptable to
13 APS have to be accommodated. Unfortunately, the voices of the ESPs were given short shrift.
14 While the settlement may bring about earlier implementation of open access, this settlement will not
15 bring about meaningful competition for most consumers.

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17 The purported objective of the settlement filed in this case is to open APS's retail electric
18 markets because the Commission has determined that competition best serves the public interest.
19 Transitional rate reductions, stranded cost recovery and the creation of affiliated marketers are but
20 tangential to the overall purpose of restructuring. Unfortunately, it seems as if these issues are
21 driving the process and have somehow eclipsed the ultimate objective of creating a vigorous,
22 competitive marketplace for consumers in APS's territory. To the contrary, the record contains
23 absolutely nothing to indicate that the settlement will create such a vibrant market. In fact, all the
24 ESP participants, the parties who are out marketing power on a daily basis, have testified and
25 presented evidence to the contrary.
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B. Procedural Issues

From a procedural perspective, Enron believes that the Chairman of the Commission had his mind irrevocably closed on many of the issues at hand, and thus should be disqualified from voting on the APS settlement. Simply stated, he was not the impartial decisionmaker contemplate and required under the Arizona Constitution and the Arizona Revised Statutes. Illustrative of this is the fact that he stated he would not approve a settlement arrangement that was not supported by the signatory parties to the May 17, 1999 Settlement Agreement. In addition, the Chairman also allowed APS to supplement the record after it had been closed, and did not permit other parties to respond to APS's supplemental evidence.

C. Substantive Issues

The first substantive issue goes to the lack of parity between standard offer rates and direct access rates. The key consideration here is the inadequacy of the shopping credit, which is the difference between the fully bundled standard offer rate which APS offers all retail customers and the direct access rates that APS will charge to customers taking service from ESPs. The Order did not improve the settlement's artificially created "shopping credit," leaving ESPs to compete with a standard offer rate they cannot begin to beat. The record in this case is replete with documentation that the shopping credit, which itself varies with the customer class and customer size, does not even cover wholesale energy prices. As will be discussed below, the shopping credit must be enhanced, not to give ESPs a guaranteed profit, but to give the market a chance to work. There are additional rate-related issues as well.

For example, rate decreases for standard offer service occur on July 1, while the rate decreases for direct access occur on Jan. 1 each year under the settlement as approved. This lack of

1 synchronization in rate decreases squeezes the shopping credit even further, giving APS's standard
2 offer service yet another competitive edge. In addition, failure to eliminate cross-subsidies going
3 from large customers to small customers keeps the large customer class direct access rates high and
4 reduces, to unacceptable levels, the shopping credit that should be available to those customers.
5 Similarly, standard offer service for the E-32 rate schedule does not contain a demand charge for the
6 first 5 kW of customer demand, but the direct access rate schedule for the same customer does
7 contain a CTC demand charge for the first 5 kW. These factors also render the chance for
8 meaningful competition in the APS market slim.
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10 A second substantive flaw lies in the Commission's failure to limit the market power APS will
11 enjoy after competition begins. The impact of residual market power may be hard to quantify but
12 is just as pernicious as any other market barrier. The Order addresses market power only in the
13 context of the generation affiliate. It simply requires APS to add language to the Settlement
14 Agreement to reflect that (1) it will create a generation affiliate under the parent company, Pinnacle
15 West; (2) it intends to procure generation for standard offer customers from the wholesale generation
16 market, and (3) APS's generation affiliate could bid for that load but would otherwise have no
17 automatic privilege to serve.
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19 Enron argued at the hearing that, under the Settlement Agreement, APS could subsidize the spun-
20 off assets by manipulating the capital structure of APS and the generation affiliate. The Order
21 provides that the capital structure of APS will be scrutinized in its 2004 rate case. However,
22 delaying for 5 years the review of cross-subsidization and related issues is a patently inadequate
23 solution. By that time, all the damage that cross-subsidization and preferential treatment can do in
24 an emerging market will have been done. Similarly, the Order does state that the Commission will
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1 review actual asset transfers. However, it is far from clear what, if any, meaningful action the
2 Commission would be able to take at that time to address capital structure and related concerns,
3 given that the settlement specifically authorizes and approves APS's asset transfer to its affiliate as
4 of this point in time.

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6 A related market power concern arises from the delay APS has obtained in transferring its
7 competitive generation assets to its affiliate. Under the Order, this transfer will not occur until the
8 end of 2002. Thus, for the years 2000, 2001 and 2002, APS will be supplying standard offer service
9 with the generation it continues to own and control, just as it does today. APS will not be required
10 to competitively bid out the standard offer service in this pre-transfer period and the record show that
11 it has no intention of doing so.

12
13 The final concern over market power comes from the allocation of risk in the Settlement
14 Agreement. Under its provisions, APS would be able to set the standard offer price for power at the
15 time of market opening, and then to recover any shortfalls in later periods. This sets the stage for
16 a successful predatory pricing scenario in which APS can set the standard offer price below market,
17 thereby keeping out competitors, and then recover dollars lost through such actions by means of risk-
18 free adjustments starting in 2004. That is a result which the Commission must address now, and
19 preclude.

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21 If APS is to offer merchant service in a competitive market, then its risk profile must be the same
22 as other competitors. It must offer a price and bear the market risk of that price. It cannot be
23 permitted to offer a price and then recover, through regulated, non-bypassable charges, losses
24 attributed to that price some years down the road. The Commission must not allow APS to
25 accumulate undercollections during the settlement period for deferred recovery several years later,
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1 inasmuch as this takes away the benefits of lower rates which the customers believe the settlement
2 has provided, while undermining competition.

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4 **II.**
5 **SPECIFICATIONS OF ERROR**

6 **A. Denial of Procedural Due Process**

7 **Statement of Relevant Facts**

8 On September 9, 1999, the Chairman of the Commission sent a letter to Bill Post, President and
9 Chief Executive Officer of APS, in which the Chairman alluded to recent actions of certain Wall
10 Street analysts in relation to the stock of Pinnacle West, APS's parent corporation.¹ That letter made
11 specific references to Docket No. E-01345A-98-0473, and was in fact docketed in that proceeding.
12 Therein the Chairman requested that Mr. Post identify those aspects of the then-pending Chief
13 Hearing Officer's recommended opinion and order in the aforesaid docket which might be of
14 concern to said Wall Street analysts,
15 and make recommendations to eliminate those portions of the settlement [sic] that could negatively
16 impact Pinnacle West and its consumers.²

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19 On September 16, 1999, one of Enron's hearing counsel wrote to the Chairman following his
20 receipt of a copy of the September 9, 1999 letter to Mr. Post. Therein he made the following
21 observation with regard to the Chairman's request of Mr. Post:

22 In effect, you have 'opened up the record' in the above-captioned
23 matter for the express purpose of allowing the primary applicant
24

25 ¹ A copy of the Chairman's Sept. 9, 1999 letter is attached as Appendix "A" and incorporated herein by reference.

26 ² In a September 17, 1999 letter to Enron's hearing counsel, the Chairman clarified that the reference to "settlement"
27 in his September 9, 1999 letter was intended to be a reference to the Chief Hearing Officer's recommended opinion and
28 order.

1 (APS) to provide additional information as to how the 'settlement
2 agreement' might be modified 'to eliminate those portions of the
3 settlement that could negatively impact Pinnacle West Such
4 opening occurs at a point in time after (i) the evidentiary record has
5 been closed, (ii) Post-Hearing Briefs have been filed, (iii) a
6 recommended Opinion and Order has been issued and (iv) Exceptions
7 thereto have been submitted by various hearing participants,
8 including Enron.³

9 Enron's letter was transmitted by facsimile to the Chairman, as well as submitted to the
10 Commission's docket control.

11 That same day, the Chairman sent a letter to all parties of record in the aforesaid docket.
12 Therein he sought to clarify the purpose of his September 9, 1999 letter to Mr. Post, in light of
13 "concerns about the letter as expressed by some of the parties involved" in the docketed proceeding.

14 He then proceeded to make the following significant, and legally fatal, statement:

15 *First, I have no intentions in changing the substantive provisions of*
16 *a negotiated settlement. I gave a commitment to all parties in the*
17 *deregulation process that I would support a negotiated agreement*
18 *between affected utilities and its customers, provided the customers*
19 *were well represented in the negotiations. That I believe has*
20 *occurred. [Emphasis added.]*⁴

21 Thus, through his own language, the Chairman acknowledged that he was predisposed to approve
22 the settlement arrangement which had been negotiated between APS and other signatory parties,
23 notwithstanding such arguments in opposition or for changes as had been made by non-signatory
24 parties, such as Enron.

25 ³ A copy of the September 16, 1999 letter from Enron's counsel is attached as Appendix "B" and incorporated herein
26 by reference.

27 ⁴ A copy of the Chairman's September 16, 1999 letter is attached as Appendix "C" and incorporated by reference
28 herein

1 On September 17, 1999, the Chairman wrote a letter to Enron's counsel in response to the
2 latter's September 16, 1999 letter to the Chairman. Therein the Chairman endeavored to assure
3 Enron's counsel that his decision on the Settlement Agreement "as always will be based on the
4 record."⁵ Thereafter, he made the following significant statement, which is also legally fatal:

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6 Further, should [the Wall Street analysts'] concerns be related to the
7 Opinion and Order, I would support modifications only if supported
8 by the record *and by those who were in support of the settlement filed*
9 *earlier* with this Commission.

10 In other words, in his opinion, the arguments and positions of non-supporting parties on the merits
11 (and demerits) of the Settlement Agreement were not worthy of consideration!

12 Discussion of Applicable Law

13 A "fair trial in a fair tribunal is a basic requirement of due process." *In re Murchison*, 349
14 U.S. 133, 136 (1955). "This applies to administrative agencies as well as the courts." *Gibson v.*
15 *Berryhill*, 411 U.S. 564, 579 (1973). The Commission is such an agency, and in ruling upon the
16 proposed Settlement Agreement and the Chief Hearing Officer's recommended opinion and order
17 it was exercising its adjudicative authority. In addition, "not only is a biased decisionmaker
18 constitutionally unacceptable but 'our system of law has always endeavored to prevent even the
19 probability of unfairness.'" *In re Murchison, supra.* at 136; *Tuney v. Ohio*, 273 U.S. 510, 532 (1927).
20 Finally, "such an administrative hearing 'must be attended, not only with every element of fairness,
21 but with the very appearance of complete fairness.'" *Cinderella Career and Finishing Schools, Inc.*
22 *v. FTC*, 425 F.2d 583, 591 (DC Cir. 1970), citing *Amos Treat & Co. v. SEC*, 306 F.2d 260, 267 (DC
23 Cir. 1962).
24

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26 _____
27 ⁵ A copy of the Chairman's September 17, 1999 letter is attached as Appendix "D" and incorporated by reference
28 herein

1 Sadly, in this instance, these attributes and the requisite constitutional protections were
2 lacking. In this regard, the Chairman erred in such fundamental ways that Decision No. 61973 must
3 be vacated or rescinded.

4 First, through his September 9, 1999 letter to Mr. Post, the Chairman opened up the record
5 in Docket No. E-10345A-98-0473 (and Docket Nos. E-01345A-97-0773 and RE-00000C-94-0165)
6 and allowed APS to submit additional evidence without allowing any other parties to the
7 consolidated proceedings an opportunity to test the same through cross-examination, and/or rebut
8 it with their own evidence. That evidence was hand-delivered to the Chairman on September 17,
9 1999 in the form of a September 17, 1999 letter from Mr. Post to the Chairman, together with a one-
10 page chart.⁶ Despite APS's attempt to suggest in the penultimate paragraph of its letter that it had
11 addressed the Wall Street analysts' concerns in the Exceptions it previously filed on September 7,
12 1999, the reality is that Enron and other parties were summarily denied that procedural due process
13 to which they are entitled as a matter of law.

14 Second, the Chairman did not possess that objectivity and impartiality legally required of him
15 in connection with his consideration of and decision upon the merits of the proposed Settlement
16 Agreement and the Chief Hearing Officer's recommended opinion and order. To the contrary, his
17 statements in his September 16, 1999 letter to the parties of record, and his September 17, 1999 letter
18 to Enron counsel, "reveal a tribunal [member] not meeting the demands of due process for a hearing
19 with fairness and the appearance of fairness." *Staton v. Mayes*, 552 F.2d 908, 914 (10th Cir. 1977),
20 citing *Cinderella Career and Finishing Schools v. FTC*, *supra*.

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27 ⁶ A copy of that letter and chart" are attached as Appendix "E" and incorporated by reference herein.

1 More specifically, in each of those letters the Chairman in effect indicated that his exercise
2 of discretion was subject to what changes in the Settlement Agreement, if any, would be acceptable
3 to the signatory parties to that document. These written remarks on his part

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5 . . . were not mere statements on a policy issue related to the dispute,
6 leaving the decisionmaker capable of judging a particular controversy fairly on
7 the basis of its own circumstances. *Staton v. Mayes, supra*.

8 To the contrary, these remarks involved, in effect

9 "statement on the merits by those [i.e. the Chairman] who must make factual determinations
10 on contested fact issues . . ." *Staton v. Mayes, supra*.

11 In this instance, the views of the signatory parties would have a controlling influence on the
12 Chairman's exercise of his discretion as to the merits on various issues involving the Settlement
13 Agreement.

14 In a sense, the Chairman's two letters are analogous to the speeches of the former Chairman
15 of the Federal Trade Commission that were at issue in *Texaco, Inc. v. FTC*, 336 F.2d 754 (DC Cir.
16 1964) and *Cinderella Career and Finishing Schools v. FTC, infra*. In those cases, the reviewing
17 court concluded that in such speeches the FTC Chairman had indicated that he had already to some
18 extent reached a decision as to the matters then pending before the FTC. In the present
19 circumstances, the Chairman of the Commission has clearly indicated that he had no intention of
20 changing any substantive provision of the Settlement Agreement that was not acceptable to the
21 signatory parties, regardless of the arguments of other parties or the recommendations of the Chief
22 Hearing Officer.

23
24 In summary, Enron regretfully concludes and submits that the Chairman's mind was
25 "irrevocably closed" as to arguments against and recommended changes in the Settlement Agreement
26 that were not acceptable to the signatory parties. As a consequence, the basis for his disqualification
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1 to participate in the issuance of Decision No. 61973 has been demonstrated, and that decision should
2 be rescinded or vacated. *See Havasu Heights v. Desert Valley Wood*, 167 Ariz. 383, 387 (App.
3 1990), citing *FTC v. Cement Institute*, 333 U.S. 683, 701 (1948). The Chairman's own written
4 acknowledgment of the importance of the views of the signatory parties attests to the existence of
5 a prejudgment on his part as to the resolution of specific facts that are at issue, thereby warranting
6 his disqualification. *See Havasu Heights, supra*, citing *Cinderella Career and Finishing Schools*
7 *v. FTC, supra*.

9 In *Cinderella*, the reviewing court made the following statement:

10 The rationale for remanding the case despite the fact that former Chairman
11 Dixon's vote was not necessary for a majority is well established:

12 'Litigants are entitled to an impartial tribunal whether it consists of
13 one man or twenty and there is no way which we know of whereby
14 the influence of one upon other the others can be quantitatively
15 measured. *Berkshire Employees Ass'n of Berkshire Knitting Mills*
16 *v. NLRB*, 121 F.2d 235, 239 (3rd Cir. 1941).

17 Given the fact that Decision No. 61973 was issued by a 2 to 1 vote, with the Chairman
18 participating in the majority, it is manifest that decision must be vacated or rescinded at this time.

19 B. Substantive Matters

20 **Statement of Relevant Facts.**

21 Enron and other ESPs were opposed to Settlement Agreement as filed. The Commission did
22 make several modifications to the Settlement Agreement. APS was ordered to provide credits for
23 metering and billing services (when performed by the ESP, and not APS), based on the embedded
24 costs of those services, not the decremental costs as the settlement had provided for. APS was also
25 ordered to allow customers with usage in excess of 3 MW to return to standard offer service on less
26 than one year's notice, provided the customer agrees to pay for any additional costs its return to
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1 standard offer causes APS to incur. The Commission revised section 2.8 of the Settlement
2 Agreement as well. This section allows APS to seek rate increases under certain circumstances, but
3 precluded any other party from seeking rate relief. The section was revised to allow the Commission
4 to seek or authorize a change in either unbundled or standard offer rates prior to July 1, 2004 under
5 emergency circumstances or material changes in APS's cost of service due to changes in laws,
6 regulations or judicial decisions. The parties to the settlement were directed, and agreed, to file
7 revised language for Section 7.1 which otherwise would have bound future commissions.
8

9 The Commission ordered APS to add language to the settlement to indicate that it will
10 establish a new generation affiliate under Pinnacle West, that it intends to procure generation for
11 standard offer customers from the wholesale market as provided for in the Commission's electric
12 competition rules, and that the generation affiliate could bid to serve the APS standard offer but that
13 there would be no automatic privilege for the affiliate to serve this load. The Commission
14 authorized APS to recover only 67% of the costs it incurs in transferring its generation assets to an
15 affiliate. The Commission stated that it will closely scrutinize the capital structure of APS in its
16 2004 rate case to prevent any cross-subsidies to the generation assets. The Commission supported
17 and authorized the transfer of the competitive assets as set forth in the settlement but required APS
18 to provide, 30 days prior to any transfer, a specific list of assets to be transferred along with their
19 book value at the time of transfer. The Commission reserved the right to verify whether the assets
20 are competitive assets and whether there are other assets that should also be transferred.
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23 While the modifications move the Settlement Agreement in the right direction, they do not
24 alter the overarching anticompetitive nature of the settlement. The deck chairs were rearranged, but
25 the ship is still doomed.
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1 A. The Settlement Neither Assures All Potential Suppliers Fair Access to Customers Nor
2 Provides Customers With an Opportunity to Purchase Electricity from the Supplier of their Choice.

3 1. The Implied Shopping Credit Does Not Reflect Market Prices of Energy or the
4 Costs of Providing Retail Service.

5 The shopping credit is the difference between the bundled standard offer rate available as a
6 default service to APS's retail customers, and the direct access rate available to customers who take
7 service from ESPs. The standard offer rate becomes the cap on what the ESP can charge for its
8 services. If the ESP cannot purchase power and cover its other retailing costs within the "shopping
9 credit," it will not be able to offer competitively priced services. The Settlement Agreement's
10 shopping credit is an artificial division of costs resulting from APS's "black box" rates. It does not
11 reflect the true costs to either APS or the ESP in providing retail service. Nonetheless, since APS
12 has not unbundled its rates based on costs, the Commission must look at the shopping credit to see
13 if it is adequate for competitive retail service.
14

15 Indeed, if the shopping credit is set low, ESPs cannot supply energy to consumers. ESPs will
16 not be able to recover the direct access portion of the rate, the generation component and the additive
17 costs of providing retail service, because the resulting bundled ESP rate would then exceed the
18 standard offer rate. There are retailing costs which ESPs will incur and must be able to recover, over
19 and above the unbundled services the Commission listed in its April 23, 1999 proposed Electric
20 Competition Rules ("ECR").⁷ These are commodity acquisition and supply portfolio management,
21 energy imbalance costs, planning reserves and certain functions related to metering, billing and
22 customer handling. As Enron witness Kingerski explained,⁸ prices for non-competitive services
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26 ⁷ Decision No. 61634.

27 ⁸ Enron Exhibit 6, Direct Testimony of H. Kingerski, pp. 16-17. *See also* Exhibit HJK-1 in Enron Exh. 6.
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1 should be competitively neutral and should not affect a customer's decision to purchase competitive
2 services. The success of competitors should depend on their success at providing competitive
3 services and not on the pricing of non-competitive services.

4
5 Mr. Kingerski and others testified that the shopping credit was too low for competition to
6 occur. Mr. Kingerski presented a calculation which showed, as an example, that for a 500 kW
7 customer with a 50% load factor, the shopping credit was insufficient to cover the ESP's wholesale
8 energy cost, much less the additional retail activities an ESP must perform in order to provide
9 service to the retail customer.⁹ APS claimed that the shopping credit was sufficient for at least
10 certain customers in the 40 kW to 200 kW class. Mr. Kingerski explained that the shopping credit
11 even for this group was insufficient, once APS's numbers are adjusted for current wholesale energy
12 costs and the cost of hourly interval metering, which APS will require for the direct access
13 customer.¹⁰ But even if APS were correct, a shopping credit that works only for some customers in
14 certain classes with particular load profiles is not a shopping credit that fairly opens all of the market
15 to choice.
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18 The Commission's Order stated that the shopping credit level was one of the most
19 contentious issues in this case. It noted that the ESPs argued that the shopping credits were "not
20 sufficient to allow new entrants to make a profit." (Order at p. 7). Staff also argued that the
21 shopping credits were too low. The testimony in favor of the shopping credit came from, not
22 surprisingly, APS and the AECC. AECC argued that larger shopping credits just increased ESP
23 margins. APS simply asserted that the shopping credit was adequate for a particular subclass of
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26 ⁹ Tr. at pp. 845-6, *see also* APS Witness Davis at Tr. p. 223, lines 15-18.

27 ¹⁰ Oral Surrebuttal of H. Kingerski, Tr. at pp. 845, line 20 - 847, line 11.

1 customers. The Order does not find that either of these parties maintained that the shopping credit
2 would allow new entrants to compete for all segments of the APS retail market. The Commission
3 did find, however, that the "shopping credits appear to be reasonable to allow ESPs to compete in
4 an efficient manner." In face of the overwhelming and uncontroverted evidence presented by those
5 very ESPs to the contrary, this finding is simply erroneous and unsupported by the record.
6

7 Staff proposed that the shopping credit could be increased, without raising rates to APS
8 customers, by reducing the competitive transition charge ("CTC") which is the surcharge imposed
9 on all customers to recover the allowed stranded cost amount. The Commission discussed this at
10 the open meeting on September 23, 1999. Staff was asked how much longer the CTC would have
11 to remain in rates, if the recommended reduction in the CTC was implemented. While Staff
12 answered that it might take up to one additional year to fully recover the \$350 million in stranded
13 costs the settlement provided for, it is Enron's view that the recovery will be completed in far less
14 time. This is because the settlement did not account for the load growth which APS will experience
15 over the next few years. Indeed, as Commissioner Irvin points out in his dissent to the Commission
16 order, APS/Pinnacle West obviously believe that the APS territory will experience significant
17 growth, as evidenced by its recent announcement that it plans to build and upgrade its generation
18 facilities to meet demands of customer growth.
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21 2. To Assure that All Suppliers Have Fair Access to the Wires, The Direct Access Rate and The
22 Standard Offer Rate Must Both Be Unbundled to Provide a Measure for Comparability of
23 Service and to Allow Consumers to Compare Providers.

24 The "ECR" require that APS unbundle its standard offer tariff and separately price a minimum
25 of ten components.¹¹ By separating the rates into its unbundled components which reflect the cost
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27 ¹¹ The elements are: Electricity: Generation, Competitive Transition Charge, Must-Run Generating Units; Delivery:
28 Distribution Services; Transmission Services; Ancillary Service; Other: Metering Service, Meter Reading Service and
Billing and Collection; System Benefits. R14-2-1606C.

1 of pricing the service,¹² parties can compare standard offer and direct access rates. The rate for each
2 unbundled service, be it transmission, distribution, ancillary services, etc., should be the same for
3 both a standard offer or direct access customer, as the service provided is identical, regardless of who
4 is selling that customer power. Having rates for both services unbundled into their separate
5 components ensures that ESPs enjoy "comparability of service." For example, the distribution
6 charge for a standard offer customer should be the same charge if that customer takes direct access
7 service, because the distribution service is no different. If the rate for distribution service is more
8 under the direct access rate schedule, then ESPs face an economic barrier which thwarts competition.
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12 We do, however, have an example of non-comparability of service between the standard offer
13 and direct access rate schedules, which was examined at the hearing. Rate decreases under the
14 settlement occur for standard offer customers on July 1 of each year. The direct access rate
15 decreases take effect on the following January 1. The monthly residential customer charge under
16 Standard Offer is \$7.50. If a customer under that rate schedule opts for direct access service, the
17 charge goes up to \$10.00.¹³ This means that the ESP must find \$2.50 of monthly savings before it
18 can even offer a lower price for generation, be able to entice customers and show a profit.
19 Furthermore, the Settlement Agreement sets a CTC demand charge for every kW of demand for
20 direct access customers while standard offer customers have no such charge for the first 5 kW of
21 demand. These examples illustrate that the settlement as approved does not give ESPs comparability
22 of service. It provides unduly discriminatory service to their substantial detriment.
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27 ¹² Order No. 61634, App. A, R14-2-1606C(4) and 1606H.

28 ¹³ See Cross Examination of APS Witness Propper Tr. pp. 1166-1167.

1 Mr. Kingerski addressed APS Witness Propper's argument that unbundling standard offer
2 rates would result in extreme dislocations in class revenues and major rate dislocations. The rate
3 dislocation stems from the fact that large customers' rates subsidize the rates of smaller customers.
4 While this continues, the direct access rates for those larger customers remains higher than it would
5 under true cost-of-service ratemaking. These artificially high direct access rates squeeze the
6 shopping credit for this class of customer.
7

8 In Enron Exhibit 9, Mr. Kingerski provided an illustrative example of how standard offer
9 rates can be unbundled with no effect on the customers' total rate.¹⁴ He further explained that this
10 can be done even where the total rate for a given class is different from the actual cost of service for
11 that class. The value of this unbundling is that it provides for non-discriminatory, comparable prices
12 for non-competitive services, as demonstrated in Enron Exhibit 9. Since APS has not conducted the
13 cost of service study, the only viable option for immediately unbundling both direct access and
14 standard offer rates is to use the top down approach. This approach necessitates making adjustments
15 to each of the non-competitive, unbundled rate components if there are situations where the total rate
16 for a given class is less than the actual cost of service for that class.¹⁵
17
18

19 3. The Settlement Protects APS From Market Risk, Even as It Allows APS to Offer
20 Products into a Competitive Marketplace.

21 The Commission's ECR requires that after Jan. 1, 2001, power purchased by an investor-
22 owned utility for standard offer Service shall be acquired from the competitive market through
23 prudent, arm's-length transactions and with at least fifty percent through a competitive bid process.
24 APS's recovery of the costs it incurs in obtaining power for the standard offer service is of vital
25

26 _____
27 ¹⁴ Enron Exhibit 9, and Oral Surrebuttal of Enron Witness Kingerski at Tr. pp. 848-850.

28 ¹⁵ See Cross Examination of Enron Witness Kingerski at pp. 881-886.

1 interest to ESPs, as provision for deferred recovery of costs for generation will make the standard
2 offer more attractive to consumers. These customers are not receiving accurate "real time" price
3 signals if the standard offer rate can be adjusted in later periods to recoup losses for under-recovery.

4 Enron raised this before the Commission during the hearing. Enron Witness Kingerski
5 explained that the settlement allows APS to recover costs it incurs in providing standard offer service
6 at no risk to APS.¹⁶ Section 2.5 of the Settlement Agreement allows APS to defer costs, including
7 costs incurred in providing standard offer service, for later full recovery through an adjustment
8 mechanism. Section 2.8 authorizes APS to seek increases in its standard offer rate, even during the
9 rate freeze period prior to July 1, 2004, under certain conditions, which APS was unable to describe
10 with any certainty at the hearing.¹⁷ Enron has argued throughout that this allows APS to sell
11 standard offer service below market or even below cost, making it impossible for ESPs to compete.
12 APS can then recover any revenue shortfalls through the adjustment mechanism in Section 2.6 or
13 the safety valve provision in Section 2.8. This is carte blanche for APS to engage in predatory
14 pricing. The Commission did not address this concern in its Order, and it must do so on rehearing.

15
16
17
18 B. The Transfer of Generation Assets to An APS Affiliate Raises Market Power and Related
19 Regulatory Concerns Which the Commission Failed to Address Adequately.

20 The Settlement Agreement as approved permits APS to carry its monopoly market power
21 forward into the competitive arena, through, *inter alia*, its treatment of the generation assets. The
22 Commission failed to ensure that APS's market power would not be transferred to deregulated
23 services either through its standard offer service or through the transfer of assets to an affiliate.

24
25 ¹⁶ See Direct Testimony of Witness Kingerski, p. 9, lines 19-21, discussing Settlement Agreement sections 2.6 and 2.8.
26 Section 2.6 allows APS to defer costs, including Standard Offer costs, for later full recovery through an adjustment
27 clause. Section 2.8 authorizes APS to seek increases in its unbundled or standard offer rate even during the rate freeze
28 period prior to July 1, 2004.

¹⁷ Cross Examination of APS Witness Davis, Tr. at p. 264, line 17 through p. 271, line 15..

1 1. APS's Monopoly Market Power Will Be Transferred to GENCO

2 It is incumbent upon the Commission to identify and address market power in generation or other
3 areas that will result if the settlement is approved. Enron Witness Frankena made several significant
4 findings regarding generation market power in Arizona. He found that load pockets exist in the
5 Phoenix and Yuma areas (Phoenix is a relevant geographic market during high load periods), APS
6 and SRP own 35% and 65% of the generating capacity in the Phoenix load pocket, and market power
7 is a serious problem in this area. Dr. Frankena testified that further investigation may show that
8 there exist additional relevant geographic markets for electric capacity and energy larger than the
9 identified load pockets, which would give APS substantial market share. Next he concluded that the
10 settlement leaves ownership of the generating capacity in Arizona unchanged but for the fact that
11 APS's share would be owned by an APS affiliate, which would have the same ability and incentive
12 to exercise market power as the incumbent. Lastly, Dr. Frankena concluded that the settlement did
13 not mitigate APS's market power or reduce the likelihood of the exercise of this power through
14 coordinated behavior by two or more parties. The leverage this Commission has to reduce market
15 power derives from its treatment of APS's stranded costs. Once that decision is reached, as it would
16 be through approval of this settlement, then the Commission loses its ability to address market
17 concerns.
18
19
20

21 APS Witness Hieronymous attempted to rebut Dr. Frankena's conclusions. Mr. Hieronymous
22 used the FERC Appendix A methodology to address market power. Dr. Frankena challenged the
23 use of the Appendix A methodology in great detail,¹⁸ and even Mr. Hieronymous has been critical
24 of Appendix A.¹⁹ Mr. Hieronymous criticizes Mr. Frankena's point that there may be relevant
25

26 _____
27 ¹⁸ Oral Surrebuttal of Enron Witness Frankena, Tr. at pp. 175, line 5 to p. 178, line 7.

28 ¹⁹ Cross Examination of APS Witness Hieronymous, Tr. at pp. 1251-1253.

1 markets larger than the load pockets identified, stating that this analysis is not required by the DOJ
2 Guidelines.²⁰ Witness Hieronymous simply concludes that if he had looked at larger markets, APS's
3 share would have been less.²¹ However, this is an opinion without any substantiation. The sum and
4 substance of Dr. Frankena's testimony, which remains unrefuted by APS, is simply this: the public
5 interest requires a more detailed analysis of market power than the last minute analysis Witness
6 Hieronymous provided based on the controversial Appendix A methodology. Absent such a detailed
7 study, the Commission has no reliable basis from which to ascertain the competitive impact of the
8 wholesale transfer of APS's competitive assets to an affiliate.
9

10 2. The Asset Transfer Raises Other Regulatory Concerns, Including Subsidization of
11 Unregulated Services by Regulated Services.

12 The asset transfer proposal in the settlement must be viewed not only in terms of generation
13 market power, but also in the fairness of the resulting stranded cost recovery, and cross-subsidization
14 concerns. Enron Witness Rosenberg addressed these issues, testifying that the settlement provides
15 insufficient evidence that the transfer of generation assets to an unnamed APS affiliate ("GENCO")
16 will sufficiently safeguard customers and promote competition.
17

18 The Commission must deal with cost-shifting between GENCO and APS. There is no indication
19 in the Settlement Agreement as to how APS will deal with GENCO once the generation assets have
20 been transferred. In fact, APS does not even plan to transfer the competitive assets to GENCO or
21 any other affiliates until the end of 2002. This means that, for at least the first three years of
22 competition, there will not even be the protection against cross-subsidization and other intra-
23
24

25 _____
26 ²⁰ Oral Surrebuttal of APS Witness Hieronymous, Tr. at p. 1242, lines 15-16. DOJ Guidelines are the Department of
Justice/Federal Trade Commission merger guidelines.

27 ²¹ Oral Surrebuttal of APS Witness Hieronymous, Tr. at p. 1242, lines 16-18 and p. 1244 at lines 11-13.
28

1 corporate favoritism that corporate separation between the provider of standard offer service and the
2 owner of the assets offers. Absent functionally unbundled rates, we can be assured that some
3 measure of the generation service is being recovered in the direct access rates, a clear situation where
4 competitive services provided by third parties are subsidizing the regulated standard offer against
5 which they compete. Additionally, APS rates will recover certain costs associated with the
6 generation facilities it will transfer to GENCO, giving GENCO yet another advantage in the
7 wholesale electric market.²²

9 Dr. Rosenberg further identified a concern that APS might retain favorable purchase power
10 contracts in the wires company, which would otherwise be a stranded benefit to ratepayers, and
11 certainly imbues standard offer service with a competitive advantage.²³ Mr. Davis testified for APS
12 that in fact, the "only purchase power contract we have in terms of magnitude" is the Salt River
13 Project power purchase contract. He testified that if APS has less standard offer service than the
14 magnitude of that contract, they would transfer it to an affiliate, if not, then the contract would stay
15 in the wires company, to supply its standard offer service.²⁴ This is precisely the kind of cherry-
16 picking that Dr. Rosenberg warned against.

19 Dr. Rosenberg also testified that the asset transfer proposed in the Settlement Agreement raises
20 concerns over capitalization and capital structure. The issue here is that the transfer of assets from
21 APS to GENCO requires a new division of debt and equity.²⁵ This division has implications for all
22

23 ²² Cross Examination of APS Witness Davis, Tr. at p. 263, decommissioning and fuel disposal costs will be
24 recovered in systems benefit charge.

25 ²³ Enron Exhibit 1, Direct Testimony of A. Rosenberg, at p. 3.

26 ²⁴ Tr. at pp. 1118-1119.

27 ²⁵ Dr. Rosenberg illustrates this on pp. 6-9 of his Direct Testimony, Enron Exhibit 1.

1 customers. Debt financing is cheaper than equity financing and is tax deductible to the corporation.
2 A more highly leveraged structure benefits customers, but if the transfer shifts the higher cost of
3 capital (equity) to the regulated company, the GENCO gets the unearned competitive advantage
4 derived from a low capital cost. APS indicated that it had not determined the future funding method
5 for its competitive affiliates.²⁶
6

7 The Commission in the Order stated that it "shared the concerns that the non-competitive portion
8 of APS not subsidize the spun-off competitive assets through an unfair financial arrangement."
9 However, it also stated that the Commission "supports and authorizes the transfer by APS to an
10 affiliate or affiliates of all its generation and competitive electric service assets as set forth in the
11 Agreement." (Order at p. 10.) The Commission went on to state that "the Commission will closely
12 scrutinize the capital structure of APS at its 2004 rate case and make any necessary adjustments."
13 APS is poised to open its market in the closing days of 1999. It will transfer its generation asset to
14 an affiliate in late 2002. If the Commission waits until a 2004 rate case (which likely won't be
15 resolved until 2005 or after), APS and its affiliates will have enjoyed more than 5 years of
16 unexamined and untouchable competitive preference. The harm to the competitive marketplace will
17 have been long done and the customers will have long ago signed up with APS or its affiliate for
18 retail electric service. The ex post facto Commission review the Order provides for is much too little
19 and far too late to prevent the harm it should, and the goal of introducing and fostering a viable
20 competitive marketplace in APS's service area will not have been realized.
21
22

23
24 3. AISA/Desert Star May Not Adequately Address Market Power Issues.
25
26

27 ²⁶ Enron Exhibit 1, Direct Testimony of A. Rosenberg, at p. 8.
28

1 Enron argued in these proceedings that allowing APS to transfer all of the generation APS
2 currently owns to a GENCO affiliate simply transfers APS's generation market power to an
3 unregulated company. APS addressed this by stating that the Arizona Independent System
4 Administrator, ("AISA") and later the Regional Transmission Organization ("Desert Star") will
5 mitigate its market power.²⁷ Enron Witness Delaney discussed at length the problems associated
6 with AISA and Desert Star, and this was echoed by APS's own witness, Mr. Propper, who stated that
7 "the AISA had not completed its protocols or even filed them with the FERC." The Federal Energy
8 Regulatory Commission ("FERC") would review and either approve, modify or reject the filing. He
9 further stated that it is not known whether FERC will accept whatever AISA files.²⁸
10

11
12 Mr. Delaney explained in depth the shortcomings of AISA which render its ability to address
13 market concerns minimal at best. He recommended that the Commission impose a standard of
14 conduct on the GENCO which would require it to sell a portion of its output to non-affiliated
15 purchasers. He also suggested that some degree of divestiture of the generating assets could also
16 effectively mitigate the market power that the GENCO would otherwise enjoy. In lieu of divestiture,
17 APS (or the GENCO) could be required to exchange or sell output of load pocket resources to
18 unaffiliated entities, or could be required to file, with the FERC, a "recourse tariff" which would cap
19 the price at which APS/GENCO could sell in the identified load pockets. This would shift the risk
20 of managing these assets from the ratepayer to the generator. Second, the recourse tariff should
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22
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26 ²⁷ APS Exhibit 9, Davis Rebuttal, pp. 27-29.

27 ²⁸ APS Exhibit 11, Propper Rebuttal, at p. 12.

1 allow any potential purchaser to call on APS/GENCO to sell power in the load pockets and in
2 Northern Arizona. Third, the tariff should cap ancillary services sold by APS/GENCO.²⁹

3 The Commission did not address any of these arguments in the Order. One can only assume then
4 that the Commission believed that existing or future structures will limit the GENCO's market
5 power. Enron does not believe that existing or future structures will effectively blunt the APS-
6 affiliated GENCO's market power, and it submits that the Commission's failure to address this issue
7 constitutes serious error.
8

9 4. The Delay in Transferring Assets Leaves Open Potential for Market Power Abuse.

10 Section 4.1 of the Settlement Agreement allows APS to delay transferring its competitive assets
11 to an affiliate until Dec. 31, 2002.³⁰ Thus, for the first three years of open markets, APS will
12 continue to own and operate all of the competitive assets it now has, including generation and those
13 assets associated with customer (revenue cycle) services. The Settlement Agreement is completely
14 silent as to how APS will manage the competitive assets while it still owns them. The Order directed
15 APS to include in its Code of Conduct, which must be filed by November 6, 1999, "provisions to
16 govern the supply of generation during the two-year period of delay for the transfer of generation
17 assets so that APS doesn't give itself an undue advantage over the ESPs." (Order at p. 12.) Enron
18 would note in this regard that the period which the Code of Conduct should cover is from the present
19 time until the end of 2002 (when it plans to transfer its assets) is over three years.
20
21
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25 ²⁹ Enron Exhibit 5, Direct Testimony of T. Delaney at p. 8.

26 ³⁰ APS Witness Davis testified that while APS could transfer the assets at any time during that three-year period, it would
27 likely not be done much before the December 31, 2002 date, and that all assets will be transferred to GENCO
28 simultaneously. Tr. at p. 334, line 4 through p. 335, line 8.

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1 Second, Enron is concerned that the Commission has given no guidance to APS as to how it
2 should manage the generation assets to avoid giving itself an undue advantage over other ESPs. The
3 delay in transferring generation and other assets has implications under the Commission's ECR as
4 well. R14-2-1606B requires the utility to supply the standard offer service through the competitive
5 market. If, for the next three years, APS retains all the generation it currently owns, it is hard to see
6 how it will be supplying standard offer service from the competitive market with at least 50% of its
7 needs being purchased through a competitive bid process, as the rule also requires. The "competitive
8 market" requirement in Rule 1606B prevents the utility from using its monopoly power to give it
9 a better competitive product than ESPs can provide in the marketplace. If APS intends to use all of
10 its generation assets to serve standard offer service, it will not be in compliance with Rule 1606B.
11 The Commission should specifically state that APS is subject to this rule from the outset.
12

13 III. 14 CONCLUSION.

15 WHEREFORE, in light of the discussion above, Enron submits that the Commission should
16 (i) grant rehearing and reconsideration of Decision No. 61973, (ii) vacate or rescind Decision No.
17 61973, and (iii) issue a new Opinion and Order addressing the problems and adopting the
18 modifications described above. In so doing, the Commission can correct the legal defects currently
19 surrounding Decision No. 61973, and ensure that the resulting open marketplace in APS's service
20 area is a "level playing field" which effectively permits ESP's to bring products and services to
21 APS's customers.
22

23 Dated: October 25, 1999

24 Respectfully submitted,

25 ENRON CORP.
26
27
28

1
2 By: Lawrence V. Robertson, Jr.

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4 Munger Chadwick, P.L.C.
5 National Bank Plaza
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8 and

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1 THE ORIGINAL AND 10 COPIES OF THE FOREGOING APPLICATION FOR REHEARING
2 WERE SENT BY FEDERAL EXPRESS ON OCTOBER 25, 1999 FOR FILING ON OCTOBER
3 26, 1999 WITH:

4 Docket Control
5 Arizona Corporation Commission
6 1200 W. Washington St.
7 Phoenix, Arizona 85007

8 A COPY OF THE FOREGOING DOCUMENT WAS MAILED, FIRST CLASS, POSTAGE
9 PREPAID, ON OCTOBER 25, 1999 TO:

10 Jerry L. Rudibaugh, Chief Hearing Officer
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14 Phoenix, AZ 85007

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Appendix A

CARL J. KUNASEK
CHAIRMAN
JIM IRVIN
COMMISSIONER
WILLIAM A. MUNDELL
COMMISSIONER



BRIAN C. McNEIL
EXECUTIVE SECRETARY

ARIZONA CORPORATION COMMISSION

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September 9, 1999

Docket No. E-01345A-98-0473

Mr. Bill Post, President & CEO
Arizona Public Service
Mail Station 9036
P.O. Box 53999
Phoenix, AZ 85072

Dear Bill:

In the past couple of weeks, I have noticed that at least a couple of Wall Street analysts have downgraded Pinnacle West stock. As you know, this could have an adverse affect on the company's ability to borrow money at favorable rates going forward. In turn, this could cost Arizona consumers in the form of higher rates.

To assist the Commission in its efforts to maintain favorable market conditions for Arizona consumers, please identify those concerns that have been raised which have affected the performance of Pinnacle West stock. If they are related to the settlement agreement, can you please identify the areas of concern and make recommendations to eliminate those portions of the settlement that could negatively impact Pinnacle West and its consumers going forward.

As you know, I have long believed that competition can be good for both the shareholder and consumer and believe that we are very close to making this a win-win situation.

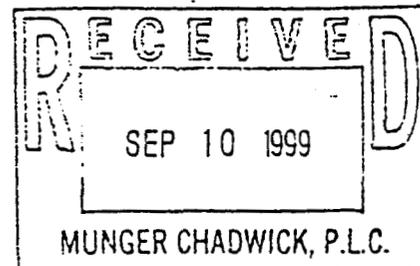
Thanking you in advance for your attention to this matter.

Sincerely,

A handwritten signature in cursive script, appearing to read "Carl".

Carl Kunasek
Chairman

Cc: Commissioner Jim Irvin
Commissioner William A. Mundell
Deb Scott
Paul Bullis
Docket Control
Parties of Record



Appendix B

MUNGER CHADWICK, P.L.C.

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DISTRICT OF COLUMBIA

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PHOENIX, ARIZONA

OF COUNSEL
OGARRIO Y DIAZ ABOGADOS
MEXICO, D.F., MEXICO
(LICENSED SOLELY IN MEXICO)

September 16, 1999

Hon. Carl Kunasek, Chairman
Arizona Corporation Commission
1200 W. Washington
Phoenix, AZ 85007

Re: Docket No. E-01345A-98-0473
(Arizona Public Service Company)

Dear Chairman Kunasek:

This letter is written on behalf of Enron Corp. ("Enron") in response to your letter of September 9, 1999 to Bill Post, in his capacity as President and CEO of Arizona Public Service Company ("APS"). A copy of that letter is attached as Appendix "A."

Your letter represents a procedural development that does not appear to be contemplated or provided for by the Commission's Rules of Practice and Procedure. In effect, you have "opened up the record" in the above-captioned matter for the express purpose of allowing the primary applicant (APS) to provide additional information as to how the "settlement agreement" might be modified "to eliminate those portions of the settlement that could negatively impact Pinnacle West . . ."¹ Such opening occurs at a point in time after (i) the evidentiary record has been closed, (ii) Post-Hearing Briefs have been filed, (iii) a recommended Opinion and Order has been issued and (iv) Exceptions thereto have been submitted by various hearing participants, including Enron.

It remains to be seen whether or how APS will respond to the invitation. In any event, Enron believes it must register its concern at this time. On its face, your letter does not appear to contemplate that other parties of record would have an opportunity to respond to such information

¹ Perhaps your reference to "settlement agreement" was inadvertent, and you intended to refer to the recently issued proposed Opinion and Order. Presumably APS is not opposing the Settlement Agreement to which it is a signatory party.

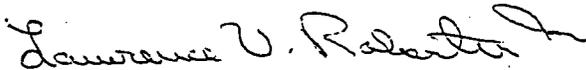
Hon. Carl Kunasek, Chairman
Arizona Public Service Company
September 16, 1999
Page 2

as APS might decide to provide. Nor does it suggest that they would be allowed to test its credibility or place it into context through cross-examination of representatives of APS and/or third parties (e.g. rating agencies) to whom APS might allude. "Parties of record" were indicated recipients of copies of your correspondence, but for no apparent purpose.

Against this background, Enron hereby respectfully requests that you withdraw the invitation to APS set forth in your September 9 letter. The Commission has before it the full record it needs to act on the recommended opinion and order. To receive additional information at this juncture in the manner contemplated by your letter would deny due process to Enron and others similarly situated.

As previously noted, your letter represents a procedural development neither contemplated nor provided for under the Commission's rules. Accordingly, an original of this letter is being mailed to you, and a duplicate original and ten (10) copies are also being filed with the Commission's Docket Control.

Very truly yours,



Lawrence V. Robertson, Jr.
MUNGER CHADWICK, P.L.C.
Attorney for Enron Corp.

cc: Commissioner Jim Irvin
Commissioner William A. Mundell
Jerry Rudibaugh, Hearing Division
Deb Scott, Utilities Division
Paul Bullis, Legal Division
Docket Control
Parties of Record

Appendix C

CARL J. KUNASEK
CHAIRMAN

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September 16, 1999

Docket No. E-01345A-98-0473

RE: Docket No. E-01345A-98-0473

To All Parties of Record:

As you probably know, last week I sent a letter to Mr. Bill Post of Arizona Public Service in an effort to ascertain why Pinnacle West (PW) stock had declined and more specifically to find out what concerns have caused some Wall Street analysts to downgrade PW stock.

Because of concerns about the letter as expressed by some of the parties involved in the Arizona Public Service stranded cost settlement, I thought it appropriate to clarify the purpose of my letter.

First, I have no intentions in changing the substantive provisions of a negotiated settlement. I gave a commitment to all parties in the deregulation process that I would support a negotiated agreement between affected utilities and its customers, provided the customers were well represented in the negotiations. That I believe has occurred.

However, I do want to know the reasons for the recent stock downgrades and depressed stock price. More important, I want to know if these concerns are long-term in nature, something that would affect the company's bond rating and potentially increase customer rates.

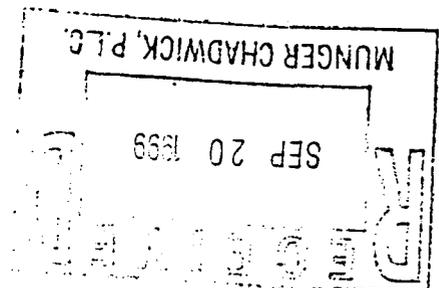
To the extent these concerns stem from our activities, I want to know what changes could be made that would not impact the other parties to the settlement. Whether that can occur remains to be seen.

Sincerely,

A handwritten signature in cursive script, appearing to read "Carl J. Kunasek".

Carl J. Kunasek
Chairman

cc: Commissioner Jim Irvin
Commissioner William A. Mundell
Brian McNeil
Deborah Scott
Paul Bullis
Docket Control



Appendix D

CARL J. KUNASEK
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September 17, 1999

Mr. Lawrence V. Robertson, Jr.
Munger Chadwick, P.L.C.
333 North Wilmot, Suite 300
Tucson, AZ 85711

Dear Mr. Robertson:

I'm in receipt of your letter dated September 16, 1999. By now you should be in receipt of a second letter that clarified my letter of September 9, 1999. I have enclosed a copy of my September 16th correspondence for your review.

First, let me say that you are correct when you suggest that I was referring to the proposed Opinion and Order, and not the settlement agreement as suggested in my earlier letter.

Second, and I note, that my letter of September 9, 1999 simply requests information from APS about recent concerns expressed by at least two Wall Street analysts as well as suggestions as to how those concerns can be addressed. I want to know what those concerns are so that I can evaluate whether those concerns might have a long-term negative impact on APS's ability to borrow money at preferred rates.

I do not know if these concerns are related to the Opinion and Order. If they are, then I would expect APS to file exceptions in the docket which would address those issues. However, I would also hope that APS would respond to my letter so that its exceptions are specifically identified in relation to those concerns held by at least two Wall Street analysts.

No where in my letter do I promise an outcome. Further, my decision as always will be based on the record. I am simply asking for clarification in a shortened format. Additionally, I will note that my request was done in accordance with Commission rules of practice and procedure – it was docketed and sent to all parties of record. It is my job to be concerned about the ability of Arizona utilities to fund ongoing build outs and infrastructure improvements, and I want to make sure that the concerns held by at least two Wall Street analysts do not have an unnecessary and negative impact on APS.

To the extent you believe that Commissioners are unable to inquire about concerns expressed about APS by analysts – or anyone else for that matter – at a time when the Commission is contemplating taking action that concerns APS, I disagree. Further, should the concerns be related to the Opinion and Order, I would support modifications only if supported by the record and by those who were in support of the settlement filed earlier with this Commission.

I do recognize that the electric restructuring process has not been a smooth ride, and I assure you it is not my intention to add to those troubles.

Sincerely,

A handwritten signature in cursive script, appearing to read "Carl J. Kunasek".

Carl J. Kunasek
Chairman

cc: Commissioner Jim Irvin
Commissioner William A. Mundell
Brian McNeil
Deborah Scott
Paul Bullis
Docket Control
All Parties of Record

Appendix E



William J. Post
Chief Executive Officer

TEL 602/250-2588
FAX 602/250-3002

Mail Station 9036
P.O. Box 53999
Phoenix, AZ 85072-3999

September 17, 1999

Via Hand Delivery

Carl J. Kunasek
Chairman
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Re: APS Settlement Proceeding (ACC Docket Nos. E-01345A-98-0473, et. al.)

Dear Commissioner Kunasek:

In response to your letter of September 9, 1999, Pinnacle West's stock has certainly performed poorly since the August 26, 1999 issuance of the Hearing Officer's Recommended Order in our settlement proceeding. Attached is a chart showing this decline as compared to the industry average. You will note that our stock price has dropped almost 10% since that date for a total loss in value of more than \$300 million. In contrast, the Everen Index of 80 electric utilities has declined only 2.9% during the same time. In fact, Pinnacle West's stock performance (price change) in the last month is the fourth worst out of the 83 integrated electric utilities reported by Bloomberg Financial Services. Such a trend, if continued, will adversely affect APS' cost of both debt and equity in the manner described in your letter. While the Company's bond rating has not currently been impacted, the substantive changes the hearing officer proposes to Section 2.8 of the settlement create additional uncertainty which may negatively impact the cost of future debt issuances. This is a significant concern because, as testified to in the settlement hearing, APS will be spending over \$1 billion of capital during the transition period to improve our transmission and distribution facilities.

As also noted in your letter of September 9, 1999, Pinnacle West's stock has been downgraded by two analysts since issuance of the Recommended Order. One of these analysts, (Morgan Stanley/Dean Witter), specifically cited the Recommended Order as the reason for the downgrade, while the other (Credit Suisse First Boston) indicated that the Recommended Order was not the cause. The Company is aware of two other analysts, Salomon Smith Barney and Dresdner Kleinwort Benson, have since commented on the Recommended Order although neither changed its overall rating of Pinnacle West.

Carl J. Kunassek
September 17, 1999
Page 2

All four of the security analysts referenced above, even the one that gave the Recommended Order an overall positive review, identified the substantive proposed changes to Section 2.8 of the Settlement as the most negative feature of the recommendation. Other changes to the Settlement noted with disfavor were the arbitrary disallowance of one-third of the Company's forced divestiture costs and the increase in revenue cycle service (metering, etc.) credits. APS has addressed each of these items in its September 7, 1999 filed Exceptions and has proposed specific amendments to the Recommended Order to rectify these and other shortcomings of the Recommended Order.

I hope this has been responsive to your inquiry.

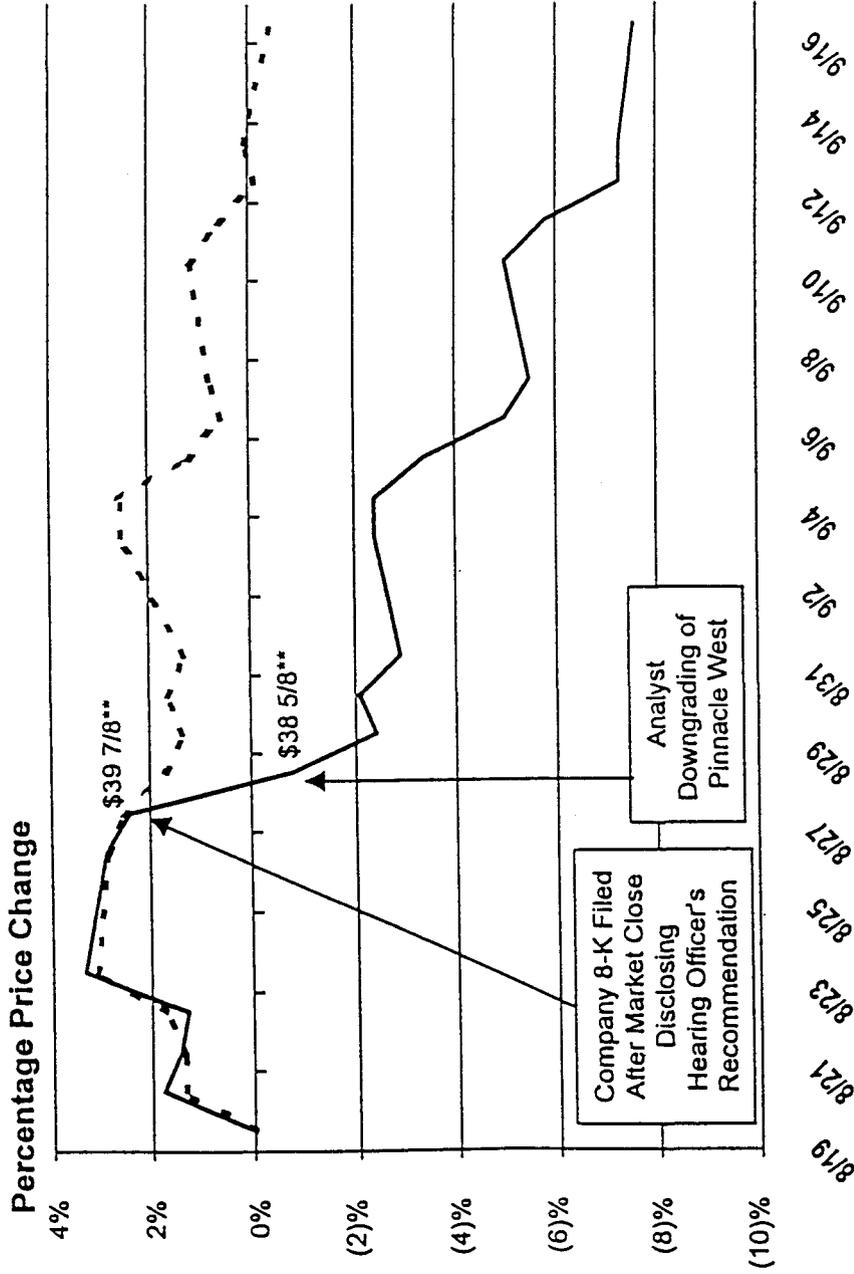
Sincerely,

A handwritten signature in cursive script that reads "Bill Post". The signature is written in dark ink and is positioned to the right of the typed name.

William Post

cc: Jim Irvin
William A. Mundell
Jerry Rudibaugh
Paul Bullis
Deborah Scott
All parties of record

Pinnacle West Capital Corporation Stock Performance Relative to Electric Utility Industry* August 19, 1999 - September 16, 1999



— Pinnacle West - - - Electric Industry*

* Based on Everen Index of 80 Electric Utilities

** Pinnacle West Stock Price

MEMORANDUM

TO: DISTRIBUTION LIST

FROM: DOCKET CONTROL CENTER

DATE: October 26, 1999

RE: Arizona Public Service filing on October 26, 1999

The purpose of this Memorandum is to notify you that on October 26, 1999, Enron Corporation filed an application for rehearing of Commission Decision No. 61973 issued in Docket No. E-01345A-98-0473, E-01345A-97-0773 and RE-00000C-94-0165. Document was distributed as an Exception item instead of a Rehearing.

Attached to this Memorandum is a copy of the filing which was distributed as a Exception today. Please disregard that filing and use the attached filing showing a rehearing.