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Transcript Exhibit(s)

E-01345A-03-0437, etc.

E-01345A-05-0526

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To: Docket Control

Re: APS / Rates & PSA Surcharge
E-01345A-03-0437, etc.
Volumes I through III Concluded
October 26, 27, and 28, 2005

STATUS OF ORIGINAL EXHIBITS

FILED WITH DOCKET CONTROL
10-31-2005

STAFF

1 through 5

APS

1 through 9 and 14

RUCO

1

GLEASON

1 and 2

MUNDELL

1 through 4

MAYES

1

EXHIBITS TO BE LATE-FILED

STAFF

6

APS

10 through 13

Copy to:

Lyn Farmer, CALJ (letter only)
Staff (Chris Kempley, Esq.)
APS (Cynthia Janka)

EXHIBIT
APS-1
Admitted

DIRECT TESTIMONY OF DAVID J. RUMOLO

On Behalf of Arizona Public Service Company

Docket No. E-01345A-05-0526
&
Docket No. E-01345A-03-0437

October 17, 2005

Table of Contents

DIRECT TESTIMONY OF DAVID RUMOLO
ON BEHALF OF ARIZONA PUBLIC SERVICE COMPANY
(Docket Nos. E-01345A-05-0526 & E-01345A-03-0437)

I. INTRODUCTION AND SUMMARY

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is David Rumolo. My business address is 400 North Fifth Street, Phoenix, Arizona 85004.

Q. BY WHOM ARE YOU EMPLOYED AND WHAT IS YOUR POSITION?

A. I am employed by Arizona Public Service Company ("APS" or "Company") as Manager of Regulation and Pricing. I am responsible for establishing and administering APS tariffs and contract provisions that are under the jurisdiction of the Arizona Corporation Commission ("ACC" or "Commission") or the Federal Energy Regulatory Commission ("FERC").

Q. WOULD YOU DISCUSS YOUR EDUCATIONAL BACKGROUND AND BUSINESS EXPERIENCE?

A. My background and experience are set forth in Appendix A to this testimony.

Q. WAS THIS TESTIMONY AND THE ACCOMPANYING SCHEDULE PREPARED BY YOU OR UNDER YOUR DIRECTION?

A. Yes, they were.

Q. WOULD YOU SUMMARIZE YOUR TESTIMONY?

A. My testimony supports the revised Plan of Administration ("POA") for the Power Supply Adjustment Mechanism ("PSA") developed by APS, Staff, the Residential Utility Consumer Office, and other parties to the 2004 APS Settlement. I provide an overview summary description of the PSA that was adopted as a key element of the 2004 Settlement Agreement approved by the

Commission in Decision No. 67744 (April 7, 2005) and the POA that is used to provide direction and detail for implementing the PSA. I also describe some of the key clarifications that were added to the POA since it was jointly filed by the Settlement Parties in June of this year.

II. THE PSA

Q. PLEASE DESCRIBE THE PSA.

A. The PSA applies to all retail electric schedules with the exception of Solar-1, Solar-2, E-3 (Residential Energy Support Program), E-4 (Medical Care Equipment Program), E-36 and Direct Access service. It tracks changes in the costs of obtaining power supplies. The PSA tracks the actual incurred costs compared to the system average cost included in base retail rates. A PSA Adjustor Rate will be credited or debited on customers' bills each month as an energy charge. This PSA Adjustor Rate will be the same for all affected Standard Offer customers. The PSA consists of four main components:

- a PSA Adjustor Rate that is adjusted annually;
- a Balancing Account with a defined threshold amount;
- a band that limits the amount of the PSA Adjustor Rate that can be applied each time it is changed, and which has a lifetime cap of 4 mills per kilowatthour; and
- an Amortization Surcharge (or "Surcharge") that may be implemented to reduce the size of the Balancing Account.

Q. PLEASE DESCRIBE THE PURPOSE OF THE BALANCING ACCOUNT.

A. The Balancing Account accumulates dollars associated with under-collection or over-collection from the application of the base rate power supply cost and the PSA Adjustor Rate.

Q. WILL THE BALANCING ACCOUNT ACCRUE INTEREST?

A. Yes, interest will be accrued based on the one-year Nominal Treasury Constant Maturities rate.

III. <u>POA</u>

Q. PLEASE DESCRIBE THE POA.

A. The POA is the administrative document for the PSA. It describes the PSA, defines terms found in the PSA, lists the specific information that is filed by APS each month, provides sample calculations for the PSA Adjustor Rate and Balancing Account treatment, and describes the Amortization Surcharge.

Q. PLEASE DESCRIBE THE CLARIFICATIONS ADDED TO THE POA SINCE THE POA WAS FILED BY THE SETTLEMENT PARTIES IN JUNE OF THIS YEAR.

A. The current version of the POA, as presented by Staff, provides additional clarity and explains the calculation of the annual PSA Adjustor Rate and monthly Balancing Account entries when there is an Amortization Surcharge in place. The changes include adding a list of definitions of the terms used in the PSA, adding clarification of when the PSA Adjustor Rate took effect and when an Amortization Surcharge can take effect, adding clarifying language on the administration of the Balancing Account and the application of the $100 million bank balance trigger, and elimination of Broker Fees in the description of recoverable PSA costs. This latter change is consistent with Staff's earlier recommendation of July 25, 2005 relative to the June POA and was made not because Broker Fees are not a legitimate fuel cost, but because Staff believed such Broker Fees were already included in the Base Fuel Cost. The sample PSA calculations found in the POA reflect the changes listed above.

Q. DO YOU AGREE WITH REVISED POA FILED BY STAFF?

A. I participated in discussions with Staff and the other settlement parties concerning its content, and I reviewed a draft of the POA to which I provided comments to Staff. I anticipate that we will be in agreement with the Staff's revised POA as filed however I would like to reserve the right to comment upon the final POA should the need arise.

Q. HAVE YOU INCLUDED A REVISED PSA ADJUSTMENT SCHEDULE THAT INCLUDES THE CLARIFICATIONS DESCRIBED ABOVE?

A. Yes. Attached as revised Schedule DJR-1 is Adjustment Schedule PSA-1.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

Appendix A
Statement of Qualifications
David J. Rumolo

David J. Rumolo is Arizona Public Service Company's Manager of Regulation and Pricing. He has over 30 years experience in the electric utility business as a consultant and utility professional. Mr. Rumolo holds Bachelor of Science Degrees in Electrical Engineering and Business (Finance as an area of emphasis) from the University of Colorado. He is a registered professional engineer in the states of Arizona, California, and New Mexico.

Mr. Rumolo's areas of expertise include utility rate design; embedded and marginal cost analysis; formulation of utility service policies; contract development and negotiation; utility valuation analyses; and evaluation of utility revenue requirements. Mr. Rumolo has testified on utility matters before state regulatory bodies in the states of Arizona, Colorado, Florida, and Wyoming and before judicial bodies in the states of Arizona and California. Mr. Rumolo is also experienced in the many aspects of electric utility planning and design including preparation of resource plans; transmission and distribution system planning; system protection analyses; and reliability assessments.

Mr. Rumolo has been a manager in the APS Regulation and Pricing area for approximately six years. Prior to joining that area of APS, he served as the Manager of Transmission and Market Structure Assessment for Pinnacle West Energy Corporation ("PWEC"). Before joining PWEC, Mr. Rumolo had a 15-year career as a consultant with Resource Management International, Inc., where he provided utility rate and engineering consulting services to utility clients across the United States and overseas. He began his career providing consulting services to utility clients when he joined the firm of Miner and Miner Consulting Engineers in Greeley, Colorado where he became the Manager of Planning and Rates. He later became a partner in Electrical Systems Consultants where he focused on cost of service and rate analyses, as well as transmission and distribution planning.

APPLICATION

The Power Supply Adjustment ("PSA") shall apply to all retail electric schedules with the exception of Solar-1, Solar-2, SP-1, E-3, E-4, E-36 and Direct Access service. All provisions of the customer's current applicable rate schedule will apply in addition to this charge. The PSA will apply to all fuel and purchased power costs incurred on or after April 1st 2005.

PSA ADJUSTOR RATE ANNUAL ADJUSTMENT

The main components of the PSA are: 1) a risk sharing mechanism whereby APS and its customers share in the costs/savings on a 90% customer, 10% APS basis; 2) a bandwidth that limits the amount the PSA Adjustor Rate ("Adjustor Rate") can change over the entire term of the PSA to plus or minus \$0.004 per kWh; 3) a balancing account; 4) a balancing account surcharge mechanism, separate from the Adjustor Rate, to clear the balancing account under circumstances described below; and 5) the inclusion of off-system sales. The monthly PSA calculations shall be adjusted for the calculated net savings from the methodology approved in Decision No. 67504 from the PPL Sundance docket. This adjustment will no longer be made once rates are effective that recover the capital and operating costs of the Sundance plant. The calculation method is set forth in the filed Power Supply Adjustment Plan of Administration (the "Plan"). Standard Offer services covered by this charge include a Base Rate Power Supply Cost of \$0.020743 per kilowatt-hour. An annual adjustment to the Base Rate Power Supply Cost will be made through a change in the Adjustor Rate that is based upon the annual total of PSA retail energy sales (less E-3, E-4 and E-36 sales) and power supply costs. The annual costs are compared to the base rate costs to determine the year's total over/under collection after the 90%/10% sharing incentive. If the Commission approves an Amortization Surcharge the balance will be subtracted from the total costs used to calculate the April 1st Adjustor Rate. The annual amount of PSA Retail Power Supply Costs that can be used to calculate the annual Adjustor Rate cannot exceed \$776,200,000.

The Adjustor Rate is initially set at zero as of April 1, 2005. It is calculated and reset on April 1, 2006 and thereafter on April 1st of each subsequent year. Any additional recoverable or refundable amounts shall be recorded in a balancing account and shall carry over to the subsequent year or years. The carryover amount shall not be subject to further sharing. The Adjustor Rate must remain within the plus or minus \$0.004 per kWh bandwidth that limits the amount it can increase or decrease each year. Balancing account amortization surcharges are not included in the calculation of the band limits. Balancing account entries are made each month starting with April 2005 to reflect the difference between 90 percent of incurred fuel and purchased power costs, less the balance of any approved Amortization Surcharge, and the sum of costs collected through the base cost of fuel and purchased power rate of \$0.020743 plus the applicable Adjustor Rate. An Amortization Surcharge may go into effect prior to the April 1st adjustment to the Adjustor Rate if it is approved by the Commission. The Amortization Surcharge is described in greater detail below. The total (credit)/charge collection amount is recovered over twelve months. Any revenue collected from the Adjustor Rate or any applicable Amortization Surcharge is credited to the Balancing Account described below. The Adjustor Rate is applied to the customer's bill as a monthly kilowatthour charge and is the same for all affected customer classes. The Adjustor Rate will change in billing cycle 1 of the April revenue month and it will not be prorated.

RATES

The charges shall be calculated at the following rates:

PSA Adjustor Rate

All kWh	\$0.000000	per kWh

Amortization Surcharge

All kWh	$0.000000	per kWh

AMORTIZATION SURCHARGE

Although the Company may file a request for an Amortization Surcharge at any time, the Company is required to make a filing in the following circumstance: If the size of the Balancing Account, as recorded in the monthly reports filed with the Commission, reaches plus or minus $50 million, the Company has forty-five days to either file a request for Commission approval of an Amortization Surcharge, or an explanation of why such a surcharge isn't necessary. Should the Company seek to recover or refund an amount from the Balancing Account, the timing and manner of recovery, or refund, and whether interest will be allowed to accrue on the Surcharge balance will be addressed at that time. In no event shall the Company allow the Balancing Account to reach $100 million prior to seeking recovery or refund.

Once the Company has filed seeking recovery or refund through an Amortization Surcharge, the amount requested in such filing will be excluded from the balance used to determine if the $100 million threshold has been reached. The $100 million threshold would apply each time the Company makes a filing with the Commission to address a Balancing Account balance between $50 and $100 million. After the Company makes the filing, if new accumulations in the Balancing Account were between $50 and $100 million, the Company could make a second, separate filing. Subsequently, it is possible that additional filings could be made with the $100 million threshold being applied separately to the amount being addressed in each filing. Following a proceeding authorizing recovery or refund of a bank balance between $50 million and $100 million, the balance considered in the proceeding shall be reset to zero unless otherwise ordered by the Commission.

BALANCING ACCOUNT

The PSA Balancing Account is where the monthly sum of the Company's post-sharing (over)/under collection is posted and also where interest on the balance in the account is accrued. It is used to track the cumulative total of the monthly postings. APS shall establish a PSA Balancing Account on April 1, 2005. Entries to the Balancing Account shall be made each month as follows:

1. A debit or credit entry equal to the difference between the Post-Sharing (Over)/Under Collection and the sum of the amounts recovered by the Applicable Adjustor Rate. The Post-Sharing (Over)/Under Collection is calculated by taking the amount recovered through the Base Rate Power Supply Cost of $0.020743 and subtracting it from the PSA Retail Power Supply Cost. The product of that subtraction is then multiplied by 90% to reduce the recoverable costs in accordance with the 90%/10% sharing incentive.

2. Any Amortization Surcharge balance will be shown separately on the monthly reports for the Commission Staff, and, unless otherwise ordered by the Commission, shall not be considered as part the Balancing Account.

3. A monthly debit or credit entry for interest to be applied to the account balance based on the effective one-year Nominal Treasury Constant Maturities rate that is contained in the Federal Reserve Statistical Release, H-15, or its successor publication. This includes the Amortization Surcharge balance(s) if the Surcharge balance was approved to accrue interest on the uncollected Surcharge balance. This is called the Monthly Interest and is used above in the Adjustor Rate calculations. The interest rate will be

adjusted annually on the first business day of the calendar year in the same manner as the APS customer deposit rate.

4. A debit or credit entry for refunds or payments authorized by the Commission.

COMPLIANCE REPORTS

The Adjustor Rate and Balancing Account calculations and supporting information will be provided to the Commission monthly as specified in Decision No. 67744. Workpapers and other documents supporting the calculations that contain proprietary or confidential information will be provided to the Commission Staff under an appropriate confidentiality agreement. APS will keep fuel and purchased power invoices and contracts available for Commission review. All of the information is available during the year, upon Commission request. The Commission has the right to review the prudence of fuel and power purchases and any calculations associated with the PSA at any time. Any costs flowed through the PSA are subject to refund, if those costs are found to be imprudently incurred.

DIRECTLY ASSIGNED POWER SUPPLY COSTS EXCLUDED

In cases when power supply costs are incurred for a specific customer or group of customers, the customer or group of customers will be directly charged the identified costs in accordance with the Plan. Power supply costs and related energy sales recovered through direct assignments for both existing and returning customers as described on rate schedule RCDAC-1 will be excluded from the computation of the above charges applied to other Standard Offer service customers.

SPECIAL SUPPLEMENTARY TARIFF
PURCHASED GAS COST ADJUSTMENT PROVISION

APPLICABILITY

This Purchased Gas Cost Adjustment Provision ("PGA") shall apply to all schedules except for Schedule Nos. G-30, G-60, G-80 and G-95 of this Arizona Gas Tariff.

CHANGE IN RATES

Sales rate schedules covered by this provision include a base cost of gas ("BCOG") of $.37034 per therm. In accordance with Decision Nos. 61225 and 61711, a monthly adjustment to the BCOG will be made through a change in the Purchased Gas Adjustment ("PGA") rate that is based upon the rolling twelve-month average of actual purchased gas costs and sales. In accordance with Decision No. 62994, the PGA rate calculated for the month cannot be more than $.10 per therm different than any PGA rate in effect during the preceding twelve months.

BANK BALANCE

The Utility shall establish and maintain a Gas Cost Balancing Account, if necessary, for the schedules subject to this provision. Entries shall be made to this account each month, if appropriate, as follows:

1. A debit or credit entry equal to the difference between (a) the actual purchased gas cost for the month and (b) an amount determined by multiplying the average purchased gas cost included in the sum of the Base Tariff Rate Gas Cost and the Monthly Gas Cost Adjustment as set forth on Sheet Nos. 11 and 12 of this Arizona Gas Tariff by the therms billed during the month under the applicable schedules of this Arizona Gas Tariff.

2. A debit or credit entry equal to the therms billed during the month under the applicable schedules of this Arizona Gas Tariff, multiplied by the Gas Cost Balancing Account Adjustment, if any, reflected in the rates charged during the month.

3. A debit or credit entry for refunds or payments authorized by the Commission.

4. A debit or credit entry for interest to be applied to over- and under-collected bank balances based on the non-financial three-month commercial paper rate for each month contained in the Federal Reserve Statistical Release, G-13, or its successor publication.

EXHIBIT
tabbies
APS-2
admitted

SOUTHWEST GAS CORPORATION
P.O. Box 98510
Las Vegas, Nevada 89193-8510
Arizona Gas Tariff No. 7 First Revised A.C.C. Sheet No. 88
Arizona Division Canceling Original A.C.C. Sheet No. 88

SPECIAL SUPPLEMENTARY TARIFF
PURCHASED GAS COST ADJUSTMENT PROVISION
(Continued)

MONTHLY INFORMATION FILINGS

Each month the Utility shall make a cost of gas informational filing with Commission Staff to include any and all information required by Decision No. 61225. Additionally, the Utility shall file revised tariff sheets that include the most current month's surcharge amount.

ADDITIONAL REQUIREMENTS

A special PGA review is required if the PGA bank balance reaches an over- or under-collection in the amount of $22.4 million. The Utility must file for an application for an adjustment within forty-five (45) days of completing the Monthly Informational Filing that illustrates the threshold has been exceeded or contact the Commission to discuss why a PGA rate adjustment is not necessary at this time. The Commission, upon review, may authorize the balance to be amortized through a predetermined rate included as part of the PGA for a specified period. Lost and unaccounted for gas recovery is limited to the lesser of the actual costs incurred or one percent (1%) of total annual purchases.

Issued On April 21, 1999 | Issued by Edward S. Zub, Senior Vice President | Effective May 28, 1999
Docket No. G-00000C-98-0568 | Decision No. 61225 / 61711

HELD FOR FUTURE USE

Exhibit APS____

STANDARD &POOR'S | RATINGSDIRECT

Return to Regular Format

Research:

Summary: Arizona Public Service Co.

Publication date: 04-Oct-2005
Primary Credit Analyst: Anne Selting, San Francisco (1) 415-371-5009; anne_selting@standardandpoors.com

EXHIBIT
APS-3
admitted

Credit Rating: BBB/Stable/A-2

Rationale

Arizona Public Service Co. (APS) is a wholly owned subsidiary of Pinnacle West Capital Corp. (PWCC), and the most significant company within the PWCC family. PWCC's satisfactory business profile (a '5' on a 10-point scale where '1' is excellent) reflects the vertically integrated utility operations of APS and the absence of significant non-regulated businesses within PWCC.

APS' credit strengths include a Phoenix service territory that is the second-fastest growing region in the U.S. (behind Las Vegas), a diversified power supply portfolio, and a 4.21% increase in retail rates that began on April 1, 2005 in conjunction with the settlement of the utility's general rate case in March 2005. This increase had been expected to modestly shore up a financial performance that has been weakening over the past several years.

However, challenges are increasing for the utility, and performance on a 12-month rolling basis ended June 30, 2005 indicates that the utility is pressured by the rising costs of purchased power and natural gas. The addition of a fuel and purchased power cost adjuster to retail rates has not assisted APS in timely receipt of cash because revisions occur only in the spring of each year, with the first opportunity arising in April 2006. The settlement provides for the use of a surcharge filing to provide the utility with an interim vehicle for recovering costs if they exceed $50 million. As anticipated, APS did accrue this level of deferrals over the summer. Through June 30, 2005, purchased power and fuel costs totaled $401 million, of which $34 million was deferred. At Aug. 31, 2005, the deferred balance had increased to $117 million. The company's estimates of total fuel and purchased power costs in 2005 are confidential, but as a basis of comparison, in 2004 the utility spent $763 million. In July 2005, APS filed an application with the Arizona Corporation Commission (ACC) requesting that it be allowed to recover $100 million through a two-year surcharge that would increase rates by about 2.2%.

Both the pace and disposition of this proceeding will be critical to credit quality. The ACC staff and at least one commissioner have questioned whether the utility should be allowed to collect $20 million of the $100 million requested, the former being the amount roughly associated with Palo Verde replacement power costs during four months from April through July 2005. (Since then, Units 1 and 2 suffered outages in late August.) In late September, the company announced that to expedite an ACC decision, it would reduce its request for surcharge recovery to $80 million and address the $20 million in deferred costs in a later proceeding. The ACC has established a schedule for the proceeding to address the $80 million, with hearings to begin Oct. 26, 2005.

For fiscal 2005, the company continues to expect it will achieve results in line with credit metrics needed to support the current rating. And in April 2006, the utility will be able to receive additional relief through the annual fuel and purchased power adjustment mechanism. But upward adjustments are limited to 4 mills/kWh over the life of the adjuster. Because existing retail rates are based on 2003 costs, reflecting gas prices of about $5.50/MMBtu, the company expects the entire 4 mill headroom will be utilized at the first reset. The utility is expected to file another rate case by the end of 2005, but its resolution could extend well into 2006. Thus, it is clear that timely near-term cost collection will be the key driver of credit quality. Standard & Poor's is becoming increasingly concerned with the utility's ability to achieve this. A relatively weak power supply adjustment mechanism, in combination with rapidly escalating and volatile gas prices, as well as the potential for a protracted surcharge proceeding, could cause deterioration in financial performance which, year to date, has been sub par for the rating.

Whether the company's consolidated targets will be met will largely be a function of APS' third-quarter results. For the 12 months ending June 30, 2005, consolidated adjusted funds from operations (FFO) to total debt was 12.7%, but this reflects a one-time deferred tax charge taken in December 2004 based on the expectation that APS may need to refund $130 million at the end of 2005. Excluding the deferral, adjusted FFO/total debt is closer to 15.5%. FFO to interest coverage was 3.0x for the 12 months ending June 30, or 3.5x when the deferred tax obligation is excluded. Adjusted debt to total capitalization was 55.7% and benefited from PWCC's April issuance of $250 million in equity.

APS' general rate case settlement allowed for the rate-basing of 1,790 MW of Arizona generation formerly owned by Pinnacle West Energy Corp (PWEC), PWCC's merchant generation subsidiary. In July 2005, PWEC transferred this generation capacity, through five plants, to APS. PWCC has also announced that it plans to sell its remaining 75% interest in Silverhawk, a 570 MW plant near Las Vegas, Nev., to Nevada Power (NPC; B+/Positive/NR) for $208 million. If Nevada regulators approve the sale, the transaction should be completed by the end of 2005 and mark the complete wind-down of PWEC operations. Consolidated credit benefited from the transfer by reducing merchant exposure in providing APS with needed supply to meet its growing loads.

Short-term credit factors

PWCC's short-term rating is 'A-2'. The rating is supported by the fact that the preponderance of cash flows is produced by APS, a vertically integrated electric utility. Near-term liquidity is adequate to support power purchase expenses that exceed rates. Because APS is heading into its shoulder season, when demand for electricity for space cooling drops significantly, the build-up of its power cost deferrals should slow. APS has hedged nearly all of its power and gas purchases through the remainder of 2005 and about 80% in 2006, thus its cost projections should be in line with realizations. Consolidated cash and investments stood at more than $900 million as of Sept. 31, 2005. However, $500 million was used on Oct. 3, 2005 to call the Pinnacle West Energy Company's floating-rate notes due April 2007. Also impacting the cash and invested position is the increased amount of collateral held under hedging contracts.

Both PWCC and APS maintain CP programs. Neither program had any CP balances as of June 30, 2005. PWCC's program is for $250 million and is supported by a three-year, $300 million credit facility that expires in October 2007. The revolver allows PWCC to use up to $100 million of the facility for letters of credit. The revolver has no material adverse change clauses pertaining to outstanding CP balances.

APS' short-term rating is also 'A-2'. The rating is supported by the stability of cash flows from regulated operations and good liquidity, although APS will need to continue to rely on borrowings to fund portions of its capital expenditure program, which is expected to be about $770 million in 2005 (and includes $190 million for the purchase of the Sundance power plant), up significantly from $484 million in 2004. APS maintains a $250 million CP program. In May 2004, APS renegotiated its revolver and increased the size to $325 million. This facility, also a three-year term, expires in May 2007, supports the utility's CP program, and provides an additional $75 million for other liquidity needs, including letters of credit. The supporting facility has no material adverse change clauses pertaining to outstanding CP balances.

Outlook

The stable outlook reflects Standard & Poor's expectation that the ACC will resolve APS' large deferred power costs through a surcharge ruling no later than year-end that supports timely recovery of the $80 million request. In addition, the outlook presumes that third-quarter consolidated financial results will reflect improvements that demonstrate modest advances in credit metrics. An adverse outcome in either of these areas will result in a negative outlook. No positive ratings changes are expected in short-term.

Ratings Services receives compensation for its ratings. Such compensation is normally paid either by the issuers of such securities or third parties participating in marketing the securities. While Standard & Poor's reserves the right to disseminate the rating, it receives no payment for doing so, except for subscriptions to its publications. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

EXHIBIT APS____

DIRECT TESTIMONY OF STEVEN M. WHEELER

On Behalf of Arizona Public Service Company

Docket No. E-01345A-03-0437
&
Docket No. E-01345A-05-0526

September 30, 2005

EXHIBIT
APS-4
admitted

TABLE OF CONTENTS

DIRECT TESTIMONY OF STEVEN M. WHEELER
ON BEHALF OF ARIZONA PUBLIC SERVICE COMPANY
(Docket No. E-01345A-03-0437 & E-01345A-05-0526)

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.

A. My name is Steven M. Wheeler. I am Executive Vice President, Customer Service and Regulation for Arizona Public Service Company ("APS" or "Company"). In that role, I am responsible for the planning, construction and operation of the APS transmission and distribution system. I am also responsible for all customer service, rate and related regulatory matters affecting the Company, including those before the Arizona Corporation Commission ("Commission") and the Federal Energy Regulatory Commission ("FERC").

Q. WHAT IS YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND?

A. I received a Bachelors degree from Princeton University in 1971. I graduated from Cornell University School of Law in 1974. From 1974 until 2001, I was an attorney with Snell & Wilmer LLP in Phoenix, Arizona, involved in general business, real estate, environmental and public utility issues. During my 27 years at the firm, I represented APS and other public utilities in numerous state and FERC proceedings involving utility rate and service matters, generation and transmission siting, electric industry restructuring, resource planning and prudence reviews. In 2001, I joined APS as a Senior Vice President. I assumed my present responsibilities with the Company in 2003.

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN THIS PROCEEDING?

A. My testimony will summarize the Company's request for a Power Supply Adjustment ("PSA") surcharge and discuss the need for prompt action by the Commission to reduce the escalating level of fuel and purchased power cost deferrals. I also describe the PSA rate mechanism as approved by the Commission in Decision No. 67744 and respond to issues raised about its implementation.

Q. DOES THE COMPANY HAVE OTHER WITNESSES PRESENTING DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes. Mr. Pete Ewen will describe and explain the build up of the PSA bank balance beginning in April 2005. Mr. Tom Carlson testifies concerning the Company's hedging policies and programs as they impact gas and purchased power procurement.

II. <u>SUMMARY</u>

Q. WOULD YOU PLEASE SUMMARIZE YOUR DIRECT TESTIMONY?

A. On July 22, 2005, APS requested a PSA surcharge to collect some $100 million in deferred fuel and purchased power costs. As noted in that Application, APS had deferred over $50 million in such costs as of the date of filing and anticipated reaching at least $100 million in deferrals by the end of August 2005. (The actual level of deferrals in the PSA bank balance by the end of August was approximately $115 million.) Decision No. 67744 is clear in its requirement that APS seek a PSA surcharge prior to the PSA bank balance reaching $100 million. The Company specifically requested that a PSA surcharge of $.00177 per kWh be implemented beginning in November 2005.

Subsequent to filing its Application, APS agreed with Staff and the Residential Utility Consumer Office ("RUCO") to defer $20 million from this specific PSA surcharge request. This represented more than the Company's estimate of the costs included in the $100 million resulting from unplanned Palo Verde outages during the period April 1 through July 2005. (Although Palo Verde experienced unplanned outages in August, any additional costs were not part of the $100 million request, which request expected and reflected anticipated Palo Verde operations after July.) The impact of this removal reduces the required surcharge, again beginning in November 2005, to $.001416 per kWh, or approximately a 1.7% increase for the requested two year amortization period.

By agreeing to remove the Palo Verde-related dollars and hence Palo Verde issues from this proceeding, APS is in no way suggesting or implying, let alone conceding that the costs resulting from these Palo Verde outages should not be fully recovered (subject to the 90/10 sharing, which is already reflected in the $20 million) under the PSA. To the contrary, APS intends to pursue full recovery of these outage costs in a subsequent proceeding. Indeed, by the express terms of the Commission's Procedural Order dated September 23, 2005, the Company's withdrawal of the $20 million from present consideration by the Commission in this proceeding was "without prejudice."

Since April 1, 2005, which was the effective date of the PSA per Decision No. 67744, APS has deferred some $115 million in higher fuel and purchased power costs through the end of August 2005. This, of course, represented only 90% of the actual increase in fuel and purchased power costs over the amounts reflected in base rates plus the current PSA adjustor. The remaining amounts of these higher costs, approximately $13 million, were directly expensed against income, thus reducing the Company's earnings. Mr. Ewen's testimony indicates that even with the $80 million PSA surcharge and an estimated 3 mill per kWh increase in the Annual PSA Factor, effective April 1, 2006, these PSA deferrals will reach some $255 million by the end of 2006 (including some $40 million of the $80 million surcharge amount, which will still be unrecovered as of year end 2006). And since April 1, 2005, APS shareholders will have absorbed some $39 million in unrecoverable costs by the end of 2006 due to the 90/10 sharing under the PSA, which I describe later in my Direct Testimony.

Obviously, without the requested PSA surcharge, the PSA bank balance would be even higher, reaching $274 million by year-end 2006 (even assuming a 4 mill increase in the Annual PSA Factor in April 2006). Financing such a huge balance of unrecovered costs just adds to the cost burden that eventually must be borne by APS customers. Denial of the requested PSA surcharge or even unexpected delay in its approval will also send a clear message to an already concerned financial community that the Commission is not serious about preserving the Company's financial integrity and has instead singled APS out for uniquely unfavorable treatment with regard to higher fuel costs. Customers are similarly adversely affected as the burden on future customers is increased and conservation messages are diluted when customers are not faced with the higher cost of energy.

In Decision No. 67744, the Commission authorized a PSA mechanism for APS. The PSA permitted the Company to defer for later recovery/refund 90% of the fuel and purchased power costs in excess of/below the amount recovered through base rates ("Base Fuel Recovery Amount") plus the annual fuel and purchased power adjustment factor ("Annual PSA Factor") established each

April, beginning with the \$.00000 per kWh established as of April 1, 2005. (Any PSA surcharge revenues received would likewise be credited against the deferrals in the PSA bank balance.) Decision No. 67744 further established the Base Fuel Recovery Amount, using 2003 costs, at \$.020743 per kWh and, as noted above, the Annual PSA Factor at zero. The other 10% is expensed (and paid for by APS shareholders) or retained as Other Income, depending on whether the costs are above or below the Base Fuel Recovery Amount plus the Annual PSA Factor.

Adjustments to PSA charges are made at least annually. The change to the Annual PSA Factor is on April 1 of each year beginning in 2006, based on a March 1 filing that compares fuel and purchased power costs per kWh for the preceding calendar year (in this first instance, the last nine months of 2005) after application of the 90/10 sharing provision with the Base Fuel Recovery Amount.

APS is also authorized to request a special PSA surcharge/credit when fuel and purchased power cost deferrals hit \$50 million, plus or minus. And the Company is <u>required</u> to seek such a surcharge before the "bank balance" of cost deferrals reaches \$100 million. This, of necessity, means that APS may request, and indeed may be required to request multiple PSA surcharges. Upon the date APS requests the PSA surcharge, the level of deferrals used to determine any subsequent surcharge application is reduced by the amount requested.

III. <u>DESCRIPTION OF THE PSA SURCHARGE REQUEST</u>

Q. WHAT IS APS SEEKING IN THE WAY OF A PSA SURCHARGE?

A. On July 22, 2005, APS requested a PSA surcharge to collect some \$100 million in deferred fuel and purchased power costs. This would represent an approximate 2.2% increase if recovery is spread over 24 months, as had been proposed by the Company. APS had deferred over $50 million in such costs as of the date of filing and anticipated reaching at least $100 million in deferrals by the end of August 2005. (Deferrals to the PSA bank balance by the end of August 2005 actually reached $115 million.) The Company specifically requested that a PSA surcharge of $.00177 per kWh be implemented beginning in November 2005.

Q. WHY DID APS MAKE ITS FILING WHEN IT DID?

A. Decision No. 67744 required APS to request a surcharge prior to the bank balance reaching $100 million. Although that meant APS could have delayed this filing by three or four weeks and still have been in compliance with Decision No. 67744, the request for a PSA surcharge could not have been avoided.

Aside from the requirements of Decision No. 67744, it was and is appropriate to address the escalating APS bank balance before it gets unnecessarily high, as has happened to other utilities in Arizona. As I discuss later in my Direct Testimony and as is described in Mr. Ewen's Direct Testimony, additional fuel and purchased power cost deferrals over and above the levels requested for recovery in this proceeding will add another $175 million to the PSA bank balance by year-end 2006 even with an estimated three mill per kWh increase to the Annual PSA Adjustment Factor in April 2006.

Q. WHY ASK FOR IMPLEMENTATION IN NOVEMBER 2005 RATHER THAN AN EARLIER DATE?

A. There were two primary reasons. First, APS wanted to give the Commission a reasonable period of time in which to consider the PSA surcharge Application.

Second, APS switches to winter rates in November, which on average are for residential customers some 14% less than the rates in effect for the rest of the year. Thus, the upfront impact on customers would be less.

Q. IS APS STILL SEEKING A $100 MILLION PSA SURCHARGE IN THIS PROCEEDING?

A. No. Subsequent to filing its Application, APS agreed to defer $20 million from this specific PSA surcharge request. This represented a high estimate of the additional costs included in the $100 million from unanticipated Palo Verde outages during the period April 1 through July 2005. Although Palo Verde experienced unplanned outages in August, any additional costs were not part of the $100 million request, which assumed expected Palo Verde operations after July. The impact of this deferral reduces the required surcharge, again beginning in November 2005, to $.001416 per kWh, or approximately a 1.7% increase over the two year amortization period.

Q. IS THE COMMISSION NOW BEING ASKED TO APPROVE RECOVERY OF THE COSTS ASSOCIATED WITH THE PALO VERDE OUTAGES SINCE APRIL 1, 2005?

A. No. That was the purpose behind deferring consideration of the approximately $20 million in outage-related costs that had been included in the original PSA surcharge request. But by agreeing to remove the Palo Verde-related dollars and hence Palo Verde issues from this proceeding, APS is in no way suggesting or implying, let alone conceding that the costs resulting from these Palo Verde outages should not be fully recovered (subject to the 90/10 sharing, which is already reflected in the $20 million) under the PSA. APS intends to pursue full recovery of these and other appropriate Palo Verde costs in a subsequent proceeding. Indeed, by the express terms of the Commission's Procedural Order dated September 23, 2005, the Company's withdrawal of the $20 million from present consideration by the Commission in this proceeding was "without prejudice." APS agreed to remove the Palo Verde-related costs from this proceeding to allow for a timelier procedural schedule – one that could at least potentially still allow for a PSA surcharge to go into effect in late 2005.

Q. IS APS ALONE IN ITS NEED TO RECOVER HIGHER FUEL COSTS?

A. Far from it. The Commission is aware of the situation with UniSource Energy ("UniSource") and Southwest Gas Corporation ("Southwest Gas"). However, this is a nationwide problem. For example, all major Nevada utilities have sought, and some have received large increases to recover these costs (proceedings for the remaining companies are still pending as of the time of this testimony). In fact, in each of these proceedings, the Nevada commission staff recommended greater increases than those requested by the utilities. The three large Florida electric utilities recently asked for $1.2 billion in additional revenues for the same reason. Like these other utilities, APS makes no profit from the PSA – it is a pass through of a portion of its actual costs with zero markup. Unlike these utilities, including the other Arizona utilities, APS does not even get an opportunity to recover 100% of its costs, but instead has to absorb 10% of such costs off the top, irrespective of their prudence.

IV. NEED FOR PROMPT AND POSITIVE ACTION TO ADDRESS THE ESCALATING DEFERRAL BY APS OF UNRECOVERED FUEL AND PURCHASED POWER COSTS

Q. WHY DOES THE COMPANY URGE THE COMMISSION TO ACT PROMPTLY AND POSITIVELY ON THE COMPANY'S MODIFIED REQUEST FOR A PSA SURCHARGE?

A. There are three very good reasons. First, the level of deferred fuel and purchased power costs is becoming excessive. This has adverse impacts on both the

Company and its customers. To understand this, the Commission need look no farther than the UniSource situation, where we have seen bank balances escalate to unprecedented proportions, or to Southwest Gas, where this Commission acted decisively last fall in an attempt to head off a similar problem. Second, the sooner APS customers receive more appropriate price signals about the higher cost of energy, the sooner they can attempt to adjust their usage to mitigate the overall impact. The third reason is because Wall Street is watching this proceeding very closely. There was and is concern in the financial community over the restrictions placed on the PSA by Decision No. 67744. For the Commission to then fail to implement the very PSA surcharge mechanism they had approved just a handful of months ago would diminish if not eliminate any confidence that the PSA would provide the Company with any meaningful relief from the escalating cost of natural gas and others fuel/purchased power costs.

Q. HOW MUCH HAS AND WILL APS DEFER INTO THE PSA BANK BALANCE ABSENT THE PROPOSED PSA SURCHARGE?

A. Since April 1, 2005, which was the effective date of the PSA per Decision No. 67744, APS has deferred some $115 million in higher fuel and purchased power costs through the end of August 2005. The remaining amounts of these higher costs, approximately $13 million, were directly expensed against income, thus reducing the Company's earnings. Mr. Ewen's testimony indicates that even with the $80 million PSA surcharge and an estimated three mill per kWh increase in the Annual PSA Factor, effective April 1, 2006, these PSA deferrals will again reach some $255 million by the end of 2006. And since April 1, 2005, APS shareholders will have absorbed some $39 million in unrecoverable costs through the end of 2006 due to the 90/10 sharing under the PSA. Without the requested PSA surcharge, the PSA bank balance would be even higher, reaching

$274 million by year-end 2006 (even assuming a maximum four mill increase in the Annual PSA Factor in April 2006).

Q. COULD YOU PLEASE EXPLAIN THE IMPACT OF GROWING FUEL AND PURCHASED POWER COST DEFERRALS?

A. Fuel and purchased power costs are out-of-pocket cash expenditures by APS to provide service to its customers. When revenues from the Base Fuel Cost Recovery Amount and the Annual PSA Adjustment Factor are insufficient to cover these outlays, they have to be financed from other sources. Whether this source is other internally-generated cash or outside borrowings, it is obvious that unrecovered fuel and purchased power costs consume capital that could otherwise be used to build infrastructure or refinance higher cost capital.

Q. WHY ARE CUSTOMERS ADVERSELY IMPACTED BY THE FAILURE TO ADDRESS THE CONSEQUENCES OF LARGE BALANCES OF UNRECOVERED FUEL AND PURCHASED POWER COSTS?

A. First of all, it is not in the interest of customers to have a financially distressed utility that must incur additional financing costs – costs that are invariably borne by consumers. Second, customers need to know the facts about higher energy costs so they can make whatever changes they can in their consumption of energy. APS and its customers are making a large investment in promoting conservation and energy efficiency - $48 million over the next three years. This effort is directly undermined when customers are not faced with the true cost of energy, thus effectively reducing the value of conservation and energy efficiency programs. Third, the higher the bank balances are allowed to grow, the greater the eventual impact on customer bills when these IOUs have to be paid, especially when you consider that customers also pay interest on the PSA bank balance.

Q. HOW DO YOU KNOW THAT THE FINANCIAL COMMUNITY IS CLOSELY WATCHING THIS PROCEEDING AND CONSIDER IT CRITICAL IN ITS EVALUATION OF APS' FINANCIAL CONDITION?

A. They have written it. For example, on July 27, 2005, Merrill Lynch stated: "APS has made its first fuel surcharge filing and this case will be watched closely for any signs of pushback from regulators." On August 31, 2005, JP Morgan wrote: "We continue to be concerned with the company's ability to recover the growing deferred fuel balance in a timely manner." Finally, in a report downgrading Pinnacle West, Morgan Stanley indicated on September 19, 2005: "Since PNW's [APS] fuel clause is brand new, it will likely be subject to continued state regulatory 'interpretations,' and may cut into recovery of other operating expenses, especially as AZ has traditionally been a difficult regulatory regime." And recently, Tucson Electric Power Company and its parent, UniSource, have both been placed on negative credit watch by Standard & Poor's in large part due to uncertainty regarding this Commission's willingness to address the impact of escalating energy costs on utility finances.

It will also not go unnoticed if APS is denied a PSA surcharge when the Commission has regularly approved other surcharges for gas utilities, usually for percentage amounts far in excess of the Company's request. Such unequal treatment would only deepen the financial community's concerns about the degree of regulatory support in Arizona for maintaining the financial integrity of its largest utility serving the second fastest growing service area in the country.

Q. WHY ARE THE CONCERNS OF THE FINANCIAL COMMUNITY IMPORTANT?

A. Like it or not, the financial community, which consists of investors, financial analysts and ratings agencies, determines how much APS must pay for the capital resources it needs and even whether APS will have ready access to such resources. Capital is the "life's blood" of a utility, and neither APS nor this Commission can ignore those who provide that capital and those who advise them.

V. DESCRIPTION OF PSA RATE MECHANISM

Q. COULD YOU PLEASE DESCRIBE THE PSA?

A. In Decision No. 67744, the Commission authorized a PSA mechanism for APS. In general, it was based on a model adjustment mechanism developed by Commission Staff for gas utilities, but with many more restrictions. The PSA permitted the Company to defer for later recovery/refund 90% of the fuel and purchased power costs in excess of/below the amount recovered through base rates, i.e., the Base Fuel Recovery Amount, plus the annual fuel and purchased power adjustment factor, i.e., the Annual PSA Factor, established each April, beginning with the $.00000 per kWh established as of April 1, 2005 by Decision No. 67744. (Any PSA surcharge revenues received would likewise be credited against the deferrals in the PSA bank balance.) Decision No. 67744 further established that Base Fuel Recovery Amount at $.020743 per kWh. The other 10% is expensed (and essentially paid for by APS shareholders) or retained as Other Income, depending on whether the costs are above or below the Base Fuel Recovery Amount plus the Annual PSA Factor.

Adjustments to PSA charges are made at least annually, up to a cumulative cap of four mills per kWh. The change to the Annual PSA Factor is on April 1 of each year beginning in 2006, based on a March 1 filing that compares fuel and purchased power costs per kWh for the preceding calendar year (in this first instance, the last nine months of 2005) after application of the 90/10 sharing provision with the Base Fuel Recovery Amount.

APS is also authorized to request a special PSA surcharge/credit when fuel and purchased power cost deferrals hit $50 million. And the Company is required to seek such a surcharge before the "bank balance" of cost deferrals reaches $100 million. *See* Decision No. 67744 at 17, lines 13-14. This, of necessity, means that APS may request, and indeed may be required to request multiple PSA surcharges. Upon the date APS requests the PSA surcharge, the level of deferrals used to determine any subsequent surcharge application is reduced by the amount requested.

It is important to note that the Annual PSA Factor and a PSA surcharge serve two related functions. Thus they are not redundant ("adjustor to an adjustor") but complements to a unitary and integrated PSA mechanism. The Annual PSA Factor is essentially to update the Base Fuel Recovery Amount with more recent data and is intended to, on a prospective basis, reduce or eliminate the need for additional accumulations of deferred costs in the PSA bank balance. It also may or may not result in a prospective reduction of current bank balances. The PSA surcharge, on the other hand, deals explicitly with past deferrals into the bank balance and how they will be recovered or refunded through rates. Each component of the PSA is essential to the Company's ability to recover prudently incurred fuel and purchased power costs above the level represented by the Base Fuel Recovery Amount.

Q. ON WHAT DO YOU BASE YOUR DESCRIPTION OF THE PSA?

A. It is what Decision No. 67744 says as does the rate schedule, PSA-1, filed in compliance with that Decision and effective by its own terms on April 1, 2005.

VI. <u>CONCLUSION</u>

Q. DO YOU HAVE ANY CONCLUDING REMARKS?

A. Yes. APS filed its request for a PSA surcharge both because it was required by Decision No. 67744 and to address the problem of a rapidly increasing PSA bank balance. The Company agreed with Staff and RUCO to remove prudence issues from this proceeding until a later date and reduce its present request for a PSA surcharge by $20 million in order to allow for a more expedited consideration by the Commission of the balance of the surcharge Application.

Failure of the Commission to act promptly and positively in this matter has significant negative consequences. First, we must begin the process of reducing at least the rate of growth of the PSA bank balance. Otherwise we will be building up a huge burden for future customers to pay while denying to present customers the appropriate price signals about the cost of energy consumption. It also places a strain on the Company's ability to raise necessary capital on reasonable terms for other purposes, including construction for new growth and reliability. Second, the financial community is clearly looking at this proceeding as a test case of this Commission's resolve to come to grips with higher energy costs.

The PSA was approved by the Commission in Decision No. 67744, effective April 1, 2005. All components of that rate mechanism, including the Base Fuel Recovery Amount, the Annual PSA Factor, and the potential for a PSA surcharge likewise became effective on April 1, 2005. APS is required to seek a

PSA surcharge prior to the bank balance reaching $100 million, irrespective of when and how many times that occurs. Having made such a request, the Company can continue to defer 90% of fuel and purchased power costs in excess of the sum of the Base Fuel Recovery Amount and the Annual PSA Adjustment Factor pending Commission action on the surcharge request so long as the PSA bank balance, exclusive of the amount sought in the PSA surcharge request, does not again reach $100 million prior to APS making a subsequent (second) PSA surcharge filing.

APS therefore urges the Commission to approve and authorize a PSA surcharge of $.001416 per kWh for 24 months beginning in November 2005, or as soon thereafter as possible. Although such surcharge will not eliminate the unrecovered bank balance or even prevent it from significantly growing during the amortization period, it is an important start and will send a positive signal to the financial community, smooth the impact of recovery for customers while giving more appropriate price signals, and reduce the financial burden on the Company that is inherent in significant balances of unrecovered costs.

Q. DOES THAT CONCLUDE YOUR PREFILED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes, it does.

EXHIBIT APS____

EXHIBIT

APS - 5

admitted

TESTIMONY OF THOMAS J. CARLSON

On Behalf of Arizona Public Service Company

Docket No. E-01345A-05-0526

&

Docket No. E-01345A-03-0437

September 30, 2005

Table of Contents

TESTIMONY OF THOMAS J. CARLSON
ON BEHALF OF ARIZONA PUBLIC SERVICE COMPANY
(Docket No. E-01345A-05-0526 & E-01345A-03-0437)

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.

A. My name is Thomas J. Carlson. I am the Portfolio Manager for Arizona Public Service Company ("APS" or "Company") Regulated Marketing and Trading Division. In that role, I am responsible for procuring wholesale purchased power and natural gas for APS Native Load needs and also the marketing of surplus APS generation and natural gas.

Q. WHAT IS YOUR EDUCATION AND PROFESSIONAL BACKGROUND?

A. I received a Bachelor of Science degree from the University of South Dakota in 1977. Prior to coming to APS, I worked in marketing and market research positions with the airline and motor transportation industries. I held a similar position when I joined APS in 1988. In 1992, I began in the gas trading and fuel management area of the Company, rising to Director of Generation Fuel Procurement for APS in 2001 and to Portfolio Manager in 2004.

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

A. My testimony will describe APS' natural gas and purchased power hedging philosophy and policies as such policies and procedures relate to procuring the gas and power needed to serve our native load.

II. SUMMARY OF TESTIMONY

Q. WOULD YOU PLEASE SUMMARIZE YOUR TESTIMONY?

A. Yes. APS incorporates extensive use of financial and physical contracts to minimize commodity price volatility when purchasing natural gas and purchased power to serve retail load. Since price stability is the goal of our system hedge position, financial risks associated with projected requirements of these commodities are systematically hedged at various levels three years prior to delivery with standard energy products.

APS has hedged its financial commodity risk since the late 1990's in response to unprecedented market price fluctuation and has continued with this policy, increasing its hedge percentages in June of 2005 in light of even greater price uncertainty. Because of these hedges, the current hedged price of natural gas and purchased power is significantly below the now prevailing market price through 2008.

The measured approach utilized by the system hedge plan helps APS customers largely avoid much of the turbulence of price volatility that can occur in the short-term commodity markets. Coupled with the practice of optimizing natural gas or purchased power to provide the lowest cost commodity to meet load, the current approach to hedging financial risk can provide APS customers with significant economic savings while, most importantly, attaining future price stability.

III. <u>APS HEDGING PROGRAM AND PHILOSOPHY FOR GAS AND POWER PROCUREMENT</u>

Q. WHAT IS A "HEDGE?"

A. As applied in our industry, a hedge is defined as "any technique designed to reduce or eliminate financial risk." Since commodity prices of natural gas and purchased power are extremely volatile and can change significantly from day to day, the use of a hedge can eliminate much (but not all) of the financial risk associated with price changes in these markets. From the perspective of APS, we hedge primarily with fixed price contracts, i.e. we fixed the price of the commodity for a specific term, in order to eliminate price risk during that term.

Q. HOW LONG HAS APS BEEN HEDGING ITS NATURAL GAS AND PURCHASED POWER NEEDS?

A. APS has hedged natural gas and purchased power requirements for native load customers in various respects since the late 1990's. The impetus for hedging these commodities originated from the increased exposure arising from APS' retail load growth and a coincident increase in the volatility of prices in the energy market. The continuing development of organized and relatively liquid commodity markets, and subsequently financial equivalent contracts, has since made the implementation of hedging plans far more efficient and manageable.

Q. HOW WOULD YOU DESCRIBE APS' "GOAL" IN HEDGING AND HAS THAT GOAL BEEN ATTAINED THROUGH THE APS HEDGING POLICIES?

A. Price stability is the goal of the system hedge. Price stability is, of course, a relative concept. In a consistently rising market, even hedged prices will also increase, albeit less quickly. The converse is true in a falling market. APS' system hedging philosophy is not one of trying to predict the direction of the market – that's what speculators do, and we do not speculate on behalf of our customers. This goal of price stability is achieved in the current system hedge plan by virtue of definitive target hedge levels, a requirement for strict compliance in meeting those hedge levels, and senior management oversight and direction of the hedging program.

This measured approach helps APS' customers largely avoid the turbulence that can occur in short-term commodity markets. Perhaps the most obvious recent example as to the inherent value of a long-term hedge policy is the California energy crisis of 2001 and 2002. Over-reliance on the spot markets for procurement of electricity and natural gas resulted in extreme price volatility. As a result of the implementation of a deregulation plan, the investor-owned utilities in California were restricted from entering into long-term contracts for energy. As spot energy prices increased due to any number of factors, including rising natural gas prices, transmission constraints and limited hydro production, those utilities were forced to buy power from the near-term market. Coupled with this market turbulence, both PG&E and SCE had no rate mechanism to recover rising costs from their customers. This caused extreme financial distress for the utilities and provided no incentive for their customers to curb their consumption of an increasingly expensive commodity. The result was the very well documented "energy crisis" that dramatically impacted both the utilities and their customers.

By hedging purchased power and natural gas needs over a three-year horizon, APS can mitigate the impact of volatile gas prices and wholesale capacity concerns. Many issues relating to APS' hedging activities were outlined in my presentation to the Commission's Natural Gas Forum on September 8, 2005. For reference, I have attached the slides from that presentation as Schedule TJC - 1.

Q. CAN YOU PLEASE DESCRIBE THE EVOLUTION OF THE APS HEDGE PLAN?

A. In the years prior to 2003, the volumes of natural gas and purchased power exposed to price volatility were considerably less than today's volumes (over 33% less) and, for the most part, the costs of those commodities were also significantly lower (over 66% lower) than today's costs. As APS' exposure to the requisite volumes of natural gas and/or purchased power increased dramatically, the hedges employed by APS in the fall of 2003 were restructured to allow lower levels of variances in required hedge levels.

Specifically, in the fall of 2003, APS initiated a hedge plan for total energy (natural gas and purchased power needs combined) that required near term (or "prompt calendar year") requirements to be 75% hedged prior to January 1st of that particular year. As a result of those requirements, the following hedge levels were obtained or were to be obtained by the following dates:

- Calendar 2004: was 75% hedged as of December 31, 2003.
- Calendar 2005: was 75% hedged as of December 31, 2004.
- Calendar 2006: was to be 75% hedged as of December 31, 2005.

In addition to the 75% year end hedge requirements listed above, interim hedge levels were established for Calendar Years 2005 and 2006 as follows:

- Calendar 2005: hedge levels of 25% by December 31, 2003 and 50% by June 30, 2004.
- Calendar 2006: hedge levels of 15% by December 31, 2003, 25% by December 31, 2004, and 50% by June 30, 2005.

The above requisite hedge levels were attained by APS on or before the deadlines listed above.

Q. DID APS REVISE ITS HEDGE PLAN IN 2005, AND IF SO, WHY?

A. In June of 2005, APS revised its system hedge plan to address growing concerns about still increasing market volatility and the related financial risks to APS customers. The revised hedge plan was prepared in consultation with Risk Advisors, an industry expert in the design and implementation of hedging policies and practices.

Under the revised APS System Hedge plan for total energy (again, natural gas and purchased power combined), the following hedge levels were established and met by August 1, 2005.

- Remainder of 2005: 85% hedged at the following prices:
    - Natural Gas, with an average delivered hedge price of $6.93/dth.
    - Purchased Power, with an average hedge price of $69/MWh (peak and off peak combined).
- Calendar Year 2006: 85% hedged at the following prices:
    - Natural Gas, with an average delivered hedge price of $7.24/dth.
    - Purchased Power, with an average hedge price of $56/MWh (peak and off peak combined).

(Note: The current cost and value of the 2005 and 2006 hedge prices for natural gas and/or purchased power can change as market price of the underlying commodities changes, and APS continues to manage its hedge positions to achieve physical delivery.)

Our hedge targets for 2007 (50%) and 2008 (35%) have also been met.

Q. HOW DO THESE HEDGED PRICES FOR GAS AND ELECTRICITY COMPARE TO TODAY'S FORWARD MARKET PRICES?

A. The value of the current hedged natural gas and purchased power prices are significantly lower than current forward market prices, as established by various gas and power trading hubs. Since forward market pricing changes from day to day and the price of the hedge will change as a result of any change in hedge percent or makeup, the comparison between the hedged price and forward market will also change from day to day. The following depicts forward natural gas and purchased power prices as of September 23, 2005, and the variance between those prices and the current hedge prices to date.

Remainder of 2005:

Natural Gas (delivered to APS power plants)

- Current forward market: $11.66/dth
- Hedged prices: $6.93/dth
- Current variance = $4.73/dth

Purchased Power

- Current forward market: $86/MWh
- Hedged prices: $69/MWh
- Current variance = $17/MWh

Calendar 2006:

Natural Gas (delivered to APS power plants)

- Current forward market: $10.82/dth
- Hedged prices: $7.24/dth
- Current variance = $3.58/dth

Purchased Power

- Current forward market: $80.25/MWh
- Hedged prices: $56/MWh
- Current variance = $24.25/MWh

Q. HOW DOES APS ESTIMATE ITS NATIVE LOAD REQUIREMENTS AND THUS ITS REQUIRED HEDGE VOLUMES?

A. APS serves retail load requirements by sourcing power from its nuclear, coal, and natural gas generators, and by purchasing wholesale power in the marketplace under long term agreements, or when purchasing power in shorter term or real-time markets is more cost effective than self generation.

Fuel used in the nuclear and coal fired generators is purchased through long term contracts at prices that, although escalated over time in accordance with contractual formulae, allow those units to generally run as base load units. Since our retail load demand cannot be readily predicted on an hour by hour or day to day basis, the incremental or "swing" supply of energy needed to serve load is sourced through our natural gas fired generators, through market purchases of electricity, or through a combination of both.

In attempting to assess future native load energy needs, APS utilizes a computerized simulation model called Real Time Simulation ("RTSIM") to project the requisite necessary level of incremental energy (gas fired or purchased power, or both). In the case of the APS System Hedge, we use this model to forecast three years worth of incremental energy needs, summarized monthly, in order to establish our hedge requirements. Key inputs into the model include:

- Forecast of system load requirements.
- Forward price curve of natural gas and purchased power.
- Scheduled outages of APS generators.
- Heat rate efficiencies and capacities of APS generators.
- Operating constraints such as Reliability Must Run ("RMR") requirements, minimum run time, ramp rates, etc.

In assessing estimated needs, we are also aware that generators are going to have non-scheduled outages. Because these outages generally occur randomly, APS includes a planning reserve in the monthly supply/demand balance prior to calculating the monthly total energy hedge requirement.

Q. WHAT SYSTEMS DOES APS USE TO ATTEMPT TO OPTIMIZE ITS HEDGE POSITIONS?

A. In order to capture the impact of price changes on our required hedge volumes, APS re-runs the RTSIM model every week with updated forward prices for natural gas and purchased power. Under normal situations, the total energy requirements for the three years change only minimally, although the appropriate volumetric mix between natural gas and purchased power can vary significantly. As a result, the traders will attempt to "optimize" the hedge position to capture the least expensive incremental energy to serve load, as depicted by the model, while adhering to the total energy hedge targets. By optimizing, term traders can:

- Adjust hedge levels of each specific commodity (purchased power versus natural gas).
- Modify receipt and/or delivery points by commodity in order to minimize costs and retain reliability.
- Investigate the economic value of financial/physical derivatives as opposed to outright financial/physical contracts in managing risk.

Notwithstanding such optimizations, the total energy hedge at any given time must remain at the target levels in accordance with the existing system hedge plan.

Q. WHAT TYPES OF TOOLS AND/OR CONTRACTS DOES APS USE TO HEDGE ITS NATURAL GAS AND PURCHASED POWER NEEDS?

A. APS transacts in various markets and uses various hedge tools in managing price volatility and financial risk. The most common hedge tools include:

- Physical purchased power contracts delivered at Palo Verde, Four Corners, Mead, and other accessible delivery points.

- Physical purchased power call options to hedge financial capacity risk delivered at Palo Verde, Four Corners, and Mead.
- Financial natural gas futures contracts traded on the New York Mercantile Exchange ("NYMEX"). (The NYMEX financial contracts used to hedge natural gas are very liquid and allow for physical natural gas contracts purchases prior to the delivery month).
- Physical natural gas contracts for gas from the San Juan and Permian Basins.

To give some perspective on the scope of our program, at any one time the Company has more than 10,000 individual financial and physical contracts in place.

Q. HOW DOES APS THEN GO FORWARD AND TRANSITION CONTRACTS BOUGHT FOR HEDGES TO DELIVER POWER TO APS' CUSTOMERS?

A. As stated earlier, APS uses a number of mechanisms to hedge its needs. Some are called "physical" contracts (e.g. deliverable power) and others "financial" contracts (e.g. cash settled). The most common "financial contract" is a futures contract. Futures contracts used to hedge our financial risk must be converted to physical contracts in order to obtain the physical commodity to serve load. The most common example of this is the natural gas NYMEX futures contract, which APS uses extensively in hedging.

NYMEX futures contracts expire three business days prior to the first day of the next month. For example, the September 2005 NYMEX natural gas futures contract expired on August 29, 2005. Since APS typically owns these contracts by virtue of our hedge plan, APS will sell all futures contracts back to the market on or near August 29th, and simultaneously, purchase a physical supply contract with a natural gas producer or marketer through an electronic trading platform or via 3rd party brokers, that allows APS to deliver that gas to one of our power plants. In other words, if APS had hedged the equivalent of 5 billion cubic feet (Bcf) of NYMEX natural gas futures for a particular month, APS will sell 5 Bcf of futures contracts back to the NYMEX market, and purchase 5 Bcf of physical supply through ICE (Intercontinental Exchange – the most commonly used electronic trading platform in our markets). This activity normally occurs during the last week of the month prior to delivery but must occur prior to the expiration of the NYMEX contract.

Within the delivery month, APS will take appropriate short term positions in natural gas and/or purchased power in response to changes in market price or load requirements. These modifications include both the purchase and sale of natural gas and electricity as our load requires. For example, if APS had expected to burn 100,000 mmbtu of natural gas in our generators on a given day, but because of cooler than normal temperatures, the expected load demand was reduced, APS will sell back to the market any excess natural gas purchased for that day. The same holds true for any excess purchased power. In the event the load is higher than projected, APS will purchase from the market any additional natural gas or electricity needed to serve that load in the most cost effective manner. Natural gas is normally purchased one day prior to delivery while electricity can be purchased either one day prior or hourly (real time) during the day of delivery.

Q. WHAT IS THE ECONOMIC IMPACT OF APS' HEDGING PRACTICES?

A. APS believes that price stability, and not speculative gain, is the goal of hedging. As a result, the "economic impact" of hedging can and will vary with the swings in commodity prices in short term markets. That said, under certain conditions, it is possible to also achieve positive economic value from hedging practices. Specifically, if the hedge is priced at a cost below the current market value, the "market" value of the hedge itself is positive, and can result in lower costs to the customer versus relying on spot market prices for procurement. For example, during the time period from April 2005 to August 2005, the realized value of hedging in advance saved APS over $30,000,000 in fuel and purchased power costs. Put another way, if APS had not hedged commodities in advance, and relied solely on the near term (monthly) markets to purchase its projected gas and purchased power volumes, the eventual costs of those commodities would have been over $30,000,000 more due to higher month to month prices for gas and purchased power.

It is important to note, however, that the economic value of hedging can be reduced or even eliminated if the short term price of gas and purchased power turns lower than the hedge costs. In those instances, even though price stability is realized, the final costs of hedging may be higher than purchasing needs short term (monthly or daily). That does not mean that the hedges were imprudent or even that they had no value to customers. Hedging is essentially price insurance. Insurance does not lose its value nor is its purchase imprudent simply because the risk insured against does not, in any particular instance, materialize.

The volatility of commodity pricing has been well documented over the last several years. Given the size of APS' load, even a minimal movement in pricing can have a dramatic impact to APS' customers. By example, Schedule TJC-2 to my testimony is a chart that shows the impact of a $1 adverse move in natural gas for the unhedged portion of APS' energy needs. As that chart evidences, a

$1 increase in price over the next three years can have an approximately $83 million negative impact to APS' customers.

It is also important to note, that the economic value of hedging can be reduced or even eliminated in the event a contracted counterparty fails to perform. The use of NYMEX futures contracts significantly reduces the counterparty performance risk for the term natural gas markets.

Notwithstanding, and as briefly addressed at the beginning of my testimony, the failure to hedge and instead wait for the spot market can, and has, on any number of occasions in the past, proven catastrophic. In short, we believe hedging is a long-term safety net for APS customers and in many ways should be regarded more like insurance than a speculative profit center.

Q. WHAT ARE SOME OF THE LIMITATIONS ON APS' ABILITY TO HEDGE?

A. Credit restrictions, market liquidity, and load uncertainty are the three primary factors that limit hedging.

- Credit restrictions: Can limit the number of counterparties and hedge tenor (both volume and length of transactions).
- Market liquidity: Reduced liquidity further out in time (2007 and beyond).
- Load uncertainty: Customer demand for electricity changes daily due mostly to weather.
- APS' Credit Score: The strength of APS' credit is critical in allowing APS to transact with favorably-rated counterparties, which in turn limits the amount of credit risk to APS customers.

IV. CONCLUSION

Q. DO YOU HAVE ANY CONCLUDING REMARKS?

A. Yes. APS incorporates extensive use of financial and physical contracts to minimize commodity price volatility when purchasing natural gas and purchased power to serve retail load. Since price stability is the goal of our system hedge position, financial risks associated with projected requirements of these commodities are systematically hedged at various levels three years prior to delivery with standard energy products.

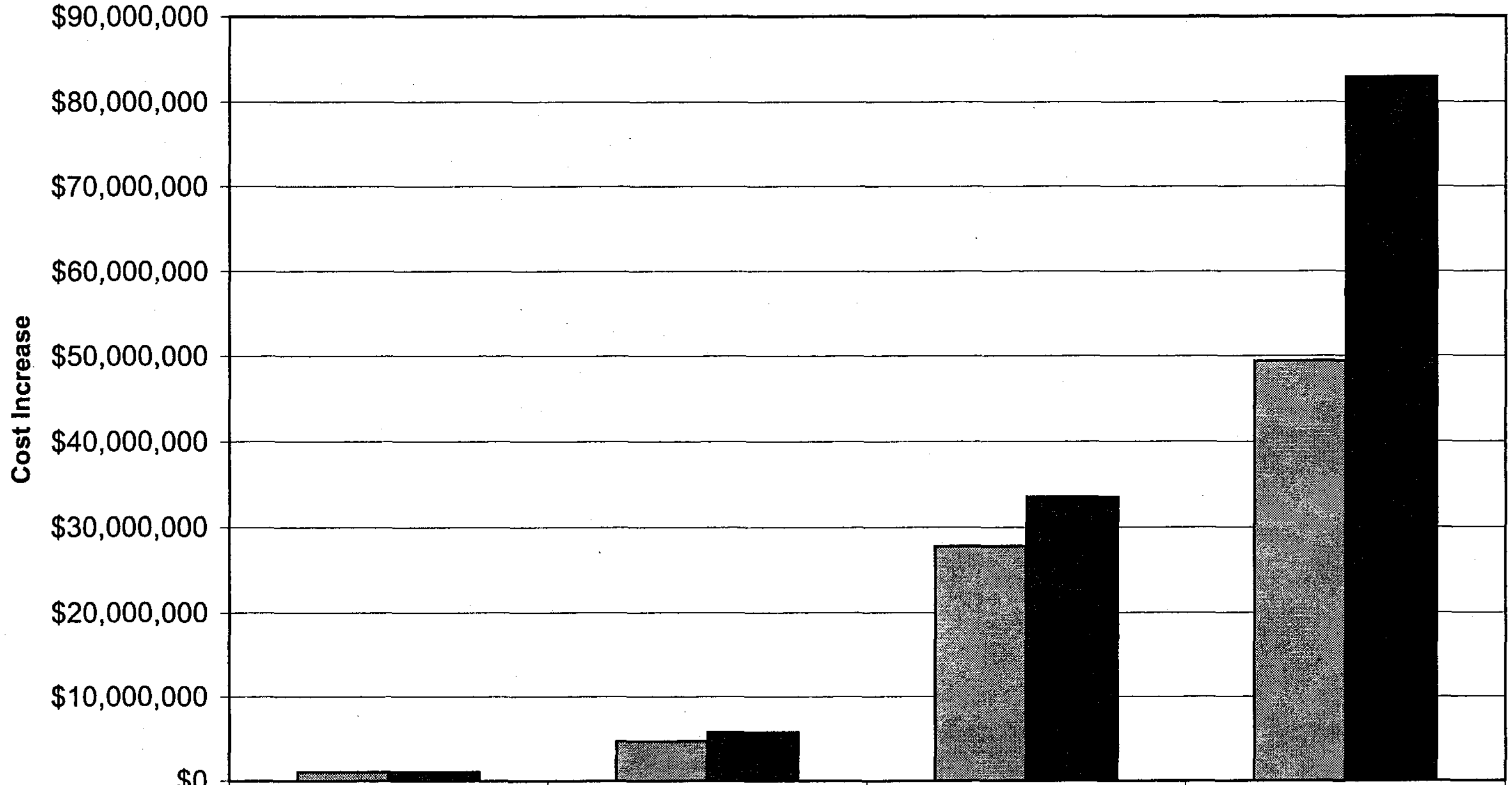
APS has hedged its financial commodity risk since the late 1990's in response to unprecedented market price fluctuation and has continued with this policy. In June of 2005, APS increased its hedge percentages in light of even greater price uncertainty. Because of these hedges, the current hedged price of natural gas and purchased power is significantly below the now prevailing market price through 2008.

The measured approach utilized by the system hedge plan helps APS customers largely avoid much of the turbulence of price volatility that can occur in the short-term commodity markets. Coupled with the practice of optimizing natural gas or purchased power to provide the lowest cost commodity to meet load, the current approach to hedging financial risk is providing APS customers with significant economic savings while attaining future price stability.

Arizona Public Service Company

Financial Impact of $1/dth Change in Unhedged Natural Gas

September 28, 2005 Forecast Loads and Market Prices



	2005	2006	2007	2008
Annual	$1,048,900	$4,706,800	$27,766,300	$49,425,500
Cumulative	$1,048,900	$5,755,700	$33,522,000	$82,947,500

EXHIBIT

APS-6

admitted

DIRECT TESTIMONY OF PETER M. EWEN

On Behalf of Arizona Public Service Company

Docket No. E-01345A-05-0526

&

Docket No. E-01345A-03-0437

September 30, 2005

TABLE OF CONTENTS

DIRECT TESTIMONY OF PETER M. EWEN ON BEHALF OF ARIZONA PUBLIC SERVICE COMPANY (Docket No. E-01345A-05-0526 & E-01345A-03-0437)

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Peter M. Ewen. My business address is 400 N. 5th Street, Phoenix, Arizona, 85004.

Q. WHAT IS YOUR POSITION WITH ARIZONA PUBLIC SERVICE COMPANY?

A. I am Manager of the Forecasts Department for Arizona Public Service Company ("APS" or "Company"). In that role, I am responsible for preparing the Company's short-range and long-range forecasts of system peak demand and energy sales and for projecting the optimal dispatch of available resources to minimize the cost of meeting those energy requirements.

Q. WHAT IS YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND?

A. I received Bachelors and Masters degrees in Economics from Arizona State University in 1985 and 1988, respectively. I have analyzed and forecasted electric energy and demand growth since 1988, first as a Staff member of the Arizona Corporation Commission ("Commission") and, since 1990, as an employee for APS. I have specifically analyzed the actual dispatch of our generating units in combination with market purchases to serve native load demand since 1998, and assumed full responsibility for making the optimal dispatch and associated fuel cost projections in 2000. I was formerly President of the Arizona Economic Round Table, a group of Arizona-based economists that specialize in studying the Arizona economy, and I am still a member of that organization. I also serve on the Joint Legislative Budget Committee's Finance Advisory Committee. This consists of a group of state economists who advise the

Joint Legislative Budget Committee staff on the adequacy of the economic projections underlying their state revenue projections.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I am supporting the Company's application for a 0.1416¢/kWh power supply adjustor ("PSA") surcharge, as shown on Schedule PME-1, by describing the extent of the Company's under-collection of its fuel and purchased power expenses as they relate to the fuel costs included in the Company's current base rates approved in Decision No. 67744 (April 7, 2005). (Here and throughout the remainder of my testimony, I will refer to fuel and purchased power expenses collectively as fuel expenses.) I describe what the extent of this under-collection is expected to be through the end of 2006, with and without the requested surcharge. I also explain the various reasons why the Company is experiencing this under-collection.

Q. WOULD YOU PLEASE SUMMARIZE YOUR TESTIMONY?

A. From April 1, 2005 through August 31, 2005, the Company has under-collected $127.7 million in fuel expenses in the provision of electricity to its retail customers, of which $115.2 million has been deferred and $12.5 million has been paid for by the Company's shareholders, reflecting the Company's 10% share of higher fuel costs as mandated by the Commission in Decision No. 67744. The Company, in its July 22 filing, initially requested a surcharge to recover $100 million over 24 months beginning November 1, 2005. As Company witness Mr. Steve Wheeler indicates in his testimony, the Company has subsequently modified its request, and is now seeking to recover $80 million over 24 months with a surcharge of 0.1416¢/kWh. If the Commission were to approve the requested $80 million surcharge, the application of the annual PSA adjustment formula results in an estimated Annual PSA Factor of 0.3¢/kWh in April 2006.

Under such circumstances, the under-collected fuel expense balance is expected to reach $255 million by the end of 2006, including the as of yet unrecovered portion of the $80 million. In the absence of this surcharge, the under-collected balance will approach $274 million by the end of 2006.

The reasons for this are fairly straightforward. First, higher fuel prices account for $45 million, the largest single source of the under-collection. These higher fuel costs are in spite of the significant savings of $31 million the Company was able to achieve through its fuel hedging program. Second, the incremental electricity sales growth since 2003 – the time period which served as the basis for the Company's base fuel rate – has been served predominately by high-cost natural gas and purchased power resources, a cost increase of $13 million. Third, the Company is under-collected by $30 million simply because the monthly pattern of fuel costs is at its highest during the spring and summer periods captured in the filing. This amount assumes no changes in fuel prices, energy sales levels, or plant operations.

II. UNDER-COLLECTED FUEL EXPENSE BANK BALANCE

Q. WHAT WAS THE AMOUNT OF FUEL EXPENSE THAT THE COMPANY DID NOT RECOVER FROM APRIL THROUGH AUGUST 2005?

A. $127,675,173.

Q. WHAT WAS THE UNDER-COLLECTED BANK BALANCE AT THE END OF AUGUST 2005?

A. $115,216,605.

Q. WHAT IS THE DIFFERENCE BETWEEN THESE NUMBERS?

A. The difference of almost $12.5 million is accounted for by the amount of fuel the Company paid for but does not get to collect from customers as a result of the 10% sharing mechanism incorporated in the PSA. The actual expense amounted to $12.8 million but was slightly offset by the interest of $0.3 million that has accrued on the unrecovered fuel expense balance.

Q. HOW WERE THESE AMOUNTS CALCULATED?

A. Each month, the Company records its fuel and purchased power expenses incurred in serving native load customer energy needs, and the revenues and fuel expenses associated with making off-system sales. The fuel and power purchase and sale transactions associated with both of these activities are managed internally in the Company's "System Book." A net cost of serving native load customers is calculated by crediting the revenues from the Company's off-system sales against the total fuel and purchased power expenses incurred in serving native load customers and off-system sales. The retail component of this net cost is calculated based on each month's proportion of retail electricity sales to that month's total native load sales. This retail customer net fuel cost is compared to the amount of revenue the Company collected from retail customers for fuel expenses, which is the Company's approved base fuel rate of 2.0743¢/kWh multiplied by that month's electricity sales to retail customers, in order to find the dollar amount the Company has under- or over-collected. Finally, any under- or over-collection is split with 90% going into a bank balance for future rate determination and 10% being expensed by the Company during the period.

Schedule PME-2 is the Company's standard monthly PSA filing with the Commission, which shows these monthly calculations for April through August 2005, the time period during which the PSA has been in effect. As can be seen from page 1 of the exhibit, the Company has under-collected its approved fuel costs in every month since the start of the PSA, with the highest cost months of July and August being the largest contributors to the under-collected balance. Of the $127.7 million the Company has spent on fuel but not recovered, $86.6

million, or two-thirds of the total, occurred in the two months of July and August.

Q. PLEASE EXPLAIN WHY THE COMPANY DOES NOT SEPARATELY CALCULATE FUEL AND PURCHASED POWER EXPENSES FOR NON-RETAIL NATIVE LOAD.

A. The Company's non-retail (wholesale) native load customers all are small districts serving rural areas of Arizona and comprise approximately 3% of total native load sales. These non-retail customers are served from the same common set of resources as the Company's retail customers, and their fuel and purchased power costs were allocated on the same basis as in the PSA Plan of Administration in determining the Base Fuel Cost adopted by the settlement and Decision No. 67744. For that matter, it is the same allocation procedure used in prior APS rate proceedings. Thus, the treatment of these loads is both consistent with prior precedent and with how costs are actually incurred to serve them.

Q. DO YOU EXPECT THE BANK BALANCE TO CORRECT ITSELF AND RETURN TO ZERO?

A. No, quite the opposite. By December 2006, the Company's under-collection is expected to be around $255 million. This amount is more than the Company's 2004 earnings. The Company will add some $214 million in under-collected fuel costs to this balance through the course of 2006, but will collect only $40 million in 2006 through the surcharge, if approved, and $67 million from re-setting of the Annual PSA Factor on April 1, 2006. This $107 million in collections will not even recoup the Company's shortfall in 2005. The December 2005 under-collected balance will be $143.1 million, or $36 million more than the Company will collect in 2006.

Q. WHAT WOULD THE UNDER-COLLECTED BALANCE BE WITHOUT THE APPROVAL OF THE SURCHARGE?

A. At the end of 2006, the bank balance would be \$274 million, or about \$19 million higher than the current projection. Without the 0.1416¢/kWh surcharge, the Annual PSA Factor – under current projections – will be re-set to 0.4¢/kWh on April 1, 2006, which partially offsets the loss of the \$40 million in surcharge collections in 2006.

III. SOURCES OF UNDER-COLLECTED FUEL EXPENSES

Q. WHAT ACCOUNTS FOR THESE HIGHER COSTS?

A. Schedule PME-3 provides a list of the major factors that have contributed to the increase in average costs relative to the 2003 base fuel rate and quantifies the impact in dollar terms. On page 1, it shows the bank balance at the end of August 2005 and the amounts which the Company is not seeking to recover at this time. The result is the "Net Balance for Current Request" of \$80 million (the \$.1 million difference is due to rounding). Page 2 shows a breakdown of the sources of fuel expense increases over the Company's base fuel rate. Note that the principal factors listed on page 2 account for more than the Company is requesting in its current application by \$8.2 million. See Schedule PME-3, page 2. This is because the Company is setting aside \$20 million of under-collected fuel expenses related to unplanned outage replacement power costs for future rate determination and because \$15 million of higher costs were never included in the Company's original request due to the timing of the application (i.e., before July and August final balances were known).

First on the list is higher fuel prices, which account for \$45 million of the increase and would be even greater were it not for the Company's hedging program. Prices for natural gas and purchased power are up 23% and 46%, respectively, for the April-August 2005 time period relative to the 2003 prices included in the Company's base fuel rate of 2.0743¢/kWh. Delivered prices for natural gas averaged \$6.96/mmbtu and purchased power prices averaged \$57.15/MWh in 2005. The corresponding prices in the base fuel rate reflect 2003 prices of \$5.65/mmbtu for natural gas and \$39.14/MWh for purchased power. These price increases contribute almost \$70 million to the Company's costs in excess of the base rate levels.

These cost increases are offset by savings of \$34 million from the Company's hedging program, or almost half of the overall price increase. The Company hedged a substantial portion of its 2005 natural gas and power needs in advance, beginning in the 4th quarter of 2003. As gas and power prices for 2005 increased steadily from the end of 2003 through the 2nd and 3rd quarters of 2005, these financial hedges that the Company had purchased gained significantly in value. When it was time to take physical delivery of natural gas and power, the Company liquidated these financial hedges and is using the proceeds to reduce the net cost to customers of high natural gas and power prices. Mr. Carlson describes the Company's hedging program in more detail in his testimony.

The change in gas and power prices has also contributed to lower off-system sales margins as the Company's gas-fired generating units became less economic relative to the 2003 base fuel rate prices. The reduced margins from these sales increased net costs by \$2 million. In combination with the other factors I have just described, the ultimate increase in cost due to higher natural gas and power prices nets to \$38 million, or \$34 million after accounting for the Company's 10% share of the increase.

Q. HAVE OTHER FUEL PRICES INCREASED?

A. Yes. In particular, prices for coal have experienced fairly substantial increases that have led to an additional \$12 million of under-collected costs, net of the

Company's 10% share. Average coal production costs are 15% higher in 2005 than what is included in the 2003 base fuel rate. Rail transportation costs for the coal burned at the Company's Cholla Generating Station also have increased as a result of a Surface Transportation Board ("STB") action in December 2004. In addition, coal prices otherwise have increased at all three of the Company's coal-fired generating plants, due to higher costs at the mines. Coal production costs averaged \$15.29/MWh in the 2005 period, but are only \$13.27/MWh in the Company's base fuel rate.

In summary, the higher prices for coal, natural gas and power account for \$45 million, or 56%, of the \$80 million under-collection in 2005.

Q. WHAT OTHER CONDITIONS ARE CONTRIBUTING TO THE FUEL EXPENSE UNDER-COLLECTION?

A. Another significant contributor is the incremental load growth that the Company has experienced since the base fuel rate was set. Retail sales of electricity are approximately 500,000 MWh greater in the April – August 2005 time period than in the corresponding months of 2003 used for the base fuel rate calculation. Holding fuel prices constant at base fuel rate levels, this additional 500,000 MWh has resulted in an under-collection of \$13 million (16%) net of the Company's 10% share. The incremental cost to serve these additional sales at base fuel rate prices is approximately \$50/MWh, or 5.0¢/kWh. When compared to the 2.0743¢/kWh collected from customers for these additional sales, it becomes apparent that the Company is under-collecting 2.93¢/kWh on each incremental kWh sold. For every 1,000 MWh, the Company ends up short by \$29,000. After absorbing 10% of the increase, every 1,000 MWh contributes just over \$26,000 to the under-collected balance.

Q. WHAT ELSE HAS LED TO THE UNDER-COLLECTION OF FUEL EXPENSES THROUGH AUGUST?

A. The monthly pattern of fuel expenses is another contributor to the uncollected balance and accounts for \$30 million (37% of the \$80 million) net of the Company's 10% share. This would be the case even if fuel prices, energy sales, and generator availability all were exactly the same as the values included in the base fuel rate. Schedule PME-4 shows graphically the pattern of 2003 average monthly fuel costs that averaged out to 2.0743¢/kWh over the entire year. The most salient feature in the exhibit is the higher costs in the summer months that are moderated out by lower costs in the spring and fall months. In the absence of higher fuel prices and higher energy sales, these short-term "timing" costs would be the only amounts uncollected through August, and the corresponding "over-collection" would occur in future months to balance out the under-collection. Combined with fuel prices that average out much higher than the 2003 prices included in base rates, though, this pattern, along with growth, helped to push the Company's under-collected balance over the \$100 million threshold that required a filing for recovery under Decision No. 67744.

Q. WILL THIS PATTERN ACT AS A SELF-CORRECTION AND REDUCE FUTURE BALANCES TOO FAR THE OTHER WAY?

A. No. Between October 2005 and April 2006, the monthly amount collected from customers is expected to be modestly over or under, depending on the specific month, the Company's actual fuel costs. Because prices are as high as they are, however, future under-collected balances will only accelerate once the summer months of 2006 arrive. As I mentioned earlier, the Company currently projects that base revenues will produce a shortfall of \$214 million relative to the anticipated fuel costs in 2006. Because this incorporates the full year, any "timing" issues are not a factor.

IV. CONCLUSION

Q. DO YOU HAVE ANY CONCLUDING REMARKS?

A. The Company has spent significantly more on fuel and purchased power between April and August 2005 than it has collected from customers through the established base fuel rate. Under current projections, this trend is only expected to continue and, in the absence of Commission approval of the Company's requested surcharge, will grow to close to $300 million by the end of 2006.

The reasons for these fuel cost increases are straight-forward. Higher natural gas and power prices, higher coal prices and the high cost of incremental sales growth are the primary contributors to the Company's request. These higher costs have been mitigated to a large extent by the Company's forward hedging of its natural gas and purchased power needs. However, the fuel prices allowed in the Company's base fuel rate from 2003 are not likely to return in the foreseeable future, so the Company's requested surcharge is necessary to prevent the under-collected fuel expense bank balance from becoming unmanageablely large.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

ARIZONA PUBLIC SERVICE COMPANY
Calculation of the Revised November 2005 PSA Surcharge

Line No.	Mth	Projected Retail Calendar MWhs	Less E-3/E-4[1] Projected MWhs	Less E-36[2] Projected MWhs	Total MWhs
1	Nov 05	1,921,888	(17,765)	(5,090)	1,899,033
2	Dec 05	2,062,795	(20,996)	(5,090)	2,036,709
3	Jan 06	2,109,012	(23,186)	(5,090)	2,080,736
4	Feb 06	1,821,752	(19,440)	(5,090)	1,797,222
5	Mar 06	1,929,711	(16,764)	(5,090)	1,907,857
6	Apr 06	2,025,386	(15,933)	(5,090)	2,004,363
7	May 06	2,374,205	(17,161)	(5,090)	2,351,954
8	Jun 06	2,704,478	(23,573)	(5,090)	2,675,815
9	Jul 06	3,041,028	(29,271)	(5,090)	3,006,667
10	Aug 06	3,253,145	(34,101)	(5,090)	3,213,954
11	Sep 06	2,670,087	(32,227)	(5,090)	2,632,770
12	Oct 06	2,096,903	(23,721)	(5,090)	2,068,092
13	Nov 06	1,998,967	(18,476)	(5,090)	1,975,401
14	Dec 06	2,146,316	(21,836)	(5,090)	2,119,390
15	Jan 07	2,192,234	(24,113)	(5,090)	2,163,031
16	Feb 07	1,893,694	(20,218)	(5,090)	1,868,386
17	Mar 07	2,006,883	(17,435)	(5,090)	1,984,358
18	Apr 07	2,105,708	(16,570)	(5,090)	2,084,048
19	May 07	2,469,635	(17,848)	(5,090)	2,446,697
20	Jun 07	2,818,195	(24,516)	(5,090)	2,788,589
21	Jul 07	3,169,580	(30,442)	(5,090)	3,134,048
22	Aug 07	3,390,383	(35,465)	(5,090)	3,349,828
23	Sep 07	2,781,625	(33,516)	(5,090)	2,743,019
24	Oct 07	2,182,782	(24,670)	(5,090)	2,153,022
		57,166,392	(559,241)	(122,160)	56,484,991

Amortized Amount	**$**	**80,000,000**
Total kWhs		56,484,991,000
PSA Surcharge per kWh	$	**0.001416**

[1] E-3 and E-4 customers will not have to pay PSA charges per Decision No. 67744.

[2] E-36 customers are directly assigned incremental fuel and purchased power per the terms of the rate schedule. Therefore, both the incremental cost and the associated MWh usage are excluded from the PSA calculations. The PWEC Units are excluded from the E-36 projections because they are being transferred to APS.

Note: The PSA Surcharge will expire at the end of the 24 month period. Any over/under collection remaining at the end of the period will be credited/debited to the PSA balancing account.

ARIZONA PUBLIC SERVICE COMPANY
Schedule 1
2005 Monthly Energy Sales and Costs

Line No.	Month	(a) PSA Retail [1] Energy Sales (kWh)	(b) Native Load [2] Wholesale Energy Sales (kWh)	(c) Native Load Energy Sales (kWh)	(d) System [3] Book Fuel and Purchased Power Costs	(e) System Book [4] Off-System Sales Revenue	(f) Net Native Load Power Supply Cost	(g) PSA Retail Power Supply Cost	(h) Base Rate Power Supply Cost	(i) Pre-Sharing (Over)/Under Collection	(j) Post-Sharing (Over)/Under Collection
				(a + b)			(d - e)	(a/c * f)	(a * 0.020743)	(g - h)	(i * 0.9)
1	January	-	-	-	$ -	$ -	$ -	$ -	$ -	$ -	$ -
2	February	-	-	-	$ -	$ -	$ -	$ -	$ -	$ -	$ -
3	March	-	-	-	$ -	$ -	$ -	$ -	$ -	$ -	$ -
4	April	1,740,332,253	66,132,000	1,806,464,253	$ 43,121,614	$ 3,912,992	$ 39,208,622	$ 37,773,252	$ 36,099,712	$ 1,673,540	$ 1,506,186
5	May	2,235,997,989	74,575,395	2,310,573,384	$ 68,036,346	$ 4,071,192	$ 63,965,154	$ 61,900,633	$ 46,381,306	$ 15,519,327	$ 13,967,394
6	June	2,565,383,692	59,137,886	2,624,521,578	$ 82,638,364	$ 3,805,618	$ 78,832,746	$ 77,056,422	$ 53,213,754	$ 23,842,668	$ 21,458,401
7	July	3,075,187,048	98,176,607	3,173,363,655	$ 117,004,560	$ 3,172,422	$ 113,832,138	$ 110,310,432	$ 63,788,605	$ 46,521,827	$ 41,869,644
8	August	2,932,462,804	95,743,670	3,028,206,474	$ 108,099,009	$ 3,857,282	$ 104,241,727	$ 100,945,887	$ 60,828,076	$ 40,117,811	$ 36,106,030
9	September	-	-	-	$ -	$ -	$ -	$ -	$ -	$ -	$ -
10	October	-	-	-	$ -	$ -	$ -	$ -	$ -	$ -	$ -
11	November	-	-	-	$ -	$ -	$ -	$ -	$ -	$ -	$ -
12	December	-	-	-	$ -	$ -	$ -	$ -	$ -	$ -	$ -
13	Total	12,549,363,786	393,765,558	12,943,129,344	$ 418,899,893	$ 18,819,506	$ 400,080,387	$ 387,986,626	$ 260,311,453	$ 127,675,173	
14											$ 114,907,655

[1] PSA Retail Energy Sales are the calendar month's kWh sales. Cumulative Retail Energy Sales of 2,894 MWhs under rate schedule E-36 were excluded from the PSA Calculations.

[2] Includes traditional sales-for-resale and Pacificorp supplemental sales.

[3] Includes native load and off-system fuel and purchased power costs less those costs associated with E-36 ($2,359,648), the non-fuel Bridge PPA, ISFSI and mark-to-market accounting adjustments. Excludes net savings of $1,159,000 associated with the Sundance units pursuant to Decision No. 67504. The Wheeling costs included this month are $2,087,952. The Broker Fees included this month are $34,515.

[4] Includes off-system revenue less mark-to-market accounting adjustments.

Definitions of commonly used terms for this filing are included in the PSA Plan for Administration. Any new terms will be defined on this page.

ARIZONA PUBLIC SERVICE COMPANY
Schedule 2
2005 Annual Balancing Account Interest

Line No.	Month	Balancing Account Monthly Interest
		(Schedule 4, Line 15)
1	January	$ -
2	February	$ -
3	March	$ -
4	April [1]	$ -
5	May	$ 3,502
6	June	$ 35,984
7	July	$ 85,959
8	August	$ 183,505
9	September	$ -
10	October	$ -
11	November	$ -
12	December	$ -
13	Total	$ 308,950

Move Forward to Schedule 3, Line 2 $ 308,950

[1] No interest was accrued in April since it is the first month for the PSA.

ARIZONA PUBLIC SERVICE COMPANY
Schedule 3
2005 Year End PSA Adjustor Rate Calculation

Line No.	PSA Adjustor Rate Calculation			
1	Post-Sharing (Over)/Under Collection Amount (From Sch. 1)		$ -	
2	Annual Balancing Account Interest (From Sch. 2)		$ -	
3	Less: Approved Amortization Surcharge Balance		$ -	
4	Bandwidth Carry Forward from Prior Period		$ -	
5	Total (Credit)/Charge Amount (Line 1 + Line 2 + Line 3 + Line 4)			$ -
6	Total (Credit)/Charge Amount	$ -		
7	Actual Energy Sales without E-3, E-4 and E-36 (kWh)	-		
8	Computed Adjustor Rate per kWh (Line 6 / Line 7)		0	
	Adjustor Rate Bandwidth			
9	Adjustor Rate Bandwidth Upper Limit		$ 0.004000	
10	Adjustor Rate Bandwidth Lower Limit		$ (0.004000)	
11	Applicable Adjustor Rate per kWh			$ -
12	Total (Credit)/Charge Carried Forward Due to Adjustor Rate Bandwidth			$ -

Note: This calculation is done once a year for the change to the PSA Adjustor Rate in April.

ARIZONA PUBLIC SERVICE COMPANY
Schedule 4
2005 Monthly Balancing Account Calculations

Line No.		January	February	March	April	May	June	July	August	September	October	November	December
	BALANCING ACCOUNT LESS APPROVED AMORTIZATION SURCHARGE BALANCE				Begins								
1	Beginning Balance	$ -	$ -	$ -	$ -	$ 1,506,186	$ 15,477,082	$ 36,971,467	$ 78,927,070	$ -	$ -	$ -	$ -
2	Approved Balance for Amortization Surcharge (if any)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
3	Balance Less Amort. Surcharge (Ln. 1 - Ln. 2)	$ -	$ -	$ -	$ -	$ 1,506,186	$ 15,477,082	$ 36,971,467	$ 78,927,070	$ -	$ -	$ -	$ -
4	Monthly Interest ((Ln. 3 * (2.79%/12)) 1yr. Const. Mat. Rate)	$ -	$ -	$ -	$ -	$ 3,502	$ 35,984	$ 85,959	$ 183,505	$ -	$ -	$ -	$ -
5	Post-Sharing (Over)/Under Collection (From Sch. 1)	$ -	$ -	$ -	$ 1,506,186	$ 13,967,394	$ 21,458,401	$ 41,869,644	$ 36,106,030	$ -	$ -	$ -	$ -
6	Less Revenue from Applicable Adjustor Rate	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
7	Residual (Over)/Under Collection (Ln. 5 - Ln. 6)	$ -	$ -	$ -	$ 1,506,186	$ 13,967,394	$ 21,458,401	$ 41,869,644	$ 36,106,030	$ -	$ -	$ -	$ -
8	Ending Balance with Interest (Ln. 3 + Ln. 4 + Ln. 7)	$ -	$ -	$ -	$ 1,506,186	$ 15,477,082	$ 36,971,467	$ 78,927,070	$ 115,216,605	$ -	$ -	$ -	$ -
	AMORTIZATION SURCHARGE BALANCE												
9	Balancing Account Amort. Surcharge per kWh	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
10	Beginning Amortiztion Surcharge Balance	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
11	Amort. Monthly Int. ((Ln. 10 * (2.79%/12)) 1yr. Const. Mat. Rate)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
12	Less Revenue from Applicable Amortization Surcharge(s)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
13	Ending Amortization Surchage Balance (Ln. 10 + Ln. 11 - Ln. 12)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
	COMBINED BALANCE												
14	Combined Balance (Ln. 8 + Ln. 13)	$ -	$ -	$ -	$ 1,506,186	$ 15,477,082	$ 36,971,467	$ 78,927,070	$ 115,216,605	$ -	$ -	$ -	$ -
15	Combined Interest (Ln. 4 + Ln. 11)	$ -	$ -	$ -	$ -	$ 3,502	$ 35,984	$ 85,959	$ 183,505	$ -	$ -	$ -	$ -

ARIZONA PUBLIC SERVICE COMPANY
August PSA Bank Balance versus Surcharge Request Amount
April - August 2005

	Fuel Expenses Greater Than Base Fuel Revenue ($000,000)	Company Shared Amount ($000,000)	Net Fuel Expense Greater Than Base Fuel Revenue ($000,000)
Balancing Account Balance at 8/31/05	127.7	12.5	115.2
Amounts Not Included in Current Request			
April-July 2005 Net Replacement Power Costs [a]	22.2	2.2	20.0
Other [b]	16.8	1.6	15.2
Subtotal	39.0	3.8	35.2
Net Balance for Current Request	**88.7**	**8.7**	**80.0**

[a] These amounts reflect an upper-end estimate of the net replacement power costs related to unplanned outages during the April through July period. Although the Company is not seeking to recover these amounts in the current proceeding, the Company believes these are legitimate and prudently incurred costs and will pursue recovery of them in the future.

[b] These amounts were not included in the Company's current request because the initial filing occurred prior to the closing of the Company's books in July and August and, therefore, before the final August month-end balance was known. Amounts reflected here include any additional unplanned outage costs incurred in August as well as a portion of the cost increases explained on PME-3 page 2.

ARIZONA PUBLIC SERVICE COMPANY
Major Factors of Fuel Expense Under-Collection
April - August 2005

Factors	Fuel Expenses Greater Than Base Fuel Revenue [a] ($000,000)	Company Shared Amount ($000,000)	Net Fuel Expense Greater Than Base Fuel Revenue ($000,000)
A. Fuel Prices			
1. Gas and Power Prices	69.5	6.9	62.5
2. Gas and Power Hedges	(34.0)	(3.4)	(30.6)
3. Coal Prices	12.8	1.3	11.6
4. Off-System Margin Credit	2.1	0.2	1.9
Subtotal	50.3	5.0	45.3
B. Incremental Load Growth	14.4	1.4	13.0
C. Monthly Cost Pattern	33.2	3.3	29.9
Total	**98.0**	**9.8**	**88.2**

[a] The Fuel Expenses shown are before the 90/10 Sharing in the PSA.

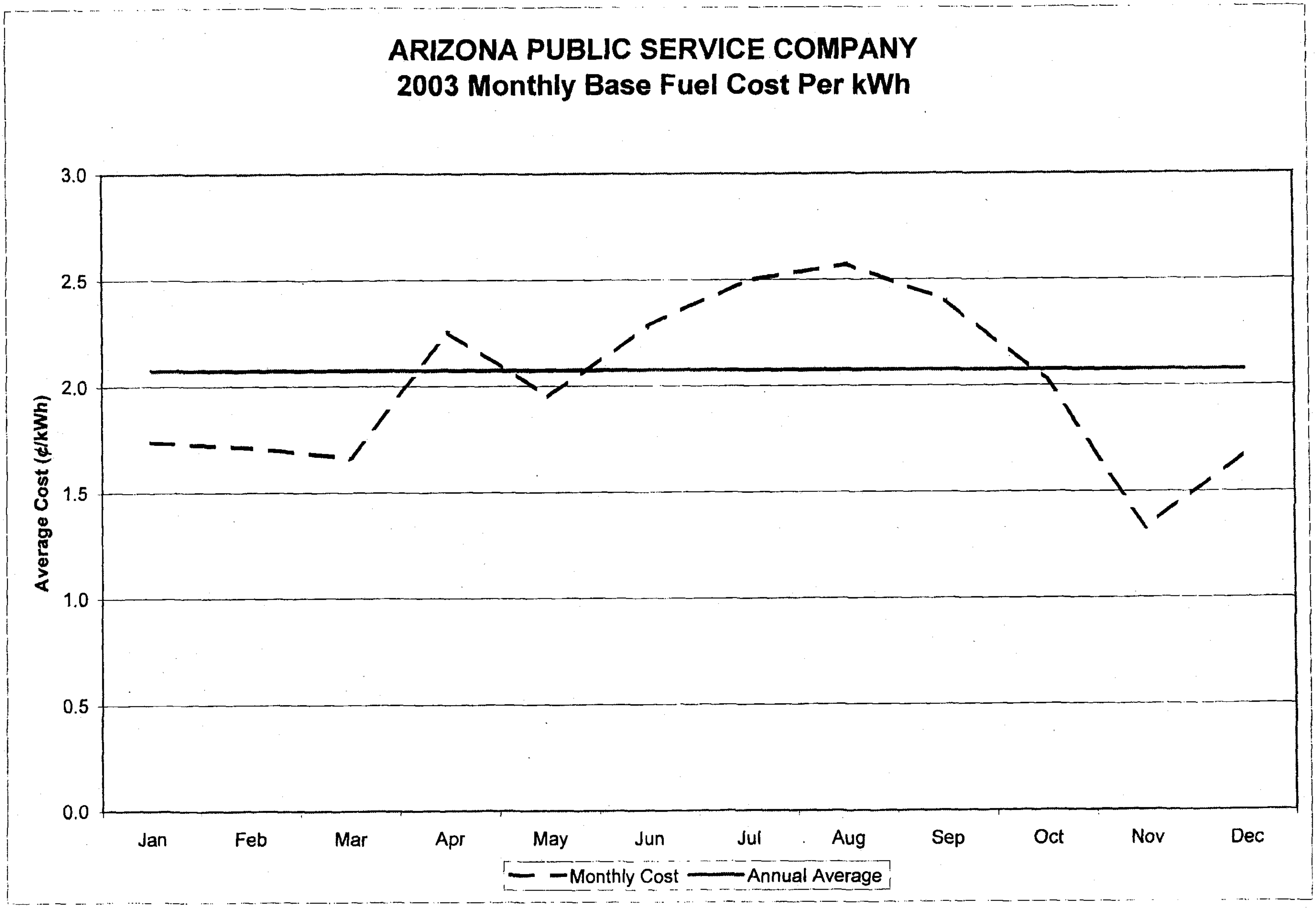

ARIZONA PUBLIC SERVICE COMPANY
2003 Monthly Base Fuel Cost Per kWh
Average Cost (¢/kWh)
3.0
2.5
2.0
1.5
1.0
0.5
0.0
Jan
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec
Monthly Cost
Annual Average

EXHIBIT
tabbies
RUCO-1
Admitted

ARIZONA PUBLIC SERVICE COMPANY

DOCKET NO. E-01345A-03-0437

SUPPLEMENTAL TESTIMONY

OF

MARYLEE DIAZ CORTEZ, CPA

ON BEHALF OF

THE

RESIDENTIAL UTILITY CONSUMER OFFICE

October 17, 2005

Q. Please state your name, occupation, and business address.

A. My name is Marylee Diaz Cortez. I am a Certified Public Accountant and the Chief of Accounting and Rates for the Residential Utility Consumer Office located at 1110 W. Washington, Phoenix, Arizona 85007.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to address the Plan of Administration the parties to the Settlement Agreement have developed for APS's Power Supply Adjustor (PSA) mechanism.

Q. Why was the Plan of Administration developed?

A. Decision No. 67744 required that the parties to the Settlement Agreement file a document that would reflect the operative terms of the PSA. This document was filed with the Commission on June 6, 2005.

Q. Have the parties subsequently revised the Plan of Administration?

A. Yes. Pursuant to questions and concerns from the Commissioners the parties revised the Plan of Administration to clarify the terms and mechanical operation of the PSA as agreed to in the Settlement Agreement and modified by the Commission.

Q. Does RUCO believe that the revised Plan of Administration clearly defines the operational terms of the PSA?

A. Yes. The revisions to the Plan of Administration were all made with the intent of clarifying the specific operational terms of the PSA. These revisions include a glossary of PSA terminology, expanded operational explanations, as well as detailed spreadsheets showing the actual mathematical calculations of all aspects of the PSA including but not limited to: the balancing account, the April 1 PSA Adjustor, Surcharge calculation and amortization, and interest accruals.

Q. Does RUCO support the revised Plan of Administration?

A. Yes. RUCO actively participated in the revisions to the Plan of Administration and believes that it accurately reflects the operational characteristics of the PSA as agreed to, and as amended by the Commission.

Q. Does this conclude your testimony?

A. Yes.

APPENDIX I

Qualifications of Marylee Diaz Cortez

EDUCATION:	University of Michigan, Dearborn B.S.A., Accounting 1989
CERTIFICATION:	Certified Public Accountant - Michigan Certified Public Accountant - Arizona
EXPERIENCE:	Audit Manager Residential Utility Consumer Office Phoenix, Arizona 85007 July 1994 - Present

Responsibilities include the audit, review and analysis of public utility companies. Prepare written testimony, schedules, financial statements and spreadsheet models and analyses. Testify and stand cross-examination before Arizona Corporation Commission. Advise and work with outside consultants. Work with attorneys to achieve a coordination between technical issues and policy and legal concerns. Supervise, teach, provide guidance and review the work of subordinate accounting staff.

Senior Rate Analyst
Residential Utility Consumer Office
Phoenix, Arizona 85004
October 1992 - June 1994

Responsibilities included the audit, review and analysis of public utility companies. Prepare written testimony and exhibits. Testify and stand cross-examination before Arizona Corporation Commission. Extensive use of Lotus 123, spreadsheet modeling and financial statement analysis.

Auditor/Regulatory Analyst
Larkin & Associates - Certified Public Accountants
Livonia, Michigan
August 1989 - October 1992

Performed on-site audits and regulatory reviews of public utility companies including gas, electric, telephone, water and sewer throughout the continental United States. Prepared integrated proforma financial statements and rate models for some of the largest public utilities in the United States. Rate models consisted of anywhere from twenty to one hundred fully integrated schedules. Analyzed financial statements, accounting detail, and identified and developed rate case issues based on this analysis. Prepared written testimony, reports, and briefs. Worked closely with outside legal counsel to achieve coordination of technical accounting issues with policy, procedural and legal concerns. Provided technical assistance to legal counsel at hearings and depositions. Served in a teaching and supervisory capacity to junior members of the firm.

RESUME OF RATE CASE AND REGULATORY PARTICIPATION

Utility Company	Docket No.	Client
Potomac Electric Power Co.	Formal Case No. 889	Peoples Counsel of District of Columbia
Puget Sound Power & Light Co.	Cause No. U-89-2688-T	U.S. Department of Defense - Navy
Northwestern Bell-Minnesota	P-421/EI-89-860	Minnesota Department of Public Service
Florida Power & Light Co.	890319-EI	Florida Office of Public Counsel
Gulf Power Company	890324-EI	Florida Office of Public Counsel
Consumers Power Company	Case No. U-9372	Michigan Coalition Against Unfair Utility Practices
Equitable Gas Company	R-911966	Pennsylvania Public Utilities Commission
Gulf Power Company	891345-EI	Florida Office of Public Counsel

Jersey Central Power & Light	ER881109RJ	New Jersey Department of Public Advocate Division of Rate Counsel
Green Mountain Power Corp.	5428	Vermont Department of Public Service
Systems Energy Resources	ER89-678-000 & EL90-16-000	Mississippi Public Service Commission
El Paso Electric Company	9165	City of El Paso
Long Island Lighting Co.	90-E-1185	New York Consumer Protection Board
Pennsylvania Gas & Water Co.	R-911966	Pennsylvania Office of Consumer Advocate
Southern States Utilities	900329-WS	Florida Office of Public Counsel
Central Vermont Public Service Co.	5491	Vermont Department of Public Service
Detroit Edison Company	Case No. U-9499	City of Novi
Systems Energy Resources	FA-89-28-000	Mississippi Public Service Commission
Green Mountain Power Corp.	5532	Vermont Department of Public Service
United Cities Gas Company	176-717-U	Kansas Corporation Commission

General Development Utilities	911030-WS & 911067-WS	Florida Office of Public Counsel
Hawaiian Electric Company	6998	U.S. Department of Defense - Navy
Indiana Gas Company	Cause No. 39353	Indiana Office of Consumer Counselor
Pennsylvania American Water Co.	R-00922428	Pennsylvania Office of Consumer Advocate
Wheeling Power Co.	Case No. 90-243-E-42T	West Virginia Public Service Commission Consumer Advocate Division
Jersey Central Power & Light Co.	EM89110888	New Jersey Department of Public Advocate Division of Rate Counsel
Golden Shores Water Co.	U-1815-92-200	Residential Utility Consumer Office
Consolidated Water Utilities	E-1009-92-135	Residential Utility Consumer Office
Sulphur Springs Valley Electric Cooperative	U-1575-92-220	Residential Utility Consumer Office
North Mohave Valley Corporation	U-2259-92-318	Residential Utility Consumer Office
Graham County Electric Cooperative	U-1749-92-298	Residential Utility Consumer Office

Graham County Utilities	U-2527-92-303	Residential Utility Consumer Office
Consolidated Water Utilities	E-1009-93-110	Residential Utility Consumer Office
Litchfield Park Service Co.	U-1427-93-156 & U-1428-93-156	Residential Utility Consumer Office
Pima Utility Company	U-2199-93-221 & U-2199-93-222	Residential Utility Consumer Office
Arizona Public Service Co.	U-1345-94-306	Residential Utility Consumer Office
Paradise Valley Water	U-1303-94-182	Residential Utility Consumer Office
Paradise Valley Water	U-1303-94-310 & U-1303-94-401	Residential Utility Consumer Office
Pima Utility Company	U-2199-94-439	Residential Utility Consumer Office
SaddleBrooke Development Co.	U-2492-94-448	Residential Utility Consumer Office
Boulders Carefree Sewer Corp.	U-2361-95-007	Residential Utility Consumer Office
Rio Rico Utilities	U-2676-95-262	Residential Utility Consumer Office
Rancho Vistoso Water	U-2342-95-334	Residential Utility Consumer Office
Arizona Public Service Co.	U-1345-95-491	Residential Utility Consumer Office
Citizens Utilities Co.	E-1032-95-473	Residential Utility Consumer Office
Citizens Utilities Co.	E-1032-95-417 et al.	Residential Utility Consumer Office

Paradise Valley Water	U-1303-96-283 & U-1303-95-493	Residential Utility Consumer Office
Far West Water	U-2073-96-531	Residential Utility Consumer Office
Southwest Gas Corporation	U-1551-96-596	Residential Utility Consumer Office
Arizona Telephone Company	T-2063A-97-329	Residential Utility Consumer Office
Far West Water Rehearing	W-0273A-96-0531	Residential Utility Consumer Office
SaddleBrooke Utility Company	W-02849A-97-0383	Residential Utility Consumer Office
Vail Water Company	W-01651A-97-0539 & W-01651B-97-0676	Residential Utility Consumer Office
Black Mountain Gas Company Northern States Power Company	G-01970A-98-0017 G-03493A-98-0017	Residential Utility Consumer Office
Paradise Valley Water Company Mummy Mountain Water Company	W-01303A-98-0678 W-01342A-98-0678	Residential Utility Consumer Office
Bermuda Water Company	W-01812A-98-0390	Residential Utility Consumer Office
Bella Vista Water Company Nicksville Water Company	W-02465A-98-0458 W-01602A-98-0458	Residential Utility Consumer Office
Paradise Valley Water Company	W-01303A-98-0507	Residential Utility Consumer Office
Pima Utility Company	SW-02199A-98-0578	Residential Utility Consumer Office
Far West Water & Sewer Company	WS-03478A-99-0144 Interim Rates	Residential Utility Consumer Office
Vail Water Company	W-01651B-99-0355 Interim Rates	Residential Utility Consumer Office

Far West Water & Sewer Company	WS-03478A-99-0144	Residential Utility Consumer Office
Sun City Water and Sun City West	W-01656A-98-0577 & SW-02334A-98-0577	Residential Utility Consumer Office
Southwest Gas Corporation ONEOK, Inc.	G-01551A-99-0112 G-03713A-99-0112	Residential Utility Consumer Office
Table Top Telephone	T-02724A-99-0595	Residential Utility Consumer Office
U S West Communications Citizens Utilities Company	T-01051B-99-0737 T-01954B-99-0737	Residential Utility Consumer Office
Citizens Utilities Company	E-01032C-98-0474	Residential Utility Consumer Office
Southwest Gas Corporation	G-01551A-00-0309 & G-01551A-00-0127	Residential Utility Consumer Office
Southwestern Telephone Company	T-01072B-00-0379	Residential Utility Consumer Office
Arizona Water Company	W-01445A-00-0962	Residential Utility Consumer Office
Litchfield Park Service Company	W-01427A-01-0487 & SW-01428A-01-0487	Residential Utility Consumer Office
Bella Vista Water Co., Inc.	W-02465A-01-0776	Residential Utility Consumer Office
Generic Proceedings Concerning Electric Restructuring Issues	E-00000A-02-0051	Residential Utility Consumer Office
Arizona Public Service Company	E-01345A-02-0707	Residential Utility Consumer Office
Qwest Corporation	RT-00000F-02-0271	Residential Utility Consumer Office

Arizona Public Service Company	E-01345A-02-0403	Residential Utility Consumer Office
Citizens/UniSource	G-01032A-02-0598 E-01032C-00-0751 E-01933A-02-0914 E-01302C-02-0914 G-01302C-02-0914	Residential Utility Consumer Office
Arizona-American Water Company	WS-01303A-02-0867	Residential Utility Consumer Office
Arizona Public Service Company	E-01345A-03-0437	Residential Utility Consumer Office
UniSource	E-04230A-03-0933	Residential Utility Consumer Office
Arizona Public Service Company	E-01345A-04-0407	Residential Utility Consumer Office
Qwest Corporation	T-01051B-03-0454 & T-00000D-00-0672	Residential Utility Consumer Office
Southwest Gas Corporation	G-01551A-04-0876	Residential Utility Consumer Office
Arizona-American Water Company	W-1303A-05-0280	Residential Utility Consumer Office

Power Supply Adjustment Plan of~~for~~ Administration

Power Supply Adjustment Plan ~~for~~ of Administration

General Description

The purpose of the Power Supply Adjustment ("PSA") is to track changes in Arizona Public Service Company's ("APS" or the "Company") cost of obtaining power supplies. This is done by making an annual adjustment to the cost of fuel and purchased power embedded in APS' base rates. The PSA will apply to all fuel and purchased power costs incurred on or after April 1, 2005. The main components of the PSA are: 1) a risk sharing mechanism whereby APS and its customers share in the costs/savings on a 90% customer, 10% APS basis; 2) a bandwidth that limits the amount the PSA Adjustor Rate ("Adjustor Rate") can change over the entire term of the PSA to plus or minus $0.004 per kWh; 3) a balancing account, 4) a balancing account surcharge mechanism, separate from the Adjustor Rate, to clear the balancing account under circumstances described below; and 5) the inclusion of off-system sales.

The monthly PSA calculations shall be adjusted for the calculated net savings from the methodology approved in Decision No. 67504 (pg. 50) from the PPL Sundance docket. APS will calculate the new fuel cost savings, purchased power savings and incremental off-system margin impacts by comparing two sets of projections for its own load fuel and purchased power costs and off-system sales margins and using the difference as the net savings amounts associated with the Sundance generation units. One set of projections would assume APS ownership of the Sundance plant and the other set would assume APS did not own the Sundance plant. The PSA will be adjusted to calculate the PSA balance as if the Sundance plant was not acquired by APS. This adjustment will no longer be made once rates are effective that recover the capital and operating costs of the Sundance plant.

The results of the PSA are applied to customer's bills through the Adjustor Rate. The Adjustor Rate is applicable to APS' retail electric rate schedules (with the exception of Solar-1, Solar-2, SP-1, E-3, E-4, E-36 and Direct Access service) and is adjusted annually. It is applied to the customer's bill as a monthly kilowatt-hour ("kWh") charge that is the same for all customer classes. The Adjustor Rate is initially set at zero as of April 1, 2005. The Adjustor Rate must remain within a plus or minus $0.004 per kWh bandwidth that limits the amount it can increase or decrease in a year. Decision No. 67744 also limits the Adjustor Rate to $0.004 from the base level ($0.000) over the entire term of the PSA. Two examples of applying the two bandwidths are as follows:

1. Assume that the Adjustor Rate was set at *negative* $0.002 per kWh. The following year, the calculation of the new Adjustor Rate would indicate a new rate of *positive* $0.003 per kWh. However, since that rate would constitute a change of $0.005 from the prior year's Adjustor Rate, the new Adjustor Rate would be set

at $0.002 per kWh. That new rate would meet the limit of $0.004 from the base level.

2. Assume that the Adjustor Rate was set at $0.003 per kWh. The following year, the calculation of the new Adjustor Rate would indicate a new rate of $0.005 per kWh. Although the annual change is less than $0.004, the new rate would constitute a change from the base level that is greater than $0.004. Therefore, the new Adjustor Rate would be set at $0.004 per kWh.

Any recoverable or refundable amounts outside of the bandwidths shall be recorded in a balancing account and shall carry over to the subsequent year or years. The carryover amount shall not be subject to further sharing. Balancing account amortization surcharges are not included in the calculation of the bandwidth limits.

The Adjustor Rate, which was initially set at zero, will be reset on April 1, 2006, and thereafter on April 1st of each subsequent year. Balancing account entries are made each month starting with April 2005. These entries will effectively reflect the difference between 90 percent of incurred fuel and purchased power costs, less the balance of any approved Amortization Surcharge, and the sum of costs collected through the base cost of fuel and purchased power rate of $0.020743 plus the applicable Adjustor Rate. An Amortization Surcharge may go into effect prior to the April 1st adjustment to the Adjustor Rate if it is approved by the Arizona Corporation Commission ("Commission"). The Amortization Surcharge is described in greater detail below. The new Adjustor Rate will be effective with the first billing cycle in April unless suspended by the ~~Arizona Corporation Commission ("~~Commission~~")~~. It will not be prorated. APS will submit a publicly available report to the Commission that shows the calculation of the new Adjustor Rate on March 1, 2006 and thereafter on March 1st of each subsequent year.

Definitions

Adjustor Rate (or PSA Adjustor Rate, PSA Adjustor, PSA Adjustment, Annual Adjustment Factor) – Cents per kWh charge that was initially set at zero and is updated annually on April 1st. The purpose of this charge is to adjust the cost of fuel and purchased power embedded in APS' base rates to reflect the prior year's actual fuel and purchased power costs. This annual adjustment was approved in Decision No. 67744 and is limited to a maximum change of plus or minus 4 mills.

Amortization Surcharge (or Surcharge, PSA Surcharge) – A cents per kWh charge that can be applied to customer bills after Commission approval to collect, or refund, an amount of revenue for the purpose of reducing the PSA Bank Balance. It can be either a positive or negative charge.

Balancing Account (or PSA Balancing Account) – The PSA Balancing Account is the account where the monthly sum of the Company's post-sharing (over)/under collection is posted and also where the interest on the balance in the account is accrued. It is used to keep track of the cumulative total of the monthly postings.

Bandwidth Carry Forward from Prior Period – An amount that was outside the $0.004 limit on change in the Adjustor Rate in a particular year that is used in the calculation of the Adjustor Rate in the following year. The Bandwidth Carry Forward is calculated by subtracting $0.004 from the prior-year computed, not the actual, Adjustor Rate per kWh and multiplying the result by the annual kWh, less any amount approved to be amortized through a Surcharge.

Bank Balance (or Account Balance) – The total amount in the PSA Balancing Account.

Base Cost of Fuel and Purchased Power – The fuel and purchased power cost embedded in the base rates approved by the Commission in the Company's most recent rate case. Currently, it is $0.020743 per kWh.

Bridge PPA – A~~n~~ purchased power agreement that ensures the non-fuel power supply costs from the PWEC generation units allowed in rate base by Decision No. 67744 will be the same as those costs embedded in base rates.

ISFSI ~~– Regulatory amortization c~~Costs associated with the Independent Spent Fuel Storage Installation that will store spent nuclear fuel.

Mark-‑to-‑Market Accounting – Recording the value of qualifying commodity contracts to reflect their current market value relative to their ~~original~~ actual cost.

Native Load – Native load includes customer load in the APS control area load for which the Company has a generation service obligation and Pacifi~~c~~Corp ~~s~~Supplemental ~~s~~Sales. ~~Native load excludes Preference Power, Unisource Electric load, Tohono O'odham Utility Authority load, City of Williams (excluding APS retail customers) load and Direct Access load.~~

Pacifi~~c~~Corp Supplemental ~~s~~Sales – The Pacifi~~c~~Corp Supplemental ~~s~~Sales agreement is a long-term contract from 1990, which requires APS to offer a certain amount of energy to Pacifi~~c~~Corp each year. It is a component of the set of agreements that led to the sale of Cholla Unit 4 to Pacifi~~c~~Corp and the establishment of the seasonal diversity exchange with Pacifi~~c~~Corp.

PSA – The Power Supply Adjustment mechanism, which includes the PSA Adjustor Rate, Balancing Account, and Amortization Surcharge. The PSA mechanism is used to update the Base Cost of Fuel and Purchased Power each year for fluctuations in the Company's actual cost of fuel and purchased power.

Preference Power – Power allocated to APS wholesale customers by federal power agencies such as the Western Area Power Administration.

Surcharge Balance – The total amount of revenue expected to be collected through a Commission-approved Amortization Surcharge less the actual revenue received from the Surcharge.

System Book Fuel and Purchased Power Costs – The costs recorded for the fuel and purchased power used by APS to serve both Native Load and off-system sales, less the costs associated with applicable special contracts, E-36, RCDAC-1, the non-fuel Bridge PPA, ISFSI, mark-to-market accounting adjustments, and the savings associated with the acquisition of the Sundance plant.

System Book Off-System Sales Revenue – The revenue recorded from sales made to non-Native Load customers, for the purpose of optimizing the APS system, using APS-owned or contracted generation and purchased power, less mark-to-market accounting adjustments.

Wheeling Costs (FERC Account 565, Transmission of Electricity by Others) – Amounts payable to others for the transmission of the Company's electricity over transmission facilities owned by others.

Calculations

The Adjustor Rate shall be calculated as follows:

Part 1. Monthly Energy Sales and Costs

1. Enter the monthly PSA Retail Energy Sales (kWh) and monthly Native Load Wholesale Energy Sales. Add these two items together to produce the monthly Native Load Energy Sales. PSA Retail Energy Sales include the calendar month's retail sales. Currently, Native Load Wholesale Energy Sales include traditional sales-for-resale and Pacifi~~c~~Corp ~~s~~Supplemental ~~s~~Sales. The traditional sales-for-resale amount is the portion of load from wholesale electrical and irrigation district resale customers served by APS, but excluding the load served with ~~p~~Preference ~~p~~Power.

2. Enter the monthly System Book Fuel and Purchased Power Costs and the monthly System Book Off-System Sales Revenue. Then subtract the System Book Off-System Sales Revenue from the System Book Fuel and Purchased Power Costs to produce the monthly Net Native Load Power Supply Cost. The ~~net savings associated with the Sundance Plant are included in the~~ System Book Fuel and Purchased Power Costs shall be adjusted for the calculated net savings from the methodology approved in Decision No. 67504 from the PPL

Sundance docket. The monthly System Book Off-System Sales Revenue includes only the off-system sales using APS owned or contracted generation and purchased power related to optimizing the APS system. The off-system sales margin is embedded in the Net Native Load Power Supply Cost. The costs associated with the off-system sales are included in the System Book Fuel and Purchased Power Costs. So when the System Book Off-System Sales Revenue is subtracted from the System Book Fuel and Purchased Power Costs the difference between the off-system sales costs and revenue ends up in the Net Native Load Power Supply Cost. That difference is the off-system sales margin. A list of the items included in the PSA sales and costs described above will be included in the PSA reporting schedules filed with the Commission each month.

3. Next, calculate the PSA Retail Power Supply Cost. Divide the PSA Retail Energy Sales by the Native Load Energy Sales and then multiply the product by the Net Native Load Power Supply Cost. The annual amount of PSA Retail Power Supply Cost that can be used to calculate the annual Adjustor Rate cannot exceed $776,200,000. Any fuel or purchased power costs above that amount will not be recovered from the ratepayers through the PSA.

4. Directly-assigned power supply costs and related energy sales from applicable Special Contract customers, Schedule E-36 customers and customers returning to Standard Offer service from competitive generation subject to Returning Customer Direct Access Charge ("RCDAC") treatment will be deducted prior to the above calculations.

Part 2. Calculation of the (Over)/Under Collection

1. The amount recovered by the power supply cost embedded in base rates has to be calculated in order to determine the monthly (over)/under collection. To calculate the monthly Base Rate Power Supply cost, multiply the PSA Retail Energy sales by the base cost of fuel and purchased power of $0.020743 per kWh. The revenue collected from an Adjustor Rate is credited to the Balancing Account (described below). For example, in April 2006 if there is an Adjustor Rate of $0.004 in effect, all of the revenue collected from that charge goes into the Balancing Account as a credit to the balance.

2. The next step is to subtract the monthly Base Rate Power Supply Cost from the PSA Retail Power Supply Cost to get the monthly Pre-Sharing (Over)/Under Collection amount.

Part 3. Sharing Incentive

1. The Post-Sharing (Over)/Under Collection amount is calculated by multiplying the Pre-Sharing (Over)/Under Collection by 90%. This

calculation is done to implement the 90%/10% sharing incentive. As described above APS and its customers share the costs/savings on a 90% customer and 10% APS basis. The monthly Post-Sharing (Over)/Under Collection amounts are summed for the year and used in the Adjustor Rate calculation.

Part 4. Adjustor Rate Calculation

1. Sum the calendar year's monthly Post-Sharing (Over)/Under Collection amounts.

2. Sum the calendar year's Balancing Account Monthly Interest to produce the Annual Balancing Account Interest. It includes interest from the Balancing Account and any outstanding balances from Commission-approved Amortization Surcharges, if the Surcharge balance was approved to accrue interest. This amount is recovered through the PSA and used in the Adjustor Rate calculation. The calculation of the Monthly Interest is described in more detail below in the Balancing Account section.

3. Subtract any Commission approved Amortization Surcharge balances. If the Commission approves an Amortization Surcharge balance it will be subtracted from the total costs used to calculate the April 1st Adjustor Rate.

~~3.~~ 4. Bring forward the Bandwidth Carry Forward from Prior Period, if any. If the Adjustor Rate Bandwidth (described below) allows for just a partial recovery of the Total (Credit)/Charge amount then the portion that is not eligible for crediting/collection in the current year is carried forward to next year as the Bandwidth Carry Forward from Prior Period. The carryover amount is not subject to further sharing.

~~4.~~ 5. Add the Post-Sharing (Over)/Under Collection amount, Annual Balancing Account Interest and the Bandwidth Carry Forward from Prior Period together to determine the Total (Credit)/Charge Amount.

~~5.~~ 6. The Computed Adjustor Rate is calculated by dividing the Total Credit/Charge Amount by the Actual Energy Sales (kWh) from the prior calendar year. The calculation of the April 1, 2006, Adjustor Rate will only include data from April through December 2005. The Computed Adjustor Rate is then compared to the plus or minus $0.004 per kWh bandwidth. The Actual Energy Sales amount will exclude E-3, E-4 and E-36 sales.

~~6.~~ 7. The Adjustor Rate Bandwidth Upper Limit is $0.004 per kWh. The Adjustor Rate Bandwidth Lower Limit is $(0.004) per kWh.

~~7.~~8. If the Computed Adjustor Rate is inside the bandwidth, the Computed Adjustor Rate becomes the Applicable Adjustor Rate. It is then applied to the customer's monthly bills for the next 12 months.

~~8.~~9. If the Computed Adjustor Rate is outside the bandwidth, the Applicable Adjustor Rate can be no higher than the upper limit of the bandwidth and no lower than the lower limit of the bandwidth.

~~9.~~10. If the Computed Adjustor Rate is outside the bandwidth, then the Bandwidth Carry Forward from Prior Period amount must be calculated. This is done by multiplying the Applicable Adjustor Rate by the Actual Energy Sales (kWh) for the next 12 months and subtracting the total from the Total (Credit)/Charge Amount used to calculate the Applicable Adjustor Rate.

Examples of these calculations are attached as Year 1, Schedules 1 through 3 and Year 2, Schedules 1 through 3. The attached schedules include two year's of schedules and two Amortization Surcharge examples.

Balancing Account and Amortization Surcharge

The PSA Balancing Account is where the monthly sum of the Company's post-sharing (over)/under collection is posted and also where interest on the balance in the account is accrued. It is used to track the cumulative total of the monthly postings. APS shall establish a PSA Balancing Account on April 1, 2005. Entries to the Balancing Account shall be made each month as follows:

1. A debit or credit entry equal to the difference between the Post-Sharing (Over)/Under Collection and the sum of the amounts recovered by the Applicable Adjustor Rate. The Post-Sharing (Over)/Under Collection is calculated by taking the amount recovered through the Base Rate Power Supply Cost of $0.020743 and subtracting it from the PSA Retail Power Supply Cost. The product of that subtraction is then multiplied by 90% to reduce the recoverable costs in accordance with the 90%/10% sharing incentive.

2. ~~A debit or credit entry equal to the kilowatt-hours billed for the month under the rate schedules subject to the Adjustor Rate multiplied by the effective Amortization Surcharge (as described below). If an Amortization Surcharge is not in effect, then no entry will be made.~~ Any Amortization Surcharge balance will be shown separately on the monthly reports for the Commission Staff, and, unless otherwise ordered by the Commission, shall not be considered as part of the Balancing Account.

3. A monthly debit or credit entry for interest to be applied to the account balance based on effective one-year Nominal Treasury Constant Maturities rate that is contained in the Federal Reserve Statistical Release, H-15, or its successor publication. This includes the Amortization Surcharge balance(s), if the Surcharge balance was approved to accrue interest. This is called the Monthly Interest and is used above in the Adjustor Rate calculations. The interest rate will be adjusted annually on the first business day of the calendar year in the same manner as the APS customer deposit rate.

4. A debit or credit entry for refunds or payments authorized by the Commission.

An example of the Balancing Account calculation is included as Year 1, Schedule 4 and Year 2, Schedule 4.

Although the Company may file a request for an Amortization Surcharge at any time, the Company is required to make a filing in the following circumstances. If the size of the Balancing Account, as shown in the monthly reports filed with the Commission, reaches plus or minus $50 million, the Company has up to forty-five days to either file a request for Commission approval of an *Amortization Surcharge* or an explanation of why such a surcharge isn't necessary. In no event shall the Company allow the Balancing Account to reach $100 million prior to seeking recovery or refund.[1] Should the Company seek to recover or refund an amount from the Balancing Account, the timing and manner of recovery, or refund, and whether interest will be allowed to accrue on the Surcharge balance, will be addressed at that time.

Once the Company has filed seeking recovery or refund through an Amortization Surcharge, the amount requested in such filing will be excluded from the balance used to determine if the $100 million threshold has been reached (see chart below).

(a) Month	(b) Month's Post-Sharing (Over)/Under Collection	(c) End of Month Balancing Account Balance	(d) June 15th Amortization Surcharge Request	(e) Balance for $100M Threshold (c + d)
May	$7,000,000	$60,000,000	$0	$60,000,000
June	$10,000,000	$70,000,000	$(60,000,000)	$10,000,000
July	$30,000,000	$100,000,000	$(60,000,000)	$40,000,000

For example, the Company has a balance of $60 million for May and it files an Amortization Surcharge request on June 15th for $60 million and the post-sharing under-

[1] ~~The Commission Staff believes that the operation of the $100 Million "cap" on the Balancing Account requires further review and discussion prior to final approval of this Plan for Administration.~~

collection for June is $10 million. The resulting June Balancing Account balance is $70 million. The balance for the purpose of determining if the Company has met the $100 million threshold for June is $10 million ($70 million balance - $60 million request = $10 million). Moving to the next month, July has a post-sharing under-collection of $30 million so the balance for the $100 million threshold calculation is $40 million ($100 million balance – $60 million request = $40 million).

The $100 million threshold would apply each time the Company makes a filing with the Commission to address a Balancing Account balance between $50 and $100 million. After the Company makes the filing, if new accumulations in the Balancing Account were between $50 and $100 million, the Company could make a second, separate filing. Subsequently, it is possible that additional filings could be made with the $100 million threshold being applied separately to the amount being addressed in each filing. Following a proceeding authorizing recovery or refund of a bank balance between $50 million and $100 million, the balance considered in the proceeding shall be reset to zero unless otherwise ordered by the Commission.

Compliance Reports

Beginning June 6, 2005, the Company shall provide monthly reports to Staff's Compliance Section *and to the Residential* Utility Consumer Office detailing all calculations related to the PSA. An APS Officer shall certify under oath that all information provided in the reports itemized below is true and accurate to the best of his or her information and belief. These monthly reports shall thereafter be due on the first day of the third month following the end of the reporting month.

The publicly available reports will include at a minimum:

1. The Balancing Account calculations, including all input and outputs.
2. Total power and fuel costs.
3. Customer sales in both kWh and dollars by customer class.
4. The number of customers by customer class.
5. A detailed listing of all items excluded from the PSA calculations.
6. A detailed listing of any adjustments to the adjustor reports.
7. Total off-system sales revenues.
8. System losses in MW and MW~~H~~h.
9. Monthly maximum retail demand in MW.
10. Identification of a contact person and phone number from the Company for questions.

Beginning June 6, 2005, the Company shall provide to Commission Staff monthly reports containing the information listed below. These reports shall thereafter be due on the first day of the third month following the end of the reporting month. All of these additional reports will be filed confidentially.

The information for each generating unit shall include the following items:

1. The net generation, in MW~~H~~h per month, and twelve months cumulatively.
2. The average heat rate, both monthly and twelve-month average.
3. The equivalent forced-outage rate, both monthly and twelve-month average.
4. The outage information for each month including, but not limited to, event type, start date and time, end date and time, and a description.
5. Total fuel costs per month.
6. The fuel cost per kWh per month.

The information on power purchases shall include the following items per seller:

1. The quantity purchased in MW~~H~~h.
2. The demand purchased in MW to the extent specified in the contract.
3. The total cost for demand to the extent specified in the contract.
4. The total cost of energy.

Information on economy interchange purchases may be aggregated. These reports shall also include an itemization of off-system sales margins per buyer. Further detail on off-system sales margin will be provided to the Commission Staff on a confidential basis for review.

Fuel purchase information shall include:

1. Natural gas interstate pipeline costs, itemized by pipeline and by individual cost components, such as reservation charge, usage, surcharges and fuel.
2. Natural gas commodity costs, categorized by short term purchases (one month or less) and longer term purchases, including price per therm, total cost, supply basin, and volume by contract.

By June 6, 2005, the Company shall provide the information itemized above relating to the base cost of fuel and purchased power adopted for the test year settlement revenue requirement.

Work papers and other documents that contain proprietary or confidential information will be filed with the Commission Staff under an appropriate confidentiality agreement. APS will keep fuel and purchased power invoices and contracts available for Commission review. All of the information is available during the year, upon Commission request. The Commission has the right to review the prudence of fuel and power purchases and any calculations associated with the PSA at any time. Any costs flowed through the PSA are subject to refund, if those costs are found to be imprudently incurred.

Allowable Costs

The allowable ~~Adjustor Rate~~PSA costs include fuel and purchased power costs incurred to provide service to retail customers. Additionally, the prudent direct costs of contracts used for hedging system fuel and purchased power will be recovered under the PSA. The Base Rate Power Supply Cost will be the allowable ~~Adjustor Rate~~power supply costs from the test year used to determine retail electric rates. The allowable cost components presently include the following Federal Energy Regulatory Commission ("FERC") accounts[2]:

1. 501 Fuel (Steam)
2. 518 Fuel (Nuclear) less ISFSI regulatory amortization
3. 547 Fuel (Other Production)
4. 555 Purchased Power less non-fuel Bridge PPA costs
5. 565 Wheeling (Transmission of Electricity by Others)
~~6.~~

These accounts are subject to change if the Federal Energy Regulatory Commission alters its accounting requirements or definitions.

Directly Assignable Power Supply Costs Excluded

Decision No. 66567 provides APS the ability to recover reasonable and prudent costs associated with customers who have left APS Standard Offer service, including Special Contract rates, for a competitive generation supplier and then return to Standard Offer service. For administrative purposes, customers who were Direct Access customers since origination of service and request Standard Offer service would be considered to be returning customers. In such cases, a direct assignment or special adjustment may be applied that recognizes the cost differential between the power purchases needed to accommodate the Returning Customer and the power supply cost component of the otherwise applicable Standard Offer service rate. This process is described in the Returning Customer Direct Access Charge rate schedule and Plan for Administration filed with the Commission.

In addition, if APS purchases power under specific terms on behalf of a Standard Offer Special Contract customer, the costs of that power may be directly assigned. In both cases, where specific power supply costs are identified and directly assigned to a large Returning Customer or Standard Offer Special Contract customer or group of customers, these costs will be excluded from the Adjustor Rate calculations. Schedule E-36 customers are directly assigned power supply costs based on the APS system incremental

[2] ~~The Commission Staff believes that the inclusion of FERC Account 557 (Broker Fees) and 565 (Wheeling) costs as allowable PSA cost components requires further review and discussion prior to the final approval of this Plan for Administration.~~

cost at the time the customer is consuming power from the APS system so their power supply costs are excluded from the PSA.

ARIZONA PUBLIC SERVICE COMPANY
Year 1, Schedule 1
Example PSA Calculation Methodology
Monthly Energy Sales and Costs

Line No.	Month	(a) PSA Retail [1] Energy Sales (kWh)	(b) Native Load [2] Wholesale Energy Sales (kWh)	(c) Native Load Energy Sales (kWh) (a + b)	(d) System [3] Book Fuel and Purchased Power Costs	(e) System Book [4] Off-System Sales Revenue	(f) Net Native Load Power Supply Cost (d - e)	(g) PSA Retail-[5] Power Supply Cost (a/c * f)	(h) Base Rate Power Supply Cost (a * 0.020743)	(i) Pre-Sharing (Over)/Under Collection (g - h)	(j) Post-Sharing (Over)/Under Collection (i * 0.9)
1	January	-	-	-	$ -	$ -	$ -	$ -	$ -	$ -	$ -
2	February	-	-	-	$ -	$ -	$ -	$ -	$ -	$ -	$ -
3	March	-	-	-	$ -	$ -	$ -	$ -	$ -	$ -	$ -
4	April	1,944,192,000	105,803,000	2,049,995,000	$ 50,508,900	$ 3,924,000	$ 46,584,900	$ 44,180,591	$ 40,328,375	$ 3,852,216	$ 3,466,994
5	May	2,279,426,000	102,849,000	2,382,275,000	$ 56,566,800	$ 4,021,200	$ 52,545,600	$ 50,277,070	$ 47,282,134	$ 2,994,936	$ 2,695,442
6	June	2,585,070,000	113,325,000	2,698,395,000	$ 73,206,000	$ 5,178,600	$ 68,027,400	$ 65,170,441	$ 53,622,107	$ 11,548,334	$ 10,393,501
7	July	2,909,896,000	110,933,000	3,020,829,000	$ 93,020,400	$ 6,676,200	$ 86,344,200	$ 83,173,408	$ 60,359,973	$ 22,813,435	$ 20,532,092
8	August	3,115,407,000	96,318,000	3,211,725,000	$ 96,375,600	$ 6,095,700	$ 90,279,900	$ 87,572,452	$ 64,622,887	$ 22,949,565	$ 20,654,609
9	September	2,560,314,000	85,311,000	2,645,625,000	$ 71,951,400	$ 4,779,000	$ 67,172,400	$ 65,006,354	$ 53,108,593	$ 11,897,761	$ 10,707,985
10	October	2,014,216,000	93,883,000	2,108,099,000	$ 50,512,500	$ 5,705,100	$ 44,807,400	$ 42,811,928	$ 41,780,882	$ 1,031,046	$ 927,941
11	November	1,921,888,000	96,941,000	2,018,829,000	$ 42,744,600	$ 6,106,500	$ 36,638,100	$ 34,878,796	$ 39,865,723	$ (4,986,927)	$ (4,488,234)
12	December	2,062,795,000	89,746,000	2,152,541,000	$ 49,290,300	$ 7,229,700	$ 42,060,600	$ 40,306,965	$ 42,788,557	$ (2,481,592)	$ (2,233,433)
13	Total	21,393,204,000	895,109,000	22,288,313,000	$ 584,176,500	$ 49,716,000	$ 534,460,500	$ 513,378,005	$ 443,759,231	$ 69,618,774	
										Move forward to Schedule 3, Line 1	$ 62,656,897
14											

[1] PSA Retail Energy Sales are the calendar month's kWh sales. Retail Energy Sales of 58,000 MWhs on rate schedules E-36 and RCDAC-1 were excluded from the PSA Calculations this year.

[2] Includes traditional sales-for-resale and Pacificorp supplemental sales.

[3] Includes native load and off-system fuel and purchased power costs less those costs associated with E-36, the non-fuel Bridge PPA, ISFSI and mark-to-market accounting adjustments. Sundance net savings are excluded~~included~~.

[4] Includes off-system revenue less mark-to-market accounting adjustments.

[5] The maximum annual amount that can be used for the PSA calculation is $776,200,000.

Definitions of commonly used terms for this filing are included in the PSA Plan for Administration. Any new terms will be defined on this page.

ARIZONA PUBLIC SERVICE COMPANY
Year 1, Schedule 2
Example PSA Calculation Methodology
Annual Balancing Account Interest

Line No.	Month	Balancing Account Monthly Interest (Schedule 4, Line 216)
1	January	$ -
2	February	$ -
3	March	$ -
4	April	$ -
5	May	$ 8,061
6	June	$ 14,346
7	July	$ 38,545
8	August	$ 86,371
9	September	$ 134,594
10	October	$ 159,803
11	November	$ 162,332
12	December	$ 140,224
13	Total	$ 744,276

Move Forward to Schedule 3, Line 2 | $ 744,276 |

ARIZONA PUBLIC SERVICE COMPANY
Year 1, Schedule 3
Example PSA Calculation Methodology
PSA Adjustor Rate Calculation

Line No.	**PSA Adjustor Rate Calculation**			
1	Post-Sharing (Over)/Under Collection Amount (From Sch. 1)		$ 62,656,897	
2	Annual Balancing Account Interest (From Sch. 2)		$ 744,276	
3	Less: Approved Amortization Surcharge Balance (Nov. 1, 2005) [1]		$ 60,000,000	
4	Bandwidth Carry Forward from Prior Period		$ -	
5	Total (Credit)/Charge Amount (Line 1 + Line 2 - Line 3 +Line 4)			$ 3,401,173
6	Total (Credit)/Charge Amount	$ 3,401,173		
7	Actual Energy Sales without E-3, E-4 and E-36 (kWh)	21,132,204,000		
8	Computed Adjustor Rate per kWh (Line 6 / Line 7)		$ 0.000161	
8.1	Current Adjustor Rate per kWh	$ -		
8.2	Diff. between Current Adj. Rate and Computed Adj. Rate (line 8.1 - line 8)	$ 0.000161		
	Adjustor Rate Bandwidth			
9	Adjustor Rate Bandwidth Upper Limit		$ 0.004000	
10	Adjustor Rate Bandwidth Lower Limit		$ (0.004000)	
11	Applicable Adjustor Rate per kWh for April 1, 2006 (EXAMPLE)			**$ 0.000161**
12	Total (Credit)/Charge *Carried Forward Due to Adjustor Rate Bandwidth*			$ -

[1] This hypothetical example assumes the Commission approval of a $60 Million Amortization Surcharge request that was made in September after the Balancing Account exceeded $50 Million. The requested Amortization Surcharge of .002697 is effective on November 1, 2005, and expires on October 31, 2006, or when $60 million is received through the Surcharge.

ARIZONA PUBLIC SERVICE COMPANY
Year 1, Schedule 4
Example of PSA Calculation Methodology
Monthly Balancing Account Calculations

Line No.		January	February	March	April	May	June	July	August	September	October	November	December
									Ending Balance[1] Exceeds $50M			Nov. 1, 2005[1] Surcharge Begins	
	BALANCING ACCOUNT LESS APPROVED AMORTIZATION SURCHARGE BALANCE												
1	PSA Adjustor Rate (Initially set at zero until April 1, 2006)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
2	Beginning Balance	$ -	$ -	$ -	$ -	$ 3,466,994	$ 6,170,497	$ 16,578,344	$ 37,148,981	$ 57,889,961	$ 68,732,540	$ 69,820,284	$ 5,494,382
3	Less: Approved Balance for Amortization Surcharge (if any)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 60,000,000	$ -
4	Balance Less Amort. Surcharge (Ln. 2 - Ln. 3)	$ -	$ -	$ -	$ -	$ 3,466,994	$ 6,170,497	$ 16,578,344	$ 37,148,981	$ 57,889,961	$ 68,732,540	$ 9,820,284	$ 5,494,382
5	Monthly Int. ((Ln. 4 * (2.79%/12) + Ln. 13) 1yr. Const. Mat. Rate)	$ -	$ -	$ -	$ -	$ 8,061	$ 14,346	$ 38,545	$ 86,371	$ 134,594	$ 159,803	$ 162,332	$ 140,224
6	Post-Sharing (Over)/Under Collection (From Sch. 1)	$ -	$ -	$ -	$ 3,466,994	$ 2,695,442	$ 10,393,501	$ 20,532,092	$ 20,654,609	$ 10,707,985	$ 927,941	$ (4,488,234)	$ (2,233,433)
7	Less: Revenue from Applicable Adjustor Rate	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
8	Residual (Over)/Under Collection (Ln. 6 - Ln. 7)	$ -	$ -	$ -	$ 3,466,994	$ 2,695,442	$ 10,393,501	$ 20,532,092	$ 20,654,609	$ 10,707,985	$ 927,941	$ (4,488,234)	$ (2,233,433)
9	Ending Balance with Interest (Ln. 4 + Ln. 5 + Ln. 8)	$ -	$ -	$ -	$ 3,466,994	$ 6,170,497	$ 16,578,344	$ 37,148,981	$ 57,889,961	$ 68,732,540	$ 69,820,284	$ 5,494,382	$ 3,401,173
9.1	Pending Surcharge Request	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 60,000,000	$ 60,000,000	$ -	$ -
9.2	Ending Balance Less Surcharge Request	$ -	$ -	$ -	$ 3,466,994	$ 6,170,497	$ 16,578,344	$ 37,148,981	$ 57,889,961	$ 8,732,540	$ 9,820,284	$ 5,494,382	$ 3,401,173
	EXAMPLE NOVEMBER 1, 2005 APPROVED AMORTIZATION SURCHARGE BALANCE												
10	Balancing Account Amort. Surcharge per kWh	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 0.002697	$ 0.002697
11	Beginning Amortization Surcharge Balance	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 60,000,000	$ 54,817,132
12	Less: Revenue from Applicable Amortization Surcharge(s)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 5,182,868	$ 5,562,860
13	Ending Amortization Surcharge Balance (Ln. 11 - Ln. 12)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 54,817,132	$ 49,254,272
14	Amort. Monthly Int. ((Ln. 11 * (2.79%/12)) 1yr. Const. Mat. Rate)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 139,500	$ 127,450
	COMBINED BALANCE												
15	Combined Balance (Ln. 9 + Ln. 13)	$ -	$ -	$ -	$ 3,466,994	$ 6,170,497	$ 16,578,344	$ 37,148,981	$ 57,889,961	$ 68,732,540	$ 69,820,284	$ 60,311,514	$ 52,655,445
16	Combined Interest (Ln. 5)	$ -	$ -	$ -	$ -	$ 8,061	$ 14,346	$ 38,545	$ 86,371	$ 134,594	$ 159,803	$ 162,332	$ 140,224

[1] This hypothetical example assumes the Commission approval of a $60 Million Amortization Surcharge request that was made in September after the Balancing Account exceeded $50 Million in August (see line 9 above). The requested Amortization Surcharge of $0.002697 is effective on November 1, 2005, and expires on October 31, 2006, or when $60 million is received through the Surcharge.

ARIZONA PUBLIC SERVICE COMPANY
Year 2, Schedule 1
Example PSA Calculation Methodology
Monthly Energy Sales and Costs

Line No.	Month	(a) PSA Retail [1] Energy Sales (kWh)	(b) Native Load [2] Wholesale Energy Sales (kWh)	(c) Native Load Energy Sales (kWh)	(d) System [3] Book Fuel and Purchased Power Costs	(e) System Book [4] Off-System Sales Revenue	(f) Net Native Load Power Supply Cost	(g) PSA Retail [5] Power Supply Cost	(h) Base Rate Power Supply Cost	(i) Pre-Sharing (Over)/Under Collection	(j) Post-Sharing (Over)/Under Collection
				(a + b)			(d - e)	(a/c * f)	(a * 0.020743)	(g - h)	(i * 0.9)
1	January	2,166,760,000	94,269,000	2,261,029,000	$ 59,739,000	$ 7,594,000	$ 52,145,000	$ 49,970,920	$ 44,945,103	$ 5,025,817	$ 4,523,235
2	February	2,123,854,000	92,403,000	2,216,257,000	$ 58,557,000	$ 7,444,000	$ 51,113,000	$ 48,981,932	$ 44,055,104	$ 4,926,828	$ 4,434,145
3	March	2,102,401,000	91,469,000	2,193,870,000	$ 57,965,000	$ 7,369,000	$ 50,596,000	$ 48,486,501	$ 43,610,104	$ 4,876,397	$ 4,388,757
4	April	2,021,960,000	110,035,000	2,131,995,000	$ 60,611,000	$ 4,081,000	$ 56,530,000	$ 53,612,414	$ 41,941,516	$ 11,670,898	$ 10,503,808
5	May	2,370,603,000	106,963,000	2,477,566,000	$ 67,880,000	$ 4,182,000	$ 63,698,000	$ 60,947,991	$ 49,173,418	$ 11,774,573	$ 10,597,116
6	June	2,688,473,000	117,858,000	2,806,331,000	$ 87,847,000	$ 5,386,000	$ 82,461,000	$ 78,997,870	$ 55,766,995	$ 23,230,875	$ 20,907,788
7	July	3,026,292,000	115,370,000	3,141,662,000	$ 111,624,000	$ 6,943,000	$ 104,681,000	$ 100,836,841	$ 62,774,375	$ 38,062,466	$ 34,256,219
8	August	3,240,023,000	100,171,000	3,340,194,000	$ 115,651,000	$ 6,340,000	$ 109,311,000	$ 106,032,810	$ 67,207,797	$ 38,825,013	$ 34,942,512
9	September	2,662,727,000	88,723,000	2,751,450,000	$ 86,342,000	$ 4,970,000	$ 81,372,000	$ 78,748,086	$ 55,232,946	$ 23,515,140	$ 21,163,626
10	October	2,094,785,000	97,638,000	2,192,423,000	$ 60,615,000	$ 5,933,000	$ 54,682,000	$ 52,246,776	$ 43,452,125	$ 8,794,651	$ 7,915,186
11	November	1,998,764,000	100,819,000	2,099,583,000	$ 51,294,000	$ 6,351,000	$ 44,943,000	$ 42,784,901	$ 41,460,362	$ 1,324,539	$ 1,192,085
12	December	2,145,307,000	93,336,000	2,238,643,000	$ 59,148,000	$ 7,519,000	$ 51,629,000	$ 49,476,426	$ 44,500,103	$ 4,976,323	$ 4,478,691
13	Total	28,641,949,000	1,209,054,000	29,851,003,000	$ 877,273,000	$ 74,112,000	$ 803,161,000	$ 771,123,468	$ 594,119,948	$ 177,003,520	
14								Move forward to Schedule 3, Line 1			$ 159,303,168

[1] PSA Retail Energy Sales are the calendar month's kWh sales. Retail Energy Sales of 60,000 MWhs on rate schedules E-36 and RCDAC-1 were excluded from the PSA Calculations this year.

[2] Includes traditional sales-for-resale and Pacificorp supplemental sales.

[3] Includes native load and off-system fuel and purchased power costs less those costs associated with E-36, the non-fuel Bridge PPA, ISFSI and mark-to-market accounting adjustments. Sundance net savings are excluded.

[4] Includes off-system revenue less mark-to-market accounting adjustments.

[5] The maximum annual amount that can be used for the PSA calculation is $776,200,000.

Definitions of commonly used terms for this filing are included in the PSA Plan for Administration. Any new terms will be defined on this page.

ARIZONA PUBLIC SERVICE COMPANY
Year 2, Schedule 2
Example PSA Calculation Methodology
Annual Balancing Account Interest

Line No.	Month	Balancing Account Monthly Interest (Schedule 4, Line 21)
1	January	$ 122,424
2	February	$ 119,640
3	March	$ 117,145
4	April	$ 114,644
5	May	$ 126,072
6	June	$ 135,397
7	July	$ 166,571
8	August	$ 226,568
9	September	$ 286,837
10	October	$ 314,930
11	November	$ 316,931
12	December	$ 304,092
13	Total	$ 2,351,251

Move Forward to Schedule 3, Line 2 | $ 2,351,251 |

ARIZONA PUBLIC SERVICE COMPANY
Year 2, Schedule 3
Example PSA Calculation Methodology
PSA Adjustor Rate Calculation

Line No.	**PSA Adjustor Rate Calculation**			
1	Post-Sharing (Over)/Under Collection Amount (From Sch. 1)		$ 159,303,168	
2	Annual Balancing Account Interest (From Sch. 2)		$ 2,351,251	
3	Less: Approved Amortization Surcharge Balance (September 1, 2006)[1]		$ 100,000,000	
4	Bandwidth Carry Forward from Prior Period		$ -	
5	Total (Credit)/Charge Amount (Line 1 + Line 2 - Line 3 +Line 4)			$ 61,654,419
6	Total (Credit)/Charge Amount	$ 61,654,419		
7	Actual Energy Sales without E-3, E-4 and E-36 (kWh)	28,380,949,000		
8	Computed Adjustor Rate per kWh (Line 6 / Line 7)		$ 0.002172	
8.1	Current Adjustor Rate per kWh	$ 0.000161		
8.2	Diff. between Current Adj. Rate and Computed Adj. Rate (line 8.1 - line 8)	$ 0.002011		
	Adjustor Rate Bandwidth			
9	Adjustor Rate Bandwidth Upper Limit		$ 0.004000	
10	Adjustor Rate Bandwidth Lower Limit		$ (0.004000)	
11	Applicable Adjustor Rate per kWh for April 1, 2007 (EXAMPLE)			**$ 0.002172**
12	Total (Credit)/Charge Carried Forward Due to Adjustor Rate Bandwidth			**$ -**

[1] This hypothetical example assumes the Commission approval of a $100 million Amortization Surcharge request that was made in July 2006 after the Balancing Account again exceeded $50 million. The requested Amortization Surcharge of $0.003357 is effective on September 1, 2006, and expires on August 31, 2007, or when $100 million is received through the Surcharge.

ARIZONA PUBLIC SERVICE COMPANY
Year 2, Schedule 4
Example of PSA Calculation Methodology
Monthly Balancing Account Calculations

Line No.		January	February	March	April 1st Adjustor[1] Rate Change	May	June Ending Balance[2] Exceeds $50M Again	July	August	September Sep. 1, 2006[2] Surcharge Begins	October	November	December
	BALANCING ACCOUNT LESS APPROVED AMORTIZATION SURCHARGE BALANCE												
1	PSA Adjustor Rate (from Year 1, Sch. 3, Ln. 11)	-	-	-	$0.000161	$0.000161	$0.000161	$0.000161	$0.000161	$0.000161	$0.000161	$0.000161	$0.000161
2	Beginning Balance	3,401,173	8,046,832	12,600,617	17,106,519	27,399,542	37,741,187	58,351,670	92,287,386	126,934,993	44,392,737	52,285,703	53,473,023
3	Less: Approved Balance for Amortization Surcharge (if any)	-	-	-	-	-	-	-	-	100,000,000	-	-	-
3.1	Less: Over-collection from November 2005 Surcharge	-	-	-	-	-	-	-	-	3,564,160	-	-	-
4	Balance Less Amort. Surcharge (Ln. 2 - Ln. 3)	3,401,173	8,046,832	12,600,617	17,106,519	27,399,542	37,741,187	58,351,670	92,287,386	23,370,833	44,392,737	52,285,703	53,473,023
5	Monthly Int. ((Ln. 4 * (2.79%/12) + Ln. 14 + Ln. 19) 1yr. Con. Mat. Ra	122,424	119,640	117,145	114,644	126,072	135,397	166,571	226,568	286,837	314,930	316,931	304,092
6	Post-Sharing (Over)/Under Collection (From Sch. 1)	4,523,235	4,434,145	4,388,757	10,503,808	10,597,116	20,907,788	34,256,219	34,942,512	21,163,626	7,915,186	1,192,085	4,478,691
7	Less Revenue from Applicable Adjustor Rate	-	-	-	325,429	381,542	432,703	487,074	521,473	426,559	337,150	321,696	345,282
8	Residual (Over)/Under Collection (Ln. 6 - Ln. 6)	4,523,235	4,434,145	4,388,757	10,178,379	10,215,574	20,475,085	33,769,145	34,421,039	20,736,067	7,578,036	870,389	4,133,409
9	Ending Balance with Interest (Ln. 4 + Ln. 5 + Ln. 8)	8,046,832	12,600,617	17,106,519	27,399,542	37,741,187	58,351,670	92,287,386	126,934,993	44,392,737	52,285,703	53,473,023	57,910,524
9.1	Pending Surcharge Request	-	-	-	-	-	-	100,000,000	100,000,000	-	-	-	-
9.2	Ending Balance Less Surcharge Request	8,046,832	12,600,617	17,106,519	27,399,542	37,741,187	58,351,670	(7,712,614)	26,934,993	44,392,737	52,285,703	53,473,023	57,910,524
	EXAMPLE NOVEMBER 1, 2005 APPROVED AMORTIZATION SURCHARGE BALANCE												
10	Balancing Account Amort. Surcharge per kWh	0.002697	0.002697	0.002697	0.002697	0.002697	0.002697	0.002697	0.002697	-	-	-	-
11	Beginning Amortization Surcharge Balance	49,254,272	43,411,043	37,784,452	32,202,633	26,824,766	20,494,190	13,291,676	5,161,400	-	-	-	-
12	Less: Revenue from Applicable Amortization Surcharge(s)	5,843,229	5,727,522	5,669,668	5,452,738	6,392,944	7,250,163	8,161,179	8,737,560	-	-	-	-
13	Ending Amortization Surcharge Balance (Ln. 11 - Ln. 12)	43,411,043	37,784,452	32,202,633	26,824,766	20,494,190	13,291,676	5,161,400	(3,564,160)	-	-	-	-
14	Amort. Monthly Int. ((Ln. 11 * (2.79%/12)) 1yr. Const. Mat. Rate)	114,516	100,931	87,849	74,871	62,368	47,649	30,903	12,000	-	-	-	-
	EXAMPLE SEPTEMBER 1, 2006 APPROVED AMORTIZATION SURCHARGE BALANCE												
15	Balancing Account Amort. Surcharge per kWh	-	-	-	-	-	-	-	-	0.003357	0.003357	0.003357	0.003357
16	Beginning Amortization Surcharge Balance	-	-	-	-	-	-	-	-	100,000,000	91,061,225	84,029,032	77,319,181
17	Less: Revenue from Applicable Amortization Surcharge(s)	-	-	-	-	-	-	-	-	8,938,775	7,032,193	6,709,851	7,201,796
18	Ending Amortization Surcharge Balance (Ln. 16 - Ln. 17)	-	-	-	-	-	-	-	-	91,061,225	84,029,032	77,319,181	70,117,386
19	Amort. Monthly Int. ((Ln. 16 * (2.79%/12)) 1yr. Const. Mat. Rate)	-	-	-	-	-	-	-	-	232,500	211,717	195,367	179,767
	COMBINED BALANCE												
20	Combined Balance (Ln. 9 + Ln. 13 + Ln. 18)	51,457,875	50,385,069	49,309,152	54,224,308	58,235,378	71,643,346	97,448,786	123,370,833	135,453,962	136,314,735	130,792,204	128,027,910
21	Combined Interest (Ln. 5)	122,424	119,640	117,145	114,644	126,072	135,397	166,571	226,568	286,837	314,930	316,931	304,092

[1] This hypothetical example assumes the first change to the original PSA Adjustor Rate of $0.000000 takes effect on April 1, 2006. The new PSA Adjustor Rate is $0.000161. See Year 1, Schedule 3 for the calculation of the charge.

[2] This hypothetical example assumes the Commission approval of a $100 Million Amortization Surcharge request that was made in July 2006 after the Balancing Account again exceeded $50 Million in June (see line 9 above). The requested Amortization Surcharge of $0.003357 is effective on September 1, 2006, and expires on August 31, 2007, or when *$100 million is received.*

This hypothetical example assumes the Commission approved November 1, 2005, Amortization Surcharge of $0.002697 expired after $60 million was received. A credit of $3,564,160 was made to the Bank Balance *to reflect an over-collection* in September 2006.

EXHIBIT
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admitted

PINNACLE WEST CAPITAL CORPORATION

PNW Stock Oct 27, 2005 at 14:47 ET 4

Investors

Dividend History

	Date Declared	Ex-Dividend Date	Record Date	Payment Date	Amt/Share
2005	10-19-05	10-28-05	11-01-05	12-01-05	.500
	07-13-05	07-28-05	08-01-05	09-01-05	.475
	03-23-05	04-28-05	05-02-05	06-01-05	.475
	01-19-05	01-28-05	02-01-05	03-01-05	.475
2004	10-20-04	10-28-04	11-01-04	12-01-04	.475
	07-16-04	07-29-04	08-02-04	09-01-04	.450
	03-17-04	04-29-04	05-03-04	06-01-04	.450
	01-21-04	01-29-04	02-02-04	03-01-04	.450
2003	10-22-03	10-30-03	11-03-03	12-01-03	.450
	07-18-03	07-30-03	08-01-03	09-01-03	.425
	04-23-03	04-29-03	05-01-03	06-01-03	.425
	01-22-03	01-30-03	02-03-03	03-01-03	.425
2002	10-23-02	10-30-02	11-01-02	12-01-02	.425
	07-12-02	07-30-02	08-01-02	09-01-02	.400
	04-17-02	04-29-02	05-01-02	06-01-02	.400
	01-23-02	01-30-02	02-01-02	03-01-02	.400
2001	10-17-01		11-01-01	12-01-01	.400
	06-20-01		08-01-01	09-01-01	.375
	04-18-01		05-01-01	06-01-01	.375
	01-18-01		02-01-01	03-01-01	.375
2000	10-18-00		11-01-00	12-01-00	.375
	06-21-00		08-01-00	09-01-00	.350
	04-19-00		05-01-00	06-01-00	.350
	01-19-00		02-01-00	03-01-00	.350
1999	10-20-99		10-28-99	12-01-99	.350
	06-23-99		08-02-99	09-01-99	.325
	04-21-99		05-03-99	06-01-99	.325
	01-20-99		02-01-99	03-01-99	.325
1998	10-21-98		11-02-98	12-01-98	.325
	06-17-98		08-03-98	09-01-98	.300
	04-22-98		05-01-98	06-01-98	.300
	01-21-98		02-02-98	03-01-98	.300
1997	10-21-97		11-03-97	12-01-97	.300
	06-18-97		08-01-97	09-01-97	.275
	04-22-97		05-02-97	06-01-97	.275
	01-22-97		02-03-97	03-01-97	.275

Corporate Headquarters: 400 North 5th Street, Phoenix, AZ 85004 (602) 250-1000 (800) 457-2983

EXHIBIT
Mundell 2
admitted

PINNACLE WEST
CAPITAL CORPORATION

INVESTOR FACTS

2nd Quarter 2005 — **NYSE: PNW**

ABOUT PINNACLE WEST

Pinnacle West Capital Corporation (PNW) is a Phoenix-based company with consolidated assets of about $11 billion and consolidated revenues of $2.9 billion. Through our subsidiaries, we generate, sell and deliver electricity and sell energy-related products and services to retail and wholesale customers in the western United States. We also develop residential, commercial and industrial real estate projects.

Strategic Objectives:

- Focus on superior long-term total returns for shareholders
- Provide Arizona electricity customers with reliable energy at fair prices
- Capture growth opportunities in our electricity markets
- Actively manage our costs and business risks
- Maximize the long-term value of our assets
- Increase our resource portfolio consistent with our native load, cash flow and market conditions
- Work with regulators to achieve positive regulatory outcomes that benefit both customers and shareholders
- Maintain a disciplined focus on our long-term goals while remaining agile

KEY INVESTMENT CONCEPTS

- Ranked first in dividend growth for 1995-2004 among U.S. electric utilities with average annual dividend growth rate of 7.8%
- Customer growth about three times U.S. electric utility average
- Profitability and operational excellence emphasized
- $1.90 per share indicated annual dividend
- 11 consecutive annual dividend increases

FINANCIAL HIGHLIGHTS

HIGHLIGHTS

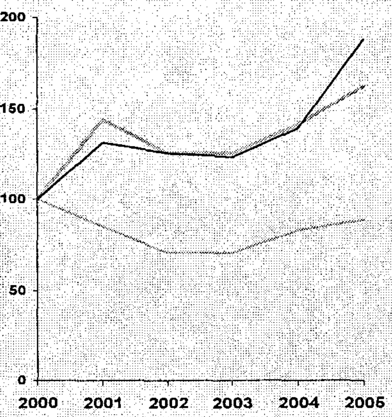
(in millions, except per share data, unaudited)

	12 Months Ended 6/30/05	Year Ended December 31, 2004	2003	2002
INCOME				
Operating Revenues	**$ 2,906**	$ 2,900	$ 2,759	$ 2,405
Income From Continuing Operations*	**$ 257**	$ 247	$ 225	$ 237
BALANCE SHEET				
Total Assets	**$10,733**	$ 9,897	$ 9,519	$ 9,139
Common Stock Equity	**$ 3,252**	$ 2,950	$ 2,830	$ 2,686
PER SHARE				
Earnings Per Share – Diluted:				
Continuing Operations*	**$ 2.76**	$ 2.69	$ 2.47	$ 2.78
Net Income*	**$ 2.05**	$ 2.66	$ 2.63	$ 1.76
Indicated Annual Dividend Rate – End of Period	**$ 1.90**	$ 1.90	$ 1.80	$ 1.70
Book Value – End of Period	**$ 32.89**	$ 32.14	$ 30.97	$ 29.40
STOCK PERFORMANCE				
Stock Price – End of Period	**$ 44.45**	$ 44.41	$ 40.02	$ 34.09
Market Capitalization – End of Period	**$ 4,377**	$ 4,077	$ 3,657	$ 3,115
ANNUALIZED GROWTH RATES				
Earnings Per Share From				
Continuing Operations – Diluted	**(2.1) %**	8.9 %	(11.2) %	(27.8) %
Dividends Per Share - Indicated	**5.6 %**	5.6 %	5.9 %	6.2 %
Operating Revenues	**2.9 %**	5.1 %	14.7 %	(8.7) %
Electric Sales in Kilowatt-Hours	**5.6 %**	7.3 %	11.4 %	13.0 %
Electric Customers – Average	**4.0 %**	3.7 %	3.3 %	3.1 %

* *Includes certain non-recurring items.*
Certain prior year amounts have been reclassified to conform to current period presentation.

STOCK PERFORMANCE COMPARISON

TOTAL RETURN
Value of $100 Invested at June 30, 2000
With Dividends Reinvested



Values as of June 30

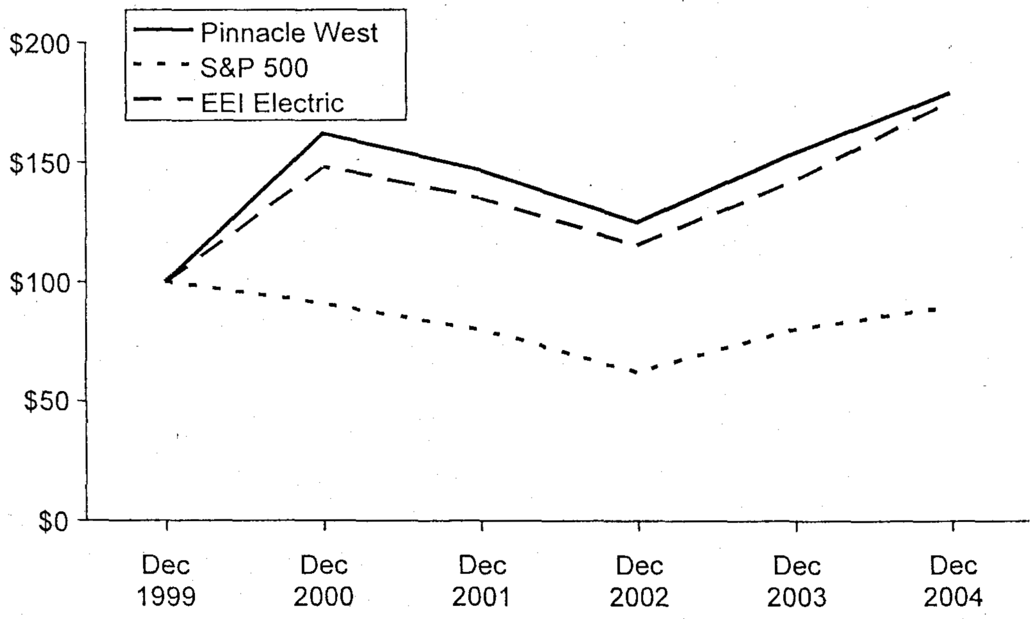
- Pinnacle West
- S&P 500 Index
- EEI Electric Index

EXHIBIT
Mundell 3
admitted

PERFORMANCE GRAPH

The following graph shows a comparison of cumulative total returns for Pinnacle West Capital Corporation stock, the Standard & Poor's 500 Stock Index, and the Edison Electric Institute Index of Investor-Owned Electrics. The graph assumes that $100 was invested on the last trading day in 1999 in Company stock and in the market represented by each of the two indices, and that any dividends were reinvested.

	1999	2000	2001	2002	2003	2004
Pinnacle West	100	162	147	125	154	179
S&P 500 Index	100	91	80	62	80	89
EEI Electric Index	100	148	135	115	142	175



Return to Regular Format

Research:

Research Update: Outlook On Pinnacle West Capital Corp. And APS's Ratings To Stable On Resolution Of Rate Case

Publication date: 01-Apr-2005
Primary Credit Analyst(s): Anne Selting, San Francisco (1) 415-371-5009; anne_selting@standardandpoors.com

Credit Rating: BBB/Stable/A-2

Rationale

On April 1, 2005, Standard & Poor's Ratings Services revised the outlook to stable from negative and affirmed the ratings on Pinnacle West Capital Corp. (PWCC) and Arizona Public Service Co. (APS), the company's wholly owned electric utility, reflecting the long-awaited resolution of APS' general rate case.

The Arizona Corporation Commission (ACC) voted 4-1 on March 28, 2005 to adopt with few changes the terms of a settlement agreement negotiated by 21 of 22 parties in August 2004 and thereby resolve many of the issues that have challenged the consolidated credit quality of PWCC and APS.

Among the most significant benefits of the settlement is the rate-basing of 1,790 MW of generation that is currently owned by Pinnacle West Energy Corp (PWEC), PWCC's nonregulated wholesale generation subsidiary. The assets will be transferred at a value of $700 million, which represents a disallowance of approximately $148 million. As a result, PWEC's merchant plant ownership will drop from about 2,200 MW of nameplate capacity to about 425 MW, significantly lowering the business risk profile of PWCC.

The transfer will require the approval of the FERC, which must assess the extent to which APS could exert regional market power if the rate-basing is approved. Until FERC authorization is granted, APS and PWEC will enter into a cost-based power purchase agreement (PPA), which will be extended to 30 years in the event that the FERC rejects APS' request. If the rate-basing is rejected, the PPA is structured to mimic the benefits that would otherwise accrue to PWCC and APS under rate-basing. Because load growth in APS' service territory is projected to grow between 4%-6% per year over the next five years, APS will still need an additional 1,200 MW by the summer of 2007 to fill the gap between power supply and demand.

The substantial reduction in PWEC's operations, combined with PWCC management's demonstrated commitment to scale back the activities of its three other unregulated subsidiaries--SunCor, El Dorado and APS Energy Services--has resulted in an improved consolidated business profile score of '5' from a '6', based on Standard & Poor's 10-point scale, where '1' represents the strongest profile. APS' business profile of '5' is unchanged.

The ACC also approved a 4.21% increase in base electric rates, which will go into effect April 1, 2005. This rate increase, along with other measures management has taken, are expected to be sufficient to maintain credit metrics in the 'BBB' category. However, because the rate increase falls short of the original 9.8% rate increase sought by the utility, it is likely that APS will need to file a new rate case in the next several years. The utility faces continued regulatory challenges in seeking rate relief. The authorization of a fuel and purchased power mechanism, called the Power Supply Adjuster (PSA), is expected to provide only modest protection to the utility in the interim because of structural weaknesses in its design. Specifically, base fuel and purchased power costs are set at 2.1 cents/kilowatt-hour (kWh), a level that is low relative to APS' projected fuel costs. While APS may request annually that the PSA be used to collect fuel, purchased power, and hedging costs in excess of this base

EXHIBIT
tabbies
Mundell 4
admitted

rate, any authorized increases are capped at 4 mills/kWh over the life of the PSA. APS expects it will reach the 4 mill limit in the first year. An additional limitation exists that caps APS' total fuel costs in any calendar year to $776 million. APS may not collect through the PSA any expenses that exceed this amount, but instead must file a rate case with the ACC. The 21-month resolution of the current rate case, which APS originally filed in June 2003, indicates that APS may not be able to rely on rate cases to provide timely adjustments to the base fuel and power purchase rate.

The decision does give the ACC the ability to establish an additional surcharge for fuel and purchased power costs outside of the annual PSA calculation. APS must notify the ACC if power and fuel cost deferrals exceed $50 million on its balance sheet, and if deferrals rise to $100 million, the ACC may elect to implement a surcharge in addition to the PSA. But the requirement for the ACC to do so, and the timing of its actions, as well as the amortization of cost recovery it would elect in such an instance, are uncertain.

APS has hedged approximately 75% of its natural gas needs for 2005 and approximately 40% for 2006, which mitigates the exposure that the utility will have under the PSA in the short term. However, over time, it is likely that APS will need a stronger PSA to maintain its current credit ratings, particularly given the expectation that over the next five years APS' fuel mix will become heavily concentrated in natural gas.

Short-term credit factors

PWCC's liquidity is adequate, and as of March 31, 2005, PWCC's consolidated cash and cash equivalents position was approximately $250 million. This very strong cash position is due largely to APS' issuance of $300 million in notes in June 2004 in order to prefinance about $400 million in utility obligations due in January and August 2005.

Both PWCC and APS maintain CP programs. Neither program had any CP balances as of March 31, 2005. PWCC's program is for $250 million and is supported by a three-year, $300 million credit facility that PWCC put into place in October 2004. The revolver allows PWCC to use up to $100 million of the facility for letters of credit. The revolver has no material adverse change clauses pertaining to outstanding CP balances.

APS maintains a $250 million CP program. In May 2004, APS renegotiated its revolver and increased the size to $325 million. Also a three-year term, the facility supports the utility's CP program and provides another $75 million for other liquidity needs, including letters of credit. The supporting facility has no material adverse change clauses pertaining to outstanding CP balances.

The revolvers do not have any termination triggers tied to credit downgrades, but they do have restrictive covenants, including interest coverage and leverage tests. The agreements also have cross-default provisions.

Outlook

The stable outlook reflects the expectation that PWCC will continue to focus on the regulated operations of APS, which is projected to contribute more than 85% of its funds from operations in 2005. The failure of PWCC or APS to meet expected financial results in 2005 and 2006, particularly in light of the weakening in consolidated and utility credit metrics in 2004, could lead to a downward revision of the outlook or a ratings change. Downward pressure on the ratings will occur if APS incurs significant power or fuel cost deferrals in excess of the PSA's limitations. Any positive rating action is unlikely in the near-term given the financial metrics and the longer term risks that the terms of the PSA present.

Ratings List

	To	From
Pinnacle West Capital Corp.		
Corporate credit rating	BBB/Stable	BBB/Negative
Senior unsecured debt	BBB-	
Commercial paper	A-2	

Arizona Public Service Co.		
Corporate credit rating	BBB/Stable	BBB/Negative
Senior unsecured debt	BBB	
Commercial paper	A-2	

Complete ratings information is available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; under Credit Ratings in the left navigation bar, select Find a Rating, then Credit Ratings Search.

BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER
Chairman
WILLIAM A. MUNDELL
Commissioner
MARC SPITZER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN, AND FOR APPROVAL OF A PURCHASED POWER CONTRACT.	DOCKET NO. E-01345A-03-0437
IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR APPROVAL OF A POWER SUPPLY ADJUSTOR SURCHARGE.	DOCKET NO. E-01345A-05-0526

TESTIMONY

OF

BARBARA KEENE

PUBLIC UTILITIES ANALYST MANAGER

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

OCTOBER 17, 2005

c

TABLE OF CONTENTS

APPENDICES

EXECUTIVE SUMMARY
ARIZONA PUBLIC SERVICE COMPANY
PLAN OF ADMINISTRATION
DOCKET NOS. E-01345A-03-0437 AND E-01345A-05-0526

Staff's testimony relates to the Plan of Administration of the Power Supply Adjustor ("PSA") for Arizona Public Service Company.

Staff's testimony describes the Plan of Administration and explains the PSA mechanism, step-by-step.

Staff recommends that the PSA Plan of Administration, as modified, be approved.

INTRODUCTION

Q. Please state your name and business address.

A. My name is Barbara Keene. My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

Q. By whom are you employed and in what capacity?

A. I am employed by the Utilities Division of the Arizona Corporation Commission as a Public Utilities Analyst Manager. My duties include supervising the energy portion of the Telecommunications and Energy Section. A copy of my résumé is provided in Appendix 1.

Q. As part of your employment responsibilities, were you assigned to review matters contained in Docket Nos. E-01345A-03-0437 and E-01345A-05-0526?

A. Yes.

Q. What is the subject matter of your testimony?

A. Staff's testimony relates to the Plan of Administration of the Power Supply Adjustor ("PSA") for Arizona Public Service Company ("APS"), describes the Plan of Administration, explains the PSA mechanism, and makes a recommendation to the Commission on the Plan.

Q. What is Staff's recommendation regarding the PSA Plan of Administration?

A. Staff recommends that the PSA Plan of Administration be approved, as modified in Appendix 2.

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BACKGROUND OF THE PLAN OF ADMINISTRATION

Q. What is the background of the Plan of Administration?

A. The Settlement Agreement, approved by the Commission in Decision No. 67744, provided for a Power Supply Adjustor to be established for APS. A plan of administration was to be filed that describes how the PSA operates. Decision No. 67744 required that the parties to the Settlement Agreement submit a PSA Plan of Administration for Commission approval that reflects the Decision.

Q. Was a Plan of Administration filed?

A. Yes. On June 6, 2005, Staff filed, on behalf of the Settling Parties, a Plan for Administration for the APS PSA. On July 25, 2005, Staff filed a memo and proposed order concerning the Plan for Administration. A modified version of the Plan is included in Appendix 2 of this testimony.

Q. What is included in the Plan of Administration?

A. The Plan of Administration describes the PSA and how calculations are made, incorporating the PSA features included in the Settlement Agreement and the provisions of Decision No. 67744. The Plan also provides definitions and includes sample schedules.

Q. Please summarize the Plan of Administration.

A. The purpose of the PSA is to track changes in APS' cost of obtaining power supplies by comparing actual costs on a going forward basis to the base cost of $0.020743 per kWh established by Decision No. 67744. The major features of the PSA are: (1) a 90 percent ratepayer/10 percent APS sharing mechanism, (2) the inclusion of off-system sales revenue, (3) the inclusion of fuel and purchased power costs, (4) an Adjustor Rate, (5) a bandwidth on changes in the Adjustor Rate of plus or minus $0.004 per kWh in a year and over the life of the PSA, (6) a balancing account, (7) a Surcharge mechanism, and (8) a limit of $776,200,000 on annual power supply costs.

The results of the PSA are applied to customer bills through the Adjustor Rate. The Adjustor Rate, initially set at zero, will be reset on April 1st of each year. APS will provide a report to the Commission on March 1st of each year that shows the calculation of the new Adjustor Rate.

According to Paragraph 19e of the Settlement Agreement, if the size of the balancing account reaches plus or minus $50 million, APS has 45 days to file a request for Commission approval of a surcharge or file an explanation of why a surcharge is not necessary. Decision No. 67744 imposed a cap on the balancing account of $100 million. APS is not to allow the Bank Balance to reach $100 million prior to seeking recovery or refund.

APS files monthly reports to Staff and the Residential Utility Consumer Office detailing all calculations related to the PSA. APS also files confidential monthly reports with Staff that provide details on generating units, power purchases, and fuel purchases.

MODIFICATIONS TO THE PLAN FOR ADMINISTRATION

Q. Please describe the modifications made to the Plan for Administration that was originally filed on June 6, 2005.

A. The modifications, marked in the red-lined Plan in Appendix 2, include the following:

1. The name of the document has been changed from "Plan *for* Administration" to "Plan *of* Administration" to be consistent with the Settlement Agreement and Decision No. 67744. Both of these documents refer to a Plan *of* Administration.

2. In the General Description section, a sentence was added that states that the PSA will apply to all fuel and purchased power costs incurred on or after April 1, 2005. This is consistent with Decision No. 67744 which did not allow fuel costs incurred before the effective date of the Decision to be included in the calculation of the PSA.

3. Decision No. 67504 authorized APS to defer the costs of owning, operating, and maintaining the Sundance Plant upon acquiring it from PPL, as long as a PSA is in effect for APS. APS was to adjust the PSA to remove savings (reduced fuel costs, reduced purchased power costs, and additional off-system sales margins) resulting from APS ownership of the Sundance Plant. This adjustment is necessary to properly capture all elements of the Sundance deferral. In the General Description section of the PSA Plan of Administration, a sentence was added that states that the adjustment made in regard to the Sundance plant will no longer be made once rates are effective that recover the capital and operating costs of the plant. It is reasonable that the savings adjustments would end if the Commission were to make the Sundance Plant a part of APS' rate base.

4. In the General Description section, a sentence was added that gives the date (April 1, 2005) that the Adjustor rate was set at zero. This is consistent with Decision No. 67744.

5. In the General Description section, the amount of the bandwidth ($0.004 per kWh in a year) was added to the sentence that states that the annual change in the Adjustor Rate is limited, as stated in the Settlement Agreement. Another sentence was added that states that the change is limited to $0.004 from the base level, consistent with Decision No. 67744. Two examples were added to illustrate how the two bandwidths are applied.

6. In the General Description section, two sentences were added that state that any additional recoverable or refundable amounts would be recorded in a

balancing account to be carried over to future years and not be subject to further sharing, consistent with the Settlement Agreement.

7. In the General Description section, language was inserted that explains that balancing account entries are made each month, starting with April 2005, that reflect the difference between 90 percent of incurred fuel and purchased power costs, less the balance of any approved Surcharge, and the sum of costs collected through the base cost rate and the Adjustor Rate. This reflects the 90/10 sharing feature included in the Settlement Agreement. Also, a Surcharge may go into effect prior to the April 1st recalculation of the Adjustor Rate, if the Surcharge is approved by the Commission.

8. The Definition section was moved forward to follow the General Description section so that it would be more useful.

9. Definitions for "Adjustor Rate," "Amortization Surcharge," "Balancing Account," "Bandwidth Carry Forward from Prior Period," "Bank Balance," "Base Cost of Fuel and Purchased Power," "PSA," "Surcharge Balance," "System Book Fuel and Purchased Power Costs," "System Book Off-System Sales Revenue," and "Wheeling Costs" were added to the Definitions section. The existing definitions for "ISFSI," "Mark to Market Accounting," and "Native Load" were revised.

10. In Part 1 of the Calculations section, a reference to the decision from the PPL Sundance docket was added.

11. In Part 2 of the Calculations section, language was added to clarify that revenue collected from the Adjustor Rate is credited to the Balancing Account.

12. In Part 4 of the Calculations section, a sentence was added that clarifies that monthly interest includes interest from both the Balancing Account and from outstanding balances from Commission-approved Amortization Surcharges, if the Surcharge balance was approved to accrue interest.

13. In Part 4 of the Calculations section, language was added that states that Commission-approved Surcharge balances are subtracted from the total costs used to calculate the April 1st Adjustor Rate. This is because costs included in a Surcharge balance have already been used to calculate a Surcharge rate, and including them again to calculate the Adjustor Rate could result in double recovery.

14. In Part 4 of the Calculations section, language was added to indicate that sample schedules have been included for two years along with two Surcharge examples.

15. In the Balancing Account and Amortization Surcharge section, language was added that describes the purpose of a Balancing Account and that the Balancing Account was to be established on April 1, 2005. This additional language clarifies that the Balancing Account serves as the vehicle for tracking the ongoing deferrals of the difference between APS' prudently incurred costs of fuel and purchased power and APS' actual recovery of those costs through base rates plus the Adjustor Rate. This additional language is consistent with paragraphs 19(h) and 20 of the Settlement Agreement.

16. In the Balancing Account and Amortization Surcharge section, a sentence was added that states that any Surcharge balance will be shown separately on monthly reports, and, unless otherwise ordered by the Commission, will not be considered part of the Balancing Account. This additional language is consistent with Decision No. 67744, in which the Commission stated that, following a proceeding to recover or refund a Bank Balance, the Bank Balance would be reset to zero, unless otherwise ordered by the Commission. Staff believes that showing a Surcharge balance separately provides more clarity.

17. In the Balancing Account and Amortization Surcharge section, a sentence was added to clarify that interest may be applied to any outstanding Surcharge balance that was approved to accrue interest.

18. In the Balancing Account and Amortization Surcharge section, language was added to clarify that the $50 million threshold trigger applies when a monthly report filed with the Commission shows a Bank Balance of at least $50 million. This section also clarifies that APS may file a request for a Surcharge at any time.

Because there is a 60-day lag between the time that APS records its monthly deferrals in its books and the time that it is required to file its monthly reports with the Commission, there has been confusion as to when the $50 million trigger is reached. This additional language resolves this issue by stating that the trigger is reached at the time that APS files a report with the Commission that contains a $50 million bank balance. This allows the Commission to monitor APS' compliance with the filing requirements set forth in the Plan of Administration on page 9.

Staff also believes that APS may file a request for a Surcharge at any time because neither the Commission's order nor the Settlement Agreement specifically precludes such a filing. Furthermore, allowing APS to file such an application provides both APS and the Commission the opportunity to more effectively respond to unexpected circumstances that may affect the Bank Balance.

19. In the Balancing Account and Amortization Surcharge section, language was added to clarify that once APS has filed a request for a Surcharge, the amount requested in the filing is excluded from the balance used to determine if the $100 million cap has been reached. A chart, plus descriptive narrative, was added to illustrate this concept. Language was also added that explains that APS could

make additional Surcharge filings with the $100 million cap applied to the amount addressed in each filing. This additional language is necessary to describe the interplay between the $100 million cap and the Balancing Account. This issue is discussed in more detail below.

20. In the Allowable Costs section, FERC account 565 Wheeling was added to the list of allowable costs, and the reference to broker fees was deleted. Staff continues to believe that broker fees are not allowable PSA costs. However, Staff has concluded that Wheeling Costs as recorded in FERC account 565 should be recovered through the PSA because these costs are legitimate costs of purchasing power.

21. "Schedule 1" was changed to "Year 1, Schedule 1." Footnote 3 on this schedule was changed to indicate that Sundance net savings are "excluded" instead of "included" from the total of System Book Fuel and Purchased Power Costs. The first change provides a more appropriate title for the schedule because schedules for two years are now provided. The second change corrects a typo.

22. "Schedule 2" was changed to "Year 1, Schedule 2." The reference line from Schedule 4 was changed from line 2 to line 16. The numbers in the table were revised. The first change provides a more appropriate title for the schedule because schedules for two years are now provided. The other changes were made because Year 1, Schedule 4 now includes an example of an Amortization Surcharge.

23. "Schedule 3" was changed to "Year 1, Schedule 3." This schedule was modified to include a Surcharge balance in the example. The first change provides a more appropriate title for the schedule because schedules for two years are now provided. The second change provides helpful clarifications.

24. "Schedule 4" was changed to "Year 1, Schedule 4." This schedule was modified to include a Surcharge balance in the example. The first change provides

a more appropriate title for the schedule because schedules for two years are now provided. The second change provides helpful clarifications.

25. The following schedules were added: Year 2, Schedule 1; Year 2, Schedule 2; Year 2, Schedule 3; and Year 2, Schedule 4. These additional schedules are intended to illustrate the mechanics of the PSA.

Q. **Please discuss the operation of the $100 million cap that Decision No. 67744 applies to the Balancing Account.**

A. In that Decision, the Commission capped the Balancing Account at $100 million. On page 17, the Decision also states, "In no event shall the Company allow the bank balance to reach $100 million prior to seeking recovery or refund." The Decision does not provide specific details about how the $100 million cap is intended to operate. Because this portion of the order was added by the Commission and was not part of the Settlement Agreement, there is no prefiled testimony to refer to for assistance with this issue. Questions have been raised as to whether the $100 million cap is supposed to serve as a means to disallow PSA deferrals in excess of $100 million or whether the cap was instead intended as a means to ensure that the Company would file timely applications to amortize an escalating Bank Balance.

Staff's review of the Open Meeting transcript has led Staff to conclude that the Commission probably did not intend to use the $100 million cap as a means to disallow otherwise prudently incurred costs. Staff has used this conclusion as the starting point for evaluating the description of the $100 million cap and its interplay with the Balancing Account in the Plan of Administration.

Q. How does the Plan of Administration propose to resolve the issue of how to apply the $100 million cap?

A. If APS files an application to establish a Surcharge, the amount requested in the filing is excluded from the Bank Balance for purposes of determining if the $100 million threshold has been met. Staff believes that this resolution provides a reasonable interpretation of how the $100 million cap is applied. It ensures that escalating balances will be brought to the Commission's attention but provides a means to avoid an automatic disallowance.

STEP-BY-STEP EXPLANATION OF THE PSA

Q. Please explain how the PSA works, step-by-step.

A. ***Step One (record retail kWh sales).***

For each calendar month, APS records its retail energy sales in Schedule 1 (Monthly Energy Sales and Costs). These sales are the kWh sales made to APS' retail customers. Excluded are the directly assigned kWh sales from applicable special contract customers, E-36 (Station Use Service) customers, and customers returning to Standard Offer service from competitive generation subject to the RCDAC-1 (Returning Customer Direct Access Charge) rate schedule. These PSA Retail Energy Sales (kWh) are shown in column a of Schedule 1. In the illustrative Year 1, Schedule 1, this figure for April is 1,944,192,000.

Step Two (record wholesale kWh sales).

For each calendar month, APS records its wholesale energy sales in Schedule 1. These sales are the kWh sales made to APS' Native Load wholesale customers. Native Load includes customers in the APS control area for which APS has a generation service obligation (also known as traditional sales-for-resale) and PacifiCorp Supplemental Sales. The traditional sales-for-resale includes the portion of load from wholesale electrical and irrigation district resale customers served by APS, but it excludes the load served with Preference Power (power allocated by federal power agencies). These Native Load

Wholesale Energy Sales (kWh) are shown in column b of Schedule 1. In the illustrative Year 1, Schedule 1, this figure for April is 105,803,000.

Step Three (add retail and wholesale kWh sales).

For each calendar month, APS adds the PSA Retail Energy Sales (column a) to the Native Load Wholesale Energy Sales (column b) to calculate the total Native Load Energy Sales (kWh) and places the result in column c of Schedule 1. In the illustrative Year 1, Schedule 1, this figure for April is 2,049,995,000.

Step Four (record fuel and purchased power costs).

For each calendar month, APS records its costs for fuel and purchased power in Schedule 1. Included in these costs are costs recorded in FERC accounts 501 Fuel (Steam), 518 Fuel (Nuclear), 547 Fuel (Other Production), 555 Purchased Power, and 565 Wheeling (Transmission of Electricity by Others). Excluded from the total costs are costs associated with applicable special contracts, E-36, RCDAC-1, the non-fuel Bridge PPA allowed by Decision No. 67744, Independent Spent Fuel Storage Installation, and mark-to-market accounting adjustments. Removing mark-to-market adjustments is appropriate so that only actual costs of fuel and purchased power, not the current value of hedges for the future, are included in the PSA. Also excluded are the savings associated with the acquisition of the Sundance plant, as required by Decision No. 67504, until the capital and operating costs of the Sundance plant are included in rates. These System Book Fuel and Purchased Power Costs are shown in column d of Schedule 1. In the illustrative Year 1, Schedule 1, this figure for April is $50,508,900.

Step Five (record off-system sales revenue).

For each calendar month, APS records revenue it receives from off-system sales in column e of Schedule 1. These off-system sales include only the off-system sales using

APS-owned or contracted generation and purchased power related to optimizing the APS system. Mark-to-market accounting adjustments are removed from the revenue figures. In the illustrative Year 1, Schedule 1, the figure for System Book Off-System Sales Revenue for April is $3,924,000.

Step Six (subtract off-system sales revenue from fuel and purchased power costs). For each calendar month, APS subtracts the System Book Off-System Sales Revenue (column e) from the System Book Fuel and Purchased Power Costs (column d) to calculate the Net Native Load Power Supply Cost and places the result in column f of Schedule 1. The Net Native Load Power Supply Cost represents total fuel and purchased power costs less off-system sales revenue. In the illustrative Year 1, Schedule 1, this figure for April is $46,584,900.

Since the costs associated with off-system sales are included in the System Book Fuel and Purchased Power Costs, subtracting the off-system sales revenue from the System Book Fuel and Purchased Power Costs results in the sales margin being embedded in the Net Native Load Power Supply Cost. Detailed information on off-system sales, including explanation for any negative margins, is included in the confidential monthly reports provided to Staff.

Step Seven (calculate retail power supply cost). For each calendar month, APS divides the PSA Retail Energy Sales (column a) by the Native Load Energy Sales (column c) and multiplies the product by the Net Native Load Power Supply Cost (column f) to calculate the PSA Retail Power Supply Cost and places the result in column g of Schedule 1. The PSA Retail Power Supply Cost represents the amount of power supply costs associated with retail sales subject to the PSA. This amount is limited to $776,200,000 per calendar year. In the illustrative Year 1, Schedule 1, the April figure for the PSA Retail Power Supply Cost is $44,180,591.

Step Eight (calculate base rate power supply cost).

For each calendar month, APS multiplies the PSA Retail Energy Sales (column a) by the base cost of fuel and purchased power cost ($0.020743) determined by Decision No. 67744 to calculate the Base Rate Power Supply Cost and places the result in column h of Schedule 1. The Base Rate Power Supply Cost represents the costs currently being paid by ratepayers for power supply costs through base rates. In the illustrative Year 1, Schedule 1, this figure for April is $40,328,375.

Step Nine (calculate change in power supply cost).

For each calendar month, APS subtracts the Base Rate Power Supply Cost (column h) from the PSA Retail Power Supply Cost (column g) to calculate the Pre-Sharing (Over)/Under Collection and places the result in column i of Schedule 1. The Pre-Sharing (Over)/Under Collection represents the increase or decrease in power supply costs compared to the base cost of fuel and purchased power. In the illustrative Year 1, Schedule 1, this figure for April is $3,852,216.

Step Ten (calculate 90/10 sharing).

For each calendar month, APS multiplies the Pre-Sharing (Over)/Under Collection (column i) by 90 percent to calculate the Post-Sharing (Over)/Under Collection amount and places the result in column j of Schedule 1. The Post-Sharing (Over)/Under Collection represents 90 percent of the increase or decrease in power supply costs compared to the base cost of fuel and purchased power. The remaining 10 percent is attributable to APS. In the illustrative Year 1, Schedule 1, this figure for April is

$3,466,994. The Post-Sharing (Over)/Under Collection is also shown on line 6 of Schedule 4 (Balancing Account Calculations).

Step Eleven (calculate annual collection amount).

After the end of the calendar year, APS sums the Post-Sharing (Over)/Under Collection (column j) amounts for all the months in the year to calculate an annual total and places the total on line 14 of Schedule 1. During 2005, only the months from April through December are included. The annual Post-Sharing (Over)/Under Collection is also entered on line 1 of Schedule 3 (PSA Adjustor Rate Calculation). In the illustrative Year 1, Schedule 1, this figure is $62,656,897.

Step Twelve (determine bank balance).

For each month, APS places the monthly Post-Sharing (Over)/Under Collection from column j of Schedule 1 on line 6 of Schedule 4 (Monthly Balancing Account Calculations). For April 2005, the Post-Sharing (Over)/Under Collection is also the Ending Balance for April and the Beginning Balance of May 2005 because there is no interest involved. Interest is entered into the Balancing Account for all months after April 2005.

The Beginning Balance (line 2) in the Balancing Account (Schedule 4) for each month is the Ending Balance with Interest (line 9) for the prior month. In the illustrative Year 1, Schedule 4, the Beginning Balance for November is $69,820,284. The balance for any Commission-approved Amortization Surcharge is placed on line 3 and subtracted from the Beginning Balance (line 2), resulting in the Balance less Amortization Surcharge on line 4. In the illustrative Year 1, Schedule 4, the Approved Balance for Amortization Surcharge for November is $60,000,000, resulting in a Balance Less Amortization Surcharge of $9,820,284.

An interest rate is applied each month to both the Balance less Amortization Surcharge (line 4) and any Amortization Surcharge Balance approved to accrue interest to determine the monthly interest shown on line 5 of Schedule 4 and in the last column of Schedule 2 (Annual Balancing Account Interest). The interest rate used is the one-year nominal Treasury constant maturities rate as contained in the Federal Reserve Statistical Release, H-15, or its successor publication. In the illustrative Year 1, Schedule 4, the interest rate used is 2.79 percent, resulting in Monthly Interest for November of $162,332 (line 5).

Revenue received from the applicable Adjustor Rate is entered on line 7 of Schedule 4 and subtracted from the Post-Sharing (Over)/Under Collection (line 6) to calculate the Residual (Over)/Under Collection placed on line 8. Since the Adjustor Rate was set at zero on April 1, 2005, the revenue received from the Adjustor Rate in 2005 is zero. In the illustrative Year 1, Schedule 4, the Residual (Over)/Under Collection for May is $2,695,442.

The Ending Balance with Interest (line 9) of the Balancing Account is calculated for each month by summing the Beginning Balance Less Amortization Surcharge (line 4), the Monthly Interest (line 5), and the Residual (Over)/Under Collection (line 8). In the illustrative Year 1, Schedule 4, this figure for May is $6,170,497.

Any pending Surcharge requests are entered on line 9.1 and subtracted from the Ending Balance with Interest (line 9) to produce the Ending Balance Less Surcharge Request (line 9.2). The Ending Balance Less Surcharge Request figure is subject to the $100 million cap.

Step Twelve (calculate annual adjustor rate).

The Adjustor Rate for 2005 is zero. After the end of the calendar year, APS calculates a new adjustor rate using Schedule 3 (PSA Adjustor Rate Calculation). The annual Post-Sharing (Over)/Under Collection Amount from line 14 of Schedule 1 is placed on line 1 of Schedule 3. Annual Balancing Account Interest from line 13 of Schedule 2 is brought forward to line 2 of Schedule 3. Any Approved Amortization Surcharge Balance is placed on line 3 of Schedule 3. In future years, any Bandwidth Carry Forward from the prior year is entered on line 4.

The Total (Credit)/Charge Amount (line 5) is calculated by adding the Post-Sharing (Over)/Under Collection Amount (line 1), the Annual Balancing Account Interest (line 2), and any Bandwidth Carry Forward from the prior year (line 4), and then subtracting any Approved Amortization Surcharge Balance (line 3). In the illustrative Year 1, Schedule 3, this figure is $3,401,173.

The Computed Adjustor Rate per kWh (line 8) is calculated by dividing the Total (Credit)/Charge Amount by the annual kWh Sales from line 13 of Schedule 1 less the kWh sales of low income discount rate customers. During 2005, only kWh sales from April through December are used. In the illustrative Year 1, Schedule 3, the Computed Adjustor Rate per kWh is $0.000161.

The Computed Adjustor Rate per kWh (line 8) is compared to a bandwidth of plus or minus $0.004 per kWh. If the Computed Adjustor Rate is within the bandwidth, then the Computed Adjustor Rate becomes the new Adjustor Rate. In the illustrative Year 1, Schedule 3, the Computed Adjustor Rate per kWh is $0.000161 because it is within the bandwidth. If the Computed Adjustor Rate is outside of the bandwidth, then the new Adjustor Rate would be plus or minus $0.004 as appropriate. The bandwidth limits changes in the Adjustor Rate to $0.004 from the base level (zero) over the entire term of the PSA. Any amount outside the bandwidth would be used to calculate the Bandwidth Carry Forward from Prior Period to be used in the Adjustor Rate calculation the following year.

On March 1st of each year, APS files a report with the Commission that shows the calculation of the new Adjustor Rate. The new Adjustor Rate becomes effective with APS' first billing cycle in April unless suspended by the Commission.

The new Adjustor Rate, replacing the old Adjustor Rate, plus any existing Surcharge is applied to the customer bill as a per kWh charge. The Adjustor Rate is applicable to all customers, except those on Solar-1, Solar-2, SP-1, E-3, E-4, E-36, and Direct Access service.

SUMMARY OF RECOMMENDATIONS

Q. Please summarize Staff's recommendations.

A. 1. Staff recommends that the PSA Plan of Administration, as modified herein, be approved.

2. Staff recommends that APS docket with the Commission a PSA Plan of Administration consistent with the Decision in this case within 15 days of the Decision.

Q. Does this conclude Staff's testimony?

A. Yes, it does.

RESUME

BARBARA KEENE

Education

B.S.	Political Science, Arizona State University (1976)
M.P.A.	Public Administration, Arizona State University (1982)
A.A.	Economics, Glendale Community College (1993)

Additional Training

Management Development Program - State of Arizona, 1986-1987
UPLAN Training - LCG Consulting, 1989, 1990, 1991
various seminars, workshops, and conferences on ratemaking, energy efficiency, rate design, computer skills, labor market information, training trainers, and Census products

Employment History

Arizona Corporation Commission, Utilities Division, Phoenix, Arizona: Public Utilities Analyst Manager (May 2005-present). Supervise the energy portion of the Telecommunications and Energy Section. Conduct economic and policy analyses of public utilities. Coordinate working groups of stakeholders on various issues. Prepare Staff recommendations and present testimony on electric resource planning, rate design, special contracts, energy efficiency programs, and other matters. Responsible for maintaining and operating UPLAN, a computer model of electricity supply and production costs.

Arizona Corporation Commission, Utilities Division, Phoenix, Arizona: Public Utilities Analyst V (October 2001-present), Senior Economist (July 1990-October 2001), Economist II (December 1989-July 1990), Economist I (August 1989-December 1989). Conduct economic and policy analyses of public utilities. Coordinate working groups of stakeholders on various issues. Prepare Staff recommendations and present testimony on electric resource planning, rate design, special contracts, energy efficiency programs, and other matters. Responsible for maintaining and operating UPLAN, a computer model of electricity supply and production costs.

Arizona Department of Economic Security, Research Administration, Economic Analysis Unit: Labor Market Information Supervisor (September 1985-August 1989), Research and

Statistical Analyst (September 1984-September 1985), Administrative Assistant (September 1983-September 1984). Supervised professional staff engaged in economic research and analysis. Responsible for occupational employment forecasts, wage surveys, economic development studies, and over 50 publications. Edited the monthly **Arizona Labor Market Information Newsletter**, which was distributed to about 4,000 companies and individuals.

Testimony

Resource Planning for Electric Utilities (Docket No. U-0000-90-088), Arizona Corporation Commission, 1990; testimony on production costs and system reliability.

Trico Electric Cooperative Rate Case (Docket No. U-1461-91-254), Arizona Corporation Commission, 1992; testimony on demand-side management and time-of-use and interruptible power rates.

Navopache Electric Cooperative Rate Case (Docket No. U-1787-91-280), Arizona Corporation Commission, 1992; testimony on demand-side management and economic development rates.

Arizona Electric Power Cooperative Rate Case (Docket No. U-1773-92-214), Arizona Corporation Commission, 1993; testimony on demand-side management, interruptible power, and rate design.

Tucson Electric Power Company Rate Case (Docket Nos. U-1933-93-006 and U-1933-93-066) Arizona Corporation Commission, 1993; testimony on demand-side management and a cogeneration agreement.

Resource Planning for Electric Utilities (Docket No. U-0000-93-052), Arizona Corporation Commission, 1993; testimony on production costs, system reliability, and demand-side management.

Duncan Valley Electric Cooperative Rate Case (Docket No. E-01703A-98-0431), Arizona Corporation Commission, 1999; testimony on demand-side management and renewable energy.

Tucson Electric Power Company vs. Cyprus Sierrita Corporation, Inc. (Docket No. E-0000I-99-0243), Arizona Corporation Commission, 1999; testimony on analysis of special contracts.

Arizona Public Service Company's Request for Variance (Docket No. E-01345A-01-0822), Arizona Corporation Commission, 2002; testimony on competitive bidding.

Generic Proceeding Concerning Electric Restructuring Issues (Docket No. E-00000A-02-0051), Arizona Corporation Commission, 2002; testimony on affiliate relationships and codes of conduct.

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Tucson Electric Power Company's Application for Approval of New Partial Requirements Service Tariffs, Modification of Existing Partial Requirements Service Tariff 101, and Elimination of Qualifying Facility Tariffs (Docket No. E-01933A-02-0345) and Application for Approval of its Stranded Cost Recovery (Docket No. E-01933A-98-0471), Arizona Corporation Commission, 2002, testimony on proposals to eliminate, modify, or introduce tariffs and testimony on the modification of the Market Generation Credit.

Arizona Public Service Company's Application for Approval of Adjustment Mechanisms (Docket No. E-01345A-02-0403), Arizona Corporation Commission, 2003, testimony on the proposed Power Supply Adjustment and the proposed Competition Rules Compliance Charge.

Generic Proceeding Concerning Electric Restructuring Issues, et al (Docket No. E-00000A-02-0051, et al), Arizona Corporation Commission, 2003-2005; Staff Report and testimony on Code of Conduct.

Arizona Public Service Company Rate Case (Docket No. E-01345A-03-0437), Arizona Corporation Commission, 2004; testimony on demand-side management, system benefits, renewable energy, the Returning Customer Direct Assignment Charge, and service schedules.

Arizona Electric Power Cooperative Rate Case (Docket No. E-01773A-04-0528), Arizona Corporation Commission, 2005; testimony on a fuel and purchased power cost adjustor, demand-side management, and rate design.

Trico Electric Cooperative Rate Case (Docket No. E-01461A-04-0607), Arizona Corporation Commission, 2005; testimony on the Environmental Portfolio Standard; demand-side management; special charges; and Rules, Regulations, and Line Extension Policies.

Publications

Author of the following articles published in the *Arizona Labor Market Information Newsletter*:

"1982 Mining Employees - Where are They Now?" - September 1984
"The Cost of Hiring" and "Arizona's Growing Industries" - January 1985
"Union Membership - Declining or Shifting?" - December 1985
"Growing Industries in Arizona" - April 1986
"Women's Work?" - July 1986
"1987 SIC Revision" - December 1986
"Growing and Declining Industries" - June 1987
"1986 DOT Supplement" and "Consumer Expenditure Survey" - July 1987
"The Consumer Price Index: Changing With the Times" - August 1987
"Average Annual Pay" - November 1987
"Annual Pay in Metropolitan Areas" - January 1988

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"The Growing Temporary Help Industry" - February 1988
"Update on the Consumer Expenditure Survey" - April 1988
"Employee Leasing" - August 1988
"Metropolitan Counties Benefit from State's Growing Industries" - November 1988
"Arizona Network Gives Small Firms Helping Hand" - June 1989

Major contributor to the following books published by the Arizona Department of Economic Security:

Annual Planning Information - editions from 1984 to 1989
Hispanics in Transition - 1987

(with David Berry) "Contracting for Power," *Business Economics*, October 1995.

(with Robert Gray) "Customer Selection Issues," *NRRI Quarterly Bulletin*, Spring 1998.

Reports

(with Task Force) *Report of the Task Force on the Feasibility of Implementing Sliding Scale Hookup Fees*. Arizona Corporation Commission, 1992.

Customer Repayment of Utility DSM Costs, Arizona Corporation Commission, 1995.

(with Working Group) *Report of the Participants in Workshops on Customer Selection Issues*," Arizona Corporation Commission, 1997.

"DSM Workshop Progress Report," Arizona Corporation Commission, 2004.

(with Erin Casper) "Staff Report on Demand Side Management Policy," Arizona Corporation Commission, 2005.

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Power Supply Adjustment Plan of~~for~~ Administration

Power Supply Adjustment Plan ~~for~~ of Administration

General Description

The purpose of the Power Supply Adjustment ("PSA") is to track changes in Arizona Public Service Company's ("APS" or the "Company") cost of obtaining power supplies. This is done by making an annual adjustment to the cost of fuel and purchased power embedded in APS' base rates. The PSA will apply to all fuel and purchased power costs incurred on or after April 1, 2005. The main components of the PSA are: 1) a risk sharing mechanism whereby APS and its customers share in the costs/savings on a 90% customer, 10% APS basis; 2) a bandwidth that limits the amount the PSA Adjustor Rate ("Adjustor Rate") can change over the entire term of the PSA to plus or minus $0.004 per kWh; 3) a balancing account, 4) a balancing account surcharge mechanism, separate from the Adjustor Rate, to clear the balancing account under circumstances described below; and 5) the inclusion of off-system sales.

The monthly PSA calculations shall be adjusted for the calculated net savings from the methodology approved in Decision No. 67504 (pg. 50) from the PPL Sundance docket. APS will calculate the new fuel cost savings, purchased power savings and incremental off-system margin impacts by comparing two sets of projections for its own load fuel and purchased power costs and off-system sales margins and using the difference as the net savings amounts associated with the Sundance generation units. One set of projections would assume APS ownership of the Sundance plant and the other set would assume APS did not own the Sundance plant. The PSA will be adjusted to calculate the PSA balance as if the Sundance plant was not acquired by APS. This adjustment will no longer be made once rates are effective that recover the capital and operating costs of the Sundance plant.

The results of the PSA are applied to customer's bills through the Adjustor Rate. The Adjustor Rate is applicable to APS' retail electric rate schedules (with the exception of Solar-1, Solar-2, SP-1, E-3, E-4, E-36 and Direct Access service) and is adjusted annually. It is applied to the customer's bill as a monthly kilowatt-hour ("kWh") charge that is the same for all customer classes. The Adjustor Rate is initially set at zero as of April 1, 2005. The Adjustor Rate must remain within a plus or minus $0.004 per kWh bandwidth that limits the amount it can increase or decrease in a year. Decision No. 67744 also limits the Adjustor Rate to $0.004 from the base level ($0.000) over the entire term of the PSA. Two examples of applying the two bandwidths are as follows:

1. Assume that the Adjustor Rate was set at *negative* $0.002 per kWh. The following year, the calculation of the new Adjustor Rate would indicate a new rate of *positive* $0.003 per kWh. However, since that rate would constitute a change of $0.005 from the prior year's Adjustor Rate, the new Adjustor Rate would be set

at $0.002 per kWh. That new rate would meet the limit of $0.004 from the base level.

2. Assume that the Adjustor Rate was set at $0.003 per kWh. The following year, the calculation of the new Adjustor Rate would indicate a new rate of $0.005 per kWh. Although the annual change is less than $0.004, the new rate would constitute a change from the base level that is greater than $0.004. Therefore, the new Adjustor Rate would be set at $0.004 per kWh.

Any recoverable or refundable amounts outside of the bandwidths shall be recorded in a balancing account and shall carry over to the subsequent year or years. The carryover amount shall not be subject to further sharing. Balancing account amortization surcharges are not included in the calculation of the bandwidth limits.

The Adjustor Rate, which was initially set at zero, will be reset on April 1, 2006, and thereafter on April 1st of each subsequent year. Balancing account entries are made each month starting with April 2005. These entries will effectively reflect the difference between 90 percent of incurred fuel and purchased power costs, less the balance of any approved Amortization Surcharge, and the sum of costs collected through the base cost of fuel and purchased power rate of $0.020743 plus the applicable Adjustor Rate. An Amortization Surcharge may go into effect prior to the April 1st adjustment to the Adjustor Rate if it is approved by the Arizona Corporation Commission ("Commission"). The Amortization Surcharge is described in greater detail below. The new Adjustor Rate will be effective with the first billing cycle in April unless suspended by the ~~Arizona Corporation Commission ("~~Commission~~")~~. It will not be prorated. APS will submit a publicly available report to the Commission that shows the calculation of the new Adjustor Rate on March 1, 2006 and thereafter on March 1st of each subsequent year.

Definitions

Adjustor Rate (or PSA Adjustor Rate, PSA Adjustor, PSA Adjustment, Annual Adjustment Factor) – Cents per kWh charge that was initially set at zero and is updated annually on April 1st. The purpose of this charge is to adjust the cost of fuel and purchased power embedded in APS' base rates to reflect the prior year's actual fuel and purchased power costs. This annual adjustment was approved in Decision No. 67744 and is limited to a maximum change of plus or minus 4 mills.

Amortization Surcharge (or Surcharge, PSA Surcharge) – A cents per kWh charge that can be applied to customer bills after Commission approval to collect, or refund, an amount of revenue for the purpose of reducing the PSA Bank Balance. It can be either a positive or negative charge.

Balancing Account (or PSA Balancing Account) – The PSA Balancing Account is the account where the monthly sum of the Company's post-sharing (over)/under collection is posted and also where the interest on the balance in the account is accrued. It is used to keep track of the cumulative total of the monthly postings.

Bandwidth Carry Forward from Prior Period – An amount that was outside the $0.004 limit on change in the Adjustor Rate in a particular year that is used in the calculation of the Adjustor Rate in the following year. The Bandwidth Carry Forward is calculated by subtracting $0.004 from the prior-year computed, not the actual, Adjustor Rate per kWh and multiplying the result by the annual kWh, less any amount approved to be amortized through a Surcharge.

Bank Balance (or Account Balance) – The total amount in the PSA Balancing Account.

Base Cost of Fuel and Purchased Power – The fuel and purchased power cost embedded in the base rates approved by the Commission in the Company's most recent rate case. Currently, it is $0.020743 per kWh.

Bridge PPA – A~~n~~ purchased power agreement that ensures the non-fuel power supply costs from the PWEC generation units allowed in rate base by Decision No. 67744 will be the same as those costs embedded in base rates.

ISFSI ~~– Regulatory amortization c~~Costs associated with the Independent Spent Fuel Storage Installation that will store spent nuclear fuel.

Mark--to--Market Accounting – Recording the value of qualifying commodity contracts to reflect their current market value relative to their ~~original~~ actual cost.

Native Load – Native load includes customer load in the APS control area load for which the Company has a generation service obligation and Pacifi~~c~~Corp ~~s~~Supplemental ~~s~~Sales. ~~Native load excludes Preference Power, Unisource Electric load, Tohono O'odham Utility Authority load, City of Williams (excluding APS retail customers) load and Direct Access load.~~

Pacifi~~c~~Corp Supplemental ~~s~~Sales – The Pacifi~~c~~Corp Supplemental ~~s~~Sales agreement is a long- term contract from 1990, which requires APS to offer a certain amount of energy to Pacifi~~c~~Corp each year. It is a component of the set of agreements that led to the sale of Cholla Unit 4 to Pacifi~~c~~Corp and the establishment of the seasonal diversity exchange with Pacifi~~c~~Corp.

PSA – The Power Supply Adjustment mechanism, which includes the PSA Adjustor Rate, Balancing Account, and Amortization Surcharge. The PSA mechanism is used to update the Base Cost of Fuel and Purchased Power each year for fluctuations in the Company's actual cost of fuel and purchased power.

Preference Power – Power allocated to APS wholesale customers by federal power agencies such as the Western Area Power Administration.

Surcharge Balance – The total amount of revenue expected to be collected through a Commission-approved Amortization Surcharge less the actual revenue received from the Surcharge.

System Book Fuel and Purchased Power Costs – The costs recorded for the fuel and purchased power used by APS to serve both Native Load and off-system sales, less the costs associated with applicable special contracts, E-36, RCDAC-1, the non-fuel Bridge PPA, ISFSI, mark-to-market accounting adjustments, and the savings associated with the acquisition of the Sundance plant.

System Book Off-System Sales Revenue – The revenue recorded from sales made to non-Native Load customers, for the purpose of optimizing the APS system, using APS-owned or contracted generation and purchased power, less mark-to-market accounting adjustments.

Wheeling Costs (FERC Account 565, Transmission of Electricity by Others) – Amounts payable to others for the transmission of the Company's electricity over transmission facilities owned by others.

Calculations

The Adjustor Rate shall be calculated as follows:

Part 1. Monthly Energy Sales and Costs

1. Enter the monthly PSA Retail Energy Sales (kWh) and monthly Native Load Wholesale Energy Sales. Add these two items together to produce the monthly Native Load Energy Sales. PSA Retail Energy Sales include the calendar month's retail sales. Currently, Native Load Wholesale Energy Sales include traditional sales-for-resale and Pacifi~~c~~Corp ~~s~~Supplemental ~~s~~Sales. The traditional sales-for-resale amount is the portion of load from wholesale electrical and irrigation district resale customers served by APS, but excluding the load served with ~~p~~Preference ~~p~~Power.

2. Enter the monthly System Book Fuel and Purchased Power Costs and the monthly System Book Off-System Sales Revenue. Then subtract the System Book Off-System Sales Revenue from the System Book Fuel and Purchased Power Costs to produce the monthly Net Native Load Power Supply Cost. The ~~net savings associated with the Sundance Plant are included in the~~ System Book Fuel and Purchased Power Costs shall be adjusted for the calculated net savings from the methodology approved in Decision No. 67504 from the PPL

Sundance docket. The monthly System Book Off-System Sales Revenue includes only the off-system sales using APS owned or contracted generation and purchased power related to optimizing the APS system. The off-system sales margin is embedded in the Net Native Load Power Supply Cost. The costs associated with the off-system sales are included in the System Book Fuel and Purchased Power Costs. So when the System Book Off-System Sales Revenue is subtracted from the System Book Fuel and Purchased Power Costs the difference between the off-system sales costs and revenue ends up in the Net Native Load Power Supply Cost. That difference is the off-system sales margin. A list of the items included in the PSA sales and costs described above will be included in the PSA reporting schedules filed with the Commission each month.

3. Next, calculate the PSA Retail Power Supply Cost. Divide the PSA Retail Energy Sales by the Native Load Energy Sales and then multiply the product by the Net Native Load Power Supply Cost. The annual amount of PSA Retail Power Supply Cost that can be used to calculate the annual Adjustor Rate cannot exceed $776,200,000. Any fuel or purchased power costs above that amount will not be recovered from the ratepayers through the PSA.

4. Directly-assigned power supply costs and related energy sales from applicable Special Contract customers, Schedule E-36 customers and customers returning to Standard Offer service from competitive generation subject to Returning Customer Direct Access Charge ("RCDAC") treatment will be deducted prior to the above calculations.

Part 2. Calculation of the (Over)/Under Collection

1. The amount recovered by the power supply cost embedded in base rates has to be calculated in order to determine the monthly (over)/under collection. To calculate the monthly Base Rate Power Supply cost, multiply the PSA Retail Energy sales by the base cost of fuel and purchased power of $0.020743 per kWh. The revenue collected from an Adjustor Rate is credited to the Balancing Account (described below). For example, in April 2006 if there is an Adjustor Rate of $0.004 in effect, all of the revenue collected from that charge goes into the Balancing Account as a credit to the balance.

2. The next step is to subtract the monthly Base Rate Power Supply Cost from the PSA Retail Power Supply Cost to get the monthly Pre-Sharing (Over)/Under Collection amount.

Part 3. Sharing Incentive

1. The Post-Sharing (Over)/Under Collection amount is calculated by multiplying the Pre-Sharing (Over)/Under Collection by 90%. This

calculation is done to implement the 90%/10% sharing incentive. As described above APS and its customers share the costs/savings on a 90% customer and 10% APS basis. The monthly Post-Sharing (Over)/Under Collection amounts are summed for the year and used in the Adjustor Rate calculation.

Part 4. Adjustor Rate Calculation

1. Sum the calendar year's monthly Post-Sharing (Over)/Under Collection amounts.

2. Sum the calendar year's Balancing Account Monthly Interest to produce the Annual Balancing Account Interest. It includes interest from the Balancing Account and any outstanding balances from Commission-approved Amortization Surcharges, if the Surcharge balance was approved to accrue interest. This amount is recovered through the PSA and used in the Adjustor Rate calculation. The calculation of the Monthly Interest is described in more detail below in the Balancing Account section.

3. Subtract any Commission approved Amortization Surcharge balances. If the Commission approves an Amortization Surcharge balance it will be subtracted from the total costs used to calculate the April 1st Adjustor Rate.

~~3.~~4. Bring forward the Bandwidth Carry Forward from Prior Period, if any. If the Adjustor Rate Bandwidth (described below) allows for just a partial recovery of the Total (Credit)/Charge amount then the portion that is not eligible for crediting/collection in the current year is carried forward to next year as the Bandwidth Carry Forward from Prior Period. The carryover amount is not subject to further sharing.

~~4.~~5. Add the Post-Sharing (Over)/Under Collection amount, Annual Balancing Account Interest and the Bandwidth Carry Forward from Prior Period together to determine the Total (Credit)/Charge Amount.

~~5.~~6. The Computed Adjustor Rate is calculated by dividing the Total Credit/Charge Amount by the Actual Energy Sales (kWh) from the prior calendar year. The calculation of the April 1, 2006, Adjustor Rate will only include data from April through December 2005. The Computed Adjustor Rate is then compared to the plus or minus $0.004 per kWh bandwidth. The Actual Energy Sales amount will exclude E-3, E-4 and E-36 sales.

~~6.~~7. The Adjustor Rate Bandwidth Upper Limit is $0.004 per kWh. The Adjustor Rate Bandwidth Lower Limit is $(0.004) per kWh.

~~7.~~8. If the Computed Adjustor Rate is inside the bandwidth, the Computed Adjustor Rate becomes the Applicable Adjustor Rate. It is then applied to the customer's monthly bills for the next 12 months.

~~8.~~9. If the Computed Adjustor Rate is outside the bandwidth, the Applicable Adjustor Rate can be no higher than the upper limit of the bandwidth and no lower than the lower limit of the bandwidth.

~~9.~~10. If the Computed Adjustor Rate is outside the bandwidth, then the Bandwidth Carry Forward from Prior Period amount must be calculated. This is done by multiplying the Applicable Adjustor Rate by the Actual Energy Sales (kWh) for the next 12 months and subtracting the total from the Total (Credit)/Charge Amount used to calculate the Applicable Adjustor Rate.

Examples of these calculations are attached as Year 1, Schedules 1 through 3 and Year 2, Schedules 1 through 3. The attached schedules include two year's of schedules and two Amortization Surcharge examples.

Balancing Account and Amortization Surcharge

The PSA Balancing Account is where the monthly sum of the Company's post-sharing (over)/under collection is posted and also where interest on the balance in the account is accrued. It is used to track the cumulative total of the monthly postings. APS shall establish a PSA Balancing Account on April 1, 2005. Entries to the Balancing Account shall be made each month as follows:

1. A debit or credit entry equal to the difference between the Post-Sharing (Over)/Under Collection and the sum of the amounts recovered by the Applicable Adjustor Rate. The Post-Sharing (Over)/Under Collection is calculated by taking the amount recovered through the Base Rate Power Supply Cost of $0.020743 and subtracting it from the PSA Retail Power Supply Cost. The product of that subtraction is then multiplied by 90% to reduce the recoverable costs in accordance with the 90%/10% sharing incentive.

2. ~~A debit or credit entry equal to the kilowatt-hours billed for the month under the rate schedules subject to the Adjustor Rate multiplied by the effective Amortization Surcharge (as described below). If an Amortization Surcharge is not in effect, then no entry will be made.~~ Any Amortization Surcharge balance will be shown separately on the monthly reports for the Commission Staff, and, unless otherwise ordered by the Commission, shall not be considered as part of the Balancing Account.

3. A monthly debit or credit entry for interest to be applied to the account balance based on effective one-year Nominal Treasury Constant Maturities rate that is contained in the Federal Reserve Statistical Release, H-15, or its successor publication. This includes the Amortization Surcharge balance(s), if the Surcharge balance was approved to accrue interest. This is called the Monthly Interest and is used above in the Adjustor Rate calculations. The interest rate will be adjusted annually on the first business day of the calendar year in the same manner as the APS customer deposit rate.

4. A debit or credit entry for refunds or payments authorized by the Commission.

An example of the Balancing Account calculation is included as Year 1, Schedule 4 and Year 2, Schedule 4.

Although the Company may file a request for an Amortization Surcharge at any time, the Company is required to make a filing in the following circumstances. If the size of the Balancing Account, as shown in the monthly reports filed with the Commission, reaches plus or minus $50 million, the Company has up to forty-five days to either file a request for Commission approval of an Amortization Surcharge or an explanation of why such a surcharge isn't necessary. In no event shall the Company allow the Balancing Account to reach $100 million prior to seeking recovery or refund.[1] Should the Company seek to recover or refund an amount from the Balancing Account, the timing and manner of recovery, or refund, and whether interest will be allowed to accrue on the Surcharge balance, will be addressed at that time.

Once the Company has filed seeking recovery or refund through an Amortization Surcharge, the amount requested in such filing will be excluded from the balance used to determine if the $100 million threshold has been reached (see chart below).

(a)	(b)	(c)	(d)	(e)
Month	Month's Post-Sharing (Over)/Under Collection	End of Month Balancing Account Balance	June 15th Amortization Surcharge Request	Balance for $100M Threshold (c + d)
May	$7,000,000	$60,000,000	$0	$60,000,000
June	$10,000,000	$70,000,000	$(60,000,000)	$10,000,000
July	$30,000,000	$100,000,000	$(60,000,000)	$40,000,000

For example, the Company has a balance of $60 million for May and it files an Amortization Surcharge request on June 15th for $60 million and the post-sharing under-

[1] ~~The Commission Staff believes that the operation of the $100 Million "cap" on the Balancing Account requires further review and discussion prior to final approval of this Plan for Administration.~~

collection for June is $10 million. The resulting June Balancing Account balance is $70 million. The balance for the purpose of determining if the Company has met the $100 million threshold for June is $10 million ($70 million balance - $60 million request = $10 million). Moving to the next month, July has a post-sharing under-collection of $30 million so the balance for the $100 million threshold calculation is $40 million ($100 million balance – $60 million request = $40 million).

The $100 million threshold would apply each time the Company makes a filing with the Commission to address a Balancing Account balance between $50 and $100 million. After the Company makes the filing, if new accumulations in the Balancing Account were between $50 and $100 million, the Company could make a second, separate filing. Subsequently, it is possible that additional filings could be made with the $100 million threshold being applied separately to the amount being addressed in each filing. Following a proceeding authorizing recovery or refund of a bank balance between $50 million and $100 million, the balance considered in the proceeding shall be reset to zero unless otherwise ordered by the Commission.

Compliance Reports

Beginning June 6, 2005, the Company shall provide monthly reports to Staff's Compliance Section and to the Residential Utility Consumer Office detailing all calculations related to the PSA. An APS Officer shall certify under oath that all information provided in the reports itemized below is true and accurate to the best of his or her information and belief. These monthly reports shall thereafter be due on the first day of the third month following the end of the reporting month.

The publicly available reports will include at a minimum:

1. The Balancing Account calculations, including all input and outputs.
2. Total power and fuel costs.
3. Customer sales in both kWh and dollars by customer class.
4. The number of customers by customer class.
5. A detailed listing of all items excluded from the PSA calculations.
6. A detailed listing of any adjustments to the adjustor reports.
7. Total off-system sales revenues.
8. System losses in MW and MW~~H~~h.
9. Monthly maximum retail demand in MW.
10. Identification of a contact person and phone number from the Company for questions.

Beginning June 6, 2005, the Company shall provide to Commission Staff monthly reports containing the information listed below. These reports shall thereafter be due on the first day of the third month following the end of the reporting month. All of these additional reports will be filed confidentially.

The information for each generating unit shall include the following items:

1. The net generation, in MW~~H~~h per month, and twelve months cumulatively.
2. The average heat rate, both monthly and twelve-month average.
3. The equivalent forced-outage rate, both monthly and twelve-month average.
4. The outage information for each month including, but not limited to, event type, start date and time, end date and time, and a description.
5. Total fuel costs per month.
6. The fuel cost per kWh per month.

The information on power purchases shall include the following items per seller:

1. The quantity purchased in MW~~H~~h.
2. The demand purchased in MW to the extent specified in the contract.
3. The total cost for demand to the extent specified in the contract.
4. The total cost of energy.

Information on economy interchange purchases may be aggregated. These reports shall also include an itemization of off-system sales margins per buyer. Further detail on off-system sales margin will be provided to the Commission Staff on a confidential basis for review.

Fuel purchase information shall include:

1. Natural gas interstate pipeline costs, itemized by pipeline and by individual cost components, such as reservation charge, usage, surcharges and fuel.
2. Natural gas commodity costs, categorized by short term purchases (one month or less) and longer term purchases, including price per therm, total cost, supply basin, and volume by contract.

By June 6, 2005, the Company shall provide the information itemized above relating to the base cost of fuel and purchased power adopted for the test year settlement revenue requirement.

Work_papers and other documents that contain proprietary or confidential information will be filed with the Commission Staff under an appropriate confidentiality agreement. APS will keep fuel and purchased power invoices and contracts available for Commission review. All of the information is available during the year, upon Commission request. The Commission has the right to review the prudence of fuel and power purchases and any calculations associated with the PSA at any time. Any costs flowed through the PSA are subject to refund, if those costs are found to be imprudently incurred.

Allowable Costs

The allowable ~~Adjustor Rate~~PSA costs include fuel and purchased power costs incurred to provide service to retail customers. Additionally, the prudent direct costs of contracts used for hedging system fuel and purchased power will be recovered under the PSA. The Base Rate Power Supply Cost will be the allowable ~~Adjustor Rate~~power supply costs from the test year used to determine retail electric rates. The allowable cost components presently include the following Federal Energy Regulatory Commission ("FERC") accounts[2]:

1. 501 Fuel (Steam)
2. 518 Fuel (Nuclear) less ISFSI regulatory amortization
3. 547 Fuel (Other Production)
4. 555 Purchased Power less non-fuel Bridge PPA costs
5. 565 Wheeling (Transmission of Electricity by Others)
6. ~~6.~~

These accounts are subject to change if the Federal Energy Regulatory Commission alters its accounting requirements or definitions.

Directly Assignable Power Supply Costs Excluded

Decision No. 66567 provides APS the ability to recover reasonable and prudent costs associated with customers who have left APS Standard Offer service, including Special Contract rates, for a competitive generation supplier and then return to Standard Offer service. For administrative purposes, customers who were Direct Access customers since origination of service and request Standard Offer service would be considered to be returning customers. In such cases, a direct assignment or special adjustment may be applied that recognizes the cost differential between the power purchases needed to accommodate the Returning Customer and the power supply cost component of the otherwise applicable Standard Offer service rate. This process is described in the Returning Customer Direct Access Charge rate schedule and Plan for Administration filed with the Commission.

In addition, if APS purchases power under specific terms on behalf of a Standard Offer Special Contract customer, the costs of that power may be directly assigned. In both cases, where specific power supply costs are identified and directly assigned to a large Returning Customer or Standard Offer Special Contract customer or group of customers, these costs will be excluded from the Adjustor Rate calculations. Schedule E-36 customers are directly assigned power supply costs based on the APS system incremental

[2] ~~The Commission Staff believes that the inclusion of FERC Account 557 (Broker Fees) and 565 (Wheeling) costs as allowable PSA cost components requires further review and discussion prior to the final approval of this Plan for Administration.~~

cost at the time the customer is consuming power from the APS system so their power supply costs are excluded from the PSA.

ARIZONA PUBLIC SERVICE COMPANY
Year 1, Schedule 1
Example PSA Calculation Methodology
Monthly Energy Sales and Costs

Line No.	Month	(a) PSA Retail[1] Energy Sales (kWh)	(b) Native Load[2] Wholesale Energy Sales (kWh)	(c) Native Load Energy Sales (kWh)	(d) System[3] Book Fuel and Purchased Power Costs	(e) System Book[4] Off-System Sales Revenue	(f) Net Native Load Power Supply Cost	(g) PSA Retail[5] Power Supply Cost	(h) Base Rate Power Supply Cost	(i) Pre-Sharing (Over)/Under Collection	(j) Post-Sharing (Over)/Under Collection
				(a + b)			(d - e)	(a/c * f)	(a * 0.020743)	(g - h)	(i * 0.9)
1	January	-	-	-	$ -	$ -	$ -	$ -	$ -	$ -	$ -
2	February	-	-	-	$ -	$ -	$ -	$ -	$ -	$ -	$ -
3	March	-	-	-	$ -	$ -	$ -	$ -	$ -	$ -	$ -
4	April	1,944,192,000	105,803,000	2,049,995,000	$ 50,508,900	$ 3,924,000	$ 46,584,900	$ 44,180,591	$ 40,328,375	$ 3,852,216	$ 3,466,994
5	May	2,279,426,000	102,849,000	2,382,275,000	$ 56,566,800	$ 4,021,200	$ 52,545,600	$ 50,277,070	$ 47,282,134	$ 2,994,936	$ 2,695,442
6	June	2,585,070,000	113,325,000	2,698,395,000	$ 73,206,000	$ 5,178,600	$ 68,027,400	$ 65,170,441	$ 53,622,107	$ 11,548,334	$ 10,393,501
7	July	2,909,896,000	110,933,000	3,020,829,000	$ 93,020,400	$ 6,676,200	$ 86,344,200	$ 83,173,408	$ 60,359,973	$ 22,813,435	$ 20,532,092
8	August	3,115,407,000	96,318,000	3,211,725,000	$ 96,375,600	$ 6,095,700	$ 90,279,900	$ 87,572,452	$ 64,622,887	$ 22,949,565	$ 20,654,609
9	September	2,560,314,000	85,311,000	2,645,625,000	$ 71,951,400	$ 4,779,000	$ 67,172,400	$ 65,006,354	$ 53,108,593	$ 11,897,761	$ 10,707,985
10	October	2,014,216,000	93,883,000	2,108,099,000	$ 50,512,500	$ 5,705,100	$ 44,807,400	$ 42,811,928	$ 41,780,882	$ 1,031,046	$ 927,941
11	November	1,921,888,000	96,941,000	2,018,829,000	$ 42,744,600	$ 6,106,500	$ 36,638,100	$ 34,878,796	$ 39,865,723	$ (4,986,927)	$ (4,488,234)
12	December	2,062,795,000	89,746,000	2,152,541,000	$ 49,290,300	$ 7,229,700	$ 42,060,600	$ 40,306,965	$ 42,788,557	$ (2,481,592)	$ (2,233,433)
13	Total	21,393,204,000	895,109,000	22,288,313,000	$ 584,176,500	$ 49,716,000	$ 534,460,500	$ 513,378,005	$ 443,759,231	$ 69,618,774	
14									Move forward to Schedule 3, Line 1		$ 62,656,897

[1] PSA Retail Energy Sales are the calendar month's kWh sales. Retail Energy Sales of 58,000 MWhs on rate schedules E-36 and RCDAC-1 were excluded from the PSA Calculations this year.

[2] Includes traditional sales-for-resale and Pacificorp supplemental sales.

[3] Includes native load and off-system fuel and purchased power costs less those costs associated with E-36, the non-fuel Bridge PPA, ISFSI and mark-to-market accounting adjustments. Sundance net savings are excluded~~included~~.

[4] Includes off-system revenue less mark-to-market accounting adjustments.

[5] The maximum annual amount that can be used for the PSA calculation is $776,200,000.

Definitions of commonly used terms for this filing are included in the PSA Plan for Administration. Any new terms will be defined on this page.

ARIZONA PUBLIC SERVICE COMPANY
Year 1, Schedule 2
Example PSA Calculation Methodology
Annual Balancing Account Interest

Line No.	Month		Balancing Account Monthly Interest
			(Schedule 4, Line 216)
1	January	$	-
2	February	$	-
3	March	$	-
4	April	$	-
5	May	$	8,061
6	June	$	14,346
7	July	$	38,545
8	August	$	86,371
9	September	$	134,594
10	October	$	159,803
11	November	$	162,332
12	December	$	140,224
13	Total	$	744,276

Move Forward to Schedule 3, Line 2 | $ 744,276 |

ARIZONA PUBLIC SERVICE COMPANY
Year 1, Schedule 3
Example PSA Calculation Methodology
PSA Adjustor Rate Calculation

Line No.	PSA Adjustor Rate Calculation			
1	Post-Sharing (Over)/Under Collection Amount (From Sch. 1)		$ 62,656,897	
2	Annual Balancing Account Interest (From Sch. 2)		$ 744,276	
3	Less: Approved Amortization Surcharge Balance (Nov. 1, 2005) [1]		$ 60,000,000	
4	Bandwidth Carry Forward from Prior Period		$ -	
5	Total (Credit)/Charge Amount (Line 1 + Line 2 - Line 3 +Line 4)			$ 3,401,173
6	Total (Credit)/Charge Amount	$ 3,401,173		
7	Actual Energy Sales without E-3, E-4 and E-36 (kWh)	21,132,204,000		
8	Computed Adjustor Rate per kWh (Line 6 / Line 7)		$ 0.000161	
8.1	Current Adjustor Rate per kWh	$ -		
8.2	Diff. between Current Adj. Rate and Computed Adj. Rate (line 8.1 - line 8)	$ 0.000161		
	Adjustor Rate Bandwidth			
9	Adjustor Rate Bandwidth Upper Limit		$ 0.004000	
10	Adjustor Rate Bandwidth Lower Limit		$ (0.004000)	
11	Applicable Adjustor Rate per kWh for April 1, 2006 (EXAMPLE)			**$ 0.000161**
12	Total (Credit)/Charge Carried Forward Due to Adjustor Rate Bandwidth			$ -

[1] This hypothetical example assumes the Commission approval of a $60 Million Amortization Surcharge request that was made in September after the Balancing Account exceeded $50 Million. The requested Amortization Surcharge of .002697 is effective on November 1, 2005, and expires on October 31, 2006, or when $60 million is received through the Surcharge.

ARIZONA PUBLIC SERVICE COMPANY
Year 1, Schedule 4
Example of PSA Calculation Methodology
Monthly Balancing Account Calculations

Line No.		January	February	March	April	May	June	July	August	September	October	November	December
	BALANCING ACCOUNT LESS APPROVED AMORTIZATION SURCHARGE BALANCE								Ending Balance[1] Exceeds $50M			Nov. 1, 2005[1] Surcharge Begins	
1	PSA Adjustor Rate (Initially set at zero until April 1, 2006)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
2	Beginning Balance	$ -	$ -	$ -	$ -	$ 3,466,994	$ 6,170,497	$ 16,578,344	$ 37,148,981	$ 57,889,961	$ 68,732,540	$ 69,820,284	$ 5,494,382
3	Less: Approved Balance for Amortization Surcharge (if any)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 60,000,000	$ -
4	Balance Less Amort. Surcharge (Ln. 2 - Ln. 3)	$ -	$ -	$ -	$ -	$ 3,466,994	$ 6,170,497	$ 16,578,344	$ 37,148,981	$ 57,889,961	$ 68,732,540	$ 9,820,284	$ 5,494,382
5	Monthly Int. ((Ln. 4 * (2.79%/12) + Ln. 13) 1yr. Const. Mat. Rate)	$ -	$ -	$ -	$ -	$ 8,061	$ 14,346	$ 38,545	$ 86,371	$ 134,594	$ 159,803	$ 162,332	$ 140,224
6	Post-Sharing (Over)/Under Collection (From Sch. 1)	$ -	$ -	$ -	$ 3,466,994	$ 2,695,442	$ 10,393,501	$ 20,532,092	$ 20,654,609	$ 10,707,985	$ 927,941	$ (4,488,234)	$ (2,233,433)
7	Less: Revenue from Applicable Adjustor Rate	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
8	Residual (Over)/Under Collection (Ln. 6 - Ln. 7)	$ -	$ -	$ -	$ 3,466,994	$ 2,695,442	$ 10,393,501	$ 20,532,092	$ 20,654,609	$ 10,707,985	$ 927,941	$ (4,488,234)	$ (2,233,433)
9	Ending Balance with Interest (Ln. 4 + Ln. 5 + Ln. 8)	$ -	$ -	$ -	$ 3,466,994	$ 6,170,497	$ 16,578,344	$ 37,148,981	$ 57,889,961	$ 68,732,540	$ 69,820,284	$ 5,494,382	$ 3,401,173
9.1	Pending Surcharge Request	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 60,000,000	$ 60,000,000	$ -	$ -
9.2	Ending Balance Less Surcharge Request	$ -	$ -	$ -	$ 3,466,994	$ 6,170,497	$ 16,578,344	$ 37,148,981	$ 57,889,961	$ 8,732,540	$ 9,820,284	$ 5,494,382	$ 3,401,173
	EXAMPLE NOVEMBER 1, 2005 APPROVED AMORTIZATION SURCHARGE BALANCE												
10	Balancing Account Amort. Surcharge per kWh	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 0.002697	$ 0.002697
11	Beginning Amortization Surcharge Balance	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 60,000,000	$ 54,817,132
12	Less: Revenue from Applicable Amortization Surcharge(s)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 5,182,868	$ 5,562,860
13	Ending Amortization Surcharge Balance (Ln. 11 - Ln. 12)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 54,817,132	$ 49,254,272
14	Amort. Monthly Int. ((Ln. 11 * (2.79%/12)) 1yr. Const. Mat. Rate)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 139,500	$ 127,450
	COMBINED BALANCE												
15	Combined Balance (Ln. 9 + Ln. 13)	$ -	$ -	$ -	$ 3,466,994	$ 6,170,497	$ 16,578,344	$ 37,148,981	$ 57,889,961	$ 68,732,540	$ 69,820,284	$ 60,311,514	$ 52,655,445
16	Combined Interest (Ln. 5)	$ -	$ -	$ -	$ -	$ 8,061	$ 14,346	$ 38,545	$ 86,371	$ 134,594	$ 159,803	$ 162,332	$ 140,224

[1] This hypothetical example assumes the Commission approval of a $60 Million Amortization Surcharge request that was made in September after the Balancing Account exceeded $50 Million in August (see line 9 above). The requested Amortization Surcharge of $0.002697 is effective on November 1, 2005, and expires on October 31, 2006, or when $60 million is received through the Surcharge.

ARIZONA PUBLIC SERVICE COMPANY
Year 2, Schedule 1
Example PSA Calculation Methodology
Monthly Energy Sales and Costs

Line No.	Month	(a) PSA Retail [1] Energy Sales (kWh)	(b) Native Load [2] Wholesale Energy Sales (kWh)	(c) Native Load Energy Sales (kWh)	(d) System [3] Book Fuel and Purchased Power Costs	(e) System Book [4] Off-System Sales Revenue	(f) Net Native Load Power Supply Cost	(g) PSA Retail [5] Power Supply Cost	(h) Base Rate Power Supply Cost	(i) Pre-Sharing (Over)/Under Collection	(j) Post-Sharing (Over)/Under Collection
				(a + b)			(d - e)	(a/c * f)	(a * 0.020743)	(g - h)	(i * 0.9)
1	January	2,166,760,000	94,269,000	2,261,029,000	$ 59,739,000	$ 7,594,000	$ 52,145,000	$ 49,970,920	$ 44,945,103	$ 5,025,817	$ 4,523,235
2	February	2,123,854,000	92,403,000	2,216,257,000	$ 58,557,000	$ 7,444,000	$ 51,113,000	$ 48,981,932	$ 44,055,104	$ 4,926,828	$ 4,434,145
3	March	2,102,401,000	91,469,000	2,193,870,000	$ 57,965,000	$ 7,369,000	$ 50,596,000	$ 48,486,501	$ 43,610,104	$ 4,876,397	$ 4,388,757
4	April	2,021,960,000	110,035,000	2,131,995,000	$ 60,611,000	$ 4,081,000	$ 56,530,000	$ 53,612,414	$ 41,941,516	$ 11,670,898	$ 10,503,808
5	May	2,370,603,000	106,963,000	2,477,566,000	$ 67,880,000	$ 4,182,000	$ 63,698,000	$ 60,947,991	$ 49,173,418	$ 11,774,573	$ 10,597,116
6	June	2,688,473,000	117,858,000	2,806,331,000	$ 87,847,000	$ 5,386,000	$ 82,461,000	$ 78,997,870	$ 55,766,995	$ 23,230,875	$ 20,907,788
7	July	3,026,292,000	115,370,000	3,141,662,000	$ 111,624,000	$ 6,943,000	$ 104,681,000	$ 100,836,841	$ 62,774,375	$ 38,062,466	$ 34,256,219
8	August	3,240,023,000	100,171,000	3,340,194,000	$ 115,651,000	$ 6,340,000	$ 109,311,000	$ 106,032,810	$ 67,207,797	$ 38,825,013	$ 34,942,512
9	September	2,662,727,000	88,723,000	2,751,450,000	$ 86,342,000	$ 4,970,000	$ 81,372,000	$ 78,748,086	$ 55,232,946	$ 23,515,140	$ 21,163,626
10	October	2,094,785,000	97,638,000	2,192,423,000	$ 60,615,000	$ 5,933,000	$ 54,682,000	$ 52,246,776	$ 43,452,125	$ 8,794,651	$ 7,915,186
11	November	1,998,764,000	100,819,000	2,099,583,000	$ 51,294,000	$ 6,351,000	$ 44,943,000	$ 42,784,901	$ 41,460,362	$ 1,324,539	$ 1,192,085
12	December	2,145,307,000	93,336,000	2,238,643,000	$ 59,148,000	$ 7,519,000	$ 51,629,000	$ 49,476,426	$ 44,500,103	$ 4,976,323	$ 4,478,691
13	Total	28,641,949,000	1,209,054,000	29,851,003,000	$ 877,273,000	$ 74,112,000	$ 803,161,000	$ 771,123,468	$ 594,119,948	$ 177,003,520	
14										Move forward to Schedule 3, Line 1	$ 159,303,168

[1] PSA Retail Energy Sales are the calendar month's kWh sales. Retail Energy Sales of 60,000 MWhs on rate schedules E-36 and RCDAC-1 were excluded from the PSA Calculations this year.

[2] Includes traditional sales-for-resale and Pacificorp supplemental sales.

[3] Includes native load and off-system fuel and purchased power costs less those costs associated with E-36, the non-fuel Bridge PPA, ISFSI and mark-to-market accounting adjustments. Sundance net savings are excluded.

[4] Includes off-system revenue less mark-to-market accounting adjustments.

[5] *The maximum annual amount that can be used for the PSA calculation is $776,200,000.*

Definitions of commonly used terms for this filing are included in the PSA Plan for Administration. Any new terms will be defined on this page.

ARIZONA PUBLIC SERVICE COMPANY
Year 2, Schedule 2
Example PSA Calculation Methodology
Annual Balancing Account Interest

Line No.	Month	Balancing Account Monthly Interest (Schedule 4, Line 21)
1	January	$ 122,424
2	February	$ 119,640
3	March	$ 117,145
4	April	$ 114,644
5	May	$ 126,072
6	June	$ 135,397
7	July	$ 166,571
8	August	$ 226,568
9	September	$ 286,837
10	October	$ 314,930
11	November	$ 316,931
12	December	$ 304,092
13	Total	$ 2,351,251

Move Forward to Schedule 3, Line 2 $ 2,351,251

ARIZONA PUBLIC SERVICE COMPANY
Year 2, Schedule 3
Example PSA Calculation Methodology
PSA Adjustor Rate Calculation

Line No.	PSA Adjustor Rate Calculation			
1	Post-Sharing (Over)/Under Collection Amount (From Sch. 1)		$ 159,303,168	
2	Annual Balancing Account Interest (From Sch. 2)		$ 2,351,251	
3	Less: Approved Amortization Surcharge Balance (September 1, 2006)[1]		$ 100,000,000	
4	Bandwidth Carry Forward from Prior Period		$ -	
5	Total (Credit)/Charge Amount (Line 1 + Line 2 - Line 3 +Line 4)			$ 61,654,419
6	Total (Credit)/Charge Amount	$ 61,654,419		
7	Actual Energy Sales without E-3, E-4 and E-36 (kWh)	28,380,949,000		
8	Computed Adjustor Rate per kWh (Line 6 / Line 7)		$ 0.002172	
8.1	Current Adjustor Rate per kWh	$ 0.000161		
8.2	Diff. between Current Adj. Rate and Computed Adj. Rate (line 8.1 - line 8)	$ 0.002011		
	Adjustor Rate Bandwidth			
9	Adjustor Rate Bandwidth Upper Limit		$ 0.004000	
10	Adjustor Rate Bandwidth Lower Limit		$ (0.004000)	
11	Applicable Adjustor Rate per kWh for April 1, 2007 (EXAMPLE)			**$ 0.002172**
12	Total (Credit)/Charge Carried Forward Due to Adjustor Rate Bandwidth			$ -

[1] This hypothetical example assumes the Commission approval of a $100 million Amortization Surcharge request that was made in July 2006 after the Balancing Account again exceeded $50 million. The requested Amortization Surcharge of $0.003357 is effective on September 1, 2006, and expires on August 31, 2007, or when $100 million is received through the Surcharge.

ARIZONA PUBLIC SERVICE COMPANY
Year 2, Schedule 4
Example of PSA Calculation Methodology
Monthly Balancing Account Calculations

Line No.		January	February	March	April	May	June	July	August	September	October	November	December
					1st Adjustor[1] Rate Change		Ending Balance[2] Exceeds $50M Again			Sep. 1, 2006[2] Surcharge Begins			
	BALANCING ACCOUNT LESS APPROVED AMORTIZATION SURCHARGE BALANCE												
1	PSA Adjustor Rate (from Year 1, Sch. 3, Ln. 11)	$ -	$ -	$ -	$0.000161	$0.000161	$0.000161	$0.000161	$0.000161	$0.000161	$0.000161	$0.000161	$0.000161
2	Beginning Balance	$ 3,401,173	$ 8,046,832	$ 12,600,617	$ 17,106,519	$ 27,399,542	$ 37,741,187	$ 58,351,670	$ 92,287,386	$ 126,934,993	$ 44,392,737	$ 52,285,703	$ 53,473,023
3	Less: Approved Balance for Amortization Surcharge (if any)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 100,000,000	$ -	$ -	$ -
3.1	Less: Over-collection from November 2005 Surcharge	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 3,564,160	$ -	$ -	$ -
4	Balance Less Amort. Surcharge (Ln. 2 - Ln. 3)	$ 3,401,173	$ 8,046,832	$ 12,600,617	$ 17,106,519	$ 27,399,542	$ 37,741,187	$ 58,351,670	$ 92,287,386	$ 23,370,833	$ 44,392,737	$ 52,285,703	$ 53,473,023
5	Monthly Int. ((Ln. 4 * (2.79%/12) + Ln. 14 + Ln. 19) 1yr. Con. Mat. Ra	$ 122,424	$ 119,640	$ 117,145	$ 114,644	$ 126,072	$ 135,397	$ 166,571	$ 226,568	$ 286,837	$ 314,930	$ 316,931	$ 304,092
6	Post-Sharing (Over)/Under Collection (From Sch. 1)	$ 4,523,235	$ 4,434,145	$ 4,388,757	$ 10,503,808	$ 10,597,116	$ 20,907,788	$ 34,256,219	$ 34,942,512	$ 21,163,626	$ 7,915,186	$ 1,192,085	$ 4,478,691
7	Less Revenue from Applicable Adjustor Rate	$ -	$ -	$ -	$ 325,429	$ 381,542	$ 432,703	$ 487,074	$ 521,473	$ 428,559	$ 337,150	$ 321,696	$ 345,282
8	Residual (Over)/Under Collection (Ln. 5 - Ln. 6)	$ 4,523,235	$ 4,434,145	$ 4,388,757	$ 10,178,379	$ 10,215,574	$ 20,475,085	$ 33,769,145	$ 34,421,039	$ 20,735,067	$ 7,578,036	$ 870,389	$ 4,133,409
9	Ending Balance with Interest (Ln. 4 + Ln. 5 + Ln. 8)	$ 8,046,832	$ 12,600,617	$ 17,106,519	$ 27,399,542	$ 37,741,187	$ 58,351,670	$ 92,287,386	$ 126,934,993	$ 44,392,737	$ 52,285,703	$ 53,473,023	$ 57,910,524
9.1	Pending Surcharge Request	$ -	$ -	$ -	$ -	$ -	$ -	$ 100,000,000	$ 100,000,000	$ -	$ -	$ -	$ -
9.2	Ending Balance Less Surcharge Request	$ 8,046,832	$ 12,600,617	$ 17,106,519	$ 27,399,542	$ 37,741,187	$ 58,351,670	$ (7,712,614)	$ 26,934,993	$ 44,392,737	$ 52,285,703	$ 53,473,023	$ 57,910,524
	EXAMPLE NOVEMBER 1, 2005 APPROVED AMORTIZATION SURCHARGE BALANCE												
10	Balancing Account Amort. Surcharge per kWh	$ 0.002697	$ 0.002697	$ 0.002697	$ 0.002697	$ 0.002697	$ 0.002697	$ 0.002697	$ 0.002697	$ -	$ -	$ -	$ -
11	Beginning Amortization Surcharge Balance	$ 49,254,272	$ 43,411,043	$ 37,784,452	$ 32,202,633	$ 26,824,766	$ 20,494,190	$ 13,291,676	$ 5,161,400	$ -	$ -	$ -	$ -
12	Less: Revenue from Applicable Amortization Surcharge(s)	$ 5,843,229	$ 5,727,522	$ 5,669,668	$ 5,452,738	$ 6,392,944	$ 7,250,163	$ 8,161,179	$ 8,737,560	$ -	$ -	$ -	$ -
13	Ending Amortization Surcharge Balance (Ln. 11 - Ln. 12)	$ 43,411,043	$ 37,784,452	$ 32,202,633	$ 26,824,766	$ 20,494,190	$ 13,291,676	$ 5,161,400	$ (3,564,160)	$ -	$ -	$ -	$ -
14	Amort. Monthly Int. ((Ln. 11 * (2.79%/12)) 1yr. Const. Mat. Rate)	$ 114,516	$ 100,931	$ 87,849	$ 74,871	$ 62,368	$ 47,649	$ 30,903	$ 12,000	$ -	$ -	$ -	$ -
	EXAMPLE SEPTEMBER 1, 2006 APPROVED AMORTIZATION SURCHARGE BALANCE												
15	Balancing Account Amort. Surcharge per kWh	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 0.003357	$ 0.003357	$ 0.003357	$ 0.003357
16	Beginning Amortization Surcharge Balance	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 100,000,000	$ 91,061,225	$ 84,029,032	$ 77,319,181
17	Less: Revenue from Applicable Amortization Surcharge(s)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 8,938,775	$ 7,032,193	$ 6,709,851	$ 7,201,796
18	Ending Amortization Surcharge Balance (Ln. 16 - Ln. 17)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 91,061,225	$ 84,029,032	$ 77,319,181	$ 70,117,386
19	Amort. Monthly Int. ((Ln. 16 * (2.79%/12)) 1yr. Const. Mat. Rate)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 232,500	$ 211,717	$ 195,367	$ 179,767
	COMBINED BALANCE												
20	Combined Balance (Ln. 9 + Ln. 13 + Ln. 18)	$ 51,457,875	$ 50,385,069	$ 49,309,152	$ 54,224,308	$ 58,235,378	$ 71,643,346	$ 97,448,786	$ 123,370,833	$ 135,453,962	$ 136,314,735	$ 130,792,204	$ 128,027,910
21	Combined Interest (Ln. 5)	$ 122,424	$ 119,640	$ 117,145	$ 114,644	$ 126,072	$ 135,397	$ 166,571	$ 226,568	$ 286,837	$ 314,930	$ 316,931	$ 304,092

[1] *This hypothetical example assumes the first change to the original PSA Adjustor Rate of $0.000000 takes effect on April 1, 2006. The new PSA Adjustor Rate is $0.000161.* See Year 1, Schedule 3 for the calculation of the charge.

[2] This hypothetical example assumes the Commission approval of a $100 Million Amortization Surcharge request that was made in July 2006 after the Balancing Account again exceeded $50 Million in June (see line 9 above). The requested Amortization Surcharge of $0.003357 is effective on September 1, 2006, and expires on August 31, 2007, or when $100 million is received.

This hypothetical example assumes the Commission approved November 1, 2005, Amortization Surcharge of $0.002697 expired after $60 million was received. A credit of $3,564,160 was made to the Bank Balance to reflect an over-collection in September 2006.

EXHIBIT

ALL-STATE LEGAL®

S-2

admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER
Chairman
WILLIAM A. MUNDELL
Commissioner
MARC SPITZER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN, AND FOR APPROVAL OF PURCHASED POWER CONTRACT	DOCKET NO. E-01345A-03-0437
IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR APPROVAL OF A POWER SUPPLY ADJUSTOR SURCHARGE	DOCKET NO. E-01345A-05-0526

DIRECT

TESTIMONY

OF

WILLIAM GEHLEN

PUBLIC UTILITY ANALYST V

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

OCTOBER 17, 2005

TABLE OF CONTENTS

ATTACHMENTS

EXECUTIVE SUMMARY
ARIZONA PUBLIC SERVICE COMPANY
DOCKET NOS. E-01345A-03-0437 & E-01345A-05-0526

On July 22, 2005, Arizona Public Service Company ("APS" or "Company") filed with the Commission an application for approval of a Power Supply Adjustor ("PSA") Surcharge (Docket No. E-01345A-05-0526). The request was for recovery of $100 million to be collected over a period of 24 months. Subsequent to filing its application, APS agreed with Staff and the Residential Utility Consumer Office ("RUCO") to defer $20 million from this specific application. APS now requests recovery of $80 million over a 24 month period.

On September 14, 2005, this matter was consolidated for purposes of hearing with the review of the PSA Plan of Administration under Docket No. E-01345A-03-0437.

The result of Staff's analysis indicates that the PSA Surcharge amount of $80 million requested by APS is reasonable. A combination of factors including rapid load growth, significant shift to the use of natural gas fired generation, and unforeseeable increase in the price of natural gas due to tight market conditions have caused natural gas and purchased power costs to increase at unanticipated amounts, resulting in significant increases in the PSA balancing account. The initial APS filing on July 22, 2005, was made in anticipation of the under-collected amount in the PSA balancing account reaching $100 million. The most recent APS filing shows an under-collected balance of $127.5 million as of August 31, 2005, and a projected increase of approximately $20 million for September 2005. This balance did not include effects of Hurricane Katrina (August 29, 2005) and Hurricane Rita (September 24, 2005) which are having additional upward pressure on natural gas and purchased power costs.

Hurricanes Katrina and Rita and their resultant damage to the natural gas infrastructure and drilling rigs have driven natural gas prices to levels not deemed possible six weeks ago, much less four months ago when APS made their initial filing. At this point it is not likely that the under-collected balance in the PSA balancing account will fall below $100 million even with the approval of the $80 million surcharge as requested by APS. Present projections show the PSA balancing account increasing by an amount equal to, or more, per month than the average $3.33 million per month offset by the requested APS Surcharge for ten (10) of the fourteen (14) months from November 2005 through December 2006. When the hurricane damage assessment has been completed, the natural gas and purchased power markets are expected to stabilize. At that point Staff will be able to better forecast increases or decreases in the PSA to determine the long run effects on the Company and the customers.

Staff recommends approval of the APS $80 million PSA Surcharge request to be collected over a 24 month period. The Surcharge is to be implemented the first billing cycle in November 2005. The impact on the average residential bill will be an increase of $1.48 per month, (or 1.3%) during the summer months, and $0.96 per month, (or 1.6%) during the winter months.

INTRODUCTION

Q. Please state your name, occupation, and business address.

A. My name is William Gehlen. I am a Public Utility Analyst V employed by the Arizona Corporation Commission ("ACC" or "Commission") in the Utilities Division ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

Q. Briefly describe your responsibilities as a Public Utility Analyst.

A. In my capacity as a Public Utility Analyst V, I provide recommendations to the Commission on energy related issues.

Q. Please describe your educational background and professional experience.

A. I earned a BS degree in Business Administration from Aquinas College, and an MBA from Western Michigan University. My background includes 26 years of utility experience with 16 years in investor owned utilities. In the fuels area, I have been responsible for the planning, procurement and transportation of multiple fuel categories (natural gas, gasoline, coal, oil and nuclear). In addition, I have been responsible for the procurement of land, equipment, services, consulting and construction contracts, and purchased power (short, medium and long term). Management positions also included responsibility for integrated resource planning, long range forecasting, transmission planning, environmental affairs and strategic planning. My most recent 10 years experience includes 1 year with Office of Consumer Advocate for the State of Nevada as a regulatory analyst, and 9 years in the development and marketing of energy trading platforms, origination of purchase power agreements, real time energy trading, and support of merchant generators in gathering market intelligence on regulatory, fuel and product issues to aid in understanding inter and intra regional market design issues and solutions.

Q. What is the scope of your testimony in this case?

A. I will address the Arizona Public Service Company's ("APS" or "Company") request for a Power Supply Adjustor ("PSA") surcharge with a billing date to be effective the first billing cycle in November 2005. I will evaluate the costs attributable to the request, and put these costs into perspective in view of recent developments in the fuels and purchased power markets. Estimated customer cost increases will be developed and discussed. In addition, the impact of the Company hedging program will be addressed.

Q. Describe the PSA Rate Mechanism.

A. In Decision No. 67744, a PSA Rate Mechanism was authorized for the Company. The purpose of the PSA is to track APS' costs of obtaining fuel for internal generation, revenue from off-system sales, and the costs of obtaining purchased power from the market. The actual costs of fuel and purchased power on an ongoing basis would be compared to the base cost of $0.020743 per kWh (Base Fuel Recovery Amount) established in Decision No. 67744. The PSA permits the Company to defer for later recovery/refund, through the Adjustor Rate, 90 percent of the fuel and purchased power costs in excess of/below the amount recovered through the Base Fuel Recovery Amount. The major features of the PSA are: a 90 percent ratepayer/10 percent APS sharing mechanism, the recognition of off-system sales revenues, the inclusion of fuel and purchased power costs, a bandwidth on changes in the Adjustor Rate of plus or minus $0.004 per kWh over the life of the PSA, a balancing account and a surcharge mechanism.

The results of the PSA mechanism are applied to customer bills through the Adjustor Rate. The Adjustor Rate is to be reset April 1st of each year and maintained for a one year period. In subsequent years, the Company would file with the Commission on March 1 their calculation for the Adjustor rate to become effective April 1 for the next 12 months.

Per Decision No. 67744, if the on going fuel and purchased power expense in the PSA reaches plus or minus $50 million, as compared to the base Fuel Recovery Amount, the Company is required to file a request for Commission approval of a PSA surcharge/credit, or an explanation of why a surcharge/credit is not necessary. In addition a cap of $100 million was placed on the balancing account.

Q. Describe the Company's PSA Surcharge request.

A. On July 22, 2005, the Company filed for approval of a PSA Surcharge due to a projected under-collection of its fuel and purchased power expenses of $100 million by August 31, 2005. The filing anticipated a surcharge of $0.00177 per kWh with a recovery period of 24 months and the surcharge to be effective the first billing cycle in November 2005, which would result in approximately a 2.2 percent revenue increase relative to the Base Fuel Recovery Amount of $0.020743 per kWh for the requested two year amortization period. Subsequent to this request, the Company agreed with Staff and the Residential Utility Consumer Office ("RUCO") to defer $20 million from the PSA Surcharge request from this specific filing. As a result, the surcharge request was reduced to $80 million with a recovery period of 24 months and the same implementation date. The effective surcharge request is $0.001416 per kWh and would result in approximately a 1.7 percent revenue increase relative to the Base Fuel Recovery Amount of $0.020743 per kWh.

Q. Describe the review performed on the Company's application.

A. The application was reviewed for reasonableness comparing natural gas and purchased power costs against known market information. In addition, a high level overview of the Company's natural gas, purchased power, coal and nuclear fuel procurement practices was performed through data requests and on site meetings with trading, procurement, hedging, and back office personnel.

Q. Was a prudence review performed?

A. No. With the removal from the application of $20 million attributable to Palo Verde outages during the period April 1, 2005, through July 2005, the discussion of prudence has been deferred to a later date.

A formal prudence review is typically performed during a rate case where there is time to adequately review the Company's policies and procedures, dispatch practices and software, compliance with contract provisions as well as to compare fuel and purchased power to market hubs such as Palo Verde, Henry Hub and futures markets such as NYMEX.

Q. Did the procedural schedule allow time to perform a prudence review?

A. No. The estimated time to do a thorough prudence audit could approach six months plus require the services of outside consultants to address nuclear plant outages.

DRIVERS OF ENERGY COSTS

Q. What factors are responsible for the rapid growth in the PSA account?

A. The majority of growth in the PSA account can be attributed to load growth, Company generation makeup, power market shift to gas generation, and price increases in generation feedstock (natural gas, coal, and nuclear). Also, the Base Fuel Recovery Amount of $0.020743, which was based on 2003 actual costs, is not adequate to compensate for the fuel and purchased power market prices that have developed over the last two years. It is a combination of all the preceding factors that have driven up the PSA account to amounts that precipitated the filing for a PSA Surcharge.

Q. Discuss Company load growth.

A. The Company has experienced significant peak demand load growth, 600 MW over the last three years with an additional 300 MW forecasted for 2006. Figure 1 illustrates the growth in the APS peak load requirement for the period 2000 through 2005 as well as the projected 2006 peak. Load growth by itself does not necessarily result in uncollected fuel and purchased power costs when fuel costs are relatively stable and the on and off peak demands are relatively stable. The nature of the Company load during the summer is not stable, and based on the generation mix available to meet load the primary fuel source involved is natural gas for internally generated power and/or purchased power. The price of natural gas has had a direct correlation to the price of power required to meet peak load requirements.

Q. Discuss the Company's generation mix and purchased power markets.

A. Since 2001 the Company has added 1800 MWs of generation. It has all been natural gas-fired generation. Figure 1 illustrates the APS generation mix and the growth in gas-based generation utilized to meet peak demand. The coal and nuclear generation totals, which have provided a moderating effect on the PSA account, have remained constant. The MW amount of the Company's coal and nuclear generation is relatively constant, while the amount and percentage of natural gas fired generation and gas based purchased power has continued to increase. Figure 2 illustrates the percentage shift by generation type and purchased power from 2000 through the third quarter 2005. This increasing reliance on natural gas-fired generation and gas-based purchased power increases the Company's exposure to volatile gas prices. When required to go to the market for purchased power, the market price is determined once again by the price of natural gas. Almost all new generation added by merchant generators is gas-fired, including 4000 MW of generation within the state of Arizona since 2002. This means that when the Company must go to the purchased power market, now and for the foreseeable future, to meet load requirements it will pay a market price based on volatile gas prices.

Q. Discuss increases in fuel cost.

A. The Company has experienced increased costs in all fuel areas as well as purchased power. The costs of coal and nuclear fuel have increased but at a much slower rate than natural gas. Figure 3 illustrates the relative cost increase per fuel type in the Company's fuel feedstock and purchased power mix. Using 2002 as a base year the cumulative cost increase for coal has been 18 percent, nuclear fuel 9 percent, natural gas 122 percent, and purchased power 67 percent. To a degree, the Company is able to exert some control over the coal and nuclear fuel costs because they are based on negotiated contracts that are primarily cost based and escalated on negotiated indices. The market price of natural gas presently has little to no correlation to cost of production. Neither the Company, nor anyone else, can control the price of natural gas at this time. It was apparent that natural gas is becoming a scarce commodity even prior to recent hurricanes; recent damage to drilling rigs, as well as other infrastructure, has added more uncertainty to the market and has resulted in gas prices that were viewed as impossible six months ago. See figure 4 which illustrates the rapid run up in natural gas forward prices.

Q. Has the Company been able to mitigate natural gas and purchased power costs?

A. Yes. The Company developed procedures in the late 1990's that were designed to limit its exposure to volatility in the fuel and purchased power markets. The program has evolved over the years as the development of relatively liquid commodity markets and financial equivalency contracts became available. The Company intended hedging to provide price stability, not profit maximization, and has strict hedging guidelines which prevent market speculation. In response to increased reliance on natural gas, accompanied by rapidly escalating commodity prices, the Company in 2003 initiated a hedge plan that required near term (one year) gas and purchased power requirements, to be 75 percent hedged. In response to recent forecasted increases in market prices for gas and purchased power, the Company raised the hedge percentage to 85 percent for the last five months of 2005, and calendar year 2006. The Company is presently hedged 50 percent for 2007 and 35 percent for 2008. The amount of fuel and purchased power expense was reduced by approximately $30 million during the four month period April 1 through August 1, 2005 because of the Company's hedging activities. The Company hedging strategy has worked effectively to limit cost increases. Additional savings will accrue through years 2005 and 2006, barring a complete collapse of the gas and purchased power markets.

Q. Is it possible to accurately predict the future price of natural gas and purchased power?

A. No. Until the natural gas and purchased power markets know with any degree of certainty the extent of damage caused by recent hurricanes, the time frame for infrastructure repair and the extent of damage to drilling rigs, prices will remain high and volatile. See figures 4 and 5 which illustrate market price increases in natural gas and purchased power. A clearer picture of where the gas and purchased power markets are headed could be more transparent by December 31, 2005. A better market view, and additional Company cost data, will provide the information base needed to effectively evaluate the amount of change to the Base Fuel Recovery Amount Adjustor Rate for implementation in April 2006.

Q. Is it likely for the under-collected PSA account balance to fall below $100 million without the PSA Surcharge requested by the Company?

A. No. Per Company provided cost information there is an under-collected fuel and purchased power expense of $127.7 million for the period April 1, 2005, through August 31, 2005. Of this amount, $115.2 million has been deferred, and $12.5 million has been paid for by Company stockholders, reflecting the 90/10 sharing of fuel costs mandated by Decision No. 67744. Figures 4 and 5 illustrate higher gas and purchased power market prices for September than for August which will result in the continued growth of the under-collected balance through the September reporting period. Additions to the under-collected balance should moderate for the last quarter of the year since the need for gas-fired generation and purchased power will decrease over the fall and winter shoulder months.

Q. Is it likely for the under-collected PSA account balance to fall below $100 million with approval of the PSA Surcharge requested by the Company?

A. No. The $80 million surcharge requested by the Company is to be collected over 24 months from November 2005 through April 2006. The under-collected balance will continue to grow during the September reporting period. Predicted peak load growth of an additional 300 MW for 2006 only increases the reliance by the Company on high priced natural gas and purchased power to meet load, the costs of which will most likely be higher than the Base Rate Fuel Amount and Adjustor Rate was designed to recover. The Company in their filing projected an under-collected balance at year end 2006 of $255 million with the Surcharge approval and an increase of 3 mills per kWh in the Adjustor Rate in April 2006. Without the Surcharge approval, the Company projects an under-collected amount of $274 million with an increase of 4 mills per kWh in the Adjustor Rate in April 2006. Staff has reviewed the Company's projections and found them to be reasonable. The year end 2006 under-collected balance amounts were based on August 31, 2005, forward price curves for natural gas and purchased power (Figure 6 illustrates the growth in the under-collected balance through year end 2006). As of September 30, 2005, the latest forward price curves show additional price escalation in both natural gas and purchased power through year end 2006. A more precise picture of under-collected balances will emerge from the upcoming review of actual Company cost data for the period April through year end 2005. This review will determine any change to be made in the Adjustor Rate which will have a direct correlation on the growth, or decline, in under-collected fuel and purchased power expenses going forward.

CUSTOMER IMPACT

Q. Has Staff examined the impact APS' proposed PSA Surcharge would have on customers' bills?

A. Yes. Staff examined the impact of the surcharge on residential customers taking service on Rate Schedule E-12. E-12 is the Company's basic residential tariff which does not include demand charges. As of the end of September 2005, 416,095 residential customers were taking service on E-12. The E-12 rate (and rate structure) differ for summer and winter months. Also, the usage of E-12 customers differs substantially across the summer and winter. For these reasons, Staff examined the effect of the surcharge on E-12 customers in a representative summer month and a representative winter month. Chart 1 below is based on customer usage in July of 2005.

Chart 1 Surcharge Impact on E-12 Summer Bills

	kWh	Customer Bill (no surcharge)	Surcharge amount ($0.001416/kWh)	Surcharge % impact
Low Use	785	$ 80.27	$ 1.11	1.39%
Median Use	818	$ 84.13	$ 1.16	1.4%
Average Use	1047	$ 112.81	$ 1.48	1.31%
High Use	1309	$ 145.63	$ 1.85	1.27%

Chart 2 below is based on customer usage from December 2004.

Chart 2 Surcharge Impact on E-12 Winter Bills

	kWh	Customer Bill (no surcharge)	Surcharge amount ($0.001416/kWh)	Surcharge % impact
Low Use	508	$ 46.16	$ 0.72	1.56%
Median Use	531	$ 47.89	$ 0.75	1.6%
Average Use	677	$ 58.84	$ 0.96	1.63%
High Use	846	$ 71.52	$ 1.20	1.68%

Charts 1 and 2 show the Company's proposed surcharge's impact on E-12 customers with different usage characteristics. The Company's proposed surcharge will raise E-12 customers' summer bills by $1.48 or 1.3 percent on average. APS' proposed surcharge will raise E-12 customers' winter bills by $0.96 or 1.6 percent on average.

SUMMARY OF TESTIMONY AND RECOMMENDATIONS

Q. Summarize your testimony and recommendations in the filing.

A. Testimony addressed the Company load growth, generation mix, and increasing natural gas and purchased power costs. The preceding were evaluated in order to draw a correlation to the large under-collected balance in the Company PSA account. Analysis indicates the Base Rate Fuel Amount, which was based on 2003 cost data, is not adequate to compensate for a growing peak load requirement which is being met with gas-fired generation and purchased power. Natural gas prices have increased 58 percent while purchased power prices have increased 45 percent during the period 2003 through the third quarter 2005. The $80 million PSA Surcharge request is modest in comparison to the actual under-collected balance and should be approved. The impact on residential customers based on a 24-month recovery period will be an increase of $1.48 per month, (1.3%) during the summer months and $0.96 per month (1.6%) during the winter months.

Staff understands that the Company's request represents a burden on the Company's customers. However, Staff does not believe rejecting or delaying the Company's application will result in any long-term benefit for those customers. If the Company's request were to be denied or deferred, the $80 million in question would remain an under-collection in the balancing account, accrue interest, and would have to be recovered at a later date. Additionally, given the state of the natural gas market, the under-collected balance is likely to grow over the near term with, or without, approval of the Company's request (refer to Figure 6). Denying, or deferring the Company's current request will result in future Surcharge requests of even greater magnitude. Staff believes there is some value in addressing the current under-collection now so that the effect of increased fuel costs on the Company's customers can be spread over time.

Because this proceeding did not include an evaluation of the prudence of the Company's fuel and purchased power purchases, approval of the Surcharge in this proceeding shall not impair the Commission's ability to consider whether such costs are imprudent or otherwise subject to disallowance in a later rate case or proceeding specifically intended to consider the reasonableness of costs associated with the Surcharge. In other words, should the Commission determine that costs allowed for recovery in the proceeding were imprudent or not recoverable; their allowance in this proceeding shall not prevent their subsequent disallowance and implementation of a true-up related to those costs. Such findings could occur either in the Company's next rate case, or in a separate proceeding commenced specifically for that purpose.

Therefore, Staff recommends approval of the Company's requested $0.001416 per kWh Surcharge. Staff recommends that the Surcharge remain in effect until it collects $80 million or two years have elapsed from the date of Commission approval, whichever comes first.

The complexity of the PSA balancing account, and rapid changes in fuel and purchase power costs require changes in the timing, and content of the PSA Report. The changes must enable quicker and more in-depth evaluations, of the PSA Balancing Account under and over-collected balances. To enable these improvements, Staff makes the following additional recommendations:

APS provide the Power Supply Adjustor Report within thirty (30) days of the end of the reporting period. As an example, the August report would be due the last working day in September.

APS provide in the Power Supply Adjustor Report any costs attributable to unplanned outages during the reporting period, and report these costs as a separate line item. Indicate whether the outage(s) are on-going, or completed.

APS provide with the Power Supply Adjustor Report, a monthly projection for the next 12 month period showing the estimated under/over-collected balance in the PSA balancing account utilizing the latest forward price curves for natural gas and purchased power. Provide in tabular and figure formats.

Q. Does this conclude your direct testimony?

A. Yes, it does.

Figure 1
ARIZONA PUBLIC SERVICE COMPANY
Growth in Peak Demand and Resource Additions
2000 - 2005

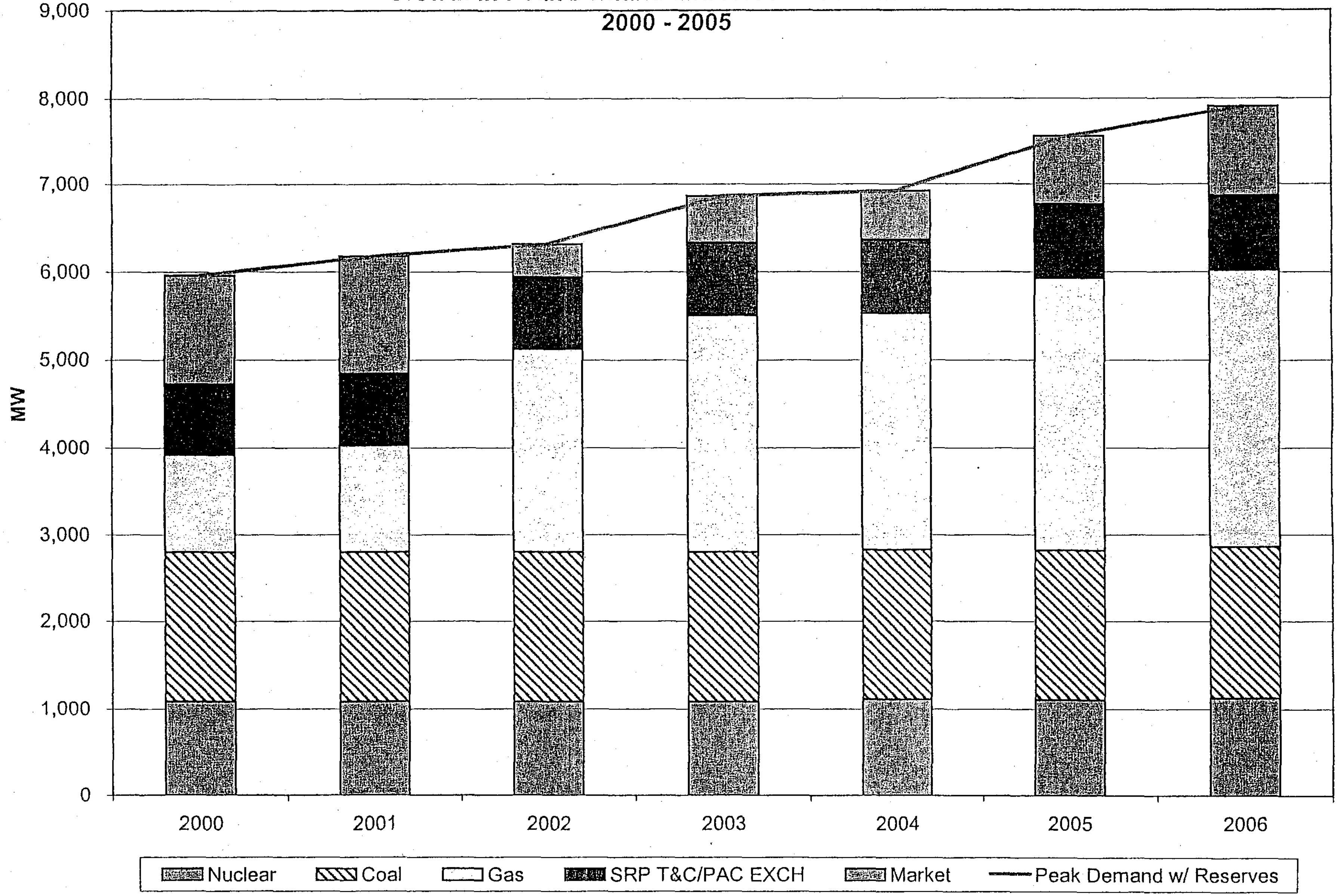


Figure 2
Arizona Public Service Company
Energy Mix by Resource Type

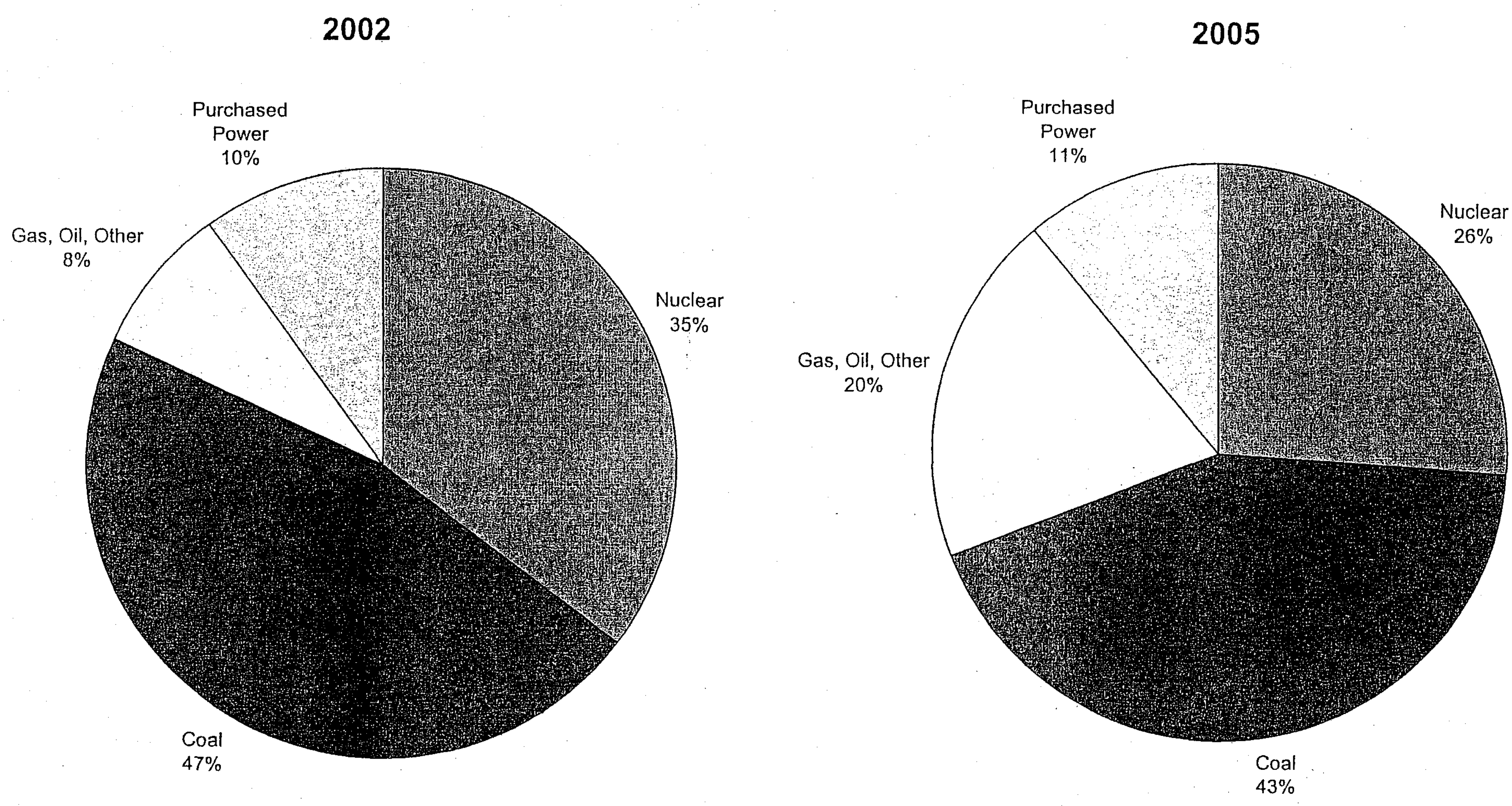
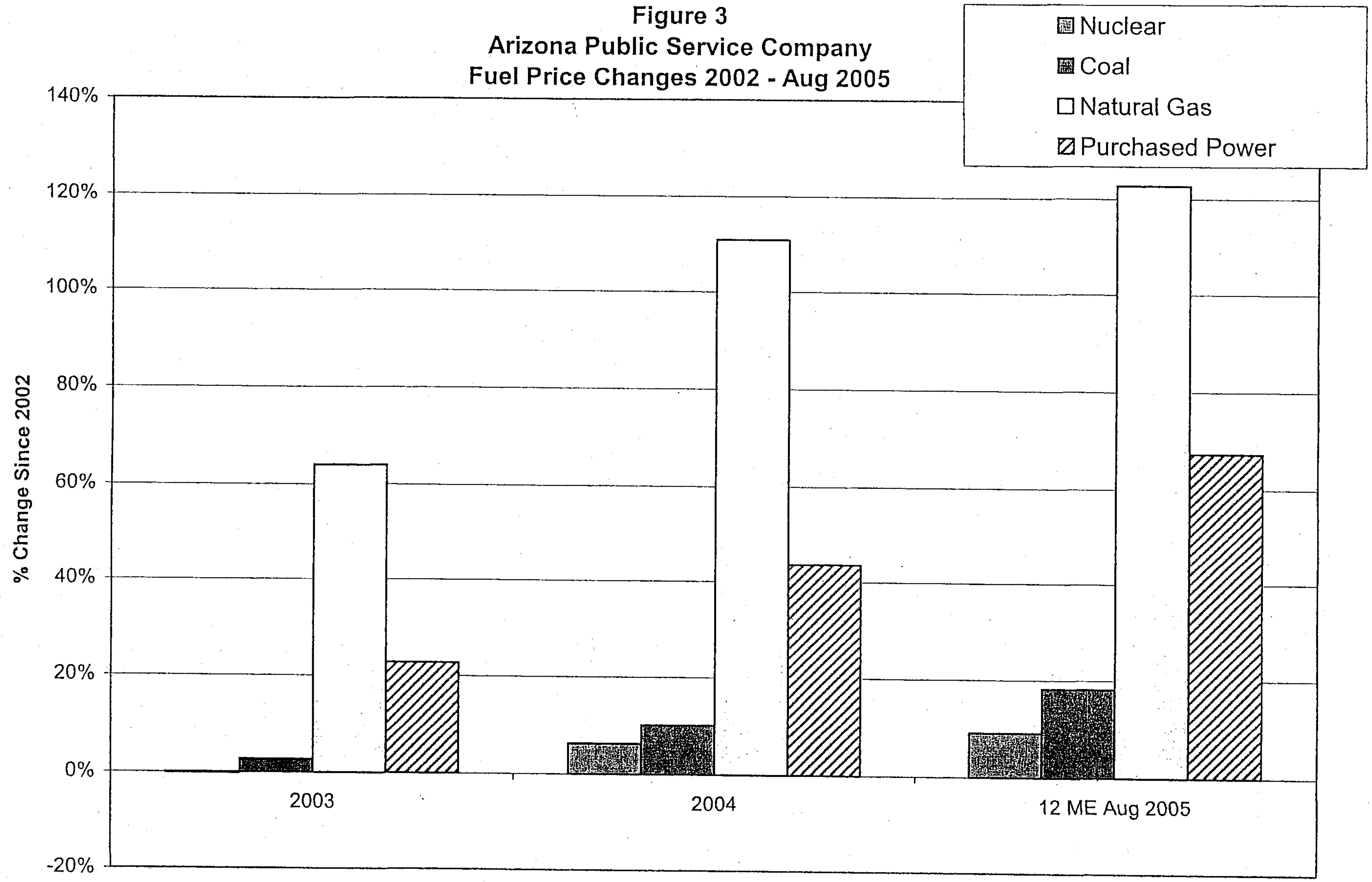
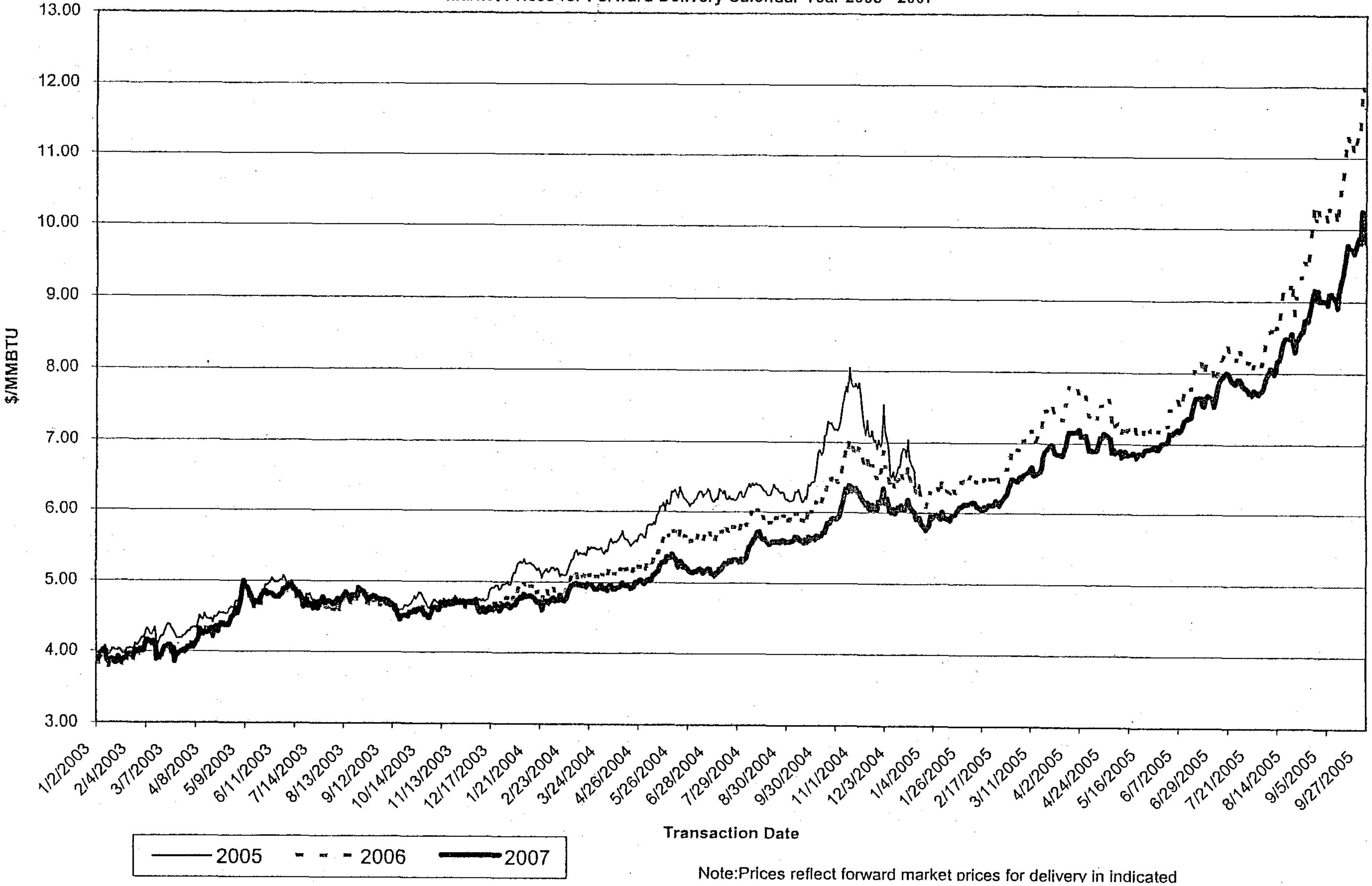


Figure 3
Arizona Public Service Company
Fuel Price Changes 2002 - Aug 2005



Note: Natural gas and power price changes do not include commodity hedging impacts.

Figure 4
Henry Hub Natural Gas Price
Market Prices for Forward Delivery Calendar Year 2005 - 2007



Note:Prices reflect forward market prices for delivery in indicated

Figure 5
Calendar Year Around-the-Clock Power Price Palo Verde

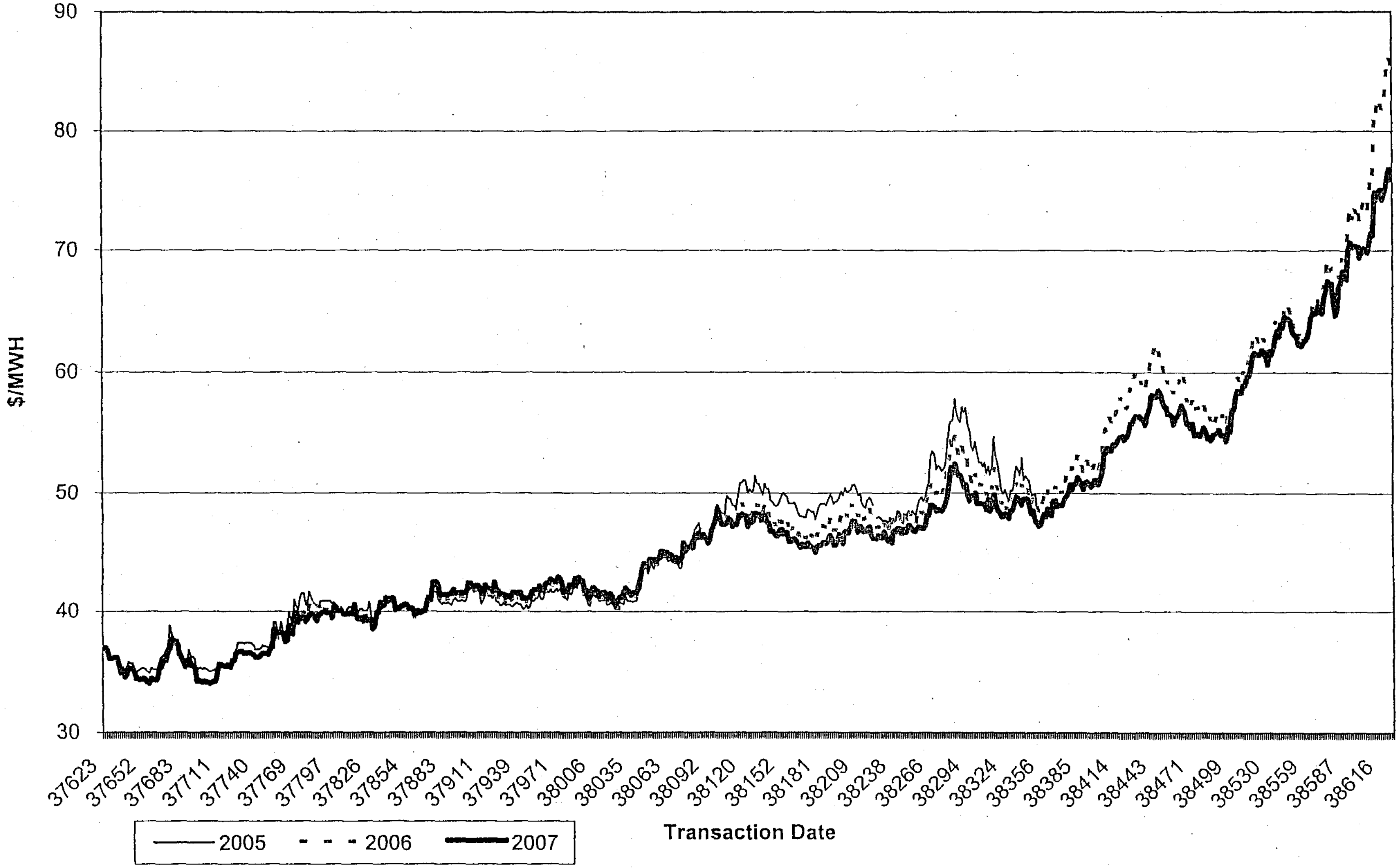
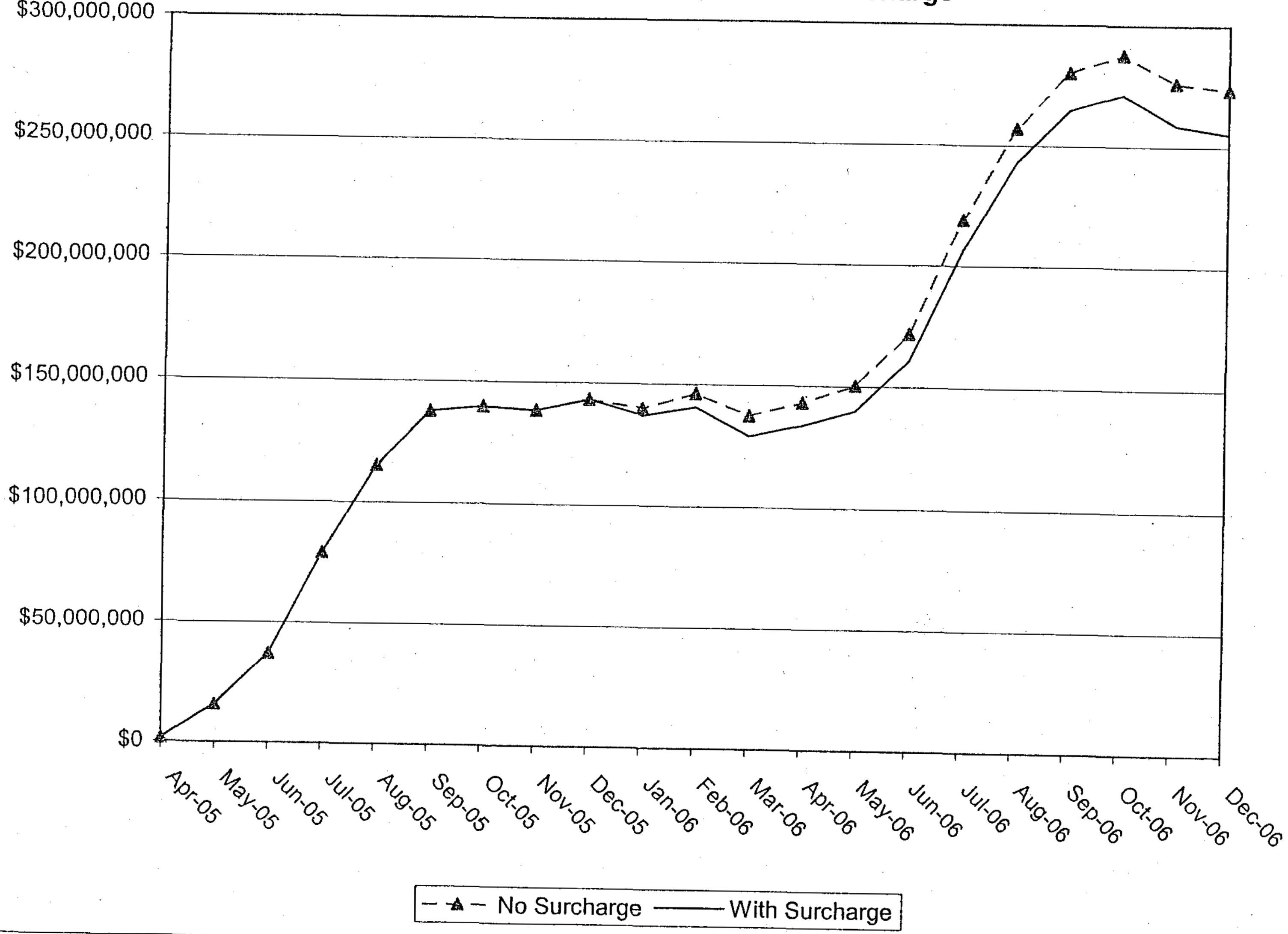


Figure 6
Projected Post-Sharing PSA Monthly Balances With and Without the $.001416 Surcharge



BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
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MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

EXHIBIT
S-3
admitted

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR APPROVAL OF A POWER SUPPLY ADJUSTOR SURCHARGE.	DOCKET NO. E-01345A-05-0526
IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN TEHREON, TO APROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN, AND FOR APPROVAL OF PURCHASED POWER CONTRACT.	DOCKET NO. E-01345A-03-0437 **NOTICE OF ERRATA**

On October 17, 2005, Arizona Corporation Commission staff ("Staff") filed the Responsive Testimony of William Gehlen on the Application of Arizona Public Service Company for Approval of a Power Supply Adjustor Surcharge in this docket. Staff discovered that it had failed to update its "Transaction Date" figures on Attachment, "Figure 5." Therefore Staff is filing the attached substitute "Figure 5." Copies of the Attachment, "Figure 5," are being provided to the parties and the Administrative Law Judge in this matter.

RESPECTFULLY SUBMITTED this 19th day of October, 2005.

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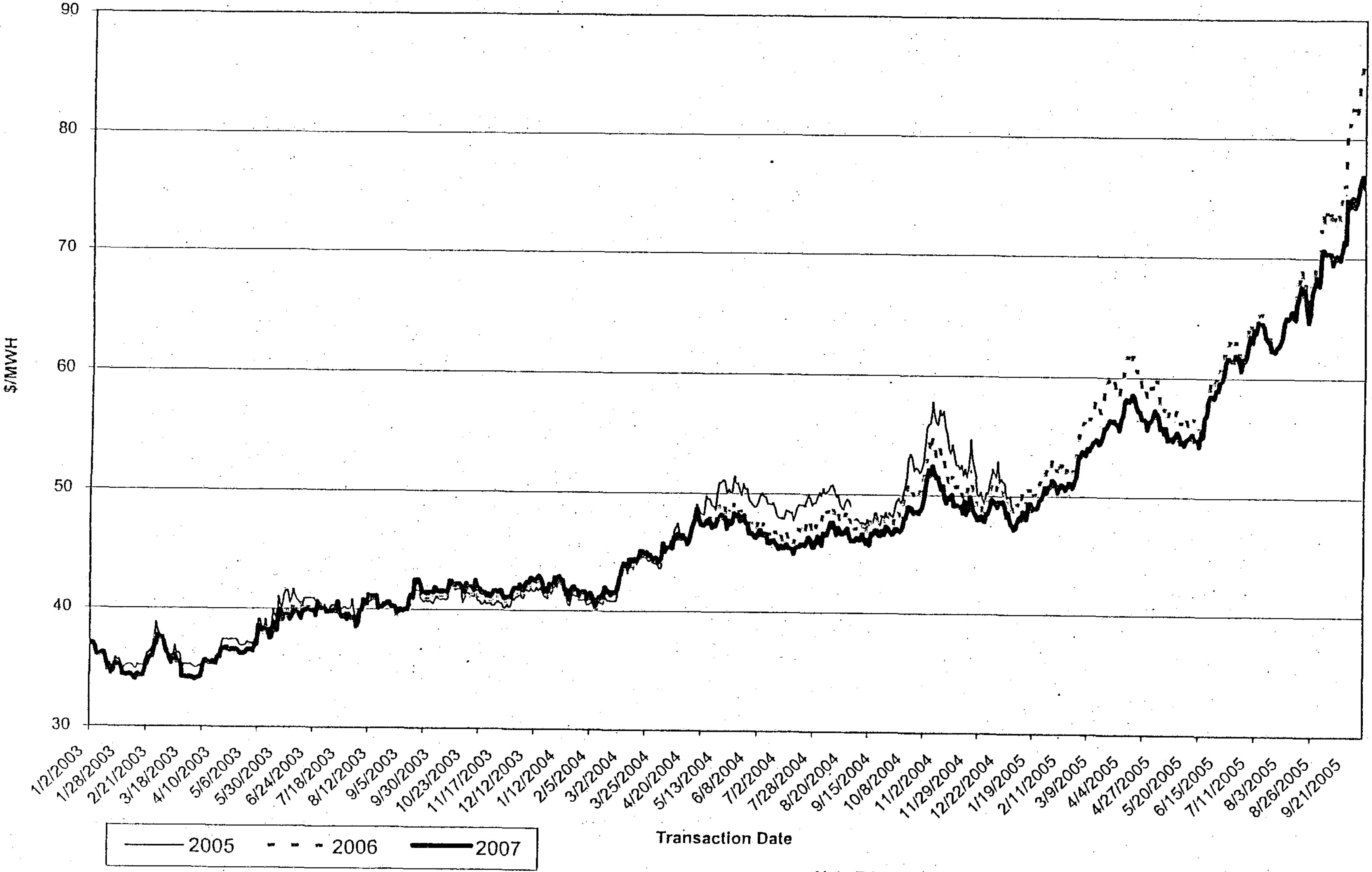
Figure 5 Calender Year Around-the-Clock Power Price Palo Verde



Note:Prices reflect forward market prices for delivery in indicated year.

EXHIBIT
S-4
Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

MARC SPITZER, Chairman
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KRISTIN K. MAYES

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN TEHREON, TO APROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN, AND FOR APPROVAL OF PURCHASED POWER CONTRACT.	Docket No. E-01345A-03-0437 **NOTICE OF ERRATA**

Commission Staff ("Staff") hereby gives notice that it inadvertently failed to mark the late filed exhibits it filed on December 10, 2004. Therefore Staff is filing substitute late filed exhibits marked as follows:

S-33 Status of WREGIS
S-34 American Jobs Creation Act of 2004
S-35 Staff Response to Commissioner Mundell's Request for Additional PSA Scenarios
S-36 Automatic Enrollment of Low-Income Customers
S-37 Marketing Costs for Low-Income Discount Programs

Copies of the exhibits are being provided to the parties, the Administrative Law Judge and the court reporter in this matter.

RESPECTFULLY SUBMITTED this 14th day of December, 2004.

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Status of WREGIS

Western Renewable Energy Generation Information System (WREGIS) is envisioned to operate as an independent accounting system and database that will track renewable energy generation and ownership of renewable energy certificates (RECs) within the Western Interconnect (11 states, 2 Canadian provinces, and northern Baja). WREGIS is currently being funded by the Western Governors' Association (WGA), the Western Regional Air Partnership and the California Energy Commission (CEC).

WREGIS is intended to be a tracking system and registry similar to a banking system that will enable the registration of generators and other account holders, the tracking of REC transfers in and out of the system, and the creation of public and private reports. The goals of WREGIS are the following:

1. Establish a single institution in the West that will record renewable energy generation information and issue, register, and track RECs for use in verification of compliance with state regulatory and voluntary market programs;

2. Develop standard definitions, rules, and operating guidelines for participants in WREGIS;

3. Improve economics for the region's renewable energy resources; and

4. Support state renewable energy policies as well as regulatory programs.

WREGIS does not define what technologies are "renewables." The states set their own policies regarding what is acceptable as "renewables" for their own programs.

In December 2003, CEC and WGA issued a needs assessment report, documenting the basic functions and capabilities of WREGIS. The WREGIS Working Group was formed in January 2004. The WREGIS Operational Rules Committee issued *WREGIS Interim Operating Rules: Functional Requirements* in July 2004. Also in July 2004, the Western Electricity Coordinating Council agreed to be the institutional home for WREGIS. The WREGIS Institutional Committee issued its report on WREGIS governance and fee structures in November 2004.

The tentative schedule for the further development of WREGIS is the following:

- Feasibility Study Report approved - Winter 2004
- Request for Proposals released - Spring 2005
- Contractor Selected - Spring/Summer 2005
- WREGIS operational - Late 2005

EXHIBIT
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S-34

American Jobs Creation Act of 2004[1]

In regard to renewable energy, the American Jobs Creation Act of 2004 (signed into law on October 22, 2004) extended and expanded the renewable energy tax credit under Section 45 of the Internal Revenue Code. Before the Act, Section 45 provided power producers a 10-year production tax credit (PTC) equal to 1.5 cents (indexed for inflation, currently 1.8 cents) per kWh of electricity produced from qualified energy resources at qualified facilities placed in service before January 1, 2004.[2] Qualified energy resources only included wind, closed-loop biomass, and poultry waste.

The Act expanded the definition of qualified energy resources to include open-loop biomass (such as mill and harvesting residues, certain wood wastes, and agricultural livestock waste), geothermal energy, solar energy, small irrigation power, and municipal solid waste (landfill gas and trash combustion facilities). The credit amount is reduced in half for open-loop biomass, small irrigation, landfill gas, and trash combustion facilities.

The Act provides an additional credit of $4.375 per ton of refined coal produced and sold to third parties for the production of steam. Refined coal is defined as a liquid, gaseous, or solid synthetic fuel produced from coal or high-carbon fly ash that when burned emits 20 percent less nitrogen oxide and either sulfur dioxide or mercury compared to feedstock or comparable coal available in the marketplace as of January 1, 2003, and that sells for at least 50 percent more than the feedstock coal. The credit for refined coal is subject to inflation adjustments and a phase-out based on market prices.

To qualify for the PTC, open-loop biomass, geothermal, solar, small irrigation, landfill gas, and trash combustion facilities must be placed in service after the date of enactment of the Act and before January 1, 2006. The credit period for those technologies will be limited to five years. A refined coal facility must be placed in service after the date of enactment and before January 1, 2009.

In addition, the Act limits the cutback of the PTC for state and local grants, tax-exempt bond financing, subsidized energy financing, and other state and local tax credits.

Section 701 of the Act puts the U.S. Environmental Protection Agency in charge of a demonstration program to provide up to $2 billion in tax-exempt financing to green building and sustainable design projects on brownfields. The aggregate goal for the program is to reduce electric consumption from traditional sources by 150 MW, reduce daily sulfur dioxide emissions by 10 tons, expand the solar photovoltaic market by 75 percent (compared to the market growth from 2001 to 2002), and generate at least 25 MW of power from fuel cells. The projects must be partly supported by state or local governments and must be nominated by state or local governments within six months.

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[1] Sources include www.perkinscoie.com, www.martinandalex.com, www.stoel.com, and www.newrules.org.

[2] The Working Families Tax Relief Act of 2004 extended the date to December 31, 2005.

Staff Response to Commissioner Mundell's Request for Additional PSA Scenarios

Attached are sheets showing the PSA accounting and customer bill impacts for the three scenarios requested by Commissioner Mundell. The scenarios work off the information contained in Scenario 11 contained in the previously provided Staff Response to Request for Analysis of How the Various Proposals for APS Rates Will Impact an Average Customer Bill. All three scenarios project customer bill impacts and PSA annual accounting through 2009 and assume 3 percent load growth with all load growth being met with additional natural gas-fired generation. Regarding the price of natural gas, Scenario 11A uses the base case cost of $5.78 per MMBtu through 2009. Scenario 11B uses the natural gas prices cited by APS during the hearing, $5.94 per MMBtu in 2006, $5.50 per MMBtu in 2007, and $5.08 per MMBtu in 2008. Scenario 11C reflects rising natural gas prices in the coming years, with the price increasing five percent annually, to $6.07 per MMBtu in 2006, $6.37 per MMBtu in 2007, and $6.69 per MMBtu in 2009. All other adjustors and inputs are held constant with how they were reflected in Scenario 11.

Residential Rate Schedule E-12 Rate Scenarios

June 2004 Average Residential Consumption (kwh) 738

assume summer rates used in all calculations

Scenario 11A - $5.78 Gas Price Through 2009

PSA Rate		$0.00182	$0.00084	$0.00263	$0.00163
		2006	2007	2008	2009
Rate Element	**Today**	**Settlement W/Adjustors**	**Settlement W/Adjustors**	**Settlement W/Adjustors**	**Settlement W/Adjustors**
Basic Service Charge	$7.50	$7.70	$7.70	$7.70	$7.70
Summer, 1st 400 kwh ($/kwh)	0.07376	$0.07570	$0.07570	$0.07570	$0.07570
Summer, Next 400 kwh ($/kwh)	0.10281	$0.10556	$0.10556	$0.10556	$0.10556
Summer, Over 800 kwh ($/kwh)	0.11991	$0.12314	$0.12314	$0.12314	$0.12314
Winter kwh ($/kwh)	0.07394	$0.07361	$0.07361	$0.07361	$0.07361
Bill, No Adjustments	$71.75	$73.65	$73.65	$73.65	$73.65
Removal of Franchise Fee	-$1.02				
Base Rates, Absent Franchise Fee	$70.74	$73.65	$73.65	$73.65	$73.65
PSA Rate		$1.34	$0.62	$1.94	$1.20
TCA		$0.07	$0.07	$0.07	$0.07
DSM Adjustor		$0.19	$0.19	$0.19	$0.19
EPS Surcharge/Adjustor	$0.35	$0.35	$0.35	$0.35	$0.35
CRCC		$0.25	$0.25	$0.25	$0.25
Subtotal	$71.09	$75.85	$75.13	$76.46	$75.71
Franchise Fee	$1.02	$1.39	$1.37	$1.40	$1.39
Final Bill	$72.10	$77.24	$76.51	$77.85	$77.10
% Change From Previous Year		7.1%	-1.0%	1.8%	-1.0%
% Change in Base Rates From Today		4.1%			

Scenario 11B - APS Projected Gas Price Through 2009

PSA Rate		$0.00182	$0.00118	$0.00164	$0.00087
		2006	2007	2008	2009
Rate Element	**Today**	**Settlement W/Adjustors**	**Settlement W/Adjustors**	**Settlement W/Adjustors**	**Settlement W/Adjustors**
Basic Service Charge	$7.50	$7.70	$7.70	$7.70	$7.70
Summer, 1st 400 kwh ($/kwh)	0.07376	$0.07570	$0.07570	$0.07570	$0.07570
Summer, Next 400 kwh ($/kwh)	0.10281	$0.10556	$0.10556	$0.10556	$0.10556
Summer, Over 800 kwh ($/kwh)	0.11991	$0.12314	$0.12314	$0.12314	$0.12314
Winter kwh ($/kwh)	0.07394	$0.07361	$0.07361	$0.07361	$0.07361
Bill, No Adjustments	$71.75	$73.65	$73.65	$73.65	$73.65
Removal of Franchise Fee	-$1.02				
Base Rates, Absent Franchise Fee	$70.74	$73.65	$73.65	$73.65	$73.65
PSA Rate		$1.34	$0.87	$1.21	$0.64
TCA		$0.07	$0.07	$0.07	$0.07
DSM Adjustor		$0.19	$0.19	$0.19	$0.19
EPS Surcharge/Adjustor	$0.35	$0.35	$0.35	$0.35	$0.35
CRCC		$0.25	$0.25	$0.25	$0.25
Subtotal	$71.09	$75.85	$75.38	$75.72	$75.16
Franchise Fee	$1.02	$1.39	$1.38	$1.39	$1.38
Final Bill	$72.10	$77.24	$76.76	$77.11	$76.53
% Change From Previous Year		7.1%	-0.6%	0.5%	-0.8%
% Change in Base Rates From Today		4.1%			

Scenario 11C - Assumes a 5% gas price increase annually through 2009

PSA Rate		$0.00182	$0.00146	$0.00339	$0.00315
		2006	2007	2008	2009
Rate Element	**Today**	**Settlement W/Adjustors**	**Settlement W/Adjustors**	**Settlement W/Adjustors**	**Settlement W/Adjustors**
Basic Service Charge	$7.50	$7.70	$7.70	$7.70	$7.70
Summer, 1st 400 kwh ($/kwh)	0.07376	$0.07570	$0.07570	$0.07570	$0.07570
Summer, Next 400 kwh ($/kwh)	0.10281	$0.10556	$0.10556	$0.10556	$0.10556
Summer, Over 800 kwh ($/kwh)	0.11991	$0.12314	$0.12314	$0.12314	$0.12314
Winter kwh ($/kwh)	0.07394	$0.07361	$0.07361	$0.07361	$0.07361
Bill, No Adjustments	$71.75	$73.65	$73.65	$73.65	$73.65
Removal of Franchise Fee	-$1.02				
Base Rates, Absent Franchise Fee	$70.74	$73.65	$73.65	$73.65	$73.65
PSA Rate		$1.34	$1.07	$2.50	$2.32
TCA		$0.07	$0.07	$0.07	$0.07
DSM Adjustor		$0.19	$0.19	$0.19	$0.19
EPS Surcharge/Adjustor	$0.35	$0.35	$0.35	$0.35	$0.35
CRCC		$0.25	$0.25	$0.25	$0.25
Subtotal	$71.09	$75.85	$75.59	$77.01	$76.84
Franchise Fee	$1.02	$1.39	$1.38	$1.41	$1.41
Final Bill	$72.10	$77.24	$76.97	$78.42	$78.24
% Change From Previous Year		7.1%	-0.4%	1.9%	-0.2%
% Change in Base Rates From Today		4.1%			

base cost $0.020743

Scenario 11A - $5.78 gas price through 2009

	April 2006 reset 2005 gas cost	April 2007 reset 2006 gas cost	April 2008 reset 2007 gas cost	April 2009 reset 2008 gas cost
Annual Gas Cost ($000)	$332,500	$376,428	$421,671	$468,272
Annual Gas Volume (000 MMBtu)	57,527	65,126	72,954	81,016
Average Cost of Gas ($/MMBtu)	$5.78	$5.78	$5.78	$5.78
Annual Native Load Sales (MWH)	26,743,000	27,545,290	28,371,649	29,222,798
Annual Net Fuel and PP Costs	$608,700,000	$652,600,000	$697,900,000	$744,500,000
Annual Costs Recovered Thru Base Cost	$554,730,049	$571,371,950	$588,513,109	$606,168,502
Over/Undercollection (negative = overcollected)	$53,969,951	$81,228,050	$109,386,891	$138,331,498
Balance After 90/10 Application	$48,572,956	$73,105,245	$98,448,202	$124,498,348
Previous Year's Balance Carryover	$0	$0	$0	$0
Previous Year's Collection from PSA Rate	$0	-$50,030,145	-$23,767,353	-$76,921,274
Remaining Balance to Address Through New PSA Rate	$48,572,956	$23,075,100	$74,680,849	$47,577,074
Balance per kwh of Native Load Sales	$0.00182	$0.00084	$0.00263	$0.00163
Balance per kwh Captured Within $0.004 band	$0.00182	$0.00084	$0.00263	$0.00163
Balance per kwh Remaining Outside $0.004 band	$0.00000	$0.00000	$0.00000	$0.00000
Balancing Account Balance	$0	$0	$0	$0
Amount Balancing Account Exceeds $50 million.	$0	$0	$0	$0

base cost $0.020743

Scenario 11B - APS Projected Gas Cost Through 2009

	April 2006 reset 2005 gas cost	April 2007 reset 2006 gas cost	April 2008 reset 2007 gas cost	April 2009 reset 2008 gas cost
Annual Gas Cost ($000)	$332,500	$386,848	$401,244	$411,560
Annual Gas Volume (000 MMBtu)	57,527	65,126	72,954	81,016
Average Cost of Gas ($/MMBtu)	$5.78	$5.94	$5.50	$5.08
Annual Native Load Sales (MWH)	26,743,000	27,545,290	28,371,649	29,222,798
Net Fuel and PP Costs	$608,700,000	$663,000,000	$677,400,000	$687,800,000
Costs Recovered Thru Base Cost	$554,730,049	$571,371,950	$588,513,109	$606,168,502
Over/Undercollection (negative = overcollected)	$53,969,951	$91,628,050	$88,886,891	$81,631,498
Balance After 90/10 Application	$48,572,956	$82,465,245	$79,998,202	$73,468,348
Previous Year's Balance Carryover	$0	$0	$0	$0
Previous Year's Collection from PSA Rate	$0	-$50,030,145	-$33,408,153	-$47,987,750
Remaining Balance to Address Through New PSA Rate	$48,572,956	$32,435,100	$46,590,049	$25,480,598
Balance per kwh of Native Load Sales	$0.00182	$0.00118	$0.00164	$0.00087
Balance per kwh Captured Within $0.004 band	$0.00182	$0.00118	$0.00164	$0.00087
Balance per kwh Remaining Outside $0.004 band	$0.00000	$0.00000	$0.00000	$0.00000
Balancing Account Balance	$0	$0	$0	$0
Amount Balancing Account Exceeds $50 million	$0	$0	$0	$0

base cost $0.020743

Scenario 11C - Gas Cost Assumes a 5% increase annually through 2009

	April 2006 reset 2005 gas cost	April 2007 reset 2006 gas cost	April 2008 reset 2007 gas cost	April 2009 reset 2008 gas cost
Annual Gas Cost ($000)	$332,500	$395,250	$464,893	$542,083
Annual Gas Volume (000 MMBtu)	57,527	65,126	72,954	81,016
Average Cost of Gas ($/MMBtu)	$5.78	$6.07	$6.37	$6.69
Annual Native Load Sales (MWH)	26,743,000	27,545,290	28,371,649	29,222,798
Net Fuel and PP Costs	$608,700,000	$671,500,000	$741,100,000	$818,300,000
Costs Recovered Thru Base Cost	$554,730,049	$571,371,950	$588,513,109	$606,168,502
Over/Undercollection (negative = overcollected)	$53,969,951	$100,128,050	$152,586,891	$212,131,498
Balance After 90/10 Application	$48,572,956	$90,115,245	$137,328,202	$190,918,348
Previous Year's Balance Carryover	$0	$0	$0	$0
Previous Year's Collection from PSA Rate	$0	-$50,030,145	-$41,287,653	-$98,921,765
Remaining Balance to Address Through New PSA Rate	$48,572,956	$40,085,100	$96,040,549	$91,996,583
Balance per kwh of Native Load Sales	$0.00182	$0.00146	$0.00339	$0.00315
Balance per kwh Captured Within $0.004 band	$0.00182	$0.00146	$0.00339	$0.00315
Balance per kwh Remaining Outside $0.004 band	$0.00000	$0.00000	$0.00000	$0.00000
Balancing Account Balance	$0	$0	$0	$0
Amount Balancing Account Exceeds $50 million	$0	$0	$0	$0

ALL-STATE LEGAL® EXHIBIT S-36

Automatic Enrollment of Low-Income Customers

At the hearing, Commissioner Mayes asked the parties to analyze the issue of automatically enrolling low-income customers in utility programs when they apply for other income-based financial assistance programs such as Food Stamps.

At first blush, the concept appears desirable. One-stop shopping may enable low-income customers to enroll in more programs for which they are eligible, more quickly, and without as much hassle.

However, Staff has not had an opportunity to evaluate implementation issues that may arise from an automatic process. Staff has talked with a representative from Arizona Community Action Association (ACAA) for information on the subject. ACAA will be filing comments in this docket that we understand to be generally supportive of the concept of automatic enrollment.

EXHIBIT
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S-37

Marketing Costs for Low-Income Discount Programs

Company	Annual Expenditures
Arizona Public Service (proposed Settlement)	$150,000 (includes $75,600 for DES)
Southwest Gas (10/03-9/04)	5,163
Tucson Electric Power (2004)	46,508
UNS Electric (2004)	15,404
UNS Gas (2004)	73,549

EXHIBIT
S-5
Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN TEHREON, TO APROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN, AND FOR APPROVAL OF PURCHASED POWER CONTRACT.	Docket No. E-01345A-03-0437 **NOTICE OF FILING**

Commission Staff hereby gives Notice of Filing Correction to Exhibit S-35, Staff's Response to Commissioner Mundell's Request for Information Regarding Future PSA Rates.

RESPECTFULLY SUBMITTED this 9th day of March, 2005.

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Nancy Roe
____

MEMORANDUM

TO: THE COMMISSION

THRU: Ernest Johnson
Director
Utilities Division

FROM: Robert Gray
Senior Economist
Utilities Division

DATE: March 9, 2005

RE: CORRECTION TO EXHIBIT S-35, STAFF'S RESPONSE TO COMMISSIONER MUNDELL'S REQUEST FOR INFORMATION REGARDING FUTURE PSA RATES (DOCKET NO. E-01345A-03-0437)

On page 16 of the proposed order in Docket Number E-01345A-03-0437, footnote 17 indicates that it appears Staff's late-filed Exhibit S-35 contains an error related to how the bank balance is carried over from one year to the next. Staff has reviewed Exhibit S-35 and concurs that it contains an error related to how the bank balance is carried over from year to year. Staff has prepared a corrected version of the tables contained in Exhibit S-35 (attached).

Exhibit S-35 was a response to Commissioner Mundell's request to have an estimate of what the PSA rate and resulting customer bills might look like if the PSA is adopted, assuming certain natural gas prices and other inputs. The nature of the error is that in each following year the revenue generated by the PSA rate which was set in the previous year is credited toward the PSA bank balance, but the previous year's PSA bank balance which said PSA rate was created to recover was not carried forward to be recovered as part of the overall PSA bank balance accounting in the following year. This results in an underestimation of the PSA bank balance remaining to be addressed (and therefore the resulting PSA rate to address this balance) for the years 2007, 2008, and 2009. The numbers shown for 2006 do not change, as there is no PSA rate in 2005 and therefore no balance carried forward into 2006. The higher PSA bank balance estimates resulting from this correction lead to higher estimated PSA rates in the following years. The end result is mildly higher estimated customer bills for 2007 – 2009. The increases in the projected PSA rates for 2007 - 2009 as a result of this correction range from $0.00076 per kWh to $0.00324 per kWh over the 2007-2009 PSA rates shown in the original Exhibit S-35. The increases in the projected monthly customer bills for 2007-2009 as a result of this correction range from $0.58 to $2.44 over the 2007-2009 customer bills shown in the original Exhibit S-35.

It is worth noting that the calculations contained in this exhibit are estimates of possible bank balances and customer bills in future years. Actual bank balances and customer bills can and likely will vary from these estimates due to future changes in a variety of factors, including natural gas commodity and transportation costs, customer consumption patterns, and other factors.

base cost $0.020743

Scenario 11A - $5.78 gas price through 2009

	April 2006 reset 2005 gas cost	April 2007 reset 2006 gas cost	April 2008 reset 2007 gas cost	April 2009 reset 2008 gas cost
Annual Gas Cost ($000)	$332,500	$376,428	$421,671	$468,272
Annual Gas Volume (000 MMBtu)	57,527	65,126	72,954	81,016
Average Cost of Gas ($/MMBtu)	$5.78	$5.78	$5.78	$5.78
Annual Native Load Sales (MWH)	26,743,000	27,545,290	28,371,649	29,222,798
Annual Net Fuel and PP Costs	$608,700,000	$652,600,000	$697,900,000	$744,500,000
Annual Costs Recovered Thru Base Cost	$554,730,049	$571,371,950	$588,513,109	$606,168,502
Over/Undercollection (negative = overcollected)	$53,969,951	$81,228,050	$109,386,891	$138,331,498
Balance After 90/10 Application	$48,572,956	$73,105,245	$98,448,202	$124,498,348
Previous Year's Balance Carryover	$0	$48,572,956	$71,648,056	$96,298,760
Previous Year's Collection from PSA Rate	$0	-$50,030,145	-$73,797,498	-$99,187,723
Remaining Balance to Address Through New PSA Rate	$48,572,956	$71,648,056	$96,298,760	$121,609,385
Balance per kwh of Native Load Sales	$0.00182	$0.00260	$0.00339	$0.00416
Balance per kwh Captured Within $0.004 band	$0.00182	$0.00260	$0.00339	$0.00416
Balance per kwh Remaining Outside $0.004 band	$0.00000	$0.00000	$0.00000	$0.00000
Balancing Account Balance	$0	$0	$0	$0
Amount Balancing Account Exceeds $50 million	$0	$0	$0	$0

base cost $0.020743

Scenario 11B - APS Projected Gas Cost Through 2009

	April 2006 reset 2005 gas cost	April 2007 reset 2006 gas cost	April 2008 reset 2007 gas cost	April 2009 reset 2008 gas cost
Annual Gas Cost ($000)	$332,500	$386,848	$401,244	$411,560
Annual Gas Volume (000 MMBtu)	57,527	65,126	72,954	81,016
Average Cost of Gas ($/MMBtu)	$5.78	$5.94	$5.50	$5.08
Annual Native Load Sales (MWH)	26,743,000	27,545,290	28,371,649	29,222,798
Net Fuel and PP Costs	$608,700,000	$663,000,000	$677,400,000	$687,800,000
Costs Recovered Thru Base Cost	$554,730,049	$571,371,950	$588,513,109	$606,168,502
Over/Undercollection (negative = overcollected)	$53,969,951	$91,628,050	$88,886,891	$81,631,498
Balance After 90/10 Application	$48,572,956	$82,465,245	$79,998,202	$73,468,348
Previous Year's Balance Carryover	$0	$48,572,956	$81,008,056	$77,567,960
Previous Year's Collection from PSA Rate	$0	-$50,030,145	-$83,438,298	-$79,894,999
Remaining Balance to Address Through New PSA Rate	$48,572,956	$81,008,056	$77,567,960	$71,141,309
Balance per kwh of Native Load Sales	$0.00182	$0.00294	$0.00273	$0.00243
Balance per kwh Captured Within $0.004 band	$0.00182	$0.00294	$0.00273	$0.00243
Balance per kwh Remaining Outside $0.004 band	$0.00000	$0.00000	$0.00000	$0.00000
Balancing Account Balance	$0	$0	$0	$0
Amount Balancing Account Exceeds $50 million	$0	$0	$0	$0

base cost $0.020743

Scenario 11C - Gas Cost Assumes a 5% increase annually through 2009

	April 2006 reset 2005 gas cost	April 2007 reset 2006 gas cost	April 2008 reset 2007 gas cost	April 2009 reset 2008 gas cost
Annual Gas Cost ($000)	$332,500	$395,250	$464,893	$542,083
Annual Gas Volume (000 MMBtu)	57,527	65,126	72,954	81,016
Average Cost of Gas ($/MMBtu)	$5.78	$6.07	$6.37	$6.69
Annual Native Load Sales (MWH)	26,743,000	27,545,290	28,371,649	29,222,798
Net Fuel and PP Costs	$608,700,000	$671,500,000	$741,100,000	$818,300,000
Costs Recovered Thru Base Cost	$554,730,049	$571,371,950	$588,513,109	$606,168,502
Over/Undercollection (negative = overcollected)	$53,969,951	$100,128,050	$152,586,891	$212,131,498
Balance After 90/10 Application	$48,572,956	$90,115,245	$137,328,202	$190,918,348
Previous Year's Balance Carryover	$0	$48,572,956	$88,658,056	$134,668,460
Previous Year's Collection from PSA Rate	$0	-$50,030,145	-$91,317,798	-$138,708,514
Remaining Balance to Address Through New PSA Rate	$48,572,956	$88,658,056	$134,668,460	$186,878,294
Balance per kwh of Native Load Sales	$0.00182	$0.00322	$0.00475	$0.00639
Balance per kwh Captured Within $0.004 band	$0.00182	$0.00322	$0.00475	$0.00639
Balance per kwh Remaining Outside $0.004 band	$0.00000	$0.00000	$0.00000	$0.00000
Balancing Account Balance	$0	$0	$0	$0
Amount Balancing Account Exceeds $50 million	$0	$0	$0	$0

Residential Rate Schedule E-12 Rate Scenarios

June 2004 Average Residential Consumption (kwh) 738

assume summer rates used in all calculations

Scenario 11A - $5.78 Gas Price Through 2009

PSA Rate		$0.00182	$0.00260	$0.00339	$0.00416
		2006	2007	2008	2009
Rate Element	**Today**	**Settlement W/Adjustors**	**Settlement W/Adjustors**	**Settlement W/Adjustors**	**Settlement W/Adjustors**
Basic Service Charge	$7.50	$7.70	$7.70	$7.70	$7.70
Summer, 1st 400 kwh ($/kwh)	0.07376	$0.07570	$0.07570	$0.07570	$0.07570
Summer, Next 400 kwh ($/kwh)	0.10281	$0.10556	$0.10556	$0.10556	$0.10556
Summer, Over 800 kwh ($/kwh)	0.11991	$0.12314	$0.12314	$0.12314	$0.12314
Winter kwh ($/kwh)	0.07394	$0.07361	$0.07361	$0.07361	$0.07361
Bill, No Adjustments	$71.75	$73.65	$73.65	$73.65	$73.65
Removal of Franchise Fee	-$1.02				
Base Rates, Absent Franchise Fee	$70.74	$73.65	$73.65	$73.65	$73.65
PSA Rate		$1.34	$1.92	$2.50	$3.07
TCA		$0.07	$0.07	$0.07	$0.07
DSM Adjustor		$0.19	$0.19	$0.19	$0.19
EPS Surcharge/Adjustor	$0.35	$0.35	$0.35	$0.35	$0.35
CRCC		$0.25	$0.25	$0.25	$0.25
Subtotal	$71.09	$75.85	$76.43	$77.02	$77.58
Franchise Fee	$1.02	$1.39	$1.40	$1.41	$1.42
Final Bill	$72.10	$77.24	$77.83	$78.43	$79.00
% Change From Previous Year		7.1%	0.8%	0.8%	0.7%
% Change in Base Rates From Today		4.1%			

Scenario 11B - APS Projected Gas Price Through 2009

Rate Element	Today	2006 Settlement W/Adjustors	2007 Settlement W/Adjustors	2008 Settlement W/Adjustors	2009 Settlement W/Adjustors
PSA Rate		$0.00182	$0.00294	$0.00273	$0.00243
Basic Service Charge	$7.50	$7.70	$7.70	$7.70	$7.70
Summer, 1st 400 kwh ($/kwh)	0.07376	$0.07570	$0.07570	$0.07570	$0.07570
Summer, Next 400 kwh ($/kwh)	0.10281	$0.10556	$0.10556	$0.10556	$0.10556
Summer, Over 800 kwh ($/kwh)	0.11991	$0.12314	$0.12314	$0.12314	$0.12314
Winter kwh ($/kwh)	0.07394	$0.07361	$0.07361	$0.07361	$0.07361
Bill, No Adjustments	$71.75	$73.65	$73.65	$73.65	$73.65
Removal of Franchise Fee	-$1.02				
Base Rates, Absent Franchise Fee	$70.74	$73.65	$73.65	$73.65	$73.65
PSA Rate		$1.34	$2.17	$2.02	$1.80
TCA		$0.07	$0.07	$0.07	$0.07
DSM Adjustor		$0.19	$0.19	$0.19	$0.19
EPS Surcharge/Adjustor	$0.35	$0.35	$0.35	$0.35	$0.35
CRCC		$0.25	$0.25	$0.25	$0.25
Subtotal	$71.09	$75.85	$76.68	$76.53	$76.31
Franchise Fee	$1.02	$1.39	$1.40	$1.40	$1.40
Final Bill	$72.10	$77.24	$78.09	$77.93	$77.71
% Change From Previous Year		7.1%	1.1%	-0.2%	-0.3%
% Change in Base Rates From Today		4.1%			

Scenario 11C - Assumes a 5% gas price increase annually through 2009

Rate Element	Today	2006 Settlement W/Adjustors	2007 Settlement W/Adjustors	2008 Settlement W/Adjustors	2009 Settlement W/Adjustors
PSA Rate		$0.00182	$0.00322	$0.00475	$0.00639
Basic Service Charge	$7.50	$7.70	$7.70	$7.70	$7.70
Summer, 1st 400 kwh ($/kwh)	0.07376	$0.07570	$0.07570	$0.07570	$0.07570
Summer, Next 400 kwh ($/kwh)	0.10281	$0.10556	$0.10556	$0.10556	$0.10556
Summer, Over 800 kwh ($/kwh)	0.11991	$0.12314	$0.12314	$0.12314	$0.12314
Winter kwh ($/kwh)	0.07394	$0.07361	$0.07361	$0.07361	$0.07361
Bill, No Adjustments	$71.75	$73.65	$73.65	$73.65	$73.65
Removal of Franchise Fee	-$1.02				
Base Rates, Absent Franchise Fee	$70.74	$73.65	$73.65	$73.65	$73.65
PSA Rate		$1.34	$2.38	$3.50	$4.72
TCA		$0.07	$0.07	$0.07	$0.07
DSM Adjustor		$0.19	$0.19	$0.19	$0.19
EPS Surcharge/Adjustor	$0.35	$0.35	$0.35	$0.35	$0.35
CRCC		$0.25	$0.25	$0.25	$0.25
Subtotal	$71.09	$75.85	$76.89	$78.02	$79.23
Franchise Fee	$1.02	$1.39	$1.41	$1.43	$1.45
Final Bill	$72.10	$77.24	$78.30	$79.44	$80.68
% Change From Previous Year		7.1%	1.4%	1.5%	1.6%
% Change in Base Rates From Today		4.1%			

EXHIBIT
APS-7
admitted

REBUTTAL TESTIMONY OF PETER M. EWEN

On Behalf of Arizona Public Service Company

Docket No. E-01345A-05-0526

&

Docket No. E-01345A-03-0437

October 24, 2005

Table of Contents

REBUTTAL TESTIMONY OF PETER M. EWEN
ON BEHALF OF ARIZONA PUBLIC SERVICE COMPANY
(Docket No. E-01345A-05-0526 & E-01345A-03-0437)

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Peter M. Ewen. My business address is 400 N. 5th Street, Phoenix, Arizona, 85004.

Q. DID YOU PREVIOUSLY FILE DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. I am responding to the testimony of Staff witness William Gehlen filed on October 17, 2005.

II. SUMMARY

Q. COULD YOU SUMMARIZE YOUR REBUTTAL TESTIMONY?

A. Yes. APS agrees with Mr. Gehlen's analysis and principal conclusions. APS would seek clarification of Staff's suggestion that APS quantify and file monthly the power replacement costs, if any, associated with all unplanned outages regardless of type of unit or duration.

III. REPLACEMENT COST REPORTING

Q. DOES THE COMPANY GENERALLY ACCEPT THE PSA REPORTING MODIFICATIONS RECOMMENDED BY STAFF WITNESS GEHLEN?

A. Yes. Mr. Gehlen recommends that the Company change its reporting related to three issues: (1) accelerate the filing of the PSA reports to no later than 30 days following the reporting month; (2) add information on the replacement power costs for unplanned outages, and; (3) provide updated under/over-collected PSA balance projections for the following 12 month period. We agree that adding this information and making it available on a timelier basis will help Staff in their efforts to complete "quicker and more in-depth evaluations" of the PSA balancing account amounts and trends.

Q. DO YOU BELIEVE STAFF'S RECOMMENDED REPORTING MODIFICATIONS SHOULD BE CLARIFIED?

A. Yes. Specifically, I recommend that the Commission clarify what will be provided on outage costs. Staff's recommendation (Staff witness Gehlen's Direct Testimony at page 12, lines 19 - 21) could be interpreted as requiring a calculation of outage costs for every APS generating unit irrespective of the length of the outage, its lack of impact on APS operations or its materiality in terms of cost.

I believe we can satisfy Mr. Gehlen's recommendation efficiently and effectively by providing in a standard format the replacement power costs of unplanned outages for our power plants aggregated for the month by resource type: nuclear, coal, and the gas combined cycle units. These three types of units normally account for 97% of APS generation output during a typical summer month. I would note that the current report does provide outage information concerning the type and duration of both planned and unplanned outages, as well as the status (complete or in progress). The additional cost report will include the energy lost to unplanned outages, the gross replacement costs incurred in replacing that energy, the fuel savings from the plants that are incurring the unplanned outages, and the net replacement power costs resulting from the gross replacement costs less the fuel savings. Also, if Staff wishes to investigate the particular details surrounding an outage or set of outages, those details will also be made available.

Q. ARE THERE OUTAGE REPLACEMENT COSTS FOR THE GAS STEAM AND COMBUSTION TURBINE UNITS?

A. Occasionally, but these amounts are typically very small. For the April through September period this year, the sum of all outage net replacement costs for the gas steam units was $4,000. We do not even calculate the outage replacement costs for combustion turbines. These units have the highest heat rates of our generation fleet and are for many months of the year marginally economic relative to purchases from the market. With the addition over the last few years of so many new combined cycle units with heat rates of around 7,000 Btu/kWh (compared to combustion turbine heat rates in excess of 12,000 Btu/kWh), these units have seen their capacity factors drop and are being used primarily for reliability purposes rather than economic energy. Any differential in cost between buying replacement power for these units and the fuel cost avoided by not having them dispatched has proved in recent years to be very small. And as I indicated previously, if there were outages at these units that appeared to Staff from the monthly PSA reports to be unusual, Staff could specifically request the same sort of outage replacement cost information as will be provided on a routine basis for our other units.

IV. <u>CONCLUSION</u>

Q. DO YOU HAVE ANY CONCLUDING REMARKS?

A. Yes. APS believes Staff has made a number of recommendations that will improve the flow of information between the Company and the Commission on a timelier basis. With the clarification on outage costs reporting discussed in my rebuttal testimony, APS fully supports the Staff recommendations in Mr. Gehlen's testimony.

APS #8

EXHIBIT
APS-8
admitted

LEHMAN BROTHERS
EQUITY RESEARCH

March 29, 2005

North America
Energy & Power
Power & Utilities

Pinnacle West Capital (PNW - $42.12) 2-Equal weight

Company Update

Rate Cases will Continue

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Investment Conclusion

- PNW finally gets APS GRC settlement approved.

Summary

- PNW's APS received approval of the GRC settlement *with various modifications potentially impacting cash* but largely immaterial EPS impact. The ACC approval will facilitate the PWEC asset transfer filing at the FERC and therefore PNW should become nearly 100% regulated by 2006.
- Major tenents of the settlement are: 1) $67.6mil base rate hike per a 10.25% ROE on 45% equity; 2) the 1800MW of PWEC will be transferred to APS at $700mil upon FERC approval and structured with a bridge PPA prior; 3) a $776.2 mil hard cap on PP & fuel is in effect until a new case is filed or the ACC adjusts; 4) APS will defer PP & fuel costs above base levels with a surcharge filing at $50mil and the balance never to exceed $100mil; 5) off system sales benefits flow to ratepayers and 6) APS must have prior approval to self build or acquire new MW's to serve load.
- We maintain our 2-EW with a $44 target (14X our $3.15 in 2006).

EPS ($) (FY Dec)

	2004	2005			2006			% Change	
	Actual	Old	New	St. Est.	Old	New	St. Est.	2005	2006
1Q	0.33A	N/A	N/A	0.42E	N/A	N/A	0.00E	N/A	N/A
2Q	0.55A	N/A	N/A	0.76E	N/A	N/A	0.00E	N/A	N/A
3Q	1.15A	N/A	N/A	1.44E	N/A	N/A	0.00E	N/A	N/A
4Q	0.33A	N/A	N/A	0.39E	N/A	N/A	0.00E	N/A	N/A
Year	2.39A	2.85E	2.85E	3.01E	3.15E	3.15E	3.10E	19%	11%
P/E			14.78			13.37			

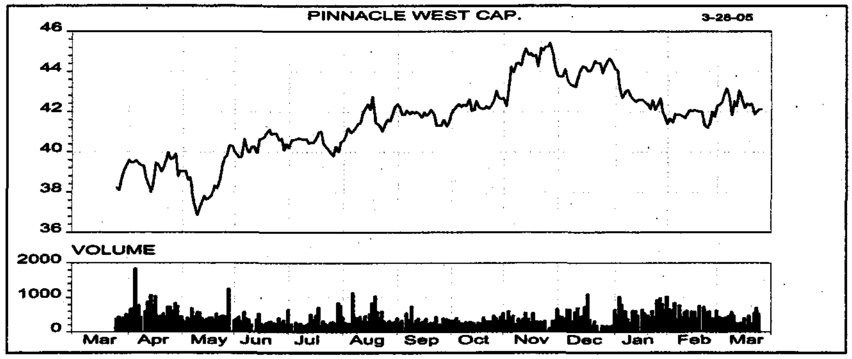
Market Data

Market Cap	3.85B
Shares Outstanding (Mil)	91.50
Float	91.40
Dividend Yield	4.51%
Convertible	No
52 wk Range	45.84 - 36.30

Financial Summary

Revenue FY05	N/A
Five-Year EPS CAGR	4.00%
Return on Equity	10%
Current BVPS	32.24
Debt To Capital	53.02%

Stock Overview



Stock Rating:

New: 2-Equal weight
Old: 2-Equal weight

Target:

New: 44.00
Old: 44.00

Sector View: 3-Negative

We view the ACC final approval as a mixed outcome as a final outcome is productive, but the process was lengthy and less satisfactory financially vs history despite the settled nature. As a result of the PSA structure, Sundance acquisition and related deferral mechanisms and rapid customer growth, it appears APS will likely file yet another rate case in late 2005/early 2006 for recovery of the aforementioned. While the rate cases aren't per se a negative, the length of the process (19months this time) and the likelihood that APS will start seeing cash recovery lag like many Western utilities is a modest negative shift in our view versus PNW's history of settled outcomes leading to healthy ROE's post settlement.

We maintain our 2-EW rating with a $44 price target. While, in our opinion, PNW is a well managed utility with superior growth prospects and a healthy dividend, we believe AZ regulation is taking a modest turn in the negative direction. Given the growth of the region and

PLEASE SEE ANALYST(S) CERTIFICATION(S) ON PAGE 2 AND IMPORTANT DISCLOSURES BEGINNING ON PAGE 3

obvious datapoints around what capped fuel/PP rates can lead to in the West, we would prefer a more flexible/incentive based structure to encourage efficiency, reliability and promote economic incentives to construct incremental infrastructure.

What's Next

First up, PNW will be looking for FERC approval of the PWEC asset transfer to APS, and separately for FERC approval of the Sundance acquisition from PPL. As APS has yet to file for the PWEC transfer, we expect this process will complete during late 2005/early 2006. Given the motivation of both parties, we expect the Sundance deal to ultimately close but no FERC timeline currently exists.

With approval of the GRC behind the company, we will be looking for PNW to completely exit the merchant business. Specifically, we expect the Silverhawk plant could be sold with the company taking a hit on the balance sheet, but improving EPS by up to $0.25-0.30 annually. Given the plant's location in Southern Nevada, we wouldn't be surprised if NVP/SNWA have interest in the plant.

Analyst Certification:

We, Daniel Ford, CFA and Thomas O'Neill, CFA, hereby certify (1) that the views expressed in this research Company Note accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Company Note and (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Company Note.

Company Description:

Security Description

citigroup
Smith Barney
Small/Mid-Cap Research

See page 6 for Analyst Certification and Important Disclosures

Estimate Change ☑

Pinnacle West Capital Corporation (PNW)

HOLD (2)
Medium Risk (M)

PNW: ACC Approves Settlement; Sundance & Silverhawk Key Value Drivers

Mkt Cap: **$3,833 mil.**

United States

March 29, 2005

ELECTRIC UTILITIES

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SUMMARY

- On 3/28/05 the ACC voted to approve, with minor amendments, the pending general rate case settlement for APS. The settlement ratebases 1,700MW of generation, provides for a retail rate increase, and the implementation of a Power Supply Adjustor (PSA).
- The key modifications to the settlement are amendments to the PSA giving the ACC more involvement in fuel cost recovery, as well as capping recoverable fuel and purchased power costs at $776mm per year.
- Our annual forecasts remain unchanged, as we feel PNW can live within the means of this cap in '05 and '06, with rate issues post-'06 addressed in the expected rate case proceeding for the Sundance acquisition.
- With the settlement behind PNW, we see the key value drivers going forward as the constructive resolution of rates related to Sundance and the potential sale of PNW's sole remaining merchant plant, Silverhawk.

FUNDAMENTALS

P/E (12/05E)	13.9x
P/E (12/06E)	13.9x
TEV/EBITDA (12/05E)	6.4x
TEV/EBITDA (12/06E)	6.5x
Book Value/Share (12/05E)	$33.21
Price/Book Value	1.3x
Revenue (12/05E)	$3,373.3 mil.
Proj. Long-Term EPS Growth	8%
ROE (12/05E)	9.2%
Long-Term Debt to Capital(a)	52.4%

PNW is in the S&P 500® Index.

(a) Data as of most recent quarter

SHARE DATA

Price (3/29/05)	$41.76
52-Week Range	$45.41-$36.85
Shares Outstanding(a)	91.8 mil.
Div(E) (Cur/Prev)	**$1.93**/$1.93

RECOMMENDATION

Rating (Cur/Prev)	2M/2M
Target Price (Cur/Prev)	**$42.00**/$42.00
Expected Share Price Return	0.6%
Expected Dividend Yield	4.6%
Expected Total Return	5.2%

EARNINGS PER SHARE

FY ends		1Q	2Q	3Q	4Q	Full Year
12/04A	**Actual**	**$0.33A**	**$0.55A**	**$1.15A**	**$0.34A**	**$2.39A**
12/05E	**Current**	**$0.36E**	**$0.72E**	**$1.47E**	**$0.45E**	**$3.00E**
	Previous	$0.36E	$0.73E	$1.47E	$0.44E	$3.00E
12/06E	**Current**	**NA**	**NA**	**NA**	**NA**	**$3.00E**
	Previous	NA	NA	NA	NA	$3.00E
12/07E	**Current**	**NA**	**NA**	**NA**	**NA**	**$3.25E**
	Previous	NA	NA	NA	NA	$3.25E

First Call Consensus EPS: 12/05E NA; 12/06E NA; 12/07E NA

OPINION

We view the resolution of PNW's general rate case settlement as constructive. With the settlement behind PNW, we see the key value drivers going forward to be the constructive resolution of rates related to Sundance acquisition and addition capital investment for rate implementation in '07. Additionally, we look to the elimination of losses from our forecasted expected sale of PNW's sole remaining merchant asset, Silverhawk, by year-end 2005.

KEY COMPONENTS OF APS GENERAL RATE CASE SETTLEMENT

On 3/28/05, the Arizona Corporation Commission (ACC_ voted to approve APS' pending general rate case settlement. Implementation of rates will become effective April 1, 2005. The key components of the settlement as agreed to by the ACC Staff, intervenors, and APS on 8/14/04 are as follows:

- APS will receive a $67.6mm retail rate increase, premised on a 10.25% allowed ROE and 45% equity capitalization. Additionally, APS will receive a $7.9mm revenue increase to recover $47.7mm costs previously incurred to comply with the ACC's 1999 electric competition rules over a five year period.
- The dedicated PWEC assets (1,700MW) will be transferred into rate base, after a write down of $148mm, at a value of $700mm.
- A power supply adjuster will provide for the recovery of prudently incurred fuel and purchased power costs. The adjuster will have a sharing mechanism where the cost and savings above a base cost of fuel and purchased power would be distributed 90% customers / 10% APS.
- APS will not be allowed to recover in rates a $234mm write-off as a result of the 1999 settlement agreement.
- APS will adopt longer service lives for certain depreciable assets, which would have the effect of reducing annual depreciation by approximately $26mm.

KEY MODIFICATIONS TO THE APPROVED SETTLEMENT

The key modifications to the initial settlement were amendments to the PSA to afford the ACC more involvement in the process of PSA recovery, as well as, capping recoverable fuel and purchased power cost at $776mm per year. Our annual forecasts remain unchanged, as we fell PNW can live within the means of this cap in '05 and '06.

The company has stated that it does not expect exceed these costs in '05 and '06, and we tend to agree. Additionally, with the assumption of a backwardated natural gas forward curve, we believe the APS could remain below this cap in '07 even with its strong projected load growth. Nevertheless, to the extent that APS could exceed this cap in '07 we feel it will be addressed in the expected rate case proceeding for ratebasing of Sundance.

Key modifications to the settlement PSA are as follows:

- As per the initial proposed PSA, the base cost of fuel and purchased power will be set at $20.743/MWh and APS will record deferrals to the extent that actual fuel and purchased power costs exceed this base rate;
- Amounts to be recovered or refunded through the PSA are limited to +/- $4.00/MWh *over the life* of the PSA, as opposed to the initial proposed bandwidth to the adjustor rate of +/- $4.00/MWh *per year*.

In addition, the ACC decision provides for a surcharge mechanism as follows:

- Each time the accumulated pretax net deferrals reach $50 million, APS must notify the ACC, but prior to the deferral balance exceeding $100 million, APS must file with the ACC to recover or refund such deferral balance through a surcharge;
- However, amounts recovered or refunded through any surcharge are not included in the $4.00/MWh PSA limit.

The final key modification to the PSA is the implementation of a cap to overall recoveries of net fuel and purchased power over the life of the PSA.

- The recoverable amount of net fuel and purchased power costs is capped at $776.2 million per year. Any fuel or purchased power costs above that threshold will not be recovered from ratepayers.

The other key modification independent of the PSA is related to the procurement of generation capacity:

- The initial settlement stipulated that APS would not pursue any self-build option within in-service date prior to 2015, unless expressly authorized by the commission;
- This self-build moratorium for generating plants was modified to include acquisition of a generating unit, or an interest in a generating unit, from any utility or merchant generator without prior ACC approval.

SUMMARY OF KEY CHANGES TO SETTLEMENT PSA

	Initial Settlement	Administrative Law Judge (ALJ) Recommendation	Changes to Approved Settlement
Base Fuel & PP Rate	$20.743/MWh	NA	NA
Sharing Levels	Costs / savings distributed 90% customers / 10% APS	NA	NA
Adjustor Bandwidth	$4.00/MWh per year	NA	$4.00/MWh in total
Surcharge Level	At +/- $50mm APS would need to file within 45 days for approval of a surcharge to amortize the balance and reset the balancing account to zero. If APS does not want to reset balance it must file a repot to explain why	NA	At +/-$50mm, APS must notify the ACC, but prior to the deferral balance exceeding $100 million, APS must file with the ACC to recover or refund such deferral balance through a surcharge
Life of Adjustor	Minimum of 5 years. ACC shall consider continuation after APS files PSA report or files new rate case, but any recommendations to abolish shall not take effect until after 5 years	ACC would be able to eliminate the PSA at any time if APS files a rate case before the expiration of the five-year period or APS does not comply with the terms of the PSA	PSA will be reviewed for continuation in APS' next rate case filing. APS intends to file a rate case by year-end '05 for rate implementation by '07
Total Cap on Recovery	NA	Cap on natural gas cost recoveries at $500mm	Cap net fuel & purchased power recoveries at $776mm

Source: Regulatory Filings, Smith Barney

VALUATION

We arrive at our target price of $42 based on applying a 14x P/E multiple on our'06E EPS of $3.00/share. Our multiple in-line with the average defensive utility multiple, which takes into account '07E earnings upside from rate increases for a return on the Sundance acquisition and a decrease in diversified earnings pressure. Overall, we believe this target multiple reflects Pinnacle's high proportion of regulated earnings and dividend growth, offset by a weak balance sheet and potential future regulatory risk.

Our average target P/E ratio for the defensive sub-group is 14.0x '06, a relative P/E of .92x to the S&P 500, and a premium to the historical median of 0.70x for electric utility stocks, given our analysis. We arrived at the target price by assessing fundamentals and utilizing our dividend matrix analysis to determine investor yield appetite given the current interest rate outlook. We are assuming an increase in 10-year Treasury note yields to between 5 – 5.5%.

Balance Sheet: Should remain stable. Our target price for PNW is based on a 7.7x EV/EBITDA multiple at year-end 2005, a premium to the median historical multiple of 6.8x for the defensive sub-group, but consistent with prior periods of overall market stability and utility credit quality, when taking into account the current low interest rate environment as it relates to defensive utility valuations. We believe our target reflects the potential future financial performance of PNW.

Standard & Poor's currently rates PNW "BBB". We expect leverage to peak at 55% debt/capital at year-end 2003 and decline slightly to approximately 53% by year-end 2007. Assuming positive regulatory treatment, PNW would have free cash after the 2007 period of increased capital expenditures to pay down debt.

Cash Flow: Capital expenditure program at the utility consumes cash in 2006. We expect PNW to generate a cash yield of 1.0% in 2006 and 1.0% in 2007, compared to cash yields averaging 2.9% and 4.1% for its peer group. This generates a cash/dividend ratio (CDR) of 0.2x and 0.2x in 2006 and 2007, as PNW is forecasting increased capital expenditures relating to environmental costs and transmission infrastructure through 2006. This compares to a forecasted defensive peer group CDR of 0.6x and 0.6x in 2006 and 2007.

Dividend Profile: We expect continued 6% growth in the common dividend: PNW has consistently grown its dividend over the last several years at a rate of 6%. The $1.93 payout expected in fiscal year 2005 represents a 64% payout ratio and a 4.6% yield. Defensive electrics currently have 4.8% average yields at a payout ratio of 69% and an average dividend growth rate of 4%.

RISKS

We rate PNW Medium Risk, as stability in the earnings of its core utility business (94% of 2006 EPS) will likely be smoothed with the approval of it 2005 rate case decision and credit quality should remain stable. Now that the regulatory overhang is lifted, we expect PNW's stock price volatility to be consistent with its historic beta of 0.58. Risks to the stock achieving our valuation target include the following:

PNW has commodity exposure to the extent that fuel and purchased power cost exceed the cap on its power supply adjustor. Pursuant to the approved settlement, APS is afforded recovery of the majority of its prudently incurred fuel and purchased power cost up to a cap of $776mm. To the extent that APS cannot remain under this cap, costs would not be recoverable from ratepayers.

Approved Settlement still requires FERC approval. Although the ACC has approved the settlement agreement, the stipulations still require Federal Energy Regulatory Commission (FERC) approval. However, it appears the possible risk of FERC intervention could be mitigated by the agreement's option of creating a 30-year PPA between PWEC and APS with pricing that reflects the cost-of-service as if APS had acquired and rate based the assets. We expect FERC approval by 3Q '05.

PNW may not get favorable regulatory treatment on the acquisition of Sundance. On January 11, 2005, the ACC approved the 36-month deferral of capital and operating cost related to Sundance. However, the company currently believes that the conditions imposed by the ACC final Sundance order could substantially limit the amount of deferrals that APS could be able to record. We assume that APS ultimately receives favorable rate treatment and is allow to earn recovery of and a return on its investment starting in '07E. Less than constructive rate treatment could cause earnings pressure in relation to our current forecast.

Absent a sale of the asset, Silverhawk is a drag on earnings in the near-term. The current spark spread environment will create an earnings drag from Silverhawk through our forecast period. We assume a sale of this asset and the subsequent reversal of these losses. A risk to our target price is the continued drag on consolidated earnings forecast if the asset is not sold.

SunCor's has low-quality earnings. Currently, the real estate development segment of PNW is implementing an accelerated asset sale program to bolster earnings and cash flow. A portion of these earnings will be considered discontinued operations. Additionally, we estimate the systemic EPS and cash flow is roughly 20% of the $0.54/share in 2005 EPS. We believe that investors will value PNW assuming a lower SunCor contribution. In the short run, failure to execute the accelerated sale program could affect EPS and cash flow and could have a negative effect on our target price.

If the impact on the company from any of these factors proves to be greater than we anticipate, the stock will likely have difficulty achieving our target price. On the other hand, we may have overestimated these risks and the stock could increase more than we expect.

INVESTMENT THESIS

We rate the shares of Pinnacle West Capital Corporation Hold/Medium Risk (2M). The state of Arizona has backtracked from its deregulation experiment and re-bundled rates in the context of its recent APS rate decision. Assuming a stable financial outlook is achieved through continued constructive resolution of rate issues, we believe Pinnacle could be a well-positioned defensive company with the potential for above-average earnings and dividend growth as they serve the needs of a growing Arizona service territory. Under our forecast we assume the company can continue to grow its dividend at the historic rate of 6%.

COMPANY DESCRIPTION

Pinnacle West Capital Corporation (PNW) is a holding company for Arizona Public Service (APS), an electric utility that provides retail and wholesale electric service to substantially all of the state of Arizona, except the Tucson metropolitan area and half of the Phoenix metropolitan area. APS serves more than 900,000 customers and owns almost 4,000MW of regulated generation facilities. Pinnacle West Energy (PWEC), a competitive generation subsidiary, is engaged in the development of generation plants and the production of wholesale electricity. PWEC has over 2,000MW of generation, either in service or in construction. PNW's other affiliates include SunCor Development Company, a developer of residential, commercial and industrial real estate; APS Energy Services, a retail energy service provider; and El Dorado Investment Company, a venture capital and investment firm.

HARRIS NESBITT

Research Comment

March 30, 2005

Pinnacle West Capital

(PNW-NYSE)

Electric Utilities and Independent Power

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Stock Rating: **Neutral**
Industry Rating: **Negative**

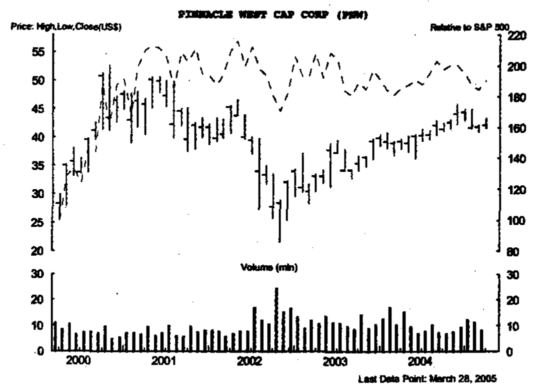
Securities Info

Price (29-Mar)	$41.76	Target Price	$42
52-Wk High/Low	$46/$36	Dividend	$1.90
Mkt Cap (mm)	$3,833	Yield	4.5%
Shs O/S (mm)	91.8	Float O/S (mm)	91.4
Options O/S (mm)	2.2	Avg Daily Vol (000s)	427

Selected Bond Iss	Ind Prc	Rat'g Mdys/S&P	YTW	Spread
Pinnacle West 4.5% '0	na	WR / BBB-		na
Pinnacle West 6.4% '0	102	Baa2 / BBB-	4.85%	169bp

Bond data from Bloomberg.

Price Performance



Valuation/Financial Data

(FY-Dec.)	2003A	2004A	2005E	2006E
EPS Pro Forma	$2.63	$2.39	$2.95	$3.19
P/E			14.2x	13.1x
First Call Cons.			*$3.01*	*$3.10*
EPS GAAP	$2.63	na	na	na
FCF	$2.02	$3.02	-$0.36	$2.10
P/FCF			nm	19.9x
EBITDA ($mm)	$920	$942	$973	$1,051
EV/EBITDA			6.9x	6.4x
Rev. ($mm)	$2,818	$2,900	$3,044	$3,147
EV/Rev			2.2x	2.1x
FCF after Div. ($mm)	$28	$102	-$216	$0

Quarterly EPS	1Q	2Q	3Q	4Q
2004A	$0.33	$0.55	$1.15	$0.36
2005E	na	na	na	na

Balance Sheet Data (1-Dec)			
Net Debt ($mm)	$2,929	TotalDebt/EBITDA	3.4x
Total Debt ($mm)	$3,273	EBITDA/IntExp	5.6x
Net Debt/Cap.	47.1%	Price/Book	1.3x

Commission Approves Rate Settlement; No Change in EPS Estimates

Event

The Arizona commission authorized a $75.5 million (4.21%) increase for Arizona Public Service (PNW's utility subsidiary) and the establishment of a fuel adjustment clause. The rate order largely tracked the settlement filed by the utility and various other parties in August 2004.

Impact

The commission decision was in line with expectations, although it did expand the cap on recoverable fuel and purchased power expenses to $776 million from $500 million (for natural gas only). We believe the new cap is more reasonable and unlikely to be exceeded over the next two years, assuming natural gas prices do not increase significantly from current levels.

Forecasts

We maintain our 2005 and 2006 EPS estimates of $2.95 and $3.19, respectively. We had earlier lowered our estimates to reflect the rate settlement.

Valuation

We find PNW shares fairly valued, with the 4.5% yield providing support at the current price, in our view.

Recommendation

We reiterate our **NEUTRAL** rating, recognizing that despite the commission's approval of the settlement, Arizona remains a challenging regulatory jurisdiction and PNW will be filing another significant general rate case later this year.

Please refer to pages 4 to 6 for Disclosure Statements, including the Analyst's Certification.

Details & Analysis

We view the commission's approval of Arizona Public Service's rate settlement as a positive, resolving some level of uncertainty from the PNW story. However, we remain cautious regarding investment in PNW shares and reiterate our **NEUTRAL** rating. In our view, regulatory uncertainty is a constant for Pinnacle West. The company expects to file another significant general rate case later this year, in part to seek rate base recovery of its pending acquisition of the Sundance gas-fired peaking plant. Given the precedent set by the Arizona commission, we would not expect a decision before 2007.

We expect the need for rate relief to be ongoing as PNW's utility, Arizona Public Service (APS), adds new generation to serve load growth. In particular, APS remains short of peaking capacity, even after assuming completion of the pending acquisition of the Sundance plant (pending FERC approval, which is expected shortly) and the transfer of 1,800 Mw of non-regulated generation from wholesale subsidiary, Pinnacle West Energy to Arizona Public Service (as approved under the current rate order). APS intends to issue an RFP (request for proposals) for 1,000 Mw of peaking capacity beginning in 2007, and 100 Mw of renewable energy beginning in 2006.

Details of the Rate Order

On March 28, 2005, the Arizona commission adopted new rates for Arizona Public Service (APS) based largely upon an agreement between APS and 21 other parties that settled issues involved in the company's general rate case filed in June 2003.

Key provisions of the rate order include:

- A $75.5 million (4.21%) rate increase;
- A fuel adjustment clause (PSA) – adjustment to the PSA, first expected to take effect in April 2006, is capped at 4 mils/kwh, or approximately 5% in addition to the increase in base rates. APS is required to file with the commission for a surcharge if unrecovered costs reach $50 million;
- The recoverable amount of net fuel and purchased power costs is capped at $776.2 million per year. APS does not expect to exceed the cap in 2005 or 2006 (a new base would be determined in the next general rate case);
- The transfer to APS of power plants in Arizona currently owned by Pinnacle West Energy and placed in service between 2001 and 2003. The company intends to seek FERC approval for the transfer;
- A disallowance of $148 million related to these same Pinnacle West Energy generating assets (taken in 2004);
- Requirements for energy efficiency initiatives and a significant increase in APS' commitment to renewable energy;

- Measures to address service improvements to Native American communities in Arizona, particularly in remote areas, and,
- A competitive procurement process to promote wholesale competition and which precludes APS from building or buying new fossil fuel power plants before 2015 unless expressly authorized by the commission or found necessary to maintain reliable service to APS customers.

No Change in Earnings Outlook

We maintain our 2005 EPS estimate of $2.95, which had previously been adjusted to reflect the August 2004 settlement proposal. While the company continues to benefit from operating in one of the fastest-growing regions of the country, the costs associated with serving this growing load continue to escalate. Our 2006 estimate of $3.19 reflects a full year of higher rates as well as the continued cost pressures. We expect PNW to file for rate relief in late 2005, but given the regulatory lag that has been the norm in Arizona, we would not expect the case to be concluded before 2007.

Our 2005 estimate assumes a $0.55 per share contribution from SunCor Development. We note that 2005 is the last year of the company's three-year accelerated sales program and we would expect earnings from this business to fall off sharply in 2006 to about $0.10-$0.15. We would expect a portion of this shortfall to be offset by a full year of rate relief at the utility as well as modest strengthening in wholesale markets.

Fitch Affirms PNW & APS' Unsecured Ratings at 'BBB' & 'BBB+'; Outlook Stable

Fitch Ratings-New York-March 30, 2005: Fitch Ratings has affirmed the senior unsecured debt ratings of Pinnacle West Capital Corporation (PNW) at 'BBB' and the senior unsecured ratings of its wholly owned electric utility subsidiary, Arizona Public Service Company (APS), at 'BBB+'. Fitch has also affirmed APS' 'BBB' secured lease obligation bond ratings and both PNW and APS' 'F2'commercial paper ratings. The Rating Outlook for all PNW and APS securities is Stable. The affirmation of the PNW and APS ratings by Fitch resolves the Negative Rating Outlook, which was initially adopted in May 2003 to reflect the possibility that the Arizona Corporation Commission (ACC) would not allow unregulated generation built by PNW to meet APS load growth to be transferred and included in the utility's rate base.

The rating affirmation and Stable Outlook for PNW and APS reflects the constructive final outcome in the utility's general rate case (GRC) that, in Fitch's view, will result in a meaningfully improved risk profile at APS and its direct parent, PNW. The ratings and Stable Outlook also consider PNW and APS' solid interest coverage ratios, moderately high debt leverage ratios relative to the current rating category, and the utility's attractive service territory characteristics.

On Monday, March 28, 2005, the Arizona Corporation Commission (ACC) issued a final order in APS' GRC adopting, with relatively minor modifications, the utility's proposed settlement agreement with virtually all relevant intervenor groups. The ACC order approves the transfer of 1,800 megawatts of non-utility generating capacity built by PNW's unregulated subsidiary, Pinnacle West Energy Corp. (PWEC), to APS and inclusion in the utility's rate base. The ACC order also approved the settlement's moratorium on APS' ability to self-build for nearly 10 years, implying greater reliance on wholesale generators to meet its rapid native load growth. However, the company retains the self-build option if wholesale power markets are unable to effectively meet the company's supply requirements and can, in any event, purchase unregulated generating capacity with commission approval.

In addition, the ACC order adopts a power supply adjuster (PSA), which is expected to significantly reduce APS commodity risk. The PSA allows 90% of net costs or benefits resulting from deviations in fuel and purchase power costs from amounts included in the rate base to be passed through to customers. The automatic pass-through feature is subject to approximately a $100 million cumulative cap on cost overruns, at which point ACC approval would be required to recover additional fuel and purchase power costs. The ACC order also authorizes a $75 million rate increase based on a 10.25% authorized return on equity. The rate increase marks the conclusion of the utility's first general rate case in 14 years, during which time customer rates were lowered 16%.

The revenue increase at PNW's utility operation is expected to enhance APS' relative contribution to consolidated PNW results, as SunCor (PNW's real estate development business) approaches the end of its 2003-2005 accelerated sales program. As a result, Fitch expects the mix of PNW's operating income and cash flow to improve significantly. The primary credit concern is the possibility that APS' significant capital spending requirements over 2005-2006 to meet rapid Arizona native load growth will result in a meaningful increase in debt leverage and/or regulatory disallowances.

Under the terms of the ACC-approved settlement agreement, APS is expected to acquire the 1,800 megawatts of PWEC generating capacity at a price of $700 million. The purchase price compares to a carrying value of approximately $850 million and is estimated by Fitch to result in a $148 million pretax charge to earnings in 2005. APS' $500 million intercompany loan is expected to be used by the utility to fund the acquisition of the PWEC assets, which is expected to close later this year. FERC approval is needed for the PWEC assets to be included in rates.

PNW and APS' ratings by Fitch are as follows:

Pinnacle West Capital:

--Senior unsecured debt 'BBB';

--Commercial paper 'F2'.

Arizona Public Service Co.:

--Senior unsecured debt 'BBB+';

--Secured lease obligation bonds 'BBB';

--Commercial Paper 'F2'.

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Research:

Research Update: Outlook On Pinnacle West Capital Corp. And APS's Ratings To Stable On Resolution Of Rate Case

Publication date: 01-Apr-2005
Primary Credit Analyst(s): Anne Selting, San Francisco (1) 415-371-5009; anne_selting@standardandpoors.com

Credit Rating: BBB/Stable/A-2

Rationale

On April 1, 2005, Standard & Poor's Ratings Services revised the outlook to stable from negative and affirmed the ratings on Pinnacle West Capital Corp. (PWCC) and Arizona Public Service Co. (APS), the company's wholly owned electric utility, reflecting the long-awaited resolution of APS' general rate case.

The Arizona Corporation Commission (ACC) voted 4-1 on March 28, 2005 to adopt with few changes the terms of a settlement agreement negotiated by 21 of 22 parties in August 2004 and thereby resolve many of the issues that have challenged the consolidated credit quality of PWCC and APS.

Among the most significant benefits of the settlement is the rate-basing of 1,790 MW of generation that is currently owned by Pinnacle West Energy Corp (PWEC), PWCC's nonregulated wholesale generation subsidiary. The assets will be transferred at a value of $700 million, which represents a disallowance of approximately $148 million. As a result, PWEC's merchant plant ownership will drop from about 2,200 MW of nameplate capacity to about 425 MW, significantly lowering the business risk profile of PWCC.

The transfer will require the approval of the FERC, which must assess the extent to which APS could exert regional market power if the rate-basing is approved. Until FERC authorization is granted, APS and PWEC will enter into a cost-based power purchase agreement (PPA), which will be extended to 30 years in the event that the FERC rejects APS' request. If the rate-basing is rejected, the PPA is structured to mimic the benefits that would otherwise accrue to PWCC and APS under rate-basing. Because load growth in APS' service territory is projected to grow between 4%-6% per year over the next five years, APS will still need an additional 1,200 MW by the summer of 2007 to fill the gap between power supply and demand.

The substantial reduction in PWEC's operations, combined with PWCC management's demonstrated commitment to scale back the activities of its three other unregulated subsidiaries--SunCor, El Dorado and APS Energy Services--has resulted in an improved consolidated business profile score of '5' from a '6', based on Standard & Poor's 10-point scale, where '1' represents the strongest profile. APS' business profile of '5' is unchanged.

The ACC also approved a 4.21% increase in base electric rates, which will go into effect April 1, 2005. This rate increase, along with other measures management has taken, are expected to be sufficient to maintain credit metrics in the 'BBB' category. However, because the rate increase falls short of the original 9.8% rate increase sought by the utility, it is likely that APS will need to file a new rate case in the next several years. The utility faces continued regulatory challenges in seeking rate relief. The authorization of a fuel and purchased power mechanism, called the Power Supply Adjuster (PSA), is expected to provide only modest protection to the utility in the interim because of structural weaknesses in its design. Specifically, base fuel and purchased power costs are set at 2.1 cents/kilowatt-hour (kWh), a level that is low relative to APS' projected fuel costs. While APS may request annually that the PSA be used to collect fuel, purchased power, and hedging costs in excess of this base rate, any authorized increases are capped at 4 mills/kWh over the life of the PSA. APS expects it will reach the 4 mill limit in the first year. An additional limitation exists that caps APS' total fuel costs in any calendar year to $776 million. APS may not collect through the PSA any expenses that exceed this amount, but instead must file a rate case with the ACC. The 21-month resolution of the current rate case, which APS originally filed in June 2003, indicates that APS may not be able to rely on rate cases to provide timely adjustments to the base fuel and power purchase rate.

The decision does give the ACC the ability to establish an additional surcharge for fuel and purchased power costs outside of the annual PSA calculation. APS must notify the ACC if power and fuel cost deferrals exceed $50 million on its balance sheet, and if deferrals rise to $100 million, the ACC may elect to implement a surcharge in addition to the PSA. But the requirement for the ACC to do so, and the timing of its actions, as well as the amortization of cost recovery it would elect in such an instance, are uncertain.

APS has hedged approximately 75% of its natural gas needs for 2005 and approximately 40% for 2006, which mitigates the exposure that the utility will have under the PSA in the short term. However, over time, it is likely that APS will need a stronger PSA to maintain its current credit ratings, particularly given the expectation that over the next five years APS' fuel mix will become heavily concentrated in natural gas.

Short-term credit factors

PWCC's liquidity is adequate, and as of March 31, 2005, PWCC's consolidated cash and cash equivalents position was approximately $250 million. This very strong cash position is due largely to APS' issuance of $300 million in notes in June 2004 in order to prefinance about $400 million in utility obligations due in January and August 2005.

Both PWCC and APS maintain CP programs. Neither program had any CP balances as of March 31, 2005. PWCC's program is for $250 million and is supported by a three-year, $300 million credit facility that PWCC put into place in October 2004. The revolver allows PWCC to use up to $100 million of the facility for letters of credit. The revolver has no material adverse change clauses pertaining to outstanding CP balances.

APS maintains a $250 million CP program. In May 2004, APS renegotiated its revolver and increased the size to $325 million. Also a three-year term, the facility supports the utility's CP program and provides another $75 million for other liquidity needs, including letters of credit. The supporting facility has no material adverse change clauses pertaining to outstanding CP balances.

The revolvers do not have any termination triggers tied to credit downgrades, but they do have restrictive covenants, including interest coverage and leverage tests. The agreements also have cross-default provisions.

Outlook

The stable outlook reflects the expectation that PWCC will continue to focus on the regulated operations of APS, which is projected to contribute more than 85% of its funds from operations in 2005. The failure of PWCC or APS to meet expected financial results in 2005 and 2006, particularly in light of the weakening in consolidated and utility credit metrics in 2004, could lead to a downward revision of the outlook or a ratings change. Downward pressure on the ratings will occur if APS incurs significant power or fuel cost deferrals in excess of the PSA's limitations. Any positive rating action is unlikely in the near-term given the financial metrics and the longer term risks that the terms of the PSA present.

Ratings List

	To	From
Pinnacle West Capital Corp.		
Corporate credit rating	BBB/Stable	BBB/Negative
Senior unsecured debt	BBB-	
Commercial paper	A-2	

Arizona Public Service Co.		
Corporate credit rating	BBB/Stable	BBB/Negative
Senior unsecured debt	BBB	
Commercial paper	A-2	

Complete ratings information is available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; under Credit Ratings in the left navigation bar, select Find a Rating, then Credit Ratings Search.

Morgan Stanley

Equity Research
North America

Industry

Electric Utilities

Industry Overview

April 10, 2005

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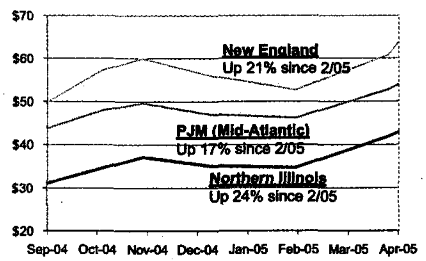
GICS SECTOR	UTILITIES
Strategist's Recommended Weight	2.7%
S&P 500 Weight	3.2%

Rolling Forward 12 Month (Year 1) Around the Clock Prices



Second-Level Commodity Plays Come out of Hiding

- **What's New: Power prices are higher and could stay there**
  Sharply higher current forward power prices (15-25% vs. 2/05). May be indicative of semi-permanent new higher levels - not only high gas prices but rising coal, emission allowances, and growing tightness of nuke and coal plant availability may mean further rising power prices driven not just by volatile gas.
- **Conclusion: Consensus could be too low**
  Stock market may be significantly low on low-cost nuke/western coal generators (and too optimistic about coal/gas burners and power buyers). Aggressive hedging is likely to lock in sharp EPS increases for low-cost sellers.
- **Stock Implications: EIX, ETR and EXC could see the most EPS upside**
  At current forward power prices, much already locked in, it appears to us that EIX is highly likely to beat consensus 2005 and 2006 estimates and ETR 2007 estimates, even if power prices fall sharply. We believe stand-alone EXC projections, assuming an Illinois auction, could produce $4.00-$4.50 EPS, which we believe is far above consensus thinking. All three stocks could produce high single to double-digit EPS growth over 3-5 years.

  Coal and power purchasers like AEP, PPL (East & West), and FE (East) and gas/power buyers PNW & PSD could see margin pressure in the near and middle term.
- **Industry View: Cautious**
  Historical tendency of the electrics is to underperform in a rising interest rate environment. Relative P/E is near the top of 15-year range, which may be difficult to sustain given our view of rising capex and declining margins for many utilities over the next several years.

Please see analyst certification and other important disclosures starting on page 22.

Who Gets Hurt by Higher Commodity Prices?

Exhibit 11

Higher Commodity Prices = Potential Harm for Coal Burners/Net Power Purchasers

		Comments
Coal Burners (1)	AEP, PPL	Margin squeeze from rising coal & emissions allowance costs.
	FE	OH rate deal allows for fuel recovery, but could be subject to prudency reviews.
Short Power - East	FE	Mostly hedged on power requirements, but poor execution could result in high-cost open market purchases.
Short Power - West	PNW, PSD	Both are essentially covered under fuel clauses - but cash recovery could be subject to regulatory lag.
	PPL, ScottishPower	At risk due to dry hydro conditions.

(1) Some possible offset from higher margin on wholesale sales, but most are done during off-peak prices, where volatility is not as great as during peak periods.

JPMorgan

US Equity Research
J.P. Morgan Securities Inc.
April 27, 2005

Pinnacle West Capital Corp

Maintaining Estimate Despite Equity Issuance

Pinnacle West Capital Corp **Neutral**

Ticker	*PNW*	*EPS*	2004A	2005E	2006E
Price(04/27/05)	$42.47	**1Q (Mar)**	$0.33	$0.27A	
52-Wk.Range	$36.30-45.84	**2Q (Jun)**	$0.55		
Mkt.Cap(BN)	$3.92	**3Q (Sep)**	$1.15		
Fiscal Year	Dec	**4Q (Dec)**	$0.34		
Shares O/S(MM)	92.08	**FY**	$2.39	$3.00	$3.00
Div Yld	4.47%	**P/E FY**	17.8	14.2	14.2

*Official EPS estimates rounded to nearest $0.05 per share.

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PNW announced that it will be issuing 5.3 to 6.1million shares of stock. However, we are maintaining our 2005 and 2006 EPS estimates despite the company's announcement as we expect there to be offsets in both years.

- PNW announced that it will be issuing 5.3 to 6.1million shares of stock. The company plans to infuse the proceeds into the utility prior to its rate case filing by year-end. Although based on the company's filing date, we believe future regulatory recovery of this investment could be challenging and the benefits of such an issuance are not expected to be received until the 2007 time frame.
- The company has disclosed that it received interest from several buyers for its Silverhawk power plant. It now appears likely that PNW will announce and potentially close on the sale before year-end.
- PNW reported operating EPS of $0.27 as compared to $0.34 in the same period in the prior year. The reduced earnings in the 1Q05 were the result of weaker performances at the utility and the marketing & trading business, which was offset by increased contribution from the real estate segment.
- We are maintaining our 2005 EPS estimate of $3.00 to account for the company's ahead of plan 1Q05 earnings as it should offset share dilution. We are also maintaining our 2006 EPS estimate of $3.00 as we are assuming the reduction of losses from a sale of Silverhawk will offset share dilution.
- We are maintaining our Neutral rating on PNW as we believe the shares look fairly valued using both a DCF and P/E valuation. We believe the shares should trade at a slight discount to the group average to reflect the continued regulatory overhang at the company's primary business segment, the regulated utility.

We expect PNW's announcement that it will issue up to 6.1million shares of stock to be dilutive in 2005 and 2006. Additionally, we believe future regulatory recovery of this investment could be challenging once infused into the utility. PNW announced that it will be issuing 5.3 to 6.1million shares of stock. The company plans to infuse the proceeds into the utility prior to its rate case filing by year-end. Based on the company's filing date however, the benefits of such an issuance are not expected to be received until the 2007 time frame since any change in rates are not expected to take effect until then. In addition, we are concerned over the regulatory environment in Arizona and believe there is some level of uncertainty over the company's ability to benefit from the entire equity infusion. Furthermore, we expect the issuance to be dilutive to earnings in both 2005 and 2006 by approximately $0.10 to $0.15 per share.

We are maintaining our 2005 estimate to account for the company's ahead of plan 1Q05 earnings as it should offset share dilution. We are also maintaining our 2006 estimate as we are assuming the reduction of losses from a sale of Silverhawk would offset share dilution. PNW reported 1Q05 earnings that were well below our estimate. However, they maintained their 2005 guidance of $3.00 per share as earnings in the quarter were ahead of plan. The ahead of plan earnings are expected to offset the impact of share dilution. As a result, we are now expecting earnings for the remainder of the year to be stronger than anticipated and are thus maintaining our 2005 EPS estimate of $3.00 per share. In addition, we are maintaining our 2006 EPS estimate of $3.00 per share as we are now assuming that PNW is successful in selling its unprofitable Silverhawk plant following its disclosure that it has received interest from several buyers for the asset. It appears likely that PNW will announce and potentially close on the sale before year-end, which is expected to raise approximately $200 to $215 million. We believe such a sale would remove the earnings loss from the plant and thus serve as an offset to the share dilution associated with the announced equity issuance.

The company reiterated its earnings guidance based on several assumptions and continues to expect a rate case filing by year-end. Based on the current share count, PNW's guidance assumes that SunCor, the real estate business, contributes $50 million or $0.55 per share to 2005 earnings and that Silverhawk has a full year's loss of between $0.20 and $0.25 per share. Additionally, the guidance assumes that costs associated with the pending Sundance plant acquisition will decrease earnings by $0.03 per share and will close in the spring of 2005. The company also reiterated its intent to file a rate case before the end of the year as result of cost increases from both the Sundance plant and its above normal growth. The company is anticipating an equity ratio in the low 50% range when filing, which includes an infusion into the utility from the announced equity issuance and potential Silverhawk sale. This level compares to an approximately 45% ratio at year-end 2004.

PNW reported operating EPS of $0.27 as compared to $0.34 in the same period in the prior year. The reduced earnings in the 1Q05 were the result of weaker performances at the utility and the marketing & trading business, which was offset by increased contribution from the real estate segment.

- The regulated utility's EPS contribution declined by $0.06 per share due to strong customer growth of about $0.04 and lower fuel/purchased power costs of about $0.07 being more than offset by milder weather and increased operating costs relating to growth. As a result, the utility's earnings decreased by about $0.06 versus last year's quarter. The quarter's results did not include the benefits from PNW's recently approved rate increase as it is set to become effective 2Q05

- Earnings from the Marketing & Trading declined by approximately $0.10 primarily due to incremental costs associated with the Silverhawk power plant, which came on-line in mid-2004, and decreased margins on retail sales in California. In its release the company also announced that it has received interest for the purchase of the Silverhawk plant. A sale is expected to be finalized in the coming weeks with a potential close in the fall of 2005. Expected net proceeds would be $200 to $215 million.

- The EPS from the Real Estate business increased by $0.08 as a result of increased asset sales. PNW noted that it continues to expect this business to contribute $50 million to 2005 earnings.

During the quarter the company received final approval of its regulatory settlement reached in mid-2004, which is positive in the near-term, but will create regulatory uncertainty going forward as the company will again file a rate case by year-end. The resolution of the settlement was positive, but it does not remove the regulatory overhang from the company. The settlement provides the company near-term protection from rising energy costs with the implementation of a power supply adjustor (PSA), which will provide a sharing of power costs using a 90/10 sharing mechanism, providing for customers to incur 90% of the variance in power costs and the company to incur 10%. As originally envisioned the PSA would have provided longer term protection, but as we will discuss below there were several modifications which resulted in the PSA only providing near-term protection. The modifications to the settlement combined with the commission's earlier decision regarding the deferral of the costs associated with the acquisition of the Sundance power plant, will likely result in a reduction in the amount of those costs ultimately deferred. This results in the company moving to file another rate case by year-end 2005.

While there were many small modifications to the settlement, below we discuss what we believe to be the two major modifications to the original settlement:

1) The commission is limiting the amount of "annual net fuel and purchase power costs" that can be used to calculate the annual PSA to no more than $776 million. Any amount of cost above those levels would not be recovered from rate payers and would be absorbed by the shareholders. At the time the company exceeds the total amount it would then need to come back to the commission to file a rate case. Increasing gas costs over the amount imbedded in the fuel cost for the base rates, potential increasing coal costs due to contracts which are re-priced in 2007, and underlying 5%+ growth in usage will likely result in the company filing for rate relief.

2) The commission approved a total bandwidth for the PSA of $4/mwh. Any amounts above that would be included in a balancing account for recovery at a later date. While the original settlement also had a $4 bandwidth, it was an annual change not a total for the life of the PSA. Additionally, language was added which would require the company to come in to address the balancing account before it reaches $100 million. While the change appears to maintain the company's right to recover the balance, the change in the bandwidth could result in an increased delay in recovery of the cash in the balancing account. It appears that with the language the company will be able to defer the costs on an accounting basis.

Upcoming Events

Date	Event	Completed
January 11	ACC Approval of Sundance	√

March	ACC Approval of Rate Case Settlement	√
April 15	FERC Filing for Approval of PWEC Asset Transfer	√
May	FERC Approval of Sundance	
Spring	Closing of Sundance	
Fall 2005	FERC Approval of PWEC transfer (assuming no hearings)	
By Y/E 2005	File Rate Case in AZ	

Source: Company and JPMorgan estimates

Valuation and Rating Analysis
We are maintaining our Neutral rating on PNW as we believe the shares look fairly valued using both a DCF and P/E valuation. On a relative P/E basis, PNW is trading at about 14.2 times our 2006E EPS, which is a 2% discount to the group average P/E of 14.5 times. We believe the shares should trade at a slight discount to the group average to reflect the continued regulatory overhang at the company's primary business segment, the regulated utility.

Risks to Our Rating
Our estimates also assume a continued population shift in the U.S. to the southwest, in particular Arizona, and thus if for some reason the area suffered an unexpected economic slowdown, not only would our demand growth assumptions at the utility likely be too high, but our assumptions for the company's real estate portfolio would also likely be too aggressive. Our estimates assume that the company's unregulated power plant located in the desert southwest continues to be a drag on earnings in our 2005 EPS estimate. If spark spreads improve beyond our expectations and the plant is able to be break-even we could see the stock react positively.

Companies Recommended in This Report
Pinnacle West Capital Corp (PNW/$42.47/Neutral)

Analyst Certification
The research analyst who is primarily responsible for this research and whose name is listed first on the front cover certifies (or in a case where multiple analysts are primarily responsible for this research, the analyst named first in each group on the front cover or named within the document individually certifies, with respect to each security or issuer that the analyst covered in this research) that: (1) all of the views expressed in this research accurately reflect his or her personal views about any and all of the subject securities or issuers; and (2) no part of any of the research analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst in this research.

Important Disclosures:

- **Lead or Co-manager: JPMSI or its affiliates acted as lead or co-manager in a public offering of equity and/or debt securities for Pinnacle West Capital Corp within the past 12 months.**
- **Client of the Firm: Pinnacle West Capital Corp is or was in the past 12 months a client of JPMSI; during the past 12 months, JPMSI provided to the company investment banking services and non-investment banking securities-related service.**
- **Investment Banking (past 12 months): JPMSI or its affiliates received in the past 12 months compensation for investment banking services from Pinnacle West Capital Corp.**
- **Investment Banking (next 3 months): JPMSI or its affiliates expect to receive, or intend to seek, compensation for investment banking services in the next three months from Pinnacle West Capital Corp.**
- **Non-Investment Banking Compensation: JPMSI has received compensation in the past 12 months for products or services other than investment banking from Pinnacle West Capital Corp. An affiliate of JPMSI has received compensation in the past 12 months for products or services other than investment banking from Pinnacle West Capital Corp.**

Global Credit Research
Summary Opinion
28 Apr 2005

Moody's Investors Service

Summary Opinion: Pinnacle West Capital Corporation

Pinnacle West Capital Corporation

Opinion

Credit Strengths

Credit strengths for Pinnacle West Capital Corp. (Pinnacle) are:

-Stable cash flows generated by subsidiary APS.

-Growth rates within APS' service territory are above the national average.

-Management has historically been able to adequately manage the less predictable and challenging regulatory environment that exists within Arizona.

-Accelerated asset sales program at real estate subsidiary Suncor is expected to provide a significant enhancement to cash flow through 2005.

-Renewed focus on core regulated operations.

-Demonstrated intent to maintain leverage at a reasonable level.

Credit Challenges

Credit challenges for Pinnacle are:

-Pinnacle's cash flows are highly dependent upon dividends from APS.

- The increase approved in APS recently concluded rate case was less than half of the company's original request.

- Peak demand in APS's service territory (6,402 MW in 2004) is greater than the company's 5,806 MW of capacity of which 4,006 MW is owned generating capacity and 1,800 MW are generating assets owned by its affiliate Pinnacle West Energy Corporation that are included in rates and will be transferred to APS after FERC approval.

- APS' growing territory requires increasing amounts of capital expenditures.

Rating Rationale

The Baa2 rating of Pinnacle West Capital Corporation's (Pinnacle) senior unsecured debt reflects the strength of its principal subsidiary, Arizona Public Service Company (APS: senior unsecured Baa1), the economic strength of its service territory, the utility's historically predictable cash flow, and a conservative dividend payout ratio. The rating also considers the level of structural subordination that exists relative to subsidiary debt.

The rating reflects a projected stabilization of cash flow metrics following the recent finalization of APS' 2003 rate case combined with Pinnacle's announced intent to raise approximately $250 million of new equity, and to divest its interest in the Silverhawk facility, the proceeds of both of which will be invested in APS. By 2006, Pinnacle's funds from operation (FFO) as a percentage of total adjusted debt is projected to be about 18%.

Pinnacle's rating recognizes the less predictable regulatory environment in Arizona, but assumes APS' historical ability to effectively operate against this backdrop will continue. The rating also assumes that potential additions to APS' generating resources and/or improvements in its delivery system would be accomplished in a manner that would allow consolidated leverage to remain at about the current level.

The rating considers the near term rate clarity that has resulted from the ultimate conclusion of APS' 2003 rate case in March. Although the approved rate increase was less than half of the company's original request, the Arizona Corporation Commission (ACC) decision did allow for a 4.2% increase in retail rates, and provided for the inclusion of 1,800 MW of PWEC held generating capacity in APS rate base. The decision also incorporated an adjustment mechanism for the cost of fuel and purchased power that is expected to positively impact APS cash flow beginning in 2006. The rating recognizes the company's demonstrated intent to improve financial strength by financing a portion of its increasing capital expenditures with equity. The proceeds of Pinnacle's equity offering (approximately $250 million), along with proceeds of its divestiture of the Silverhawk facility, will be used to fund a portion of APS increasing capital expenditures, including the purchase of the Sundance plant.

Rating Outlook

Pinnacle's rating outlook is stable reflecting near term rate clarity, an economically strong service territory, the company's focus on core regulated operations and its demonstrated intention to maintain leverage at an appropriate level as it incurs additional capital expenditures.

What Could Change the Rating - UP

The rating outlook could be revised upward if there were to be a substantial reduction in leverage, a sustainable increase in cash flow which could lead to adjusted FFO as a percentage of adjusted total debt above 20%, or an improvement in regulatory predictability.

What Could Change the Rating - DOWN

Adverse regulatory rulings, significant increases in capital expenditures that are financed in a manner inconsistent with the company's historically strong leverage ratios, or sustained inability to meet customer demand for power from available resources.

Global Credit Research
Summary Opinion
28 Apr 2005

Moody's Investors Service

Summary Opinion: Arizona Public Service Company

Arizona Public Service Company

Opinion

Credit Strengths

Credit strengths for Arizona Public Service Company are:

-Growth rates within the company's service territory are above the national average.

-Relatively strong operating cash flow.

-Management has historically been able to adequately address the less predictable and challenging regulatory environment that exists within Arizona.

-Recovery of fuel and purchased power costs through an adjustment mechanism that was approved by ACC in March 2005.

-Demonstrated intent to maintain leverage at a reasonable level.

Credit Challenges

Credit challenges for Arizona Public Service Company are:

- Recently approved rate increase was less than half of the company's original request.

-Peak demand in APS' service territory (6,402 MW in 2004) is greater than the company's 5,806 MW of capacity of which 4,006 MW is owned generating capacity and 1,800 MW are generating assets owned by its affiliate Pinnacle West Energy Corporation that are included in rates and will be transferred to APS after FERC approval.

- Growing territory requires increasing amounts of capital expenditures.

- APS operates its business in a challenging state regulatory environment.

-Uncertainty exists regarding the future of competition within the state of Arizona.

Rating Rationale

The Baa1 rating of Arizona Public Service Company's (APS) senior unsecured debt recognizes the economic strength of APS' service territory, a low number of industrial customers, and management's ability to operate within a sometimes challenging regulatory environment. The rating also reflects a projected stabilization of cash flow metrics following the recent finalization of APS' 2003 rate case combined with the announced intent of its parent Pinnacle West Capital Corporation (Pinnacle) to infuse approximately $250 million of new equity, as well as the proceeds from its pending sale of the Silverhawk facility, into APS. By 2006, APS adjusted funds from operation (FFO) as a percentage of total adjusted debt is projected to be approximately 20%.

The rating also recognizes the less predictable regulatory environment in Arizona, but incorporates an assumption that APS' demonstrated ability to effectively operate against this backdrop will continue. The rating also assumes that potential additions to generating resources and improvements in delivery systems will be accomplished in a manner that allows leverage measures to improve over the near to medium term. The rating assumes management will continue its renewed focus on regulated operations.

The rating considers the near term rate clarity that has resulted from the ultimate conclusion of APS' 2003 rate case in March. Although the approved rate increase was less than half of the company's original request, the Arizona Corporation Commission (ACC) decision did allow for a 4.2% increase in retail rates, and provided for the inclusion of 1,800 MW of PWEC held generating capacity in APS' rate base. The decision also incorporated an adjustment mechanism for the cost of fuel and purchased power that is expected to positively impact APS cash flow beginning in 2006. The rating recognizes the company's demonstrated intent to improve financial strength by financing a portion of its increasing capital expenditures with equity. The proceeds of Pinnacle's equity offering (approximately $250 million), along with the proceeds of its divestiture of the Silverhawk facility, will be used to fund a portion of APS' increasing capital expenditures, including the purchase of the Sundance plant.

Rating Outlook

APS' rating outlook is stable, reflecting near term rate clarity, an economically strong service territory and the company's demonstrated intention to maintain leverage at an appropriate level as it incurs additional capital expenditures.

What Could Change the Rating - UP

The rating outlook could be revised upward if there were to be a substantial reduction in leverage, a sustainable increase in cash flow such that adjusted FFO as a percentage of adjusted total debt would be above 20%, or an improvement in regulatory predictability.

What Could Change the Rating - DOWN

Adverse regulatory rulings, significant increases in capital expenditures that are financed in a manner inconsistent with the company's historically strong leverage ratios, or sustained inability to meet customer demand for power from available resources.

STANDARD &POOR'S	RATINGSDIRECT

Research:

Return to Regular Format

Summary: Arizona Public Service Co.

Publication date: 24-May-2005
Primary Credit Analyst(s): Anne Selting, San Francisco (1) 415-371-5009; anne_selting@standardandpoors.com

Credit Rating: BBB/Stable/A-2

Rationale

Arizona Public Service (APS) is a wholly owned subsidiary of Pinnacle West Capital Corp. (PWCC), and by far the most important company within the PWCC family. The ratings on APS and PWCC are based on the consolidated credit assessment method, resulting in the same corporate credit rating for the holding company and APS.

APS' business profile is satisfactory, a '5' on Standard & Poor's Ratings Services' 10-point scale where '1' is excellent). Strengths specific to the utility include a Phoenix service territory that is the second-fastest growing region in the U.S. behind Las Vegas, Nev., a diversified power supply portfolio, and the recent approval by the Arizona Corporation Commission (ACC) of a settlement in APS' rate case, which, through a 4% increase in retail rates and the addition of a fuel and purchased power costs adjuster, should shore up a financial performance that has been weakening over the last several years.

APS' near-term challenges are largely regulatory. Timely recovery of costs incurred in the rate base will remain challenges for the utility, despite the recent completion of a major rate case. APS filed its recently completed rate case in June 2003, and the process that culminated in the settlement allowed a modest rate increase that took effect in April 2005, nearly two years later. Because these rates are based on a December 2002 test year, the utility will need to soon file a new rate case to reflect its significant capital expenditures and to keep current on its generation costs that are gradually becoming more concentrated in natural gas. While the fuel and purchased power adjuster is expected to provide some rate relief to the utility, the adjuster is capped at a level that will likely need to be revisited well before its expiration in five years. And, because load growth in APS' service territory is projected to grow between 4%-6% per year over the next five years, APS will still need an additional 1,200 MW by the summer of 2007 to fill the gap between power supply and demand.

PWCC's business profile of '5' reflects the most significant benefit of the APS settlement, which is the authorization the utility received from the ACC to rate-base 1,790 MW of generation that is currently owned by Pinnacle West Energy Corp (PWEC), PWCC's non-regulated wholesale generation subsidiary. The transfer will require the approval of the FERC. PWCC is also in discussions with a third party to sell PWEC's 425 MW interest in Silverhawk. The elimination of merchant operations from PWCC's consolidated operations, combined with the scaling back of activities of its three other unregulated subsidiaries--SunCor, El Dorado, and APS Energy Services--has improved consolidated business risks and should help to achieve improved financial metrics, which have been weakening since 2002 as a function of APS' need for a rate adjustments and PWEC's merchant operations. However, in 2004 consolidated financial metrics remained largely in line with the rating. While 2004 funds from operations to total debt was slightly weak at 14.5%, the company's forecasts expect 2005 metrics to stabilize, which should occur given the positive developments at APS and PWEC.

Short-term credit factors

PWCC's short-term rating is 'A-2'. The rating is supported by the consolidated corporate credit rating, the fact that the preponderance of cash flows are produced by APS, a vertically integrated electric utility, and the expectations for diminish capital and liquidity requirements at PWEC. As of March 31, 2005 PWCC's liquidity was ample, with consolidated cash and cash equivalents at about $250 million. This very strong cash position is due largely to APS' issuance of $300 million in notes in June 2004 in order to pre-finance about $400 million in utility obligations due in January and August 2005.

Both PWCC and APS maintain CP programs. Neither program had any CP balances as of March 31, 2005. PWCC's program is for $250 million and is supported by a three-year, $300 million credit facility that PWCC put into place in October 2004. The revolver allows PWCC to use up to $100 million of the facility for letters of credit. The revolver has no material adverse change clauses pertaining to outstanding CP balances.

APS' short-term rating is also 'A-2'. The rating is supported by the stability of cash flows from regulated operations and good liquidity, although APS' will need to continue to rely on borrowings to fund portions of its capital expenditure program, which is expected to be $770 million in 2005, up significantly from $484 million in 2004. APS maintains a $250 million CP program. In May 2004, APS renegotiated its revolver and increased the size to $325 million. Also a three-year term, the facility supports the utility's CP program and provides another $75 million for other liquidity needs, including letters of credit. The supporting facility has no material adverse change clauses pertaining to outstanding CP balances.

Outlook

The stable outlook reflects the expectation that PWCC will continue to focus on the regulated operations of APS, which is projected to contribute more than 85% of its funds from operations in 2005. The failure of PWCC or APS to meet expected financial results in 2005 and 2006, particularly in light of the weakening in consolidated and utility credit metrics in 2004, could lead to a downward revision of the outlook or a ratings change. Downward pressure on the ratings will occur if APS incurs significant power or fuel cost deferrals in excess of the fuel and purchased power adjuster's limitations. Any positive rating action is unlikely in the near-term given the financial metrics and the longer term risks that the terms of the PSA present.

Merrill Lynch

United States
Electric Utilities

27 July 2005

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Pinnacle West Capital

Rate Relief Fuels Q2 Growth

NEUTRAL

Reason for Report: Q2 Review; Raising 2006E for SunCor Contribution

Volatility Risk: MEDIUM

Price: $45.60

Estimates (Dec)	2004A	2005E	2006E
EPS:	$2.39	$3.20	$3.10
P/E:	19.1x	14.3x	14.7x
GAAP EPS:	$2.66	$2.42	$3.10
GAAP P/E:	17.1x	18.8x	14.7x
EPS Change (YoY):		33.9%	-3.1%
Consensus EPS: (First Call: 27-Jun-2005)		$3.06	$3.09
Cash Flow/Share:	$5.92	$6.45	$7.25
Price/Cash Flow:	7.7x	7.1x	6.3x
Dividend Rate:	Nil	$2.00	$2.10
Dividend Yield:	Nil	4.4%	4.6%

Opinion & Financial Data	
Investment Opinion:	B-2-7
Mkt. Value / Shares Outstanding (mn):	$4,468.8 / 98
Book Value/Share (Jun-2005):	$32.89
Price/Book Ratio:	1.4x
ROE 2005E Average:	9.9%
Total Debt / Capital:	51.3%
Est. 5 Year EPS Growth:	6.0%
Est. 5 Year Dividend Growth:	5.0%

Stock Data	
52-Week Range:	$46.16-$39.63
Symbol / Exchange:	PNW / New York
Institutional Ownership-Vickers:	73.5%
Brokers Covering (First Call):	11

Highlights:

- **Q2 operating EPS of $0.89 came in well ahead of consensus ($0.80) and our high-end $0.85E.** The result was up $0.33 (+59%) versus Q2 last year or $0.30 if we exclude the Q2 2004 Silverhawk drag.
- **The key positive was APS's rate increase (+$0.17).** Other benefits were fuel deferrals (+$0.05) and lower depreciation (+$0.06). Absence of regulatory asset amortization was a benefit for the last time (+$0.06).
- **Retail growth was again a key driver (+$0.08) with customer count up 4.2%.** Real estate (SunCor) also had a strong Q2 (+$0.06). O&M was up as expected (-$0.15) but should moderate in H2. Lower M&T gross margin (-$0.06) was the other main negative.
- **PNW reiterated an earnings outlook of a range around $3.00/sh.** This includes a Silverhawk drag, which we exclude from our $3.20E given its impending sale. An updated outlook is expected later this year, with SunCor one area where we may see upside given sustained asset values. We are raising our 2006E EPS by $0.10 to $3.10 on the expectation of a less severe slowdown at SunCor.
- **Earnings power for 2007 remains a key focus and we see $3.30 as a reasonable range.** This is also an increase of $0.10 given our stronger SunCor outlook.
- **APS still expects to file its next rate case later this year, with a decision expected by late 2006 or early 2007.** In the meantime, APS has made its first fuel surcharge filing and this case will be watched closely for any signs of pushback from regulators.
- **We remain Neutral with the stock trading at 13.8x our indicative 2007 earnings power.** This is a slight discount to integrated electric peers, which we see as reasonable given uncertainty around the rate case and other Arizona regulatory outcomes. PNW's growth is attractive, but also presents challenges in the context of a relatively unpredictable regulatory regime.

Refer to important disclosures on pages 6 to 7. Analyst Certification on page 4.

Rate Relief Fuels Q2 Growth

PNW posted Q2 results well above market estimates and indicated that they remain on track for the full year. As in Q1 – when results had fallen well short of market forecasts – PNW stated that the Q2 performance was consistent with their own projections.

Management guidance for 2005 remains a "reasonable range around \$3.00/share". We note, however, that this still includes an assumed annual operating drag from the Silverhawk plant which we are excluding in our \$3.20E.

Raising 2006E on SunCor Outlook

We are raising our 2006E EPS from \$3.00 to \$3.10 given expectations of more sustained real estate earnings at SunCor. Management indicated that they will be giving an updated outlook – including specific comments on their business plan for SunCor – later in the year. Timing for this disclosure remains uncertain, although it could come as soon as the investor meetings scheduled for August 31 (Boston) and September 1 (NYC). PNW's last formal outlook for SunCor indicated earnings likely would drop into the \$10M (\$0.10 on current share count) range from 2006 once the three-year accelerated sale program ended. In our opinion, continued strong market fundamentals and the hiring of a new CEO suggest that the drop-off would in fact be less than this. In addition, SunCor's accounts show an asset base which has not been shrinking as we would have expected given its accelerated sales program. In view of this, we have raised our estimate for SunCor in 2006 from \$20M (\$0.20/share) to the \$30M range (\$0.30/share). While a meaningful jump versus the last official outlook, we note that this level of ongoing contribution would still be much lower than both 2003 (\$56M) or 2004 (\$49M).

2007 Earnings Power Remains Key

Our analysis indicates post-rate case earnings power (2007) in the \$3.30/share range. Assumptions for the electric businesses remain unchanged, but we have added \$0.10/share for our revised estimate of sustainable Suncor earnings. Components of our revised forecast are therefore \$2.85 for APS; \$0.30 for SunCor; \$0.15 from marketing and trading (including off-system sales); and break-even from the parent and other businesses combined.

Rate base method suggests \$2.85 of regulated EPS in 2007. As laid out in more in our last quarterly note (4/28) we project Arizona jurisdictional rate base of about \$4.4B in the upcoming case. We start with \$3.9B as of year-end 2004, add two years of growth in the \$170M range and the \$190M purchase price for the Sundance acquisition. The current allowed equity is 45% but we expect APS to file for a level in the low-50% range after equity infusions. Using a ratio of 52% and an ROE of 10.25% (unchanged) we calculate net income potential of \$240M. To this we add FERC-regulated transmission rate base (about \$650M) on which we estimate annual earnings in the \$40M range. Combined earnings power would therefore be \$280M or \$2.85/share on the current share count.

Regulatory Agenda Still Busy

New APS Rate Case Filing Late 2005

As noted above, APS is expected to file another rate case later this year. A decision is expected by year-end 2006 or early 2007 – hence our focus on 2007 for post rate case earnings. The issues are expected to be much less controversial than the last case, which was complicated by the aborted transition of generation assets to competitive status and the request to rate-base PWEC generation assets. This time around APS will be seeking rate base treatment for the Sundance plant – although the uncertainty relates more to the approved investment level than to the rate-basing itself. It is also possible that APS may seek to include further generation assets in rate base, depending on the outcome of its ongoing RFPs. In this case, any additional assets acquired as part of the RFPs might be added to the rate case as an amendment to the initial request. More likely, given the timing, such an application would probably be made in a future filing.

First Filing Under PSA Recently Made

APS recently filed for recovery of \$100M of deferred power costs. Under its new PSA clause, APS now defers 90% of the difference between actual fuel and purchased power costs and the level included in base rates (¢2.0743 per kWh). Under terms of the PSA, the utility is required to file for a surcharge when its deferred balance is in the \$50-\$100M range and it passed the threshold earlier in July. While the PSA filing should be relatively routine, we note that this is the first such proceeding under the new mechanism. Given a somewhat unpredictable regulatory environment in Arizona of late, investors likely will watch the progression of this case with interest.

PSA cost cap not expected to be an issue in 2005/2006. Separately, we note that the PSA includes a cap of \$776M on overall fuel and purchased power expense. With actual costs now deferred, it is more difficult to keep track of progress versus this cap, although we believe there is some headroom before this becomes an issue. Retail fuel and power expense for full-year 2004 was \$567M and is about \$600M including deferrals for the twelve months ended in June. If the cap were breached, it remains unclear whether this might be addressed through a waiver or potentially considered within the construct of a general rate case. In any event, with hedges in place for 85% of remaining 2005 price exposure and 75% for 2006, PNW sees little chance that it would end up above the cap either this year or next (i.e. before the next rate case).

RFP Outcomes Expected in the Fall

Management expects to complete its two ongoing RFP processes this fall. The larger "Reliability RFP" is for at least 1,000 MW to be delivered beginning in 2007. Bids were recently received and are currently being evaluated. Short-listed bidders are due to be notified by August 30, with notification of the winning bidders in mid-October.

Meanwhile, in the smaller Renewable RFP, APS is seeking 100 MW of renewable supply starting from 2006. This process is further along, with short-listed bidders already notified and a final decision targeted for mid-September.

RFPs may result in further APS rate base additions. Management would not be drawn as to whether the RFPs might result in the acquisition of a generation asset(s) for inclusion in APS's rate base. This is clearly a possibility, however, and would likely be additive to earnings power assuming necessary regulatory approvals.

Q2 Earnings Review

Second Quarter 2005 – *Reported* $0.28 vs. $0.79 per share. ***Operating*** $0.89 vs. $0.56 per share.

Adjustments: 2005 – $0.57 Silverhawk write-down and $0.04 Silverhawk operating losses. 2004 – $0.23 gain on sales of Phoenix Suns.

Twelve Months Ended June 2005 – *Reported* $2.05 vs. $2.88 per share. ***Operating*** $2.72 vs. $2.64 per share.

Adjustments: 2005 – As above, plus $0.06 Silverhawk operating losses in Q1 and $0.03 gain on sale of NAC in Q4. 2004 – As above.

Table 1: PNW – Q2 and Annual Segment EPS

	Q2 2005	Q2 2004	12m 6/05	Yr. 2004
Regulated Electric	0.71	0.41	1.97	1.65
Marketing & Trading	0.04	0.09	0.05	0.20
Other	0.13	0.06	0.69	0.54
Operating EPS	**0.89**	**0.56**	**2.72**	**2.39**
Special Items	(0.61)	0.23	(0.67)	0.27
Reported EPS	**0.28**	**0.79**	**2.05**	**2.66**

Source: PNW and Merrill Lynch. Note: Our presentation excludes Silverhawk earnings from operating EPS beginning from Q1 2005.

Table 2: PNW – Company EPS Breakdown

	Q2 2005	Q2 2004	12m 6/05	Yr. 2004
Arizona Public Service	0.66	0.60	2.24	2.19
Pinnacle West Energy	0.12	(0.12)	(0.29)	(0.51)
APSES Retail	0.01	0.01	(0.02)	0.03
SunCor Real Estate	0.12	0.05	0.67	0.54
El Dorado	0.00	(0.01)	(0.02)	(0.02)
Parent Company	(0.03)	0.03	0.14	0.18
Operating EPS	**0.89**	**0.56**	**2.72**	**2.39**
Special Items	(0.61)	0.23	(0.67)	0.27
Reported EPS	**0.28**	**0.79**	**2.05**	**2.66**

Source: PNW and Merrill Lynch. Note: Our presentation excludes Silverhawk earnings from operating EPS beginning from Q1 2005.

PNW posted Q2 operating EPS of $0.89, well ahead of consensus ($0.80) and our top-of-range $0.85E. The result was an improvement of $0.33 (+59%) versus Q2 2004 and $0.30 (+51%) if we exclude Silverhawk losses from the prior period.

While the quarter came in ahead of estimates, PNW noted that it was in line with their plan. We recall that Q1 results fell well short of market expectations, but were also on track with management's (undisclosed) plan.

The main improvement came from higher APS rates reflecting the rate case settlement (+$0.17). This rate increase became effective from April 1 and benefited the results for the first time this quarter. Other rate settlement items were deferrals under the new fuel clause (+$0.05) and lower depreciation (+$0.06). Absence of regulatory the asset amortization was a benefit (+$0.06) and will no longer be a factor in future quarterly comparisons.

Retail growth continued to be a key driver (+$0.08) with annual customer growth running at 4.2% — up from 4.0% at the Q1 stage. Weather-normalized sales were up by 3.4% overall and by 5.1% in the residential segment. These rates are higher than seen in Q1, although we note that the Q1 growth rates were somewhat distorted by 2004 having been a leap year (i.e. 1.1% more days in Q1).

SunCor posted a strong Q2 (+$0.07). The real estate contribution remains somewhat lumpy and unpredictable in terms of timing, and we had assumed that the bulk of SunCor's would arise more typically towards the end of the year.

On the negative side, Q2 was hurt by higher O&M costs (-$0.15). This continued the trend seen in Q1 and included maintenance; customer service spending; and employee benefits. As stated last quarter, management is still expecting O&M comparisons to be more favorable in the second half, with spending levels little changed versus H2 of 2004. The other notable negative was Marketing & Trading (-$0.05) which benefited from an unusually strong second quarter last year.

Analyst Certification

I, Steven I. Fleishman, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

JPMorgan

Pinnacle West Capital Corp

Real Estate Timing Drives 2Q EPS - Corrected Note supersedes any previous versions

Neutral

$45.60
27 July 2005

Electric Utilities

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We are maintaining our EPS estimates despite PNW reporting 2Q05 earnings that were ahead of our estimate as the difference was primarily the result of a timing shift in real estate earnings. The company also maintained its 2005 earnings guidance of about $3.00 per share.

- PNW reported 2Q05 EPS of $0.89 versus our and the consensus estimate of $0.80. The primary difference versus our estimate was the approximately $0.08 of higher EPS contribution from the real estate business as a result of increased parcel sales. However, the company is still expecting the real estate business to contribute $50 million to earnings in 2005.

- PNW recently made a filing requesting a surcharge to recover $100 million in deferred fuel and purchased power costs over a period of two years. However, there has been no pre-established timeline for the surcharge recovery period or the timing by which the commission must act.

- We are maintaining our Neutral rating on PNW as we believe the shares look fairly valued using both a DCF and P/E valuation. We believe the shares should trade at a slight discount to the group average to reflect the continued regulatory overhang at the company's primary business segment, the regulated utility.

Pinnacle West Capital Corp (PNW;PNW US)

	2004A	2005E	2006E
EPS ($)			
Q1 (Mar)	0.33	0.27A	
Q2 (Jun)	0.55	0.89A	
Q3 (Sep)	1.15		
Q4 (Dec)	0.34		
FY	2.39	3.00	3.00
P/E FY	19.1	15.2	15.2

Source: Company data, Reuters, JPMorgan estimates.

Company Data	
Price ($)	45.60
Date Of Price	27 July 05
52-week Range	39.63 - 46.16
Mkt Cap ($ mn)	4,190.00
Fiscal Year End	Dec
Shares O/S (mn)	92
Div. Yield	4.2%

J.P. Morgan Securities Inc.

We are maintaining our EPS estimates despite PNW reporting 2Q05 earnings that were ahead of our estimate as the difference was primarily the result of a timing shift in real estate earnings. The company also maintained its 2005 earnings guidance of about $3.00 per share. PNW reported 2Q05 EPS of $0.89 versus our and the consensus estimate of $0.80. The primary difference versus our estimate was the approximately $0.08 of higher EPS contribution from the real estate business as a result of increased parcel sales. However, the company is still expecting the real estate business to contribute $50 million to earnings in 2005, consistent with our expectation and prior estimates. Below is a more a detailed discussion of PNW's earnings by business segment:

- The regulated utility's EPS contribution increased by $0.28 per share primarily due to the rate increase that went into effect 4/1/2005 which contributed approximately $0.18 per share. Also as a result of the rate case, the utility benefited by approximately $0.05 per share from deferred purchased power and fuel costs, net of higher costs. Other drivers for the quarter were customer growth of $0.08 per share and $0.10 per share of decreased D&A from lower deprecation rates and the absence of regulatory asset amortization. Offsetting these improvements were higher O&M and interest costs of approximately $0.13 per share.
- The Real Estate business increased its EPS contribution by approximately $0.08 from to $0.12 from $0.04 in last year's quarter. As mentioned above the improvement was driven by increased parcel sales.
- The Marketing & Trading business contributed approximately $0.04 to 2Q05 earnings versus $0.09 in the prior year's quarter. The $0.05 decline in EPS contribution was primarily the result of lower realized margins on wholesale sales. The EPS contribution for the Other segment was unchanged year-over-year at $0.01.

In July PNW surpassed the $50 million threshold requiring it to file for a surcharge to recover the deferred balance in its PSA (Power Supply Adjuster). PNW recently made a filing requesting a surcharge to recover $100 million in deferred fuel and purchased power costs over a period of two years. The company proposed for the surcharge to begin in November. However, there has been no pre-established timeline for the surcharge recovery period or the timing by which the commission must act. As a result we believe there is a fair amount of uncertainty regarding the recovery of this cash and the company's cash flows. In 2Q05 the company deferred $34 million of fuel and purchased power costs and is expecting to have deferred over $100 million plus by the end of August. However, it is worth noting that the company does have in place hedges for 85% and 75% of its remaining 2005 and 2006 purchase power and natural gas prices, respectively. According to management, these hedges are substantially below forward market prices limiting the potential magnitude of the deferrals. While there is a cap on the total annual purchased power and fuel expense of $786 million, we do not expect the company to hit this threshold until after 2006.

The company continues to expect a rate case filing by year-end. The company also reiterated its intent to file a rate case before the end of the year as result of cost increases from both the Sundance plant and its above normal growth. The company is anticipating an actual equity ratio in the low 50% range when filing, which includes an infusion into the utility from the equity issuance and Silverhawk sale.

This level compares to an approximately 45% ratio at year-end 2004. We believe this rate case could be contentious as the company just received a 4.2% rate increase in March and will be asking for additional rate relief to recover higher fuel/power costs.

Upcoming Events

Date	Event	Completed
March	ACC Approval of Rate Case Settlement	√
July 2005	FERC Approval of PWEC transfer	√
3Q05	Transfer of PWEC assets to APS	
3Q05	Sale of Silverhawk	
TBD	Commission decision on surcharge request	
By Y/E 2005	File Rate Case in AZ	

Source: Company and JPMorgan estimates

Valuation and Rating Analysis

We are maintaining our Neutral rating on PNW as we believe the shares look fairly valued using both a DCF and P/E valuation. On a relative P/E basis, PNW is trading at about 15.2 times our 2006E EPS, which is a 2% discount to the group average P/E of 15.6 times. We believe the shares should trade at a slight discount to the group average to reflect the continued regulatory overhang at the company's primary business segment, the regulated utility.

Risks to Our Rating

Our estimates also assume a continued population shift in the U.S. to the southwest, in particular Arizona, and thus if for some reason the area suffered an unexpected economic slowdown, not only would our demand growth assumptions at the utility likely be too high, but our assumptions for the company's real estate portfolio would also likely be too aggressive. Conversely, the company is planning to file a rate case by year-end. If the outcome of the case is better than expected, our long-term estimates could be conservative.

Morgan Stanley

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September 19, 2005

Stock Rating
Underweight

Industry View
Cautious

Pinnacle West

Downgrading on More Expected Regulatory Uncertainty

What's Changed	
Rating	**Equal-weight to Underweight**
ModelWare 2005 EPS	**From $3.18 To $3.15**
ModelWare 2006 EPS	**From $3.00 To $3.07**

What's New: Recovery of rising expenses could be tough in an election year. Rising gas and power prices mean higher incremental costs for fully regulated PNW who needs to buy both to serve its growing retail demand. Since PNW's fuel clause is brand new, it will likely be subject to continued state regulatory "interpretations," and may cut into recovery of other operating expenses, especially as AZ has traditionally been a difficult regulatory regime. Plus, 2006 is an election year for 2 of 5 commissioners.

Conclusion: Downgrading to Underweight. In a best case scenario, regulators would allow for recovery of these expenses, but probably still on a lagged timeframe. PNW will likely file for another rate case later this year, and has already asked for a 2.2% increase to cover rising fuel costs – all on top of a 5% rate increase already granted earlier this year, which we think will put AZ regulators in a tough spot. Meanwhile, gas and power prices continue to rise.

Implications: We prefer names with upside exposure to rising prices. In this environment, we like those with deregulated low-cost generation that can realize expanding margins from rising power prices, and have less likelihood of earnings clawbacks by state regulators. These include EIX, ETR and FE (Please see our note "New Upside Stage for Deregulated Coal and Nuke" published 9/19/05).

Key Ratios and Statistics

Reuters: PNW.N Bloomberg: PNW US

United States of America / Electric Utilities

Price target	**NA**
Shr price, close (Sep 16, 2005)	$45.68
Mkt cap, curr (mm)	$4,200
52-Week Range	$46.68-40.99

Year Ending	Dec 2003	Dec 2004	Dec 2005e	Dec 2006e
ModelWare EPS ($)*	2.39	2.34	3.15	3.07
Prior ModelWare EPS ($)	-	-	3.18	3.00
P/E	16.7	19.0	14.5	14.9
Cons EPS ($)	2.57	2.37	3.08	3.08
P/BV	1.4	1.5	1.5	1.4
EV/EBITDA	6.4	6.8	6.6	6.8
Div yld (%)	4.3	4.1	4.2	4.4
FCF yld ratio (%)	7.8	4.0	0.7	0.2

* = Please see explanation of Morgan Stanley ModelWare later in the note.
e = Morgan Stanley Research estimates

Please see analyst certification and other important disclosures starting on page 8.

Investment Case

We See Regulatory Uncertainty Ahead for PNW due to the following:

- PNW will likely file for another rate case later this year, and has already asked for a 2.2% increase to use its new fuel clause to recover rising fuel costs. A 5% rate increase was just granted earlier this year, which we think will put AZ regulators in a tough spot.

- Arizona has traditionally been a difficult regulatory environment. And now 2006 is an election year for 2 of 5 commissioners.

- Regulators gave PNW a fuel clause recovery mechanism this year, but this is still subject to a "prudency" review by regulators. And since this is the first year for a fuel clause, we think regulators will continue to have differing interpretations of how it should be used. Questions have come up about the fact that PNW's Palo Verde nuclear plant has had 48 days of unplanned outages this year on at least one of its units. PNW will likely defer incremental fuel costs, and they may ultimately receive full recovery of fuel costs, but this may cut into recovery of other operating expenses, which often tends to happen in less constructive regulatory regimes.

- In a best case scenario, regulators would allow for recovery of all fuel and operating expenses, but this will not likely be on a timely basis. The last rate proceeding took 23 months to complete – and this was with a settlement. Even when regulators approved PNW's purchase of the Sundance gas-fired power plant last Jan., they deferred a decision on the recovery of costs until a later proceeding.

- On 7/22, PNW filed to recover fuel and purchased power cost increases of $100 mm, the limit allowed under the fuel clause annually. Since then, prices have continued to go up implying the need for another rate increase in the near future on top of the current requested one.

Exhibit 1

Estimated Fuel Cost Increase Since 7/22 Filing

Even if PNW is allowed to recover its requested $100 mm of fuel costs, we project that costs have gone up an additional $42 mm since their request was filed, as gas and power prices have continued to increase.

	2006E
Gas Consumed (mmbtu)	50
Estimated Open Position (%)	25%
Gas Price Increase (Since 7/22) ($/mmbtu)	$2.50
Gas Cost Increase Since 7/22 ($mm)	$31
Market Power Purchases (mmMWh)	2.5
Offset by wholesale sales (mmMWh)	(1.7)
Net Power Purchases (mmMWh)	0.8
Peak Palo Verde Price Increase ($/MWh)	$13
Power Purchase Cost Increase Since 7/22 ($mm)	$10
Total Fuel & Purch. Power Increase ($mm)	**$42**
Incremental Rate Increase Needed for Recovery	2%

Source: Morgan Stanley Equity Research, Company Data

- On our new '06E, PNW trades at a slight discount to the utility average. Our Underweight call is based on our view that the risk/reward should be relatively negative going into these rate proceedings – we see more likely downside than upside to our earnings estimates over the next couple years.

- PNW's real estate segment could be a source of minor EPS upside, but we don't think the market will award any value for it until a more visible earnings stream for the business can be seen.

Exhibit 2

PNW – Segment EPS

Segment EPS	2004A	2005E	2006E	2007P
Arizona Public Service	$2.18	$2.56	$2.88	$2.99
Trading (Previous contracts)	($0.41)	$0.14	$0.13	$0.12
APSES (Retail Supply)	($0.03)	($0.01)	($0.01)	($0.01)
SunCor	$0.49	$0.53	$0.14	$0.13
Parent/Other	$0.10	($0.07)	($0.07)	($0.08)
TOTAL EPS	**$2.34**	**$3.15**	**$3.07**	**$3.16**
Shares Out. (mm)	*91.4*	*97.0*	*98.7*	*98.7*

Source: Company Data, Morgan Stanley Research

STANDARD &POOR'S	RATINGSDIRECT

Return to Regular Format

Research:

Summary: Arizona Public Service Co.

Publication date: 04-Oct-2005
Primary Credit Analyst: Anne Selting, San Francisco (1) 415-371-5009; anne_selting@standardandpoors.com

Credit Rating: BBB/Stable/A-2

Rationale

Arizona Public Service Co. (APS) is a wholly owned subsidiary of Pinnacle West Capital Corp. (PWCC), and the most significant company within the PWCC family. PWCC's satisfactory business profile (a '5' on a 10-point scale where '1' is excellent) reflects the vertically integrated utility operations of APS and the absence of significant non-regulated businesses within PWCC.

APS' credit strengths include a Phoenix service territory that is the second-fastest growing region in the U.S. (behind Las Vegas), a diversified power supply portfolio, and a 4.21% increase in retail rates that began on April 1, 2005 in conjunction with the settlement of the utility's general rate case in March 2005. This increase had been expected to modestly shore up a financial performance that has been weakening over the past several years.

However, challenges are increasing for the utility, and performance on a 12-month rolling basis ended June 30, 2005 indicates that the utility is pressured by the rising costs of purchased power and natural gas. The addition of a fuel and purchased power cost adjuster to retail rates has not assisted APS in timely receipt of cash because revisions occur only in the spring of each year, with the first opportunity arising in April 2006. The settlement provides for the use of a surcharge filing to provide the utility with an interim vehicle for recovering costs if they exceed $50 million. As anticipated, APS did accrue this level of deferrals over the summer. Through June 30, 2005, purchased power and fuel costs totaled $401 million, of which $34 million was deferred. At Aug. 31, 2005, the deferred balance had increased to $117 million. The company's estimates of total fuel and purchased power costs in 2005 are confidential, but as a basis of comparison, in 2004 the utility spent $763 million. In July 2005, APS filed an application with the Arizona Corporation Commission (ACC) requesting that it be allowed to recover $100 million through a two-year surcharge that would increase rates by about 2.2%.

Both the pace and disposition of this proceeding will be critical to credit quality. The ACC staff and at least one commissioner have questioned whether the utility should be allowed to collect $20 million of the $100 million requested, the former being the amount roughly associated with Palo Verde replacement power costs during four months from April through July 2005. (Since then, Units 1 and 2 suffered outages in late August.) In late September, the company announced that to expedite an ACC decision, it would reduce its request for surcharge recovery to $80 million and address the $20 million in deferred costs in a later proceeding. The ACC has established a schedule for the proceeding to address the $80 million, with hearings to begin Oct. 26, 2005.

For fiscal 2005, the company continues to expect it will achieve results in line with credit metrics needed to support the current rating. And in April 2006, the utility will be able to receive additional relief through the annual fuel and purchased power adjustment mechanism. But upward adjustments are limited to 4 mills/kWh over the life of the adjuster. Because existing retail rates are based on 2003 costs, reflecting gas prices of about $5.50/MMBtu, the company expects the entire 4 mill headroom will be utilized at the first reset. The utility is expected to file another rate case by the end of 2005, but its resolution could extend well into 2006. Thus, it is clear that timely near-term cost collection will be the key driver of credit quality. Standard & Poor's is becoming increasingly concerned with the utility's ability to achieve this. A relatively weak power supply adjustment mechanism, in combination with rapidly escalating and volatile gas prices, as well as the potential for a protracted surcharge proceeding, could cause deterioration in financial performance which, year to date, has been sub par for the rating.

Whether the company's consolidated targets will be met will largely be a function of APS' third-quarter results. For the 12 months ending June 30, 2005, consolidated adjusted funds from operations (FFO) to total debt was 12.7%, but this reflects a one-time deferred tax charge taken in December 2004 based on the expectation that APS may need to refund $130 million at the end of 2005. Excluding the deferral, adjusted FFO/total debt is closer to 15.5%. FFO to interest coverage was 3.0x for the 12 months ending June 30, or 3.5x when the deferred tax obligation is excluded. Adjusted debt to total capitalization was 55.7% and benefited from PWCC's April issuance of $250 million in equity.

APS' general rate case settlement allowed for the rate-basing of 1,790 MW of Arizona generation formerly owned by Pinnacle West Energy Corp (PWEC), PWCC's merchant generation subsidiary. In July 2005, PWEC transferred this generation capacity, through five plants, to APS. PWCC has also announced that it plans to sell its remaining 75% interest in Silverhawk, a 570 MW plant near Las Vegas, Nev., to Nevada Power (NPC; B+/Positive/NR) for $208 million. If Nevada regulators approve the sale, the transaction should be completed by the end of 2005 and mark the complete wind-down of PWEC operations. Consolidated credit benefited from the transfer by reducing merchant exposure in providing APS with needed supply to meet its growing loads.

Short-term credit factors

PWCC's short-term rating is 'A-2'. The rating is supported by the fact that the preponderance of cash flows is produced by APS, a vertically integrated electric utility. Near-term liquidity is adequate to support power purchase expenses that exceed rates. Because APS is heading into its shoulder season, when demand for electricity for space cooling drops significantly, the build-up of its power cost deferrals should slow. APS has hedged nearly all of its power and gas purchases through the remainder of 2005 and about 80% in 2006, thus its cost projections should be in line with realizations. Consolidated cash and investments stood at more than $900 million as of Sept. 31, 2005. However, $500 million was used on Oct. 3, 2005 to call the Pinnacle West Energy Company's floating-rate notes due April 2007. Also impacting the cash and invested position is the increased amount of collateral held under hedging contracts.

Both PWCC and APS maintain CP programs. Neither program had any CP balances as of June 30, 2005. PWCC's program is for $250 million and is supported by a three-year, $300 million credit facility that expires in October 2007. The revolver allows PWCC to use up to $100 million of the facility for letters of credit. The revolver has no material adverse change clauses pertaining to outstanding CP balances.

APS' short-term rating is also 'A-2'. The rating is supported by the stability of cash flows from regulated operations and good liquidity, although APS will need to continue to rely on borrowings to fund portions of its capital expenditure program, which is expected to be about $770 million in 2005 (and includes $190 million for the purchase of the Sundance power plant), up significantly from $484 million in 2004. APS maintains a $250 million CP program. In May 2004, APS renegotiated its revolver and increased the size to $325 million. This facility, also a three-year term, expires in May 2007, supports the utility's CP program, and provides an additional $75 million for other liquidity needs, including letters of credit. The supporting facility has no material adverse change clauses pertaining to outstanding CP balances.

Outlook

The stable outlook reflects Standard & Poor's expectation that the ACC will resolve APS' large deferred power costs through a surcharge ruling no later than year-end that supports timely recovery of the $80 million request. In addition, the outlook presumes that third-quarter consolidated financial results will reflect improvements that demonstrate modest advances in credit metrics. An adverse outcome in either of these areas will result in a negative outlook. No positive ratings changes are expected in short-term.

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Research:
Summary: Arizona Public Service Co.

Publication date: 19-Oct-2005
Primary Credit Analyst: Anne Selting, San Francisco (1) 415-371-5009; anne_selting@standardandpoors.com

Credit Rating: BBB/Stable/A-2

Rationale

Arizona Public Service (APS) is a wholly owned subsidiary of Pinnacle West Capital Corp (PWCC) and contributes the majority of cash flows to consolidated operations. The ratings for APS reflect a satisfactory business profile of '5' and a financial profile that is somewhat strained at the current level. APS announced on Oct. 17, 2005 that units 2 and 3 of the Palo Verde Nuclear Generating Station are expected to return to service by this week, averting the potential for a rapid deterioration of credit quality.

At the time of the outage, it was unclear when the 2,561 MW (745 MW of which is owned by APS) of nuclear capacity would be allowed to return to service. (Unit 1 remains offline for a scheduled refueling that began in early October.) The short duration of the outage results in a modest level of replacement power costs for the utility.

Units 2 and 3 were operating at full power when they were shut down Oct. 11 after APS could not immediately validate for the Nuclear Regulatory Commission (NCR) that certain aspects of the plant's emergency core cooling system (ECCS) would operate properly under a range of accident scenarios. Additional modeling and analysis performed over the past six days has demonstrated that the ECCS would flood the reactor with water in the highly unlikely event of a loss-of-coolant accident.

Despite the short duration of the Palo Verde outage, APS' credit quality continues to erode as a function of increasing levels of cost deferrals. As of Aug. 31, 2005, APS had incurred $117 million in deferrals. Because September is a high usage month, these deferrals have continued to grow since August. To recoup these costs, APS is expected to seek relief in three different Arizona Corporation Commission (ACC) proceedings, each of which has a separate timeline for resolution:

- $80 million of the total deferred amount has been requested as part of a special surcharge filing the company submitted in August and amended in September. Staff filed testimony on Oct. 17, 2005 in support of APS' request. Hearings are scheduled to begin on Oct. 26, 2005, and the ACC is expected to rule on the request before year-end 2005, with recovery of authorized amounts beginning in 2006 and occurring over a two-year time horizon.
- $20 million will be requested as part of a later proceeding, but expectations are that any rate recovery for this amount will not occur until mid-2006. This amount is roughly associated with Palo Verde replacement power costs that were incurred over a four-month period from April through July 2005. ACC staff and at least one commissioner have stated that these costs should be reviewed before the utility be allowed to collect costs related to the outages
- Additional deferred amounts incurred through Sept. 30, 2005 and beyond, as well as the current Palo Verde outage, will be requested as an increase in the utility's annual power supply adjuster, which is scheduled to be revised on April 1, 2006. However, the adjuster may not be increased more than 4 mills/kilowatt hour and APS may not request more than $776 million in total expenses to be recovered through the adjuster. The company has indicated that it does not believe it will hit either cap in 2006.

Timely recovery of fuel and purchased power costs is essential to any utility's credit quality, and especially so for APS, which has a rapidly growing service territory, a rising dependence on natural gas, and recent performance issues for its nuclear units, which typically provide nearly one-third of the utility's energy requirements.

Current retail rates are based on 2003 costs, and the modest 4.21% retail rate increase that the ACC authorized in April 2005 has resulted in little flexibility for the company to sustain adverse events without pressuring credit metrics. In particular, the consolidated funds from operation (FFO) to total debt ratio is a concern. For the 12 months ending June 30, 2005, consolidated adjusted FFO to total debt was 12.7%; however, excluding a one-time deferred tax charge taken in December 2004, adjusted FFO/total debt is closer to 15.5%. FFO to interest coverage was 3.0x for the 12 months ending June 30, or 3.5x excluding the deferred tax obligation. Adjusted debt to total capitalization was 55.7% and benefited from PWCC's April issuance of approximately $250 million in equity.

Palo Verde's aggregate capacity factor in 2005 has been lower than historic levels, at about 83% as of Sept. 30. Issues with the unit's emergency cooling systems were first identified in August 2004 and unit 3 has also had problems with heater elements in the pressurizer, which has necessitated replacement and resulted in an extended outage of about 32 days.

The NRC flagged the cooling system issue as "yellow," the second most serious of four violation categories. In April, the NRC issued a report and began further on-site inspections in September. These inspections were suspended when the units were brought down last week. With the return to service of units 2 and 3, the NRC is expected to shortly resume the second half of its two-week inspection process and will issue a report of its findings likely by year-end.

Short-term credit factors

Consolidated liquidity is sufficient to support the deferrals, which APS has been paying out of its cash on hand. PWCC's short-term rating is 'A-2'. The rating is supported by the fact that the preponderance of cash flows is produced by APS, a vertically integrated electric utility. Because APS is heading into its shoulder season, when demand for electricity for space cooling drops significantly, the build-up of its power cost deferrals should slow. APS has hedged nearly all of its power and gas purchases through the remainder of 2005 and about 85% in 2006, thus its cost projections should be in line with realizations. Consolidated cash and investments stood at more than $900 million as of Sept. 30, 2005. However, $500 million was used on Oct. 3, 2005 to call the Pinnacle West Energy Company's floating-rate notes due in April 2007. Also positively impacting the cash and invested position is the increased amount of collateral held under hedging contracts.

Both PWCC and APS maintain CP programs. Neither program had any CP balances as of Sept. 30, 2005. PWCC's $250 million program is supported by a three-year, $300 million credit facility that expires in October 2007. The revolver allows PWCC to use up to $100 million of the facility for letters of credit. The revolver has no material adverse change clauses pertaining to outstanding CP balances.

APS' short-term rating is also 'A-2'. APS maintains a $250 million CP program. The rating is supported by the stability of cash flows from regulated operations and good liquidity, although APS will need to continue to rely on borrowings to fund portions of its capital expenditure program, which is expected to be about $770 million in 2005 (and includes $190 million for the purchase of the Sundance power plant), up significantly from $484 million in 2004. A $325 million revolver backstops APS' CP program. This facility expires in May 2007 and provides an additional $75 million for other liquidity needs, including letters of credit. The supporting facility has no material adverse change clauses pertaining to outstanding CP balances.

Outlook

The stable outlook reflects Standard & Poor's Ratings Services' expectation that the ACC will resolve APS' large deferred power costs through a surcharge ruling no later than year-end that supports timely recovery of APS' $80 million request. In addition, the outlook presumes that over time consolidated financial results will reflect modest improvements in credit metrics, and that the Palo Verde units will return to their typically strong capacity factors. Any related adverse development will result in a negative outlook or a rating action. No positive rating changes are expected in the short term.

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ARIZONA PUBLIC SERVICE COMPANY
Projected Monthly PSA Collections and Balances Summary

Line No.	Year	Month	Pre-Sharing (Over)/Under Collection	**With 776M Cap** Pre-Sharing (Over)/Under Collection	Post-Sharing (Over)/Under Collection	**With 776M Cap** Post-Sharing (Over)/Under Collection	Balancing Acct. End of Month Balance w/ Int. 4 Mill Chg Apr. 06 No Amort. Surchg.	**With 776M Cap** Balancing Acct. End of Month Balance w/ Int. 4 Mill Chg Apr. 06 No Amort. Surchg.	Balancing Acct. End of Month Balance w/ Int. 3.024 Mill Chg Apr. 06 With $80M Amort. $.001416 Surcharge	**With 776M Cap** Balancing Acct. End of Month Balance w/ Int. 3.024 Mill Chg Apr. 06 With $80M Amort. $.001416 Surcharge
1	2005	April (Actual)	$ 1,673,540	$ 1,673,540	$ 1,506,186	$ 1,506,186	$ 1,506,186	$ 1,506,186	$ 1,506,186	$ 1,506,186
2		May (Actual)	$ 15,519,327	$ 15,519,327	$ 13,967,394	$ 13,967,394	$ 15,477,082	$ 15,477,082	$ 15,477,082	$ 15,477,082
3		June (Actual)	$ 23,842,668	$ 23,842,668	$ 21,458,401	$ 21,458,401	$ 36,971,467	$ 36,971,467	$ 36,971,467	$ 36,971,467
4		July (Actual)	$ 46,521,827	$ 46,521,827	$ 41,869,644	$ 41,869,644	$ 78,927,070	$ 78,927,070	$ 78,927,070	$ 78,927,070
5		August (Actual)	$ 40,117,811	$ 40,117,811	$ 36,106,030	$ 36,106,030	$ 115,216,605	$ 115,216,605	$ 115,216,605	$ 115,216,605
6		September (Projected)	$ 24,732,941	$ 24,732,941	$ 22,259,647	$ 22,259,647	$ 137,744,131	$ 137,744,131	$ 137,744,131	$ 137,744,131
7		October (Projected)	$ 1,852,998	$ 1,852,998	$ 1,667,698	$ 1,667,698	$ 139,732,084	$ 139,732,084	$ 139,732,084	$ 139,732,084
8		November (Projected)	$ (1,736,689)	$ (1,736,689)	$ (1,563,020)	$ (1,563,020)	$ 138,493,941	$ 138,493,941	$ 138,493,941	$ 138,493,941
9		December (Projected)	$ 4,788,125	$ 4,788,125	$ 4,309,313	$ 4,309,313	$ 143,125,252	$ 143,125,252	$ 143,125,252	$ 143,125,252
10	2006	January (Projected, with $.001416 Surc.)	$ (3,842,775)	$ (3,842,775)	$ (3,458,498)	$ (3,458,498)	$ 139,999,520	$ 139,999,520	$ 137,020,366	$ 137,020,366
11		February (Projected)	$ 6,521,652	$ 6,521,652	$ 5,869,487	$ 5,869,487	$ 146,194,506	$ 146,194,506	$ 140,636,032	$ 140,636,032
12		March (Projected)	$ (10,027,471)	$ (10,027,471)	$ (9,024,724)	$ (9,024,724)	$ 137,509,684	$ 137,509,684	$ 129,213,023	$ 129,213,023
13		April (Projected, 4 or 3.024 Mill Chg.)	$ 14,940,763	$ 14,940,763	$ 13,446,687	$ 13,446,687	$ 143,194,897	$ 143,194,897	$ 133,989,475	$ 133,989,475
14		May (Projected)	$ 17,992,561	$ 17,992,561	$ 16,193,305	$ 16,193,305	$ 150,244,670	$ 150,244,670	$ 139,974,798	$ 139,974,798
15		June (Projected	$ 35,699,080	$ 35,699,080	$ 32,129,172	$ 32,129,172	$ 171,925,609	$ 171,925,609	$ 160,443,405	$ 160,443,405
16		July (Projected)	$ 65,168,420	$ 65,168,420	$ 58,651,578	$ 58,651,578	$ 218,833,162	$ 218,833,162	$ 205,987,635	$ 205,987,635
17		August (Projected)	$ 56,281,836	$ 56,281,836	$ 50,653,652	$ 50,653,652	$ 257,003,381	$ 257,003,381	$ 242,697,972	$ 242,697,972
18		September (Projected)	$ 37,048,031	$ 37,048,031	$ 33,343,228	$ 33,343,228	$ 280,284,154	$ 280,284,154	$ 264,772,171	$ 264,772,171
19		October (Projected)	$ 16,809,917	$ 16,809,917	$ 15,128,925	$ 15,128,925	$ 287,697,488	$ 287,697,488	$ 271,228,480	$ 271,228,480
20		November (Projected)	$ (4,726,286)	$ (4,726,286)	$ (4,253,657)	$ (4,253,657)	$ 276,137,220	$ 276,137,220	$ 258,752,080	$ 258,752,080
21		December (Projected)	$ 5,948,312	$ (38,749,591)	$ 5,353,481	$ (34,874,632)	$ 273,567,816	$ 233,339,703	$ 255,199,542	$ 214,971,429
22		Total	$ 395,126,588	$ 350,428,685	$ 355,613,929	$ 315,385,816				
23		Difference from Pre to Post-Sharing			$ 39,512,659					
24		Difference from Without Surcharge to with Surcharge							$ 18,368,274	

EXHIBIT
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APS 9
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PLEASE READ: AN IMPORTANT NOTICE ABOUT POSSIBLE INCREASES TO YOUR BILL

Arizona Public Service Company (APS) has asked the Arizona Corporation Commission (ACC) to approve a $.001770 per kWh Power Supply Adjustment (PSA) Surcharge on customer's bills to recover a portion of the increased fuel and purchased power costs. If approved as requested, the surcharge would be applied to customers' bills beginning with billing cycle 1 of November 2005 and would be removed in 24 months. It would add an estimated $2.74, or about 2.1 percent to the average monthly residential bill. The average non-residential customer's monthly bill will increase an estimated $14.93 or about 1.8 percent*. The actual increase each customer will have depends on their individual usage and rate schedule.

Customers can minimize the impact of the surcharge by using electricity efficiently and wisely, thus reducing their overall energy usage. Tips on how to reduce your energy usage are available on our website www.aps.com under APS Services or on the bill inserts that accompany your monthly bill. Customers who are on the Company's Residential Energy Support Program (E-3) or Medical Care Equipment Program (E-4) will not have to pay the surcharge.

Continued on back

The surcharge will recover a portion of the increased fuel and purchased power costs already incurred to provide electricity for customers. Due to the current market conditions, fuel and purchased power costs have increased to the point where the Company was required to file the surcharge request with the ACC. While APS regrets any increase in our customer's costs, the under-collected PSA balance needs to be reduced. The proposed PSA surcharge is different from and in addition to the annual PSA adjustment (if any) in April 2006. For more information on current natural gas prices and a description of the PSA, visit our website at www.aps.com under Power Supply Adjustment (PSA). For more information about the Company's request you can visit the website above or call either 1-800-253-9405 or 602-371-7171 (in metro Phoenix).

The Company is requesting that the ACC schedule an Open Meeting to discuss and vote upon this matter prior to November 1, 2005. To find out when this Open Meeting will be scheduled or how to comment on the proposed surcharge you can contact the ACC at www.cc.state.az.us or call 1-800-222-7000. Additionally, you can contact the Company at the numbers specified above.

* *The stated non-residential increase is based on an E-32 customer with Summer usage of 9,504 kWhs and 33 kW and Winter usage of 7,812 kWhs and 30 kW.*

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PLEASE READ! IMPORTANT NEWS ABOUT YOUR ELECTRIC BILL

Dear APS Customer:

As we move into the heart of another Arizona summer, APS expects to meet the highest demand for electricity in our history. And, while we're well prepared and do not expect a repeat of last summer's events, we are facing other challenges this year. The cost of natural gas and, to a lesser extent, other fuels used to generate electricity has increased and remains stubbornly high. As a result, we have asked the Arizona Corporation Commission (ACC) for a temporary adjustment to our rates to recover the higher costs of fuel that are not included in current rates. (A power supply adjustor is a commonly-used regulatory mechanism to reflect changes in fuel and purchased power costs)

In the last year, I am sure that you have been impacted by the soaring cost of gasoline at the pump. The price of natural gas has increased in a similar manner. Costs incurred by APS for fuel and purchased power currently exceed the cost included in APS' rates by about 24 percent. By the end of August, the company could see a shortfall in its fuel-costs collection of about $100 million. That's why we've requested a temporary surcharge of about 2.2 percent to recover this under-collection over two years, beginning this Fall.

The plain fact is that fuel is the largest single cost of providing electricity to our customers, and we only charge our customers what the fuel costs us — we add no mark-up. If approved, the surcharge would add about $2.74 to the average monthly residential bill. And, if fuel costs continue to increase, we could be faced with further price adjustments.

The positive news is that our customers will continue to receive the top-notch, reliable service they have come to expect from us. Just as important, the price you pay for our service will remain a strong value. Even with the proposed surcharge, our rates will still be lower than they were in 1991. By comparison, the Consumer Price Index has increased by 43 percent over the same period.

But, using energy wisely makes good sense for all of us. That's why I encourage you and your family to adopt energy-efficient practices. Conservation not only helps keep our fuel costs down, it helps lower your overall energy bills.

To learn more about energy saving tips or the power supply adjuster, log on to our web site at www.aps.com.

Sincerely,

Jack Davis

Jack Davis
President & CEO

THE POWER TO MAKE IT HAPPEN

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Kris Fenex
Law Department
Pinnacle West Capital Corporation
400 North Fifth Street
Phoenix, Arizona 85004

Fax: (602) 250-3393
E-mail: kris.fenex@pinnaclewest.com

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APS and you regarding information available on, in or through this Site. This Agreement, including all other documents, disclaimers, agreements and notices referenced herein and in the Site, represent the entire understanding between you and APS regarding your use of this Site, and supersedes any prior statements or representations. You agree to be bound to this Agreement by your use of the Site.

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Power Supply Adjustment (PSA)

On March 28, 2005, the Arizona Corporation Commission (ACC) issued a decision that established the Power Supply Adjustment (PSA), described below.

- Power Supply Adjustment (PSA)
- News release: APS Seeks Approval of Power Supply Adjustor Surcharge
- PSA Surcharge: Important notice about possible increases to your bill

more news

Discounts now available on energ efficient lighting!
This fall, APS is partnering with local retailers to offer disco on compact fluoresce lighting.

Heating/AC Check
Call for an APS Quali Contractor heating/co check-up for $54.95.

Solar Open House
Learn about the lates solar technology duri open house at the ST Center, Saturday, Oc 2005.

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A3514

APS Seeks Approval of Power Supply Adjustor Surcharge

July 22, 2005

Phoenix, AZ -

Responding to dramatically higher natural gas prices, APS today asked approval of the Arizona Corporation Commission (ACC) to implement a temporary power supply adjustor surcharge to recover the higher costs of fuel and purchased power that are not included in current rates. If approved, the surcharge would begin this fall, and conclude two years later. The surcharge of $0.001770 per kilowatt-hour would add about $2.74, or 2.1 percent, to the average monthly residential bill.

"Just as gasoline prices have soared at the pumps, the cost of natural gas and other fuels we buy to run APS' power plants have increased and remain stubbornly high," said Steve Wheeler, APS executive vice president, customer service and regulation. "Despite our cost control and risk management efforts, our fuel and purchased power expenses have exceeded what is currently being collected in rates, and we need timely recovery of these costs to continue providing quality service to our customers."

Wheeler noted that current power supply costs exceed those included in present APS rates by about 24 percent. By August, the Company could see a shortfall in its fuel-costs collection of about $100 million.

"Fuel is the largest single cost of providing electricity to our customers," he said. "And, since we only charge our customers for what the fuel costs us, our rates need to reflect the true prices we pay."

If the surcharge is approved, APS' prices will still be lower than they were in 1991. APS rates now average 8.1 cents per kilowatt-hour; after the surcharge, the average rate will be 8.3 cents. In 1991, the rate was 8.75 cents per kilowatt-hour. By comparison, the Consumer Price Index has increased by 43 percent over the same period.

However, Wheeler added that "if our fuel and purchased power costs continue to increase, we could expect to see further price adjustments."

Under an ACC decision issued this past spring, APS is required to request a surcharge before the under-collection of fuel costs reaches a predetermined level. A power supply adjustor is a commonly-used regulatory mechanism to send timely price signals, and to ensure customers pay only for the actual and reasonable costs of power supplies by allowing upward or downward revisions to the fuel portion of customers' bills.

"Using energy wisely makes good sense for all of us," Wheeler stressed. "So we encourage our customers to adopt energy-efficient practices. Conservation helps keep our fuel costs down, and helps customers lower their power bills."

To learn more about conservation tips or the power supply adjustor, log on to APS' web site at www.aps.com. Once at the site, customers will find various tools to help reduce energy usage and lower their electricity bills.

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Return to News Releases Index

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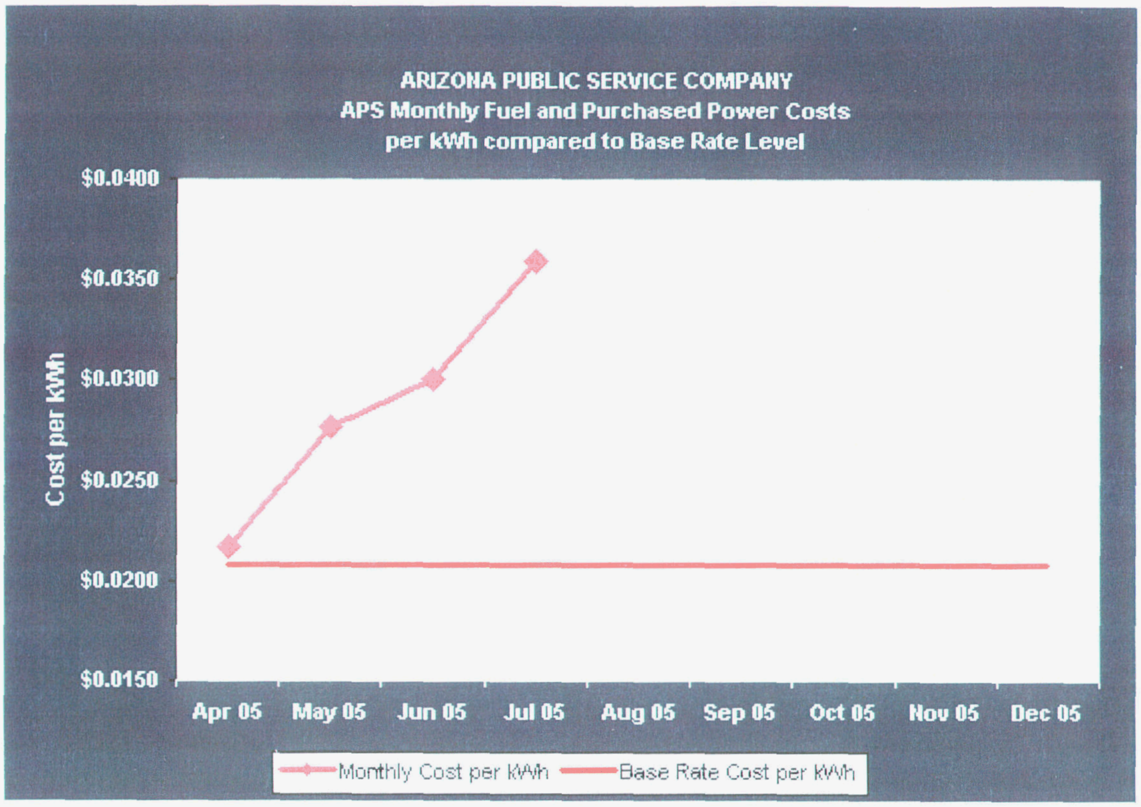
ARIZONA PUBLIC SERVICE COMPANY
APS Monthly Fuel and Purchased Power Costs
per kWh compared to Base Rate Level
Cost per kWh
$0.0400
$0.0350
$0.0300
$0.0250
$0.0200
$0.0150
Apr 05
May 05
Jun 05
Jul 05
Aug 05
Sep 05
Oct 05
Nov 05
Dec 05
Monthly Cost per kWh
Base Rate Cost per kWh

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Important Notice About Possible Increases to Your Bill

Arizona Public Service Company (APS) has asked the Arizona Corporation Commission (ACC) to approve a $.001770 per kWh Power Supply Adjustment (PSA) Surcharge on customer's bills to recover a portion of the increased fuel and purchased power costs. If approved as requested, the surcharge would be applied to customers' bills beginning with billing cycle 1 of November 2005 and would be removed in 24 months. It would add an estimated $2.74, or about 2.1 percent to the average monthly residential bill. The average non-residential customer's monthly bill will increase an estimated $14.93 or about 1.8 percent.[1] The actual increase each customer will have depends on their individual usage and rate schedule.

Customers can minimize the impact of the surcharge by using electricity efficiently and wisely, thus reducing their overall energy usage. Tips on how to reduce your energy usage are available on our website www.aps.com under APS Services or on the bill inserts that accompany your monthly bill. Customers who are on the Company's Residential Energy Support Program (E-3) or Medical Care Equipment Program (E-4) will not have to pay the surcharge.

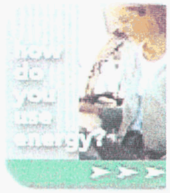
The surcharge will recover a portion of the increased fuel and purchased power costs already incurred to provide electricity for customers. Due to the current market conditions, fuel and purchased power costs have increased to the point where the Company was required to file the surcharge request with the ACC. While APS regrets any increase in our customer's costs, the under-collected PSA balance needs to be reduced. The proposed PSA surcharge is different from and in addition to the annual PSA adjustment (if any) in April 2006. For more information on current natural gas prices and a description of the PSA, visit our website at www.aps.com under Power Supply Adjustment (PSA). For more information about the Company's request you can visit the website above or call either 1-800-253-9405 or 602-371-7171 (in metro Phoenix).

The Company is requesting that the ACC schedule an Open Meeting to discuss and vote upon this matter prior to November 1, 2005. To find out when this Open Meeting will be scheduled or how to comment on the proposed surcharge you can contact the ACC at www.cc.state.az.us or call 1-800-222-7000. Additionally, you can contact the Company at the numbers specified above.

[1] The stated non-residential increase is based on an E-32 customer with Summer usage of 9,504 kWhs and 33 kW and Winter usage of 7,812 kWhs and 30 kW.

Posted July 22, 2005

Energy Audit



Energy Survey

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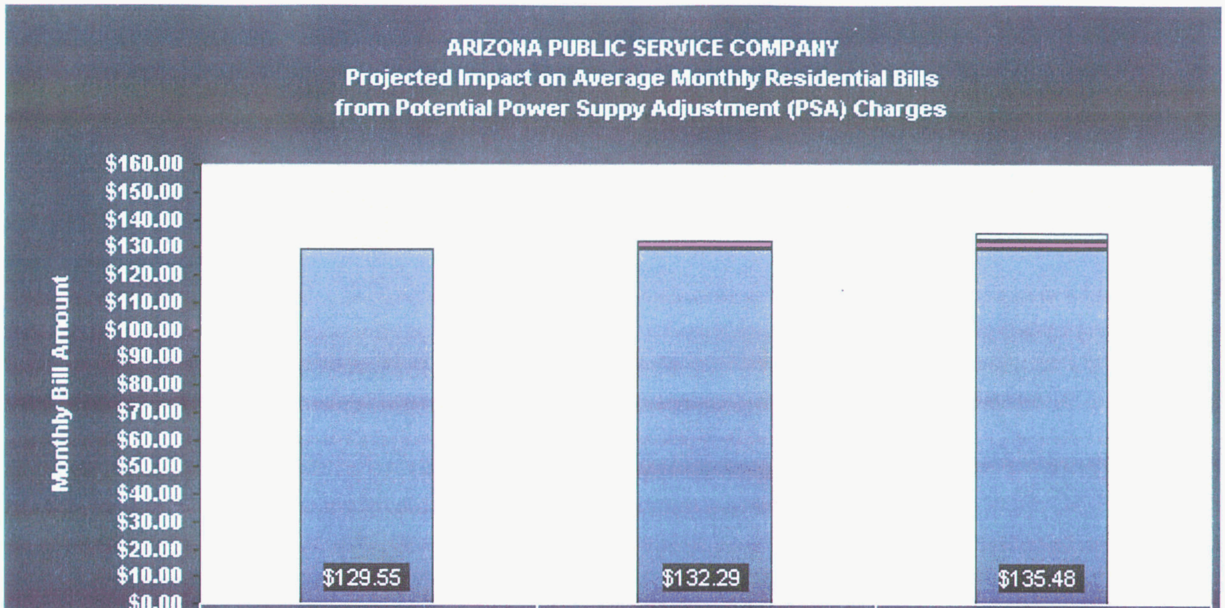

	Current Rates	Projected Nov. 1, 2005	Projected Apr. 2006
PSA Charge	$0.00	$0.00	$3.19
PSA Surcharge	$0.00	$2.74	$2.74
Current Rates	$129.55	$129.55	$129.55
Total	$129.55	$132.29	$135.48

Low Income Programs

The APS Energy Support Program (E-3), administered through the Arizona Department of Economic Security (DES), assists customers living on a limited income.

If you qualify under the low-income guidelines established by the federal government, you may be eligible to receive a discount of as much as 40 percent off your cost of electricity.

The amount of the discount depends upon how much electricity you use each month.

You may open and print a copy of the application form* for the APS Energy Support Program or they can be picked up at all APS business offices, as well as several community action agencies, senior centers and food banks.

*This link requires Adobe Acrobat® Reader™ for viewing and printing. If necessary, you may download this free software now.

More Low Income Programs

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Using energy wisely makes good sense for all of us, so we provide various tools to help you reduce your energy usage. In this section you'll find ideas to help save energy and lower your electricity bills.

Whether you're buying a new home, planning home improvements or simply have questions about home energy efficiency, you'll find ways to help you make informed and economical decisions about your energy use.

Ways to Save
Making wise use of energy, no matter what your needs, will save you money and help protect the environment.

Energy Efficient Lighting
Installing compact flourescent ights is one of the easiest ways to start making an impact on your energy bills.

Summer Vacation Tips
How to reduce your energy costs and protect your home while you're away.

High Bill Causes
Review the Top Ten reasons for a higher than usual bill. See if any of these reasons might help you manage your energy use.

Residential Energy Answers
Learn great ways to lower the energy usage of your existing home. View or download 15 Energy Fact Sheets about home energy efficiency in Arizona.

Quick Tips
Explore areas for home energy savings. Read quick tips describing what you can do to reduce the amount of energy used in your home.

Home Energy Test
Calculate an estimate of typical annual energy savings from energy efficiency improvements.

Energy Survey
Managing your home energy can be fun and easy. Visit our Energy Survey to get an idea of how you use energy and ways to save.

Energy Savings in Apartments
Renters can make simple and inexpensive changes to reduce energy use and save money.

Appliance Usage Information
Review information about typical energy usage of your home appliances and electronic equipment.

Tips for Home Buyers
Information to help you work with your builder to design and build a home that will provide you and your family with a comfortable and energy efficient home.

Energy Efficiency Contractor Referrals
Now that you know what to do to make your home more energy efficient, let APS help you find the right contractor to do the job.

Performance Built Homes™
Houses that carry the APS Performance Built Homes designation guarantee homeowners that the cost to heat and cool their home will not exceed a guaranteed annual amount.

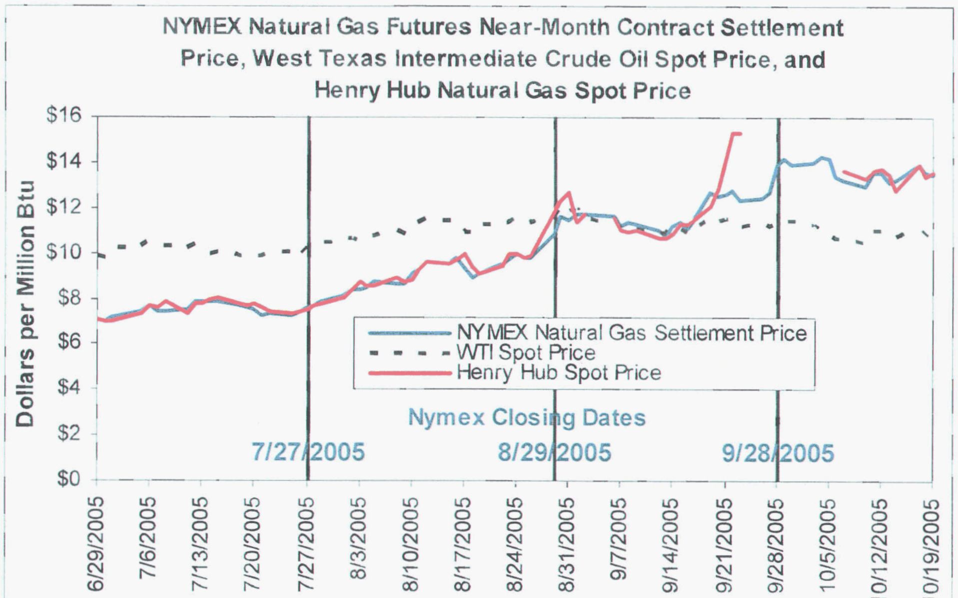
eia.doe.gov

Natural Gas Weekly Update

XXXXX

Overview: Thursday, October 20 (next release 2:00 p.m. on October 27)

Since Wednesday, October 12, spot prices decreased at virtually all market locati Lower 48 States. For the week (Wednesday–Wednesday), prices at the Henry Hub 24 cents or about 2 percent to $13.52 per MMBtu. Yesterday (October 19), the pı NYMEX futures contract for November delivery settled at $13.549 per MMBtu, about 3 cents or 0.2 percent since last Wednesday. The Energy Information Adm (EIA) reported that working gas in storage was 3,062 Bcf as of Friday, October reflects an implied net increase of 75 Bcf. The spot price for West Texas Intermedi crude oil decreased $2.02 per barrel, or about 3 percent, on the week to settle ye $62.11 per barrel, or $10.71 per MMBtu.



Note: The West Texas Intermediate crude oil price, in dollars per barrel, is converted to $/MMBtu using a conversion factor of 5.80 MMBtu per barrel. The dates marked by vertical lines are the NYMEX near-month contract settlement dates.
Source: NGI's *Daily Gas Price Index* (http://Intelligencepress.com)

Prices:

Spot prices ended the week lower at most market locations, with modest decline mostly from about 5 to 50 cents. Higher prices on the week were seen at only six scattered in the East Texas, Midcontinent, the Rocky Mountains, and the Northea: with increases averaging 29 cents. However, the week-on-week results mask unusı price swings, particularly the large decreases on Friday (October 14) and the sharp on Monday (October 17). Generally mild temperatures nationwide, expec temperatures for the weekend, and many storage facilities recording nearly full supported a decrease in spot prices on Friday, which declined across the board by ε of 82 cents, with many declines of $1 or more. As news of yet another tropical storı Monday trading, spot prices gained an average of $1.12 in the Lower 48 States

$1.42 in some locations. Since Monday, however, price declines at virtually all sp locations resulted in price levels by yesterday that were less than those of the Wednesday. The El Paso Bondad location in the Rocky Mountain region noted a MMBtu decrease, the largest on the week in the Lower 48 States. El Paso Bondad yesterday at $10 per MMBtu. The Henry Hub however showed a more modest de the week of about $0.25 per MMBtu, trading yesterday at $13.52, or about 2 percen on Wednesday, October 12.

Spot Prices ($ per MMBtu)	Thur. 13-Oct	Fri. 14-Oct	Mon. 17-Oct	Tue. 18-Oct	Wed 19-Oct
Henry Hub	13.50	12.80	13.88	13.40	13.52
New York	14.11	13.50	14.70	14.09	14.13
Chicago	12.21	11.09	12.31	11.92	12.24
Cal. Comp. Avg,*	11.67	10.72	11.71	11.47	11.34
Futures ($/MMBtu)					
Nov delivery	13.103	13.219	13.887	13.421	13.549
Dec delivery	13.663	13.749	14.297	13.801	13.860

*Avg. of NGI's reported avg. prices for: Malin, PG&E citygate, and Southern California Border Avg.

Source: NGI's Daily Gas Price Index (http://intelligencepress.com).

At the NYMEX, the price of the futures contract for November delivery at the H increased by about 3 cents during the week to settle at $13.549 per MMBtu on W October 19. Futures prices increased on Monday, October 17, as the market b Hurricane Wilma, the record 21st storm of the hurricane season. After reaching $1 MMBtu on Monday, the price of the November 2005 contract declined about 34 ce new projected storm path indicated that Wilma is expected to take a course towar instead of the producing areas of the West and Central Gulf of Mexico. By contrast the futures contracts for delivery during the remaining months in the 2005-200 season decreased roughly 13 to 19 cents or about 1 percent per MMBtu since last W Despite the price decreases, contracts for delivery during the heating season traded at an average premium of about 37 cents to the Henry Hub spot price, with d ranging up to 72 cents for the January delivery contract. The 12-month strip, or th price for contracts over the next year, closed yesterday at just under $12 per MM increase of a little more than 4 cents on the week.

Recent Natural Gas Market Data

Estimated Average Wellhead Prices

	Apr-05	May-05	Jun-05	Jul-05	Aug-05	Sept-05
Price ($ per Mcf)	6.44	6.02	6.15	6.69	7.68	9.76
Price ($ per MMBtu)	6.27	5.86	5.99	6.51	7.48	9.50

Note: Prices were converted from $ per Mcf to $ per MMBtu using an average heat content of 1,027 Btu per cubic foot as published in Table A4 of the Annual Energy Review 2002.
Source: Energy Information Administration, Office of Oil and Gas.

Storage:

Working gas in storage as of October 14 totaled 3,062 Bcf, which is 1.8 percent ab year average inventory level for the week according to EIA's *Weekly Natural Ga*

Report (See Storage Figure). Working gas in underground storage climbed past the 3,000 Bcf mark for the first time in 2005. The net addition to storage was 75 Bcf, which is about 34 percent above the 5-year average net injection of 56 Bcf and about 16 percent above the net injection of 64 Bcf during the report week last year. This marks the first time in 5 weeks, and the fourth time since June 3, 2005, that the weekly net change exceeded the 5-year average net increase, as current storage levels climbed to 53 Bcf more than the 5-year average. Furthermore, this is the first time since September 16, 2005, and the second time in the past 16 weeks that the net change exceeded last year's levels. During the report week, temperatures were moderate according to the number of degree days as measured by the National Weather Service (See Temperature Maps). Based on degree days in the Lower 48 States for the week ending October 13, only the Rocky Mountains, West South Central, and West North Central U.S. Census regions registered cooler-than-normal temperatures. Moderate temperatures, favorable economics, and possible industrial demand destruction owing to the elevated level of natural gas prices likely contributed to the increased level of injections for the week. The 6-month futures strip traded at a significant premium to the Henry Hub spot price throughout most of the report week, providing economic incentives to continue injecting gas into storage.

All Volumes in Bcf	Current Stocks 10/14/05	One-Week Prior Stocks 10/7/05	Implied Net Change from Last Week	Estimated Prior 5-Year (2000-2004) Average	Percent Difference from 5 Year Average
East Region	1,819	1,774	45	1,800	1.1%
West Region	423	417	6	382	10.7%
Producing Region	820	796	24	828	-1.0%
Total Lower 48	3,062	2,987	75	3,009	1.8%

Source: Energy Information Administration: Form EIA-912, "Weekly Underground Natural Gas Storage Report," and the Historical Weekly Storage Estimates Database. Row and column sums may not equal totals due to independent rounding.

Other Market Trends:

Natural Gas Rig Count: The number of rigs drilling for natural gas in the United States was 1,262 as of Friday, October 14, 2005, according to Baker-Hughes Incorporated. The current number of rigs reflects a slight decrease from the record number of 1,273 set during the week ending September 30, 2005, and is more than 19 percent higher than the number of rigs drilling for natural gas during this week last year. Of the total rigs currently drilling in the United States, 85.2 percent are rigs drilling for natural gas. Although the percentage of total rigs drilling for natural gas is down from the record high of over 89 percent in June, it has remained over 85 percent for the past 5 weeks. Of the 1,262 natural gas rigs, 60 are located in the Gulf of Mexico, which is 2 more than last week's Gulf total. This rig count reflects a number of offshore rigs that were lost or damaged owing to recent hurricane activity in the Gulf of Mexico.

Current Assessment of Hurricane Impact on Gas Processing Plants: As of October 19, 2005, 30 natural gas processing plants in the coastal counties of Texas, Louisiana, Mississippi, and Alabama, with capacities equal to or greater than 100 million cubic feet per day, are active. These plants have a total capacity of 12.9 billion cubic feet per day (Bcf/d) and had a pre-hurricane flow of 8.7 Bcf/d. Current flows associated with the operating plants are 93 percent of the pre-hurricane volumes. In some cases, this flow may include volumes that bypass the plant. Another 16 processing plants in Louisiana and Texas, with capacities equal to or greater than 100 million cubic feet per day, are not active owing to the hurricanes. These plants have an aggregate capacity of 9.71 Bcf/d, and a total pre-hurricane flow volume of 5.45 Bcf/d. A number of inactive plants are operational, but are not operating owing to upstream or downstream infrastructure problems or supplies being unavailable. These operational inactive plants have a total capacity of 1.35 Bcf/d and had a pre-hurricane flow rate of 0.54 Bcf/d. A number of the inactive plants are expected to be operating within 4 weeks. The incremental available capacity at that time would be 2.23 Bcf/d with pre-hurricane flow of 1.08 Bcf/d.

Summary:
Spot prices decreased on the week at almost all market locations. While the November contract price increased, the futures prices for delivery in the coming heating season decreased slightly but continue to carry a premium over current cash prices. Working gas in underground storage as of October 14 has exceeded 3 Tcf and was 1.8 percent above the 5-year average.

Short-Term Energy Outlook

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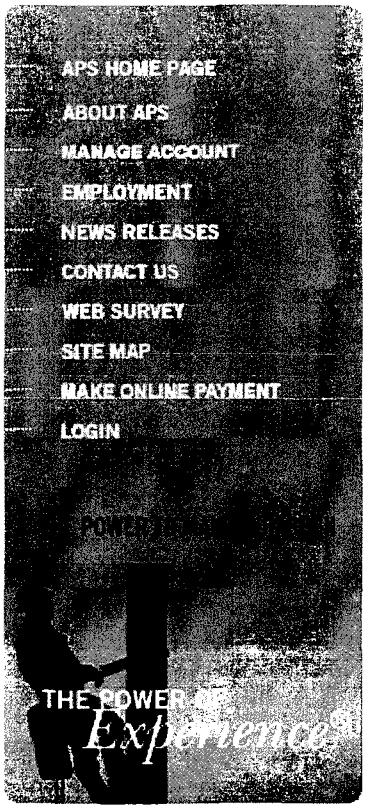

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APS Seeks Approval of Power Supply Adjustor Surcharge

July 22, 2005

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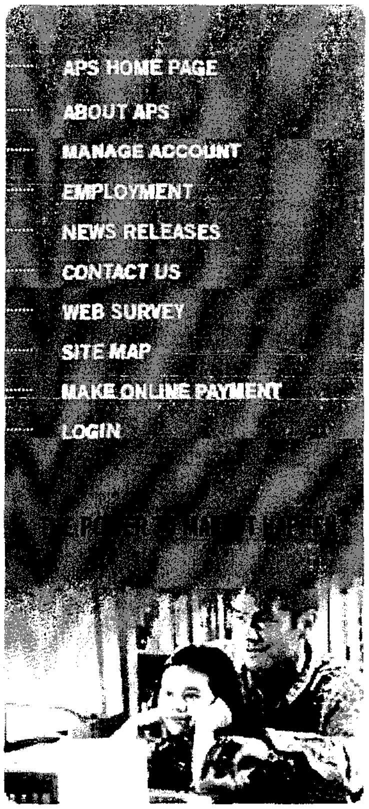

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Please Read: Important News about Possible Increase to Your Electric Bills and the Power Supply Adjustor (PSA)

On March 28, 2005, the Arizona Corporation Commission (ACC) issued a decision that increased the average residential monthly bill by $3.13 effective April 1, 2005. However, the increase for individual customers varies according to individual usage and rate plans. The decision also allowed APS to pass on certain fuel and purchased power costs to customers that could increase customer bills by another 5 percent, as described below.

The rate increase was necessary to keep up with the increased costs of serving one of the nation's fastest growing areas and will help enhance reliability for customers and financial integrity for the company. Specifically, the ACC decision provided for the addition of generating facilities, energy efficiency programs, an increased commitment to procurement of energy from renewable resources and enhanced financial assistance for low income customers. The decision was based largely upon an agreement between APS and 21 other parties that settled issues involved in the company's general rate case filed in June 2003.

To deal with the rapid changes in fuel and purchased power costs, APS requested the authorization to pass on fuel (primarily natural gas) and power costs beyond those in base rates through a Power Supply Adjustor (PSA).

Q: How does the Power Supply Adjustor work?

A base cost of fuel and purchased power of $0.020743 per kWh is included in APS base rates. The PSA is an adjustment mechanism that collects or refunds the annual fuel costs that differ from the base year level.

The difference between what we are collecting from our customers through our base rates and what we are paying for fuel and purchased power is accrued in a balancing account for future recovery or refund to customers.

- Fuel and purchased power costs. This chart shows the APS' actual cost of fuel and purchased power compared to the base year amount that is currently included in our rates. The data shown on the chart is the monthly retail cents per kWh total that is filed with the ACC two months after the last day of the month in which the costs were incurred.

Q: Will APS customers pay the full cost associated with an increase in fuel and purchased power costs?

The fuel and purchased power costs are split between customers and APS as the result of a ACC approved 90/10 sharing mechanism. APS can recover 90% of the costs from the customers and has to pay the remaining 10% itself. The ACC approved this as a way to encourage APS to minimize its fuel and purchased power costs. Any costs flowed through the PSA are subject to refund should the ACC determine that such costs were not prudently incurred. APS files its PSA costs and balancing account total with the ACC monthly.

Q: When can the PSA charge or potential surcharge go into effect?

Any changes to the PSA charge will go into effect on April 1, 2006 and will be modified on April 1st of each subsequent year during the period the PSA remains in effect. On March 1, 2006, and each subsequent year the PSA remains in effect, APS will submit a publicly available report to the ACC that provides the calculation of the new PSA rate. If the balancing account referenced above exceeds plus or minus $50 million, APS is required to file a request for a PSA surcharge to either collect or refund the balance or file an explanation of why such a surcharge isn't necessary. The surcharge can only be implemented with ACC approval and any such surcharge would be in addition to the PSA charge. If a surcharge is approved to collect a portion of the balance this would be in addition to the PSA charge that changes annually on April 1st. If approved, a surcharge will have a specific time period that it can be in effect before it expires. Typically, this is one to two years.

Q: Has APS filed a request for a PSA surcharge?

Yes. On July 22, 2005 APS filed a request with the ACC to approve a PSA surcharge of $.001770 per kWh that, if approved, would go into effect beginning with billing cycle one of November 2005.

Q: What is the potential impact to my monthly bill from the PSA charge and surcharge?

The Projected Impact on Average Monthly Residential Bills from Potential Power Supply Adjustment (PSA) Charges chart shows the projected impacts from the PSA charge and surcharge based on the July 22, 2005 PSA surcharge request.

Q: Is there a limit to how much I can be charged through the PSA?

The ACC approved the PSA with modifications including a cap at four-tenths of a cent per kilowatt-hour not including any surcharges authorized by the ACC. A four-tenths of a cent per kWh PSA charge would increase an average bill by another 5 percent. An ACC approved PSA surcharge as described above can cause the combined PSA charge and surcharge amount to exceed four-tenths of a cent per kilowatt-hour.

Q: What if fuel and purchased power cost go down?

If fuel and purchased power costs were to decline below the base level, the PSA would be revised downward and would result in a credit on customer's bills. For example, if fuel and purchased power costs increased in 2005 over the level in base rates, customers will be charged a fee indicated on the Power Supply Adjustor line of their bills beginning in April 2006 to recover those increased costs. If these costs decrease, customers will receive a credit indicated on this line. The adjustor is limited to a maximum increase or decrease of $0.004 per kilowatt-hour

Q: Will all APS customers be billed for the PSA?

Customers who are on APS' Residential Energy Support Program (E-3) or Medical Care Equipment Program (E-4) will not receive any PSA charges. Information on the Energy Support Program and the Medical Care Equipment Program is available on this Web site or by calling the APS Medical Care Division at (602) 371-6884 for Metro Phoenix or 1-800-253-9405, ext. 6884.

Q: Can APS help me make my energy cost more manageable?

Customers can minimize the impact of the PSA by using electricity efficiently and wisely, thus reducing their overall energy usage. Tips on how to reduce your energy usage are available on this Web site or on the bill inserts that accompany your monthly bill.

It is important to remember that your energy usage this year will impact the PSA charge that goes into effect next year. As described above, the PSA charge for next year is calculated using the fuel and purchased power costs incurred by the

Company this year.

Q: Do natural gas prices impact APS' fuel and purchase power costs?

Yes. Just as gasoline prices have soared at the pumps, the cost of natural gas and other fuels we buy to run APS' power plants have increased. Fuel is the largest single cost of providing electricity to our customers. Since we only charge our customers for what the fuel costs us, our rates reflect the true prices we pay.

Q: Where can I get more information on current natural gas prices?

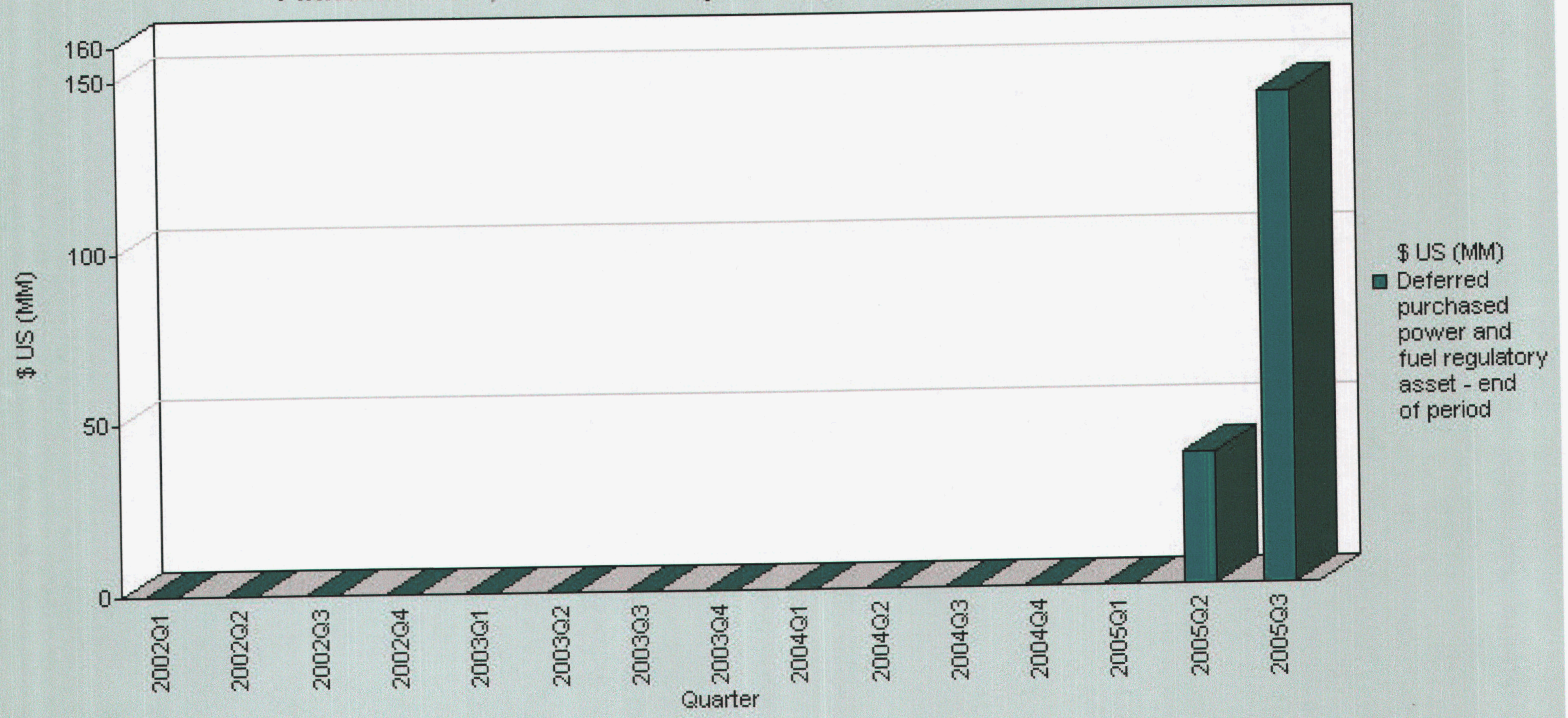
More information on natural gas costs. This link will take you to another party's Web site and is included only to provide access to information indicating the current national natural gas market trend, which may not reflect what APS pays for natural gas in the future. APS purchases gas from different basins and at different prices than what is shown. Additionally, APS' natural gas costs include several additional costs such as taxes, shrinkage, and pipeline transportation costs, among others. Market prices can change by the minute and forecasts are not always accurate. Please see our Terms of Use for additional information and disclaimers applicable to Third Party Sites.

EXHIBIT

Mayes 1

admitted

Pinnacle West, Financial & Operating Data by Quarter, 2002 - 2005



Source: Pinnacle West

Confidential Exhibit

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Pages 1 - 19

EXHIBIT
GLEASON-2
admitted

0.020743 base cost

	April 2006 reset <u>2005 gas cost</u>	April 2007 reset <u>2006 gas cost</u>	April 2008 reset <u>2007 gas cost</u>	April 2009 reset <u>2008 gas cost</u>	April 2010 reset <u>2009 gas cost</u>	April 2011 reset <u>2010 gas cost</u>
A) Annual Gas Cost ($000)	$332,500	$395,250	$464,893	$542,083	$628,816	$723,139
B) Amount Allowed Due to $500,000,000 Cap	$332,500	$395,250	$464,893	$500,000	$500,000	$500,000
C) Annual Gas Volume (000 MMBtu)	57,527	65,126	72,954	81,016	89,118	97,138
D) Average Cost of Gas ($/MMBtu)	$5.78	$6.07	$6.37	$6.17	$5.61	$5.15
E) Annual Native Load Sales (MWH)	22,009,792	29,233,450	38,880,489	51,711,050	68,775,696	91,471,676
F) Annual Net Fuel and PP Costs	$610,756,469	$776,200,000	$776,200,000	$776,200,000	$776,200,000	$776,200,000
G) Annual Costs Recovered Thru Base Cost	$456,549,115	$606,389,453	$806,497,973	$1,072,642,304	$1,426,614,264	$1,897,396,972
H) Over/Undrcollction (neg. is overcollected)	$154,207,354	$169,810,547	$0	$0	$0	$0
I) Balance After 90/10 Application	$138,786,618	$152,829,492	$0	$0	$0	$0
J) Previous Year's Balance Carryover	$0	$88,039,168	$116,933,800	-$38,588,154	$12,734,091	-$4,202,250
K) Previous Year's Collection from PSA Rate	$0	-$116,933,800	-$155,521,954	$51,322,245	-$16,936,341	$5,588,992
L) Remaining Balance	$138,786,618	$123,934,860	-$38,588,154	$12,734,091	-$4,202,250	$1,386,742
M) Amnt Expcted to Collect Through PSA Rate	$88,039,168	$116,933,800	-$38,588,154	$12,734,091	-$4,202,250	$1,386,742
N) Bal. per kwh of Native Load Sales	$0.00631	$0.00424	-$0.00099	$0.00025	-$0.00006	$0.00002
O) Bal. per kwh Captured Within $0.004 band	$0.00400	$0.00400	-$0.00099	$0.00025	-$0.00006	$0.00002
P) Bal. per kwh Rmnng Outside $0.004 band	$0.00231	$0.00024	$0.00000	$0.00000	$0.00000	$0.00000
Q) Balancing Account Balance	$50,747,450	$57,748,510	$57,748,510	$57,748,510	$57,748,510	$57,748,510
R) Amount Bal. Account Exceeds $50 million	$747,450	$7,748,510	$7,748,510	$7,748,510	$7,748,510	$7,748,510

Information in blue is 'placeholder' data from example chart supplied in rate case. Actual data which would update the blue rows was not supplied by APS. This lack of actual data does not affect chart below line D. Orange data is confidential data supplied by APS. Data in green are Staff's projections based on data in orange.

This version carries Line M up to Line J.