

OPEN MEETING ITEM



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COMMISSIONERS  
GARY PIERCE - Chairman  
BOB STUMP  
SANDRA D. KENNEDY  
PAUL NEWMAN  
BRENDA BURNS

ORIGINAL



ARIZONA CORPORATION COMMISSION

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DATE: MARCH 13, 2012  
DOCKET NO.: E-01345A-10-0474

Arizona Corporation Commission  
**DOCKETED**

MAR 13 2012

TO ALL PARTIES:

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Enclosed please find the recommendation of Administrative Law Judge Lyn Farmer. The recommendation has been filed in the form of an Opinion and Order on:

ARIZONA PUBLIC SERVICE COMPANY  
(PURCHASE ASSETS/ACCOUNTING ORDER)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by **4:00** p.m. on or before:

MARCH 22, 2012

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Open Meeting to be held on:

MARCH 27, 2012 AND MARCH 28, 2012

For more information, you may contact Docket Control at (602) 542-3477 or the Hearing Division at (602) 542-4250. For information about the Open Meeting, contact the Executive Director's Office at (602) 542-3931.

ERNEST G. JOHNSON  
EXECUTIVE DIRECTOR

1200 WEST WASHINGTON STREET, PHOENIX, ARIZONA 85007-2927 / 400 WEST CONGRESS STREET, TUCSON, ARIZONA 85701-1347

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1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 COMMISSIONERS

3 GARY PIERCE - Chairman  
4 BOB STUMP  
5 SANDRA D. KENNEDY  
6 PAUL NEWMAN  
7 BRENDA BURNS

8 IN THE MATTER OF THE APPLICATION OF  
9 ARIZONA PUBLIC SERVICE COMPANY FOR  
10 AUTHORIZATION FOR THE PURCHASE OF  
11 GENERATING ASSETS FROM SOUTHERN  
12 CALIFORNIA EDISON AND FOR AN  
13 ACCOUNTING ORDER.

DOCKET NO. E-01345A-10-0474

DECISION NO. \_\_\_\_\_

**OPINION AND ORDER**

10 DATE OF HEARING: June 30, 2011 (Pre-hearing conference); July 14, 15,  
11 August 8, 9, and September 1, 2011.

12 PLACE OF HEARING: Phoenix, Arizona

13 ADMINISTRATIVE LAW JUDGE: Lyn Farmer

14 IN ATTENDANCE: Gary Pierce, Chairman  
15 Sandra D. Kennedy, Commissioner  
16 Paul Newman, Commissioner  
17 Brenda Burns, Commissioner

18 APPEARANCES: Ms. Meghan H. Grabel and Mr. Thomas Mumaw,  
19 PINNACLE WEST CAPITAL CORPORATION, on  
20 behalf of the Applicant;

21 Mr. Daniel W. Pozefksy, Chief Counsel, on behalf of  
22 the Residential Utility Consumer Office;

23 Mr. Lawrence V. Robertson, Jr. and Mr. Greg Patterson  
24 on behalf of the Arizona Competitive Power Alliance;

25 Mr. Travis Ritchie on behalf of the Sierra Club;

26 Mr. Timothy Hogan, ARIZONA CENTER FOR LAW  
27 IN THE PUBLIC INTEREST, on behalf of Western  
28 Resource Advocates and Environmental Defense Fund;  
and

Mr. Wesley Van Cleve and Mr. Scott Hesla, Staff  
Attorneys, Legal Division, on behalf of the Utilities  
Division of the Arizona Corporation Commission.

**BY THE COMMISSION:**

On November 22, 2010, Arizona Public Service Company ("APS" or "Company") filed with

1 the Arizona Corporation Commission (“Commission”) an application for authorization for the  
2 purchase of generating assets from Southern California Edison (“SCE”) and for an accounting order.  
3 The application seeks authority for APS to acquire SCE’s interest in the Four Corners Power Plant.

4 By Procedural Orders, intervention was granted to the Residential Utility Consumer Office  
5 (“RUCO”), the Arizona Competitive Power Alliance (the “Alliance”), Western Resource Advocates  
6 (“WRA”), Southwestern Power Group II, L.L.C. and Bowie Power Station, L.L.C. (“SWPG/Bowie”),  
7 the Environmental Defense Fund (“EDF”), and the Sierra Club. SWPG/Bowie later requested to  
8 withdraw as an intervenor, and its request was granted.

9 The hearing commenced on July 14, 2011, and continued on July 15, August 8, 9, and  
10 September 1, 2011. No members of the public appeared to make public comment. APS presented  
11 testimony of Jeffrey B. Guldner, Patrick Dinkel, Mark A. Schiavoni, and Judah L. Rose; WRA  
12 presented testimony of David Berry; the EDF presented testimony of Bruce Polkowsky; the Sierra  
13 Club presented testimony of David A. Schlissel; the Alliance presented testimony of Greg Patterson;  
14 RUCO presented testimony of Thomas H. Fish and Royce Duffett; and Staff presented testimony of  
15 Laura A. Furrey, Jeffrey Michlik, and Margaret Little.

## 16 BACKGROUND

### 17 Four Corners Power Plant

18 The Four Corners Power Plant (“Four Corners”) consists of five generating units located on  
19 the Navajo Nation in Fruitland, New Mexico. Electricity is generated using coal mined from the  
20 adjacent Navajo mine<sup>1</sup> and APS operates Four Corners pursuant to a Co-Tenancy Agreement with the  
21 other plant owners.

22 APS owns Units 1, 2, and 3 which went online during 1963-64 and have a combined output of  
23 560 MW. Units 4 and 5 went online during 1969-70 and have a combined output of 1540 MW.  
24 Units 4 and 5 are co-owned by SCE (48 percent or 739 MW); APS (15 percent or 231 MW); Public  
25 Service Company of New Mexico (13 percent); Salt River Project (10 percent); El Paso Electric  
26 Company (7 percent); and Tucson Electric Power Company (7 percent). APS’ total ownership  
27

28 <sup>1</sup> The Navajo mine is owned and operated by BHP Billiton (“BHP”). APS Application at p. 2.

1 interest in Four Corners provides 791 MW of baseload generation, approximately 19 percent of the  
2 Company's total generation needs.<sup>2</sup>

### 3 Issues Related to Four Corners' Future

#### 4 Environmental Regulations and Legislation

5 In its application, APS identified environmental challenges facing Four Corners that it  
6 believes may threaten the plant's viability. Those complex environmental issues include regulations  
7 promulgated or expected to be promulgated by the Environmental Protection Agency ("EPA") that  
8 will require coal generators to install various environmental controls. These include the Clean Air  
9 Act requirements concerning regional haze and mercury emissions, and coal ash handling related to  
10 the Resource Conservation Recovery Act. Other environmental uncertainties include New Source  
11 Reviews under the Clean Air Act and federal carbon legislation. APS projects that bringing all units  
12 of Four Corners into compliance with environmental requirements may exceed \$660 million in  
13 capital costs by 2016.<sup>3</sup>

#### 14 Lease with Navajo Nation

15 Four Corners is located on the Navajo reservation and at the time of the application, was  
16 subject to a lease that expired in 2016. Prior to installing any environmental controls that would  
17 extend the life of the plant beyond 2016, the plant owners needed to negotiate and obtain an approved  
18 lease renewal from the Navajo Council. APS witness Mark Schiavoni testified that negotiations with  
19 the Navajo Nation are complete, but the lease must be approved by the Department of Interior – a  
20 process that could take between three to five years. Mr. Schiavoni testified that the lease extension  
21 runs through 2041 and the Navajo Nation is paid \$7 million per year. The parties are treating the  
22 lease as approved and the first annual payment under the new lease has been made.<sup>4</sup>

#### 23 Fuel Contract

24 Four Corners obtains all its coal from the Navajo mine under a fuel contract with BHP that  
25 ends in 2016. At the time of the hearing, APS was engaged in negotiations with BHP to extend the  
26

27 <sup>2</sup> APS Exhibit 8, Dinkel Direct at 3.

<sup>3</sup> APS Exhibit 11, Schiavoni Direct at 5.

28 <sup>4</sup> Tr. at 326-327. SCE is not a party to the lease extension agreement.

1 fuel agreement, with an expected February 2012 resolution.<sup>5</sup>

2 California Law and SCE

3 In September 2006, California adopted a law ("Senate Bill 1368") that "established a  
4 minimum performance requirement, concluding that greenhouse gas ("GHG") emissions rates for  
5 baseload generation sources must be no higher than the GHG emissions rate of a combined-cycle gas  
6 turbine power plant."<sup>6</sup> In response to Senate Bill 1368, in January 2007, the California Public  
7 Utilities Commission ("CPUC") established an emissions performance standard ("EPS") that  
8 prohibited SCE from entering into a long-term financial commitment involving baseload generation  
9 unless it complied with the new EPS.

10 In January, 2008, SCE requested that Four Corners be exempted from the requirements of the  
11 EPS and the CPUC issued its Decision on October 14, 2010, denying SCE's request for a wholesale  
12 exemption for Four Corners.<sup>7</sup> The Decision denied rate recovery of any capital expenditures planned  
13 for Units 4 and 5 after January 1, 2012, if the expenditures would increase the life of the plant by five  
14 years or more.<sup>8</sup> It also prohibited SCE from extending any of its co-tenancy agreements or entering  
15 into new agreements to expand or extend its ownership interest in Four Corners without first  
16 obtaining CPUC approval.<sup>9</sup>

17 On November 8, 2010, SCE agreed to sell its interest in Four Corners Units 4 and 5 to APS.

18 **The Purchase and Sale Agreement with SCE**

19 The Purchase and Sale Agreement ("Agreement") provides that SCE will sell its 48 percent  
20 interest in Units 4 and 5 to APS for a cash price of \$294 million on the anticipated closing date of  
21 October 1, 2012. The sales price will increase by \$7.5 million per month for each month the closing  
22 date is accelerated, and decrease by \$7.5 million per month for each month the closing is delayed.  
23 The Agreement also provides that APS will assume certain SCE obligations, including plant  
24 decommissioning and mine reclamation liabilities. Under the terms of the Four Corners Co-Tenancy  
25 Agreement, the other plant owners had a Right of First Refusal allowing them to acquire SCE's

26 <sup>5</sup> Tr. at 298, 357.

27 <sup>6</sup> Alliance Exhibit 4, CPUC Decision No. 10-10-016; Staff Exhibit 3, Furrey Direct at 16.

28 <sup>7</sup> Staff Exhibit 3, Furrey Direct at 17.

<sup>8</sup> CPU Decision No. 10-10-016 at 30.

<sup>9</sup> *Id.*

1 ownership interest, but none exercised that right.

2 APS Power Procurement

3 APS' acquisition of generation is governed by several Commission Decisions and rules.

4 Decision No. 67744

5 On April 7, 2005, the Commission issued Decision No. 67744 in APS' 2003 rate case. That  
6 Decision adopted the Settlement Agreement<sup>10</sup> reached by 22 parties, with modifications. Section IX  
7 of the Settlement Agreement provides:

- 8
- 9 74. APS will not pursue any self-build option having an in-service date prior to  
10 January 1, 2015, unless expressly authorized by the Commission. For  
11 purposes of this Agreement, "self-build" does not include the acquisition of a  
12 generating unit or interest in a generating unit from a non-affiliated merchant  
13 or utility generator, the acquisition of temporary generation needed for system  
14 reliability, distributed generation of less than fifty MW per location, renewable  
15 resources, or the up-rating of APS generation, which up-rating shall not  
16 include the installation of new units.
- 17 75. As part of any APS request for Commission authorization to self-build  
18 generation prior to 2015, APS will address:
- 19 a. The Company's specific unmet needs for additional long-term  
20 resources.
  - 21 b. The Company's efforts to secure adequate and reasonably-priced long-  
22 term resources from the competitive wholesale market to meet these needs.
  - 23 c. The reasons why APS believes those efforts have been unsuccessful,  
24 either in whole or in part.
  - 25 d. The extent to which the request to self-build generation is consistent  
26 with any applicable Company resource plans and competitive resource  
27 acquisition rules or orders resulting from the workshop/rulemaking proceeding  
28 described in paragraph 79.
  - e. The anticipated life-cycle cost of the proposed self-build option in  
comparison with suitable alternatives available from the competitive market  
for a comparable period of time.
76. Nothing in this section shall be construed as relieving APS of its existing  
obligation to prudently acquire generating resources, including but not limited  
to seeking the above authorization to self-build a generating resource or  
resources prior to 2015.
77. The issuance of any RFP or the conduct of any other competitive solicitation in  
the future shall not, in and of itself, preclude APS from negotiating bilateral

<sup>10</sup> Settlement Agreement dated August 18, 2004 ("2004 Settlement Agreement").

agreements with non-affiliated parties.

Decision No. 67744 modified the definition of "self-build" contained in Paragraph 74 of the 2004 Settlement Agreement to "include acquisition of a generating unit or interest in a generating unit from any merchant or utility generator."<sup>11</sup> As a result, Decision No. 67744 requires APS to obtain Commission authorization before APS acquires any unit or interest in a generating unit other than "the acquisition of temporary generation needed for system reliability, distributed generation of less than fifty MW per location, renewable resources, or the up-rating of APS generation" when the in-service date is prior to January 1, 2015.

Decision No. 70032

Pursuant to Decision No. 67744 and Paragraph 79 of the 2004 Settlement Agreement, Staff conducted workshops on resource planning issues. On December 4, 2007, the Commission issued Decision No. 70032 which adopted the Staff-recommended "Best Practices for Procurement."

Decision No. 71722 and Arizona Administrative Code ("A.A.C.") R14-2-705

On June 3, 2010, the Commission issued Decision No. 71722 which adopted revisions to the existing electric resource planning rules and included new rules addressing procurement and independent monitors. A.A.C. R14-2-705 ("Procurement") provides:

- A. Except as provided in subsection (B), a load-serving entity may use the following procurement methods for the wholesale acquisition of energy, capacity, and physical power hedge transactions:
1. Purchase through a third-party online trading system;
  2. Purchase from a third-party independent energy broker;
  3. Purchase from a non-affiliated entity through auction or an RFP process;
  4. Bilateral contract with a non-affiliated entity;
  5. Bilateral contract with an affiliated entity, provided that non-affiliated entities were provided notice and an opportunity to compete against the affiliated entity's proposal before the transaction was executed; and
  6. Any other competitive procurement process approved by the Commission.
- B. A load-serving entity shall use an RFP process as its primary acquisition process for the wholesale acquisition of energy and capacity, unless one of the following exceptions applies:

<sup>11</sup> Decision No. 67744 at 38. This modification resulted from adoption of an amendment at the Commission's Open Meeting.

1. The load-serving entity is experiencing an emergency;
2. The load-serving entity needs to make a short-term acquisition to maintain system reliability;
3. The load-serving entity needs to acquire other components of energy procurement, such as fuel, fuel transportation, and transmission projects;
4. The load-serving entity's horizon is two years or less;
5. The transaction presents the load-serving entity a genuine, unanticipated opportunity to acquire a power supply resource at a clear and significant discount, compared to the cost of acquiring new generating facilities, and will provide unique value to the load-serving entity's customers;
6. The transaction is necessary for the load-serving entity to satisfy an obligation under the Renewable Energy Standard rules; or
7. The transaction is necessary for the load-serving entity's demand-side management or demand response programs.

### DISCUSSION

In its application, APS requests that the Commission 1) authorize it to acquire SCE's ownership interest in Units 4 and 5 under the terms of the "self-build moratorium" contained in Decision No. 67744; and 2) grant APS an accounting order authorizing cost deferral and facilitating the early retirement of Units 1-3. As part of its requested authorization to acquire SCE's share of Units 4 and 5 and in response to EPA-proposed environmental controls for Four Corners, APS plans to accelerate retirement of Units 1, 2 and 3 (eliminating 560 MW of less efficient generation) and also plans to add pollution control equipment to Units 4 and 5 by 2018 (together, "proposed transaction").<sup>12</sup>

Staff, RUCO, WRA, and EDF make recommendations in support of the Company's request, and the Alliance and the Sierra Club oppose it.<sup>13</sup>

<sup>12</sup> On October 19, 2010, the EPA published a proposal to promulgate a source specific Federal Implementation Plan requiring Four Corners to achieve emissions reductions required by the Clean Air Act's Best Available Retrofit Technology ("BART") provision. On November 24, 2010, APS acting on behalf of Four Corners' owners, submitted a letter to EPA offering an alternative proposal whereby APS would shut down Units 1-3 by 2014, and install and operate Selective Catalytic Reduction ("SCR") technology on Units 4 and 5 by the end of 2018.

<sup>13</sup> The Sierra Club does not support APS' acquisition of SCE's interest in Units 4 and 5 without further analysis and recommends that the Commission order APS to retire Units 1-3.



Acquisition of SCE's share of Units 4 and 5Public Interest ArgumentsAPS

APS believes that its proposal to acquire SCE's share of Units 4 and 5 is in the public interest because the proposed transaction is good for ratepayers, the Navajo Nation, and the environment.

Effect on ratepayers

APS presented testimony that its proposal is good for ratepayers because 1) the purchase price is a good deal; 2) the existing interest in a reliable generation asset is preserved; and 3) because the diversity of APS' resource portfolio is maintained.

1) Purchase Price. APS witness Patrick Dinkel testified that coal is a baseload resource and a fundamental component of APS' generation portfolio. A baseload resource is designed to run 24 hours a day, everyday, and must be both reliable and cost-effective. If Units 4 and 5 were shut down, potential baseload replacements would be coal and nuclear, geothermal and biomass/biogas, and natural gas.<sup>14</sup> Mr. Dinkel testified that for various reasons, additional nuclear and geothermal and biomass/biogas resources would not be available or adequate to provide the needed baseload generation if Units 4 and 5 shut down in 2016. Mr. Dinkel identified 3 remaining options: (1) continue to operate Units 1-3 if Units 4 and 5 shutdown in 2016, with a 231 MW shortfall in baseload generation; (2) replace any power lost from Four Corners with combined-cycle gas generation; or (3) retire Units 1-3 early and acquire SCE's interest in Units 4 and 5.<sup>15</sup>

Mr. Dinkel conducted several analyses of the purchase price and cost of the proposed transaction. He presented a capital cost comparison that demonstrated that APS' proposal (option 3, including the costs of installing all required environmental controls) is the lowest cost alternative in terms of initial capital dollars paid for the generation resource.<sup>16</sup> He also presented a life cycle levelized cost comparison<sup>17</sup> demonstrating that APS' proposal is the lowest cost for customers over

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<sup>14</sup> According to Mr. Dinkel, solar and wind generation are intermittent resources that cannot adequately substitute for night and day generation 365 days each year. APS Exhibit 8, Dinkel Direct at 3-4.

<sup>15</sup> APS Exhibit 8, Dinkel Direct at 4-5.

<sup>16</sup> *Id.* at 5-6.

<sup>17</sup> The total cost of the generation resource, fully integrated into the electrical system, levelized over the full life cycle of the plant, compared on a dollar per megawatt hour basis. APS Exhibit 8, Dinkel Direct at 6.

1 the project life. Mr. Dinkel also testified that a comparison of alternatives based upon the net present  
2 value of customer revenue requirements demonstrates that acquisition of SCE's share of Units 4 and  
3 5 results in a revenue requirement that is \$488 million lower than the alternative of replacing the  
4 retired Four Corners energy with natural gas generation, and \$1 billion less than the alternative of  
5 investing in and continuing to operate Units 1-3.

6 APS also presented the testimony of Judah Rose, who conducted his own analysis of the  
7 proposed transaction's value as rebuttal to the testimony of witnesses from the Sierra Club and the  
8 Alliance.<sup>18</sup> His analysis showed that customers would receive a net present value savings of \$712  
9 million with APS' proposed acquisition of Units 4 and 5, which is even higher than APS' estimate.  
10 He termed the purchase "a once-in-a-lifetime opportunity" where APS acquires \$1 billion of plant  
11 (SCE's share of Units 4 and 5) for only \$294 million.<sup>19</sup> Mr. Rose believes that APS' analysis showed  
12 a lower benefit because APS used conservative assumptions about natural gas prices and carbon  
13 costs, and because it was conducted when the application was filed in 2010. Mr. Rose's analysis  
14 reflects that to the extent that gas prices have risen, and carbon costs projections have decreased, the  
15 net value of savings to customers has increased.

16 2) Preservation of existing interest in reliable, low-cost generation. APS presented testimony  
17 that its proposal is good for its customers because it will allow APS to maintain its existing 15  
18 percent interest in a substantially depreciated generation plant that provides reliable, low-cost  
19 electricity for its customers.<sup>20</sup> Mr. Schiavoni testified that SCE informed APS and the other co-  
20 owners that they would no longer participate in contracts that extended beyond 2016; that SCE was  
21 limited in terms of making capital investments; that it did not intend to market its share of Units 4 and  
22 5 in the open market; that it would offer its share to the other owners but if the acquisition could not  
23 be accomplished in an expeditious manner, arrangements should be made for a shutdown in 2014.<sup>21</sup>  
24 No other existing owner exercised its right of first refusal to purchase SCE's share. Mr. Rose

25 \_\_\_\_\_  
26 <sup>18</sup> Mr. Rose is the Managing Director of ICF International and has extensive experience in assessing wholesale electric  
27 power issues, including valuing power plants and assessing environmental regulations and their impacts in wholesale  
28 markets. APS Exhibit 10, Rose Direct at 1-2.

<sup>19</sup> Tr. at 182.

<sup>20</sup> See Dinkel testimony, Tr. at 385; Guldner testimony, Tr. at 658; Schiavoni testimony, Tr. at 323.

<sup>21</sup> Tr. at 288-289.

1 testified that a sale to a third-party buyer would be complicated by the co-tenancy agreement with six  
2 owners, regulation by four states, a land lease, due diligence on a coal mine, and the rights of first  
3 refusal. Mr. Guldner explained that APS, as Operating Agent for all Four Corners units and also as  
4 sole owner of Units 1-3, was uniquely situated to purchase SCE's interest because no other purchaser  
5 would have the ability or opportunity to close three existing units, bring environmental benefits, and  
6 help maintain jobs in the Navajo Nation.<sup>22</sup> APS believes that if the proposed transaction is not  
7 authorized, a substantially depreciated asset that has brought reliable and cost-effective electricity to  
8 APS ratepayers for over 40 years will be shut down prematurely.

9       3) Maintenance of diverse resource portfolio. APS also presented testimony that its proposal  
10 is good for its customers because it is the only alternative that maintains APS' well-balanced resource  
11 portfolio. Mr. Dinkel testified that resource planning (and procurement) is not about picking the best  
12 resource, but is designed to create a balanced portfolio that manages the risks associated with all  
13 generation resources.<sup>23</sup> Risks include price volatility of natural gas, environmental regulations  
14 affecting coal, and other unseen future events, all of which may make one resource more or less cost-  
15 effective or beneficial at any time. Mr. Guldner also explained that a utility manages uncertainty by  
16 diversifying its resources so that risks are spread over different types of resources, thereby limiting  
17 the impact of any adverse impact from a particular resource.<sup>24</sup> Although APS will meet virtually all  
18 its energy growth needs in the next five years with renewable energy and energy efficiency, it will  
19 need baseload generation support from coal, nuclear and natural gas. APS plans to meet its future  
20 incremental baseload energy needs using natural gas, and therefore, the natural gas component of its  
21 portfolio will increase.<sup>25</sup> Mr. Dinkel testified that if APS were to replace its existing 791 MW of  
22 baseload coal capacity from Four Corners with natural gas generation, 40 percent of APS' total  
23 generation would become "dependent upon potentially volatile natural gas markets"<sup>26</sup> and would  
24

25 <sup>22</sup> Tr. at 656; APS Exhibit 21. In 2010, Four Corners and the BHP mine collectively employed about 1,000 employees and  
26 APS estimates that about 350 positions will eventually be eliminated through voluntary separation and retirement,  
27 resulting in a total combined workforce of about 650 employees between the plant and the mine (360 at Four Corners, 300  
28 at the mine).

<sup>23</sup> Tr. at 495.

<sup>24</sup> Tr. at 657.

<sup>25</sup> Dinkel Testimony, Tr. at 508-509.

<sup>26</sup> APS Exhibit 8, Dinkel Direct at 10.

1 expose ratepayers to the “potential for enormous, unanticipated cost increases through the Power  
2 Supply Adjustor.”<sup>27</sup> APS explains that this “risk of over-exposure to that kind of price volatility is  
3 precisely the kind of resource planning risk that the proposed transaction seeks to hedge.”<sup>28</sup>

4 Effect on Navajo Nation

5 APS presented testimony that its proposal is good for the Navajo Nation. Mr. Schiavoni  
6 testified that “Four Corners is the economic lifeblood of the Navajo Nation, contributing millions of  
7 dollars in payroll and tax revenue to the Navajo Nation and surrounding community.”<sup>29</sup> Four Corners  
8 and the Navajo mine provide jobs for approximately 1,000 people, with a combined payroll of over  
9 \$100 million. According to Mr. Schiavoni, 35 percent of the Navajo Nation’s general fund is from  
10 annual tax and royalty payments (approximately \$65 million) associated with plant operations. Mr.  
11 Schiavoni testified that retiring Four Corners would have a devastating impact on the Navajo Nation,  
12 citing a letter written from the Nation’s president to the EPA. APS believes that its proposal  
13 eliminates the potential for Four Corners to shut down completely when SCE withdraws in 2016. If  
14 the transaction moves forward as proposed by APS, it expects that jobs will be saved, no Four  
15 Corners employee will be laid off, and the Navajo Nation will continue to benefit from the payroll  
16 revenue and tax, fee and royalty contributions due to the continued operation of Units 4 and 5.

17 Effect on environment

18 APS presented testimony that its proposed transaction would result in the emission of fewer  
19 environmental pollutants and provide a cleaner generation resource for ratepayers. Mr. Schiavoni  
20 testified that if the transaction is completed and APS accelerates the retirement of Units 1-3, plant  
21 capacity will decrease from 2,100 to 1,540 MW and emission controls will be installed on Units 4  
22 and 5. As a result, 2.6 million fewer tons of coal will be burned each year and water consumption  
23 will decrease by 20 percent. Closing Units 1-3 will reduce site emissions for mercury by 61 percent,  
24 particulate matter by 43 percent, sulfur dioxide by 24 percent, and carbon dioxide by 30 percent.  
25 Closing Units 1-3 will also reduce site NOx emissions by 36 percent, and once post-combustion

26 <sup>27</sup> APS Opening Brief at 12, “That disruption [change to resource portfolio mix in 2017 to 40 percent natural gas] alone  
27 could cause gas costs through the Company’s Power Supply Adjustor (“PSA”) to increase by \$300 million per year. See  
Dinkel Testimony, Tr. at 391.”

28 <sup>28</sup> APS Opening Brief at 12.

28 <sup>29</sup> APS Exhibit 11, Schiavoni Direct at 3.

1 controls are installed on Units 4 and 5, total NOx emissions will be reduced by 86 percent.<sup>30</sup>

2 Staff

3 Although Staff recommends that the Commission authorize APS to pursue the acquisition of  
4 SCE's share of Units 4 and 5, Staff's recommendation was not based upon a public interest  
5 analysis.<sup>31</sup> Specifically, Staff is not recommending approval or denial of the acquisition itself,  
6 because Staff believes that APS' management should make the decision whether to purchase the  
7 asset, and then justify its decision in a rate case. However, Staff does agree that APS' analyses show  
8 that the transaction is projected to result in a lower system-wide revenue requirement and lower  
9 customer bills than the other options of either a new combined-cycle natural gas facility or  
10 investment in environmental upgrades to keep Units 1-3 operating.<sup>32</sup> Staff also agreed that the  
11 transaction will help APS maintain its well-balanced mix of reliable baseload energy while limiting  
12 dependency on a volatile fuel source.<sup>33</sup>

13 RUCO

14 RUCO agreed that APS' analyses showed that the APS proposed transaction saves APS'  
15 customers money and "has a lower bill impact than that of every likely alternative."<sup>34</sup> RUCO also  
16 agreed that APS' proposed transaction significantly reduces carbon dioxide and other pollutant  
17 emissions; it "preserves the diversity of APS' current generation portfolio while tempering the  
18 Company's exposure to volatile natural gas prices;" it maintains the mix of reliable baseload energy;  
19 and it "saves hundreds of jobs and millions of dollars of revenue that are critical to the Navajo Nation  
20 and local economy."<sup>35</sup>

21 WRA and EDF

22 WRA and EDF recommend that the Commission approve APS' request for authorization to  
23 acquire SCE's interest in Four Corner Units 4 and 5, but only if the Commission also requires the  
24 retirement of Units 1-3 by the end of 2013. They believe that the proposed transaction produces large

25 <sup>30</sup> *Id.* at 8.

26 <sup>31</sup> Staff's recommendation is that the Commission should waive the moratorium on "self-build" imposed by Decision No. 67744.

27 <sup>32</sup> Staff Exhibit 3, Furrey Direct at 10, 18-22.

28 <sup>33</sup> *Id.* at 13, 21.

<sup>34</sup> RUCO Exhibit 1, Fish Direct at 11.

<sup>35</sup> *Id.* at 11-12.

1 benefits for customers and Arizona. WRA's witness conducted a lifecycle cost analysis comparing  
2 APS' proposal with three other options, concluding that APS' plan is the least costly option under a  
3 range of reasonable assumptions.<sup>36</sup> Their witnesses also testified that the proposed transaction would  
4 result in major environmental improvements with significant benefit to human health. Dr. Berry  
5 found that relative to 2009, emissions would decrease for carbon dioxide by 19-34 percent; sulfur  
6 dioxide by about 25 percent; nitrogen oxide by about 88 percent; mercury by at least 61 percent; and  
7 water use would decrease by 18-30 percent.<sup>37</sup> He testified that the decrease in these emissions would  
8 reduce the negative health impacts to humans and wildlife, improve visibility in and near national  
9 parks, and reduce contributions to long term climate change.<sup>38</sup>

10 EDF witness Polkowsky also testified about the health and environmental impacts of APS'  
11 proposal to retire Units 1-3 and implement advanced pollution controls for nitrogen oxide on Units 4  
12 and 5. Mr. Polkowsky testified that Four Corners is the largest industrial source of nitrogen oxides in  
13 the United States and is facing new EPA regulations to comply with the Clean Air Act requirements  
14 to reduce haze in national parks and wilderness areas such as the Grand Canyon National Park.<sup>39</sup> In  
15 response to the EPA, APS has proposed that instead of installing SCR at all units at Four Corners by  
16 the end of 2016, it will shut down Units 1-3 by the end of 2013 and install SCR on Units 4 and 5 by  
17 the end of 2018. The Regional Haze Rule and the EPA allow for such an alternative if "more  
18 reasonable progress" is made with the alternative than with BART.<sup>40</sup> Mr. Polkowsky testified that  
19 sixteen Class I national parks and wilderness areas<sup>41</sup> are affected by emissions from Four Corners,  
20 and depending upon the final EPA determination of BART emissions limits, "APS' proposal would  
21 reduce the magnitude of peak visibility impacts by one half to two thirds."<sup>42</sup>

22  
23 <sup>36</sup> WRA Exhibit 1, Berry Direct at 8.

24 <sup>37</sup> *Id.* at 3.

25 <sup>38</sup> *Id.* at 4-5.

26 <sup>39</sup> EDF Exhibit 1, Polkowsky Direct at 2.

27 <sup>40</sup> *Id.* at 8. The EPA has not made a final determination on APS' proposed alternative.

28 <sup>41</sup> Arches National Park, Bandelier Wilderness Area, Black Canyon of the Gunnison Wilderness Area, Canyonlands National Park, Capitol Reef National Park, Grand Canyon National Park, Great Sand Dunes National Park, La Garita Wilderness Area, Maroon Bells Snowmass Wilderness Area, Mesa Verde National Park, Pecos Wilderness Area, Petrified Forest National Park, San Pedro Peaks Wilderness Area, Weminuche Wilderness Area, West Elk Wilderness Area and Wheeler Peak Wilderness Area. The average impact of these areas is 3 deciviews, or three times the level required to be noticeable. EDF Exhibit 1, Polkowsky Direct at 9-10.

<sup>42</sup> EDF Exhibit 1, Polkowsky Direct at 9-10.

1 Sierra Club

2       The Sierra Club opposes APS' request for authorization to purchase SCE's interest in Four  
3 Corners Units 4 and 5, but supports APS' plan to retire Units 1-3. The Sierra Club believes that APS  
4 "failed to fully analyze the financial risks of investments in coal-fired generation that will result from  
5 increasingly stringent environmental regulations and other coal related costs . . . and to adequately  
6 consider a range of alternatives to meet its demand needs."<sup>43</sup>

7 Alliance

8       The Alliance believes that the evidentiary record is insufficient for the Commission to make a  
9 determination as to whether or not it is in the public interest to authorize APS to acquire SCE's share  
10 of Units 4 and 5. The Alliance believes that the Commission should require APS to conduct a  
11 Request for Proposals ("RFP") for the amount of baseload generation capacity APS proposes to  
12 acquire from SCE. If the Commission does not require an RFP and authorizes the proposed  
13 transaction, the Alliance recommends that the Commission should consider requiring APS  
14 shareholders (not ratepayers) to bear any environmental costs not included in the application and  
15 whether any implications from the incorrect cost assumptions should be reflected in the "ultimate  
16 'prudent' plant value that is recognized and recoverable in rates."<sup>44</sup>

17 **Public Interest Conclusion**

18       The Commission does not usually or routinely make public interest determinations when a  
19 public service corporation is considering purchasing a particular generation asset. A public service  
20 corporation has a duty to provide adequate, efficient, and reasonable utility service to its customers  
21 and must support and defend its plant as prudently acquired and used and useful in order to gain  
22 recovery on and of its asset in rate base. In Decision No. 67744, the Commission considered the  
23 public interest when it determined that APS would be subject to a "self-build" moratorium for a  
24 number of years, and when it set forth the factors that APS must address in any request to self-build  
25 during the time period of the moratorium. Accordingly, we agree with Staff, and find that our  
26 primary analysis of this application is whether APS has complied with Decision No. 67744's

27 \_\_\_\_\_  
28 <sup>43</sup> Sierra Club Post-Hearing Reply Brief at 2-3.

<sup>44</sup> Alliance Initial Post-Hearing Brief at 22-23.

1 requirement that APS address the criteria contained therein.

2 **“Self-Build” Moratorium/Decision No. 67744**

3 APS requests that the Commission authorize the proposed transaction under the terms of the  
 4 2004 Settlement as adopted in Decision No. 67744. As set forth in the discussion on power  
 5 procurement above,<sup>45</sup> the “self-build” moratorium (“moratorium”) negotiated by the parties<sup>46</sup> in the  
 6 2004 Settlement Agreement prohibited APS from building generation with an in-service date prior to  
 7 January 1, 2015, unless expressly authorized by the Commission. This was one of several provisions  
 8 related to competitive procurement and according to APS, was intended to counterbalance a  
 9 provision allowing APS to acquire and ratebase generation assets owned by its affiliate, Pinnacle  
 10 West Energy Corporation (“PWEC”). The negotiated moratorium did not apply to APS’ acquisition  
 11 of a generating unit or interest in a generating unit from a non-affiliated merchant or utility generator  
 12 such as SCE. However, during the Commission’s Open Meeting, an amendment was passed that  
 13 modified the definition of “self-build” to include acquisition of a generating unit or interest in a  
 14 generating unit from a non-affiliated merchant or utility generator and defined “competitive  
 15 solicitation” to include bilateral contracts.<sup>47</sup> APS argues that the Commission’s concern about the  
 16 “anti-competitive” impact of the acquisition of a generation plant was not focused upon either the  
 17 nature of the counterparty or the chosen solicitation method, but upon whether APS would be  
 18 acquiring a generation asset instead of buying energy from the market.<sup>48</sup>

19 **Factors to be addressed pursuant to Paragraph 75 of 2004 Settlement Agreement/Decision No. 67744**

20 a. **The Company’s specific unmet needs for additional long-term resources.**

21 APS explained that the proposed transaction is not about acquiring “additional” or  
 22 incremental resources to meet “future unmet needs” but rather an attempt to “preserve the value of an  
 23 existing APS asset” and maintain the Company’s resource portfolio.<sup>49</sup> APS witness Dinkel testified  
 24 that even if the proposed transaction moves forward, APS will need another 545 MW to meet its

25 <sup>45</sup> APS Power Procurement at 5-7.

26 <sup>46</sup> Including the Alliance, WRA, RUCO, Staff, and APS.

27 <sup>47</sup> “Competitive solicitation” includes any solicitation issued pursuant to APS’ Secondary Procurement Protocol.  
 Decision No. 67744, footnote 35 at 25. The Secondary Procurement Protocol includes “bilateral contracts with non-  
 affiliated entities.” Secondary Procurement Protocol filed on March 31, 2003 in Docket Nos. E-00000A-02-0051 et. al.

28 <sup>48</sup> APS Initial Post-Hearing Brief at 16-17.

<sup>49</sup> *Id.* at 18; Tr. at 487-488.



1 2017 load requirements.<sup>50</sup>

2 Staff agrees that APS has adequately addressed its specific unmet needs for additional long-  
3 term resources. Staff noted that APS presented testimony that in 2017 it will need another 545 MW  
4 even if the proposed transaction is consummated; 1,500 MW if it is not; and that if the Navajo  
5 Generating Station capacity is lost, the net increase of 179 MW from the proposed transaction will  
6 help provide protection against volatile natural gas prices. The WRA and EDF agree that APS has  
7 addressed its specific unmet needs for additional long-term resources when it retires Units 1-3, and  
8 they believe that the acquisition of interests in Units 4 and 5 and the retirement of Units 1-3 is a  
9 package, as there is no evidence that APS will retire Units 1-3 without acquiring the interest in Units  
10 4 and 5.

11 b. The Company's efforts to secure adequate and reasonably-priced long-term  
12 resources from the competitive wholesale market to meet these needs.

13 APS defined its "specific unmet need" as a transaction that could preserve the value of its  
14 existing Four Corners asset and maintain a well-balanced portfolio. APS explained its efforts to  
15 negotiate an arms-length contract for wholesale coal generation with SCE, which it believes is the  
16 only entity that could meet the identified need.<sup>51</sup> APS witness Guldner testified that SCE has market-  
17 based rates and is a major player in the competitive wholesale market. He believes that "SCE is as  
18 much a participant in the 'competitive wholesale market' as the merchant firms" represented by the  
19 Alliance, and that the proposed transaction cannot be characterized as anti-competitive.<sup>52</sup>

20 APS responded to RFPs conducted by natural-gas fired merchant generators in 2010 but was  
21 unsuccessful with its bids, and therefore, it plans to use a combination of renewable energy and  
22 competitively procured natural gas.<sup>53</sup> APS testified that the additional, "incidental" 179 MW of  
23 capacity resulting from the proposed transaction will not affect how APS accesses the competitive  
24 market to meet future needs, as it will still need an additional 545 MW to meet its 2017 load  
25 requirements. APS believes that the evidence demonstrates its commitment to using the competitive

26 <sup>50</sup> APS Exhibit 8, Dinkel Direct at 12. If the proposed transaction fails, APS' need for new resources could increase to  
27 over 1,500 MW.

28 <sup>51</sup> Tr. at 658-659.

<sup>52</sup> Tr. at 707-708.

<sup>53</sup> Tr. at 508.

1 wholesale market to acquire resources to satisfy its unmet future needs.

2 Staff believes that APS has sufficiently addressed its efforts to secure adequate and  
3 reasonably-priced long-term resources from the competitive wholesale market to meet its resource  
4 needs and that APS explained the reasons why the efforts were unsuccessful. Staff noted that none of  
5 the other possible baseload generation resources were found to be suitable to replace the Four  
6 Corners capacity and that there is no existing market for a coal or nuclear resource available under  
7 the necessary timeline. Also, Staff believes that APS satisfactorily explained why a natural gas  
8 resource is not a suitable alternative to the proposed transaction as it would be costly and increase  
9 ratepayers' exposure to natural gas price volatility by decreasing resource diversity. Staff disagrees  
10 with the Alliance's position that APS can not adequately address this issue without conducting an  
11 RFP to replace energy capacity lost if Units 4 and 5 were shutdown, because an RFP is not required  
12 under the Resource Planning and Procurement Rules. Staff believes that APS showed that an RFP is  
13 neither advisable nor likely to result in any bids that could compete with the savings from the  
14 proposed transaction. Staff also noted that the Alliance failed to introduce any evidence of the value  
15 of any bids that may result from an RFP to rebut to APS' evidence. Staff recommends that the  
16 Commission not require APS to issue an RFP.

17 The WRA and EDF also agree that APS addressed its efforts to secure adequate and  
18 reasonably priced long-term resources from the competitive wholesale market, citing Mr. Dinkel's  
19 testimony that APS monitors market conditions and resource purchases and sales.<sup>54</sup> They believe that  
20 under the circumstances of this proposed transaction (including the fact that a portion of a generating  
21 unit managed by APS unexpectedly became available for purchase due to a change in California law,  
22 and because the analyses show clear cost advantages) additional solicitations for replacement  
23 generation would not result in lower costs and in less pollution.

24 The Alliance believes that Paragraph 75(b) of the 2004 Settlement Agreement which requires  
25 APS to "address...[t]he Company's efforts to secure adequate and reasonably-priced long-term  
26 resources from the competitive wholesale market to meet these needs" requires APS to issue an  
27

28 <sup>54</sup> WRA/EDF Post-Hearing Brief at 6.

1 RFP.<sup>55</sup> Although APS submitted bids in response to at least two solicitations to purchase merchant  
 2 gas facilities, APS did not issue its own RFP, and therefore, according to the Alliance, it cannot show  
 3 that it made an effort to secure resources from the competitive wholesale market.

4 c. The reasons why APS believes those efforts have been unsuccessful, either in  
 5 whole or in part.

6 APS does not believe that its efforts were unsuccessful, as it was able to negotiate an arms-  
 7 length contract for wholesale coal generation with SCE. APS believes that the prior RFP-generated  
 8 bids to merchant generators to acquire natural gas resources were likely unsuccessful because APS'  
 9 bid was too low. But APS believes that these failed bids helped to inform it as to the costs associated  
 10 with existing natural gas resources, thereby reinforcing APS' conclusion that the Four Corners  
 11 proposed transaction was "by far the most economic."<sup>56</sup>

12 WRA and EDF agree with APS' conclusions that alternatives would be more costly and  
 13 natural gas generation would expose it to uncertain gas prices.

14 The Alliance believes that because APS "did not conduct the requisite competitive  
 15 procurement required by Section 75(b)" APS cannot explain why its "solicitation efforts" were  
 16 unsuccessful.<sup>57</sup>

17 d. The extent to which the request to self-build generation is consistent with any  
 18 applicable Company resource plans and competitive resource acquisition rules or orders resulting  
 19 from the workshop/rulemaking proceeding described in paragraph 79.

20 APS witness Dinkel testified that the acquisition of the SCE interest in Units 4 and 5,  
 21 combined with the early retirement of Units 1-3, is fully consistent with APS' Resource Plan. Mr.  
 22 Dinkel explained that the Company's Resource Plan "stresses the value of maintaining a diverse  
 23 energy supply portfolio – one that balances coal, gas, and nuclear generation to complement the ever-  
 24

25 <sup>55</sup> See Alliance Initial Post-Hearing Brief at 5. The Alliance states that "APS admittedly did not seek any proposals from  
 26 the competitive wholesale market, as contemplated and required by Section 75(b) of the Settlement Agreement." The  
 27 cited reference was to page 465 of the transcript where APS witness Dinkel was asked and agreed that it was correct that  
 "APS has not had occasion to conduct an RFP seeking bids on capacity that would be equivalent to what it is proposing to  
 acquire from Southern California Edison, which is the subject of this proceeding?"

28 <sup>56</sup> APS Initial Post-Hearing Brief at 20.

<sup>57</sup> Alliance Initial Post-Hearing Brief at 6.

1 growing role of renewable resources and energy efficiency in meeting its customers' energy needs."<sup>58</sup>  
 2 APS believes that the proposed transaction will preserve its diversity of fuel resources, maintain a  
 3 balanced portion of coal in its portfolio, and limit reliance on natural gas generation to mitigate the  
 4 risk of exposure to fuel cost volatility.

5 APS believes that the proposed transaction is fully consistent with the Procurement rule  
 6 contained in A.A.C. R14-2-705. The Procurement rule allows APS to procure generation using  
 7 several methods, including a "bilateral contract with a non-affiliated entity"<sup>59</sup> such as the one  
 8 between APS and SCE. It also requires APS to use an RFP process as its primary acquisition process  
 9 for the wholesale acquisition of energy and capacity, subject to some exceptions.<sup>60</sup> Mr. Dinkel  
 10 testified that since Decision No. 67744 was issued in 2005, APS has used RFPs, almost without  
 11 exception, and has acquired over 2,000 MW of capacity from RFPs.<sup>61</sup> He also noted that APS has  
 12 almost 3,500 MW of planned gas resources which will be solicited via RFPs.<sup>62</sup> APS argues that this  
 13 demonstrates that there is little doubt that it has used and will continue to use the RFP process as its  
 14 primary acquisition process, in compliance with the Procurement rule.

15 APS believes that an RFP is not appropriate or required with the proposed transaction because  
 16 it fits within one of the Procurement rule's exceptions to the RFP requirement. Specifically, APS  
 17 argues that the proposed transaction "presents the load-serving entity a genuine, unanticipated  
 18 opportunity to acquire a power supply resource at a clear and significant discount, compared to the  
 19 cost of acquiring new generating facilities, and will provide unique value to the load-serving entity's  
 20 customers."<sup>63</sup>

21 APS presented testimony that the revenue requirement associated with constructing new  
 22 natural gas facilities is about \$1,253/kW,<sup>64</sup> and that the contract price for the interest in Units 4 and 5  
 23 is "one-tenth the cost of replacement of a new coal-powered plant."<sup>65</sup> APS witness Rose testified that

24 <sup>58</sup> APS Exhibit 8, Dinkel Direct at 13.

25 <sup>59</sup> A.A.C. R14-2-705(A).

26 <sup>60</sup> A.A.C. R14-2-705(B).

27 <sup>61</sup> Tr. at 400.

28 <sup>62</sup> *Id.*

<sup>63</sup> A.A.C. R14-2-705(B).

<sup>64</sup> APS Exhibit 8, Dinkel Direct at 10; Tr. at 136, Rose testimony (\$1,300/kW); Tr. at 631, Fish testimony (\$1.25 million/MW).

<sup>65</sup> Tr. at 138.

1 “[e]ffectively, you would have to offer your existing combined cycle at a zero price, or very close to  
2 a zero price, well below the recorded price in the history of the industry”<sup>66</sup> to beat the APS/SCE  
3 contract price, and that “it’s an algebraic impossibility, in my view, that an RFP or solicitation would  
4 result in an option that is anywhere close to being comparable.”<sup>67</sup> APS concludes that whether the  
5 comparison is to a new or existing facility, it has demonstrated that there is a significant customer  
6 revenue requirement savings of at least \$500 million net present value compared to a natural gas  
7 alternative and therefore, a clear and significant discount.

8 APS notes that no party questioned whether the opportunity to acquire SCE’s interest in Units  
9 4 and 5 was “genuine” or that it provided “unique value” to APS’ customers. APS points out that the  
10 Alliance’s witness Mr. Patterson agreed that “ownership in what is the cheapest asset you can  
11 essentially get, which is a nearly fully depreciated coal plant” provides a lower cost of power for  
12 ratepayers than would result from a new gas-fired generating plant.<sup>68</sup> APS cited other examples of  
13 “unique value” with the proposed transaction, including maintaining the balance of APS’ diverse  
14 resource portfolio, preserving the economic benefits to the Navajo Nation, lowering Four Corners’  
15 emissions, and improving the environment.

16 APS explained why the opportunity to acquire SCE’s interest in Units 4 and 5 and offset that  
17 acquisition by retiring Units 1-3 was “unanticipated.” Although APS was aware that California  
18 policy was moving away from coal-fired generation and that regulations might impact SCE’s ability  
19 to participate in coal projects, “neither APS, SCE nor any of the other project participants had any  
20 clear understanding of what the change in California environmental policy would require of SCE and  
21 when.”<sup>69</sup> APS witness Schiavoni testified that although in December 2009, SCE notified the co-  
22 owners that it intended to either sell its interest to a project participant or they should look at making  
23 arrangements to shutdown Units 4 and 5 starting in 2014, SCE had applied to the CPUC for an  
24 exemption for Four Corners, and the CPUC’s final decision did not come out until October 2010.<sup>70</sup>  
25 Mr. Schiavoni testified that the SCE notification, EPS determinations about environmental upgrades

26 <sup>66</sup> Tr at 138.

27 <sup>67</sup> *Id.*

28 <sup>68</sup> APS Initial Post-Hearing Brief at 23; Tr. at 1016.

<sup>69</sup> APS Initial Post-Hearing Brief at 23, Tr. at 285-286.

<sup>70</sup> Tr. at 286-289.

1 needed at all five Four Corners units, and the upcoming agreement expirations (land lease with the  
2 Navajo Nation, fuel contract, and participant agreements), all coincided around the same time.<sup>71</sup> APS  
3 witness Guldner testified that these events created the “unanticipated opportunity” for APS to acquire  
4 SCE’s interest in Units 4 and 5, and thereby maintain APS’ existing interest in those units while at  
5 the same time retire Units 1-3 which were going to require more costly environmental upgrades. He  
6 believes that no other party would have had that “opportunity to come up with a proposal that would  
7 allow the closure of three existing units, the environmental benefits, the value that brings to the  
8 Navajo Nation of keeping jobs for the Navajo, and at the same time manage through a very complex  
9 proceeding.”<sup>72</sup> He believes that it was an unplanned opportunity presented to APS, which moved  
10 quickly to bring it to the Commission.

11 APS believes that the Procurement rule was designed to make sure that APS used the RFP  
12 process as its primary method to acquire generation, with the flexibility to allow the Company to take  
13 advantage of exceptional opportunities when they are presented. APS believes that it has  
14 demonstrated its commitment to procuring resources through the competitive market and explained  
15 why an RFP process is not needed with this proposed transaction.

16 In response to the Alliance’s position that APS was required to issue an RFP for a resource  
17 alternative to the proposed transaction before it filed an application with the Commission for  
18 authorization to proceed, APS argues that the Alliance’s legal interpretation of Decision No. 67744  
19 ignores the express language concerning the “self-build” provision; the resource need filled by the  
20 proposed transaction is more specific than the Alliance acknowledges; and the Alliance’s analysis of  
21 the nature of the resource “opportunity” is too narrow. APS believes that requiring it to conduct an  
22 RFP for evidentiary purposes would “fail to produce the evidence that supports a natural gas  
23 alternative, waste bidders’ time and money, damage the Company’s credibility with the market, and  
24 further increase the risk that the transaction will fall through.”<sup>73</sup> APS believes the Alliance’s  
25 prudence argument is premature and not relevant because the proposed transaction “is not about  
26 acquiring more coal and exposing customers to greater risk – it is about maintaining the existing coal

27 <sup>71</sup> Tr. at 343-346.

28 <sup>72</sup> Tr. at 656.

<sup>73</sup> APS Reply Brief at 7.

1 generation in APS's resource portfolio and making it more environmentally friendly, thus mitigating  
2 the risk attendant to coal and all other generation resources."<sup>74</sup> APS notes that even with the  
3 additional 179 MW of coal, the percentage of coal in APS' energy mix will decrease from 39 percent  
4 to 33 percent, between now and 2017.

5 Staff believes that APS has adequately addressed how the proposed transaction is consistent  
6 with APS' applicable resource plan. The goal of APS' resource plan is to maintain a balanced and  
7 diverse energy resource portfolio, and if the proposed transaction is not consummated, its reliance on  
8 natural gas would increase from 25 to 40 percent and its reliance on coal would decrease from 39 to  
9 14 percent of its energy supply portfolio.<sup>75</sup> Staff believes that this demonstrates that the proposed  
10 transaction is consistent with APS' Resource Plan because it will help maintain a balanced energy  
11 supply portfolio and will limit "reliance on natural gas which is important to managing fuel cost  
12 volatility and the potential for customer price impacts."<sup>76</sup> Staff witness Laura Furrey also testified  
13 that APS addressed how the proposed transaction is consistent with other considerations in APS'  
14 Resource Plan, including resource self-sufficiency, positioning for climate change policy, long-term  
15 planning and flexibility.<sup>77</sup>

16 Staff also believes that APS has adequately addressed how the proposed transaction is  
17 consistent with the Procurement rules. Specifically, Staff agrees that the proposed transaction meets  
18 the exception to the RFP requirement found in A.A.C. R14-2-705(B)(5). Staff reviewed the events  
19 leading up to the purchase agreement in November 2010 and concluded that the timing of the  
20 proposed transaction represents a genuine, unanticipated opportunity for APS because it had no  
21 control over the events that influenced and precipitated SCE's offer to sell its interest in Units 4 and  
22 5. Staff noted that until the CPUC rejected SCE's request for an exemption on October 14, 2010, it  
23 was possible that SCE could have maintained its interest in Units 4 and 5. Staff also believes that the  
24 proposed transaction reflects an offering at a clear and significant discount when compared to the cost  
25 of acquiring new generation facilities. Staff witness Furrey testified that there are several ways to  
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27 <sup>74</sup> *Id.*

<sup>75</sup> Tr. at 499; APS Exhibit 8, Dinkel Direct at 11.

<sup>76</sup> Staff Exhibit 3, Furrey Direct at 11.

28 <sup>77</sup> *Id.* at 11-15.

1 evaluate and compare the costs of the proposed transaction and the alternatives, including the capital  
2 cost of the resource on a per MW basis; the levelized cost of the resource over its life; and the  
3 resource's impact on system-wide revenue requirements over its life. According to Ms. Furrey, the  
4 capital cost analysis showed that the capital costs of the proposed transaction total approximately  
5 \$626 million, or about \$847/kW, and \$85/MWh over the life of the plant.<sup>78</sup> The next practical  
6 alternative to baseload coal generation would be to replace all of APS' interest in Four Corners with  
7 combined-cycle natural gas generation, at a capital cost of approximately \$680 million (not including  
8 necessary transmission), or \$1,253/kW. Including transmission would increase the cost to \$798  
9 million or \$1,357/kW, and about \$100/MWh over the life of the investment. Staff also analyzed the  
10 alternative of APS continuing to operate Four Corners Units 1-3 and making all the necessary  
11 environmental upgrades, with APS investing in natural gas combined-cycle facilities sooner than  
12 expected and at a higher level than with the proposed transaction. The environmental upgrades to  
13 Units 1-3 are estimated to cost up to \$616 million, or \$1,100/kW, or \$116/MWh over the life of the  
14 plant.<sup>79</sup> Staff concluded that the cost of the proposed transaction is significantly lower than the cost  
15 of the alternative. From a revenue requirement analysis, the proposed transaction results in a revenue  
16 requirement that has a net present value that is \$488 million less than the natural gas generation  
17 alternative, and \$1.08 billion less than the alternative of upgrading Units 1-3. Finally, Staff believes  
18 that the proposed transaction will provide unique value to APS' customers by resulting in the lowest  
19 revenue requirement of the alternatives, by using a fuel that is less volatile and that limits over-  
20 reliance on a single generation resource, and by resulting in the smallest bill impact to customers.<sup>80</sup>

21 RUCO believes that the proposed transaction is in the best interest of ratepayers and provides  
22 numerous economic and environmental benefits. RUCO's independent analysis of the proposed  
23 transaction and the other alternatives resulted in conclusions consistent with those of APS – that the

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24 <sup>78</sup> *Id.* at 18-19.

25 <sup>79</sup> *Id.* at 19-20. Units 1-3 would require \$235 million emissions controls with EPA mercury rules as early as 2014, \$351  
26 million in proposed BART to comply with EPA visibility requirements as early as 2016, and additional costs anticipated  
for compliance with ash rules.

27 <sup>80</sup> *Id.* at 22. Under the proposed transaction, customer bills would increase almost 4 percent by 2017 (7 percent with a  
28 carbon tax of \$20/ton); under the alternative where Units 4 and 5 are retired and APS invests in environmental upgrades  
to keep Units 1-3 operational, bills would increase by almost 7 percent by 2017 (9 percent with the carbon tax); and under  
the alternative where Units 1-5 are all retired and replaced with new combined-cycle natural gas generation, bills would  
increase by approximately 8 percent by 2017.



1 “proposal is optimal and a very good deal for ratepayers.”<sup>81</sup> RUCO believes that APS’ proposed  
2 transaction should not be subject to an RFP process, as APS has gone to the market to acquire  
3 replacement long-term natural gas contracts without much success and there is no evidence in the  
4 record that a long-term natural gas contract would be less expensive than Four Corners generation.  
5 Further, RUCO has “significant concerns with an electric utility having to rely on a third party to  
6 provide such a large amount of generation to meets its baseload obligations.”<sup>82</sup> RUCO also agrees  
7 with Staff’s analysis that the proposed transaction falls within the “genuine, unanticipated  
8 opportunity” exception to the Procurement rules. Finally, RUCO notes that members of the Alliance,  
9 who are requesting that the Commission require APS to conduct an RFP, have a vested interest in the  
10 RFP process, as they stand to benefit if the proposed transaction fails (and benefits to ratepayers and  
11 the Navajo Nation are lost) due to a delay caused by an RFP.<sup>83</sup> RUCO recommends that the  
12 transaction be delayed as long as is possible without jeopardizing the closing, because the purchase  
13 price is reduced by \$7.5 million for every month after the October 1, 2012 anticipated closing.  
14 RUCO acknowledges APS’ concern that delay may compromise APS’ ability to install the  
15 environmental remediation measures required by the EPA, and does not intend its recommendation to  
16 prevent adequate time to comply with the EPA mandate.<sup>84</sup>

17 WRA/EDF agree with Staff’s conclusion that the proposed transaction represents a genuine,  
18 unanticipated opportunity for APS to acquire a power supply at a clear and significant discount that  
19 provides unique value to APS’ customers.<sup>85</sup> WRA/EDF argues that the Alliance misreads Paragraph  
20 77 of the 2004 Settlement Agreement, and that there is no requirement that APS must first conduct a  
21 competitive solicitation before negotiating a bilateral agreement – the paragraph just says that if APS  
22 issues an RFP it may still negotiate a bilateral agreement.<sup>86</sup> WRA/EDF also disagree with the  
23 Alliance’s implication that APS should have issued an RFP as early as 2006 because there would  
24 have been no way for APS to have known what it needed until SCE determined that it would sell its

25 \_\_\_\_\_  
26 <sup>81</sup> RUCO Opening Brief at 5.

<sup>82</sup> *Id.* at 6.

<sup>83</sup> *Id.* at 8.

<sup>84</sup> *Id.* at 6.

<sup>85</sup> WRA/EDF Post-Hearing Brief at 7, WRA/EDF Reply Brief at 2-3.

<sup>86</sup> WRA/EDF Reply Brief at 3.

1 interest in December 2009. WRA/EDF also believes that issuing an RFP today would not benefit  
2 ratepayers, because based upon its analysis, the effort would not produce useful results and the delay  
3 “may even jeopardize the substantial economic and environmental benefits” of the proposed  
4 transaction.<sup>87</sup>

5 The Alliance believes that APS cannot demonstrate consistency with the Commission’s  
6 resource and acquisition rules and decisions or the exceptions to the requirement that utilities should  
7 seek to use an RFP as the primary acquisition process. Specifically, the Alliance argues that APS  
8 cannot meet the “genuine, unanticipated opportunity” requirement because APS had notice “as early  
9 as January 2008, if not in 2006 or 2007, that there was reason to believe that SCE would have to  
10 terminate or divest its ownership in Units 4 and 5, due to legislative and regulatory environmental  
11 developments in California.”<sup>88</sup> Further, the Alliance argues that Paragraph 76 that says that “nothing  
12 in this section relieves APS of its existing obligation to prudently acquire generating resources,  
13 including but not limited to seeking the above authorization to self-build a generating resource or  
14 resources prior to 2015” does not “override” the provisions of Paragraphs 74 and 75. The Alliance  
15 argues that “APS has admitted it did not make the solicitation effort required” and therefore it cannot  
16 satisfy the requirements of Section 75(c) and (d).<sup>89</sup> Finally, the Alliance argues that Paragraph 77,  
17 which provides that “the issuance of any RFP or the conduct of any other competitive solicitation in  
18 the future shall not, in and of itself, preclude APS from negotiating bilateral agreements with  
19 nonaffiliated parties” does not allow APS to avoid compliance with the requirements of Section 75.  
20 The Alliance believes that APS has failed to meet its burden of proof and that its request to acquire  
21 SCE’s interest in Units 4 and 5 should be “stayed” pending APS’ “conduct of an appropriate form of  
22 RFP soliciting proposals from the competitive wholesale market for generation capacity  
23 approximately equivalent to SCE’s interest in Units 4 and 5.”<sup>90</sup> The Alliance believes that only after  
24 APS conducts the RFP and determines the results do not satisfactorily meet its “need” can it consider  
25 proceeding to negotiate a bilateral agreement with a non-affiliated party.<sup>91</sup>

26 <sup>87</sup> WRA/EDF Reply Brief at 4.

27 <sup>88</sup> Alliance Initial Post-Hearing Brief at 7-8.

28 <sup>89</sup> *Id.* at 16.

<sup>90</sup> *Id.* at 17.

<sup>91</sup> *Id.* at 17.

1 e. The anticipated life-cycle cost of the proposed self-build option in comparison  
 2 with suitable alternatives available from the competitive market for a comparable period of time.

3 Although APS does not believe that natural gas generation is a “suitable alternative” to  
 4 baseload coal generation, it conducted two analyses comparing the life cycle cost of acquiring SCE’s  
 5 interest in Units 4 and 5 with the cost of a natural gas option. As discussed above, both Mr. Dinkel  
 6 and Mr. Rose’s analysis showed that the proposed transaction (including the cost of environmental  
 7 upgrades) is “far less expensive than the alternatives.”<sup>92</sup>

8 Staff believes that APS has adequately addressed the anticipated life-cycle cost of the  
 9 proposed transaction and has shown that it is lower (\$85 per MWh) than any expected offering from  
 10 suitable alternatives from the competitive market (\$91 per MWh with existing natural gas generation  
 11 or \$100 per MWh with new natural gas generation).<sup>93</sup>

12 WRA witness Dr. Berry conducted his own independent incremental life-cycle cost analysis  
 13 which included the costs of complying with various environmental regulations related to nitrogen  
 14 oxide and mercury emissions, handling and storage of coal combustion residuals, and mine  
 15 reclamation. He also included scenarios with different costs of complying with future carbon dioxide  
 16 emission regulations. He compared the proposed transaction to three alternatives: 1) continue to  
 17 operate Units 1-3 through 2037 with pollution controls to reduce NO<sub>x</sub>, mercury, and particulate  
 18 emissions and continue to collect and dispose of byproducts; 2) replace Units 1-3 with gas-fired  
 19 generation from the competitive market; and 3) replace Units 1-3 with a portfolio of natural gas-fired  
 20 generation and renewable energy.<sup>94</sup> Dr. Berry concluded that “APS’ plan is the least costly option  
 21 under a range of reasonable assumptions.”<sup>95</sup> WRA believes that the evidence it and APS presented  
 22 strongly indicate that no credible proposal from the wholesale market could result in a lower price  
 23 and guarantee significant environmental improvements, and notes that the Alliance “**presented no**  
 24 **evidence that alternative resources would be less costly and result in greater environmental**  
 25 **benefits.**”<sup>96</sup>

26 <sup>92</sup> APS Initial Post-Hearing Brief at 20.

27 <sup>93</sup> Staff Closing Brief at 10.

28 <sup>94</sup> WRA Exhibit 1, Berry Direct at 5-6.

<sup>95</sup> *Id.* at 8

<sup>96</sup> WRA/EDF Reply Brief at 4, (emphasis original).

1 The Sierra Club's witness testified that APS' modeling analysis showed that retrofitting Units  
2 1-3 is more expensive than retiring the units, and recommended that APS immediately begin planning  
3 for retirement of Units 1-3.<sup>97</sup> However, the Sierra Club does not support APS' request to acquire  
4 Units 4 and 5. The Sierra Club's witness, Mr. Schlissel, recommended that the Commission not rely  
5 upon APS' "biased" analysis that Units 1-3 should be replaced with SCE's interest in Units 4 and 5  
6 because he believes that APS only speculates that Units 4 and 5 would be retired; APS failed to  
7 consider other alternatives such as converting existing turbines into a combined cycle unit, using a  
8 Power Purchase Agreement ("PPA") with an existing merchant combined cycle, or including  
9 additional renewable resources; and because he believes that APS emphasizes the risks of natural gas  
10 volatility but ignores the risks of continued operation of Units 4 and 5.<sup>98</sup>

11 The Sierra Club argues that APS relied upon "an assumption that construction or acquisition  
12 of new combined cycle natural gas capacity would cost up to \$1,253/kW" although one APS witness  
13 testified that recent transactions were reported at \$553/kW and \$600/kW.<sup>99</sup> The Sierra Club  
14 concludes that APS' analysis of cost comparisons is faulty, and therefore "incomplete."

15 In its Opening Brief, the Sierra Club also argues that the proposed transaction does not  
16 comply with the self-build moratorium and is "antithetical to the Commission's stated purpose in  
17 Decision No. 67744 because it did not involve a competitive process, it did not rely on a fully  
18 developed resource plan, and it would further increase APS' exposure to aging coal units."<sup>100</sup> The  
19 Sierra Club also criticized APS' use of the RedHawk and West Phoenix CC units, alleging that APS  
20 underutilized those assets and "instead sought in this proceeding to acquire yet another generating  
21 asset through this transaction,"<sup>101</sup> and also characterized the proposed transaction as a "backroom  
22 deal between co-owners of the same plant" resulting from a "hasty process."<sup>102</sup> The Sierra Club  
23 recommends that the Commission "order APS to begin planning to immediately retire Four Corners

24 <sup>97</sup> Sierra Club Exhibit 2, Schlissel Direct at 4-5.

25 <sup>98</sup> *Id.* at 5-6. However, Mr. Schlissel agreed on cross-examination that he had made a mistake in his calculations by  
26 failing to adjust the changes in variable costs that would be required from a downward adjustment to the capacity factor, a  
27 mistake that when corrected would show a lower cost per megawatt hour for Units 4 and 5 and that would support APS'  
28 analysis.

<sup>99</sup> Sierra Club Opening Brief at 12.

<sup>100</sup> *Id.* at 9.

<sup>101</sup> *Id.* at 10.

<sup>102</sup> *Id.* at 9.

1 Units 1-3...and reject APS' proposed acquisition of SCE's share of Four Corners Units 4-5 with  
2 leave to refile pending a complete resource plan analysis that includes (1) the upcoming compliance  
3 risks that the coal plant will face, and (2) the technical feasibility and economic viability of  
4 alternatives to the Four Corners plant."<sup>103</sup>

5 APS argues that the Sierra Club's recommendation that there needs to be a more robust  
6 analysis is premised upon an inaccurate statement - that APS' economic analysis focused only on  
7 certain costs and excluded others. APS noted that the testimony and evidence showed that the more  
8 than \$500 million present value revenue requirement savings estimate was "based on a  
9 comprehensive economic sensitivity analysis that included all of the known and anticipated costs  
10 associated with continuing to run Four Corners Units 4 and 5, including (but not limited to) those  
11 resulting from the regulatory areas identified on pages 5 and 6 of the Sierra Club's Post-Hearing  
12 Brief."<sup>104</sup> APS also argued that the Sierra Club never focused on the "most comprehensive of the  
13 three analyses presented, the revenue requirement analysis, but instead tried unsuccessfully to  
14 undermine the levelized life cycle cost comparison."<sup>105</sup>

15 In response to the Sierra Club's argument that APS had underutilized its RedHawk and West  
16 Phoenix generation assets, APS explained that natural gas units are dispatched when it is economic to  
17 fill existing resource needs, and that running them "into the ground at maximum capacity" is not  
18 necessary to realize customer value.<sup>106</sup> APS also disputed the Sierra Club's characterization of the  
19 proposed transaction, arguing that "the lack of an RFP in this case does not convert an arms-length,  
20 hotly negotiated contract between two sophisticated business entities into a 'backroom deal' or  
21 otherwise evidence anti-competitive behavior," and noted that a bilateral contract with a non-affiliate  
22 was an approved form of "competitive solicitation" under Decision No. 67744 and remains an  
23 acceptable procurement method.<sup>107</sup>

24 **"Self-Build" Moratorium/Decision No. 67744 Conclusion**

25 We find that APS has satisfactorily addressed the requirements necessary for waiver of the

26 <sup>103</sup> Sierra Club Opening Brief at 14.

27 <sup>104</sup> APS Reply Brief at 8.

28 <sup>105</sup> *Id.*, See Tr. at 66, note 83 above.

<sup>106</sup> APS Reply Brief at 9.

<sup>107</sup> *Id.*

1 self-build moratorium contained in Decision No. 67744. We believe that our analysis of the  
2 provisions of the 2004 Settlement Agreement and Decision No. 67744 must include the context of the  
3 events occurring at that time, including APS' acquisition of the PWEC assets and concerns by  
4 merchant generators about their investments and the viability of the competitive market. The 2004  
5 Settlement Agreement, as negotiated, did not require Commission authorization for APS to acquire a  
6 generating unit or an interest in one from a non-affiliated merchant or utility generator, such as SCE.  
7 Clearly, the parties to the Settlement Agreement (including the Alliance) did not object to APS  
8 acquiring additional generation from another utility or a merchant plant. We agree with APS that the  
9 Commission's amendment to modify the definition of "self-build" to include generation from a utility  
10 or merchant appears to reflect an interest in whether APS will own an asset or buy energy from the  
11 market for a certain time period.

12       The 2004 Settlement Agreement's Paragraph 75 includes five items that APS must address in  
13 any request for authorization to "self-build." Those considerations require APS to identify and  
14 evaluate what is needed; why it is needed; and how best to acquire it consistent with its obligations to  
15 provide safe, reliable and efficient service while complying with Commission Decisions and  
16 regulations.

17       The first consideration, "specific unmet needs" is difficult to evaluate under the facts of this  
18 case. Currently, there is no "specific unmet need" for additional long-term resources and this  
19 application is not concerned with unmet needs for additional long-term generation – APS has testified  
20 that those needs will be met with renewables, energy efficiency, and additional natural gas  
21 generation. Only if APS decides to retire Units 1-3 will there be an unmet need for replacement coal  
22 generation.<sup>108</sup> Accordingly, we agree that APS has identified what the "specific unmet need" will be  
23 if it decides to accelerate the retirement of Units 1–3 - replacement baseload coal generation that  
24

25 <sup>108</sup> It is not clear that the self-build provision was ever intended to apply to a situation where APS proposed to replace an  
26 existing generating resource (Units 1-3) by retiring it early in order to maintain its existing investment in another  
27 generating resource. Paragraph 75 was written by the settling parties and did not prohibit APS' acquisition of an interest  
28 in a generating unit from a non-affiliated merchant or utility generator such as SCE. Decision No. 67744 explained that  
the Alliance supported the Settlement Agreement because APS' prohibition from building its own generation or acquiring  
it from an affiliate would mean that growth would create opportunities for Alliance members to participate in the  
competitive market. Decision No. 67744 at 8.

1 would allow APS to maintain its existing interest in Units 4 and 5.

2 The second consideration, efforts to secure adequate and reasonably-priced long-term  
3 resources from the competitive market to meet the "specific unmet needs," has also been addressed  
4 by APS. We find that the language of the "self-build" provision of Decision No. 67744 defines  
5 "competitive solicitation" to include bilateral contracts with non-affiliated entities, and does not  
6 require APS to undergo an RFP process prior to seeking authorization of the proposed transaction.<sup>109</sup>

7 We agree with APS that SCE is a participant in the competitive market and that an arms-  
8 length, negotiated bilateral agreement for wholesale coal generation is not anti-competitive. APS'  
9 witnesses testified that APS monitored the market conditions and resources and found no existing  
10 baseload coal or nuclear resource available under the necessary timeline; that APS' primary resource  
11 acquisition process has been and will continue to be RFPs; and that APS had responded to at least  
12 two RFPs issued by natural gas-fired merchant generators in 2010. We disagree with the Alliance's  
13 interpretation that Paragraph 75(b) of the 2004 Settlement Agreement requires that APS must issue  
14 an RFP in order to address its efforts to secure resources for its "specific unmet need" from the  
15 competitive wholesale market.<sup>110</sup> Efforts made by APS may vary depending upon the resource to be  
16 acquired, and the availability of the resource in the market. The Alliance did not demonstrate that  
17 other baseload coal generation was available for APS to acquire from the wholesale generation  
18 market and acknowledged that its members were aware of the proposed transaction and were not  
19 prohibited from approaching APS with a better deal.<sup>111</sup> Accordingly, we find that APS has addressed  
20 its efforts to secure adequate and reasonably-priced long-term resources from the competitive market.

21 The third consideration, reasons why those efforts have been unsuccessful, either in whole or  
22 in part, was addressed by APS in that APS does not believe that the efforts were unsuccessful  
23 because they resulted in a negotiated, arms-length contract for wholesale coal generation. APS

24 <sup>109</sup> "Competitive solicitation includes an RFP issued pursuant to Paragraph 78 of the Settlement Agreement or any other  
25 solicitation issued by APS in using its Secondary Procurement Protocol pursuant to Paragraph 80 of the Settlement  
26 Agreement." Decision No. 67744, footnote 35, at 25. See also APS' Secondary Procurement Protocol, filed March 31,  
2003, in Docket No. E-00000A-02-0051 et. al., which includes bilateral contracts with non-affiliated entities as  
permissive protocol.

27 <sup>110</sup> We also disagree with the Alliance's statement that "APS admitted it did not make the solicitation effort required by  
28 Section 75(b)." The Alliance's citation to Mr. Dinkel's testimony shows that he was only asked whether APS issued an  
RFP - he was not asked whether he agreed that APS was required to conduct an RFP under Section 75 and failed to do so.

<sup>111</sup> Tr. at 1013-1014.

1 explained that other efforts to secure replacement baseload coal generation in the required timeframe  
2 were not possible, because there were no other assets to acquire. Further, APS' failed RFP bids  
3 helped it to understand the costs associated with a resource that did not meet its "specific unmet  
4 needs."

5 The fourth consideration, the extent that self-build is consistent with APS Resource Plans and  
6 competitive resource acquisition rules or orders, was addressed by APS. No party disagreed that  
7 APS' Resource Plan stressed the value of maintaining a diverse energy supply portfolio that balances  
8 coal, gas, and nuclear generation to complement the growing role of renewable resources and energy  
9 efficiency needed to meet APS' customers' energy needs. It is clear that the proposed transaction  
10 would maintain that balance by preventing the shutdown of Units 4 and 5 and allowing the  
11 accelerated retirement of Units 1-3. Also, no party disagreed with Staff's assessment that the  
12 proposed transaction is consistent with other considerations in the Resource Plan, including self-  
13 sufficiency, positioning for environmental regulations and climate change policy, and long-term  
14 planning and flexibility.

15 APS also addressed the proposed transaction in relation to the competitive resource  
16 acquisition rules. Although A.A.C. R14-2-705(B) provides that an RFP shall be the primary  
17 acquisition process for the wholesale acquisition of energy and capacity, it lists seven exceptions to  
18 that requirement, and A.A.C. R14-2-705(A) identifies the other procurement methods (including a  
19 bilateral contract with a non-affiliated entity A.A.C. R14-2-705(A)(4)) that are available for use with  
20 the circumstances set forth in the seven exceptions. We find the proposed transaction falls within  
21 exception A.A.C. R14-2-705(B)(5), which does not require an RFP when the transaction presents  
22 APS with a genuine, unanticipated opportunity to acquire a power supply resource at a clear and  
23 significant discount, compared to the cost of acquiring new generating facilities, and will provide a  
24 unique value to APS' customers. We also find that the proposed transaction is a bilateral contract  
25 between non-affiliated entities and therefore complies with A.A.C. R14-2-705(A).

26 APS offered testimony that demonstrated the "unique value" the proposed transaction offered,  
27 including preserving its existing interest in a reliable, low-cost generation resource as well as the  
28 substantial economic benefits to the Navajo Nation and surrounding communities, the acceleration of



1 lower emissions that will result in environmental improvements, and maintaining the balance of APS'  
2 diverse resource portfolio for the benefit of ratepayers.

3 Although the Sierra Club argued that APS did not offer a complete analysis of maintaining  
4 coal as a resource, we find that APS' analysis showed that retiring the older, "dirtier" plants early and  
5 acquiring an interest in the more efficient plants and installing environmental upgrades would provide  
6 "unique value" to its customers, both from an environmental and rate impact standpoint. APS'  
7 analyses, confirmed by Staff, RUCO, and WRA, show that whether the comparison is to a new (as  
8 contemplated by R14-2-705(B)(5)) or existing facility, the proposed transaction has a significant  
9 ratepayer revenue requirement savings of \$500 million net present value. Contrary to the Sierra  
10 Club's argument,<sup>112</sup> APS did consider the financial risks of its coal generation exposure in its  
11 analyses and even considering those risks, the evidence showed that the proposed transaction resulted  
12 in a "clear and significant discount."

13 Both the Alliance and the Sierra Club recommend that the Commission not authorize APS to  
14 acquire SCE's interest in Units 4 and 5, but they appear to have different motivations. As noted by  
15 APS, the Alliance did not address APS' need to maintain a diverse resource portfolio, or the fact that  
16 the "specific unmet need" that APS seeks to fill is replacement coal generation that will maintain the  
17 balance of coal resources in its resource portfolio while preserving APS' and its customers' existing  
18 interest in Units 4 and 5. The Alliance did not argue that coal generation was inappropriate or should  
19 not be part of APS' portfolio. It also did not identify any other coal generation resource that would  
20 be available if APS conducted an RFP. Therefore, its position that an RFP is mandatory appears to  
21 only serve the Alliance's interest that APS acquire a resource other than what APS has identified as  
22 its "specific unmet need."

23 As a "national, non-profit environmental and conservation organization...dedicated to the  
24 preservation of public health and the environment,"<sup>113</sup> the Sierra Club believes that "[c]oal is an old  
25 and dirty resource that increases mortality and is harmful to the public health" and the "Commission  
26

27 <sup>112</sup> Sierra Club's Reply Brief at 3. We disagree with the Sierra Club's characterization that APS would be purchasing "an  
28 asset that SCE chose to abandon due to the risks of future pollution controls and liabilities" because the evidence in the  
record shows that under California law, SCE would be prohibited from recovering any costs of needed pollution controls.

<sup>113</sup> Sierra Club's March 11, 2011 Petition for Leave to Intervene at 1-2.

1 should make every effort to move its regulated utilities beyond coal as quickly as possible.”<sup>114</sup>  
2 Although both the Alliance and the Sierra Club argue that more analysis is needed before the  
3 Commission authorizes the proposed transaction, neither the Alliance nor the Sierra Club presented  
4 credible evidence to rebut the testimony of APS, WRA/EDF, RUCO, or Staff about the “unique  
5 value” of, or the “clear and significant discount” presented by, the proposed transaction.

6 We also find that APS has demonstrated that the proposed transaction represents a “genuine,  
7 unanticipated opportunity” under R14-2-705(B)(5). The Alliance’s argument that the proposed  
8 transaction did not result from a genuine, unanticipated opportunity focuses on APS’ knowledge that  
9 California’s law and policy was changing. Therefore, the Alliance argues, SCE’s decision to sell its  
10 interest in Units 4 and 5 was not unanticipated by APS. We find this argument to be unpersuasive  
11 because APS had no control over the events that ultimately resulted in the change of California law or  
12 in the CPUC’s decision to deny SCE’s exemption request. We also agree with APS that the  
13 “opportunity” was not just the ability to purchase SCE’s interest in Units 4 and 5, but the ability to  
14 time that acquisition with the closure of Units 1-3; to propose an alternative plan to the EPA to  
15 resolve pending issues related to required environmental upgrades for all units; to resolve other  
16 outstanding uncertainties, including renegotiating the lease with the Navajo Nation as well as the fuel  
17 contracts with BHP – all without causing severe economic impacts to the Navajo Nation and  
18 surrounding communities, or to APS ratepayers. No party presented evidence that the purchase  
19 agreement was not genuine. Based upon the evidence, we agree that APS was uniquely situated to  
20 realize the full opportunities presented and to act on them to the benefit of its ratepayers.

21 We find that pursuant to Paragraph 75 of the 2004 Settlement Agreement, APS has addressed  
22 the issues necessary for waiver of the self-build moratorium, including that the proposed transaction  
23 is consistent with its Resource Plan and the competitive procurement rules, specifically R14-2-  
24 705(B)(5), and R14-2-705(A)(4). Accordingly, for the reasons set forth herein, APS has complied  
25 with the self-build provisions contained in Decision No. 67744, and APS is authorized, if it chooses,  
26 to pursue the acquisition of SCE’s interest in Units 4 and 5, together with the retirement of Units 1-3.

27 <sup>114</sup> Sierra Club’s Opening Brief at 13. We note, however, that the early retirement of Units 1-3 and the associated  
28 environmental benefits would be jeopardized if APS does not acquire SCE’s interest in Units 4 and 5.

1 We agree with the concerns expressed by the WRA and the Sierra Club about planning for coal plant  
2 retirements, and as discussed below, will require APS to comprehensively address this issue in its  
3 resource plans.

#### 4 Accounting Order

5 APS' application stated that while the proposed transaction is a good value for customers and  
6 cost-effective compared to the alternatives, it will require APS to make a significant investment. In  
7 order to address the timing, cost, and benefit mismatch that will occur between when the transaction  
8 closes and when new rates are set that include the additional interest in Units 4 and 5, APS seeks an  
9 accounting order that will:

10  
11 (1) allow the Company to defer for future recovery  
12 depreciation and amortization costs, operations and maintenance costs,  
13 property taxes, final coal mine reclamation, and carrying charges  
14 associated with APS acquiring SCE's share of Units 4 and 5; and

15 (2) provide assurance that APS will be allowed to fully  
16 recover its investment in and carrying costs of Units 1-3, and any  
17 additional costs (most notably, decommissioning and mine reclamation)  
18 incurred in connection with the closure of those units.

19 APS states that a deferral accounting order is a regulatory mechanism that allows it to  
20 capitalize certain costs that would otherwise be either expensed or lost, and defer consideration of  
21 them until a future rate proceeding. APS also requests that it be allowed to capitalize a return on all  
22 of the deferred costs, comparing its request to how an Allowance for Funds Used During  
23 Construction ("AFUDC") is calculated. APS believes that an accounting order is necessary because:  
24 1) although there will be long-term savings to customers from the proposed transaction, it will come  
25 at the expense of significant short-term costs (an estimated revenue requirement of over \$70 million  
26 the first year, of which \$37.7 million is capital costs) that would otherwise have to be absorbed  
27 entirely by APS with no opportunity for recovery; 2) the PSA mechanism will create an inequity in  
28 that customers will immediately benefit from the fuel savings associated with the proposed  
transaction,<sup>115</sup> but due to the 90/10 sharing mechanism, APS will only have ten percent of those

<sup>115</sup> APS estimates the fuel savings flowed through to customers will be approximately \$40 million per year. APS Reply Brief at 12.

1 savings to offset the transaction's significant costs; and 3) because APS won't be able to file a rate  
2 case until June 2013,<sup>116</sup> APS will face potential financial erosion. APS agrees that some expenses  
3 related to Units 1-3 that are now being recovered in rates may be avoided after retirement and should  
4 be used to offset the authorized deferral.

5 APS cited other Commission decisions, as well as decisions from other state regulatory  
6 commissions, which it believes support its request for an accounting order that includes capital  
7 carrying costs on both the plant and the deferred balances. APS included in its application proposed  
8 accounting language which it requests that the Commission use in this Decision so that under the  
9 applicable accounting rules, it is sufficiently clear that the costs are "probable of recovery."

10 Staff defines an accounting order as "a rate-making mechanism for use by regulatory  
11 authorities that provides regulated utilities the ability to defer costs that would otherwise be  
12 expensed using generally accepted accounting principles ("GAAP") and provides for alternative  
13 rate-making treatment of capital costs and other costs via creation of regulatory assets and  
14 liabilities."<sup>117</sup> Staff analyzed the request using three criteria: 1) would APS incur irreparable  
15 economic harm absent an accounting order; 2) would APS endure a significant inequity absent an  
16 accounting order; and 3) what are the relative costs and benefits to ratepayers resulting from granting  
17 an accounting order. Staff testified that although APS would not incur irreparable economic harm,  
18 the impact of no deferral would be significant and could result in a decline in APS' return on equity  
19 by one percent or could contribute to a downgrade of APS' investment rating. Staff also believes  
20 that the timing of the transaction in the context of APS' rate cases, as well as the effect of the PSA,  
21 create inequities that justify an accounting order.

22 Although Staff concludes that the circumstances in this case warrant the Commission  
23 authorizing an accounting order, Staff does not agree that the accounting order should allow  
24 "carrying charges or compounding of those carrying costs." Staff believes that it is premature to  
25 address cost of capital issues associated with this transaction, because it is unknown when and at  
26 what cost APS would take ownership of Units 4 and 5. Staff distinguishes an accounting order from

27 \_\_\_\_\_  
28 <sup>116</sup> 2009 Rate Case Settlement in Decision No. 71448 (December 30, 2009) would allow a 2012 test year.

<sup>117</sup> Staff Exhibit 3, Michlik Direct at 3.

1 AFUDC by explaining that while an asset is under construction, it is not providing service to  
2 customers, but with the purchase of an existing generating unit, APS will be able to earn revenues  
3 once the plant is placed in service. Staff believes that APS will be able to take advantage of  
4 regulatory lag for Units 1-3 and Units 4 and 5, and that the cases cited by APS are situation-specific  
5 and do not provide guidance in this case.

6 Staff and APS did agree on the language to be included in the accounting order, with the  
7 exception of the issue of whether capital costs should be allowed to be deferred and compounded.

8 RUCO initially opposed the accounting order, but modified its position to allow an  
9 accounting order that contained the same conditions present in the Commission's Decision in the  
10 Sundance case, Decision No. 67504 (January 20, 2005). RUCO also disagrees with APS' request to  
11 earn a return on the deferred accounts, stating that it would be "simply guaranteeing the Company a  
12 return rather than providing it with an opportunity to recover that return via its operating  
13 efficiency."<sup>118</sup>

14 APS disagrees with RUCO's recommendation that an accounting order should be subject to  
15 the same conditions that were included in the Decision concerning the Sundance transaction because  
16 those conditions were tailored to that specific situation. APS also disagrees with Staff and RUCO's  
17 recommendation that no cost of capital be allowed in the deferral authorization, stating that the  
18 "Commission has *never* chosen" to completely disallow cost of capital in a deferral authorization,  
19 nor has any other regulatory commission that APS knows of.<sup>119</sup> APS argues that if capital costs are  
20 not included in the deferral order, APS will permanently lose the opportunity to recover the \$37  
21 million per year in financing costs while APS customers save up to \$40 million in fuel costs every  
22 year through the PSA for 26 years.

23 We find that APS' request for an accounting order should be granted. As discussed herein,  
24 APS has identified benefits associated with the proposed transaction and Staff and RUCO agree that  
25 circumstances warrant a variation from the usual ratemaking treatment of plant acquired between rate  
26 cases. Although the subject matter of the accounting treatment and the testimony attempting to  
27

28 <sup>118</sup> RUCO Opening Brief at 13.

<sup>119</sup> APS Reply Brief at 13. (Emphasis original)

1 explain it were not always entirely clear, Staff and RUCO agreed with the non-fuel costs that APS  
 2 sought to be deferred, but did not agree to allow “carrying charges or the compounding of the  
 3 carrying costs.”<sup>120</sup>

4 Staff and RUCO considered the financial impact the acquisition of Units 4 and 5 would have  
 5 on APS as a reason to grant an accounting order, but did not address APS’ limited ability to minimize  
 6 the regulatory lag as a result of the stay out provisions of the 2009 Settlement Agreement.<sup>121</sup>  
 7 Accordingly, we believe an accounting order is appropriate that allows deferral of the non-fuel costs,  
 8 except that we will include as “non-fuel costs” only the documented debt cost of acquiring SCE’s  
 9 interest in Units 4 and 5, and will not authorize any carrying charges on any deferred costs.<sup>122</sup>

10 We expect APS to manage the acquisition of the interest in Units 4 and 5 and the proposed  
 11 transaction with a goal of minimizing the rate impact to customers, while at the same time,  
 12 maximizing the environmental benefits of accelerating the retirement of Units 1-3.

### 13 Other Recommendations

14 WRA believes that both APS’ plan and the natural gas alternative expose APS to some  
 15 potentially significant risks, and WRA recommends that the Commission order APS to:

- 16
- 17 1. Undertake a comprehensive planning process to retire additional coal-fired power plants within the next 10 years or so and include coal plant retirement options in its resource plans to be filed after a decision in this docket. The options should include portfolios of clean energy resources, including large quantities of renewable energy, to replace the retired energy and capacity. WRA does not have a proposed schedule in mind for additional coal plant retirements, but will look to the review of APS’ 2012 resource plan to help in the development of a coal plant retirement schedule.
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22  
 23 <sup>120</sup> Staff Opening Brief at 15. Staff also defined this as “allowing for a deferral of a return and earning a return” which Staff and RUCO believe are more like providing a guarantee to the Company. It is not clear whether RUCO believes that the financing cost of acquiring the asset is a cost that should be deferred. See RUCO Opening Brief at 13, “[t]he Commission should reject the Company’s request to earn a return on the deferral amounts.”

24  
 25 <sup>121</sup> We take administrative notice of APS’ pending rate application in Docket No. E-01345A-11-0224, and the Settlement Agreement in that docket where a provision would keep that record open to allow APS to request a rate adjustment to include the rate base and expense effects if APS acquires SCE’s interest in Units 4 and 5 and retires Units 1-3, and any cost deferral authorized in this docket.

26  
 27 <sup>122</sup> The “non-fuel costs” that are authorized for deferral include: depreciation, amortization of the acquisition adjustment, decommissioning costs, operations and maintenance costs, property taxes, final coal reclamation costs, the documented debt costs of acquiring SCE’s interest in Units 4 and 5, and miscellaneous other costs. In its late-filed Exhibit 21 filed September 21, 2011, APS estimated that the costs to wind down operations at Units 1-3 would be approximately \$20 million and would be incurred between the acquisition date of Units 4 and 5 through 2016.

1           2. Evaluate a solar-coal hybrid at Four Corners 4 or 5 or other coal-fired  
2           power plant. The evaluation should be concluded within one year of the  
3           Commission's decision in this docket and APS should then propose to the  
4           Commission, either in a separate filing or in the next scheduled resource  
5           plan filing, how it plans to proceed with a coal-solar hybrid facility.<sup>123</sup>

6           In response to cross-examination from WRA/EDF, Mr. Dinkel testified that APS would  
7           include additional retirements of coal-fired power plants as options in future resource plans and that  
8           APS is conducting studies of solar hybrid resources and would report on those studies as part of its  
9           Renewable Energy Standard compliance reports and implementation plans.<sup>124</sup> WRA/EDF agrees that  
10          the issue of retiring coal plants is broader than just this docket and that a systematic review of options  
11          for managing risks on a more comprehensive basis, like in resource plan dockets, is more appropriate.

12          We agree that APS should undertake a systematic review of options for managing its resource  
13          risks and include additional retirements of coal-fired power plants as options in future resource plans.  
14          Additionally, APS should report on its studies of solar hybrid resources as part of its Renewable  
15          Energy Standard compliance reports and implementation plans.

16          The WRA/EDF and RUCO made recommendations related to the timing of the proposed  
17          transaction. The WRA/EDF recommended that APS' authority to pursue the proposed transaction be  
18          tied to a requirement that APS retire Units 1-3 by December 31, 2013 because it believes that the  
19          proposed transaction brings substantial benefits, mainly the "early retirement of the old, relatively  
20          inefficient and costly" Units 1-3.<sup>125</sup> RUCO recommended that APS delay closing the proposed  
21          transaction as long as feasible in order to reduce the purchase price. We believe that both of these  
22          issues are relevant considerations for APS to evaluate to the extent that it can control the timing of  
23          the proposed transaction and related events. We agree with WRA/EDF that the early retirement of  
24          Units 1-3 is an important part of the "unique value" of the proposed transaction as contemplated in  
25          A.A.C. R14-2-705(B)(5) and we expect APS to insure that its customers realize that value. If APS  
26          consummates the acquisition of SCE's interest in Four Corners, we will require APS to notify the  
27          Commission by making a compliance filing in this docket within ten business days after closing, and  
28          to thereafter make compliance filings on a quarterly basis updating the Commission on its progress

<sup>123</sup> WRA/EDF Post-Hearing Brief at 9.

<sup>124</sup> Tr. at 405-408.

<sup>125</sup> WRA/EDF Post-Hearing Brief at 2.

1 retiring Units 1-3, with a goal that retirement occur by December 31, 2013.

2 \* \* \* \* \*

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

5 **FINDINGS OF FACT**

6 1. APS filed an application for authorization to purchase SCE's 48 percent interest in  
7 Four Corners Units 4 and 5 and for an accounting order allowing it to defer certain costs for possible  
8 future recovery in a rate proceeding.

9 2. APS will also accelerate the retirement Four Corners Units 1-3 if it acquires SCE's  
10 interest in Units 4 and 5.

11 3. By Procedural Orders, intervention was granted to RUCO, the Alliance, WRA,  
12 SWPG/Bowie, EDF, and the Sierra Club.

13 4. By Procedural Order issued March 31, 2011, the hearing was scheduled to commence  
14 on July 14, 2011, testimony deadlines were established, and APS was directed to publish notice of the  
15 hearing.

16 5. On April 27, 2011, APS filed certification that notice of the hearing was published in  
17 the *Navajo Times* on April 7, 2011, and in the *Farmington Daily Times* and the *Arizona Republic* on  
18 April 11, 2011.

19 6. On May 31, 2011, SWPG/Bowie filed a Motion to Withdraw as an Intervenor  
20 ("Motion to Withdraw") and the Alliance filed a Notice of Substitution of Counsel, designating  
21 Lawrence V. Robertson, Jr. as counsel for the Alliance.

22 7. On June 21, 2011, by Procedural Order, the Motion to Withdraw was granted.

23 8. On June 24, 2011, Staff filed a Request for a Pre-Hearing Conference.

24 9. By Procedural Order issued June 27, 2011, a pre-hearing conference was scheduled  
25 for June 30, 2011.

26 10. The June 30, 2011 pre-hearing conference was held as scheduled.

27 11. The hearing commenced on July 14, 2011, and continued on July 15, August 8 and 9,  
28 and September 1, 2011.



1           12.     APS presented testimony of Jeffrey B. Guldner, Patrick Dinkel, Mark A. Schiavoni,  
2 and Judah L. Rose; WRA presented testimony of David Berry; the EDF presented testimony of Bruce  
3 Polkowsky; the Sierra Club presented testimony of David A. Schlissel; the Alliance presented  
4 testimony of Greg Patterson; RUCO presented testimony of Thomas H. Fish and Royce Duffett; and  
5 Staff presented testimony of Laura A. Furrey, Jeffrey Michlik, and Margaret Little.

6           13.     On September 12, 2011, APS filed its Late-Filed Exhibit 21 which included responses  
7 to questions posed by Commissioner Burns and Commissioner Newman during the hearing. No  
8 objections were filed to APS Exhibit 21, and it was admitted into evidence.

9           14.     Post-hearing initial briefs were filed by APS, Staff, RUCO, the Alliance, and WRA on  
10 September 30, 2011, and by the Sierra Club on October 3, 2011. Reply briefs were filed by APS,  
11 Staff, RUCO, the Alliance, WRA/EDF, and the Sierra Club on October 14, 2011.

12           15.     On October 13, 2011, Commissioner Paul Newman docketed a letter requesting that  
13 the parties address several matters discussed in his letter.

14           16.     On October 24, 2011, APS, Staff, and WRA filed responses to Commissioner  
15 Newman's letter.

16           17.     APS presented testimony and evidence that its proposed transaction is good for  
17 ratepayers because the purchase price is a "good deal"; the existing interest in a reliable, low-cost  
18 generation asset is preserved; and because the diversity of APS' resource portfolio is maintained.

19           18.     APS also presented testimony and evidence that its proposed transaction would result  
20 in the emission of fewer environmental pollutants and provide a cleaner generation resource for  
21 ratepayers, and that the Navajo Nation will continue to benefit from the payroll revenue and tax, fee  
22 and royalty contributions due to the continued operation of Units 4 and 5.

23           19.     Staff, RUCO, WRA/EDF recommended that the Commission find that APS has met  
24 the requirements of Decision No. 67744 and that APS can pursue the proposed transaction. The  
25 Sierra Club recommended that the Commission direct APS to begin planning for the immediate  
26 retirement of Units 1-3 and to reject APS' acquisition of SCE's interest in Units 4 and 5 pending  
27 further analysis. The Alliance recommended that the Commission find that APS has not met the  
28 requirements of Decision No. 67744 and order APS to conduct an RFP; or that in the event that the

1 Commission finds that the requirements of Decision No. 67744 have been met, that the Commission  
2 may include conditions that require shareholders to bear the risk of APS' analytic assumptions.

3       20. Pursuant to Paragraph 75 of the 2004 Settlement Agreement and Decision No. 67744,  
4 we find that APS has addressed the issues necessary for a waiver of the self-build moratorium,  
5 including that the proposed transaction is consistent with its Resource Plan and the competitive  
6 Procurement rules, specifically A.A.C. R14-2-705(B)(5), and A.A.C. R14-2-705(A)(4).

7       21. APS has complied with the self-build provisions contained in Decision No. 67744 and  
8 APS should be authorized, if it chooses, to pursue the acquisition of SCE's interest in Units 4 and 5,  
9 together with the accelerated retirement of Units 1-3.

10       22. APS should be authorized to defer, for possible later recovery through rates, all non-  
11 fuel costs (as defined herein) of owning, operating, and maintaining the acquired SCE interest in Four  
12 Corners Units 4 and 5 and associated facilities, as well as all unrecovered costs associated with Four  
13 Corners Units 1-3 and additional costs incurred in connection with the closure of Four Corners Units  
14 1-3, as set forth herein.

15       23. APS should reduce the deferrals by non-fuel operations and maintenance and property  
16 tax savings associated with the closure of Four Corners Units 1-3.

17       24. APS should undertake a systematic review of options for managing its resource risks  
18 and include additional retirements of coal-fired power plants as options in future resource plans.

19       25. APS should report on its studies of solar hybrid resources as part of its Renewable  
20 Energy Standard compliance reports and implementation plans.

21       26. If APS consummates the acquisition of SCE's interest in Four Corners, APS should  
22 notify the Commission by making a compliance filing in this docket within ten business days after  
23 closing, and thereafter make compliance filings on a quarterly basis updating the Commission on its  
24 progress retiring Units 1-3, with a goal that retirement occur by December 31, 2013.

25       27. We expect APS to manage the acquisition of the interest in Units 4 and 5 and the  
26 proposed transaction with a goal of minimizing the rate impact to customers, while at the same time,  
27 maximizing the environmental benefits of accelerating the retirement of Units 1-3.

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**CONCLUSIONS OF LAW**

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1. APS is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. §§ 40-250, 40-251, and 40-367.

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

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

4. Pursuant to A.R.S. § 40-361, every public service corporation shall furnish and maintain such service, equipment and facilities as will promote the safety, health, comfort and convenience of its patrons, employees and the public, and as will be in all respects adequate, efficient and reasonable.

5. It is reasonable and in the public interest to authorize APS to defer, for possible later recovery through rates, all non-fuel costs (as defined herein) of owning, operating, and maintaining the acquired Southern California Edison interest in Four Corners Units 4 and 5 and associated facilities, as well as all unrecovered costs associated with Four Corners Units 1-3 and additional costs incurred in connection with the closure of Four Corners Units 1-3.

6. APS shall reduce the deferrals by non-fuel operations and maintenance and property tax savings associated with the closure of Four Corners Units 1-3.

7. The cost deferral authorization as granted herein does not constitute a finding or determination the costs are reasonable, appropriate, or prudent.

8. This Decision should not be construed to limit this Commission's authority to review the acquisition of Four Corners Units 4 and 5, or the unrecovered costs or additional costs incurred in connection with the closure of Four Corners Units 1-3 at the appropriate time, and to make disallowances thereof due to imprudence, errors or inappropriate application of the requirements of this Decision.

9. This Decision should not be construed to limit this Commission's authority to review the accumulated deferred balance associated with all amounts deferred pursuant to this Decision and to make disallowances thereof due to imprudence, errors or inappropriate application of the requirements of this Decision.

...

**ORDER**

1  
2 IT IS THEREFORE ORDERED that, having complied with the self-build provisions  
3 contained in Decision No. 67744, Arizona Public Service Company is hereby authorized, if it so  
4 chooses, to pursue the acquisition of Southern California Edison's interest in Four Corners Units 4  
5 and 5, together with the retirement of Four Corners Units 1-3.

6 IT IS FURTHER ORDERED that Arizona Public Service Company is authorized to defer for  
7 possible later recovery through rates, all non-fuel costs (as defined herein) of owning, operating, and  
8 maintaining the acquired Southern California Edison interest in Four Corners Units 4 and 5 and  
9 associated facilities. Nothing in this Decision shall be construed in any way to limit this  
10 Commission's authority to review the entirety of the acquisition and to make any disallowances  
11 thereof due to imprudence, errors or inappropriate application of the requirements of this Decision.

12 IT IS FURTHER ORDERED that Arizona Public Service Company shall reduce the deferrals  
13 by non-fuel operations and maintenance and property tax savings associated with the closure of Four  
14 Corners Units 1-3.

15 IT IS FURTHER ORDERED that Arizona Public Service Company is authorized to defer for  
16 possible later recovery through rates, all unrecovered costs associated with Four Corners Units 1-3  
17 and additional costs incurred in connection with the closure of Four Corners Units 1-3. Nothing in  
18 this Decision shall be construed in any way to limit this Commission's authority to review either the  
19 unrecovered costs or additional costs incurred in connection with the closure of Four Corners Units 1-  
20 3 and to make any disallowances thereof due to imprudence, errors or inappropriate application of the  
21 requirements of this Decision.

22 IT IS FURTHER ORDERED that the accumulated deferred balance associated with all  
23 amounts deferred pursuant to this Decision will be included in the cost of service for rate-making  
24 purposes in either Arizona Public Service Company's pending or next general rate case. Nothing in  
25 this Decision shall be construed to limit this Commission's authority to review such balance and to  
26 make disallowances thereof due to imprudence, errors or inappropriate application of the  
27 requirements of this Decision.

28 IT IS FURTHER ORDERED that Arizona Public Service Company shall prepare and retain

1 accounting records sufficient to permit detailed review, in a rate proceeding, of all deferred costs and  
2 cost benefits as authorized herein.

3 IT IS FURTHER ORDERED that Arizona Public Service Company shall prepare a separate  
4 detailed report of all costs deferred under this authorization and shall include that report as an integral  
5 component of each of its general rate applications in which it requests recovery of those deferred  
6 costs.

7 IT IS FURTHER ORDERED that Arizona Public Service Company shall file each January  
8 with Docket Control, as a compliance item in this Docket, an annual status report for each preceding  
9 calendar year, of all matters related to the deferrals, and the cumulative costs thereof, with the first  
10 such report due not later than January 31, 2013.

11 IT IS FURTHER ORDERED that Arizona Public Service Company shall undertake a  
12 systematic review of options for managing its resource risks and include additional retirements of  
13 coal-fired power plants as options in future resource plans.

14 IT IS FURTHER ORDERED that Arizona Public Service Company shall report on its studies  
15 of solar hybrid resources as part of its Renewable Energy Standard compliance reports and  
16 implementation plans.

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1 IT IS FURTHER ORDERED that upon consummating the acquisition of Southern California  
2 Edison's interest in Four Corners Units 4 and 5, Arizona Public Service Company shall notify the  
3 Commission by making a compliance filing in this docket within ten business days after closing and  
4 thereafter make compliance filings on a quarterly basis updating the Commission on its progress  
5 retiring Units 1-3, with a goal that retirement occur by December 31, 2013.

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

7 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.  
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9

10 CHAIRMAN \_\_\_\_\_ COMMISSIONER

11  
12 COMMISSIONER \_\_\_\_\_ COMMISSIONER \_\_\_\_\_ COMMISSIONER

13  
14 IN WITNESS WHEREOF, I, ERNEST G. JOHNSON,  
15 Executive Director of the Arizona Corporation Commission,  
16 have hereunto set my hand and caused the official seal of the  
17 Commission to be affixed at the Capitol, in the City of Phoenix,  
18 this \_\_\_\_\_ day of \_\_\_\_\_ 2012.

19 \_\_\_\_\_  
20 ERNEST G. JOHNSON  
21 EXECUTIVE DIRECTOR

22 DISSENT \_\_\_\_\_

23 DISSENT \_\_\_\_\_  
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1 SERVICE LIST FOR:

ARIZONA PUBLIC SERVICE COMPANY

2 DOCKET NO.:

E-01345A-10-0474

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4 Meghan H. Grabel  
5 Thomas L. Mumaw  
6 PINNACLE WEST CAPITAL CORP.  
7 P.O. Box 53999, Mail Station 8695  
8 Phoenix, AZ 85072-3999  
9 Attorneys for Arizona Public Service  
10 Company

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

11 Greg Patterson  
12 916 West Adams, Suite 3  
13 Phoenix, AZ 85007

Steven M. Olea, Director  
Utilities Division  
ARIZONA CORPORATION COMMISSION  
1200 West Washington Street  
Phoenix, AZ 85007

14 Lawrence V. Robertson, Jr.  
15 ATTORNEY AT LAW  
16 P.O. Box 1448  
17 Tubac, AZ 85646  
18 Attorney for Arizona Competitive Power  
19 Alliance

20 Timothy M. Hogan  
21 ARIZONA CENTER FOR LAW  
22 IN THE PUBLIC INTEREST  
23 202 E. McDowell Rd., Suite 153  
24 Phoenix, AZ 85004

25 Pamela Campos  
26 ENVIRONMENTAL DEFENSE FUND  
27 2060 Broadway  
28 Boulder, CO 80302

David Berry  
WESTERN RESOURCE ADVOCATES  
P.O. Box 1064  
Scottsdale, AZ 85252-1064

Daniel W. Pozefsky  
RUCO  
1110 W. Washington St., Suite 220  
Phoenix, AZ 85007

Travis Ritchie  
SIERRA CLUB ENVIRONMENTAL  
LAW PROGRAM  
85 Second Street, 2<sup>nd</sup> Floor  
San Francisco, CA 94105

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