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June 9, 2009

**Re: Proposed APS Settlement Agreement Term Sheet; Request for additional information. Docket No. E-01345A-08-0172.**

Dear Parties to the Docket:

I have read the term sheet filed in this docket on May 4 describing the fundamental structure of what may become a proposed Settlement Agreement in the Arizona Public Service Company's ("APS") rate case, and would like to pose the following questions to the Parties to be addressed in any final proposed Settlement Agreement filed for the Commission's consideration.

- According to the term sheet, the Parties propose a rate freeze for APS under which the Company would be prevented from filing another rate case until 2012, utilizing a 2011 Test Year. Presumably, this "stay out provision" is being offered as a benefit for consumers associated with the proposed Settlement Agreement. And yet, on May 5, during APS' First Quarter earnings call with investors, the Company's Chief Financial Officer, Jim Hatfield responded to an analyst's question about this provision by implying that the provision was immaterial, as APS would likely have filed a new rate case in 2011 regardless of what occurred in this docket. Specifically, Mr. Hatfield stated, "based on the settlement, we'll have the opportunity to file with 2010 past [sic] year....[a]nd frankly that's not a whole lot different than we would have anyway." I would like to know whether, given this admission by a top executive of APS that the stay out provision mirrors the Company's pre-existing intention regarding the timing of the filing of the Company's next rate case, this provision can fairly be considered as a true benefit to consumers. I would also like to know what weight it was given by the Settling Parties in arriving at the proposed Agreement.

- The initial outline of the Settlement Agreement would grant APS an authorized Return on Equity of 11 percent, which is .25 percent higher than the ROE granted in the last APS rate case (Decision No. 69663), and would represent one of the highest authorized ROE's granted to a utility Company in Arizona during my tenure as a Commissioner. I would like the Parties, in the final Settlement Agreement and supporting testimony, to lay out the justification for this higher ROE, and whether granting an amplified ROE would argue in favor of a longer stay-out period than is provided for in the term sheet.

- The term sheet calls upon the Commission to process all future APS rate cases within 12 months of a sufficiency finding. First, I would like to know whether this provision was

crafted assuming the Commission's current budget remains intact. Second, given the possibility that the Commission's budget could undergo significant cuts, as is called for under the budget passed this week by the Arizona Legislature, I would like the Parties to address, in the final Settlement Agreement and supporting testimony, whether it continues to be in the public interest to enact a 12 month processing requirement. More specifically, it would appear obvious that Staff's ability to process cases under even normal time clocks would be disadvantaged by the proposed cuts to the Commission's budget, begging the question whether the Commission could achieve the 12 month time clock provision called for in the term sheet if the Legislature's cuts are enacted.

- The initial outline of the proposed Settlement Agreement would allow APS to treat Schedule 3 funds as revenues, a change from the current system of accounting for these line extension payments in which the funding is booked as CIAC. Please describe, in the final Settlement Agreement and supporting testimony, the rate impacts of this change both in the near and long-term; specifically, state whether treating Schedule 3 as revenue would place upward pressure on rates in the future. The term sheet also indicates a willingness to make other changes to Commission policy on Schedule 3,[1] presumably in response to several letters from Commissioners calling for Schedule 3 to be re-assessed. While I am not opposed to re-examining Schedule 3, and possibly making prudent alterations to it, I believe the rate impacts associated with any changes should be made clear.[2] Please state what the rate increase to the rate increase proposed in this case would be associated with any change to Schedule 3, including allowing 50 free feet of line extension, 100 feet, 500 feet, and 750 feet.

- The term sheet includes a provision under which APS would agree to construct a new utility scale solar energy project in Arizona designed to bolster the Company's commitment to renewable energy. I would like to know whether the solar plant referenced in the term sheet is the same solar plant already announced by APS in partnership with Lockheed Martin, whether it is one of the other projects identified in APS' proposed Resource Plan, or whether it goes beyond those projects previously identified by the Company. If it is a utility scale project that was already in APS' Resource Plan, please tell the Commission, in the final Settlement Agreement and supporting testimony, why it should be considered a benefit in this case.

- The term sheet identifies as a benefit to consumers the Company's agreement to issue an RFP for proposals for in-state wind generation within 90 days, but identifies no time

[1] Schedule 3 was modified in Decision No. 70185 to eliminate the prior policy of granting 1,000 free feet for power line extensions.

[2] The term sheet refers to the fact that these changes would be made "revenue neutral". While changes to Schedule 3 may be revenue neutral for the Company, they most certainly would not be revenue neutral for the ratepayer.

frame for the completion of that action, nor does it seem to bind the Company to actually complete the construction of a wind project after the conclusion of the RFP. Please identify in the final Settlement Agreement and supporting testimony a time frame and a process for selecting this proposed wind project and state whether the Settlement Agreement would require the construction or purchase of a wind project in Arizona by the Company.

- The term sheet identifies enhanced energy efficiency at APS as a potential benefit of the Settlement Agreement, including the adoption of "energy efficiency goals" that would lead to annualized energy savings of approximately 320,000 MWhs in 2010 ramping up to 490,000 MWhs in 2012. I would like to know how these goals line up with what has been proposed by various Parties, including the Southwest Energy Efficiency Project ("SWEEP"), in the Commission's energy efficiency workshops. Additionally, please comment in the Settlement Agreement and supporting testimony, on whether the same energy efficiency standard that is being considered in those workshops could be adopted as part of this rate case.

- In the record leading up to Decision No. 69663 APS averred that it would comply with the provisions of the Renewable Energy Standard ("RES") and the Decision adopted the RES rules as appropriate for APS. Please tell the Commission whether the Parties believe it is in the public interest to adopt the RES in this case. Additionally, I would like the Parties to state, in the final Settlement Agreement and supporting testimony, whether they would object to the Commission requiring that APS exceed the RES, such that the Company would secure 8.813 million MWhs of renewable energy by the year 2025. More specifically, is such a requirement appropriate in light of the provision in the term sheets that APS will acquire 1.7 million MWhs of new renewable resources by December 31, 2015, beyond what the Company has already procured or contracted, recent evidence demonstrating that renewable energy will shield ratepayers from the painful economic effects of cap and trade or a carbon tax,[3] and recent public statements by the Company's Chief Executive Officer that the Company intends to make Arizona "the solar energy capitol of the world."[4] Additionally, please inform the Commission in the final Settlement Agreement and supporting testimony in this case whether the 1.7 million

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[3] APS officials have stated that the cost of both the Solana and Starwood Solar One projects will be equal to or less than the cost of traditional carbon-based generation under a cap and trade program that placed a price on carbon of $25 per pound. It goes without saying that the cost-effectiveness of renewable energy rises in proportion to the price placed on carbon under either a cap and trade program or a carbon tax. Additionally, in an April 1, 2009 letter from Arizona Public Service Company to U.S. Senator Jon Kyl, APS estimated that carbon legislation could raise electric rates eleven to forty one percent, suggesting that the need to shield Arizonans from the negative rate effects related to carbon based electricity has become all too real. And Decision No. 69127, which approved Arizona's Renewable Energy Standard and Tariff Rules, found that "[i]t is just, reasonable, proper, and necessary to require a diverse fuel supply for Arizona's electricity needs in order to reduce reliance on fossil fuel energy sources in Arizona to promote and safeguard the security, convenience, health and safety of the Affected Utilities' customers and the public in Arizona."

[4] See http://www.youtube.com/watch?v=18iKP_p92bU.

MWhs of additional renewable energy is in addition to or part of the 400 MWs of renewable resources referenced in APS' 3-Year Action Plan contained within the Company's Resource Plan filed with the Commission on January 29. Please also state whether the 1.7 million MWhs exceeds the Company's announcement this month that it would achieve nearly double the amount of renewable energy required under the RES in the Year 2015 with its announced Starwood Solar One project, or whether it represents essentially the same level of achievement.[5] If it was the Company's pre-existing plan to double its RES requirements by adding an additional 1.7 million MWhs of renewable generation, should the Commission consider this a benefit to consumers to be counted against the detriments of the rate increase proposed in this case?

- On February 14, 2008, California adopted a capped feed-in tariff program under which businesses wishing to install solar energy systems may receive a heightened rate for the energy produced by these solar systems.[6] Such a program is not included in the term sheet of the Settlement Agreement, but I would like the Parties to address in testimony and during the hearing in this case, whether it would be in the public interest to require APS to adopt a feed-in tariff pilot program that would encourage the rapid adoption of solar either by Arizona businesses or in areas of the state that APS projects will see significant growth. As the Parties know, the Distributed Generation Cost Valuation Study conducted by APS and Ordered by the Commission indicates that APS ratepayers will receive the greatest benefit from solar generation when systems are targeted at specific areas where additional incremental infrastructure can be avoided, specifically, areas where significant growth is highly likely to occur. I would like the Parties to outline the desired number of Megawatts for inclusion in a proposed pilot feed-in tariff, as well as any additional features necessary to the adoption of a feed-in tariff suitable for APS customers. Additionally, the term sheet makes no mention of allowing Construction Work in Progress ("CWIP") for renewable energy projects completed by the utility, an issue which I requested be addressed by the Parties in the Settlement talks. Please describe, in supporting testimony, why such a provision was not included in the final Settlement Agreement.

- Under the Renewable Energy Standard Tariff and Rules, Commission regulated utilities are allowed to count Renewable Energy Credits ("REC") only if they maintain all of the attributes of the REC: the kWh, the renewable attributes and any environmental

[5] For instance, according to APS' 2009 REST Plan filing (Docket No. 08-0331) pursuant to the RES, APS will be required to produce or purchase 1.728 million MWhs of renewable energy by the Year 2015. If the Company adds an additional 1.7 million MWh's to this total, it would represent a doubling of the Company's RES commitment, which appears to be essentially what was announced by APS last month when it unveiled its plans for the Starwood Solar One plant.

[6] Specifically, in Energy Division Resolution E-4137, the California PUC approved proposed tariffs and standard contracts for the purchase of eligible renewable energy from public water and wastewater facilities. Separate tariffs were also approved for the purchase of eligible renewable generation from entities other than public water and wastewater agencies. The statewide total for both sets of tariffs is 478.447 MW.

attributes, such as carbon credits. As renewable energy efforts continue to advance, I would like the Commission to have the opportunity to determine whether it is in the public interest to require that any monetized benefits associated with banked carbon credits accrue back to ratepayers, or that they be utilized to further enhance APS' renewable energy infrastructure. I would like APS, in supporting testimony to the proposed Settlement Agreement, to describe its current policy with regard to the banking of carbon credits associated with the RES, whether it intends to monetize those carbon credits or use them to offset the Company's future requirements under a federal cap and trade program, and whether it would be in the public interest to create a carbon trust fund for the benefit of ratepayers or some other mechanism to insure that ratepayers receive the full benefits associated with carbon credits created by the RES. I would like the Parties to be prepared to provide the same information regarding carbon credits, and the need for a possible carbon trust fund, associated with energy efficiency programs at APS.

Thank you for your consideration of these matters. Your answers will aid me in my deliberations in this case.

Sincerely,

Kris Mayes
Chairman

Cc: Commissioner Gary Pierce
Commissioner Sandra Kennedy
Commissioner Paul Newman
Commissioner Bob Stump
Ernest Johnson
Janice Alward
Lyn Farmer
Michael Kearns
Rebecca Wilder