PINNACLE WEST CAPITAL CORP

FORM 8-K
(Current report filing)

Filed 09/17/02 for the Period Ending 09/10/02

Address	400 NORTH FIFTH STREET MS8695 PHOENIX, AZ 85004
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CIK	0000764622
Symbol	PNW
SIC Code	4911 - Electric Services
Industry	Electric Utilities
Sector	Utilities
Fiscal Year	12/31

PINNACLE WEST CAPITAL CORP

FORM 8-K
(Unscheduled Material Events)

Filed 9/17/2002 For Period Ending 9/10/2002

Address	400 NORTH FIFTH STREET . PHOENIX, Arizona 85004
Telephone	602-379-2500
CIK	0000764622
Industry	Electric Utilities
Sector	Utilities
Fiscal Year	12/31

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): September 10, 2002

PINNACLE WEST CAPITAL CORPORATION

(Exact name of registrant as specified in its charter)

Arizona	1-8962	86-0512431
(State or other jurisdiction of incorporation)	(Commission File Number)	(IRS Employer Identification Number)

400 North Fifth Street, P.O. Box 53999, Phoenix, Arizona 85072-3999
(Address of principal executive offices) (Zip Code)

(602) 250-1000
(Registrant's telephone number, including area code)

NONE
(Former name or former address, if changed since last report)

ITEM 5. OTHER EVENTS

ARIZONA ELECTRIC INDUSTRY RESTRUCTURING

TRACK A ORDER

On September 10, 2002, the Arizona Corporation Commission ("ACC") issued its written order on "Track A" issues (the "Track A Order") related to the generic docket established by the ACC in January 2002. The Track A Order documents decisions made by the ACC at an open meeting on August 27, 2002, as previously reported in the Report on Form 8-K of Pinnacle West Capital Corporation (the "Company"), dated August 27, 2002. A copy of the Track A Order is attached to this Report as Exhibit 99.1. Arizona Public Service Company ("APS") intends to file a motion for reconsideration of the Track A Order on or before September 30, 2002. The major provisions of the Track A Order include, among other things:

Provisions related to the reversal of the generation asset transfer requirement:

* The ACC reversed its decision, as reflected in the ACC's electric competition rules, to require APS to transfer its generation assets either to an unrelated third party or to a separate corporate affiliate (see the Track A Order, first Ordering Paragraph); and

* The ACC unilaterally modified the 1999 settlement agreement, which authorized APS' transfer of its generating assets, and directed APS to cancel its activities to transfer its generation assets to Pinnacle West Energy ("PWEC") (see the Track A Order, Conclusion of Law No. 7 and the first Ordering Paragraph).

Provisions related to the wholesale competitive energy procurement process ("Track B" issues):

* The ACC stayed indefinitely the requirement of the ACC's electric competition rules that APS acquire 100% of its energy needs for its standard offer customers from the competitive market, with at least 50% obtained through a competitive bid process (see the Track A Order, second Ordering Paragraph);

* The ACC established a requirement that APS competitively procure, at a minimum, any required power that it cannot produce from its existing assets in accordance with the ultimate outcome of the Track B proceedings (see the Track A Order, fourth Ordering Paragraph);

* The ACC directed the parties to develop a competitive procurement ("bidding") process that can begin by March 1, 2003 (instead of January 1, 2003) (see the Track A Order, sixth Ordering Paragraph);

and

* The ACC stated that "the PWEC generating assets that APS may acquire from PWEC shall not be counted as APS assets in determining the amount, timing and manner of the competitive solicitation" for Track B purposes, thereby bifurcating the regulatory treatment of the existing APS assets and the PWEC assets (see the Track A Order, sixth Ordering Paragraph).

The ACC Staff is conducting workshops on the Track B issues with various parties to determine and define the appropriate process to be used for competitive power procurement. On September 13, 2002, the ACC Staff issued a "proposal and request for comments" describing a process by which APS would procure power not supplied by its own resources. Comments from parties participating in the Track B process are due by September 18, 2002. The Company cannot predict when the ACC Staff will issue its final report on the Track B issues or when the ACC commissioners will make a final decision in this matter. As described above, the ACC has directed the parties to complete the Track B proceedings such that the competitive procurement process can begin by March 1, 2003.

FINANCING APPLICATION

The Track A Order stated that if APS wished to acquire PWEC's generating assets, as suggested in a letter APS filed with the ACC on July 11, 2002, APS must file an appropriate application with the ACC. On September 16, 2002, APS filed an application with the ACC (the "Financing Application") requesting the ACC to allow APS to borrow up to $500 million and to lend the proceeds to PWEC; to guarantee up to $500 million of PWEC's debt; or a combination of both, not to exceed $500 million in the aggregate. The loan and/or the guarantee would be used to refinance debt incurred to fund the construction of PWEC generation assets. A copy of the Financing Application is attached to this Report as Exhibit 99.2.

The Financing Application addresses, among other things, the following matters:

* APS noted that its April 19, 2002 filing with the ACC had sought unification of "PWEC Assets" (West Phoenix Combined Cycle Units 4 and 5, Redhawk Units 1 and 2, and Saguaro Combustion Turbine Unit 3) and APS generation assets under a common financial and regulatory regime. APS further noted that the Track A Order's language regarding the treatment of the PWEC Assets for Track B purposes (see the last bullet point under "Track A Order" above) appears to postpone a decision regarding the inclusion of the PWEC Assets in APS' rate base, thereby effectively precluding the consolidation of the PWEC Assets at APS under a common financial and regulatory regime.

* APS stated that it did not intend or desire to foreclose the possibility that it would acquire all or part of the PWEC Assets or that it may propose that the PWEC Assets be included in APS' rate base or afforded cost-of-service regulatory treatment to the extent the PWEC Assets are used by APS customers. APS stated that these issues would be appropriate topics in APS' 2003 general rate case and noted that the Track A Order specifically stated that the ACC would not pre-judge the eventual rate treatment of the PWEC Assets (see the Track A Order, tenth Ordering Paragraph).

* APS stated that the Track A Order's reversal of the generation asset transfer requirement and the resulting bifurcation of generation assets between APS and PWEC under different regulatory regimes results in PWEC being unable to attain investment grade credit ratings. This, in turn, precludes PWEC from accessing capital markets to refinance the bridge financing provided by the Company to fund the construction of the PWEC Assets or from effectively competing in the wholesale markets. APS noted that PWEC had previously received investment grade credit ratings contingent upon its receipt of APS generation assets, and that the Company's credit ratings could be adversely affected if PWEC is unable to finance its capital requirements.

* APS stated that the amount of the requested loan and/or guarantee is APS' present estimate of the amount of credit support necessary through APS to restore PWEC and the Company to their credit status prior to the ACC's issuance of the Track A Order. APS further stated that if the requested amount proves to be inadequate, APS reserves the right to submit a second financing application seeking additional credit support.

* APS requested ACC approval of the requested loan and/or guarantee by December 31, 2002.

The Company cannot currently predict the outcome of the matters discussed in this Report, and continues to evaluate its legal and regulatory options.

ITEM 7. FINANCIAL STATEMENTS, PRO FORMA FINANCIAL INFORMATION AND EXHIBITS.

(c) Exhibits.

Exhibit No.	Description
99.1	Arizona Corporation Decision No. 65154, dated September 10, 2002.
99.2	Arizona Public Service Company Application filed with the Arizona Corporation Commission on September 16, 2002.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

PINNACLE WEST CAPITAL CORPORATION
(Registrant)

Dated: September 16, 2002 By: Michael V. Palmeri Michael V. Palmeri Vice President, Finance

Exhibit 99.1

BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL
CHAIRMAN
JIM IRVIN
COMMISSIONER
MARC SPITZER
COMMISSIONER

IN THE MATTER OF THE GENERIC PROCEEDINGS CONCERNING ELECTRIC RESTRUCTURING ISSUES.	DOCKET NO. E-00000A-02-0051
IN THE MATTER OF ARIZONA PUBLIC SERVICE COMPANY'S REQUEST FOR VARIANCE OF CERTAIN REQUIREMENTS OF A.A.C. R14-2-1606.	DOCKET NO. E-01345A-01-0822
IN THE MATTER OF THE GENERIC PROCEEDING CONCERNING THE ARIZONA INDEPENDENT SCHEDULING ADMINISTRATOR.	DOCKET NO. E-00000A-01-0630
IN THE MATTER OF TUCSON ELECTRIC POWER COMPANY'S APPLICATION FOR A VARIANCE OF CERTAIN ELECTRIC COMPETITION RULES COMPLIANCE DATES.	DOCKET NO. E-01933A-02-0069
IN THE MATTER OF THE APPLICATION OF TUCSON ELECTRIC POWER COMPANY FOR APPROVAL OF ITS STRANDED COST RECOVERY.	DOCKET NO. E-1933A-98-0471 DECISION NO. 65154 OPINION AND ORDER

DATES OF HEARING:	June 14, 2002 (pre-hearing); June 17, 18, 19, 20, 21, 27, and 28, 2002
PLACE OF HEARING:	Phoenix, Arizona
ADMINISTRATIVE LAW JUDGE:	Lyn Farmer
IN ATTENDANCE:	William A. Mundell, Chairman Marc Spitzer, Commissioner
APPEARANCES:	Mr. Jay L. Shapiro, FENNEMORE CRAIG and Mr. Michael R. Engleman, DICKSTEIN, SHAPIRO, MORIN & OSHINSKY on behalf of Panda Gila River, L.P.; Mr. Lindy Funkhouser, Director, and Mr. Scott S. Wakefield, Chief Counsel, on behalf of the Residential Utility Consumer Office; Mr. Thomas L. Mumaw, Senior Attorney, PINNACLE WEST CORPORATION and Mr. Jeffrey B.

Guldner, SNELL & WILMER; on behalf of Arizona Public Service Company;

Mr. Raymond S. Heyman, ROSHKA, HEYMAN & DeWULF; on behalf of Tucson Electric Power Company;

Mr. Lawrence V. Robertson, Jr., MUNGER CHADWICK, on behalf of Sempra Energy Resources and Southwestern Power Group II;

Mr. William P. Sullivan, and Mr. Michael A. Curtis, MARTINEZ & CURTIS, P.C., on behalf of Reliant Energy Resources;

Mr. Steven Lynn Wene, MOYES, STOREY; on behalf of PPL Southwest Generation Holdings, LLC; PPL EnergyPlus, LLC; and PPL Sundance Energy, LLC;

Mr. Walter W. Meek on behalf of the Arizona Utility Investors Association;

Mr. Randall H. Warner, JONES, SKELTON & HOCHULI, P.C., and Mr. Daniel W. Douglass, LAW OFFICES OF DANIEL W. DOUGLASS, on behalf of AES NewEnergy and Strategic Energy, L.L.C.;

Mr. Greg Patterson on behalf of the Alliance;

Mr. Roger K. Ferland, QUARLES & BRADY STREIGH LANG, L.L.P., on behalf of Harquahala Generating Company;

Mr. Gary A. Dodge, HATCH, JAMES & DODGE, P.C., on behalf of Arizona for Choice and Electric Competition;

Mr. Robert J. Metli, CHEIFETZ & IANNITELLI, on behalf of Citizens Communications Company; and

Mr. Christopher K. Kempley, Chief Counsel and Ms. Janet F. Wagner, Staff Attorney, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

On October 18, 2001, Arizona Public Service Company ("APS") filed a Request for a Partial Variance to A.A.C. R14-2-1606(B) and for Approval of a Purchase Power Agreement ("Variance/PPA") (Docket No. E-01345A-01-0822).

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A Procedural Conference was held on December 5, 2001, to discuss procedural issues and the appropriate scope of the proceeding. APS filed direct testimony on December 12, 2001, and the parties filed briefs on December 19, 2001.

By Procedural Order issued January 22, 2002, the Commission opened this generic docket on electric restructuring (Docket No. E-00000A-02-0051). The Commissioners, through a series of letters, requested that the parties respond to questions about electric competition.

On January 28, 2002, Tucson Electric Power Company ("TEP") filed a Request for Variance (Docket No. E-01933A-02-0069).

On January 30, 2002, the Commission's Utilities Division Staff ("Staff") filed a Response to the Procedural Order establishing the generic docket and requested consolidation of all related electric competition dockets, including the generic docket, the APS variance request, the TEP variance request, the Arizona Independent Scheduling Administrator ("AISA") inquiry, and the TEP request to amend its market generation credit, Docket No. E-01933A-98-0471.

A Procedural conference was held on January 31, 2002, to discuss procedural issues and on February 8, 2002, a Procedural Order was issued consolidating the dockets, ordering Staff to file a Staff Report in the Generic Docket, and establishing a hearing date on APS' Variance/PPA application.

Intervention was granted to the following: the Residential Utility Consumer Office ("RUCO"); Reliant Resources, Inc. ("Reliant"); Panda Gila River, LP (Panda"); Arizona Competitive Power Alliance ("Alliance"); Arizonans for Electric Choice and Competition ("AECC"); Harquahala Generating Co., LLC ("Harquahala"); Arizona Utility Investors Association ("AUIA"); Sempra Energy Resources ("Sempra"); Southwestern Power Group II, Inc. ("SWPG"); AES New Energy Inc. ("AES NE"); Strategic Energy, LLC ("Strategic"); Toltec Power Station, LLC; Bowie Power Station, LLC; PG&E National Energy Group; Arizona Transmission Dependent Utility Group; Duke Energy Arlington Valley, LLC; Duke Energy North America, LLC; Kroger & Co.; Land & Water Fund of the Rockies; Arizona Cogeneration Association; Conoco, Inc.; APS Energy Services Co., Inc.; Department of Defense; Stirling Energy System; Arizona Consumer Council; Southwest Energy Efficiency Project; and Arizona Community Action Association ("ACAA").

On March 19, 2002, Panda Gila River, L.P. ("Panda") filed a Request for Order to Show Cause.

On March 22, 2002, Staff filed its Staff Report in this Generic Docket, summarizing the parties' answers to the Commissioners' questions and making recommendations about electric restructuring.

On April 22, 2002, APS filed a Motion for Determination of Threshold Issue, which indicated that APS intended to submit its "30-day letter" regarding the asset transfer on approximately August 1, 2002, irrespective of the Commission's resolution of the Variance/PPA request or the proceedings in the generic electric docket.(1)

On April 25, 2002, the Commission held a Special Open Meeting at which the Commission stayed the APS Variance/PPA hearing, denied Panda's Request for an OSC, and directed that certain issues be addressed in the Generic Docket.

By Procedural Order issued on May 2, 2002, a hearing was set on the issues identified by the Commission, including: the transfer of assets and associated market power issues; Code of Conduct; Affiliated Interest Rules; and jurisdictional issues raised by Chairman Mundell, collectively referred to as "Track A" issues. Track B, Competitive Procurement, was also established. The Procedural Order also put the parties and the general public on notice that the Commission may initiate rulemaking(s), or, pursuant to A.R.S. ss. 40-252, after hearing, enter such orders as may be appropriate relating to electric restructuring, including variances from Commission rules and/or Decisions.

Notice of the hearing was published in newspapers of general circulation in the APS and TEP service areas and statewide between May 26 and June 6, 2002.(2)

The hearing was held as scheduled. No members of the public appeared to make public comment. Witnesses testified on behalf of APS, TEP, AUIA, AECC, RUCO, Panda, Harquahala, Sempra/SWPG, Reliant, AES NE/Strategic, and Staff.

By Procedural Order issued on July 10, 2002, TEP's application to amend its market generation credit was removed from this consolidated proceeding.

On July 10, 2002, the parties filed briefs.

BACKGROUND

On May 20, 1994, the Commission opened Docket No. U-0000-94-165 to investigate the introduction of retail electric competition. On December 26, 1996, the Commission issued Decision No. 59943, which adopted A.A.C. R14-2-1601 through 1616, the Retail Electric Competition Rules. Hearings were held on generic stranded cost issues, and on June 28, 1998, the Commission issued Decision No. 60977 on Stranded Costs. On August 10, 1998, in Decision No. 61071,

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(1) See footnote 3 to the Motion.
(2) Arizona Republic, Bisbee Daily Review, Sierra Vista Herald, Tri-Valley Dispatch, Douglas Daily Dispatch, Flagstaff Arizona Daily Sun, Holbrook Tribune/Silver Creek Herald, Parker Pioneer, Payson Round Up, Prescott Daily Courier, Sedona Red Rock News/Cottonwood Journal Extra/Camp Verde Journal/ Wickenburg Sun, Winslow Mail, Yuma Daily Sun, Arizona Daily Star, and the Tucson Citizen.

the Commission adopted amended rules on an emergency basis, and on December 11, 1998, adopted the emergency rules on a permanent basis in Decision No. 61272. On January 11, 1999, the Commission issued Decision No. 61311, which stayed the Retail Electric Competition Rules and related decisions, including Decision No. 60977.

On April 27, 1999, the Commission issued Decision No. 61677, which amended Decision No. 60977, the Commission's prior Stranded Cost decision. Decision No. 61677 ordered the Hearing Division to issue a Procedural Order to set dates for consideration of stranded costs and unbundled tariffs for each Affected Utility. The revised Retail Electric Competition Rules were published on May 14, 1999 and public comment sessions were held. On May 18, 1999, APS filed for approval of a settlement agreement and on June 9, 1999, TEP filed for approval of a settlement agreement. Hearings were held on both applications, and the Commission issued Decision No. 61973 (October 6, 1999) in the APS docket, and Decision No. 62103 (November 30, 1999) in the TEP docket. On September 29, 1999, the Commission issued Decision No. 61969, which approved the revised Retail Electric Competition Rules ("Retail Electric Competition Rules"). In Decision No. 62924 (October 10, 2000) the Commission adopted clarifying revisions to the Retail Electric Competition Rules.

The Settlement Agreements provided and Decision Nos. 61973 and 62103 granted two-year extensions of time, until December 31, 2002, for APS and TEP to separate assets (A.A.C. 1615(A)(3)) and also granted a "similar two-year extension" for compliance with A.A.C. R14-2-1606 (B)(4). APS planned to divest its competitive generation assets to a yet-to-be formed generation affiliate. The Addendum to APS' Settlement Agreement also provided that: "[a]fter the extensions granted in Section 4.1 have expired, APS shall procure generation for Standard Offer customers from the competitive market as provided for in the Electric Competition Rules. An affiliated generation company formed pursuant to this Section 4.1 may competitively bid for APS' Standard Offer load, but enjoys no automatic privilege outside of the market bid on account of its affiliation with APS." (4.1(3)).

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(3) A.A.C. R14-2-1615(A) provides: "All competitive generation assets and competitive services shall be separated from an Affected Utility prior to January 1, 2001. Such separation shall either be to an unaffiliated party or to a separate corporate affiliate or affiliates. If an Affected Utility chooses to transfer its competitive generation assets or competitive services to a competitive electric affiliate, such transfer shall be at a value determined by the Commission to be fair and reasonable." ("Rule 1615(A)")
(4) A.A.C. R14-2-1606(B) provides: "After January 1, 2001, power purchased by an investor owned Utility Distribution Company for Standard Offer Service shall be acquired from the competitive market through prudent, arm's length transactions, and with at least 50% through a competitive bid process." ("Rule 1606(B)")

APS' Variance/PPA application stated that "adherence to the competitive bidding requirements of the Electric Competition Rules will not produce the intended result of reliable electric service for Standard Offer customers at reasonable rates" and requested that the Commission grant a partial variance to R14-2-1606(B) that would otherwise obligate APS to acquire all of its customers' Standard Offer generation requirements from the competitive market, and to approve a long-term purchase power agreement with its affiliate, Pinnacle West Capital Corporation ("PWCC").

TEP's Variance application requested that the Commission grant an extension of the compliance dates in Rule 1606(B) and Rule 1615(A) to either December 31, 2003, or six months after the Commission has issued a final order in this docket, whichever occurs later.

By Procedural Order issued February 8, 2002, the Commission determined that APS' Variance/PPA application required proceeding according to A.R.S. ss. 40-252 in addition to proceeding as a request for a rule variance. Our May 2, 2002, Procedural Order in this proceeding also stated that the parties and the general public are put on notice that the Commission may initiate rulemaking(s) or, pursuant to A.R.S. ss. 40-252, after hearing, enter such orders as may be appropriate relating to electric restructuring, including variances from Commission rules and/or Decisions and required notice to be given that provided as full notice and opportunity for participation on the part of the public as possible.

The Track A issues to be resolved in this portion of the docket are: Issue #1 Market Power; Issue # 2 Divestiture; Issue # 3 Code of Conduct/Affiliate Transactions; and Issue # 4 Jurisdictional Issues.

ISSUE # 1 MARKET POWER

STAFF

On the issue of the condition of the wholesale market, Staff finds and recommends:

1. The wholesale market is not currently workably competitive; therefore, reliance on that market will not result in just and reasonable rates.

2. APS has market power in its Phoenix Valley and Yuma load pockets.

3. TEP has market power in its Tucson load pocket.

4. The Commission should require APS and TEP to produce market power studies accompanied by market mitigation plans before allowing them to divest.

5. The wholesale market applicable to Arizona is poorly structured and susceptible to possible malfunction and manipulation.

APS

APS argues that the evidence presented at hearing demonstrated that its generation affiliate, Pinnacle West Electric Corporation ("PWEC") will not have unmitigated market power post-divestiture. APS states that all parties that conducted the Supply Margin Assessment ("SMA") analysis as used by the Federal Energy Regulatory Commission ("FERC") "came to the conclusion that APS passes the most recent and stringent market power test proposed by FERC in determining whether or not a wholesale electric market is functionally competitive." (APS Brief at pp 19-20). APS believes that the market power of generation owners within transmission-constrained areas is not caused by divestiture and will not be ameliorated by retention of load pocket generation, but will be mitigated by the "must-run" provisions of the AISA and the WestConnect protocols. Further, APS points out that A.A.C. R14-2-1609(I) requires that contracts for "must-run" generation must be in place prior to divestiture. APS believes that Staff's proposed new market power study is "unnecessary and assumes the existence of a problem requiring a solution." (APS Brief at p. 21)

TEP

TEP believes that there is not sufficient consensus in the record upon which the Commission can make a decision as to how to quantify market power and how to resolve market power issues as they arise. Consequently, TEP recommends that the issue of market power should be subject to further evaluation.

PANDA

Panda agrees with APS' witness, Dr. Hieronymus' definition of market power as "the ability to profitably sustain an above-competitive price in the marketplace." Panda's witness, Dr. Roach, testified that APS has both transmission and generation market power in both the APS Market as a whole and in the APS Valley Market. Dr. Roach's load pocket-specific SMA analysis for the Phoenix load center found that APS' market power in the Valley Market is even more significant than its market power in the region at large. (Roach direct at p.15) Panda recommends that the Commission should find that APS has market power today, and that its affiliate will have market power in the future.

Although Panda does not believe that additional market power studies are necessary, it advises that if the Commission decides that market power analysis is essential, the SMA test, as adjusted by Dr. Roach, is the best approach to measuring market power. Dr. Roach identified three assumptions that tend to overstate the supply margin, which, according to him, results in an understatement of market power. He recommends modifying the SMA as applied by FERC to adjust for those factors. Dr. Roach criticized APS' witness, Dr.

Hieronymus' SMA analysis for not accounting for the SMA test's inherent overstatement of supply margin; for not accounting for capacity that is foreclosed from competing by APS; and for significantly overstating import capacity into the APS region by including transmission facilities that APS does not own or control.

Panda believes that APS' market power can be mitigated through competitive procurement. Panda believes that the market power problem in Arizona is not that there is an insufficient number of competitors, but that APS is in a position to foreclose the opportunity for those competitors to compete, such as with its proposed PPA which would allow APS to use its existing market power to protect two facilities built and owned as merchant plants by its affiliates, thereby harming ratepayers by forcing them to pay higher prices and bearing more market risk than necessary.

Panda also believes that APS' position on market power is "ironic". According to Panda, when APS discusses whether it has market power, APS says it does not because of a "vast wholesale market and over 11,000 MW of import capacity", but when claiming it cannot competitively bid, it cites lack of competitors and existing transmission constraints. (Panda Brief at pp. 6-7)

RELIANT

Reliant states that most parties "recognize that the transfer of all UDC generation assets to an affiliate will result in a concentration of market resources that provide the opportunity for the affiliate to exert market power on the wholesale generation market." (Reliant Brief at p. 4).

Reliant proposed a "two-prong" approach that it believes alleviates both the market power and transmission-constraint issues. Reliant proposes a capacity auction that allows wholesale market participants to acquire specific portions of the output of capacity transferred by the UDC to an affiliate, and a competitive solicitation process structured as "slice of system" auctions. Bidders would compete to provide a specific percentage of APS' daily load requirement, using staggered delivery dates and varying contract lengths. Reliant believes that this is a potential market-based solution to concerns about short-term market power. It would avoid unnecessary delay in the implementation of competition for Arizona Standard Offer load, resulting in consumers receiving the benefits of competition in a timely manner. Further, Reliant asserts, it allows for the divestiture of generation assets and makes further market power studies unnecessary.

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AECC

AECC signed and supports the APS and TEP Settlement Agreements and continues to believe they are in the public interest. However, the AECC does not want the Commission to ignore critical policy issues such as "the potential that market power could unfairly impact retail prices after divestiture and after the termination of existing price caps". (AECC Brief at p. 3) AECC notes that the "concerns expressed by APS and others about the near-term viability of the wholesale market make it difficult for divestiture to proceed within the time frame contemplated by the APS Settlement Agreement. [footnote omitted] APS, for example, has characterized the western wholesale market as `not functioning properly' because liquidity has `gone in the tank'" (AECC Brief at p. 5, quoting Jack Davis). Further, AECC notes that to "the extent that the Commission is not enamored with the proposed PPA, but otherwise shares APS' concerns about the wholesale market, the Commission will naturally be hesitant to allow divestiture to move forward on the current schedule without sufficient protections in place to protect the public interest." (AECC Brief at pp. 5-6). AECC recommends that the parties, including the Commission, should seek a consensus approach to market power testing, monitoring, and mitigation, and should proactively seek adoption of that approach by FERC.

AUIA

AUIA believes that the threat of market power has been vastly overstated, and that the solution to the threat of market power can probably be found in Track B.

RUCO

RUCO believes that electric deregulation is "in trouble." (RUCO Brief at p.
1) As support, RUCO states that "[e]lectricity wholesale markets in the western United States are dysfunctional and remain under federal price-cap controls" and that competition and its benefits have not materialized for Arizona's small retail customers, who will be charged for the costs of transition. RUCO supports Staff's recommendation that before divestiture is allowed to occur, a comprehensive market power study for the Arizona regional wholesale power market needs to be done. RUCO believes that the study should be performed on a cooperative basis with input from all parties through a technical advisory team, using computer-based modeling of strategic behavior. The results would be used to determine the future of electric restructuring in Arizona.

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DOCKET NO. E-00000A-02-0051 ET AL.

ISSUE # 2 DIVESTITURE OF COMPETITIVE GENERATION ASSETS

STAFF

On the issue of asset transfer, Staff recommends:

1. The Commission should immediately issue an order that stays Rule 1606.B, Rule 1615.A, and the transfer provisions of Decision No. 61973 and 62103 until the Commission can conclude that the wholesale market is workably competitive.

2. The Commission should initiate a rulemaking proceeding to amend Rule 1615.A.

3. The utilities should not be prohibited from transferring their generation assets. However, such transfers should not be permitted unless the transfer will serve the public interest.

4. Asset transfers will promote competition, and thereby serve the public interest, as long as the wholesale market is workably competitive.

5. In order to transfer its assets, a utility should file a market power study, a market mitigation plan, and a proposed code of conduct. It may be feasible for the Commission to consider these items in a consolidated proceeding.

Staff points out that when the Commission approved the Electric Competition Rules and the Settlement Agreements, all the parties thought that retail competition was imminent - that the wholesale market would be competitive; that a significant number of retail competitors would be entering the market; and that customers would leave the incumbent utility and purchase power from the new competitors. Instead, Staff argues, the "wholesale market has faltered, the new competitors have failed to materialize, and incumbent utilities have not lost customers in any meaningful number." (Staff Brief at p. 2). Staff believes that the timing of the transfer is problematic. Staff states that "APS has admitted that implementation of the terms of the rules and the settlement agreements as they currently stand will put the public at risk." (Staff Brief at p. 5, citing testimony of APS witness Davis).

In response to some witnesses' recommendations to rely on FERC to police the market, Staff cites the General Accounting Offices' ("GAO") conclusion that FERC has not yet defined or implemented an effective regulatory and oversight approach for competitive energy markets, which means that FERC "lacks assurance that today's energy markets are producing interstate wholesale natural gas and electricity prices that are just and reasonable." (Mundell Ex. A at pp. 5-6) The timing problem is also apparent in the lack of a functioning Regional Transmission Organization ("RTO"). According to Staff, it is not possible to comply with the competitive bidding requirements of 1606(B) by the end of the year, and even APS seems to agree.

Because the circumstances that the rules were designed to address have not developed, because asset transfer combined with an ineffective wholesale market places the public at substantial risk, and because it "appears that reliance on FERC to police the wholesale market may be ill advised", Staff recommends that the Commission should not allow asset transfer until it is convinced that the transfer is in the public interest. Staff advises that "[w]ithout conditions designed to address market structure concerns, the transfer is NOT in the public interest." (Staff Brief at p. 4, emphasis original).

Staff believes that before the Commission decides whether a particular utility should be allowed to divest, the utility should indicate whether it wants to divest.(5) If a Company wants to divest, it should file market power studies and a proposed code of conduct, Track B should be concluded, and in any event, no reliability must-run generation ("RMR") should be divested. Staff's states that its recommendations on divestiture may have implications for future rate setting, because if a utility chooses to retain its assets, the Staff believes that the Commission should apply cost of service principles when setting rates.

In response to APS' argument that the Commission is bound by the Settlement Agreement, Staff argues that the Commission is not contractually bound. Staff states that if a regulatory agency finds a proposed settlement to be reasonable, the terms of the settlement form the substance of a decision that binds all parties to the proceeding, and the approved agreement assumes the nature of an agency decision enacted in the public interest, losing its private contractual character. (Citing CAJUN ELEC. POWER COOP., INC. V. F.E.R.C., 924 F.2d 1132, 1135 (D.C. Cir. 1991). Staff also argues that it is unlikely that a contract was formed due to the Commission's amendments to the agreement. Staff further argues that, assuming for the sake of argument that a contract exists, it is unenforceable because the "alleged contract was based on the existence of a workably competitive wholesale market, and because a workably competitive market does not exist, the purpose of the alleged contract has been frustrated, thereby excusing performance." (Staff Brief at p. 19)

APS

APS believes that divestiture will benefit APS customers in the long run and will not harm them in the short run. It acknowledges that the benefits of divesture are more long-term in nature, while the "risks of the market loom today". (APS Brief at p. 12) APS points out that through its Settlement Agreement, its customers have protection against the market through June 2004, and that intermediate to long-term protection for consumers is available through the proposed PPA.

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(5) Staff recommends that utilities should inform the Commission within 30 days of the conclusion of Track B.

APS argues that no party has presented a compelling argument against divestiture. APS cites other jurisdictions that have authorized divestiture without harm to consumers and in furtherance of industry restructuring as support for its own divestiture. APS argues that Staff's preconditions to divestiture are so ambiguous and onerous as to make timely divestiture impossible from both a regulatory and commercial standpoint. APS states that claims of horizontal market power concerns were not raised in 1999; no party suggested that another code of conduct was necessary to address other affiliate issues; and that competitive bidding has always been tied to divestiture and divestiture must occur first. APS believes that the parties' arguments on these issues are attempts to indefinitely delay or unnecessarily condition divestiture.

APS states that divestiture has already been finally authorized by Decision No. 61073 and Rule 1615(A), and cannot be delayed or stayed in these proceedings without breaching the APS Settlement. According to APS, the Commission entered into a binding contract, and this interpretation has been upheld by the Arizona Court of Appeals. APS states that Staff's claimed change in circumstances, including the "failure of retail competition to develop as apparently Staff had envisioned back in 1999, the existence of market power during a few hours of the year in transmission constrained areas of APS service territory, the alleged `loss' of Commission jurisdiction over electric generation, and some non-specific concerns over the efficacy of the wholesale market" actually are not a change in circumstances or "represent changes irrelevant to the issue of divesture." (APS Brief at p. 9). APS believes that the "failure of the wholesale competitive market to develop as quickly as was once envisioned and the apparently inherent volatility and unpredictability of the wholesale electric market is a legitimate concern." (APS Brief at p. 10) However, APS' solution to that "legitimate concern" is approval of its PPA, not to delay divestiture. APS also argues that another "dramatic change of circumstances since 1999" was the creation of a new and separate generation affiliate.(6)

TEP

TEP has requested, in its Variance, an "extension of the compliance date in Rule 1615.A, which requires that all competitive generation assets and competitive services be separated from TEP." TEP believes that the date should be extended to either December 31, 2003 or six months after the Commission issues a final order in this proceeding, whichever occurs later. In its Variance

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(6) Although APS claims that "APS has been REQUIRED by this Commission to create a new and separate generation affiliate" (APS Brief at p.9, emphasis added), the Electric Competition Rules (1615(A)) contemplate divestiture to either an "unaffiliated party or to a separate corporate affiliate or affiliates" and in Decision No. 61973 at page 10, we state that "[w]e also recognize the Company is making a business decision to transfer the generation assets to an affiliate instead of an unrelated third party", indicating that it was APS' choice to create a "new and separate generation affiliate".

application, TEP states that "given the recent history - and current state - of the western power markets, TEP believes that neither an immediate transition to the 50% competitive bid requirement or the generation separation requirement is prudent at this time." (Variance Application at p. 4)

PANDA

Generally, Panda supports the proposed divestiture of APS and TEP generation assets to an affiliate on the terms that were agreed to in the Settlement Agreements (i.e. that divestiture would be contemporaneous with competitive procurement). Panda believes that any divestiture of generation assets to affiliates should be conditioned on implementation of the competitive procurement framework as established in Track B. According to Panda, "[c]ompetitive procurement will yield substantial benefits to Arizona ratepayers because there is an emerging oversupply of generation capacity in the near term." (7) (Panda Brief at p. 3) Panda believes that competitive procurement will benefit Arizona ratepayers with or without divestiture. Panda argues that "[e]ven leaving aside replacement of inefficient or environmentally undesirable generation owned by APS today, APS needs significant additional generation to meet its needs in the future. APS should not be allowed to meet these needs without a reasonable market test to determine whether its arrangements for doing so are in the public interest. Specifically, the new RedHawk and West Phoenix plants built by APS' merchant generation affiliate must be subject to challenge through competitive procurement to assure Arizona ratepayers are getting the best deal in terms of price, risk, and reliability. Neither of these plants has gone through prudence review and neither is in rate base." (Panda Brief at p. 4)

Panda believes that the concerns about divestiture raised by other parties can be addressed through a competitive bidding framework and an appropriate prudence review, but if the "above-market, self-dealing PPA is the only way to mitigate the market power of APS affiliates, then the Commission should reject divestiture." (Panda Brief at p.8).

RELIANT

Reliant believes that allowing divestiture without appropriate competitive solicitation procedures in place and underway will "severely jeopardize the long-term viability of competition among wholesale suppliers in Arizona" and "places at risk the long-term viability of the existing and new generation projects constructed to serve the region's electrical demand." (Reliant Brief at

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(7) According to Panda, APS' projected summer 2003 load is approximately 6,000 MW and by that time or soon thereafter, 6,500 MW of new competitive supply will be on-line in the APS service territory, for a total of 12,500 MW of capacity potentially competing to serve 6,000 MW of load. (Panda Brief at p. 3)

pp. 7 & 9) Reliant believes that by requesting a variance to 1606(B), APS effectively "stagnates the wholesale market in Arizona." (Reliant Brief at p. 10)

AECC

AECC recommends that the Commission should "direct the parties to the APS and TEP settlement agreements (and other parties of interest) to make a prompt, good faith effort to address the following issues within the framework of the settlement agreements:

(a) timing of divestiture - the parties should consider the need to modify the timing of divestiture, as necessary, to comport with the Track B findings, (e.g., in the event that competitive bidding is delayed, then divestiture may be delayed); alternatively, APS can bring forward, for the consideration of the other parties and the Commission, a power purchase agreement that provides a short-term `bridge' through 2003, to the extent such a product is needed to supplement APS' standard offer requirements in light of Track B findings;

(b) longer-term power purchase agreement - APS can bring forward, for the consideration of the other parties and the Commission, a power purchase agreement that provides long-term resources using today's rate-based generation as part of a portfolio that is limited to meeting demand BEYOND the standard offer requirements that are competitively bid (as determined in Track B)." (AECC Brief at pp. 3-4).

AUIA

AUIA believes that the Commission can safely allow APS to transfer its assets to PWEC and conduct a competitive solicitation within the limits imposed by the marketplace, or in the alternative, the Commission can examine the PPA concept proposed by APS. AUIA states that if none of these options are acceptable, the Commission should suspend the electric competition rules and continue cost-of-service regulation until it has completed a re-examination of electric competition in Arizona.

AUIA believes that the "Commission has a legal and moral obligation to abide by the terms of the 1999 Settlement Agreement it entered into with APS, absent a demonstration that extraordinary circumstances have intervened since then." (AUIA Brief at p. 6) AUIA believes that there has been no such showing in this proceeding.

SEMPRA/SWPG

Sempra and SWPG argue that because Rule 1606(B) and 1615 are "intrinsically interwoven", and because of market power concerns, the Commission should "establish as a fundamental principle that generation asset transfers will not be allowed to occur under Rule 1615 until the competitive procurement process

contemplated by and provided for under Rule 1606(B) has been implemented."
(Sempra/SWPG Brief at p. 4). Sempra/SWPG define "implemented" to include: "(i)
contracts for the provision of electric power have been awarded by UDCs pursuant to a Commission - approved competitive procurement process, (ii) the results of that process have been publicly announced and (iii) the resulting power procurement contracts have been reviewed and approved by the Commission."
(Sempra/SWPG Brief at p. 4)

Sempra/SWPG believes that it is premature to alter the deadlines for the asset transfers and competitive power procurement because they believe that a viable competitive procurement process may still be put in place by January 1, 2003; that APS and TEP could both still complete asset transfers prior to January 1, 2003; and that market power studies could be completed, evaluated and used constructively before the end of the year. Sempra/SWPG believe that asset transfer and implementation of competitive procurement could be phased in, to the extent, and when market power problems do not exist.

HARQUAHALA

Harquahala believes that contracting for competitive procurement should occur prior to divestiture and that it should not include existing network transmission service rights.

RUCO

RUCO recommends:

1. Until the Commission is assured that FERC is adequately overseeing Arizona's wholesale electric market, the Commission should suspend the divestiture requirement.

2. Once the Commission is confident that the wholesale market is workable and free of market power pricing, divestiture should be accompanied by purchase power agreements that assure Standard Offer customers have access to electricity at cost-based prices.

3. If the Commission decides to allow divestiture without a PPA in place, it should delay divestiture for at least a year to conduct further study, including strategic behavior modeling, to accurately assess market conditions.

4. The Commission must balance the need for further study with the costs.

ISSUE # 3 CODE OF CONDUCT/AFFILIATE TRANSACTIONS

STAFF

On the issues of Code of Conduct and Affiliate Relationships, Staff recommends:

1. Any investor-owned utility that wants to purchase power from an affiliate within twelve months of a Commission decision in this docket must file a Code of Conduct for Commission approval within ninety days of a Commission decision in this docket.

2. Any investor-owned utility that has already purchased power from an affiliate must file a Code of Conduct for Commission approval within ninety days of a Commission decision in this docket.

3. Any investor-owned utility that has not made a filing in response to #s 1 & 2 above but in the future plans to purchase power from an affiliate must obtain Commission approval of a Code of Conduct before executing any affiliate transactions.

4. Prior to a transfer of generation assets to an affiliate, an investor-owned utility must file a code of conduct for Commission approval unless such Code of Conduct has already been filed in response to recommendations #s 1, 2, or 3 above.

5. The Commission should adopt a Code of Conduct to fill the gaps among existing Codes of Conduct.

APS

On the issue of Code of Conduct/Affiliate Transactions, APS argues that it already has both a Commission-approved Code of Conduct and Policies and Procedures to effectuate the Code, and FERC-imposed Standards of Conduct, in addition to the affiliated interest rules, and that nothing is "broken" and in need of "fixing". However, APS states that if divestiture is permitted in accordance with the Settlement Agreement, APS would be willing to submit a revised Code of Conduct covering PWEC, PWM&T, and APS Energy Services. APS believes that divestiture should not be held up pending Commission consideration and approval of any amended Code of Conduct.

PANDA

Panda believes that the "existing Code of Conduct and Affiliate Interest Rules do not adequately address problems of self-dealing, preferential treatment of affiliates and cross-subsidization of competitive services." (Panda Brief at
p. 32) Panda agrees with Staff that "before divesting generation or transacting with an affiliate in any way, a UDC should be required to file with the Commission a proposed Code of Conduct that mitigates any potential for conflicts of interest, affiliate abuse, self-dealing or cross-subsidization, and which strictly limits access to commercially sensitive or confidential information." (Id. at 32) Further, Panda believes that notice should be provided to interested parties and an opportunity to comment on such a Code of Conduct should be

provided, with a complaint process before the Commission if a UDC or any of its affiliates violates the Code of Conduct.

RELIANT

Reliant agrees with Staff that further consideration of Codes of Conduct is appropriate to ensure that ratepayers do not subsidize non-regulated competitive operations, but that it should not cause a material delay in the competitive procurement of Standard Offer load.

SEMPRA/SWPG

Sempra/SWPG support Staff's recommendation on adopting additional Code of Conduct requirements, but suggest that the Commission hold public hearings and/or an oral and written comment procedure on the Codes of Conduct filed in response to Staff's recommendations, and that such Codes of Conduct be in place by January 1, 2003.

ISSUE #4 JURISDICTIONAL ISSUES

STAFF

On the Jurisdictional/Legal issues, Staff made the following recommendations:

1. If an asset transfer occurs, the Commission will lose its ratemaking jurisdiction over those assets and will have no jurisdiction over any power purchase agreement that occurs after the transfer of assets.

2. Once an asset transfer occurs, APS' acquisition of power would be wholesale transactions under the jurisdiction of the FERC.

3. The FERC has jurisdiction over both profit and not-for-profit RTOs.

4. The Commission is not contractually bound by the APS Settlement Agreement

APS

On the issue of jurisdiction of the Commission, APS asserts that the Commission will not lose any meaningful jurisdiction over the setting of retail rates as a result of generation divestiture. APS states that "[s]tate regulators have never had jurisdiction over most wholesale transactions." (APS Brief at p. 28) APS states that just as the Commission could not "deny rate recovery to a prudently acquired and operated resource that is used and useful in providing service" to a vertically integrated electric utility, the "Commission cannot deny rate recovery of a prudently acquired and administered purchase power expense that is used and useful in providing service to the Company's customers." (APS Brief at p. 29) APS states that the Commission's jurisdiction is not affected by the formation of or participation in a "for profit" RTO.

. . .

TEP

On the jurisdictional issue, TEP states that it is unaware of any jurisdictional impact attributable to the "for-profit" status of WestConnect.

PANDA

Panda argues that with divestiture, the Commission will not lose jurisdiction over "the most important aspect of its mandate: what APS' Standard Offer Service customers pay for APS purchases from its affiliate and other merchant generators for the capacity necessary to supply Standard Offer customers." (Panda Brief at p. 31) Panda recommends that the "Commission can and should condition any divestiture . . . on APS' agreeing to a market test prudency standard." (Id.) Panda further believes that the Commission will maintain substantial jurisdiction by its control of the competitive procurement process. Panda believes that the issue of for-profit or not-for profit RTO form does not affect the Commission's jurisdiction.

MISCELLANEOUS ISSUES

TRANSMISSION

On the issue of Transmission, Staff recommends:

1. The Commission should encourage an industry-wide collaborative planning process to resolve transmission constraints (Smith Direct, Ex. S-13 at 25)

2. Staff recommends that the Commission initiate an appropriate proceeding to consider the adoption of the following standards:

a. There should be sufficient transmission import capability to reliably serve all loads in a utility's service area without limiting consumer access or benefit to more economical or less polluting generation located external to the service area.

b. A power plant must have sufficient interconnected transmission capacity to reliably deliver its full output without use of remedial action schemes for single contingency (N-1) outages or displacing a priori generation interconnected at the same switchyard or on the same transmission lines.

3. The Commission should order jurisdictional utilities to resolve RMR generation concerns. Specifically, the utilities should be ordered to:

a. perform a study within thirty days of a Commission decision in Track A analyzing the merits of existing dependence on RMR generation instead of building transmission to resolve local transmission import reliability constraints;

b. perform a study analyzing the merits of any future contemplated utilization of RMR to defer transmission projects; and

c. file such RMR study reports with the Commission for review within thirty days of their completion and prior to implementing any new RMR generation strategies.

4. Staff recommends that the Commission should consider appropriate avenues to establish the following criteria:

a. Future power plant applications for CECs should be denied for sufficiency purposes if they have not fulfilled the statutory technical study requirements demonstrating the impact of the project on the existing Arizona transmission system; and

b. Power plants that fail to demonstrate the ability to reliably deliver to a market without displacing a priori generation interconnected at the same location or utilizing the same interconnected transmission system should not be granted a CEC.

5. Both transmission providers and merchant power plants should share the burden and obligation to resolve Arizona's transmission constraints.

In response to Staff's recommendation, APS states that the Commission should continue to monitor transmission issues and complete the next Biennial Transmission Assessment. APS and Staff agree that successful transmission planning will require collaboration with all affected parties, including parties not subject to the Commission's regulatory jurisdiction. APS believes that there are no "must run" or transmission market power issues that should affect the timing of divestiture.

PWEC'S GENERATION

APS added an additional issue: termed the "West Phoenix and Redhawk" issue. APS states that although the West Phoenix Power Plant Expansion and Redhawk Power Units 1 and 2 are being constructed by PWEC and are therefore "merchant plants", they are being built to meet the reliability needs of APS' Standard Offer customers.

APS also wants the Commission to address what it calls the "bifurcation issue" and states that the Commission should allow APS and its affiliates to recover all costs incurred in reliance on the provisions of the APS Settlement. Specifically, APS believes that the Commission should: "indicate that APS is entitled to recover all reasonable incurred and increased costs occasioned by the Commission's change in position" (including costs of its affiliates); allow "APS to acquire and finance the Dedicated Units presently owned by PWEC"; reconsider other aspects of the APS Settlement during the Company's next rate proceeding or in a separate proceeding held prior to the next rate case, including how to restore the "$234 million write-off" and "the one-third of divestiture-related costs the Company was forced to absorb under Decision No. 61973." (APS Brief at pp. 42-43.)

Panda believes that APS introduced significant testimony going well beyond the identified Track A issues, mainly that the "PWEC merchant facilities were constructed 'for the benefit of APS customers.' Tr. At 130". Panda believes that

whether PWEC's merchant facilities (RedHawk 1 & 2 and West Phoenix 4 & 5) should be transferred to APS is not before the Commission at this time.

Panda notes that while APS presented evidence of steps it took to divest in reliance on the Settlement Agreement, there is nothing in the record of any reasonable, timely efforts to comply with the requirement to competitively procure power for its Standard Offer customers. Specifically, Panda states that there is "no evidence that APS ever issued an RFP, made a competitive solicitation on any significant scale for any period following entry of the APS Settlement Agreement, circulated its long-term energy or capacity requirements to any party, other than its merchant affiliate, to allow the market to be responsive to those needs, or otherwise sought a competitive alternative to its affiliate's construction projects. .. .In fact, the testimony in this proceeding demonstrated that APS is relying on affiliate transactions to supply needs in 2002, again without any apparent effort to solicit those needs from the competitive market." (Panda Brief at p. 6)

In a footnote in its brief, Reliant states that PWEC must not be allowed to transfer RedHawk and West Phoenix to APS if divestiture does not occur, as these were built as competitive assets. According to Reliant, "[a]ny non-competitive transfer to APS will effectively eliminate the possibility of creating a robust competitive wholesale market, and the benefits to retail customers . . . ."
(Reliant brief at p. 10)

RETAIL COMPETITION

TEP proposed that if retail electric competition is to proceed at this time, the Commission should allow only customers with a load of 3 MW or more direct access for now.

AES NE/Strategic discussed only one issue in their brief: TEP's proposal to deny retail customer choice to all of Arizona's residential customers and to commercial and industrial customers with load requirements of less than 3 MW.

AES NE/Strategic believe that TEP's proposal is a fundamental breach of its Settlement Agreement. According to AES NE/Strategic, retail choice was a fundamental and significant element of the settlement; TEP seeks to preserve its own benefits gained under the Settlement while denying a fundamental benefit achieved by other parties to the Settlement; and TEP has failed to comply with its obligations to defend the Amended Settlement Agreement and has taken actions that are inconsistent with its provisions.

AES NE/Strategic notes that TEP did not make any effort to discuss the issue or consult with other parties to the Settlement Agreement, but made a unilateral proposal in its testimony in this proceeding. AES NE/Strategic also argues that TEP's efforts to declare competition dead ignores TEP's own role in

forestalling competition, citing as the primary reason why direct access customers returned to bundled service with TEP, the failure of TEP to pay the required competitive transition charge to direct access customers when market prices spiked in the west.

AES NE/Strategic believes that if the Commission were to "accept TEP's anti-competitive proposal, the end result for retail competition in Arizona would be the same as if the Commission acted to repeal the Retail Electric Competition Rules adopted in September 1999 - it would be the death knell to retail competition in Arizona." (AES NE/Strategic Brief at p. 11)

AECC criticized TEP and RUCO for introducing into the record proposed changes to Arizona's retail direct access program, which are outside the scope of this Track A proceeding. AECC strongly objects to the proposed changes, and views TEP's proposal as a "bad faith attempt to advance its pre-settlement agreement objectives." (AECC Brief at p. 2) Accordingly, AECC did not brief the issue, but reserved its right to argue against the positions advanced in the appropriate forum.

RUCO's witness testified that TEP's recommendation that only customers with loads of 3 MW or greater be allowed to participate in retail competition is a reasonable option to consider, if traditional cost-of-service bundled retail rates are maintained for all other customers, and if divestiture does not occur.

ANALYSIS

MARKET POWER

All the parties to the proceeding, with the exception of APS and AUIA, agree that market power/market abuse issues are real and should be addressed. We find that APS and TEP have market power today in their Phoenix Valley, Yuma and Tucson load pockets, respectively. Moreover, we note that there is no RTO currently in existence in Arizona and believe that it is desirable to establish a process that builds upon, but goes beyond, the Arizona ISA "must-run generation" protocol to evaluate the long-term infrastructure needs of service to load pockets. We disagree that market power in the load pockets is best addressed through sole reliance on the "must-run generation" protocol of the Arizona ISA. We believe that it is appropriate to conduct market power studies that focus not only on regional market power, but on how market power can be exercised in Arizona specific areas, and how it can best be mitigated. Although Reliant posed an interesting concept to mitigate market power through a supply auction, we are not convinced that such a process is workable or appropriate in Arizona at this time. Accordingly, we adopt Staff's recommendations and will require APS and TEP to produce market power studies accompanied by market mitigation plans before allowing them to divest. Further, we agree with AECC and

RUCO that the parties should seek a consensus approach to market power testing, monitoring, and mitigation.

Our findings about market power are intended to be used for purposes of this proceeding only as they relate to the issue of asset divestiture. We are not making any finding regarding any FERC determination of market power, and our findings about market power are not intended to be used in any FERC proceeding or in another forum.

DIVESTITURE

In retrospect, it was a good idea to delay divestiture and competitive procurement in the APS and TEP Settlement Agreements, given what has happened in the last two or so years, including the experience in California; the market volatility and illiquidity; and the lack of public confidence in the transition to electric deregulation and ability of regulators to prevent price spikes, ensure reliable service, and prevent bankruptcies. Even today, there is not agreement amongst economists, much less regulators, as to why and what happened in California, happened, and how to prevent a similar or related occurrence.

It is clear that the Commission and all parties expected benefits from retail competition, yet there is no active retail competition, so actual benefits are still unknown. It is said that consumers will benefit from wholesale competition, but not without the proper market structure and regulatory framework that will support it. It was anticipated that at the time that APS and TEP divested, ESPs would be providing direct access to retail customers. In actuality, no retail competition exists; market power is held by the incumbent utilities; no RTO is in effect; transmission constraints exist that potentially exacerbate market abuse; the GAO has issued a negative report on FERC's ability to manage competitive markets; both TEP and APS recognize a problem - one wants to postpone its divestiture while the other is affected by its parent's and affiliates' adverse financial considerations; proposed new generation may be cancelled if it is not able to find a market; more protections are needed against self-dealing and inappropriate affiliate transactions; and investigations are ongoing into market manipulations and improprieties. Contrary to what APS argues, these changes relate to the question of divestiture, especially to our willingness to transfer our ratemaking jurisdiction over generation assets to FERC, given its recent history regulating the wholesale market and the conclusions contained in the recent GAO report.

We find that due to circumstances outside our control or the control of any party, and in order to protect the public interest, we must take further action to regulate the transition to competition. We want to take action in a manner that is fair to all parties and that protects ratepayers. Neither the Commission

nor any party to this proceeding anticipated the current state of electric competition nor caused the problems that have been identified. Therefore, the wise course of action is to try to minimize the effects and figure out a way to move forward that will ultimately result in a market structure that performs efficiently and rationally, and that will result in the benefits that were promoted in the move to competition. As a constitutionally created state agency, our overriding concern is the public interest. This means maintaining the ability, through our jurisdiction, to insure that Arizona ratepayers receive reliable, safe, economic, and efficient electric power.

Therefore, we find that the public interest requires that the divestiture requirement found in A.A.C. R14-2-1615(A) and our extensions of that requirement until January 1, 2003, found in Decision Nos. 61973 and 62103, must be modified in the following manner: TEP is granted a waiver of A.A.C. R14-2-1615(A); APS is granted a waiver of A.A.C. R14-2-1615(A); and both companies are hereby directed to cancel any plans to divest interests in any generating assets. Should either company wish to pursue the divestiture outlined in R14-2-1615(A) in the future, they should file applications to that effect for Commission consideration. This determination is consistent with our planned transition to competition and as we said in Decision No. 61973, ". . . the Commission must be able to make rule changes/other future modifications that become necessary over time." (Decision No. 61973 at p. 9) As we also said in Decision No. 61973, it is "not the Commission's intent to undermine the benefits that parties have bargained for."
(Id.) Recognizing this, it is incumbent upon all parties to work together in such a manner that will allow competition and its expected benefits to develop in whatever timeframe is needed to make it successful, while ensuring that the citizens of Arizona have safe, reliable and fairly priced electric power. Accordingly, we will modify Decision Nos. 61973 and 62103 to stay the asset transfer provisions as outlined above.

Further, we will modify R14-2-1606(B) and Decision Nos. 61973 and 62103's requirement that 100 percent of power purchased for Standard Offer Service shall be acquired from the competitive market, with at least 50 percent through a competitive bid process; but effective upon implementation of the outcome of Track B, we will require APS and TEP to acquire, at a minimum(8), any required power that cannot be produced from its own existing assets, through the competitive procurement process as developed in the Track B proceeding.(9) The amount of power, the timing, and the form of procurement shall be determined in the Track B proceeding. We believe that in this way we can encourage a phase-in to competition, encourage the development of a robust wholesale market for

(8) APS and TEP may decide to retire or displace inefficient, uneconomic, environmentally undesirable plants.
(9) The Commission will closely monitor APS' and TEP's power procurement for potential affiliate concerns until the Track B competitive procurement process is implemented.

generation, and obtain some of the benefits of the new Arizona generation resources, while at the same time protecting ratepayers.

The waivers and actions ordered herein should allow the market power issue and any necessary future market power studies to be performed and recommendations made; allow FERC to gain experience and expertise in regulating competitive wholesale markets; increase the supply of new generation; allow for necessary revisions to the Electric Competition Rules; allow the development of an effective RTO or other such entity; allow for some transmission constraints to be resolved; allow the Commission, APS, TEP, and the parties to develop and implement a phased-in competitive procurement process; and allow all participants to analyze and learn from the events that have occurred during the past two years. We agree with TEP that the overriding concern of the Commission must continue to be "ensuring that the citizens of Arizona have safe, reliable and fairly priced electric power".

APS' request for a change to the competitive procurement requirement of 1606(B) is no different than a request for a change to the requirement of divestiture in 1615(A).(10) Although APS tries to argue that the Commission can modify one provision (1606(B)) but not the other provision (1615(A)), the two provisions have always been paired together. Even APS witness Jack Davis testified to their linkage. When asked whether divestiture and competitive bidding under Rule 1606(B) are linked, he responds: "Absolutely, both in the historical context of the Electric Competition Rules and in the practical sense
. . . Even during the approval process of the 1999 APS Settlement Agreement, the variance granted to Rule 1606(B) was referred to as a 'corresponding delay,' that is, 'corresponding' to the delay in implementation of Rule 1615." (Davis Direct at pp. 9-10)

Both were treated the same in Decision No. 61973 - granted "two-year extensions", therefore, if granting a "variance" from 1606(B) would not violate the Settlement Agreement, then granting a "stay" or "variance" of 1615(A) would similarly not violate the Settlement Agreement. To the extent that any party believes that such a variance to 1615(A) is a violation of the Settlement Agreement, the Commission once again(11) urges the parties to meet and work to resolve the issue. Even if we were to believe that granting a stay or variance

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(10) Although upon redirect examination, Mr. Davis testified that neither the decision approving the settlement nor the addendum filed on December 1, 1999 in accordance with the Commission's order mentioned 1606(B), the Variance/PPA application at page 5 states "Decision No. 61973 provided : '[A] similar two-year extension shall be authorized for compliance with A.A.C. R14-2-1606(B).' ID. at 9.", which quote is also found in the addendum at page 3, in paragraph 5, as set forth in 4.1(1).
(11) See February 8, 2002 Procedural Order at page 8, lines 22-23.

of the divestiture requirement would necessitate modification of the Settlement Agreement, the public interest requires such action.

CODE OF CONDUCT/AFFILIATED INTEREST

We agree with Staff that the Codes of Conduct we have already approved need additional provisions and should cover an investor-owned electric utility regulated by the Commission and all affiliates in energy-related fields, including affiliates who sell power. The Commission has an interest in and jurisdiction over affiliate wholesale purchases used to serve Arizona retail customers. At a minimum, the Code of Conduct should address the items identified by Staff, including: arm's length transactions; access to confidential information; cross-subsidization; preferential treatment to affiliates; joint employment and employee transfer issues; sharing of office space, equipment, and services; proprietary customer information; financing arrangements with affiliates; and conflicts of interest. Accordingly, we will require APS and TEP to submit modifications as suggested by Staff to their Codes of Conduct as adopted in Decision No. 62416 (April 3, 2000) and Decision No. 62767 (August 2, 2000). Such proposed revisions shall be filed with the Commission and provided to any requesting party, with a hearing to be held as provided in R14-2-1616. Regarding Panda's request for a complaint procedure, we note that 1616(B)(9) currently provides for a complaint process.

JURISDICTIONAL ISSUES

The parties are in agreement that once an asset transfer occurs, APS' acquisition of power would be wholesale transactions under the jurisdiction of the FERC and that FERC has jurisdiction over both profit and not-for-profit RTOs. The parties agree that the Commission's jurisdiction over public service corporations is unaffected whether an RTO approved by FERC is for-profit or not-for-profit.

MISCELLANEOUS ISSUES

We agree with Staff's recommendation to form an Electric Competition Advisory Group. This will facilitate communication and information sharing among Staff, stakeholders, and market participants. Additionally, we believe that Staff should prepare and file quarterly reports detailing the activities of the Advisory Group.

We are in general agreement with the Staff recommendations on transmission issues, and we encourage an industry-wide planning process to resolve transmission constraints. We believe that both transmission providers and merchant power plants should share the burden and obligation to resolve Arizona's transmission constraints. Further, we will order APS and TEP to work with Staff to develop a 2002 study process to resolve RMR generation concerns, such study plan results to be included in the 2004 Biennial Transmission Assessment. This would include studying and analyzing the merits of existing

dependence on RMR generation instead of building transmission to resolve transmission import reliability constraints and the merits of any future contemplated utilization of RMR to defer transmission projects. Until the 2004 Biennial Transmission Assessment is issued with RMR study plan results resolved, APS and TEP shall file annual RMR study reports with the Commission in concert with their January 31 annual ten year plan for review prior to implementing any new RMR generation strategies.

We recognize that APS has asserted that the generation units owned and built by its affiliate, PWEC, should be acquired by APS. This issue is not the subject of this Track A proceeding, and there is not sufficient evidence on the record to make a finding thereon, nor have parties had an opportunity to present evidence on the issue. If APS wishes to pursue this issue, it should file the appropriate application(s) by September 15, 2002. The results of the proceeding on such application shall not affect the amount, timing, and manner of the competitive procurement process. This proceeding should not address the ratemaking treatment of these assets. In authorizing this proceeding, we are not predetermining the relative merits of the issues to be addressed. Once an Application is filed, the Hearing Division shall promptly issue a Procedural Order scheduling a procedural conference to discuss the scope of the proceeding.

Although TEP made a recommendation concerning changing the availability of Retail Competition, this was not an issue the Commissioners agreed to be decided in Track A, and there is insufficient evidence in the record to make a determination on this issue. Accordingly, we will not modify the direct access provisions of the Retail Electric Competition Rules at this time.

Staff recommends that the following Rules and/or Decisions may need to be stayed/amended: A.A.C. R14-2-1606(B); A.A.C. R14-2-1611(A); A.A.C. R14-2-1615(A); Decision No. 61973 (APS Settlement); and Decision No. 62103 (TEP Settlement).

APS essentially argues that it does not recommend any changes, but that if divestiture is not allowed, it recommends a comprehensive review of all Electric Competition Rules to determine if other rules are also implicated, and also with other Commission decisions, such as Decision No. 62416 which approved APS' Code of Conduct but also prohibited APS from providing competitive generation.

As contained in the discussions above, we have granted a waiver of A.A.C. R14-2-1615(A) and found that A.A.C. R14-2-1606(B) and A.A.C. R14-2-1611(A) as applied to TEP and APS' captive customers, should be stayed, and Decision No. 61973 (APS Settlement); Decision No. 62103 (TEP Settlement); Decision No. 62416 (APS Code of Conduct) and Decision No. 62767 (TEP Code of Conduct) should be

modified as discussed herein. Further, we agree with APS that there should be a comprehensive review of all Electric Competition Rules to determine if other rules or Commission decisions are also implicated as a result of our determinations in Track A, and we also believe that such a review and rulemaking may be appropriate at the conclusion of Track B. Accordingly, we will direct Staff to open a rulemaking docket to address any required changes to rules, and will keep this docket open for parties to file comments upon what other decisions/issues may need to be revisited.

* * * * * * * * * *

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

FINDINGS OF FACT

1. On October 18, 2001, Arizona Public Service Company filed a Request for a Partial Variance to A.A.C. R14-2-1606(B) and for Approval of a Purchase Power Agreement.

1. By Procedural Order issued January 22, 2002, the Commission opened this generic docket on electric restructuring (Docket No. E-00000A-02-0051). The Commissioners, through a series of letters, requested that the parties respond to questions about electric competition.

2. On January 28, 2002, Tucson Electric Power Company filed a Request for Variance (Docket No. E-01933A-02-0069).

3. Intervention was granted to numerous parties.

4. On March 19, 2002, Panda Gila River, L.P. filed a Request for Order to Show Cause.

5. On March 22, 2002, Staff filed its Staff Report in the generic docket, summarizing the parties' answers to the Commissioners' questions and making recommendations about electric restructuring.

6. On April 22, 2002, APS filed a Motion for Determination of Threshold Issue, which indicated that APS intended to submit its "30-day letter" regarding the asset transfer on approximately August 1, 2002, irrespective of the Commission's resolution of the Variance/PPA request or the proceedings in the generic electric docket.

7. On April 25, 2002, the Commission held a Special Open Meeting at which the Commission stayed the APS Variance/PPA hearing, denied Panda's Request for an OSC, and directed that certain issues be addressed in the Generic Docket.

8. By Procedural Order issued on May 2, 2002, a hearing was set on the issues identified by the Commission, including: the transfer of assets and associated market power issues; Code of Conduct; Affiliated Interest Rules; and jurisdictional issues raised by Chairman Mundell, collectively referred to as "Track A" issues. Track B, Competitive Procurement, was also established.

9. The May 2, 2002 Procedural Order also put the parties and the general public on notice that the Commission may initiate rulemaking(s), or, pursuant to
A.R.S. ss. 40-252, after hearing, enter such orders as may be appropriate relating to electric restructuring, including variances from Commission rules and/or Decisions.

10. Notice of the hearing was published in newspapers of general circulation in the APS and TEP service areas and statewide between May 26 and June 6, 2002.

11. The hearing was held as scheduled. No members of the public appeared to make public comment. Witnesses testified on behalf of APS, TEP, AUIA, AECC, RUCO, Panda, Harquahala, Sempra/SWPG, Reliant, AES NE/Strategic, and Staff.

12. By Procedural Order issued on July 10, 2002, TEP's application to amend its market generation credit was removed from this consolidated proceeding.

13. On July 10, 2002, the parties filed briefs.

14. The Commission has an interest in and jurisdiction over affiliate wholesale purchases used to serve Arizona retail customers.

15. Market power could unfairly impact retail prices after divestiture and after the termination of existing price caps.

16. The wholesale market applicable to Arizona is poorly structured and susceptible to possible malfunction and manipulation.

17. APS has market power in its Phoenix Valley and Yuma load pockets.

18. TEP has market power in its Tucson load pocket.

19. APS and TEP have market power today in their Phoenix Valley, Yuma and Tucson load pockets, respectively. Full divestiture of their generating assets would limit the jurisdictional ability of this Commission to ensure that such market power does not and will not exist in the future. Thus, we find that the provisions of A.A.C. R14-2-1615(A) requiring full divestiture are, at this time, not in the public interest.

20. APS and TEP's market power cannot be mitigated solely through reliance on competitive procurement at this time.

21. Our findings about market power are intended to be used for the purposes of this proceeding only as they relate to the issue of asset divestiture. We are not making any finding regarding any FERC determination of market power, and our findings about market power are not intended to be used in any FERC proceeding or in another forum.

22. Asset transfers should not be permitted unless the transfer will serve the public interest.

23. The waiver of the asset transfer requirements of A.A.C. R14-2-1615(A) serves the public interest and recognizes the current state of the wholesale market in Arizona.

24. Absent conditions in place to address market structure concerns, generation asset transfers as contemplated in prior Commission Decisions and
A.A.C. R14-2-1616(A) are not in the public interest.

25. The wholesale market is not currently workably competitive; therefore, reliance on that market without recognizing its current uncertainty and limitations will not result in just and reasonable rates for captive customers.

26. The FERC has not yet defined or implemented an effective regulatory and oversight approach for competitive energy markets, so assurance is lacking that wholesale electricity prices are just and reasonable.

27. In order to transfer assets, a utility should file a market power study, a market mitigation plan, and revisions to its Code of Conduct.

28. At the time that the Commission approved the Electric Competition Rules and the Settlement Agreements, the parties thought that retail competition was imminent and that the wholesale market would be competitive; that a significant number of retail competitors would be entering the market; and that customers would leave the incumbent utility and purchase power from the new competitors.

29. Contrary to the parties' expectations and assumptions, the wholesale market has faltered, the new competitors have failed to materialize, and incumbent utilities have not lost customers in any meaningful number.

30. The competitive conditions that formed the basis of the Settlement Agreement and the adoption of the Retail Electric Competition Rules have not occurred as expected.

31. Competition and its benefits have not materialized for Arizona's small retail customers.

32. In its Variance/PPA application, APS concluded that adherence to the competitive bidding requirements of the Electric Competition Rules will not produce the intended result of reliable retail electric service for Standard Offer customers at reasonable rates.

33. The Codes of Conduct that we have already approved need additional provisions and should cover an investor-owned electric utility regulated by the Commission and all affiliates in energy-related fields, including affiliates who sell power at wholesale.

34. APS and TEP shall submit modifications as recommended by Staff to their Codes of Conduct as adopted in Decision No. 62416 (April 3, 2000) and Decision No. 62767 (August 2, 2000). Such proposed revisions shall be filed with the Commission and provided to any requesting party, with a hearing to be held as provided in A.A.C. R14-2-1616.

35. A.A.C. R14-2-1615(A) should be waived and Decision Nos. 61973 and 62103 should be modified as directed herein.

36. A.A.C. R14-2-1606(B) should be stayed and Decision Nos. 61973 and 62103 should be modified to stay the requirement that 100 percent of power purchased for Standard Offer Service shall be acquired from the competitive market, with at least 50 percent through a competitive bid process; but effective upon implementation of the outcome of Track B, we will require APS and TEP to acquire, at a minimum, any required power that cannot be produced from its own existing assets, through the competitive procurement process as developed in the Track B proceeding. The amount of power, the timing, and the form of procurement shall be determined in the Track B proceeding.

37. We believe that requiring some power to be purchased through the competitive procurement process developed in Track B will encourage a phase-in to competition, encourage the development of a robust wholesale market for generation, and obtain some of the benefits of the new Arizona generation resources, while at the same time protecting ratepayers. We direct the parties to continue their efforts in Track B of this proceeding to develop a competitive solicitation process that can begin by March 1, 2003. For the purposes of the competitive procurement process, the pwec generating assets that APS may seek to acquire from pwec shall not be counted as aps assets in determining the amount, timing, and manner of the competitive procurement.

38. Staff's recommendation to form an Electric Competition Advisory Group is adopted, and Staff should prepare and file quarterly reports during the first two years following the effective date of this decision,(12) detailing the activities of the Advisory Group, with the first such report filed in January 2003 and detailing activities conducted during the third quarter of this year.

39. Both transmission providers and merchant power plants should share the burden and obligation to resolve Arizona's transmission constraints.

40. APS and TEP should work with Staff to develop a 2002 study process to resolve RMR generation concerns, such study plan results to be included in the 2004 Biennial Transmission Assessment. This includes studying and analyzing the merits of existing dependence on RMR generation instead of building transmission

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(12) After two years, the reports should be filed on a semi-annual basis.

to resolve transmission import reliability constraints and the merits of any future contemplated utilization of RMR to defer transmission projects.

41. Until the 2004 Biennial Transmission Assessment is issued with RMR study plan results resolved, APS and TEP shall file annual RMR study reports with the Commission in concert with their January 31 annual ten year plan for review prior to implementing any new RMR generation strategies.

42. Nothing in the Retail Electric Competition Rules abrogates APS and TEP's responsibility to provide reliable and reasonably priced service to their customers.

43. The issue of APS acquiring PWEC's generation assets is not the subject of this Track A proceeding, and there is not sufficient evidence on the record to make a finding, nor have parties had an opportunity to present evidence on the issue. If APS wishes to pursue this issue, it should file the appropriate application(s) by September 15, 2002. The results of the proceeding on such application shall not affect the amount, timing, and manner of the competitive procurement process. This proceeding should not address the ratemaking treatment of these assets. In authorizing this proceeding, we are not predetermining the relative merits of the issues to be addressed. Once an Application is filed, the Hearing Division shall promptly issue a Procedural Order scheduling a procedural conference to discuss the scope of the proceeding.

44. The continued availability of retail direct access is not an issue in this proceeding and there is insufficient evidence in the record to make a determination on this issue.

45. The parties agree that the Commission's jurisdiction over public service corporations is unaffected whether an RTO approved by FERC is for-profit or not-for profit.

46. It is incumbent upon all parties to work together in such a manner that will allow competition and its expected benefits to develop in whatever timeframe is needed to make it successful, while ensuring that the citizens of Arizona have safe, reliable and fairly priced electric power.

CONCLUSIONS OF LAW

1. The Commission has jurisdiction over these proceedings.

2. Notice of these proceedings was given as required by law.

3. Pursuant to Article 15, ss. 3 of the Arizona Constitution, the Commission has full power to make and enforce reasonable rules, regulations, and orders for convenience, comfort, and safety and the preservation of the health of the employees and patrons of public service corporations.

4. Pursuant to A.R.S. ss. 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. Pursuant to A.R.S.ss.ss.40-321 and 40-331, the Commission has broad authority to regulate the service and facilities of public service corporations in order to protect the public.

6. The evidence presented in this proceeding demonstrates that, at this time, pursuant to Article 15, ss.3 of the Arizona Constitution and A.R.S. ss.ss. 40-361, -321, and -331, the public interest requires the suspension of the time deadline requirements of A.A.C. R14-2-1606(B), as amended by Decision Nos. 61973 and 62103, pending a Decision in these dockets on the Track B issues.

7. The evidence presented in this proceeding demonstrates that, at this time, pursuant to Article 15,ss.3 of the Arizona Constitution and A.R.S.ss.ss.40-361, -321, and -331, the public interest requires the waiver of
A.A.C. R14-2-1615(A), as amended by Decision Nos. 61973 and 62103, and further, to prohibit the transfer of generation assets.

8. The evidence presented in this proceeding demonstrates that, at this time, pursuant to Article 15,ss.3 of the Arizona Constitution and A.R.S.ss.ss.40-361 the public interest requires the suspension of A.A.C. R14-2-1611(A)'s applicability to APS and TEP's captive customers.

9. The Codes of Conduct as adopted in Decision No. 62416 (April 3, 2000) and Decision No. 62767 (August 2, 2000) must be revised in order to protect the public interest.

10. A rulemaking proceeding to review the Retail Electric Competition Rules in light of our decisions herein and to address issues resolved in Track B, and to amend A.A.C. R14-2-1615(A), A.A.C. R14-2-1606(B), and A.A.C. R14-2-1611(A) should be initiated immediately.

11. The Commission's jurisdiction over public service corporations is unaffected by whether such public service corporations participate in a for-profit or not-for profit RTO.

12. Our findings about market power are intended to be used for purposes of this proceeding only as they relate to the issue of asset divestiture. We are not making any finding regarding any FERC determination of market power, and our findings about market power are not intended to be used in any FERC proceeding or in another forum.

ORDER

IT IS THEREFORE ORDERED that Tucson Electric Power Company and Arizona Public Service Company are granted waivers of A.A.C. R14-2-1615(A), Decision Nos. 61973 and 62103 are modified as discussed herein, and both companies are hereby ordered to cancel any plans to divest interests in any generating assets.

IT IS FURTHER ORDERED that A.A.C. R14-2-1606(B) is stayed and Decision Nos. 61973 and 62103 are modified to stay the requirement that 100 percent of power purchased for Standard Offer Service shall be acquired from the competitive market, with at least 50 percent through a competitive bid process.

IT IS FURTHER ORDERED that A.A.C. R14-2-1611(A)'s applicability to APS and TEP's captive customers is stayed.

IT IS FURTHER ORDERED that upon implementation of the outcome of Track B, APS shall acquire, at a minimum, any required power that cannot be produced from its own existing assets, through the competitive procurement process as developed in the Track B proceeding. The minimum amount of power, the timing, and the form of procurement shall be determined in the Track B proceeding.

IT IS FURTHER ORDERED that upon implementation of the outcome of Track B, TEP shall acquire, at a minimum, any required power that cannot be produced from its own existing assets, through the competitive procurement process as developed in the Track B proceeding. The minimum amount of power, the timing, and the form of procurement shall determined in the Track B proceeding.

IT IS FURTHER ORDERED that the parties are directed to continue their efforts in Track B of this proceeding to develop a competitive solicitation process that can begin by March 1, 2003. For the purposes of the competitive solicitation process, the PWEC generating assets that APS may seek to acquire from PWEC, shall not be counted as APS assets in determining the amount, timing and manner of the competitive solicitation.

IT IS FURTHER ORDERED that Staff shall open a rulemaking to review the Retail Electric Competition Rules in light of our decisions herein and to address issues resolved in Track B, and to amend A.A.C. R14-2-1615(A), A.A.C. R14-2-1606(B), and A.A.C. R14-2-1611(A).

IT IS FURTHER ORDERED that APS and TEP shall work with Staff to develop a plan as discussed herein to resolve reliability must-run generation concerns. Staff shall include results of such a plan in the 2004 Biennial Transmission Assessment.

IT IS FURTHER ORDERED that APS and TEP shall file annual reliability must-run generation study reports with the Commission in concert with their January 31 ten year plan, for review prior to implementing any new RMR generation strategies until the 2004 Biennial Transmission Assessment is issued.

IT IS FURTHER ORDERED that if APS wishes to pursue the issue of acquiring PWEC's generation assets, it shall file the appropriate application(s) by

September 15, 2002. The results of the proceeding on such application shall not affect the amount, timing, and manner of the competitive procurement process. This proceeding should not address the ratemaking treatment of these assets. In authorizing this proceeding, we are not predetermining the relative merits of the issues to be addressed. Once an Application is filed, the Hearing Division shall promptly issue a Procedural Order scheduling a procedural conference to discuss the scope of the proceeding.

IT IS FURTHER ORDERED that APS and TEP shall submit modifications as recommended by Staff to their Codes of Conduct as adopted in Decision No. 62416 (April 3, 2000) and Decision No. 62767 (August 2, 2000). Such proposed revisions shall be filed with the Commission and provided to any requesting party, within 60 days of the effective date of this Decision.

IT IS FURTHER ORDERED that an Electric Competition Advisory Group is hereby formed in order to facilitate communication and information sharing among Staff, stakeholders, and market participants.

IT IS FURTHER ORDERED that Staff shall prepare and file reports detailing the activities of the Advisory Group, as directed herein.

IT IS FURTHER ORDERED that APS and TEP shall comply with all of the findings and orders discussed herein.

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

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL,
Executive Secretary of the Arizona
Corporation Commission, have hereunto
set my hand and caused the official seal
of the Commission to be affixed at the
Capitol, in the City of Phoenix, this
day of _____, 2002.

BRIAN C. McNEIL
EXECUTIVE SECRETARY

DISSENT _____
LAF

SERVICE LIST FOR: GENERIC PROCEEDINGS, ARIZONA PUBLIC SERVICE COMPANY and TUCSON ELECTRIC POWER COMPANY

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Exhibit 99.2

BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM MUNDELL
Chairman
JIM IRVIN
Commissioner
MARC SPITZER

Commissioner

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR AN ORDER OR ORDERS AUTHORIZING IT TO ISSUE, INCUR, OR ASSUME EVIDENCES OF LONG-TERM INDEBTEDNESS; TO ACQUIRE A FINANCIAL INTEREST OR INTERESTS IN AN AN AFFILIATE OR AFFILIATES; TO LEND MONEY TO AN AFFILIATES OR AFFIILIATES; AND TO GUARANTEE THE OBLIGATIONS OF AN AFFILIATE OR AFFILIATES	DOCKET NO. E-01345A-02-____ APPLICATION

Pursuant to A.R.S.ss.ss.40-285; 40-301, ET SEQ.; and A.A.C. R14-2-804, Arizona Public Service Company ("APS" or "Company") hereby requests one or more orders from the Arizona Corporation Commission ("Commission"):

(a) authorizing APS to assume, issue, or incur up to $500,000,000 in aggregate principal amount of Recapitalization Debt (as discussed and defined herein) in connection with the refinancing or recapitalization of costs incurred by Pinnacle West Capital Corporation ("Pinnacle West") and Pinnacle West Energy Corporation ("PWEC") in the financing of PWEC's construction of West Phoenix CC Units 4 and 5, Redhawk Units 1 and 2, and Saguaro CT Unit 3 (collectively referred to as the "PWEC Assets");

(b) finding that such Recapitalization Debt will not be classified or treated as Continuing Debt (as discussed and defined below);

(c) authorizing APS to guarantee the obligations (including principal, interest, and associated fees, charges and expenses)(1) of PWEC and/or PWCC ("APS Guarantees") up to an aggregate principal amount of $500,000,000 (less any Recapitalization Debt) for a period not to exceed a weighted average life of 10 years;

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(1) These items are also incurred by APS in any direct issuance of debt and are not unique to guarantees.

(d) finding that such APS Guarantees will not be classified or treated as Continuing Debt;

(e) authorizing APS to obtain a financial interest in PWEC or Pinnacle West in the form of an inter-affiliate loan, APS Guarantees, or a combination of the two up to a maximum aggregate principal amount of $500,000,000; and

(f) authorizing APS to make such expenditures, sign and deliver such documents, and negotiate such terms and conditions with underwriters or selling agents, purchasers and/or lenders, including but not limited to those pertaining to terms, rates, and collateral requirements (if any), all as described herein, as may be reasonably necessary to economically effectuate the other authorizations granted by the Commission.

APS further requests that the Commission's Hearing Division issue a Procedural Order, as called for by Decision No. 65154 (September 10, 2002), establishing a procedural conference and a procedural schedule for timely consideration of this Application.

This Application is filed to address the serious and unique financial harm faced by APS, PWEC and Pinnacle West as a result of the Commission's "reversal of course" on the issue of APS generation asset divestiture. The damages to the Company and its affiliates resulting from their good faith efforts to comply with a long-standing Commission regulation mandating divestiture and their detrimental reliance on the promise of divestiture made in a Commission-encouraged, approved, and adopted Settlement Agreement ("1999 Settlement") are significant and should be promptly addressed by this Commission. The instant Application is just one step, but an important and necessary first step, in that process.(2)

INTRODUCTION

In Decision No. 65154, the Commission significantly modified those provisions of the 1999 Settlement directing the divestiture of APS generation to PWEC. PWEC was the APS generation affiliate created by Pinnacle West pursuant to and in compliance with Decision No. 61973 (October 6, 1999), which Decision had previously adopted and approved the 1999 Settlement.

(2) The Company also intends to seek reconsideration of Decision No. 65154 within the period permitted by law.

Although Decision No. 65154 provides for the possibility of "unifying" the PWEC Assets with those of APS under the corporate name of APS, the mere change of legal title to the PWEC Assets from PWEC to APS, without more, does little to resolve the total bifurcation issue. This issue was identified last April in the Company's Motion for Threshold Determination. The "unification" sought by APS in that Motion and testified to at the recent Track A hearing was the restoration of the Commission's promise to provide a common financial and regulatory regime for all of the combined generation of APS and PWEC. With Decision No. 65154, the long-anticipated regulatory regime of unregulated generation competition is no longer possible. Traditional cost-of-service regulation, or an acceptable surrogate for such unregulated competition, must now be substituted as that common regulatory regime. It is that concept of "unification" that APS believes was postponed in the Commission's deliberations on Decision No. 65154.(3) For this reason, the Company must now find a financial remedy rather than a structural remedy--one that will permit the PWEC Assets to remain at PWEC until the Commission determines the final rate treatment of the PWEC Assets.

By seeking this remedy, APS does not intend or desire to foreclose the possibility that it may seek to acquire all or part of the PWEC Assets in the future. APS may also propose that the PWEC Assets should be included in the Company's rate base or otherwise afforded cost-of-service regulatory treatment

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(3) The Sixth Ordering Paragraph in Decision No. 65154, which was added by an amendment to the Recommended Order, when combined with the Administrative Law Judge's pre-existing language in the Fourth Ordering Paragraph, would (by the Company's interpretation) appear to effectively preclude the inclusion of the PWEC Assets in APS' rate base at this time, despite other language in the Decision seeming to leave this issue open. This is because assets included in rate base cannot, as a practical matter, be "contestable" by the sort of competitive procurement process presently being discussed in Track B.

to the extent the PWEC Assets are used to serve APS customers.(4) Indeed, these would be appropriate topics in the Company's upcoming 2003 general rate case. Decision No. 65154 specifically states that there will be no pre-judgement by the Commission of the eventual rate treatment of these assets. (Decision No. 65154 at p.34, lines 3-4.)

APS also wishes to make clear that this Application does not affect nor is it intended to affect the Commission's consideration of, or the Company's position on, any of the "Track B" issues identified in Commission Docket No. E-00000A-02-0051. This too was an express part of the Commission's order in Decision No. 65154. (ID. at pp.33-34, Tenth Ordering Paragraph.)

The Company did not support generation divestiture when Commission Staff first proposed it in 1998. APS also was aware that a start-up, stand-alone generation company would lack the initial cash flow necessary to support the investment-grade financing needed to be fully competitive in the market. Thus, APS was only willing to agree to the 1999 Settlement on terms that allowed all APS-owned generation and anticipated future generation to enjoy an investment-grade rating.

For these reasons, the impact of Decision No. 65154 on PWEC is both inequitable and dramatic. Prior to Decision No. 65154, PWEC had an investment grade debt rating once divestiture was complete.(5) With no divestiture, or no prospect of a long-term purchase power agreement such as APS proposed last fall in substitution for full market dependence, PWEC is simply not sufficiently creditworthy under present market conditions absent credit support from APS. Under the best of market conditions, a start-up merchant generator with only some 2000 megawatts of localized, uncommitted, gas-fired generation would not

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(4) If the PWEC Assets or any portion thereof were to be acquired by APS in the future, APS could receive appropriate credit for any amounts loaned to PWEC and then still outstanding.

(5) In its press release describing its contingent award to PWEC of a BBB+ rating, Fitch stated: "The generating assets and associated debt will be transferred to PWEC by December 31, 2002. THE RATING IS CONTINGENT UPON THE SUCCESSFUL TRANSFER OF A MAJORITY OF APS' ELECTRIC GENERATING ASSETS TO PWEC." EMPHASIS SUPPLIED.

have the investment grade rating needed to compete with investment-grade companies. Being non-investment grade means more than just being unable to raise capital in bad markets (such as today) or doing so at significantly higher cost in good markets; it directly impacts the ongoing competitiveness of the enterprise. Thus, it should come as no surprise that APS would not have agreed to the 1999 Settlement and that PWEC would never have constructed the PWEC Assets absent the promised unification of generation under the 1999 Settlement. In fact, PWEC would never have existed.

Pinnacle West is likewise adversely affected by Decision No. 65154. As the parent company of APS and PWEC, Pinnacle West was compelled to provide interim bridge financing for construction of the PWEC Assets. Because of the impending divestiture of APS generation to PWEC, the market always regarded this bridge financing as necessarily being only a temporary situation, i.e., one that would only be in place until the divestiture promised by the 1999 Settlement had been accomplished. Then, PWEC could recapitalize that debt on its own through long-term financing. In a very real sense, it was the 1999 Settlement that Wall Street accepted as collateral for Pinnacle West's bridge financing. Indeed, it was in reliance on that 1999 Settlement that Pinnacle West has been permitted by the rating agencies to carry significantly more debt than likely would otherwise have been permitted by these same rating agencies without a downgrade.(6) But as noted above, the PWEC credit rating required for that permanent financing was itself always expressly contingent upon receipt by PWEC of the present APS generation assets pursuant to the provisions of Decision No. 61973 and A.A.C. R14-2-1615 (A) ["Rule 1615(A)"]. Project specific financing--a far more expensive option for PWEC even under good market conditions and one that would

(6) In a report dated September 10, 2002, Moody's (after noting the adverse implications of Decision No. 65154) stated: "The rating outlook [for Pinnacle West] is stable and assumes the Pinnacle bridge financing is refinanced at an operating subsidiary in the intermediate term. Failure to do so could have negative rating implications."

have made the PWEC Assets non-competitive--is simply unavailable to PWEC under today's market conditions.

Given its debt burden and with no prospect of APS generation divestiture to PWEC, Pinnacle West's ability to refinance the aforementioned bridge financing of the PWEC Assets, on even a short-term basis and without a credit downgrading, is in serious question.(7) A credit downgrading would significantly increase Pinnacle West's own cost of capital. The historical cost of even a single level credit drop (from BBB to BBB- or from Baa2 to Baa3) would be some 150 basis points or over $17,000,000 per year. The loss of investment grade rating altogether would add another 150 or more basis points to the damage caused. This amounts to approximately $350,000,000 over a ten-year period.

It is also dangerous to assume that APS could remain wholly unaffected by these events. Some rating agencies, such as S&P, already evaluate the Company's credit quality in the overall context of Pinnacle West. And the Commission-induced financial disruption of the Company's parent corporation and generation affiliate, when combined with the unilateral revision to the 1999 Settlement ordered in Decision No. 65154, would undoubtedly add a significant regulatory risk premium to the Company's cost of obtaining and retaining capital.

The Company's Application is evidence of the Company's continued desire to find a solution to the need to permanently recapitalize the financing of the PWEC Assets, as was discussed at great length by the Commissioners during the August 27th Special Open Meeting that resulted in Decision No. 65154.(8) At the same time, it satisfies the stated desire of some of the parties to maintain

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(7) Much of the Pinnacle West bridge financing will come due next summer, with the balance maturing in early 2004. Any issuance of debt, as is contemplated herein, will take several months to plan and even longer to actually implement. Thus, a ruling on the Application before the end of 2002 is needed.

(8) The Company had, in fact, previously suggested a purchase power agreement between APS and Pinnacle West covering the PWEC Assets. This would have resolved the refinancing problem described herein in a manner APS continues to believe would be more advantageous to the Company's customers over the long run. Acquisition by APS of the PWEC Assets and their future inclusion in the Company's rate base is also an option, but one not chosen by the Company at this time given the apparent rejection by the Commission of that option for the present and the Commission's admonition (in Decision No. 65154) that APS not

separation between APS' regulated assets and the PWEC Assets. Thus, as noted above, and in an effort to deal solely with the financing impact of the Commission's reversal on divestiture, the Company is proposing a financing solution that keeps the PWEC Assets at PWEC.

That solution is a loan from APS to PWEC (or potentially to Pinnacle West for the benefit of PWEC, if such is more cost-effective for APS and its affiliates), which is in turn secured by a note back to APS. Alternatively, there could be the guarantee by APS of PWEC obligations (or potentially those of Pinnacle West incurred on behalf of PWEC, if such is more cost-effective for both APS and its affiliates), which would then be secured by a reimbursement agreement in favor of APS. Or APS could use a combination of these two financial vehicles. In either or both cases, the amount of credit support would not exceed an aggregate principal amount of $500,000,000 plus interest and the type of associated fees, expenses and charges previously discussed in this Application.

Therefore, and in support of this Application, the Company respectfully states as follows:

BACKGOUND

1. APS, Pinnacle West and PWEC are corporations duly organized and existing under the laws of the State of Arizona. Their corporate headquarters are at 400 North Fifth Street, Phoenix, Arizona 85004.

2. APS is a public service corporation principally engaged in furnishing electricity in the State of Arizona. APS provides either retail or wholesale electric service to substantially all of the state of Arizona, with the major exceptions of the Tucson metropolitan area and about one-half of the Phoenix metropolitan area. The Company also generates and, through the Pinnacle West marketing and trading division, sells and delivers electricity to wholesale customers in the western United States.

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seek a ratemaking determination in this filing and that the filing not affect "the amount, timing, and manner of the competitive procurement process [in Track
B]." (ID. at 34.)

3. PWEC is principally engaged in the generation of electric power for sale to APS at wholesale and was created pursuant to Commission Decision No. 61973, which Decision also specifically found that the creation of PWEC was in the public interest.

4. Pinnacle West is the parent company of both APS and PWEC.

5. The attorneys for APS in this proceeding, and the individuals upon which all notices and pleadings should be served, are:

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THE BRIDGE DEBT

6. As of July 1, 2002, Pinnacle West had incurred approximately $635,000,000 in primarily short-dated debt ("Bridge Debt") to finance the construction of the PWEC Assets. This has raised total Pinnacle West debt as of that date to $959,000,000. The Bridge Debt is expected to further increase to $765,000,000 by the middle of 2003. Some $550,000,000 of the aforementioned Bridge Debt will mature in 2003. Another $215,000,000 of Bridge Debt will mature in early 2004. The Company's efforts to refinance this Bridge Debt must necessarily begin some months in advance of the maturity date thereof.

7. Based upon Decision No. 65154 in Track A of Docket No. E-0000A-02-0051, the Company will not be permitted to divest its generating assets to PWEC as

unconditionally authorized and required by Decision No. 61973 and Rule 1615(A). In view of the need to obtain recapitalization of the PWEC Assets through refinancing of the Bridge Debt and given the current generally favorable market conditions for the Company's issuance of long-term debt, APS proposes to provide for the recapitalization of the PWEC Assets through a direct loan or loans to PWEC or via the guarantee of PWEC obligations relating to the PWEC Assets.(9) The net proceeds of such APS loan(s) to PWEC or the net proceeds from any issuance of APS-guaranteed PWEC debt would be transferred by PWEC to Pinnacle West to repay or refinance a significant portion of the Bridge Debt.

THE CONTINUING LONG-TERM INDEBTEDNESS

8. At June 30, 2002, APS had total outstanding long-term indebtedness in an aggregate principal amount of approximately $2,206,780,000 (including current maturities of long-term indebtedness). A schedule showing the calculation of this amount is attached to this Application as Exhibit A.

9. Decision No. 55017 (May 6, 1986) (the "1986 Order") allows APS to, among other things, have outstanding at any one time (subject to a thirty-day "window" described in the 1986 Order) up to an aggregate principal amount of long-term indebtedness (including current maturities thereof) of $2,698,917,000. A copy of the 1986 Order is attached to this Application as Exhibit B.

10. The 1986 Order superseded the long-term indebtedness limitation granted to APS in Decision No. 54230 (November 8, 1984) ("the 1984 Order"). A copy of the 1984 Order is attached to this Application as Exhibit C.(10)

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(9) There is a possibility that the loans and/or guarantees might be to Pinnacle West for the reasons discussed in the Introduction section of this Application. By the reference to only PWEC in this and other paragraphs of the Application, APS does not mean to preclude that possibility but only to simplify the verbiage of the Application itself.

(10) The 1984 Order also included, among other things, authority for the Company to have, at any one time outstanding, up to $576,301,000 in aggregate par value of the Company's preferred stock and to issue, reissue, refund, refinance, or roll-over short-term debt in an amount up to 7% of the Company's total

11. As noted in the 1986 Order, "[t]he financing flexibility sought herein and as previously granted by Decision No. 54230 [the 1984 Order] has permitted APS to take advantage of rapid and sometimes unanticipated changes in the capital markets."(11) As described herein, this "financing flexibility" has served the Company's customers and shareholders extremely well for almost 18 years by allowing APS to access frequently volatile capital markets in a timely and efficient manner, thereby reducing the Company's financing costs and eventually the cost of capital reflected in customers' rates. APS has continuously complied with each of the terms and conditions of the 1986 Order and of the 1984 Order (to the extent not superceded by the 1986 Order) in all respects and is in compliance with such Orders as of the date of this Application.

12. Also based on the Company's outstanding long-term indebtedness as of June 30, 2002 and the present Continuing Debt limit, APS had the authority to incur up to $492,137,000 in additional long-term debt. The amount of this debt margin (below the Continuing Debt limit) has varied significantly over the past 18 years, but has been a critical component of the financing flexibility afforded by the 1986 Order.

13. The Company requests that the Commission maintain the current margin under the Continuing Debt limit by finding that the Recapitalization Debt (as described and defined hereinafter) should not be classified or treated as Continuing Debt as set forth in the 1984 and 1986 Orders.

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capitalization. SEE A.R.S. ss. 40-302(D). The 1986 Order did not affect these prior authorizations, and it is not intended that thE authorization requested in this Application will supersede or limit, or in any other way affect, the 1984 Order and its effectiveness as to short-term debt and preferred stock.

(11) During the period from 1985 to the present, APS has issued over $5,000,000,000 in long-term debt, taking advantage of every trough in the interest rate cycle and turning over the Company's entire debt capitalization more than twice. As a result, embedded weighted long-term debt costs (a component used to set APS rates) have dropped from 10.7% in 1985 to less than 6% today. In 1992 alone, the Company voluntarily refinanced $650,000,000 of debt, producing total interest savings of some $120,000,000 over the then remaining life of the refinanced debt. And the amount of long-term debt has actually dropped since 1985 to the present, despite the continued growth of the Company during that same period.

14. In connection with such recapitalization or refinancing of the PWEC Assets, APS may incur additional long-term indebtedness in an aggregate principal amount of up to $500,000,000.(12) This would occur through the issuance or incurring by APS of new indebtedness (such indebtedness is referred to in this Application as the "Recapitalization Debt").

15. Consistent with the 1986 Order and the 1984 Order, the Company proposes to determine the terms of any such Recapitalization Debt (or the individual components of each if more than one), the maturities thereof, the interest and/or discount rates thereon, the necessity for any form of any security therefor, the applicable financial markets (whether domestic or foreign) or lenders, the nature of the offerings (whether public or private) or borrowings, and the type or types of transaction in which debt would be sold or incurred by reference to conditions in the financial markets at the time or times of commitment. Maturity, interest rate, discount, and other related determinations would be negotiated with the intent of obtaining the most favorable terms for the Company and would bear a close relationship to those of comparable borrowings of other comparable borrowers, as applicable at or about the time of incurrence of the Company's own debt with respect to the appropriate financial market, and would further reflect negotiations between the Company and the underwriters or selling agents, ultimate purchasers or lenders of, or the receipt by the Company of competitive bids relating to, such debt. Although it is the Company's firm intent to use unsecured debt for purposes of the Recapitalization Debt, it is always possible that market conditions will dictate otherwise. Therefore, the security, if any, for any such debt by APS may consist of a mortgage lien on all or a portion of the Company's assets, third-party

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(12) This represents the Company's present estimate of the amount of credit support necessary through APS to restore PWEC and Pinnacle West to their pre-Decision No. 65154 credit status. If this proves to be inadequate in practice, APS reserves the right to submit a second financing application seeking such additional credit support in the future.

credit support or other form of security acceptable to both APS and the lender. Third-party credit support may include a letter of credit, draws on which may be reimbursable by the Company immediately or over time and, to such extent, may involve the issuance of a separate evidence or separate evidences of indebtedness. In this regard, APS notes that the 1984 Order states that any indebtedness arising to the issuer of a letter of credit which results from a draw under such letter of credit does not require separate or additional Commission approval under A.R.S. ss. 40-301, ET SEQ., if the underlying debt which the letter of credit secured was itself authorized by the Commission.(13)

16. The proceeds from the issuance of the Recapitalization Debt would be loaned by APS to PWEC in exchange for a note or notes (the "Repayment Note") reimbursing APS for the all-in cost of issuing and servicing the Recapitalization Debt over the term or terms of the Repayment Note. The Repayment Note would also require full repayment of principal and interest to APS.

17. In addition to the Recapitalization Debt, the balance of the funds needed for the permanent recapitalization of the PWEC Assets (estimated at approximately $532,000,000) is presently planned to come from one or more equity infusions from Pinnacle West. These may be in the form of contribution(s) of (i) cash or property; (ii) forgiveness of indebtedness; (iii) internal generation of funds at PWEC; or (iv) a combination of the foregoing. This will result in an appropriately conservative capital structure for PWEC.

THE GUARANTEE OPTION

18. As an alternative to the issuance or incurrence of all or a portion of the Recapitalization Debt, APS also seeks authorization to provide PWEC with a

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(13) This is because the draw down on the letter of credit would reduce the underlying debt, thus resulting in no overall increase in the amount of outstanding APS obligations.

corporate guarantee or guarantees ("APS Guarantees") of indebtedness (including principal, interest, and associated fees, charges and expenses) up to an aggregate principal amount of $500,000,000 for a period not to exceed a weighted average life of 10 years. Such APS Guarantees would be reduced dollar for dollar by the aggregate principal amount of any Recapitalization Debt such that the total of the two principal amounts could not exceed an aggregate principal amount of $500,000,000.

19. In exchange for the APS Guarantees, APS shall receive a reimbursement agreement from PWEC and/or Pinnacle West providing for repayment to APS of all amounts (if any) paid by APS pursuant to such APS Guarantees.

CONSEQUENCES IF THE INSTANT APPLICATION IS NOT GRANTED

20. Pinnacle West is presently carrying more debt than its own capitalization and income could support under the ratings criteria established by national ratings agencies such as S&P, Moody's, and Fitch. Any attempt to refinance at Pinnacle West a significant portion of the aforementioned Bridge Debt would likely result in a loss of Pinnacle West's present credit rating.

21. The loss of Pinnacle West's present credit rating would raise its overall cost of issuing new debt, including the refinancings discussed in Paragraph No. 6, by as much as 150 basis points. This would translate into higher annual interest costs of some $17,000,000. A loss of Pinnacle West's investment grade ratings altogether would more than double that amount.

22. PWEC's credit rating was expressly contingent on receiving the Company's generating assets, and without such rating, a public offering of debt at present is impossible. The alternatives of project or bank financing are more expensive under the best of market conditions and unavailable under present market conditions.

23. Without permanent financing in place and with no potential to obtain financing on commercially reasonable terms, if at all, PWEC cannot effectively compete in the competitive wholesale market under the present credit constraints in that market.

24. If PWEC could not recapitalize the PWEC Assets itself at any cost, it would be forced to sell them into the presently depressed market at a very substantial loss compared to both their cost and their going concern value under the assumption that PWEC had received the Company's generation assets as promised in Decision No. 61973.

25. Timely Commission approval of the instant Application could mitigate all or a portion of the adverse consequences described above.

APS FINANCIAL CONDITION

26. The Company's most current public financial statements for the period ending June 30, 2002 are attached to this Application as Exhibit D.

27. The Company's current credit ratings are shown in Exhibit E.

28. Attached to this Application as Exhibit F are the estimated financial impacts of the increased debt authorizations sought herein under varying assumptions as to interest rates.

29. Exhibit F also provides the relevant financial indicators for APS debt. Exhibit F shows these indicators both with and without any amounts received by APS under the Repayment Note or the reimbursement agreement.

30. Exhibit F indicates that APS can accommodate the increased debt authorizations sought by the Application without a loss of the Company's overall credit quality or debt rating. Such debt would have an immaterial effect on the Company's cost of capital.

31. APS would not be primarily liable for the payment of principal and interest under the APS Guarantees, but rating agencies would probably treat the APS Guarantees as APS debt in determining the amount of leverage and interest coverage for debt ratings purposes. Thus, the financial analysis of the APS Guarantees on the Company would be very similar to that set forth in Exhibit F.

GENERAL STATUTORY FINDINGS(14)

32. In the Company's opinion, the proposed issuance or incurrence of the Recapitalization Debt, or the issuance of the APS Guarantees, all as contemplated herein, are for lawful purposes which are within its corporate powers and are compatible with the public interest, with sound financial practices, and with the proper performance by the Company of service as a public service corporation and will not impair its ability to perform that service.

33. APS is further of the opinion that the foregoing authorizations, all as contemplated herein, are reasonably necessary or appropriate for such purposes and that such purposes, except as otherwise set forth herein, are not wholly or in part, reasonably chargeable to the Company's operative expenses or to income. To the extent that the purposes set forth herein may be considered reasonably chargeable to operative expenses or to income, the Company requests that the order or orders of the Commission in this matter authorize such charge or charges.

NOTICE, TIMING, AND EFFECTIVE DATE OF COMMISSION ORDER

34. APS requests that notice of the filing of this Application be given in conformity with A.R.S. ss. 40-302 by a single publication of such notice in a newspaper of general circulation within its electric service area. APS will either cause such notice to be given or will agree to reimburse the Commission for any costs incurred by the Commission in preparing and distributing such notice.

35. APS requests issuance of the order or orders sought by this Application by December 31, 2002.

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(14) These findings are required by A.R.S.ss.ss.40-301 and 40-302. They are standard "boilerplate" in all financing orders of the Commission.

36. APS requests that the order or orders sought by this Application become effective immediately upon the issuance thereof.

PRAYER FOR RELIEF

WHEREFORE, the Company asks that the Commission cause notice of the filing of this Application to be given as above-requested; issue the Procedural Order described in Decision No. 65154; hold such hearing or hearings at a time or times to be specified by such Procedural Order, and making such inquiry or investigation as the Commission may deem of assistance; make any findings required by law relative to purposes of the issuance and incurring of the Recapitalization Debt, and/or the issuance by the Company of the APS Guarantees, all as contemplated herein; and thereafter make one or more immediately effective orders which, together:

(i) authorize the Company to assume, issue, or incur up to $500,000,000 in aggregate principal amount of Recapitalization Debt;

(ii) authorize the Company to determine the terms associated with the Recapitalization Debt, including whether any portion of the Recapitalization Debt will be secured by all or a portion of the Company's assets;

(iii) authorize the Company to provide the APS Guarantees in accordance with the Application;

(iv) authorize the Company to determine the terms associated with the APS Guarantees, including whether any portion of the APS Guarantees will be secured by all or a portion of the Company's assets; (v) provide that the Recapitalization Debt and the APS Guarantees will not be classified or counted as Continuing Debt;

(vi) find that the issuance and incurrence of Recapitalization Debt, and the issuance of the APS Guarantees are reasonably necessary or appropriate for the purposes set forth in this Application and that such purposes are within those permitted by A.R.S. ss.40-301, ET SEQ.;

(vii) permit such purposes to the extent they may be reasonably chargeable to operative expenses or to income and allow the payment of related expenses as contemplated herein; and

(viii) authorize APS to obtain a financial interest in PWEC or Pinnacle West in the form of an inter-affiliate loan, APS Guarantees, or a combination of the two up to a maximum aggregate principal amount of $500,000,000; and

(ix) authorize APS to make such expenditures, sign and deliver such documents, and negotiate such terms and conditions with underwriters or selling agents, purchasers and/or lenders, including but not limited to those pertaining to terms, rates, and collateral requirements (if any), all as described herein, as may be reasonably necessary to economically effectuate the other authorizations granted herein; and

(x) grant the Company such additional relief as is appropriate under the circumstances.

RESPECTFULLY SUBMITTED this 16th day of September 2002.

SNELL & WILMER

By: Jeffrey B. Guldner

Matthew P. Feeney, Esq.

Jeffrey B. Guldner, Esq.

and

PINNACLE WEST CAPITAL CORPORATION
LAW DEPARTMENT

By: Thomas L. Mumaw
Thomas L. Mumaw, Esq.

Attorneys for Arizona Public Service Company

ARIZONA PUBLIC SERVICE
SCHEDULE OF LONG TERM DEBT AND CURRENT MATURITIES
AS OF JUNE 30, 2002

FIRST MORTGAGE BONDS	DATE OF ISSUE	DATE OF MATURITY	DEBT OUTSTANDING
8.000% SERIES	02/09/93	02/01/25	33,075,000
7.250% SERIES	08/10/93	08/01/23	54,150,000
5.500% SERIES PC	09/02/93	08/15/28	25,000,000
5.875% SERIES PC	09/02/93	08/15/28	141,150,000
5.875% SERIES PC	09/02/93	08/15/28	12,850,000
6.625% SERIES	03/02/94	03/01/04	80,000,000
6.75% SENIOR NOTES	11/22/96	11/15/06	83,695,000
SUB TOTAL			$ 429,920,000
P.C. BONDS			
1994 A MARICOPA	05/25/94	05/01/29	45,000,000
1994 B MARICOPA	05/25/94	05/01/29	45,000,000
1994 C MARICOPA	05/25/94	05/01/29	57,000,000
1994 D MARICOPA	05/25/94	05/01/29	35,000,000
1994 E MARICOPA	05/25/94	05/01/29	35,000,000
1994 F MARICOPA	05/25/94	05/01/29	36,980,000
1994 A FARMINGTON	05/25/94	05/01/24	49,400,000
1994 B FARMINGTON	09/14/94	09/01/24	65,750,000
1994 C FARMINGTON	09/14/94	09/01/24	31,500,000
1994 A COCONINO	10/12/94	10/01/29	32,650,000
1996 A COCONINO	12/12/96	12/01/31	6,710,000
1998 COCONINO	11/16/98	11/01/33	16,870,000
1999 COCONINO	04/07/99	04/01/34	20,000,000
SUB-TOTAL			$ 476,860,000
OTHER LONG TERM DEBT			
6.25% UNSECURED NOTE	1/13/98	1/15/05	$ 100,000,000
5.875% UNSECURED NOTE	2/24/99	2/15/04	$ 125,000,000
7.625% UNSECURED NOTE	08/07/00	8/1/005	$ 300,000,000
6.375% UNSECURED NOTE	10/05/01	10/15/11	$ 400,000,000
6.50% UNSECURED NOTE	3/1/2002	3/1/2012	$ 375,000,000
SUB-TOTAL			$ 1,300,000,000

TOTAL LONG TERM DEBT & CURRENT MATURITIES 2,206,780,000

Exhibit B

BEFORE THE ARIZONA CORPORATION COMMISSION

RENZ D. JENNINGS
CHAIRMAN
MARCIA WEEKS
COMMISSIONER
SHARON B. MEGDAL
COMMISSIONER

IN THE MATTER OF THE APPLICATION) DOCKET NO. U-1345-86-003
OF ARIZONA PUBLIC SERVICE COMPANY) FOR AN ORDER OR ORDERS AUTHORIZING IT) TO ISSUE, INCUR AND AMEND EVIDENCES OF) DECISION NO. 55017 LONG-TERM INDEBTEDNESS, TO ISSUE OR) INCUR NUCLEAR FUEL DEBT, AND TO) EXECUTE A NEW SUPPLEMENTAL INDENTURE OR)

INDENTURES.)

ORDER

Open Meeting
April 30, 1986
Phoenix, Arizona

BY THE COMMISSION:

On December 31, 1985, Arizona Public Service Company ("APS") filed an Application with the Arizona Corporation Commission ("Commission") wherein APS sought authorization to, among other things, implement various financings.

On February 25, 1986, the Residential Utility Consumer Office ("RUCO") filed an Application to Intervene herein. Said Application was granted by Procedural Order dated March 4, 1986.

On April 17, 1986, the Commission's Utilities Division Staff ("Staff") filed a Memorandum recommending approval without hearing of the proposed financing program. Attached thereto was written testimony by a Staff Senior Rate Analyst, which testimony supported Staff's overall recommendation.

* * * * * *

Having considered the Application, the exhibits and draft testimony submitted therewith, as well as Staff's memorandum and attached testimony, and being fully advised in the premises, the Commission finds, concludes and orders that:

FINDINGS OF FACT

1. APS is an Arizona corporation engaged in providing electric service to the public within portions of Arizona pursuant to authority granted by this Commission.

2. By its Application, as supplemented by APS's draft testimony in this matter, APS requests one or more orders seeking the following:

(a) authorization to issue, sell, and incur in 1986 or pursuant to lending, purchase, or underwriting commitments obtained in 1986. in one or more transactions, up to $275,000,000 in aggregate principal amount of additional evidences of long-term indebtedness (all such evidences of indebtedness hereinafter being referred to as "New Debt"), it being specified that the nature and terms of all such issuances and sales of New Debt would be determined by APS by reference to conditions in the financial markets at the time or times of commitment;

(b) authorization to increase the long-term indebtedness limitation authorized in the Commission's Order in Decision No. 54230, dated November 8, 1984, that allowed APS, among other things, to have, at any one time outstanding in 1985 or thereafter, long-term indebtedness (including current maturities thereof) in an aggregate principal amount of $2,374,093,000, so as to allow APS to have, at any one time outstanding, up to an aggregate principal amount of long-term indebtedness (including current maturities thereof) of $2,698,917,000, such authorization to permit any redemptions, refinancings,

refundings, renewals, reissuances and roll-overs of any such outstanding indebtedness, the incurrence or issuance of any additional long-term indebtedness, and the amendment or revision of any terms of provisions of or relating to any long-term indebtedness, as long as total long-term indebtedness at any one time outstanding does not exceed (without further Commission authorization) $2,698,917,000 during any period of more than thirty days, it being specified that the nature and terms of all such issuances and sales of such long-term indebtedness would be determined by APS by reference to conditions in the financial markets at the time or times of such issuances (all such long-term indebtedness to be issued pursuant to this authorization being herein referred to as "Continuing Debt"), and such authorization to supercede the long-term indebtedness limitation authorized by Decision No. 54230.

(c) authorization in connection with providing security for any New Debt or Continuing Debt, to execute and deliver one or more new supplemental indentures to its Mortgage and Deed of Trust in the event it is deemed appropriate by APS to do so;

(d) authorization for APS to finance its nuclear fuel requirements in connection with the operation of the Palo Verde Nuclear Generating Station by instituting a financing program involving the issuance of APS of commercial paper, intermediate-term notes,

and/or other evidences of indebtedness in an aggregate principal amount of up to $200,000,000, all of which may constitute long-term debt (collectively, the "Nuclear Fuel Debt"). and in connection therewith, to issue or incur evidences of indebtedness in 1986 or thereafter, and to refund or roll-over all or a portion of the Nuclear Fuel Debt, any short-term debt to be issued in connection therewith to be in addition to short-term debt previously authorized by the Commission or permitted by
A.R.S. Section 40-302.D, it being specified that the nature and terms of any issuances and sales of Nuclear Fuel Debt would be determined by APS by reference to conditions in the financial. markets at the time or times of commitment.

3. On April 17, 1986, Staff filed a Memorandum and written testimony supporting the Application and recommending summary approval thereof.

4. The New Debt and the Continuing Debt will be utilized for APS's construction program, the refinancing, retirement, or redemption of outstanding securities, the repayment of short-term debt which previously financed construction projects, and, if necessary, the payment of certain of APS's working captial and other cash requirements. The Nuclear Fuel Debt will be used to finance APS's nuclear fuel requirements for the Palo Verde Nuclear Generating Station, and/or to refund or roll-over the Nuclear Fuel Debt.

5. The costs of nuclear fuel will be charged to operating expense or income as such fuel is consumed.

6. The Nuclear Fuel Debt would not exceed $200,000,000 through a combination of intermediate-term domestically issued debt (not to exceed $50,000,000), a European commercial paper program, and a short-term European

loan facility. The Nuclear Fuel Debt may exceed APS's net nuclear fuel assets (up to the $200,000,000 limit).

7. The exact timing of any issuances to be made pursuant to the requested authorization would be dictated by then prevailing market conditions as would the terms and conditions of such issuances, including the type of security (mortgage, deed of trust, letter of credit, standby purchase agreement, etc.), if any, provided therefor.

8. The reasonableness of such timing as well as of terms and conditions of sale would be governed by the exercise in good faith of prudent business judgement.

9. APS does not anticipate that it will actually have to issue all of the debt for which authorization is being sought.

10. The financing flexibility sought herein and as previously granted by Decision No. 54230 has permitted APS to take advantage of rapid and sometimes unanticipated changes in the capital markets.

11. Upon the issuance of all the debt for which authorization is sought herein, APS would have adequate operating income to service such debt under existing rates for electric service.

12. After issuance of all the debt for which authorization is sought herein, APS's financial ratios as to interest coverage, long-term debt, cash flow, and common equity would be below those of comparable investment grade investor-owned utilities, thus creating some risk of down-rating to sub-investment grade.

13. Although such a down-rating would be significantly harmful to both APS and its ratepayers, the risk of its occurrence is small and can be further reduced by either APS receiving rate relief in its pending rate application or by a reduction in discretionary expenditures or by a combination of both.

14. There is no reason to believe that any other form of long-term

financing would on a risk adjusted basis prove to be less expensive to APS and its ratepayers.

15. With the possible exception of the Nuclear Fuel Debt and the payment of certain of APS's working captial and other cash requirements, none of the purposes for which debt is to be issued pursuant to the authorization sought herein is reasonably chargeable to operating expense or income.

16. The proposed financing and the authorizations in connection therewith are reasonably necessary for the purposes set forth herein and in the Application.

17. The proposed financing program is compatible with sound financial practices and with APS's obligations as a public service corporation and will not impair its ability to provide service to the public.

18. The proposed financing program has been approved by APS's board of directors.

CONCLUSIONS OF LAW

1. APS is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. ss40-301, et seq.

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

3. The proposed financing plan, as described herein and in APS's Application, is for lawful purposes within the corporate powers of APS and is compatible with the public interest.

ORDER

IT IS THEREFORE ORDERED that Arizona Public Service Company be, and the same is hereby authorized:"

(a) to issue, sell, and incur up to $275,000,000 in aggregate principal amount of New Debt, to issue, sell, and incur the Continuing Debt, and to amend the terms and provisions of

outstanding long-term indebtedness:

(b) to execute and deliver one or more supplemental indentures to the Arizona Public Service Company's Mortgage and Deed of Trust as may be deemed appropriate by Arizona Public Service Company in connection with the New Debt and Continuing Debt:

(c) to issue, sell, and incur up to $200,000,000 in aggregate principal amount of Nuclear Fuel Debt: and,

(d) to pay related expenses, all as contemplated in the Application and by the exhibits and testimony filed in connection therewith.

IT IS FURTHER ORDERED that Arizona Public Service Company is hereby authorized to sign and deliver such documents and to engage in such acts as are reasonably necessary to effectuate the authorization granted hereinabove.

IT IS FURTHER ORDERED that the purposes for which the proposed issuances of New Debt and Continuing Debt are herein authorized are to augment the funds available from all sources to finance Arizona Public Service Company's construction program, to redeem or retire outstanding securities, to repay or refund other outstanding long-term debt, to repay short-term debt which has previously financed construction projects, and, if necessary, to meet cetain working capital and other cash requirements, regardless of the extent to which such purposes may be reasonably chargeable to operative expenses or to income.

IT IS FURTHER ORDERED that the purposes for which the proposed issuances of Nuclear Fuel Debt are herein authorized are to finance the Arizona Public Service Company's nuclear fuel requirements in connection with the operation of the Palo Verde Nuclear Generating Station, and/or to refund or roll-over the Nuclear Fuel Debt, which purposes are hereby specifically authorized regardless of the extent to which they may be reasonably chargeable to operative expenses or to income.

IT IS FURTHER ORDERED that the Commission's authorization of the above financing does not constitute approval of any particular expenditure of the proceeds derived thereby for the purposes of setting just and reasonable rates.

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

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

/s/ Renz D. Jennings */s/ Sharon B. Megdal*

CHAIRMAN *COMMISSIONER* *COMMISSIONER*

IN WITNESS WHEREOF, I, JAMES MATTHEWS, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this 6 day of May, 1986.

/s/ James Matthews

JAMES MATTHEWS
Executive Secretary

DISSENT */s/ Marcia Weeks*
TLM/djp

Exhibit C

BEFORE THE ARIZONA CORPORATION COMMISSION

RICHARD KIMBALL
CHAIRMAN
JUNIUS HOFFMAN
COMMISSIONER
MARIANNE M. JENNINGS
COMMISSIONER

IN THE MATTER OF THE APPLICATION of) DOCKET NO. U-1345-84-220
ARIZONA PUBLIC SERVICE COMPANY FOR AN)

ORDER AUTHORIZING IT TO ISSUE, INCUR)
AND AMEND EVIDENCES OF LONG-TERM) DECISION NO. 54230
INDEBTEDNESS, TO EXECUTE A NEW)

SUPPLEMENTAL INDENTURE OR INDENTURES,) TO ISSUE SHARES OF COMMON AND PREFERRED) STOCK AND TO ISSUE AND INCUR EVIDENCES)

OF SHORT-TERM INDEBTEDNESS.) OPINION AND ORDER

DATE OF HEARING: October 4, 1984

PLACE OF HEARING: Phoenix, Arizona

PRESIDING OFFICER: Thomas L. Mumaw

IN ATTENDANCE: Marianne M. Jennings, Commissioner

APPEARANCES: Jaron B. Norberg, Senior Vice-President and Corporate Counsel; Snell & Wilmer, by Steven M. Wheeler and James A. Martin, on behalf of Arizona Public Service Company

Timothy M. Hogan, Attorney, Legal Division, on behalf of the Arizona Corporation Commission Staff

Roger A. Schwartz, Attorney, on behalf of the Residential Utility Consumer Office

Tim Gerin, Intervenor, in propria persona

BY THE COMMISSION:

On September 12, 1984, Arizona Public Service Company ("Company") filed an Application ("Application") with the Commission requesting an order authorizing the Company, among other things, to implement various proposed financings during 1984 and subsequent years.

Notions requesting Leave to Intervene herein were filed by Robert Foucher and Tim Gerin, as well as by the Residential Utility Consumer Office. Said Motions were granted by the Presiding Officer herein prior to the scheduled hearing on the Application held at the Commission's offices in Phoenix,

Arizona, on October 4, 1984.

* * * * * * * * * *

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

FINDINGS OF FACT

1. The Company is an Arizona corporation engaged in providing electric and gas service to the public within various portions of Arizona pursuant to authority granted by this Commission.

2. By its Application, the Company requests one or more orders approving various financings and certain other matters as follows:

(a) authorization to issue and sell (or, in the case of the below mentioned indebtedness, to otherwise incur), in 1985 or pursuant to firm lending, purchase or underwriting commitments obtained in 1985, in one or more transactions, (i) up to $400,000,000 in aggregate principal amount of additional evidences of long-term indebtedness, (ii) up to $75,000,000 in par value of one or more new series of additional Serial Preferred Stock and (iii) up to 2,000,000 new shares of its Common Stock, $2.50 par value, (all such evidences of indebtedness, shares of Preferred Stock and shares of Common Stock hereinafter being referred to as "New Debt," "New Preferred Stock" and "New Common Stock," respectively), it being specified that the nature and terms of all such issuances and sales of New Debt, New Preferred Stock and New Common Stock would be determined by the Company by reference to conditions in the financial markets at the time or times of commitment;

(b) authorization to issue or incur, in 1984 or thereafter,

evidences of indebtedness, long or short-term, in the aggregate principal amount of up to $75,000,000 (over and above amounts previously authorized by this Commission), and to refinance all or a portion of such amount, in connection with the proposed program to finance and/or refinance pollution control facilities located at the Palo Verde Nuclear Generation Station ("Palo Verde"), it being specified that the nature and terms of all such issuances of such indebtedness would be determined by the Company by reference to conditions in the financial markets at the time or times of commitments (all such evidences of indebtedness to be issued pursuant to this authorization being herein referred to as the "Pollution Control Financings");

(c) authorization to have, at any one time outstanding in 1985 or thereafter, (i) long-term indebtedness including current maturities thereof in an aggregate principal amount of $2,374,093,000 (including the New Debt and long-term Pollution Control Financings), and (ii) $576,301,000 in aggregate par value of the Company's preferred stock (including the New Preferred Stock), such authorization to permit any redemptions, refinancings, refundings, renewals, reissuances and rollovers of any such outstanding indebtedness or preferred stock, the incurrence or issuance of any additional long-term indebtedness or preferred stock, and the amendment or revision of any terms or provisions of or relating to any long-term indebtedness, as long as total long-term indebtedness or preferred stock at any one time outstanding does not exceed the levels set forth in this

subparagraph (c), it being specified that the nature and terms of all such issuances and sales of such long-term indebtedness or preferred stock would be determined by the Company by reference to conditions in the financial markets at the time or times of such issuances (all such long-term indebtedness and preferred stock to be issued pursuant to this authorization being herein referred to as "Continuing Debt" and "Continuing Preferred Stock," respectively);

(d) authorization in connection with providing security for any New Debt, Continuing Debt, or Pollution Control Financings, to execute and deliver one or more new supplemental indentures to its Mortgage and Deed of Trust, and to enter into and issue evidences of indebtedness pursuant to one or more letter of credit or other security arrangements or agreements, in the event it is deemed appropriate by the Company to do so, including, without limitation and specifically with respect to any Pollution Control Financings, any reimbursement agreements and standby bond purchase agreements;

(e) authorization to issue, incur and sell, and to have outstanding at any one time in 1984 or thereafter, notes and indebtedness payable at periods of not more than twelve months after the date incurred or issued (and not separately authorized by any Order of this Commission) ("Short-Term Debt") in an amount up to seven (7) percent of the Company's total capitalization, and to reissue, renew and resell any such Short-Term Debt and to refund, refinance or rollover any such Short-Term Debt with or into additional Short-Term Debt

so long as such seven (7) percent limit is not exceeded, it being specified that the nature and terms of all such issuances and incurrences of such Short-Term Debt would be determined by the Company by reference to conditions in the financial markets at the time or times of such issuances or incurrences (any such Short-Term Debt to be issued pursuant to this authorization being herein referred to as "Authorized Short-Term Debt");

(f) authorization to borrow funds pursuant to a credit agreement dated as of May 15, 19$4 ("Credit Agreement") among the Company and various banks, for the term of that Credit Agreement and any extensions or renewals thereof, such borrowings, to the extent they are long-term, to be authorized and allowed in addition to and over and above the Continuing Debt limitation, and, to the extent repayable at periods of not more than twelve months after the date of borrowing, to be authorized and allowed in addition to and over and above (i) any indebtedness which may be incurred by the Company pursuant to Arizona Revised Statutes Section 40-302(D), and (ii) any Authorized Short-Term Debt;

(g) confirmation that (i) letters of credit securing any indebtedness or security of the Company constitute evidences of indebtedness only to the extent of draws thereon, (ii) the indebtedness which arises from a draw under any such letter of credit is authorized to the extent thereof, and does not require separate or additional approval or authorization, if the issuance of the indebtedness or security which the letter of credit secures was authorized by the Commission, and (iii)

the indebtedness which arises from a draw under any such letter of credit does not require authorization as any other type of indebtedness or security other than that indebtedness or security which the letter of credit secures and does not reduce or apply against any authorization for any other type of indebtedness or security.

3. The Company intends to use the net proceeds from the sale of New Debt, New Preferred Stock and New Common Stock, and the issuance of Continuing Debt and Continuing Preferred Stock for its construction program, the redemption or retirement of outstanding securities, the repayment or refunding of other outstanding long-term debt, and the repayment of short-term debt which previously financed construction projects.

4. In the event any portion of the New Debt or Continuing Debt takes the form of indebtedness owed to, or the guarantee of indebtedness owed by, the Company's wholly-owned finance subsidiary, a portion of the New Debt or Continuing Debt may be incurred for the purpose of contributing to the capital of such subsidiary to maintain its debt to equity ratio at a satisfactory level.

5. Any amendments to the terms and provisions of any long-term indebtedness shall be for the purpose of improving terms or cost thereof to the Company or obtaining other benefits or advantages for the Company.

6. The proceeds of any issuance, sale, or subsequent refunding of Pollution Control Financings will be used to pay construction costs of pollution control facilities at Palo Verde, to reimburse the Company for such construction costs previously incurred, and/or to refund any pollution control financing or financings then in effect.

7. The Company intends to use the proceeds from the issuance or incurrence of the Authorized Short-Term Debt to augment funds available to the

Company to finance the Company's construction program, to maintain and provide an adequate level of working capital, to contribute capital to the Company's finance subsidiary as necessary to maintain its debt to equity ratio at a satisfactory level, and to refund, refinance, rollover, renew or reissue any notes or indebtedness payable at periods of not more than twelve months after the date issued or incurred and otherwise issued or incurred for proper purposes.

8. The Company intends to use funds available under the Credit Agreement as a standby line of credit in the event of any disruptions in the capital markets, and, as such, these funds say be used to augment funds available to the Company to meet its capital requirements as specified in Findings of Fact Nos. 3, 4, 6, and 7, hereinabove.

9. The letters of credit referred to in the Application and any evidences of indebtedness arising thereunder are or will be for the purpose of securing other evidences of indebtedness or securities otherwise authorized and approved by this Commission.

10. The Company's proposed issuances of New Debt, New Preferred Stock and New Common Stock, and the issuance of Continuing Debt and Continuing Preferred Stock, are reasonably necessary and appropriate for the purposes of augmenting the funds available from all sources to finance the Company's construction program, redeeming or retiring outstanding securities, repaying or refunding other outstanding long-term debt, and repaying short-term debt which previously financed construction projects.

11. In connection with any New Debt or Continuing Debt, the execution of one or more new supplemental indentures to the Company's Mortgage and Deed of Trust, and the issuance or incurrence of any indebtedness in up to a matching amount as the result of any use of a related letter of credit security device or other similar arrangements, are also reasonably necessary for such purposes.

12. Additionally, capital contributions to the Company's wholly-owned finance subsidiary which are to be a part of the New Debt or Continuing Debt are reasonably necessary and appropriate in order to maintain its debt to equity ratio at satisfactory levels.

13. The proposed pollution control financing or financing: and the Company's issuance or; incurrence of indebtedness in connection with such pollution control financing or financings are reasonably necessary and appropriate to pay construction costs associated with pollution control facilities at or related to Palo Verde, to reimburse the Company for such construction costs previously incurred, and/or to refund any pollution control financing or financings then in effect.

14. The execution of one or more new supplemental indentures to the Company's Mortgage and Deed of Trust, and the issuance or incurrence of any indebtedness in up to a matching amount as the result of any use of a related letter of credit security device, standby bond purchase agreement or other security arrangements, are also reasonably necessary for such purposes.

15. The Company's proposed issuance, or incurrence of Authorized Short-Term Debt is reasonably necessary and appropriate for the purposes of augmenting funds available to the Company to finance the Company's construction program, maintaining and providing an adequate level of working capital, and refunding, refinancing, rolling over, renewing or reissuing any notes or indebtedness payable at periods of not more than twelve months after the date issued or incurred and otherwise issued or incurred for proper purposes.

16. Additionally, capital contributions to the Company's wholly-owned finance subsidiary with the proceeds of the Authorized Short-Term Debt are reasonably necessary and appropriate in order to maintain its debt to equity ratio at satisfactory levels.

17. Certain working capital uses of the proceeds of Authorized

Short-Term Debt of any debt refunded by Authorized Short-Term Debt say be chargeable to operative expenses or to income.

18. The Company's proposed issuance of evidences of indebtedness in the form of borrowings under the Credit Agreement is reasonably necessary and appropriate for the purpose of augmenting funds available to the Company to meet its capital requirements as specified in paragraphs 3 and 5 above.

19. Certain working capital uses of the proceeds of such borrowings may be chargeable to operative expenses or to income.

20. The Company's proposed issuance of any evidences of indebtedness arising under letters of credit is reasonably necessary and appropriate for the purpose of securing other evidences of indebtedness or securities otherwise authorized and approved by this Commission.

21. The Company's proposed issuances of New Debt, New Preferred Stock and New Common Stock, the issuance of Continuing Debt and Continuing Preferred) Stock, the proposed pollution control financing or financings, the issuance or incurrence of Authorized Short-Term Debt, and the issuance of any evidences of indebtedness pursuant to the Credit Agreement or any letter of credit securing debt of the Company, all as contemplated in the Application, testimony and exhibits relating to this matter, are compatible with the public interest, with sound financial practices, and with the proper performance by the Company of service as a public service corporation and will not impair its ability to perform that service.

22. The Company's propsed issuances of New Debt, New Preferred Stock and New Common Stock, the issuance of Continuing Debt and Continuing Preferred Stock, the proposed pollution control financing or financings, the issuance or incurrence of Authorized Short-Term Debt, and the issuance of any evidences of indebtedness pursuant to the Credit Agreement or any letter of credit securing debt of the Company, all as contemplated in the Application, testimony and

exhibits relating to this matter, are reasonably necessary or appropriate for lawful purposes (as set forth above) and such purposes, other than those' relating to the issuance, or incurrence of Authorized Short-Term Debt and the issuance of any evidences of indebtedness pursuant to the Credit Agreement are not, wholly or in part, reasonably chargeable to operative expenses or to income, except as set forth at Findings of Fact Nos. 17 and 19, hereinabove.

CONCLUSIONS OF LAW

1. The Company is a public service corporation within the meaning of Article XV, of the Arizona Constitution and A.R.S. Sections 40-301 and 40-302.

2. The Commission has jurisdiction over the Company and of the subject matter of the Application.

3. The Company's proposed issuance of New Debt, New Preferred Stock and New Common Stock, the issuance of Continuing Debt and Continuing Preferred Stock, the proposed pollution control financing or financings, the issuance or incurrence of Authorized Short-Term Debt, and the issuance of any evidences of indebtedness pursuant to the Credit Agreement or any letter of credit securing debt of the Company, are for lawful purposes which are within the Company's corporate powers.

4. The Company's proposed pollution control financing or financings, the issuance or incurrence of indebtedness in connection therewith, and the issuance or incurrence of any indebtedness in a matching amount as the result of any use of a related letter of credit security device, standby bond purchase agreement or other security arrangements, are for lawful purposes which are within the Company's corporate powers.

5. The Company's financing requests, as well as the other matters set forth in the Application, exhibits and testimony herein are in the public interest and should be approved.

...

ORDER

IT IS THEREFORE ORDERED that the Company is hereby authorized (i) to issue, sell, and incur up to $400,000,000 in aggregate principal amount of New Debt, to issue, sell and incur the Continuing Debt, and to amend the terms and provisions of outstanding long-term indebtedness, (ii) to issue and sell up to $75,000,000 in par value of one or more series of New Preferred Stock and, to issue and sell the Continuing Preferred Stock, (iii) to issue and sell up to 2,000,000 shares of New Common Stock (iv) to carry out and effect the proposed Pollution Control Financings and to issue or incur evidences of indebtedness in an amount up to $75,000,000 in connection therewith, (v) to issue, sell and incur the Authorized Short-Term Debt, (vi) to make borrowings and issue evidences of indebtedness in connection with the Credit Agreement, (vii) to execute and deliver one or more new supplemental indentures or enter into such letter of credit or other security arrangements or agreements as may be deemed appropriate by the Company in connection with the New Debt, Continuing Debt and Pollution Control Financings, and (viii) to pay all related expenses, all as contemplated in the Application and by the exhibits and testimony presented during the hearing in the above-captioned matter.

IT IS FURTHER ORDERED that the operation and effect of any letter of credit securing any indebtedness or security of the Company, as set forth in the Application, is hereby confirmed.

IT IS FURTHER ORDERED that the purposes for which the proposed issuances of New Debt, New Preferred Stock, New Common Stock, and the issuance of Continuing Debt and Continuing Preferred Stock are herein authorized to augment the funds available from all sources to finance the Company's construction program, to redeem or retire outstanding securities, to repay or refund other outstanding long-term debt, to repay short-term debt which previously financed construction projects and to make capital contributions to

the Company's finance subsidiary as necessary to maintain its debt to equity ratio at a satisfactory level. The proposed issuances in connection with the New Debt or Continuing Debt of any evidences of indebtedness arising under letters of credit are for the above purposes and for the purpose of securing the New Debt and Continuing Debt.

IT IS FURTHER ORDERED that the purposes for which the Pollution Control Financings and the issuance or incurrence of indebtedness in connection therewith, are herein authorized are to pay construction costs associated with pollution control facilities at or related to Palo Verde, to reimburse the Company for such construction costs previously incurred, and/or to refund pollution control financing or financings then in effect. The proposed issuances or incurrences in connection with Pollution Control Financings of any' indebtedness as the result of any use of a letter of credit security device, standby bond purchase agreement or other security arrangements are for the, above purposes and for the purpose of securing the Pollution Control' Financings.

IT IS FURTHER ORDERED that the purposes for which the issuance of the Authorized Short-Term Debt are herein authorized are to augment funds available to the Company to finance the Company's construction program, to maintain and' provide an adequate level of working capital, to make capital contributions to! the Company's finance subsidiary as necessary to maintain its debt to equity ratio at a satisfactory level, and to refund, refinance, rollover, renew or reissue any notes or indebtedness payable at periods of not more than twelve months after the date issued or incurred and otherwise incurred for proper purposes regardless of the extent to which they may be reasonably chargeable to operative expenses or to income.

IT IS FURTHER ORDERED that the purposes for which the proposed issuances of evidences of indebtedness pursuant to the Credit Agreement are herein

authorized are to augment funds available from all sources to finance the Company's construction program, to redeem or retire outstanding securities, to repay or refund other outstanding long-term debt, to repay short-term debt which previously financed construction projects, to maintain and provide an adequate level of working capital, to make capital contributions to the Company's finance subsidiary as necessary to maintain its debt to equity ratio at a satisfactory level, and to refund, refinance, rollover, renew or reissue any notes or indebtedness payable at periods of not more than twelve months after the date issued or incurred and otherwise incurred for proper purposes regardless of the extent to which they may be reasonably chargeable to operative expenses or to income.

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

BY ORDER OF THE ARIZONA CORPORATION COMMISSION

	/s/ JUNIUS HOFFMAN	*/s/ MARIANNE M. JENNINGS*
CHAIRMAN	*COMMISSIONER*	*COMMISSIONER*

IN WITNESS WHEREOF, I, LORRIE DROBNY,

Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this 8th day of November, 1984.

/s/ Lorrie Drobny

LORRIE DROBNY
Executive Secretary

DISSENT /s/ RICHARD KIMBALL

jg

Exhibit D

ARIZONA PUBLIC SERVICE COMPANY
CONDENSED STATEMENTS OF INCOME
(Unaudited)

Six Months Ended June 30, 2002

(Dollars in Thousands)

ELECTRIC OPERATING REVENUES:

Retail segment	$ 891,452
Marketing and trading segment	13,062
Total	904,514
PURCHASED POWER AND FUEL COSTS:	
Retail segment	184,643
Marketing and trading segment	12,367
Total	197,010
OPERATING REVENUES LESS PURCHASED POWER AND FUEL COSTS	707,504
OTHER OPERATING EXPENSES:	
Operations and maintenance excluding purchased power and fuel cost	232,266
Depreciation and amortization	196,812
Income taxes	65,274
Other taxes	54,376
Total	548,728
OPERATING INCOME	158,776
OTHER INCOME (DEDUCTIONS):	
Income taxes	2,370
Other income	3,859
Other expense	(9,219)
Total	(2,990)
INCOME BEFORE INTEREST DEDUCTIONS	155,786
INTEREST DEDUCTIONS:	
Interest on long-term debt	64,038
Interest on short-term borrowings	2,299
Debt discount, premium and expense	1,340
Capitalized interest	(8,093)
Total	59,584
INCOME BEFORE ACCOUNTING CHANGE	96,202
Cumulative Effect of a Change in Accounting for Derivatives - net of income tax benefit of $1,793	--
NET INCOME	$ 96,202

ARIZONA PUBLIC SERVICE COMPANY
CONDENSED STATEMENTS OF INCOME
(Unaudited)

Twelve Months Ended June 30, 2002

(Dollars in Thousands)

ELECTRIC OPERATING REVENUES:

Retail segment	$ 2,301,416
Marketing and trading segment	87,479
Total	2,388,895
PURCHASED POWER AND FUEL COSTS:	
Retail segment	837,661
Marketing and trading segment	46,937
Total	884,598
OPERATING REVENUES LESS PURCHASED POWER AND FUEL COSTS	1,504,297
OTHER OPERATING EXPENSES:	
Operations and maintenance excluding purchased power and fuel cost	462,234
Depreciation and amortization	409,366
Income taxes	162,506
Other taxes	104,709
Total	1,138,815
OPERATING INCOME	365,482
OTHER INCOME (DEDUCTIONS):	
Income taxes	4,659
Other income	9,860
Other expense	(19,368)
Total	(4,849)
INCOME BEFORE INTEREST DEDUCTIONS	360,633
INTEREST DEDUCTIONS:	
Interest on long-term debt	126,336
Interest on short-term borrowings	4,230
Debt discount, premium and expense	2,655
Capitalized interest	(15,233)
Total	117,988
INCOME BEFORE ACCOUNTING CHANGE	242,645
Cumulative Effect of Change in Accounting for Derivatives - net of income tax benefit of $8,099 and $1,793	(12,446)
NET INCOME	$ 230,199

ARIZONA PUBLIC SERVICE COMPANY
CONDENSED BALANCE SHEETS

ASSETS
(Dollars in Thousands)

June 30, 2002
(Unaudited)

UTILITY PLANT:	
Electric plant in service and held for future use	$ 8,134,802
Less accumulated depreciation and amortization	3,383,422
Total	4,751,380
Construction work in progress	308,425
Intangible assets, net of accumulated amortization	90,446
Nuclear fuel, net of accumulated amortization	51,661
Utility plant - net	5,201,912
INVESTMENTS AND OTHER ASSETS:	
Decommissioning trust accounts	208,641
Assets from risk management and trading activities - long-term	30,620
Other assets	37,514
Total investments and other assets	276,775
CURRENT ASSETS:	
Cash and cash equivalents	7,776
Accounts receivable:	
Service customers	159,564
Other	208,251
Allowance for doubtful accounts	(1,450)
Accrued utility revenues	110,689
Materials and supplies, at average cost	82,300
Fossil fuel, at average cost	31,105
Assets from risk management and trading activities	9,907
Other	43,047
Total current assets	651,189
DEFERRED DEBITS:	
Regulatory assets	291,473
Unamortized debt issue costs	15,319
Other	52,862
Total deferred debits	359,654
TOTAL ASSETS	$ 6,489,530

ARIZONA PUBLIC SERVICE COMPANY
CONDENSED BALANCE SHEETS

CAPITALIZATION AND LIABILITIES
(Dollars in Thousands)

	June 30, 2002
	(Unaudited)
CAPITALIZATION:	
Common stock	$ 178,162
Additional paid-in capital	1,246,804
Retained earnings	801,491
Accumulated other comprehensive loss	(36,092)
Common stock equity	2,190,365
Long-term debt less current maturities	2,199,837
Total capitalization	4,390,202
CURRENT LIABILITIES:	
Commercial paper	198,000
Current maturities of long-term debt	451
Accounts payable	82,022
Accrued taxes	157,385
Accrued interest	41,504
Customer deposits	33,317
Deferred income taxes	3,244
Liabilities from risk management and trading activities	21,811
Other	73,991
Total current liabilities	611,725
DEFERRED CREDITS AND OTHER:	
Deferred income taxes	1,011,032
Liabilities from risk management and trading activities - long-term	46,996
Unamortized gain - sale of utility plant	61,772
Customer advances for construction	67,598
Other	300,205
Total deferred credits and other	1,487,603
COMMITMENTS AND CONTINGENCIES (Note 12)	
TOTAL LIABILITIES AND EQUITY	$6,489,530

ARIZONA PUBLIC SERVICE COMPANY
CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30, 2002
	(Dollars in Thousands)
Cash Flows from Operating Activities:	
INCOME BEFORE ACCOUNTING CHANGE	$ 96,202
Items not requiring cash:	
Depreciation and amortization	196,812
Nuclear fuel amortization	15,214
Deferred income taxes - net	(30,722)
Mark-to-market gains - trading	--
Mark-to-market (gains) losses - system	(6,697)
Changes in certain current assets and liabilities:	
ACCOUNTS RECEIVABLE - NET	(31,642)
Accrued utility revenues	(34,558)
Materials, supplies and fossil fuel	(5,167)
Other current assets	(1,038)
Accounts payable	(13,522)
Accrued taxes	49,790
Accrued interest	461
Other current liabilities	(39,126)
Increase in regulatory assets	(5,992)
Changes in risk management trading investments - at cost	(24,030)
Other net long term assets	(15,768)
Other net long term liabilities	(964)
Net cash flow provided by operating activities	149,253
Cash Flows from Investing Activities:	
Trust fund for bond redemption	--
Capital expenditures	(253,829)
Capitalized interest	(8,093)
Other	38,808
Net cash flow used for investing activities	(223,114)
Cash Flows from Financing Activities:	
Issuance of long-term debt	369,930
Short-term borrowings - net	26,838
Dividends paid on common stock	(85,000)
Repayment and reacquisition of long-term debt	(246,952)
Net cash flow provided by (used for) financing activities	64,816
Net increase (decrease) in cash and cash equivalents	(9,045)
Cash and cash equivalents at beginning of period	16,821
Cash and cash equivalents at end of period	$ 7,776
Supplemental Disclosure of Cash Flow Information:	
Cash paid during the period for:	
Interest (excluding capitalized interest)	$ 57,726
Income taxes	$ 48,943

Exhibit E

APS Credit Ratings

	MOODY'S	S & P	FITCH
Senior Secured Debt	A3	A-	A-
Senior Unsecured Debt	Baa1	BBB	BBB+
Secured Lease Obligation Bonds	Baa2	BBB	BBB
Commercial Paper	P2	A2	F2

Exhibit F

Financial Impact of Recapitalization Debt

in ($000)

CURRENT APS		WITH RECAPITALIZATION DEBT	
Current APS Debt	$2,206,780	Additional Debt	$500,000
Weighted Cost of Debt	5.93%	Additional Interest @ 6.0%	$30,000
		Additional Interest @ 6.5%	32,500
Annualized Long-Term Interest	$130,862	Additional Interest @ 7.0%	35,000

Financial Indicators

S&P "BBB"

	June 2002	+ $500M	Targets Business Position 5
DEBT RATIO			
Adj. Total Debt / Total Capital	54%	59%	47% - 55%
COVERAGE RATIOS			
Pretax Interest Coverage	3.80	3.10	2.40 - 3.50
Adj. Pre-Interest FFO Interest Coverage	4.53	3.92	3.00 - 4.00
Adj. FFO / Avg. Total Debt	23%	21%	21% - 27%
