

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 **COMMISSIONERS**

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4 **WILLIAM A. MUNDELL**
5 **JEFF HATCH-MILLER**
6 **KRISTIN K. MAYES**
7 **GARY PIERCE**

7 **IN THE MATTER OF ARIZONA**
8 **PUBLIC SERVICE COMPANY'S**
9 **APPLICATION ON RESOURCE**
10 **PLANNING**

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DOCKET NO. E-01345A-
APPLICATION

11 With rapid growth in both customers and energy consumption, Arizona Public Service
12 Company ("APS" or "Company") faces a significant resource gap in the future. Closing that
13 gap, while enhancing and diversifying the portfolio of resources that serves APS customers,
14 requires the Company to begin taking steps today, in parallel with the ongoing Arizona
15 Corporation Commission ("Commission") proceeding addressing resource planning matters
16 on a generic basis.¹ In particular, an effective utility-specific resource planning process
17 should be both transparent and participatory, seeking broad input and feedback from market
18 participants, policy advocates, customer groups, and regulatory authorities – much like
19 today's process for identifying and siting major transmission projects. Such broad input and
20 discussion is a critical first step to permit APS to formulate and advance more specific plans
21 and proposals, and seek the appropriate regulatory authorizations and approvals.

22 The Company is submitting this application ("Application") to initiate a utility-
23 specific process that will first seek input and feedback from interested stakeholders on core
24 APS resource planning issues, to build a public understanding of the Company's resource
25 planning challenges, and then to obtain the specific Commission guidance and approval
26 necessary to proceed. APS believes that it is critical to have an early, informed dialogue on
27 the alternative resource options that may be available—both in the short term and in the long

28 ¹ Commission Docket No. E-00000E-05-0431.

1 term—and the issues associated with these options. Further, the Company believes that such
2 specific discussions, which will likely involve expansive issues related to future energy
3 policy, are complementary to the Commission’s generic proceeding addressing resource
4 planning and can provide useful information for the Commission and all parties as that
5 proceeding progresses.

6 As part of this process, APS is requesting certain approvals from the Commission.
7 For short-term resource planning, the Company is seeking stakeholder input and
8 Commission approval to expand its current purchased power and natural gas hedging
9 program from three years to five years. Such an increase will offset some of the risk from
10 price volatility relating to the Company’s increasing reliance on natural gas-fired generation.
11 To facilitate its long-term planning, APS is seeking stakeholder input, and ultimately policy
12 guidance from the Commission, on the appropriate mix of long-term resources that APS
13 should pursue, the regulatory treatment and recovery of development costs APS incurs for
14 new resources, and the appropriate approach APS should take to pursue specific projects.

15 **A. Background**

16 Arizona’s population continues to grow at one of the fastest rates in the nation, while
17 at the same time, use of electricity per customer is also increasing. APS customer demand is
18 expected to grow by 46 percent by 2020. The Company’s short-term resource plans,
19 including appropriate hedging and power procurement practices, will provide for customers’
20 needs until about 2015. However, APS needs to make plans now to add new resources to its
21 portfolio to serve customers beyond 2015. Such new generation resources could include
22 renewables, coal, nuclear, and natural gas, as well as expanded demand-side efforts. The
23 long lead times required to develop, permit, and construct certain new resources require that
24 decisions relating to the appropriate mix of these resources must be made soon.

25 Adding to the substantial challenge facing APS in meeting customer and load growth
26 are uncertainties surrounding the Company’s resource planning decisions, such as the
27 impacts of potential new environmental regulations, fuel price volatility, increasing
28 construction costs, transmission system constraints, regulatory treatment of resource

1 investments, and other economic, policy and operational factors. All of these issues are
2 discussed in detail in APS's Resource Alternatives Report and Resource Alternatives
3 Technical Analysis, which are attached as Exhibit A. Addressing such challenges with the
4 assistance of a collaborative process, particularly with input from stakeholders and policy-
5 makers, is important because selecting resource alternatives involves risks and trade-offs,
6 and requires flexibility and adjustments during the planning and development process.

7 Further, the Company's investment in new resources will be substantial. The
8 anticipated 5,000 megawatts needed from new resources by 2020 will require billions of
9 dollars of financial commitments by APS. Much of this investment must be made years
10 before a resource is actually placed into service. The cost of financing these kinds of
11 projects, and ultimately customer rates, will be impacted by financial institutions'
12 perceptions of the regulatory risk of cost recovery. APS cannot make this level of financial
13 commitment, with its resultant customer rate impacts, without the support of the Commission
14 and other stakeholders.

15 **B. Enhanced Hedging Policy**

16 In the short-term (until 2015), the Company is well situated to meet its peak generation
17 needs, which are projected to grow by approximately 300 megawatts per year. The Company
18 will continue to seek renewable generation and implement new demand-side management
19 measures to address some of this need, but APS expects natural gas-fired generation to meet
20 the majority of the Company's short-term incremental energy needs. APS currently has a
21 hedging program to manage the volatility of natural gas and purchased power prices. As part
22 of this Application, the Company is seeking to expand its current hedging program from three
23 years to five years as a means to further mitigate risks of price volatility as the Company's
24 exposure to natural gas increases. APS intends to host a stakeholder meeting to address the
25 issue of hedging, and will subsequently file in this docket a specific hedging program for
26 approval, which will take into consideration the views of interested parties.²

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28 ² This is consistent with the Commission's Fuel Audit Report, which recommended that the Company work with
stakeholders and the Commission to set objectives for its hedging program. The Company believes that the

1 **C. Stakeholder Meetings**

2 To support a transparent and collaborative planning process that the Company believes
3 will aid the Commission in its review of this application, APS intends to host multiple public
4 stakeholder meetings on the topics set forth below to exchange information and to engage
5 participants in a discussion of critical resource planning issues. The Company intends to file
6 written summaries of the stakeholder meetings with the Commission. The Company
7 anticipates having its initial stakeholder meetings during the first quarter of 2008. The
8 Company will provide further notice of the stakeholder meetings to the parties that have been
9 participating in the Commission's generic resource planning proceeding and to any other
10 interested party that requests to be included.

11 APS will seek input on the following list of topics, which is not intended to be
12 exhaustive; if the participants believe additional meetings are beneficial, the Company will
13 schedule further meetings.

- 14 • **Short-term Planning and Hedging Program:** This would include discussion of
15 the Company's current short-term resource approach, as well as its hedging
16 program, including risks and risk management techniques for hedging and the
17 Company's proposal to extend its hedging policy to five years.
- 18 • **Growth and Resource Needs:** This would include a discussion of the Company's
19 load forecasts, existing resources, including supply and transmission, as well as
20 needs assessment.
- 21 • **Planning for a Sustainable Future - Policies and Economic Impacts:** This
22 would include a discussion of the drivers and trends that influence current APS
23 resource planning decisions, such as changing laws and regulations related to
24 environmental issues, sustainability, national energy policy, fuel price volatility,
25 and new technologies.
- 26 • **Resource Portfolio Development - Renewable Energy, Conventional Resources
and Energy Efficiency:** This would include a review of potential renewable,
conventional and customer-side resource options, methods for evaluating resource
alternatives, and an assessment of the benefits, costs and risks.

27 stakeholders' meetings in this docket respond to that recommendation. *See*, THE LIBERTY CONSULTING GROUP,
28 FINAL AUDIT REPORT – APS FUEL AND PURCHASED POWER PROCUREMENT AND COSTS at 80 (Aug. 31, 2006),
available at <http://www.cc.state.az.us/divisions/utilities/electric/fuelrpt.pdf>.

- 1 • **Regulatory Issues:** Included in this discussion would be the nature and timing of
2 regulatory approvals, jurisdictional conflicts, regulatory certainty, consistency with
3 legislative mandates, and prudence determinations.

- 4 • **Economic and Financial Impacts:** This would include a discussion of capital
5 investment levels, financing methods, capital availability, cost recovery
6 procedures, impact on customer rates, and utility financial health.

7 To facilitate discussion at these workshops, APS has prepared a detailed, substantive
8 discussion of resource planning issues, which is contained in Exhibit A. The Technical
9 Analysis describes the Company's future resource needs, including existing resources,
10 predicted growth and the resulting resource gap; preliminarily evaluates various resource
11 options, including the costs and risks of each resource and portfolio option; and identifies cost
12 recovery mechanisms that could support resource development and provide recovery of
13 prudent development costs, which would allow APS to maintain its financial health while
14 providing for the growing needs of our customers.

15 **D. Conclusion**

16 A transparent, collaborative stakeholder process seeking input and dialogue on
17 resource planning issues affecting APS is a critical first step before moving to more specific,
18 concrete proposals and projects. Therefore, APS respectfully seeks participation from the
19 Commission and interested parties in this process. As part of this Application, the Company
20 seeks approval of modifications to its hedging program and will submit additional details on
21 this request following the stakeholder meeting regarding hedging and short-term
22 procurement. The Company also seeks policy guidance from the Commission on
23 determining the appropriate mix of long-term resources that APS should pursue, the
24 regulatory treatment and recovery of development costs APS incurs for new resources, and
25 the appropriate approach the Company should take to pursue specific projects. While some
26 of these issues may ultimately be addressed in the Commission's generic proceeding on
27 resource planning, some issues may need to be addressed on an interim basis in response to
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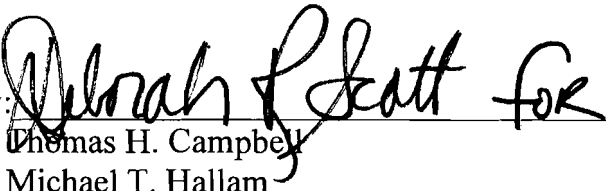
1 specific projects APS may bring to the Commission during the pendency of the generic
2 proceeding.

3 RESPECTFULLY SUBMITTED this 7th day of January, 2008.

4 PINNACLE WEST CAPITAL CORPORATION
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15
16 ORIGINAL and thirteen (13) copies
17 of the foregoing filed this 7th day of
18 January, 2008, with:

19 Docket Control
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23 Parties of Record per attached list.
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28

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