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ARIZONA CORPORATION COMMISSION

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January 27, 2009

Re: APS Notice of Settlement Discussions; Request for issues to be addressed during potential settlement negotiations; Docket No. E-01345A-08-0172.

Dear Parties to the docket:

As you know, on January 23, Arizona Public Service Company ("APS") filed in this docket a Notice of Settlement Discussions, inviting the Parties to engage the Company in Settlement talks beginning this Friday, January 3.

As they weigh whether to commence Settlement negotiations with APS, I would like the Parties to consider whether a Settlement in this case would allow the Commission to adequately assess the appropriateness of the Company's requested rate increase in light of the changed circumstances in Arizona, including a much depressed growth rate in utility hook-ups, deflation rather than inflation, in the cost of materials such as steel and cement, and deflation in the cost of natural gas.

I am also concerned that any Settlement Agreement in this case could precede the results of the study that has been ordered by the Commission of APS' management. This study is designed to compare APS' performance, results and expenses, considering management expense, operational costs, FFO/Debt ratio and other measures with a group of similarly situated utilities. The Commission engaged a consultant to prepare this report and file it in this rate case, so that we could better judge the validity of the Company's repeated assertions that its rate increase requests are due to circumstances – such as high growth rates and escalating commodity costs – that are outside its control, rather than poor management by the Company's executives. I would be hesitant to contemplate any Settlement Agreement without the context that this report would provide the Commission, and request that the Parties address this issue when considering the possibility of Settlement discussions.

Additionally, it is my view that the Commission should not address the results of any proposed Settlement Agreement until the Company has complied with the provisions in Decision No. 70667, which called on APS to pare $20 million in operational expenses, including, but not limited to, potential cuts to executive bonuses, advertising, lobbying expenditures and payroll overhead. Any action on the results of Settlement talks prior to a demonstration that APS has trimmed expenses would undermine the will of the Commission that the Company tighten its own belt at a time when it is asking for a rate increase.

If the Parties are able to address the aforementioned issues, and determine that a Settlement may still be appropriate, I believe the following matters must be included in the Parties' Settlement discussions, and considered as part of any comprehensive resolution of this case. Without the

Parties' fulsome attention to these issues in Settlement discussions, it would be difficult for me to adequately deliberate on a resulting Settlement Agreement.

First, I would like the Parties to consider whether the Commission, as part of any proposed Settlement in the case, should order an expansion of APS' energy efficiency programs – which have proven to be the cheapest form of energy available and which assist ratepayers in holding down their energy usage and thereby limiting their exposure to rate increases like the one proposed in this case. More specifically, I would like the Parties to consider the proper level of increased expenditures on energy efficiency, any necessary additions to APS' arsenal of energy efficiency programs, such as direct home-by-home installation of energy efficiency measures by the utility, and whether we should require that the Company meet a specific energy efficiency target, such as 20 percent energy efficiency by the year 2020.

Second, if the Parties proceed with Settlement discussions, I would request that the question of whether the Company's requirement for the purchase of renewable energy should be increased, and whether the Company could be encouraged to bolster its efforts to diversify its energy portfolio with renewable resources by allowing the costs associated with utility-scale solar, wind, geothermal or biomass projects to be met through Construction Work in Progress ("CWIP") adjustments to rate base.

Third, I would like the Parties, as part of potential Settlement discussions, to address the question of whether low-income customers should be held harmless from any resulting rate increase.

Fourth, I would like the Parties to analyze whether any changes to the Company's Time of Use tariffs are necessary, to allow more customers the opportunity to control their energy costs and shield themselves from the ill-effects of future rate increases.

Thank you for your consideration of these matters.

Sincerely,

Kris Mayes
Chairman

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