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Executive Director

October 24, 2006

Re: Arizona Public Service Company General Rate Case
Docket Nos. E-01345A-05-0816, E-01345A-05-0826, E-01345A-05-0827

Dear APS and Parties to the Docket:

Additional information related to whether APS has the financial resources to maintain a reliable and adequate electric system for its customers would be helpful in my review of this matter. As part of the APS rate case, I would like the company to explain its resource planning (including financing of it) through 2020 for the development of new generation and transmission projects. (APS' August 1, 2006 letter refers to the subject generally.) This information should include preliminary RFPs for long-term power resources, potential self-build generation projects requiring Commission approval and major interstate transmission projects that would increase import capabilities.

I am also concerned that since APS agreed to a self-build moratorium in the Rate Case Settlement (Decision No. 67744), the company may face challenges in procuring additional power supplies through 2015. In the interim, competitive procurement of generation resources may prove problematic as natural gas prices remain volatile and subject to possible supply and delivery constraints. I would like APS and the Parties to provide information on this topic as well, in order to develop the evidentiary record in this area.

Further, during the hearings, APS has offered several solutions to improve its creditworthiness, such as including construction-work-in-progress in rate base, allowing accelerated depreciation and authorizing a higher return on equity (ROE). In this regard, I have several questions that need to be addressed by APS.

- How would these proposed financial changes enable APS to improve its credit rating to the point where it could ensure system reliability, power supply adequacy, as well as meet load growth through 2020? How does sustaining sufficient cash flow and obtaining higher realized earnings interplay with this question?

- If APS is granted these financial "innovations" but is *unable* to recover its costs for fuel and purchased power in a timely manner, how can the company improve its bond rating when various credit rating agencies, most notably S&P, appear to view prompt cost recovery as imperative?

- Excluding cost recovery for fuel and purchased power, is APS able to attain its authorized ROE of 10.25 percent? If not, is growth or something else eroding APS' earnings? Why then would it be constructive to grant an even higher ROE?

I welcome APS and the other parties to provide their perspectives on these questions. Your responses will aid me in my full consideration of this case.

Sincerely,

Jeff Hatch-Miller
Chairman

Cc: Commissioner William A. Mundell
Commissioner Mike Gleason
Commissioner Kristin Mayes
Commissioner Barry Wong
Parties to the Docket