

120 FERC ¶ 61,153
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Pinnacle West Capital Corporation	Docket Nos. ER00-2268-017 ER00-2268-022 EL05-10-000 EL05-10-008
Arizona Public Service Company	ER99-4124-014 ER99-4124-018 EL05-11-000 EL05-11-007
Pinnacle West Energy Corporation	ER00-3312-015 ER00-3312-018 EL05-12-000 EL05-12-007
APS Energy Services Company, Inc.	ER99-4122-017 ER99-4122-022 EL05-13-000 EL05-13-007 EL07-82-000

ORDER ON MARKET-BASED RATES, REQUEST FOR REHEARING,
INSTITUTING SECTION 206 PROCEEDING, AND ESTABLISHING A REFUND
EFFECTIVE DATE

(Issued August 13, 2007)

1. In this order, the Commission finds that Pinnacle West Capital Corporation, Arizona Public Service Company (APS), Pinnacle West Energy Corporation (Pinnacle West Energy), and APS Energy Services, Inc. (collectively, Pinnacle) have complied

with the Commission's December 2006 Order¹ in revising their Simultaneous Import Limit (SIL) study and Delivered Price Test (DPT) analysis. Upon review of these studies, the Commission finds that Pinnacle's load in the Phoenix Valley² is a separate market from the rest of the APS control area.³ In a previous order, the Commission revoked Pinnacle's market-based rate authority in the APS control area because its SIL study failed to comply with the Commission's requirements.⁴ Based on the Commission's analysis using Pinnacle's most recently filed DPT, the Commission finds that Pinnacle has rebutted the presumption of market power in the portion of the APS control area outside the Phoenix Valley (Northern Arizona) and the Commission, therefore, reinstates Pinnacle's market-based rate authority in this area. In this order, the Commission terminates the section 206 proceeding instituted in this proceeding with regard to the portion of the APS control area outside the Phoenix Valley. Further, based on Pinnacle's DPT analysis, the Commission finds that Pinnacle has also rebutted the presumption of market power in the APS portion of the Phoenix Valley in all seasons except the summer. Therefore, the Commission reinstates Pinnacle's market-based rate authority in the APS portion of the Phoenix Valley for all seasons except the summer, and terminates the section 206 proceeding instituted in this proceeding with regard to the APS portion of the Phoenix Valley for those seasons.

¹ *Pinnacle West Capital Corp.*, 117 FERC ¶ 61,316 (2006) (December 2006 Order).

² The Phoenix Valley (which does not include Northern Arizona) includes an APS and Salt River Project (SRP) integrated network and the Rogers substation, which is interconnected with two Western Area Power Administration transmission lines located in a portion of the Western Area Lower Colorado control area. The Phoenix Valley is served primarily from four major extra high voltage (EHV) substations: Westwing, Rudd, Pinnacle Peak, and Kyrene. These four EHV stations form the cornerstones of an extensive internal network of 230 kV transmission lines that constitute the high voltage energy delivery system within the Phoenix Valley. *See* Pinnacle's February 18, 2005 filing in Docket No. ER00-2268-010, Attachment C, "APS Reliability Must-Run Analysis 2003-2005," January 31, 2003, APS Transmission Planning, APS Resource Planning at 16.

³ While for purposes of this order we refer to "control area," we note that the Commission adopted the use of "balancing authority area" instead of "control area" in *Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, Order No. 697, 72 Fed. Reg. 39,904 (July 20, 2007), FERC Stats. & Regs. ¶ 31,252 at P 252 (2007).

⁴ *Pinnacle West Capital Corp.*, 115 FERC ¶ 61,055 (2006) (April 2006 Order).

2. However, Pinnacle's own DPT analysis indicates that Pinnacle has market power in the Phoenix Valley during the summer season, and accordingly, in this order, the Commission affirms its decision to revoke Pinnacle's market-based rate authority in the APS portion of the Phoenix Valley during the summer season.⁵ Also, given the results of Pinnacle's SIL and DPT studies, the Commission herein institutes a section 206 proceeding to determine whether Pinnacle's market-based rate authority for the remainder of the Phoenix Valley, which is comprised of the SRP control area and the Rogers substation (*i.e.*, sales in the Phoenix Valley that are not in the APS portion of the Phoenix Valley), remains just and reasonable during the summer season. For the protection of customers, we will establish a refund effective date pursuant to the provisions of section 206 of the Federal Power Act (FPA).⁶ This order also directs Pinnacle to show cause as to why the Commission should not revoke its authority to sell power at market-based rates in the rest of the Phoenix Valley (*i.e.*, the non-APS portion of the Phoenix Valley) during the summer season in light of the Commission's finding herein that Pinnacle has market power in the Phoenix Valley during the summer season.

3. In addition, in light of the Commission's action in this order and the December 2006 Order, the Commission dismisses in part and grants in part Pinnacle's request for rehearing of an earlier Commission order in this proceeding.

I. Background

4. On December 20, 2004, the Commission issued an order⁷ on an updated market power analysis filed by Pinnacle determining that Pinnacle had not provided adequate information for the Commission to determine whether Pinnacle passed the generation market power screens in the APS, Public Service Company of New Mexico (PNM), and Tucson Electric Power Company (TEP) markets. Accordingly, the Commission instituted a section 206 proceeding pursuant to the Federal Power Act⁸ to investigate whether Pinnacle's market-based rate authority should be revoked. The Commission limited the section 206 proceeding, as well as any resulting mitigation or refunds, to the APS control area and the TEP and PNM first-tier control areas.

5. For the APS control area, the Commission stated that the SIL study provided by Pinnacle did not comply with requirements set forth in Appendix E of the April 14

⁵ As discussed further below, the Commission will require Pinnacle to mitigate sales for the summer season (*i.e.*, months of June, July, and August).

⁶ 16 U.S.C. § 824e (2000).

⁷ *Pinnacle West Capital Corp.*, 109 FERC ¶ 61,295 (2004).

⁸ 16 U.S.C. § 824e (2000).

Order.⁹ The Commission gave Pinnacle the option to either: (1) file a revised SIL study that complies with the requirements in Appendix E of the April 14 Order;¹⁰ (2) file a DPT analysis; (3) file a mitigation proposal tailored to its particular circumstances that would eliminate the ability to exercise market power; or (4) inform the Commission that Pinnacle would adopt the April 14 Order's default cost-based rates or propose other cost-based rates and submit cost support for such rates.

6. In addition, for the PNM and TEP first-tier control areas, the Commission gave Pinnacle the option to file revised wholesale market share analyses that exclude uncommitted capacity imports from control areas that are not directly interconnected with the PNM or TEP control areas.

7. Pinnacle subsequently provided a revised wholesale market share screen for the PNM and TEP control areas. In addition, Pinnacle included revised generation market power analyses incorporating a revised SIL study for the APS control area and for the combined APS/SRP control areas. In a separate filing, Pinnacle also filed a DPT analysis for the APS control area and the combined APS/SRP control areas.

8. In the April 2006 Order, the Commission found that Pinnacle passed the generation market power screens in the PNM and TEP first-tier markets. However, because Pinnacle's re-filed SIL study for its home control area continued to fail to comply with the requirements in Appendix E of the April 14 Order, the Commission found that continuation of Pinnacle's market-based rate authority in the APS control area was not just and reasonable, and the Commission thus revoked Pinnacle's market-based rate authority in that area.

9. On May 17, 2006, Pinnacle submitted a compliance filing to revise its market-based rate tariffs in accordance with the April 2006 Order. The compliance filing includes revisions to its market-based rate tariffs so that they apply only to areas outside of the APS control area and includes new default cost-based rate tariffs for service in the APS control area, effective February 27, 2005. Concurrently, Pinnacle submitted a request for rehearing of the April 2006 Order.

10. In the December 2006 Order, the Commission provided guidance and clarification on how Pinnacle must revise its SIL study if it wished to satisfy the Commission's requirements in Appendix E of the April 14 Order, and allowed Pinnacle an opportunity to re-file a revised SIL study and DPT.

⁹ *AEP Power Marketing, Inc.*, 107 FERC ¶ 61,018 (April 14 Order), *order on reh'g*, 108 FERC ¶ 61,026 (2004) (July 8 Order).

¹⁰ Appendix E sets forth the Commission's requirements of how to properly conduct a SIL study.

11. On February 20, 2007, Pinnacle filed a revised SIL study and DPT to support reinstatement of its market-based rate authority in the APS control area, the default relevant geographic market. Pinnacle submitted SIL and DPT studies for the APS control area, the combined APS/SRP control areas, and as requested by the Commission in the December 2006 Order, the Phoenix Valley.

II. Notice of Filing

12. Notice of Pinnacle's February 20, 2007 filing was published in the *Federal Register*, 72 Fed. Reg. 9518 (2007), with interventions and protests due on or before March 13, 2007. None was filed.

III. Discussion

A. Pinnacle's SIL Study

13. As stated above, in its December 2006 Order, the Commission provided greater specificity of the errors contained in Pinnacle's SIL study, and provided guidance and clarification on how Pinnacle must revise its SIL study if it wished to satisfy the Commission's requirements. The December 2006 Order also provided Pinnacle with an opportunity to re-file a revised SIL study in accordance with the Commission's requirements and to revise its DPT filed on January 20, 2006. On February 20, 2007, Pinnacle submitted a revised SIL study and accompanying DPT. The Commission finds that Pinnacle has complied with Commission directives in the December 2006 Order on revising its SIL study and the accompanying DPT.

14. In particular, in the December 2006 Order, the Commission directed Pinnacle to use actual, historical data to model the capability of its transmission grid to accommodate simultaneous imports of power from generating resources that are remote from its control area, as required by Appendix E of the April 14 Order. In its revised SIL study, Pinnacle complied with that directive by adjusting load levels for APS and SRP to match actual peak demand levels and did not use higher loads than actually achieved in Northern Arizona.¹¹

15. The Commission also directed Pinnacle not to assume that wheeling through capability in Northern Arizona equates to the existence of higher import capability to meet loads in the APS control area because this wheeling through capability is irrelevant in assessing the ability of imports to meet most loads in the APS control area, which are concentrated in the internally-constrained Phoenix Valley area. Accordingly, in its revised SIL study, Pinnacle did not attempt to simulate wheeling through transactions. The calculated SIL values are the total measured net interchange into each study area.

¹¹ Pinnacle's February 20, 2007 filing, Attachment A at 5.

16. The Commission also directed Pinnacle to treat remote resources of Palo Verde, Cholla, Navajo, and Four Corners generating stations, which are located outside of the APS control area, but are relied upon to meet load in the APS control area, consistent with historical practices, as required by Appendix E, and not scale these remote resources to zero. In computing import capability in its revised SIL study, Pinnacle dispatched the remote, base load generating plants in accordance with their actual, historical transmission operating practices.¹² Pinnacle notes that additional deductions of the SIL were made to account for APS's firm transmission rights,¹³ as required by Appendix E.

17. The Commission directed Pinnacle to model two study areas: the APS control area and the Phoenix Valley. Pinnacle studied both of these areas in its revised SIL study. The Commission directed Pinnacle to study the APS control area because it is the default geographic market of APS, and the April 14 Order requires that all applicants must provide market power studies based on their home control area as a relevant geographic market.

18. Because Pinnacle's system is composed of some regions of less dense loads with fewer constraints and other regions of dense loads with significant constraints (the Phoenix Valley), and Pinnacle's own filing¹⁴ acknowledges the existence of a Phoenix Valley load pocket, the Commission also required Pinnacle to study the Phoenix Valley.¹⁵ In fact, in conducting several SIL studies, Pinnacle froze load in the Phoenix Valley when imports into the Phoenix Valley load pocket became constrained and then increased the load in the remainder of the control area to determine what additional supply can be imported into this unconstrained area outside of the Phoenix Valley. The provision of a separate study for the Phoenix Valley enables the Commission to clearly evaluate the possibility of an alternative geographic market due to a load pocket and the potential for market power there.

¹² Pinnacle's February 20, 2007 filing, Attachment A at 7 and 13.

¹³ Pinnacle's February 20, 2007 filing, Attachment A at 11 and 15. Particularly, deductions to the SIL were made for firm transmission rights for power across the Phoenix Valley. In fact, imports from APS's and SRP's generation outside of the Phoenix Valley to serve loads consume all of the available transmission, leaving import capability at zero.

¹⁴ Pinnacle's April 22, 2005 Response to Deficiency Letter.

¹⁵ Moreover, earlier in this proceeding intervenors alleged the existence of a Phoenix Valley load pocket and asked the Commission to investigate the existence of market power there. *See* Arizona Districts March 7, 2005 request for technical conference. We note that Pinnacle filed an Offer of Settlement April 11, 2005 stating that those intervenors have settled their issues of concern in this proceeding and the Commission accepted this Offer of Settlement in *Pinnacle West Capital Corp.*, 115 FERC ¶ 61,129 (2006).

B. The DPT

19. In the April 14 Order, the Commission stated that an applicant's failure of one or more of the indicative screens establishes a rebuttable presumption of market power. If such an applicant chooses not to proceed directly to mitigation, it must present a more thorough analysis using the Commission's DPT.¹⁶ The DPT is used to analyze the effect on competition for transfers of jurisdictional facilities in section 203 proceedings,¹⁷ using the framework described in Appendix A of the Merger Policy Statement and revised in Order No. 642.¹⁸ The DPT is a well-established test that the Commission has used routinely to analyze market power in the merger context for many years.

20. The DPT defines the relevant market by identifying potential suppliers based on market prices, input costs, and transmission availability, and calculates each supplier's economic capacity, and available economic capacity each season/load condition.¹⁹ The results of the DPT are then used to perform the pivotal supplier, market share and market concentration analyses. A detailed description of the mechanics of the DPT is provided in Appendix F of the April 14 Order and Appendix A of the Merger Policy Statement.

21. Using the economic capacity for each supplier, applicants must provide pivotal supplier, market share, and market concentration analyses. Examining these three factors with the more robust output from the DPT gives the Commission a more complete view of the competitive conditions and the applicant's position in the relevant markets.²⁰

22. Under the DPT, to determine whether an applicant is a pivotal supplier in each of the season/load conditions, the Commission compares the load in the destination market to the amount of competing supply (the sum of the economic capacities of the competing suppliers). The applicant will be considered pivotal if the sum of the competing

¹⁶ April 14 Order, 107 FERC ¶ 61,018 at P 105-12.

¹⁷ 16 U.S.C. § 824b (2000).

¹⁸ *Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, 61 Fed. Reg. 68,595 (1996), FERC Stats. & Regs., Regulations Preambles July 1996-December 2000 ¶ 31,044 (1996), *reconsideration denied*, Order No. 592-A, 62 Fed. Reg. 33,341 (1997), 79 FERC ¶ 61,321 (1997) (Merger Policy Statement); *see also*, Revised Filing Requirements Under Part 33 of the Commission's Regulations, Order No. 642, 65 Fed. Reg. 70,983 (2000), FERC Stats. & Regs., Regulations Preambles July 1996-December 2000 ¶ 31,111 (2000), *order on reh'g*, Order No. 642-A, 66 Fed. Reg. 16,121 (2001), 94 FERC ¶ 61,289 (2001).

¹⁹ Super-peak, peak, and off-peak, for Winter, Shoulder and Summer periods and an additional highest super-peak for the Summer.

²⁰ April 14 Order, 107 FERC ¶ 61,018 at P 107-08.

suppliers' economic capacity is less than the load level (plus a reserve requirement that is no higher than state and regional reliability council operating requirements for reliability) for the relevant period. Applicants are also required to perform an analysis using available economic capacity to account for applicants' and competing suppliers' native load commitments. In that case, native load in the relevant market is subtracted from the load in each season/load period. The native load subtracted is the average of the actual native load for each season/load condition.

23. Each supplier's market share is calculated based on economic capacity (the DPT's analog to installed capacity). The market shares for each season/load condition reflect the costs of the applicant's and competing suppliers' generation, thus giving a more complete picture of the applicant's ability to exercise market power in a given market. For example, in off-peak periods, the competitive price may be very low because the demand can be met using low-cost capacity. In that case, a high-cost peaking plant that would not be a viable competitor in the market would not be considered in the market share calculations because it would not be counted as economic capacity in the DPT. Applicants must also present an analysis using available economic capacity (the DPT's analog to uncommitted capacity) and explain which measure more accurately captures conditions in the relevant market.

24. Under the DPT, applicants must also calculate the market concentration using the Herfindahl-Hirschman Index (HHI) based on market shares.²¹ HHIs are usually used in the context of assessing the impact of a merger or acquisition on competition. However, as noted by the U.S. Department of Justice in the context of designing an analysis for granting market-based pricing for oil pipelines, concentration measures can also be informative in assessing whether a supplier has market power in the relevant market.²²

25. Under Commission policy, a showing of an HHI less than 2,500 in the relevant market for all season/load conditions for applicants that have also shown that they are not pivotal and do not possess more than a 20 percent market share in any of the season/load conditions would constitute a showing of a lack of market power, absent compelling contrary evidence from intervenors. Concentration statistics can indicate the likelihood

²¹ The HHI is the sum of the squared market shares. For example, in a market with five equal size firms, each would have a 20 percent market share. For that market, $HHI = (20)^2 + (20)^2 + (20)^2 + (20)^2 + (20)^2 = 400 + 400 + 400 + 400 + 400 = 2,000$.

²² See Comments of the United States Department of Justice in response to Notice of Inquiry Regarding Market-Based Ratemaking for Oil Pipelines, Docket No. RM94-1-000 (January 18, 1994). "The Department and the Commission staff have previously advocated an HHI threshold of 2,500, and it would be reasonable for the Commission to consider concentration in the relevant market below this level as sufficient to create a rebuttable presumption that a pipeline does not possess market power."

of coordinated interaction in a market. All else being equal, the higher the HHI, the more firms can extract excess profits from the market. Likewise, a low HHI can indicate a lower likelihood of coordinated interaction among suppliers and could be used to support a claim of a lack of market power by an applicant that is pivotal or does have a 20 percent or greater market share in some or all season/load conditions. For example, an applicant with a market share greater than 20 percent could argue that it would be unlikely to possess market power in an unconcentrated market (HHI less than 1,000).

26. Applicants and intervenors may present evidence such as historical wholesale sales, which can be used to calculate market shares and market concentration and to refute or support the results of the DPT. In the April 14 Order, we encouraged applicants to present the most complete analysis of competitive conditions in the market as the data allow. We have used actual data in our analysis of mergers and other section 203 jurisdictional transactions to supplement or support the analysis of the effect of such transactions on competition.

C. Pinnacle's DPT Analysis

1. The Relevant Geographic Market

27. The Commission's generation market power screens use the control area in which the applicant is located as the default relevant geographic market, but allow applicants and intervenors to present evidence that the relevant market is broader or smaller than a particular control area.²³ As stated above, Pinnacle's revised DPT studies the APS control area, the combined APS/SRP control areas, and the Phoenix Valley.

28. Pinnacle proposes that the combined APS/SRP control areas are the relevant geographic market. However, Pinnacle's SIL study indicates that there are transmission constraints within the combined APS/SRP control areas, specifically in the Phoenix Valley, which show that the Phoenix Valley is highly dependent upon transmission imports. Indeed, Pinnacle's own studies that model all of its firm, network, and grandfathered transmission rights into the Phoenix Valley show that there is no transmission access for competitors in two summer super peak periods.²⁴ This, in addition to significant Reliability Must-Run (RMR) requirements in the Phoenix Valley,

²³ April 14 Order, 107 FERC ¶ 61,018 at P 75.

²⁴ Pinnacle analyzes four summer periods: summer super peak 1 (top 1 percent of peak load hours), summer super peak 2 (top 1-10 percent of peak load hours), summer peak (remaining peak hours), and summer off-peak hours (all off peak hours).

indicates a constrained load pocket.²⁵ As a general matter, during periods when transmission becomes so constrained that no additional imports from outside a load pocket are possible and generators located inside the load pocket are the only suppliers that can sell inside the load pocket, the load pocket should be defined as a separate relevant geographic market.²⁶

29. The Commission noted in Order No. 642²⁷ that transmission allocation is a key issue in defining relevant geographic markets in the analysis of constrained markets. Because there are binding transmission constraints that separate the Phoenix Valley from the rest of APS, the Commission finds based on record evidence that the Phoenix Valley is a relevant geographic market.

2. Pinnacle's DPT Results and Alternative Data

30. Pinnacle's market-based rate authority for the APS control area has been revoked.²⁸ Because the Commission finds the Phoenix Valley to be a relevant geographic market, the Commission has evaluated Pinnacle's market-based rate authority in the Phoenix Valley and the portion of the APS control area outside of the Phoenix Valley.

31. Taking the portion of the APS control area outside the Phoenix Valley first, the Commission's analysis of the record evidence indicates that under the available economic capacity measure of the DPT, Pinnacle is not pivotal in any season. Furthermore, our analysis indicates that Pinnacle's market shares using the available economic capacity measure are below 20 percent in six out of 10 season/load periods and are only slightly

²⁵ According to APS's RMR Analysis for 2003-2005, APS load in the Phoenix Valley had RMR requirements of 835 MW for a peak demand of 4,456 MW in 2003, 956 MW for a peak demand of 4,614 MW in 2004, and 1,024 MW for a peak demand of 4,733 MW in 2005. See Pinnacle's February 18, 2005 filing in Docket No. ER00-2268-010, *et al.*, Attachment C, "APS Reliability Must-Run Analysis 2003-2005," January 31, 2003, APS Transmission Planning, APS Resource Planning.

²⁶ *Wisvest-Connecticut, LLC*, 96 FERC ¶ 61,101 at 61,401 (2001).

²⁷ *Revised Filing Requirements Under Part 33 of the Commission's Regulations*, Order No. 642, FERC Stats. & Regs. ¶ 31,111 (2000), *order on reh'g*, Order No. 642-A, 94 FERC ¶ 61,289 (2001).

²⁸ April 2006 Order, 115 FERC ¶ 61,055 at P 5.

above 20 percent during the other four season/load periods, with the highest market share at 26 percent using a conservative measure.²⁹ Moreover, Pinnacle's HHIs are below 2,500 for all season/load periods.

32. With regard to the portion of the APS control area outside of the Phoenix Valley, Pinnacle is not a pivotal supplier in any study period, market shares are below 20 percent in six of the 10 periods and are only slightly above 20 percent in the other study periods, and HHIs are below 2,500. Accordingly, the Commission finds that the presumption of market power has been rebutted. Therefore, the Commission reinstates Pinnacle's market-based rate authority in the portion of the APS control area outside the Phoenix Valley and will terminate the section 206 proceeding instituted in this proceeding with regard to the portion of the APS control area outside the Phoenix Valley. For the portion of the APS control area outside the Phoenix Valley, the Commission finds that no refunds are due for sales during the refund period.

33. With regard to the Phoenix Valley, Pinnacle's most recent DPT analysis (which includes a properly conducted SIL study) indicates that, other than summer super peak 1 and summer super peak 2, for each period studied under the available economic capacity measure of the DPT, Pinnacle is not pivotal. Furthermore, Pinnacle's DPT analysis indicates that Pinnacle's market shares using the available economic capacity measure for these periods are no higher than 20 percent in seven out of eight season/load periods. Moreover, Pinnacle's HHIs are below 2,500 for these periods.

34. However, Pinnacle is a pivotal supplier in summer super peak 1 and summer super peak 2 in the Phoenix Valley. In addition, using the available economic capacity measure, Pinnacle's DPT shows that Pinnacle's market shares are 100 percent for summer super peak 1 and summer super peak 2 in that market. Pinnacle's market concentration of over 9,000 in that market for summer super peak 1 and summer super peak 2 is well above the Commission's HHI threshold of 2,500.

35. In addition to the DPT analysis required by the Commission, Pinnacle also provided sensitivity analyses which separately analyze what effect, if any, an increase of

²⁹ Our analysis estimated transmission imports into the Northern Arizona portion of the APS control area based on data contained in Pinnacle's SIL study for the entire APS control area and for the Phoenix Valley. Our analysis is conservative because the DPT for the portion of the APS control area outside of the Phoenix Valley includes APS' uncommitted capacity in the Phoenix Valley. The uncommitted capacity in the Phoenix Valley, however, would typically serve customers in the Phoenix Valley during periods of constraint, rather than being used to serve customers in Northern Arizona.

10 percent or a decrease in 10 percent of the market price would have on the results of its DPT analysis. Pinnacle's DPT sensitivity analyses indicate that "...basic findings are unchanged..."³⁰

36. Pinnacle also analyzed historical sales data as reported in the Commission's Electric Quarterly Reports of 2005 and 2006 to compute market shares and HHIs for each quarter based on the total amount of short-term sales designated in the APS/SRP control areas as well as the Four Corners and Palo Verde hubs.³¹ Pinnacle uses this study to support its contention that the combined APS/SRP control areas have ample competition for wholesale sales and that it should be permitted to make market-based rate sales without geographic restriction.³²

37. Based on Pinnacle's most recent DPT analysis of the Phoenix Valley, the Commission finds that Pinnacle has rebutted the presumption of market power in the APS portion of the Phoenix Valley in all periods studied except the summer season. Therefore, the Commission reinstates Pinnacle's market-based rate authority in the APS portion of the Phoenix Valley for the remaining three seasons³³ and will terminate the section 206 proceeding instituted in this proceeding with regard to the APS portion of the Phoenix Valley for those three seasons. For the APS portion of the Phoenix Valley for those three seasons, the Commission finds that no refunds are due for sales during the refund period.

38. However, the Commission finds that Pinnacle's own DPT results indicate that Pinnacle has market power in the Phoenix Valley during the summer season because at times during the summer, it is a pivotal supplier, has market shares as high as 100 percent, and HHIs of over 9,000.³⁴ In addition, Pinnacle's sensitivity analyses are further

³⁰ Pinnacle's February 20, 2007 filing, Attachment B at 214.

³¹ The Market Monitor for APS routinely focuses on sales at the Four Corners and Palo Verde market hubs.

³² This analysis shows that Pinnacle's highest market share for the combined APS/SRP control areas is 10 percent. For the study of APS/Four Corners, two quarters in 2005 and 2006 have market shares above 20 percent, the highest being 30 percent. For the study of APS/SRP/Four Corners/Palo Verde, three quarters in 2005 and 2006 have market shares above 20 percent, the highest being 30 percent.

³³ Fall (September/October/November); winter (December/January/February); and spring (March/April/May).

³⁴ Although Pinnacle does present alternative data for the combined APS/SRP control areas, Pinnacle does not provide an analysis using this sales data for the Phoenix Valley, a relevant geographic market.

proof that Pinnacle has market power in the Phoenix Valley during the summer season. Therefore, the Commission affirms the revocation of Pinnacle's market-based rate authority in the APS portion of the Phoenix Valley during the summer season.³⁵

39. We direct Pinnacle, within 60 days of the date of issuance of this order, to revise its May 17, 2006 compliance filing consistent with the Commission's decision to reinstate Pinnacle's market-based rate authority in the portion of the APS control area outside the Phoenix Valley and in the APS portion of the Phoenix Valley for the fall, winter, and spring seasons. We also direct Pinnacle within 60 days of the date of issuance of this order, to revise its May 17, 2006 compliance filing consistent with the Commission's decision to revoke its market-based rate authority in the APS portion of the Phoenix Valley during the summer season. As discussed in further detail below, Pinnacle has the opportunity to propose mitigation for sales made into the APS portion of the Phoenix Valley during the summer season.

40. With regard to Pinnacle's sales in the rest of the Phoenix Valley, we will institute a section 206 proceeding in Docket No. EL07-82-000 to determine whether Pinnacle's market-based rate authority for the non-APS portion of the Phoenix Valley remains just and reasonable during the summer season. In cases where, as here, the Commission institutes a section 206 investigation on its own motion, section 206(b) requires that the Commission establish a refund effective date that is no earlier than the date of the publication of the notice of the initiation of the Commission's investigation in the *Federal Register*, and no later than five months after the publication date. In order to give maximum protection to customers, and consistent with our precedent,³⁶ we will establish a refund effective date at the earliest date allowed. This date will be the date on which notice of the initiation of the investigation in Docket No. EL07-82-000 is published in the *Federal Register*.

41. Under the section 206 proceeding established herein, Pinnacle must show cause, within 60 days of the date of issuance of this order, as to why the Commission should not revoke its authority to sell power at market-based rates in the non-APS portion of the Phoenix Valley during the summer season. In this regard, Pinnacle and intervenors may

³⁵ Because Pinnacle's market shares are 100 percent, its HHIs are over 9,000 for the summer super peak 1 and summer super peak 2, and because such peak periods will vary from year to year and are not known until after the fact, to ensure that customers are protected, we will affirm the revocation of Pinnacle's market-based rate authority for the entire summer season (*i.e.*, the months of June, July, and August).

³⁶ *See, e.g., Canal Elec. Co.*, 46 FERC ¶ 61,153, *reh'g denied*, 47 FERC ¶ 61,275 (1989).

present alternative evidence such as historical sales and transmission data to support or rebut the Commission's finding that Pinnacle has market power in the rest of the Phoenix Valley during the summer season.³⁷

42. In lieu of the show cause filing discussed above, in the alternative, Pinnacle may: (1) file a mitigation proposal tailored to its particular circumstances that would eliminate the ability to exercise market power; or (2) inform the Commission that Pinnacle will adopt the April 14 Order's default cost-based rates or propose other cost-based rates and submit cost support for such rates.

43. Pinnacle is also directed to file an updated market power analysis pursuant to the regional schedule adopted in Order No. 697 for the markets in which it retains market-based rate authority. The Commission also reserves the right to require such an analysis at any intervening time.

D. Request for Rehearing

44. On May 17, 2006, Pinnacle submitted a request for rehearing of the April 2006 Order. On June 7, 2006, Tucson Electric Power Company (Tucson) filed a motion for leave to comment and comments to the request for rehearing. Rule 713(d)(1) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713(d)(1) (2007), prohibits an answer to a request for rehearing. Therefore, we will not accept Tucson's comments.

45. In its rehearing request, Pinnacle argues that the Commission erred in revoking Pinnacle's market-based rate authority for alleged failure to submit a SIL study that meets the requirements of Appendix E without holding an evidentiary hearing, without disclosing the basis for its determination that the filed SIL studies were deficient, and without permitting Pinnacle to contest the staff SIL analysis that apparently was the basis for the rejection of the SIL study submitted by Pinnacle.³⁸ Pinnacle further argues that the Commission erred in revoking Pinnacle's market-based rate authority when the only record evidence supports Pinnacle's SIL calculations and demonstrates that Pinnacle does not have market power in either the APS control area or the combined APS/SRP control areas.³⁹ Pinnacle also contends that the Commission erred in rejecting its DPT.⁴⁰

³⁷ Order No. 697, FERC Stats. & Regs. ¶ 31,252 at P 75.

³⁸ Commission staff analysis of Pinnacle's previously submitted SIL study (submitted prior to the February 20, 2007 study) is explained in the April 2006 Order and the December 2006 Order.

³⁹ Pinnacle's Request for Rehearing at 26-31.

⁴⁰ *Id.* at 38.

46. Pinnacle also questions the basis for a number of the deficiencies in its study identified in the April 2006 Order.⁴¹ It argues that the Commission erred in concluding that Pinnacle's previous SIL study submissions violate the requirements of Appendix E in the following respects: (a) the previous SIL study did not follow historical operating conditions that represent actual OATT-OASIS⁴² practices; (b) the previous SIL study used available transmission capacity in Northern Arizona as if it would have been available to the Phoenix Valley; (c) the previous SIL study did not use actual, historical load in Northern Arizona; and (d) Pinnacle failed to support their selective scaling analysis.

47. Pinnacle raises a number of other arguments in its request for rehearing. It maintains that the Commission erred in: (a) refusing to consider specific mitigation proffered by Pinnacle; (b) concluding that mitigation is required for sales in the APS control area that are used to serve loads in control areas where Pinnacle is authorized to sell at market-based rates;⁴³ and (c) ordering use of "default" mitigation for all transactions, including those under the Western Systems Power Pool Agreement.⁴⁴ Pinnacle further states that the Commission erred to the extent that the April 2006 Order includes the Bridge power purchase agreement (PPA) and the Tucson Electric Power Company –PPL Energy Plus, LLC (Tucson/PPL) PPAs as agreements subject to refund.⁴⁵

48. We find that the issues regarding Pinnacle's SIL study and DPT raised in Pinnacle's rehearing request have been rendered moot by virtue of our action in the December 2006 Order and the instant order. As noted above, in the December 2006 Order, we provided greater specificity of the errors contained in Pinnacle's SIL study and provided guidance and clarification on how Pinnacle must revise its SIL study if it wished to satisfy the Commission's requirements. In the December 2006 Order, we also provided Pinnacle with an opportunity to re-file a revised SIL study and to revise its DPT. In the instant order, we find that Pinnacle has complied with the December 2006 Order in revising its SIL study and DPT. Accordingly, the issues raised in Pinnacle's rehearing challenging the revocation of its market-based rate authority for failure to submit a SIL study that meets the Commission's requirements and the rejection of Pinnacle's DPT are now moot.

49. In the instant order, we also find that Pinnacle has rebutted the presumption of market power in the portion of the APS control area outside the Phoenix Valley.

⁴¹ *Id.* at 31-33.

⁴² Open Access Transmission Tariff/Open Access Same Time Information System.

⁴³ Pinnacle's Request for Rehearing at 42-45.

⁴⁴ *Id.* at 42-44.

⁴⁵ *Id.* at 45-46.

Accordingly, we find that the mitigation arguments Pinnacle raises on rehearing are moot to the extent that they relate to the portion of the APS control area outside the Phoenix Valley. Further, while we affirm the revocation of Pinnacle's market-based rate authority in the APS portion of the Phoenix Valley for the summer season, we do so on grounds different than those in the April 2006 Order. The instant order finds, based on the results of Pinnacle's DPT, which includes a properly conducted SIL study (*i.e.*, filed in compliance with the December 2006 Order), that Pinnacle has market power in the APS portion of the Phoenix Valley during the summer season and affirms the revocation of Pinnacle's market-based rate authority in the APS portion of the Phoenix Valley for the summer season. In other words, our initial revocation of market-based rate authority was based on procedural grounds (failure to file a properly conducted study), while our decision here to retain that revocation is based on the merits of the evidence that is in this record (including a properly conducted study).

50. With regard to Pinnacle's argument that the Commission erred in refusing to consider specific mitigation proffered by Pinnacle and in ordering use of "default" mitigation for all transactions, including those under the Western Systems Power Pool (WSPP) Agreement, to the extent that this argument relates to the APS portion of the Phoenix Valley (where we affirm the revocation of Pinnacle's market-based rate authority for the summer season, but on different grounds than those contained in the April 2006 Order), we will grant rehearing as set forth below.

51. In the April 2006 Order, the Commission stated that "[r]ather than proposing tailored mitigation, [Applicants] simply note their belief that the WSPP's cost-based rates are more appropriate than the cost-based rates defined in the April 14 Order."⁴⁶ The Commission did not find Pinnacle's representation in this regard⁴⁷ to constitute an adequate mitigation proposal. The Commission found that Pinnacle "merely referenc[ed] alternatives to market-based rates in the event the Commission finds the Pinnacle West Companies' market-based rates to be inappropriate."⁴⁸ On this basis, the Commission directed Pinnacle to submit a compliance filing with the default cost-based rates.⁴⁹

52. Upon further review, however, we will grant rehearing on this issue and give Pinnacle the opportunity to propose mitigation other than the Commission's default cost-based rates to apply during the refund effective period beginning February 27, 2005 in

⁴⁶ April 2006 Order, 115 FERC ¶ 61,055 at P 58.

⁴⁷ See Pinnacle's February 18, 2005 filing at 15, n. 14

⁴⁸ April 2006 Order, 115 FERC ¶ 61,055 at P 60.

⁴⁹ The Commission further stated that such a cost-based compliance filing was without prejudice to Pinnacle proposing, on a prospective basis, case-specific mitigation tailored to its particular circumstances that eliminates its ability to exercise market power. *Id.* at P 62-63.

this proceeding. On reconsideration, we conclude that Pinnacle may not have anticipated that the issue of mitigation would be addressed at that stage in the proceeding. Therefore, we will grant rehearing on this issue and give Pinnacle the opportunity to submit, within 60 days of the date of issuance of this order, a revised compliance filing that clearly sets forth Pinnacle's mitigation proposal.⁵⁰

53. With regard to Pinnacle's claim that the Commission erred in rejecting Pinnacle's argument that limitations on market-based rate sales in a mitigated area should only apply to sales to wholesale load in that area, we note that the Commission recently addressed this issue in Order No. 697. The Commission determined that it would allow mitigated sellers to make market-based rate sales at the metered boundary between a mitigated balancing authority area and a balancing authority area in which the seller has market-based rate authority subject to the conditions set forth in Order No. 697.⁵¹ Therefore, we will provide Pinnacle the opportunity to revise its pending compliance filing to propose on a prospective basis, as of the effective date of Order No. 697, a mitigation proposal consistent with the terms of Order No. 697.

54. Finally, in Pinnacle's rehearing request, Pinnacle seeks clarification that the Tucson PPA and the Bridge PPA are not subject to refund. We clarify that because the Tucson PPA was executed in May 2003,⁵² it qualifies as an existing market-based rate contract entered into prior to the refund effective date of this proceeding and, accordingly, is not subject to refund.⁵³ With regard to the Bridge PPA, which became effective on April 1, 2005, Pinnacle states that this PPA was negotiated prior to the refund effective date of February 27, 2005 as part of a settlement in a retail rate

⁵⁰ In Pinnacle's February 18, 2005 filing, Pinnacle suggests that to the extent mitigation is needed for the Phoenix Valley, it should be limited to sales within the defined Phoenix Valley during periods of constraint, *i.e.*, when RMR generation is operated out of merit for reliability purposes. We will provide Pinnacle the opportunity to clearly set forth the details of its mitigation proposal in a compliance filing.

⁵¹ *See* Order No. 697, FERC Stats. & Regs. ¶ 31,252 at P 830 (Such sales will be allowed provided (i) legal title of the power sold transfers at the metered boundary of the balancing authority area where the seller has market-based rate authority; (ii) any power sold is not intended to serve load in the seller's mitigated market; and (iii) no affiliate of the mitigated seller will sell the same power back into the mitigated seller's mitigated market. Seller must retain, for a period of five years from the date of the sale, all data and information related to the sale that demonstrates compliance with items (i), (ii) and (iii) above.).

⁵² Pinnacle's July 28, 2006 Supplemental Compliance Filing.

⁵³ April 2006 Order, 115 FERC ¶ 61,055 at n. 5 (the revocation of Pinnacle's market-based rate authority does not apply to, or affect, existing market-based rate contracts that were entered into prior to the refund effective date in this proceeding).

proceeding before the Arizona Corporation Commission.⁵⁴ Pinnacle argues that the Bridge PPA was not negotiated directly by APS. Rather, Pinnacle explains that the Bridge PPA, which was between APS and its affiliate, Pinnacle West Energy, was created as a temporary arrangement to bridge the period between the Arizona Corporation Commission's approval of the transfer of Pinnacle West Energy's generating assets and the Commission's approval under FPA section 203 of the transfer of assets from Pinnacle West Energy to APS.⁵⁵ Although the Bridge PPA took effect during the refund effective date of this proceeding, we use our discretion not to require refunds with regard to this agreement because, as represented by Pinnacle, it was negotiated earlier, was in place for less than 12 weeks, and was entered into pursuant to a settlement before the Arizona Corporation Commission.

The Commission orders:

(A) Pinnacle's revised SIL study and DPT submitted on February 20, 2007 are accepted as complying with the Commission's directives in the December 2006 Order, as discussed in the body of this order.

(B) The Commission reinstates Pinnacle's market-based rate authority in the portion of the APS control area outside the Phoenix Valley.

(C) The section 206 proceeding instituted in this proceeding with regard to the portion of the APS control area outside the Phoenix Valley is terminated.

(D) The Commission reinstates Pinnacle's market-based rate authority in the APS portion of the Phoenix Valley in the following seasons: fall (September/October/November); winter (December/January/February); and spring (March/April/May), as discussed in the body of this order.

(E) The section 206 proceeding instituted in this proceeding with regard to the APS portion of the Phoenix Valley is terminated as it relates to Pinnacle's market-based rate authority for the fall (September/October/November); winter (December/January/February); and spring (March/April/May) seasons.

(F) The Commission affirms the revocation of Pinnacle's market-based rate authority in the APS portion of the Phoenix Valley during the summer season (June/July/August).

⁵⁴ Pinnacle's May 17, 2006 Compliance Filing.

⁵⁵ See *Arizona Pub. Serv. Co.*, 111 FERC ¶ 62,302 (2005); see also APS's and Pinnacle West Energy's April 15, 2005 filing in Docket No. EC05-69-000. The term of the Bridge PPA was set at 30 years in the event necessary approvals for the transfer of assets were not obtained.

(G) Pinnacle is directed, within 60 days of the date of issuance of this order, to revise its May 17, 2006 compliance filing, as discussed in the body of this order.

(H) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and by the Federal Power Act, particularly section 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the Federal Power Act (18 C.F.R., Chapter I), the Commission hereby institutes a proceeding in Docket No. EL07-82-000 concerning the justness and reasonableness of Pinnacle's market-based rate authority in the non-APS portion of the Phoenix Valley during the summer season (June/July/August), as discussed in the body of this order.

(I) Pinnacle is directed within 60 days of the date of issuance of this order to show cause as to why the Commission should not revoke Pinnacle's authority to sell power at market-based rates in the non-APS portion of the Phoenix Valley during the summer season (June/July/August). In lieu of the show cause filing discussed above, in the alternative, Pinnacle may: (1) file a mitigation proposal tailored to its particular circumstances that would eliminate the ability to exercise market power; or (2) inform the Commission that Pinnacle will adopt the April 14 Order's default cost-based rates or propose other cost-based rates and submit cost support for such rates.

(J) The Secretary shall promptly publish in the *Federal Register* a notice of the Commission's initiation of the proceeding under section 206 of the FPA in Docket No. EL07-82-000.

(K) The refund effective date established pursuant to section 206(b) of the FPA will be the date of the publication in the *Federal Register* of the notice discussed in Ordering Paragraph (J) above.

(L) Pinnacle's request for rehearing is granted in part and dismissed as moot in part, as discussed in the body of this order.

(M) Pinnacle's request for clarification is granted, as discussed in the body of this order.

(N) Pinnacle's next updated market power analysis is due pursuant to the regional schedule adopted in Order No. 697.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.