

122 FERC ¶ 61,035
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. ER00-2268-019 ER00-2268-023 EL05-10-000
Arizona Public Service Company	ER99-4124-016 ER99-4124-020 EL05-11-000
Pinnacle West Energy Corporation	EL05-12-000
APS Energy Services Company, Inc.	ER99-4122-018 ER99-4122-024 EL05-13-000
Pinnacle West Marketing & Trading Co., LLC	ER07-428-001 ER07-428-002 EL07-82-000

ORDER ON COMPLIANCE AND CLARIFICATION

(Issued January 17, 2008)

1. In this order, the Commission acts on the filings of Pinnacle West Capital Corporation (Pinnacle Capital),¹ Arizona Public Service Company (APS), Pinnacle West Energy Corporation (Pinnacle Energy), APS Energy Services, Inc. (APS Energy), and

¹ We note that Pinnacle Capital was succeeded by Pinnacle West Marketing & Trading Co., LLC, effective February 1, 2007. See *Pinnacle West Marketing & Trading Co., LLC*, Docket No. ER07-428-000 (March 9, 2007) (unpublished letter order).

Pinnacle West Marketing & Trading Co., LLC (Pinnacle Trading) (collectively, Pinnacle) made in compliance with the Commission's August 2007² and April 2006³ Orders.

2. In accordance with the Commission's August 2007 Order, we conditionally accept Pinnacle's compliance filing submitted on October 12, 2007 (August 2007 Order compliance filing) with regard to its revised market-based rate tariffs implementing the Commission's decision to reinstate Pinnacle's market-based rate authority in the portion of the APS control area outside of the Phoenix Valley (Northern Arizona) in all seasons and in the APS portion of the Phoenix Valley in all seasons other than the summer,⁴ as modified to reflect an effective date of August 13, 2007. We also accept in part Pinnacle's accompanying mitigation proposal for the Phoenix Valley, which includes Pinnacle's mitigation with regard to long-term sales. In addition, as requested, we clarify Pinnacle's refunds for inter-affiliate sales and address Pinnacle's compliance with Order No. 697.⁵

I. Background

3. In the April 2006 Order, the Commission revoked Pinnacle's market-based rate authority in the APS control area because Pinnacle failed to comply with the requirements on how to perform a market power study, as set forth in a market-based rate interim policy order issued on April 14, 2004.⁶ In May 2006, as supplemented on July 2006, Pinnacle submitted a compliance filing to the April 2006 Order revising its market-based rate tariffs in accordance with that order (April 2006 Order compliance filing). Specifically, the April 2006 Order compliance filing included two revised sets of Pinnacle's market-based rate tariffs: (1) to limit Pinnacle's sales at market-based rates to areas outside the APS control area, effective February 27, 2005 (the

² *Pinnacle West Capital Corp.*, 120 FERC ¶ 61,153 (2007) (August 2007 Order).

³ *Pinnacle West Capital Corp.*, 115 FERC ¶ 61,055 (2006) (April 2006 Order).

⁴ The summer season is defined as the months of June, July, and August.

⁵ *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 (2007).

⁶ *AEP Power Marketing, Inc.*, 107 FERC ¶ 61,018 (April 14 Order), *order on reh'g*, 108 FERC ¶ 61,026 (2004) (July 8 Order). As discussed above, subsequent to the April 2006 Order, the Commission reinstated Pinnacle's market-based rate authority in Northern Arizona and the APS portion of the Phoenix Valley for the fall, winter, and spring seasons.

refund effective date established in the December 2004 Order),⁷ and (2) to limit Pinnacle's market-based rates to areas outside the APS control area, except that sales at Four Corners⁸ are permitted as long as the counterparty does not serve load in the APS control area, effective April 17, 2006.⁹ Pinnacle also submitted, in accordance with the April 2006 Order, cost-based rate tariffs (default cost-based rate tariffs) for sales in the APS control area based on the Commission's default cost-based rate mitigation.¹⁰ In addition, Pinnacle proposed that for certain sales, it would use its existing cost-based rate tariffs as mitigation, effective April 17, 2006. Concurrently, Pinnacle submitted a request for rehearing of the April 2006 Order.

4. On December 21, 2006, the Commission issued an order providing guidance and clarification, and allowed Pinnacle the opportunity to submit a revised market power study. On February 20, 2007, Pinnacle submitted a revised market power study.

5. On August 13, 2007, the Commission issued an order¹¹ that found that in its most recent study, Pinnacle had rebutted the presumption of market power in Northern Arizona. The Commission also found that Pinnacle had rebutted the presumption of

⁷ *Pinnacle West Capital Corp.*, 109 FERC ¶ 61,295 (2004) (December 2004 Order). This order instituted a section 206 proceeding to determine whether Pinnacle may continue to charge market-based rates in the APS control area as well as the Public Service Company of New Mexico and the Tucson Electric Power Company first-tier control areas.

⁸ Pinnacle defines Four Corners as the generating station and the plant switchyards, and associated facilities, at the Four Corners Power Plant (near Farmington, New Mexico) that are operated by APS.

⁹ Pinnacle argues that during the refund period effective February 27, 2005, Pinnacle could sell at market-based rates, though those sales would be subject to refund.

¹⁰ The Commission's default cost-based rates are as follows: (1) sales of power of one week or less will be priced at the seller's incremental cost plus a 10 percent adder; (2) sales of power of more than one week but less than one year (sometimes referred to as "mid-term sales") will be priced at an embedded cost "up to" rate reflecting the costs of the unit or units expected to provide the service; and (3) new contracts for sales of power for one year or more will be priced at a rate not to exceed the embedded cost of service, and the contract will be filed with the Commission for review and approved prior to the commencement of service.

¹¹ August 2007 Order, 120 FERC ¶ 61,153.

market power in the APS portion of the Phoenix Valley¹² in the fall, winter, and spring seasons. Therefore, the Commission reinstated Pinnacle's market-based rate authority in Northern Arizona and in the APS portion of the Phoenix Valley for the fall, winter, and spring seasons and directed Pinnacle to revise its earlier compliance filing that was made in compliance with the April 2006 Order.¹³ In addition, the August 2007 Order affirmed the Commission's revocation of Pinnacle's market-based rate authority in the APS portion of the Phoenix Valley during the summer season and instituted a section 206 proceeding to determine whether Pinnacle's market-based rate authority in the non-APS portion of the Phoenix Valley remains just and reasonable during the summer season.¹⁴

6. On October 12, 2007, Pinnacle submitted a compliance filing to the August 2007 Order that included a definition of the Phoenix Valley, revisions to its market-based rate tariffs, a mitigation proposal based on the Commission's default cost-based rates and the Western Systems Power Pool (WSPP) Agreement for service in the Phoenix Valley during the summer season, and a clarification request regarding mitigation of long-term sales and refunds for inter-affiliate sales. Pinnacle also amended its market-based rate tariffs to comply with Order No. 697, which became effective on September 18, 2007.

II. Notice of Filing

7. Notice of Pinnacle's April 2006 Order compliance filing was published in the *Federal Register*,¹⁵ with interventions and protests due on or before June 29, 2006. None was filed. Notice of Pinnacle's July 2006 supplement to the April 2006 compliance filing was published in the *Federal Register*¹⁶ with interventions and protests due on or before August 21, 2006. None was filed. Notice of Pinnacle's August 2007 Order compliance filing was published in the *Federal Register*,¹⁷ with interventions and protests due on or before November 2, 2007. None was filed.

¹² The Phoenix Valley includes APS and Salt River Project (SRP) control areas and the Rogers substation that is a part of the Western Area Power Administration (WAPA) control area.

¹³ As discussed further below, the April 2006 Order, among other things, revoked Pinnacle's market-based rate authority in the APS control area.

¹⁴ 16 U.S.C. § 824e (2000). The refund effective date for the 206 proceeding instituted in the August 2007 Order is August 21, 2007.

¹⁵ 71 *Fed. Reg.* 34,907 (2006).

¹⁶ 71 *Fed. Reg.* 48,544 (2006).

¹⁷ 72 *Fed. Reg.* 60,010 (2007).

III. Discussion

8. The instant order conditionally accepts Pinnacle's August 2007 Order compliance filing that defines the Phoenix Valley, includes revised market-based rate tariffs that limit Pinnacle's sales to areas outside the Phoenix Valley during the summer season, and includes default cost-based rate tariffs and a mitigation proposal applicable for sales, including long-term sales, in the Phoenix Valley. We also clarify Pinnacle's refunds for inter-affiliate sales and address Pinnacle's market-based rate tariff compliance with Order No. 697.

9. Additionally, in accordance with the April 2006 Order, we accept in part Pinnacle's April 2006 Order compliance filing which includes revised market-based rate tariffs that limit sales to areas outside of the APS control area. We also accept Pinnacle's default cost-based rate tariffs, with an effective date of February 27, 2005, the refund effective date established in the December 2004 Order and mitigation effective April 17, 2006.

A. Pinnacle's August 2007 Order Compliance Filing

1. Definition of the Phoenix Valley

10. In order to provide clarity regarding mitigated sales, Pinnacle proposes to include in its market-based rate tariffs the following definition of the Phoenix Valley:

all delivery points at or within the 'Phoenix 230 kV loop,' including the 230 kV substations forming the boundaries of the loop, which include: Westwing, Pinnacle Peak, Kyrene, Rudd, Knox, Browning, Goldfield, Liberty, and Rogers.

11. Pinnacle states that this definition of the Phoenix Valley is consistent with the 2006 Reliability Must-Run (RMR) analysis submitted to the Arizona Corporation Commission by both APS and SRP in coordination with WAPA. Pinnacle states that only the Phoenix 230 kV loop (and below) facilities are used to serve load within the Phoenix Valley and thus only those facilities should be considered as needing to be mitigated because those are the only facilities that have an impact on the Phoenix Valley load-serving capability. Pinnacle states that deliveries using the 345 kV and 500 kV substations surrounding the Phoenix Valley, which include Westwing, Pinnacle Peak, Kyrene, Rudd, Browning, and Silverking, would not be mitigated because these 345 kV and 500 kV lines do not serve load within the Phoenix Valley. Only when deliveries are "stepped down" to reach the

“Phoenix 230 kV loop” does Pinnacle serve load within the Phoenix Valley.¹⁸ Therefore, Pinnacle proposes to mitigate all sales made with a delivery point at or within the “Phoenix 230 kV loop” during the summer season and the portion of the lines that are above the 230 kV would not be mitigated.

12. We will accept Pinnacle’s proposed definition of the Phoenix Valley and note that the definition is consistent with the definition used in the August 2007 Order.¹⁹ Further, the Commission finds that the “Phoenix 230 kV loop,” including the 230 kV substations forming the boundaries of the loop (which include: Westwing, Pinnacle Peak, Kyrene, Rudd, Knox, Browning, Goldfield, Liberty, and Rogers) properly identifies the boundaries of the Phoenix Valley and is consistent with Pinnacle’s 2006 RMR analysis. In particular, this definition of the outer boundaries of the Phoenix Valley is consistent with the transmission constraints on the transformers identified in the instant proceeding that limit transmission imports into the Phoenix Valley. In addition, we accept Pinnacle’s assertion that the newly constructed Raceway 230 kV facilities will be part of the Phoenix Valley and direct Pinnacle to revise the appropriate sections of its market-based rate tariff to include the Raceway 230 kV facilities as mitigated, within 30 days of the date on which this facility becomes operational.

2. Revisions to Market-Based Rate Tariffs

a. Effective Date

13. As stated above, the August 2007 Order found that Pinnacle rebutted the presumption of market power in Northern Arizona and, therefore, reinstated Pinnacle’s market-based rate authority in Northern Arizona. Furthermore, the Commission found that Pinnacle also rebutted the presumption of market power in the APS portion of the Phoenix Valley in the fall, winter, and spring seasons. Therefore, the Commission reinstated Pinnacle’s market-based rate authority in the APS portion of the Phoenix Valley for the fall, winter, and spring seasons.

¹⁸ Pinnacle notes that a new 230 kV facility (Raceway Facility) is being constructed and will have an impact in the Phoenix Valley in the 2010 timeframe. Therefore, Pinnacle will consider the sales from the Raceway 230 kV facilities as being mitigated.

¹⁹ The August 2007 Order defined the Phoenix Valley as including the APS and SRP integrated network and the Rogers substation and as being served primarily from four major extra high voltage substations: Westwing, Rudd, Pinnacle Peak, and Kyrene, which 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.

14. The August 2007 Order, however, affirmed the Commission's decision to revoke Pinnacle's market-based rate authority in the APS portion of the Phoenix Valley during the summer season.²⁰ It also instituted a section 206 proceeding to determine whether Pinnacle's market-based rate authority for the remainder of the Phoenix Valley (*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 and directed Pinnacle to show cause as to why the Commission should not revoke its authority in the non-APS portion of the Phoenix Valley during the summer season. In lieu of the show cause filing, Pinnacle could: (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.

15. The Commission directed Pinnacle to submit a compliance filing consistent with the Commission's decision to reinstate Pinnacle's market-based rate authority in Northern Arizona and in the APS portion of the Phoenix Valley for the fall, winter, and spring seasons pursuant to the Commission's findings in the August 2007 Order.²¹ The Commission also directed Pinnacle to submit a 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.

16. Pinnacle's August 2007 Order compliance filing proposes revised market-based rate tariffs for Pinnacle Capital, APS, and Pinnacle Trading reinstating market-based rate authority in Northern Arizona and in the APS portion of the Phoenix Valley during the fall, winter, and spring seasons.²² Furthermore, rather than challenging the Commission's preliminary finding of market power in the non-APS portion of the Phoenix Valley during the summer season, Pinnacle proposes mitigation for its sales in the non-APS portion of the Phoenix Valley during the summer season.²³ Pinnacle also proposes mitigation for its sales in the APS portion of the Phoenix Valley for the summer season.

17. Although Pinnacle does not provide its reasoning, Pinnacle includes on its revised market-based rate tariff sheets an effective date of February 27, 2005. Pinnacle apparently misinterprets the Commission's August 2007 Order as retroactively reinstating Pinnacle's market-based rate authority. This is not the case. Although the

²⁰ August 2007 Order, 120 FERC ¶ 61,153 at P 38.

²¹ August 2007 Order, 120 FERC ¶ 61,153 at P 39.

²² We note that for APS Energy, Pinnacle submits a revised market-based rate tariff that prohibits market-based rate sales in the APS Balancing Authority Area.

²³ Below we address the merits of Pinnacle's mitigation proposal.

August 2007 Order did not specify a date for the reinstatement of Pinnacle's market-based rate authority, we clarify that we reinstated Pinnacle's market-based rate authority on a prospective basis as of August 13, 2007, the date of issuance of the August 2007 Order. We did not reinstate Pinnacle's market-based rate authority back to February 27, 2005. In fact, nowhere does the August 2007 Order indicate that the Commission retroactively reinstated Pinnacle's market-based rate authority. Moreover, language in the August 2007 Order supports an interpretation that the Commission reinstated Pinnacle's market-based rate authority on a prospective basis but exercised its discretion not to order refunds for the refund effective period. In particular, the Commission stated that "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."²⁴ The August 2007 Order also states that "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."²⁵ Had we reinstated Pinnacle's market-based rates effective as of February 27, 2005 (which we did not), then those rates (*i.e.*, market-based rate authorization) would have been accepted and there would no longer have been a refund period at issue in this case.

18. That the August 2007 Order did not reinstate Pinnacle's market-based rate authority back to the refund effective date established in the December 2004 Order is consistent with the April 2006 Order, in which the Commission stated "The revocation of [Pinnacle's] market-based rate authority in the APS control area is without prejudice to [Pinnacle] making a new filing with the Commission under section 205 of the [Federal Power Act] to request market-based rate authority *prospectively* for the APS control area."²⁶

19. Therefore, we conditionally accept Pinnacle's market-based rate tariffs that limit Pinnacle's sales to areas outside the Phoenix Valley during the summer season and direct Pinnacle, within 30 days of the date of this order, to revise its market-based rate tariffs submitted in its August 2007 Order compliance filing to reflect the appropriate effective date of August 13, 2007.

²⁴ August 2007 Order, 120 FERC ¶ 61,153 at P 32.

²⁵ August 2007 Order, 120 FERC ¶ 61,153 at P 37.

²⁶ April 2006 Order, 115 FERC ¶ 61,055 at P 65, emphasis added.

b. Other Tariff Revisions

20. In addition to the tariff revisions discussed above, Pinnacle removes the market behavior rules²⁷ and revises its market-based rate tariffs to comply with Order No. 697 by including one of the standard required provisions.²⁸

21. With regard to the removal of the market behavior rules, consistent with Commission requirements, we accept Pinnacle's removal of the market behavior rules from its market-based rate tariffs.²⁹

22. In Order No. 697, the Commission determined that continuing to allow inconsistencies in market-based rate tariffs due to the lack of consistent form and content was unjust and unreasonable under sections 205 and 206 of the Federal Power Act. As such, the Commission required that all market-based rate sellers revise their respective tariffs to contain two standard required provisions:³⁰ (1) a provision requiring compliance with Commission regulations and (2) a provision identifying all limitations and exemptions regarding the seller's market-based rate authority.³¹ The Commission required that all market-based rate sellers make a section 206 compliance filing³² to modify their existing tariffs to include these standard required provisions as well as the standard applicable provisions.³³

23. Consistent with Order No. 697, we find that Pinnacle's inclusion of the provision requiring compliance with Commission regulations in its revised market-based rate tariffs is consistent with Order No. 697 and is therefore accepted.

²⁷ *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 114 FERC ¶ 61,165 (2006).

²⁸ Order No. 697, FERC Stats. & Regs. ¶ 31,252 at P 914-915.

²⁹ *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 114 FERC ¶ 61,165 (2006).

³⁰ Order No. 697, FERC Stats. & Regs. ¶ 31,252 at P 912-915.

³¹ Order No. 697, FERC Stats. & Regs. ¶ 31,252 at P 912-915.

³² These compliance filings are to be made the next time a seller proposes a tariff change, makes a change in status filing, or submits an updated market power analysis (or demonstration that Category 1 status is appropriate) in accordance with the schedule in Appendix D, whichever occurs first.

³³ Order No. 697, FERC Stats. & Regs. ¶ 31,252 at P 923. The standard applicable provisions must be included in a seller's market-based rate tariff to the extent that they are applicable based on the services provided by the seller. A complete description of these standard applicable provisions is available in Appendix C of Order No. 697.

24. However, Pinnacle does not include the other required tariff provision. In particular, Order No. 697 also requires sellers to include a provision identifying any limitations and exemptions regarding their market-based rate authority. Specifically, a seller must identify all limitations on its market-based rate authority (including markets where the seller does not have market-based rate authority) and any exemptions from, waivers of, or blanket authorizations under the Commission's regulations that the seller has been granted (such as an exemption from affiliate sales restrictions; waiver of the accounting regulations; blanket authority under Part 34 for the issuances of securities and liabilities, etc.), including cites to the relevant Commission orders.³⁴ Accordingly, we direct Pinnacle, within 30 days of the date of this order, to revise its market-based rate tariffs to include the required provision identifying all limitations and exemptions regarding the seller's market-based rate authority consistent with Order No. 697.

25. Further, in Order No. 697, the Commission also determined that provisions concerning the reassignment or sale of transmission capacity or firm transmission rights (FTRs) should be removed from a seller's market-based rate tariff³⁵ because sellers who seek to reassign transmission capacity should adhere to the provisions of Order No. 890.³⁶

26. Because Pinnacle's market-based rate tariffs include provisions concerning the reassignment or sale of transmission capacity or FTRs, we find that Pinnacle has failed to comply with the directives set forth in Order No. 697 and direct Pinnacle, within 30 days of the date of this order, to remove all provisions governing the reassignment of transmission capacity from its respective market-based rate tariffs.

27. Pinnacle also includes change in status reporting requirement language in its revised market-based rate tariffs. However, it is unnecessary to include this language as part of Pinnacle's market-based rate tariffs. The change in status reporting requirement is codified in the Commission's regulations at section 35.42, and the provision requiring compliance with Commission regulations, which Pinnacle has included in its market-based rate tariffs provides that ". . . failure to comply with the applicable provisions of 18 C.F.R. Part 35, Subpart H. . . will constitute a violation of this tariff." Accordingly, Pinnacle is directed to remove, within 30 days of the date of this order, the change in status provisions from its market-based rate tariffs.³⁷

³⁴ Order No. 697, FERC Stats. & Regs. ¶ 31,252 at P 916.

³⁵ *Id.* P 920.

³⁶ *Preventing Undue Discrimination and Preference in Transmission Service*, Order No. 890, 72 Fed. Reg. 12,266 (Mar. 15, 2007), FERC Stats. & Regs. ¶ 31,241 at P 814-816 and n.496 (2007) (Order No. 890).

³⁷ *Niagara Mohawk Power Corporation, et. al.*, 121 FERC ¶ 61,275 at P 35 (2007).

28. Pinnacle also includes a code of conduct in its revised market-based rate tariffs. However, Order No. 697 adopted certain affiliate restrictions that are codified in section 35.39 of the Commission's regulations. These restrictions govern the relationship between franchised public utilities with captive customers and their "market-regulated" affiliates, *i.e.*, affiliates whose power sales are regulated in whole or in part on a market-based rate basis. Because the affiliate restrictions are codified in the Commission's regulations, it is unnecessary to include a code of conduct as part of Pinnacle's market-based rate tariffs. Accordingly, Pinnacle is directed, within 30 days of the date of this order, to remove the code of conduct language from its market-based rate tariffs.

3. Mitigation Proposal for the Phoenix Valley

a. Sales of less than one year

29. The August 2007 Order provided Pinnacle the opportunity to propose mitigation for the APS portion of the Phoenix Valley applicable to the summer season.³⁸ Pinnacle proposed mitigation for all sales in the APS portion of the Phoenix Valley as well as for all sales in the non-APS portion of the Phoenix Valley during the summer season effective February 27, 2005. In this regard, Pinnacle proposes to limit all sales inside the Phoenix Valley during the summer season to either cost-based rates under the WSPP Agreement or its default cost-based rate tariffs.

30. With regard to the WSPP Agreement, Pinnacle states that sales in the Phoenix Valley during the summer season made under the terms of the WSPP Agreement with a party that is a member of the WSPP Agreement will be subject to the cost-based rate caps under Schedule C of the WSPP Agreement. Consistent with past Commission action regarding the use of the WSPP Agreement by mitigated sellers, we will conditionally accept Pinnacle's proposal to transact under the WSPP Agreement for mitigation in the Phoenix Valley.³⁹ However, our action in this regard is subject to the outcome of the section 206 proceeding in which the Commission is investigating whether the WSPP Agreement rate for coordination energy sales is just and reasonable for a public utility seller in a market in which such seller has been found to have market power, or is presumed to have market power.⁴⁰

³⁸ August 2007 Order, 120 FERC ¶ 61,153 at P 52.

³⁹ We note that in its April 2006 Order compliance filing, Pinnacle also proposes to use the WSSP Agreement for sales in the APS control area effective April 17, 2006. We discuss this proposal further below.

⁴⁰ See *Western Systems Power Pool*, 119 FERC ¶ 61,302 (2007). Pinnacle states in its August 2007 Order compliance filing that it will abide by the outcome of the pending section 206 proceeding.

31. In addition, Pinnacle also proposes that other sales in the Phoenix Valley during the summer season be subject to its default cost-based rate tariffs that are specifically limited to the Phoenix Valley.⁴¹ Pinnacle commits to keep records of the “cost basis” for any transactions occurring during the summer season inside the Phoenix Valley for a period of five years from the date of the transaction.

32. Pinnacle’s default cost-based rate tariffs for short-term (*i.e.*, less than one year) wholesale sales of capacity and energy include ceiling rates, which cap sales at a specific price.⁴² The ceiling rate for sales of one week or less (seven days or less) is incremental costs plus 10 percent, and for sales of more than one week but less than one year (eight to 364 days) is incremental costs plus 10 percent plus a demand charge. The demand charge proposed by Pinnacle is \$18.36/MW hour.⁴³

33. For calculating incremental cost, Pinnacle proposes that incremental cost (*i.e.*, system incremental cost (SIC)) means, with respect to power and energy from generating units on Pinnacle’s system, any costs that are directly incurred by Pinnacle by reason of its generation of such power and energy and that otherwise would not have been incurred by Pinnacle, but are not limited to, fuel, labor, variable operation and maintenance, start-up, shutdown, fuel handling, regulatory commission charges, emission allowance and other environmental compliance costs, transmission losses, wheeling charges, any applicable taxes or assessments based on the revenues received or quantities sold under the transaction, and with respect to capacity and energy purchased from a third party, the total amount paid by Pinnacle, plus any cost that otherwise would not have been incurred, including, but not limited to, regulatory commission charges, emission allowances, transmission losses, wheeling charges and taxes.⁴⁴

⁴¹ As discussed more fully below, in the instant proceeding, Pinnacle has submitted two sets of rate sheets for its default cost-based rate tariffs. In its August 2007 Order compliance filing, the rate sheets in Pinnacle’s default cost-based rate tariffs limit the applicability of the sheets to *sales in the Phoenix Valley*, effective February 27, 2005. In Pinnacle’s April 2006 Order compliance filing, the rate sheets state that these rates are available *where energy is sold in the APS control area*, effective February 27, 2005.

⁴² Discussed below is Pinnacle’s mitigation proposal regarding long-term sales.

⁴³ This demand charge is based on peak pricing (*i.e.*, five days per week, 16 hours per day).

⁴⁴ Pinnacle proposes this SIC for both short-term and long-term sales. Pinnacle adopts this definition of SIC from incremental cost language in its APS Coordination Tariff, which is a tariff currently approved and on file with the Commission. *See* APS FERC Electric Coordination Tariff, Original Vol. No. 1, approved in Docket No. ER94-1681-000 in *Arizona Public Service*, (November 18, 1994) (unpublished letter order).

34. With regard to Pinnacle's default cost-based rate tariffs for sales of more than one week but less than one year, Pinnacle proposes to charge incremental costs plus 10 percent plus a demand charge.⁴⁵ The use of incremental costs plus 10 percent for these types of sales is consistent with the Commission's policy.⁴⁶ With regard to Pinnacle's proposed demand charge, in Order No. 697 the Commission stated that it does not confine mitigated sellers to rates that forego a contribution to fixed/capacity costs, which are the types of costs recovered through a demand charge.⁴⁷ The Commission explained that "most utilities maintain on file for all services flexible demand charge ceilings designed to reflect a 100-percent contribution to the fixed costs of their facilities."⁴⁸ In addition, the Commission noted that it has previously approved a cost-based "up-to" capacity charge and a cost-based energy charge for power sales of less than one year to alleviate the Commission's market power concerns.⁴⁹ Finally, the Commission's review using our fixed charge rate and stacking analysis of Pinnacle's proposed demand charge indicates that Pinnacle's proposed demand charge is supported by the record evidence.⁵⁰

35. In summary, Pinnacle's default cost-based rate tariffs for sales of less than one year appear to be just and reasonable, have not been shown to be unjust, unreasonable, unduly discriminatory or preferential or otherwise unlawful. In particular, with regard to sales of one week or less, we find that Pinnacle's proposed rate of incremental costs plus 10 percent is consistent with the Commission's default cost-based rates for such sales. With regard to sales of more than one week but less than one year, we find that Pinnacle's proposed rate of incremental cost plus 10 percent is consistent with Commission precedent and its proposed demand charge has been cost justified using the Commission's fixed charge rate and stacking analysis.

⁴⁵ With regard to charging incremental costs plus 10 percent for sales of greater than one week or less than one year, Pinnacle adopts the same incremental cost language explained above.

⁴⁶ See, e.g., Order No. 697, FERC Stats. & Regs. ¶ 31,252 at P 621.

⁴⁷ Order No. 697, FERC Stats. & Regs. ¶ 31,252 at P 625.

⁴⁸ Order No. 697, FERC Stats. & Regs. ¶ 31,252 at P 625 *citing Terra Comfort Corp.*, 52 FERC ¶ 61,241 at 61,839 (1990).

⁴⁹ Order No. 697, FERC Stats. & Regs. ¶ 31,252 at P 626 *citing Carolina Power & Light*, 113 FERC ¶ 61,130 at P 23-24 (2005); *Illinois Power Co.*, 57 FERC ¶ 61,213 at 61,669-700 (1991).

⁵⁰ The fixed charge rate and stacking analysis described in *Carolina Power & Light Co.*, 113 FERC ¶ 61,130 (2005) at P 8 was approved by the Commission.

36. For the reasons stated above, Pinnacle's default cost-based rate tariffs for the Phoenix Valley during the summer season are conditionally accepted, effective February 27, 2005, as requested.⁵¹

b. Sales of one year or more

37. With regard to long-term sales, Pinnacle requests clarification that the Commission's intent was to mitigate power sales only during the summer season in the Phoenix Valley. In this regard, Pinnacle requests clarification that it may enter into long-term agreements at market-based rates, without prior Commission approval of specific agreements, provided that sales during the summer season in the Phoenix Valley are mitigated. To address the Commission's market power concerns for sales in the summer season in the Phoenix Valley, Pinnacle proposes that any agreement, regardless of length, will be subject to the cost-based mitigation explained above. Pinnacle states that to the extent that it enters into a long-term agreement for deliveries in the Phoenix Valley, Pinnacle will mitigate during the summer season the rates to the lower of the contract price (*e.g.*, discounted cost-based rate) or the cost-based rate cap.

38. Pinnacle states that it will use actual after-the-fact SIC for this comparison, which it states will capture the true cost on the system during each hour. Pinnacle states that it finalizes each month's hourly SIC on or about the 20th of the following month in which service was provided. In this regard, Pinnacle states that the generating unit(s) and/or purchase(s) setting the SIC during each hour is determined by the most economic dispatch of the system unless a RMR requirement forces a unit to be run out of merit.

39. Pinnacle states it will mitigate prices by comparing, on a billing-cycle basis, the total revenues allowable for each transaction based upon the mutually-negotiated contract price against the total revenues allowable based upon the actual after-the-fact hourly SIC plus the applicable cost-based tariff adders. Pinnacle states that should the revenues for that billing-cycle exceed those allowable based on the applicable cost-based rate caps, the results of this comparison would show as a credit on the customer's bill for the next month. In addition, Pinnacle states that should the Commission in the future modify the level of mitigation for the summer season in the Phoenix Valley, Pinnacle, from the effective date of that modification, will abide by that determination when mitigating both short- and long-term contract pricing.

⁵¹ In light of the discussion above regarding the prospective reinstatement of Pinnacle's market-based rate authority and that Pinnacle has submitted two distinct sets of rate sheets for its default cost-based rate tariffs but both sets have the same tariff designation, Pinnacle is directed to revise its designations consistent with Order No. 614, *Designation of Electric Rate Schedule Sheets*, Order No. 614, FERC Stats. & Regs. ¶ 31,096 (2000).

40. To ensure that these long-term agreements meet the Commission's limitation on market-based rate sales within the Phoenix Valley during the summer season, Pinnacle agrees to apply the proposed mitigation plan to every applicable long-term (*i.e.*, one year or longer) transaction, regardless of length. Therefore, customers to these long-term transactions would be eligible to receive a credit if the rate charged is higher than the mitigated price during the summer season. Pinnacle requests the Commission to clarify that such long-term transactions will be permitted and that pre-approval of each deal is not required for the agreement to be effective.

41. As an initial matter, we clarify that Pinnacle's power sales in the Phoenix Valley are mitigated only during the summer season. Further, the Commission will allow Pinnacle to enter into long-term agreements at market-based rates without prior Commission approval of each agreement to the extent that those long-term agreements are priced at the lower of the contract price or the cost-based rate caps found in its respective cost-based tariffs for sales in the Phoenix Valley during the summer season(s) subject to the discussion below.

42. However, we reject as inconsistent with past Commission precedent Pinnacle's proposal to mitigate long-term sales by comparing, on a billing-cycle basis, the total revenues for each transaction based upon the mutually-negotiated contract price against the total revenues allowable based upon the actual after-the-fact hourly SIC plus the applicable cost-based tariff adders.⁵²

43. Commission precedent provides that mitigation should be applied on the same basis on which the sale is made, *i.e.*, rates for hourly transactions should be mitigated on an hourly basis.⁵³ Pinnacle's proposal to mitigate based on revenues over the billing cycle is inconsistent with this precedent and could result in Pinnacle exercising unmitigated market power over hourly sales. This is so because Pinnacle proposes to only mitigate total revenues over a billing cycle which includes many hours of trading. For example, in any one or more hours, when supplies are tight, Pinnacle would be free to exercise market power by commanding excessive rates provided that in other hours, when other suppliers are available, Pinnacle's rates are low enough so that at the end of the billing cycle, total revenues charged are at or below what total revenues should have been based on incremental hourly costs. Therefore, Pinnacle is directed, within 30 days of the date of this order, to file a mitigation proposal that addresses the Commission's market power concerns with regard to sales of one year or more in the Phoenix Valley during the summer season.

⁵² See *San Diego Gas & Electric Co.*, 102 FERC ¶ 61,317, *order on reh'g*, 105 FERC ¶ 61,066 (2003) (*SDG&E*).

⁵³ See *San Diego Gas & Electric Company*, 110 FERC ¶ 61,293 (2005).

44. Further, we continue to require Pinnacle to file any long-term contract with the Commission for approval prior to transacting until such time as the Commission issues a subsequent order in this proceeding accepting Pinnacle's mitigation proposal in this regard.

B. Pinnacle's April 2006 Order Compliance Filing

45. As discussed above, Pinnacle's market-based rate authority for the APS control area was revoked by Commission order on April 17, 2006.⁵⁴ Subsequently, Pinnacle submitted in its April 2006 Order compliance filing for Pinnacle Capital, APS, and APS Energy revised market-based rate tariffs to limit Pinnacle's sales at market-based rates to areas outside the APS control area, effective February 27, 2005.⁵⁵ Additionally, Pinnacle's revised market-based rate tariffs submitted in its April 2006 Order compliance filing include the Commission's change in status reporting requirement and remove the market behavior rules.⁵⁶

⁵⁴ April 2006 Order, 115 FERC ¶ 61,055 at P 5.

⁵⁵ Pinnacle also submitted alternate tariff sheets to limit Pinnacle's market-based rates to areas outside the APS control area, except that sales at Four Corners are permitted as long as the counterparty does not serve load in the APS control area, effective April 17, 2006. We will not accept alternate tariff sheets. In Order No. 697, the Commission concluded that adequately protecting customers from the potential exercise of market power required that it continue to apply mitigation to *all* sales in the balancing authority area in which a seller is found, or presumed, to have market power. *See* Order No. 697, FERC Stats. & Regs. ¶ 31,252 at P 817. However, the Commission stated that it would allow mitigated sellers to make market-based rate sales at the metered boundary with a balancing authority area in which the seller has market-based rate authority under certain circumstances. *See* Order No. 697, FERC Stats. & Regs. ¶ 31,252 at P 830. In this regard, we note that the August 2007 Order addressed this issue on rehearing and allowed Pinnacle 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. We provided 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. However, Pinnacle did not address this issue in its August 2007 Order compliance filing.

⁵⁶ We note that Pinnacle Energy cancelled its market-based rate tariff effective March 31, 2006. *See Pinnacle West Energy Corp.*, Docket No. ER06-535-000 (March 14, 2006) (unpublished letter order).

46. The revised market-based rate tariffs that limit Pinnacle's sales at market-based rates to areas outside the APS control area, effective February 27, 2005, for Pinnacle Capital, APS, and APS Energy are consistent with the Commission's April 2006 Order revoking Pinnacle's market-based rate authority in the APS control area and are hereby accepted.

47. In addition, in its April 2006 Order compliance filing, Pinnacle submitted default cost-based rate tariffs for APS and Pinnacle Capital for sales in the APS control area, similar to those submitted in the August 2007 Order compliance filing discussed above.⁵⁷ For the reasons discussed above regarding Pinnacle's default cost-based rate tariffs, we accept these default cost-based rate tariffs for the APS control area, effective February 27, 2005.

48. In the April 2006 Order, the Commission stated that Pinnacle's default cost-based rate compliance filing was without prejudice to Pinnacle's ability to make sales under its existing Commission approved cost-based rate tariffs prospectively.⁵⁸ In its April 2006 Order compliance filing, Pinnacle requested authorization to transact prospectively in the APS control area under the APS Coordination tariff⁵⁹ and the WSPP Agreement.⁶⁰

49. Because the Commission has previously accepted the APS Coordination tariff and found it to be a just and reasonable cost-based rate, we will accept Pinnacle's mitigation proposal in this regard. In addition, for the reasons stated above regarding Pinnacle's use of the WSPP Agreement for mitigation in the Phoenix Valley, we will conditionally

⁵⁷ We note that Pinnacle states that it did not file a default cost-based rate tariff for APS Energy or for Pinnacle Energy. With regard to APS Energy, Pinnacle states that during the refund effective period APS Energy's wholesale sales were made outside the APS balancing authority area. APS Energy's tariff contains the limitation that "sales under this tariff may not be made inside the APS balancing authority area." Therefore, since APS Energy makes no sales inside the APS control area, there is no need to mitigate such sales from APS Energy. With regard to Pinnacle Energy, Pinnacle states that, effective March 31, 2006, Pinnacle Energy's market-based rate tariff was canceled, as explained above. In addition, Pinnacle states that Pinnacle Energy no longer owns any generation assets and is in the process of being dissolved.

⁵⁸ April 2006 Order, 115 FERC ¶ 61,055 at P 64. We note that the April 2006 Order also stated that any sales made under Pinnacle's market-based rate tariff since the refund effective date would be under the default cost-based rate tariffs.

⁵⁹ *Arizona Public Service*, APS FERC Electric Coordination Tariff, Original Vol. No. 1, Docket No. ER94-1681-000 (November 18, 1994) (unpublished letter order). As stated above, the APS Coordination tariff has been accepted by the Commission.

⁶⁰ *Western Systems Power Pool*, 55 FERC ¶ 61,099 (1991).

accept Pinnacle's mitigation proposal for the APS control area concerning use of the WSPP Agreement for prospective sales, subject to the outcome of Docket No. EL07-69-000. Accordingly, we accept Pinnacle's use of the APS Coordination tariff and the WSPP Agreement for mitigation in the APS control area for any sales made after April 17, 2006.

50. In sum, for mitigation in the APS control area in all seasons and the Phoenix Valley during the summer season, we accept Pinnacle's default cost-based rate tariffs, effective February 27, 2005. We also accept use of the WSPP Agreement for sales in the Phoenix Valley during the summer season, effective February 27, 2005. Finally, we accept the use of Pinnacle's APS Coordination tariff and the WSPP Agreement for mitigation for sales in the APS control area for any sales made after April 17, 2006.

51. With regard to the refund period, the August 2007 Order found that no refunds are due for sales in Northern Arizona.⁶¹ Furthermore, the Commission found that no refunds are due for sales in the APS portion of the Phoenix Valley during the fall, winter, and spring seasons.⁶² However, refunds may be due for sales in the APS portion of the Phoenix Valley during the summer season effective February 27, 2005, the refund effective date established in the December 2004 Order. Accordingly, Pinnacle is directed, within 30 days from the date of this order, to make refunds based on its default cost-based rate tariffs or cost-based caps under the WSPP Agreement. Since the August 2007 Order also instituted a section 206 proceeding concerning Pinnacle's market-based rate authority for the non-APS portion of the Phoenix Valley, we also direct Pinnacle to make refunds for sales in the non-APS portion of the Phoenix Valley beginning the refund effective date of August 21, 2007. Additionally, we direct Pinnacle to file a refund report with the Commission within 15 days of the date refunds are made.

C. Refunds for Inter-Affiliate Sales

52. Pinnacle requests that the Commission waive the requirement to provide refunds for sales from APS to a Pinnacle affiliate because such refunds would reallocate funds from retail customers to shareholders. Pinnacle explains that APS has a Power Supply Adjustor which flows through off system sales revenues as a credit to retail customers. As a result of this PSA, any such refunds would flow through to Pinnacle's retail customers as a negative credit and end up benefiting the parent corporation to the detriment of retail customers.

53. The Commission will grant Pinnacle's request for waiver of the requirement to provide refunds for sales from APS to a Pinnacle affiliate. We find that, in this case,

⁶¹ August 2007 Order, 120 FERC ¶ 61,153 at P 32.

⁶² *Id.* P 37.

because APS' Power Supply Adjustor flows through off system sales revenues as a credit to retail customers, any such refunds would be to the detriment of the retail customers. Therefore, we will grant Pinnacle's request for waiver of the requirement to provide refunds for any sales from APS to an affiliate.

The Commission orders:

(A) Pinnacle's definition of the Phoenix Valley is hereby accepted, as discussed in the body of this order.

(B) Pinnacle's revised market-based rate tariffs submitted in its August 2007 Order compliance filing that limit Pinnacle's market-based rate sales to areas outside of the Phoenix Valley during the summer season are conditionally accepted, as modified to be effective August 13, 2007, as discussed in the body of this order.

(C) Pinnacle is directed, within 30 days of the date of this order, to revise its market-based rate tariffs submitted in its August 2007 Order compliance filing, as discussed in the body of this order.

(D) Pinnacle's default cost-based rate tariffs for sales in the Phoenix Valley, are hereby conditionally accepted, effective February 27, 2005, as modified to be consistent with Order No. 614, as discussed in the body of this order.

(E) Pinnacle's mitigation proposal to use the WSPP Agreement or its default cost-based rate tariffs for short-term sales in the Phoenix Valley during the summer season is hereby accepted, effective February 27, 2005, as discussed in the body of this order.

(F) Pinnacle's mitigation proposal with regard to long-term sales is hereby rejected, as discussed in the body of this order.

(G) Pinnacle is directed to file, within 30 days of the date of this order, a mitigation proposal that addresses the Commission's market power concerns with regard to long-term sales in the Phoenix Valley during the summer season, as discussed in the body of this order.

(H) Pinnacle's revised market-based rate tariffs submitted in its April 2006 Order compliance filing that limit sales at market-based rates to areas outside of the APS control area, are hereby accepted, effective February 27, 2005, as discussed in the body of this order.

(I) Pinnacle's alternate tariff sheets submitted in its April 2006 Order compliance filing that allow sales at Four Corners under certain conditions, effective April 17, 2006, are hereby rejected, as discussed in the body of this order.

(J) Pinnacle's default cost-based rate tariffs for mitigation in the APS control area during the refund effective period established in the December 2004 Order are hereby accepted, effective February 27, 2005, as discussed in the body of this order.

(K) Pinnacle's mitigation proposal for the APS control area to use the APS Coordination tariff and the WSPP Agreement, effective April 17, 2006, is hereby accepted, as discussed in the body of this order.

(L) Pinnacle is directed to make refunds within 30 days of the date of this order, and file a refund report with the Commission within 15 days of the date refunds are made, as discussed in the body of the order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.